

Chapter 1: Ethics

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Corrections were made to this workbook through January of 2010. No subsequent modifications were made.

INTRODUCTION

Tax return penalties remained substantially unchanged since the late 1970s. In late 2007, Congress placed an increased emphasis on compliance by tax practitioners. This was partially due to reports of tax preparer negligence and fraud uncovered by the Treasury Inspector General for Tax Administration (TIGTA) and the Government Accountability Office (GAO). It may also be from Congress’ efforts to reduce the tax gap.¹

The proposed regulations were issued with Treasury Decision 9436 released on January 21, 2009, and made effective as of December 22, 2008. Consequently, the following guidance is now obsolete:

- Notice 2007-54, 2007-27 IRB 12
- Notice 2008-11, 2008-3 IRB 279
- Notice 2008-12, 2008-3 IRB 280
- Notice 2008-13, 2008-3 IRB 282
- Notice 2008-46, 2008-18 IRB 868

The Small Business and Work Opportunity Tax Act of 2007 extended the application of income tax preparer penalties to include preparers of all types of tax returns. The act altered two standards of conduct that must be met to avoid imposition of the IRC §6694(a) penalty and increased applicable penalties for §§6694(a) and (b) infractions. Treasury Decision 9436 changes the “more-likely-than-not” standard to “reasonable-to-believe” standard.

The Ethics chapter in the 2007 and 2008 *University of Illinois Federal Tax Workbook* contains extensive coverage of the IRC §§6694 and 7216 penalties. When reviewing the examples in the 2007 and 2008 *University of Illinois Federal Tax Workbooks*, the “more-likely-than-not” standard does not apply. This chapter discusses current updates to these penalties and suggestions to help practitioners avoid these penalties.

¹ GAO-08-781 (Aug. 15, 2008) and TIGTA 2008-40-171 (Sep. 3, 2008).

REPORTING REQUIREMENTS FOR TAX RETURN PREPARERS

Firms or individuals employing one or more signing tax return preparers must satisfy the following requirements:

1. Retain a record of the name, identification number, and principal place of work during the return period that the return preparer was employed.
2. The record must be made available to the IRS upon request.
3. The record must be retained for three years following the close of the return period.
4. The employer may determine the form of documentation for the signing preparers.

COPY OF RETURN OR CLAIM FOR REFUND

The signing tax return preparer is required to give a copy of the return or claim for refund to the taxpayer when the return is presented for signature. An electronic copy of the return is acceptable if it is satisfactory to both the client and the preparer. The return copy must include all information contained on the return sent to the IRS except the return preparer's identification number.

The preparer must retain either a completed copy of the return or a record by list, card file, or otherwise of the name and taxpayer identification number of the taxpayer for whom the return was filed, taxable year, and the type of return or claim prepared. This record must be retained for three years following the close of the return period.

The penalty for failure to give the client a copy of the return is \$50 per violation not to exceed \$25,000 per person for each calendar year. The penalty applies unless it is shown that the failure is due to reasonable cause and not willful neglect.²

FURNISHING IDENTIFYING NUMBERS FOR RETURNS FILED AFTER DECEMBER 31, 2008

All returns or claims for refund other than those self-prepared must include the identifying number of the tax return preparer. This includes employment tax returns. The identification number may be either the preparer's social security number or preparer tax identification number issued by the IRS.

Note. This is the reason employment tax forms and all other types of tax forms now have a preparer signature block.

IRC §6694: UNDERSTATEMENT OF TAXPAYER'S LIABILITY

TAX RETURN PREPARER UNDERSTATEMENT

IRC §6694(a) addresses issues with tax practitioners taking an unreasonable position on an item reported on a taxpayer's income tax return. Some tax practitioners claim tax deductions or credits for which there is no reasonable justification. The §6694(b) penalty is assessed on practitioners for willful or reckless conduct. **The IRS does not consider ignorance of the law as an excuse for taking an invalid deduction.**

Congress amended §6694 in May 2008 to include preparers of all types of returns, not just income tax returns.

² Treas. Reg. §1.6695-1(a).

Unreasonable Positions — §6694(a)

An “unreasonable position” is one in which there is no substantial authority to justify the position taken. The IRS determines this to be a position in which there is less than a 1-in-3 chance that the position will be upheld by a court. Tax preparers can avoid the §6694(a) penalty if they disclose these positions by attaching either Form 8275, *Disclosure Statement*, or 8275-R, *Regulation Disclosure Statement*, to the tax return.

A penalty may be assessed under §6694(a) if:

- The practitioner prepares a return in which any part of an understatement of liability is due to a position that is unreasonable, and
- The preparer knew or reasonably should have known of the position.

A position is considered unreasonable if no substantial authority exists for the position. The penalty may be avoided if the position is disclosed on the return unless the understatement is due to a tax shelter or other reportable transaction and it is not reasonable to believe the position would be sustained on its own merits. There is also a reasonable cause exception. It applies when the position was taken due to reasonable cause and the preparer acted in good faith.

Unless an exception applies, the penalty is the **greater** of \$1,000 or 50% of the actual or intended income derived by the tax preparer for the return or claim.³

If the position relates to a tax shelter that the IRS identifies as fraudulent, such as a “listed tax shelter,” disclosure will not avoid the penalty.

Caution. Care should be taken when reporting a questionable transaction. While the IRS has reduced the “more-likely-than-not” standard to a “reasonable position” standard, some states still use the “more-likely-than-not” standard.

Willful or Reckless Conduct — §6694(b)

Willful or reckless conduct is defined as a willful attempt in any manner to understate the liability on the return or a reckless or intentional disregard of rules or regulations.⁴ The penalty under §6694(b) is equal to the **greater** of \$5,000 or 50% of the actual or intended income derived by the preparer for the return.

Examples of a tax preparer’s willful attempt to understate liability include:

- Disregarding information furnished by the taxpayer,
- Claiming more dependents on the return when the preparer knows the taxpayer has fewer dependents, or
- Overstating income or understating deductions in an attempt to increase the earned income credit.

A preparer is considered to have recklessly or intentionally disregarded a rule or regulation if she takes a position on the return that is contrary to a rule or regulation if she knows or should have known the rule or regulation in question. A preparer is reckless in not knowing a rule or regulation if she makes little or no effort to determine whether it exists under circumstances that substantially deviate from the standard of conduct that a reasonable preparer would follow in the situation.

A tax preparer is not considered to have recklessly or intentionally disregarded any rule or regulation if the contrary position has a reasonable basis and is adequately disclosed. In the case of a position contrary to a regulation, the position must represent a good-faith challenge to the validity of the regulation and when disclosed must identify the regulation being challenged.

³ IRC §6694(a).

⁴ IRC §6694(b).

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If the position taken is contrary to a revenue ruling or notice published by the IRS, the preparer is not considered to have recklessly or intentionally disregarded the ruling or notice if the position meets the substantial authority standard and is not a reportable transaction to which the accuracy-related penalty (§6662A) applies.

Example 1. A client provided his tax preparer, Teresa, with detailed check registers reflecting personal and business expenses. One of the expenses was for domestic help, and this expense was identified as personal on the check register. Teresa knowingly deducted the expenses of the client's domestic help as wages paid in the client's business. Teresa is subject to the §6694(b) penalty.

Example 2. A client provided her tax preparer, Eunice, with detailed check registers to compute the client's expenses. Eunice, however, knowingly overstated the expenses on the return. After adjustments by the examiner, the tax liability increased significantly. Because Eunice disregarded information provided in the check registers, she is subject to the §6694(b) penalty.

Example 3. Tax preparer Victor prepares a taxpayer's return in 2009. The client had certain expenses incurred in the purchase of a business. Final regulations provide that such expenses must be capitalized. A 2006 Tax Court case expressly invalidated that portion of the regulations. No courts have ruled favorably about the validity of that portion of the regulations. No other authorities exist on the issue. Under these facts, Victor has a reasonable basis for the position. He will not be subject to the §6694(b) penalty if the position is adequately disclosed, because it represents a good-faith challenge to the validity of the regulations.

If a tax preparer is charged with both a §6694(a) and §6694(b) penalty, the §6694(b) penalty is reduced by the amount of the §6694(a) penalty.

Example 4. Jim is liable for a §6694(a) penalty of \$1,000 and a §6694(b) penalty of \$5,000 for the same issue. He will be assessed the \$1,000 §6694(a) penalty plus \$4,000 (\$5,000 reduced by the \$1,000 §6694(b) penalty).

TAX FIRM UNDERSTATEMENT

A firm that employs a tax return preparer subject to a penalty under §§6694(a) and 6694(b) is also subject to penalty if, and only if:

- One or more members of the firm's principal management participated in or knew of the conduct;
- The firm failed to provide reasonable and appropriate procedures for review of the position for which the penalty is imposed; or
- The firm disregarded its review procedures through willfulness, recklessness, or gross indifference in the formulation of the advice, or the preparation of the return, that included the position for which the penalty is imposed.

WHO IS A TAX PREPARER?

When the IRS assesses a §6694 penalty on a tax preparer, it looks beyond the individual who signed the tax return. The signing preparer is the person who is primarily responsible for all positions on the return that gave rise to the understatement. In some firms, a number of individuals may contribute to the preparation of a tax return. Those individuals, unless they sign the tax return, are considered as nonsigning return preparers. A nonsigning return preparer could be responsible for the understatement that created the §6694 penalty. In this situation, the penalty is assessed against that nonsigning preparer.

It is possible that there is no "signing return preparer" within the firm or it may be concluded that the signing preparer is not primarily responsible for the position. In this case, the nonsigning preparer within the firm with overall supervisory responsibility for the position(s) giving rise to the understatement generally is considered the return preparer.

IRC §6694 has provisions allowing the IRS to assess the penalty against both the firm and the individual. If the individual is employed by a sole proprietorship, the sole proprietorship is considered the “firm” for purposes of the §6694 penalty.

Example 5. Adam works for the AB Tax Accounting Firm. He prepares and signs Chad’s tax return and provides advice to Chad regarding the proper treatment of an item on Chad’s tax return. The advice was given **after** all of the events regarding the transaction **had occurred**.

In preparation for providing that advice, Adam asks his coworker, Ben, for advice about proper treatment for the item. Ben provides advice on the treatment of the item, and Adam relies on this advice.

Ben’s advice is reflected on Chad’s tax return but no disclosure is made. The advice constitutes preparation of a substantial portion of the return.

The IRS challenges the position taken on the tax return and determines tax was understated. For purposes of the §6694 regulations, Adam is initially considered the tax return preparer. The IRS advises Adam that he may be subject to the §6694 penalty for Chad’s return.

Based on information received from Adam, the IRS concludes that Ben, rather than Adam, was primarily responsible for the position which resulted in the understatement. Ben may be subject to the penalty rather than Adam.

Example 6. Use the same facts as **Example 5**, except neither Adam nor any other source produced credible information showing that Ben had primary responsibility for the position. Adam is the return preparer who may be subject to the penalty for Chad’s return.

Example 7. Use the same facts as **Example 5**, except David, who works for a different accounting firm, also provides advice about the same position on which Adam relies. It is possible that David is also primarily responsible for the position on the return and may be subject to penalty under §6694.

Example 8. Use the same facts as **Example 5**, except Ben presents credible information indicating that Adam is also responsible for the position on Chad’s return that gave rise to the understatement. The IRS decides who is primarily responsible and may assess a §6694 penalty against Adam or Ben, but not both.

Note. Only one §6694 penalty can be assessed per issue. The firm may also be assessed a penalty on the same issue.

In addition to individuals in the business of preparing tax returns, the following is a list of other individuals who are considered tax return preparers:

- E-file providers,
- Software developers,
- Electronic return originators,
- Individuals working for volunteer income tax assistance (VITA) and tax counseling for the elderly (TCE),
- Other individuals who are paid to prepare returns, and
- Employees of firms providing tax preparation services.

A person may be subject to the §§6694 (a) and (b) penalties even though she does not prepare the tax return. A person is considered a preparer if she furnishes the taxpayer with sufficient information and advice so that completion of the return or claim for refund is largely a mechanical matter.⁵

⁵. Treas. Reg. §301.7701-15(a)(1).

INFORMATION VERIFICATION

A tax return preparer may generally rely in good faith and without verification upon information furnished by the taxpayer. He may also rely in good faith and without verification upon information and advice furnished by another adviser, another tax return preparer, or other party. The preparer is not required to audit, examine, or review books and records, business operations, documents, or other evidence to independently verify information provided by the taxpayer or other party. However, the tax return preparer may not ignore the implications of information furnished to him or actually known by him. He must make **reasonable inquiries** if the information furnished appears to be incorrect or incomplete. The preparer must make appropriate inquiries to determine the facts and circumstances required by the tax code as a condition of claiming a deduction or credit. For example, if written records are required, the preparer must ask the client whether the written records exist.

Example 9. The Code requires a taxpayer to maintain a mileage log in order to take a deduction for business mileage. The tax preparer must ask the client if he has a written mileage log to justify the deduction on the tax return.

The preparer may rely in good faith and without verification on a tax return that has been previously prepared by a taxpayer or another tax return preparer and filed with the IRS. For example, a practitioner who prepares an amended return need not verify the positions on the original return. However, he may not ignore the implications of information furnished to him or actually known by him. He must make reasonable inquiries if the information as furnished appears to be incorrect or incomplete. The preparer must also confirm that the position being relied upon was not adjusted by examination or otherwise.

Example 10. During an interview conducted by tax preparer Edwina, the client stated that he made a charitable contribution of real estate in the amount of \$50,000 during the tax year. In actuality, he did not make this contribution. Edwina does not inquire about the existence of a qualified appraisal or complete Form 8283, *Noncash Charitable Contributions*, in accordance with the reporting and substantiation requirements. Edwina reported a deduction on the tax return for a charitable contribution, which resulted in an understatement of tax. She signed the tax return as the tax return preparer. Edwina is subject to a penalty under §6694.

Example 11. While preparing the 2009 individual tax return for a taxpayer, preparer Frieda realizes that the taxpayer did not provide a Form 1099-INT, *Interest Income*, for a bank account that produced significant taxable income in 2008. When Frieda inquired about any other 2008 income, the taxpayer furnished the Form 1099-INT. Frieda did not know that the taxpayer had an additional bank account that generated taxable income for 2008, and the taxpayer did not reveal this when asked about additional income. Frieda signed the taxpayer's return as the tax return preparer. Frieda should not be subject to a penalty under §6694.

DE MINIMIS SAFE HARBOR

A tax preparer is not considered to have prepared a "substantial portion" of any return if the schedule, entry, or other portion of the return involves amounts of gross income, deductions, or amounts on which credits are based that are:

1. Less than \$10,000, or
2. Less than \$400,000 and also less than 20% of the gross income (or adjusted gross income if the taxpayer is an individual) as shown on the return.

PREPARER PENALTY ASSESSMENT PROCESS

The Internal Revenue Manual (IRM) was revised on February 8, 2008, to reflect new penalty guidelines. An examiner is not allowed to discuss the possibility of assessing a preparer penalty in the presence of the taxpayer.⁶ Most preparer penalties must be assessed within three years from the time the return is filed. However, the penalty for willful understatement of liability may be assessed at any time. This penalty has no statute of limitations.

IRM Section 4.10.6.3.5.3 discusses reliance on the taxpayer's representative and/or return preparer. The manual acknowledges a taxpayer often advises examiners that penalties are not applicable because they relied on the advice of a representative or preparer. They allege the representative or preparer is the cause of the noncompliance.

The manual notes that various regulations and court decisions have held that although a taxpayer may authorize a representative to prepare and file a tax return, this action does not relieve the client of meeting his legal obligations as a taxpayer. This is further emphasized in three regulations:

1. All facts and circumstances must be taken into account in determining whether a taxpayer has reasonably relied in good faith on advice (including the opinion of a professional tax advisor).⁷
2. The advice must not be based on unreasonable factual or legal assumptions.⁸
3. The substantial underpayment penalty does not apply to any portion of an underpayment when there was reasonable cause for the underpayment portion and the taxpayer acted in good faith. Reliance on the advice of a professional tax advisor does not necessarily demonstrate reasonable cause and good faith. However, reliance on professional advice is reasonable cause and good faith if, under all the circumstances, the reliance was reasonable and the taxpayer acted in good faith.⁹

The manual also advises the examiner when considering the failure-to-file penalty that the U.S. Supreme Court held that the fact that a taxpayer relies on an attorney to file a timely tax return does not relieve the taxpayer of the duty to meet the tax return deadlines.¹⁰

The manual instructs the examiner to document the taxpayer's reliance on a representative or return preparer in the case file. Instructions further explain that the examiner should make any necessary contacts with the representative or return preparer to determine appropriate penalty liability before closing the income tax case because this determination affects the results of the income tax case. Conclusions regarding the preparer's or representative's responsibility for errors should be documented.

The IRM states, "Discussions with the taxpayer must be limited to the development of the facts. The development of return preparer penalties must not be discussed or proposed in the taxpayer's presence. The preparer is to be given the right to explain why possible preparer penalties are not applicable."

The examiner is also instructed to document the consideration of preparer penalties in the case file. The workpapers should only document the taxpayer's statements and that inquiries about preparer penalties were made. All information on the preparer's activities and the assertion of preparer penalties must be separated from the taxpayer's case file.¹¹

⁶ IRM 4.10.6.3.5.3.5.

⁷ Treas. Reg. §1.6664-4(c)(1).

⁸ Treas. Reg. §1.6664-4(c)(1)(ii).

⁹ Treas. Reg. §1.6664-4(b)(1).

¹⁰ *U.S. v. Robert W. Boyle*, 105 S.Ct. 687 (Jan. 9, 1985).

¹¹ IRM 4.10.6.7.4.

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In the discussion on return-preparer penalties, the manual reminds examiners that penalty assertion is the key enforcement vehicle for noncompliant preparers. A determination on a preparer penalty case is conducted independently of, and without regard to, the determination on the income tax case. The tax case has a bearing on the preparer penalty case only insofar as assertion of the penalty requires an understatement of tax. Generally, a return-preparer penalty is not proposed until the income examination is completed at the group level. However, if the preparer case is inseparable from the income tax examination, both cases may be completed simultaneously. The examiner may pursue the preparer penalty after an agreed income tax case is submitted at the group level.

RETURNS COVERED BY IRC §6694

The §6694 penalties cover all types of tax returns and claims for refund. A complete list is found in Rev. Proc. 2009-11, issued January 21, 2009.

Note. This list changes as forms become obsolete or new forms are added.

FREQUENTLY-ASKED QUESTIONS FROM THE IRS WEBSITE

Question 1. Is there any general pro forma language that preparers can use to comply with the disclosure rules for **tax shelters**? If so, are preparers able to use this general pro forma language in every case or does the language need to be specific to the positions taken on the particular return?

Answer 1. If a preparer takes a tax deduction for a tax shelter, she must disclose and discuss the tax consequences with the taxpayer. There is no general pro forma language that a preparer may use to comply with the disclosure rules. Also, there is no special format required to satisfy the disclosure and documentation requirements.

Note. Taxpayers are already permitted to disclose multiple items on a single Form 8275 for purposes of satisfying the penalty disclosure provisions.

The preparer must disclose each item to the taxpayer in a meaningful fashion. The contemporaneous documentation must in turn memorialize the discussion regarding each disclosable item.

Question 2. Does **advice to the client about different penalty standards** have to be spoken advice, or is a memo included with the return sufficient?

Answer 2. The language of the compliance rules clearly considers advice and documentation as two separate events. A preparer runs a serious risk of not complying with the disclosure standards if the only thing the preparer does is include a memo with the return.

Question 3. What is **“gross income derived”** for purposes of calculating the amount of the §6694 penalty, and may a preparer limit the potential penalty amount for a given client by intentionally bifurcating billing into separate engagements?

Answer 3. Notice 2008-13 addresses the interim standards applicable to tax return preparers under §6694(a) and was not intended to address other aspects of the return preparer penalty. Final guidance under §6694, when issued, will address the standards applicable to tax return preparers under §6694, as well as all of the other elements of the return preparer penalty under §6694, including penalty amounts and related calculations. Nevertheless, tax return preparers and their clients should understand that the IRS has significant experience in looking through the form of transactions in determining their true substance. Preparers should expect that all billing arrangements between tax return preparers and their clients will be scrutinized to ascertain the actual substance of those arrangements.

IRC §6695: OTHER ASSESSABLE PENALTIES

The IRS assesses other preparer penalties. These include penalties for:

- Failure to furnish a copy of the return to the taxpayer,
- Failure to sign a tax return,
- Failure to furnish preparer identification number,
- Failure to retain a copy or list of tax returns prepared,
- Failure to file correct information returns,
- Negotiation of the taxpayer's refund check, and
- Failure to be diligent in determining the eligibility for the earned income credit.

IRC §§6694 AND 6695 FROM THE IRS'S PERSPECTIVE

On January 21, 2009, the IRS held a national phone forum to discuss the §§6694 and 6695 penalties. Barbara J. Fiebich, representing the examination division, began her remarks by telling the audience that the IRS recognizes that the vast majority of return preparers and practitioners are ethical, honest, and serve their clients' best interests by preparing complete and accurate tax returns. These preparers render a great service by promoting voluntary compliance. However, to retain the effectiveness of the voluntary system, the IRS needs to ensure they address preparers who do not prepare accurate returns. Consequently, a penalty structure was devised to encourage compliance by supporting the standards of behavior required to comply with the Internal Revenue Code.

Voluntary compliance consists of preparing an accurate return, filing it timely, and paying any tax due. Penalties apply to behavior that fails to meet any or all of these obligations. Part of the IRS enforcement action includes investigating allegations of wrongdoing, assessing civil penalties against return preparers, and initiating appropriate action cases. Ms. Fiebich said the IRS currently has more than 800 projects potentially impacting tax preparers.

GENERAL FIELD EXAMINATION PROCEDURES

An income tax case is separate and distinct from a possible return preparer penalty case. The IRS representative does not propose or discuss preparer conduct penalties with, or in the presence of, a taxpayer. Preparer penalties are not determined during an audit. If the audit results in significant discrepancies, a separate penalty investigation is referred to the Office of Professional Responsibility (OPR) for a Circular 230 violation.

During every field and office examination, examiners determine whether violations exist based on oral testimony and/or evidence collected during the examination. During the examination or while interviewing the taxpayer, the auditor asks questions regarding tax return preparation. These questions may include the following:

- “Did you meet with the tax return preparer?”
- “Did you complete a questionnaire or have a face-to-face meeting with the preparer?”
- “What documentation did you provide to the preparer to substantiate expense items, verify basis, or compute income?”
- “Did you receive a copy of the tax return that was prepared?”
- “How did you compensate the return preparer?”

Based on the audit outcome and answers to the above questions, the examiner determines whether a preparer may be culpable in any understatement of tax. If the revenue agent believes the preparer is responsible, a separate investigation is initiated. A separate meeting with the preparer is scheduled to gather testimony and any documents that may be applicable to the issue at hand. Questions that the examiner might ask the return preparer include the following:

- “What documentation did the taxpayer provide to help you prepare the return?”
- “Did you provide a copy of the return to the taxpayer?”
- “Were you aware of any errors, omissions, or mistakes on the return under examination?”
- “How were you compensated?”

After considering the information gathered from both the taxpayer and the return preparer, the examiner determines whether a preparer penalty applies. Ms. Fiebich stressed that the IRS does not automatically impose preparer penalties based solely on the outcome of the audit. Preparer penalties are not mechanical components of the examination process. Penalties are asserted only after due deliberation of all of the facts and circumstances.

It is possible for an examiner to consider a penalty and then determine it is not applicable. In that case, the preparer penalty case is closed.

If a penalty applies, a detailed report is prepared and a copy is given to the tax return preparer. The preparer has 30 days to request an appeal before the penalty is assessed.

Appeal Process

The tax preparer has the right to dispute any assessed preparer penalty. Even if the penalty is for a small amount, any penalty appeal to a §§6694 or 6695(c) penalty that is sustained against an attorney, CPA, or EA is reported to the Office of Professional Responsibilities (OPR).¹²

Prior to enactment of the Restructuring and Reform Act of 1998 (RRA '98), the burden of proof in a return-preparer penalty case was on the preparer. Since enactment of RRA '98, the burden of proof is on the government.¹³

The appeal of a preparer penalty case is handled in the same manner as any other appeal. Prior to assessing a preparer penalty for understatement of liability, the IRS sends a report of the examination to the preparer. It also sends a 30-day letter notifying the preparer of the proposed penalties and makes a demand for payment.

To begin the appeal process, the preparer must file a written protest. The protest must include:

1. The preparer's name, address, and daytime telephone number;
2. A statement indicating the preparer wants to appeal the IRS findings to the appeals office;
3. A copy of the 30-day letter showing the proposed penalty along with any dates or symbols from the letter;
4. The tax year(s) involved;
5. A statement showing why the preparer disagrees with the penalty;
6. The facts supporting the preparer's position;
7. The law or authority, if any, on which the preparer is relying; and
8. The preparer's signature on the written protest, stating the facts are true, under penalties of perjury.

¹² IRM 8.11.3.1.3.

¹³ IRM 8.11.3.3.1.

The perjury statement must say:

Under the penalties of perjury, I declare that I examined the facts stated in this protest, including any accompanying documents, and, to the best of my knowledge and belief, they are true, correct, and complete.

If the preparer's representative prepares and signs the protest, the representative must substitute a declaration stating:

1. That the representative is submitting the protest and accompanying documents, and
2. Whether the representative knows personally that the facts stated in the protest and accompanying documents are true and correct.

The protest should provide as much information as possible to ensure the appeal is handled expeditiously.

The protest must be filed within 30 days. However, if the taxpayer or preparer can show reasonable cause, the IRS usually grants a 30-day extension.

If the amount is not more than \$25,000, the preparer may make a small-case request instead of filing a formal written protest. The \$25,000 threshold relates to the total amount of the tax change, not just the disputed amount. For a small-case request, the preparer should follow the instructions in the IRS letter. This includes sending a letter to request appeals' consideration that indicates disagreement with the assessed penalty and the reasons for disagreement.

Example 12. The IRS examined Bill's client. The auditor made total income tax adjustments of \$28,000. Bill is assessed a preparer penalty of \$800. Because the total adjustment exceeds \$25,000, Bill must file a formal protest if he wants to appeal his penalty.

The preparer may represent himself at appeals or have an attorney, CPA, or EA represent him. In case he is represented by one of the above individuals, a properly completed Form 2848, *Power of Attorney and Declaration of Representative*, must be prepared.

The appeals officer receives the auditor's entire case file. If the taxpayer believes the auditor failed to consider important facts, these facts are documented in the appeals letter with the appropriate IRS rulings, procedures, or court cases. The true facts can be presented in a way that is most favorable to the taxpayer. Facts that would cause a court to be sympathetic to the taxpayer should also be presented in the appropriate manner.

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Example 13. Bill in **Example 12** does not believe he is subject to the §6694 penalty. He sends the following letter to the IRS.

CERTIFIED MAIL – RETURN RECEIPT REQUESTED	
Bill Tax Preparer 101 Main Street Anytown, USA Tel: (111) 222-3333	
May 31, 2009	
Internal Revenue Service [Address shown on penalty assessment letter]	
Re: Bill Tax Preparer 101 Main Street Anytown USA Tax year: 2007	
<p>I want to appeal the tax penalty assessed in the attached notice. I was assessed an IRC §6694(b) penalty in the amount of \$800. This is based on the disallowance of a deduction on the tax return for Peter and Miranda Fabricator (111-22-3333) for the tax period that ended 12/31/2007.</p> <p>The deduction disallowance was based on my client's explanation that I incorrectly advised them to take a tax deduction for which they had no documentation. I have attached a copy of the tax organizer they presented to me for use in preparing the return. I have also attached a copy of the engagement letter they signed which states I am not auditing their records and that the client is assumed to have documentation for all items listed on the organizer. There was no need to discuss the documentation of this item because of the signed engagement letter.</p> <p>IRC §6694(b) specifically states the penalty is only assessed if the understatement is due to willful or reckless conduct. Using the information provided by a client and having the client sign an engagement letter shows there was neither willful nor reckless conduct.</p> <p>Under the penalties of perjury, I declare that I examined the facts stated in this protest, including the accompanying documents, and, to the best of my knowledge and belief, they are true, correct, and complete.</p> <p>Bill Tax Preparer</p>	

If the preparer is unsuccessful in his penalty appeal, he may take his case to the United States Tax Court, the United States Court of Federal Claims, or the United States District Court, after satisfying certain procedural and jurisdictional requirements.¹⁴

As an alternative to the appeals process, the preparer may pay 15% of the proposed penalty and then file a claim for refund using Form 6118, *Claim for Refund of Tax Return Preparer and Promoter Penalties*. Within 30 days after the claim is denied, the preparer may file suit. The suit can be filed within 30 days after the expiration of the 6-month period beginning on the date the claim for refund was filed. The IRS cannot begin collection proceedings on the penalty until the court makes its final decision.

¹⁴ IRS Pub. 5, *Your Appeal Rights and How To Prepare a Protest If You Don't Agree* (Rev. 01-1999).

In order to have a penalty abated, the preparer must prove at **least one** of the following:

- The position taken on the return was adequately disclosed.
- The preparer did not know or could not have known that the questioned position was taken on the return.
- There was reasonable cause and good faith concerning the position taken.

If the IRS determines the tax liability was not understated, the penalty is abated.

Example 14. Bill in **Example 12** decides to pay 15% of the proposed penalty and files Form 6118 for a refund. His Form 6118 follows.

Form 6118 <small>(Rev. June 2009) Department of the Treasury Internal Revenue Service</small>	Claim for Refund of Tax Return Preparer and Promoter Penalties ▶ For Penalties Assessed Under IRC Sections 6694, 6695, 6700, and 6701. ▶ See instructions on page 2.	OMB No. 1545-0240																																																																																											
Print or Type	Name of preparer or promoter Bill Tax Preparer	Identifying number See instructions. 111-11-1111																																																																																											
	Address to which statement(s) of notice and demand were mailed 101 Main Street	IRS office that sent statement(s)																																																																																											
	City, town or post office, state, and ZIP code Anytown, USA	Cincinnati																																																																																											
	Address of preparer shown on return(s) for which penalties were assessed (if different from above)																																																																																												
Type of Penalty. Enter letter in column (c) below.																																																																																													
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For Example 14

6701.

Where and When To File

File Form 6118 with the IRS service center or IRS office that sent you the statement(s). Your claim under sections 6694 and 6695 must be filed within 3 years from the date you paid the penalty. Your claim under sections 6700 and 6701 must be filed within 6 years from the date you paid the penalty.

Specific Instructions

Identifying Number

If you are self-employed or employed by another preparer, enter your social security number. If you are the employer of other preparers, enter your employer identification number.

Type of Penalty

For item M (other penalties), enter the name of the penalty and the corresponding Internal Revenue Code section.

civil and criminal litigation, and to cities, states, and the District of Columbia for use in administering their tax laws. We may also disclose this information to other countries under a tax treaty, to federal and state agencies to enforce federal nontax criminal laws, or to federal law enforcement and intelligence agencies to combat terrorism.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is: Recordkeeping, 6 min.; Learning about the law or the form, 17 min.; Preparing the form, 11 min.; and Copying, assembling, and sending the form to the IRS, 20 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. You can write to the Internal Revenue Service, Tax Products Coordinating Committee, SE:W:CAR:MP:T:T:SP, 1111 Constitution Ave. NW, IR-6526, Washington, DC 20224. Do not send this form to this address. Instead, see *Where and When To File* above.

Reasons for claiming refund. Attach additional sheets if more space is needed. Write your name and Identifying number on each sheet.

The deduction disallowance was based on my client's explanation that I incorrectly advised them to take a tax deduction for which they had no documentation. I have attached a copy of the tax organizer they presented to me for use in preparing the return. I have also attached a copy of the engagement letter they signed which states I am not auditing their records and that the client is assumed to have documentation for all items listed on the organizer. There was no need to discuss the documentation of this item because of the signed engagement letter.

IRC §6694(b) specifically states the penalty is only assessed if the understatement is due to willful or reckless conduct. Using the information provided by a client and having the client sign an engagement letter shows there was neither willful nor reckless conduct.

Caution. The IRS currently has 600 §6694 preparer penalty cases in process. They have assessed \$1.8 million in preparer penalties.

IRC §7216: DISCLOSURE OR USE OF INFORMATION BY PREPARERS

Effective January 1, 2009, the new §7216 rules assess penalties for unlawful use and/or reckless or willful disclosure of client tax return information.

The basic premise behind §7216 is that a tax return preparer may not disclose any information obtained from a client's tax return without the permission of the client. Tax return information is any information in any form or manner in connection with the preparation of a taxpayer's tax return. This includes, but is not limited to, a taxpayer's name, address, or identifying number; information the taxpayer furnishes to a tax return preparer; and information furnished to the preparer by a third party.

Unlike many penalties assessed by the IRS, §7216 penalties may include both criminal and civil charges. Violation of the §7216 rules can result in a \$1,000 fine and one year imprisonment. The new rules will complicate the preparers' ability to use and/or disclose information contained in the tax return. Tax preparers should have due diligence procedures in place to prevent the assessment of the §7216 penalties.

The §7216 penalty can be assessed on individuals in addition to the individual required to sign the tax return.

Example 15. New Madison Bank is a tax return preparer and an authorized IRS *e-file* provider. The bank employs Sonia to collect information necessary to prepare a tax return. Another individual, Reggie, prepares the return on the basis of the information collected. A secretary, Susan, types the information into a computer and an administrative assistant, Tonya, uses a computer to file electronic versions of the tax returns. Under these circumstances, only Reggie is a tax return preparer for signature purposes, but all four employees are tax return preparers for purposes of the §7216 penalty.

DISCLOSURE OF STATISTICAL COMPILATIONS OF TAX RETURN INFORMATION

Previous editions of the *University of Illinois Federal Tax Workbook* discussed the prohibition of disclosing any statistical information regarding a tax practice or group of taxpayers even if the taxpayer names were not disclosed.¹⁵ The purpose of the prohibition was the fear that some tax practitioners might use the information to market their tax practice to taxpayers. **For example, Bill's Tax Service cannot advertise that every one of his tax clients received a refund in excess of \$1,000.**

The Treasury Department and the IRS have now realized this prohibition placed a burden on some practitioners and have announced certain exceptions to the prohibition.¹⁶ Statistical compilations may now be disclosed without taxpayer consent if the purpose of the disclosure is in support of the tax preparation business. In some instances, the release of the statistical information can be useful from a public policy perspective. In some cases, groups such as the VITA program, must compile statistical information showing the percentage of low-income taxpayers in order to obtain corporate and public funding for the program. Under the original regulations, this was a prohibited disclosure.

The current interim guidance now allows statistical compilation disclosures if it is in a form that cannot be associated with, or otherwise identify, directly, or indirectly, a particular taxpayer. To further insure anonymity, the data may not be from a group of less than 25 taxpayers. The data cannot be sold or exchanged for value unless it is in relation to the sale of the tax preparer's business. The disclosure of statistical compilations of average refund, credit, or rebate amounts for use in marketing or advertising is prohibited.

Notice 2009-13 shows four examples pertaining to this interim guidance.

Example 16. Alex is a tax return preparer. He used tax return information to produce statistical compilation data for both **internal management purposes** and to support his tax return preparation business. The compilation contained a cell of information showing Alex prepared 32 S corporation tax returns in 2008. In 2009, Alex decides to embark upon a new marketing campaign emphasizing his experience preparing small business tax returns. In the campaign, Alex discloses the number of S corporation returns prepared in 2008. The disclosure does not include any information that can be associated with or that can identify any specific taxpayers. Alex may disclose the anonymous statistical compilation without taxpayer consent because it complies with the interim guidance. The information was from a group of 25 or more taxpayers.

Example 17. Betsy is a tax return preparer. In 2009, in support of her tax preparation business, she advertises the average tax refund obtained for her clients in 2008 was \$2,800. Betsy is in violation of §7216 because she released a statistical compilation reflecting average refund amounts.

Example 18. Daryl is a tax return preparer. In December 2007, he produced an anonymous statistical compilation of tax return information obtained during the 2007 filing season. In 2009, he discloses portions of the data in connection with the marketing of his financial advisory and asset planning services. Daryl is required to receive taxpayer consent before disclosing the information because the disclosure is not being made in support of the tax return preparation business.

Note. "Information" in this context is considered that which is "in connection with tax return preparation." Therefore it is "tax information" if the taxpayer would not have furnished the information to the tax return preparer except with the intention to engage the tax return preparer to prepare the tax return.

¹⁵ Treas. Reg. §301.7216-2(o).

¹⁶ Notice 2009-13, IRB 2009-21 (Feb. 9, 2009).

Example 19. Allison purchases computer software to assist her with the preparation and filing of her income tax return. When Allison loads the software onto her computer, it prompts her to register the purchase of the software. In this situation, the software provider is a tax return preparer and the information Allison provides to register her purchase is tax return information because she is providing it in connection with the preparation of a tax return.

The regulations for §7216 can be very complicated as shown in the following example.

Example 20. Smith Stock Brokerage (Smith) is a brokerage firm that maintains a website through which its clients may access their accounts, trade stocks, and generally conduct a variety of financial activities. Through its website, Smith offers its clients free access to its proprietary tax preparation software.

Bryant furnished Smith with his name, address, and other information when registering to use Smith's website for brokerage services. Smith maintains a record of Bryant's brokerage account activity, including sales of stock, dividends paid, and IRA contributions.

Bryant uses Smith's tax preparation software to prepare his tax return. The software populates some fields on Bryant's return on the basis of information Smith already maintains in its databases.

Smith is a tax return preparer because it prepared and provided software for use in preparing tax returns. Database information that the software accesses to populate Bryant's return is not tax return information because Smith did not receive that information in connection with the preparation of a tax return. However, once Smith uses the information to populate the return, it is considered tax return information.

If Smith retains the information in a form in which Smith can identify that the information was used in connection with tax return preparation, the information in that form is tax return information. However, if Smith retains the information in a database in which it cannot identify whether the information was used in connection with the preparation of a return, then that information is not tax return information.

Use of return information includes any circumstance in which a preparer refers to, or relies upon, tax return information as the basis to take or permit an action.¹⁷ This is illustrated in the following example.

Example 21. Gordon is a tax return preparer. When preparing Mary's tax return, he determines that Mary is eligible to make an IRA contribution and asks whether she wishes to do so. Gordon is using tax return information when he asks whether Mary is interested in making a contribution because he based his inquiry upon knowledge gained from information Mary furnished in connection with preparing her tax return.

PERMISSIBLE DISCLOSURES ONLY WITH TAXPAYER CONSENT

A tax return preparer may disclose or use tax return information as a taxpayer directs as long as the preparer obtains a written consent from the taxpayer. The consent must be knowing and voluntary. Making provision of services contingent upon the taxpayer's furnishing consent makes the consent involuntary and renders the consent invalid. Involuntary consents do not meet the requirements of §7216.

Form and Contents of Taxpayer Consents

Rev. Proc. 2008-35 gives very specific instructions regarding the format of the consent letter:

1. The consent to disclose or use tax information may be attached to an engagement letter but must be a separate document.
2. If the consent is furnished to the taxpayer on paper, it must be provided on one or more sheets of 8½×11 inch or larger paper. All of the text on each sheet of paper must pertain solely to the disclosure or use the consent authorizes. All of the text on each sheet must be in at least 12-point type (no more than 12 characters per inch).

¹⁷ Treas. Reg. §301.7216-1(b)(4)(i).

3. Electronic consents must be provided on one or more computer screens. All of the text placed by the preparer on each screen must pertain solely to the disclosure or use of tax information authorized by the consent, except for computer navigation tools. The text of the consent must meet the following specifications: the size of the text must be at least the same size as, or larger than, the normal or standard body text used by the website or software package for direction, communications, or instructions and there must be sufficient contrast between the text and background colors. In addition, each screen separately or together must contain all applicable elements, be able to be signed by the taxpayer, and be able to be formatted in a readable and printer-friendly manner.

Consent Requirement

Consents to disclose or use Form 1040 series tax return information must satisfy several requirements:

1. The following statements are mandatory and must be included in the consent, except that a tax return preparer may substitute the preparer's name when "we" or "our" is used.
 - a. Unless a tax return preparer is obtaining a taxpayer's consent to disclose tax return information to another tax return preparer for purposes of performing services that assist in the preparation of or provide auxiliary services in connection with the preparation of the taxpayer's tax return, any consent to disclose must contain the following statements in the following sequence:

"Federal law requires this consent form be provided to you. Unless authorized by law, we cannot disclose, without your consent, your tax return information to third parties for purposes other than the preparation and filing of your tax return. If you consent to the disclosure of your tax return information, federal law may not protect your tax return information from further use or distribution."

"You are not required to complete this form. If we obtain your signature on this form by conditioning our services on your consent, your consent will not be valid. If you agree to the disclosure of your tax return information, your consent is valid for the amount of time that you specify. If you do not specify the duration of your consent, your consent is valid for one year."

- b. If a tax return preparer is otherwise required to obtain a taxpayer's consent to disclose tax return information to another tax return preparer for the purpose of performing services that assist in the preparation of or provide auxiliary services in connection with the preparation of the taxpayer's tax return, any consent to disclose tax return information must contain the following sentences in the following sequence:

"Federal law requires this consent form be provided to you. Unless authorized by law, we cannot disclose, without your consent, your tax return information to third parties for purposes other than the preparation and filing of your tax return and, in certain limited circumstances, for federal purposes involving tax return preparation. If you consent to the disclosure of your tax return information, federal law may not protect your tax return information from further use or distribution."

"You are not required to complete this form. Because our ability to disclose your tax return information to another tax return preparer affects a service that we provide to you and its cost, we may decline to provide you with service or change the terms of service that we provide to you if you do not sign this form. If you agree to the disclosure of your tax return information, your consent is valid for the amount of time that you specify. If you do not specify the duration of your consent, your consent is valid for one year."

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- c. All consents to use tax return information must contain the following sentences in the following sequence:
- “Federal law requires this consent form be provided to you. Unless authorized by law we cannot use, without your consent, your tax return information for purposes other than the preparation and filing of your tax return.”*
- “You are not required to complete this form. If we obtain your signature on this form by conditioning our services on your consent, your consent will not be valid. Your consent is valid for the amount of time that you specify. If you do not specify the duration of your consent, your consent is valid for one year.”*
- d. All consents must contain the following statement:
- “If you believe your tax return information has been disclosed or used improperly in a manner unauthorized by law or without your permission, you may contact the Treasury Inspector General for Tax Administration (TIGTA) by telephone at 1-800-366-4484, or by e-mail at complaints@tigta.treas.gov.”*
- e. If a tax return preparer to which the tax return information is to be disclosed is located outside of the United States, the taxpayer’s consent prior to any disclosure is required.
- If the tax return information to be disclosed does not include the taxpayer’s social security number, or if the social security number is fully masked or otherwise redacted, consents for disclosure of tax return information to a tax return preparer outside of the United States must contain the following sentence:

“This consent to disclose may result in your tax return information being disclosed to a tax return preparer located outside the United States.”
 - If the tax return information to be disclosed includes the taxpayer’s social security number, or if the social security number is not fully masked or otherwise redacted, consents for disclosure of the taxpayer’s tax return information including a social security number to a tax return preparer outside of the United States must contain the following statement:

“This consent to disclose may result in your tax return information being disclosed to a tax return preparer located outside the United States, including your personally identifiable information such as your social security number (“SSN”). Both the tax return preparer in the United States that will disclose your SSN and the tax return preparer located outside the United States which will receive your SSN maintain an adequate data protection safeguard (as required by the regulations under 26U.S.C. Section 7216) to protect the privacy and prevent unauthorized access of tax return information. If you consent to the disclosure of your tax return information, federal agencies may not be able to enforce U.S. laws that protect the privacy of your tax return information against a tax return preparer located outside of the United States to which the information is disclosed.”
2. All consents must require the taxpayer’s **affirmative consent** to a tax return preparer’s disclosure or use of tax return information. A consent that requires the taxpayer to remove or “deselect” disclosures or uses that the taxpayer does not wish to be made, such as an “opt-out” consent, is not permitted.
3. All consents to disclose or use tax return information must be signed by the taxpayer.
- a. For paper consents, the taxpayer’s consent to a disclosure or use must contain the taxpayer’s signature.
 - b. For electronic consents, a taxpayer must sign the consent by any method discussed below.
4. A tax return preparer shall not present a consent form with blank spaces related to the purpose of the consent to the taxpayer for signature.

Caution. The language in the §7216 regulations appear to require a consent before sending the taxpayer an “organizer showing 2008 information” to aid the taxpayer in providing information for the 2009 tax return. Consent is also required before a practitioner can assist his client with tax planning.

Electronic Signatures

If a taxpayer furnishes consent to disclose or use tax return information electronically, the taxpayer must furnish a tax return preparer with an electronic signature that verifies that the taxpayer consented to the disclosure or use. The regulations under §7216 require that the consent be knowing and voluntary. Therefore, for an electronic consent to be valid, it must be furnished in a manner that ensures affirmative, knowing consent to each disclosure or use.

A tax return preparer seeking to obtain a taxpayer's consent to the disclosure or use of tax return information electronically must obtain the taxpayer's signature on the consent in one of the following manners:

- To consent to the disclosure or use of the information, the taxpayer may type in a preassigned personal identification number (PIN) that is at least five characters long. This serves as the taxpayer's signature authorizing the disclosure or use. A PIN may not be automatically furnished by the software so that the taxpayer only has to click a button for consent to be furnished. The taxpayer must affirmatively enter the PIN for the electronic signature to be valid.
- Another method is to have the taxpayer type in the taxpayer's name and then press "enter" to authorize the consent. The software must not automatically furnish the taxpayer's name so that the taxpayer only has to click a button to consent. The taxpayer must affirmatively type the taxpayer's name for the electronic consent to be valid.
- Any other manner in which the taxpayer affirmatively enters five or more characters unique to that taxpayer and that are used by the tax return preparer to verify the taxpayer's identity is acceptable. For example, entry of a response to a question regarding a shared secret could be the type of information by which the taxpayer authorizes disclosure or use of tax return information.

Multiple Disclosures or Uses in a Single Consent Form

A taxpayer may consent to multiple uses or disclosures within the same written document. Multiple disclosures and uses consents must provide a taxpayer with the opportunity, within the same written document, to affirmatively select each separate disclosure or use. While the mandatory statements described above need only appear once in the document, the document should have a separate signature line for each item to which the taxpayer is consenting to disclosure or use.

The disclosure consent must meet the following requirements:¹⁸

- The consent must include the name of the preparer and the taxpayer.
- It must identify the intended purpose of the disclosure.
- It must identify the specific recipient of the information.
- If the consent is used for solicitation of products or services, other than tax preparation provided by the preparer, each specific type of product or service must be listed.
- The consent must specify the information to be disclosed for use by the preparer.

Consent to disclose or use information about a taxpayer not filing a return in the Form 1040 series may be in any format, including an engagement letter to a client, as long as the consent complies with the above requirements. The requirements regarding multiple disclosures discussed below are not applicable if the taxpayer is not filing a return in the Form 1040 series. If the consent is not for a taxpayer filing a form in the Form 1040 series, specific recipients need not be identified but instead may allow disclosures to a descriptive class of entities.¹⁹

¹⁸ Treas. Reg. §301.7216-3(a)(3).

¹⁹ Treas. Reg. §301.7216-3(a)(3)(E)(iii).

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The consent may be in either paper or electronic format as long as it meets the requirements of Rev. Proc. 2008-35, July 1, 2008.

Example 22. Tony, a tax preparer, sends his client, Business Buddies, Inc. (BBI), an engagement letter. Part of the engagement letter requests the consent of BBI to disclose tax return information to an investment banking firm to assist with securing long-term financing for BBI. The engagement letter includes language and information that meets the requirements of §7216. It includes the preparer's name, BBI's name, and a signature and date line for BBI. It also includes a statement indicating that BBI authorizes Tony to disclose portions of its corporate 2009 tax return to the investment banking firm. The engagement letter satisfies the requirements of §7216.

Note. This is a change from the regulation applying to disclosures prior to January 1, 2009.

Timing Requirements

The taxpayer must provide written consent **before** a tax return preparer discloses or uses the taxpayer's information. A return preparer may not request the taxpayer's consent for purposes of soliciting business unrelated to tax preparation after providing a completed tax return to the taxpayer for signature. If a taxpayer declines a request for consent, the preparer may not solicit another consent for a purpose substantially similar to that of the rejected request. In addition, no consent may be given to disclose a taxpayer's social security number to a preparer outside of the United States for a taxpayer filing a form in the Form 1040 series.

Duration of Consent

A consent document may specify the duration of the consent. If it does not specify the duration, the consent is effective for a period of one year from the date the taxpayer signed the consent.

Copy of Consent

The return preparer must provide a copy of the executed consent at the time of execution. The requirements of §7216 may be satisfied by giving the taxpayer the opportunity, at the time of executing the consent, to print the completed consent or save it in electronic form.

SAMPLE CONSENT LETTERS

The following consent letters are modified in Rev. Proc. 2008-35, July 21, 2008. They are included to assist practitioners in creating their own consent letters.

Consent To Use of Tax Return Information

	ABC Tax Service 111 Main Street Anytown, Iowa 55555
December 1, 2009	
Joe Smith 20 Broadway Anytown, IA, 55555	
Dear Joe,	
Consent to Use of Tax Return Information	
Federal law requires this consent form be provided to you. Unless authorized by law, we cannot use, without your consent, your tax return information for purposes other than the preparation and filing of your tax return.	
You are not required to complete this form. If we obtain your signature on this form by conditioning our services on your consent, your consent will not be valid. Your consent is valid for the amount of time that you specify. If you do not specify the duration of your consent, your consent is valid for one year. For your convenience, ABC Tax Service has entered into arrangements with certain banks regarding the provision of individual retirement accounts (IRAs). To determine whether the service may be of interest to you, ABC Tax Service will need to use your tax return information. If you would like ABC Tax Service to use your tax information to determine whether the service is relevant to you while we are preparing your return, please check the corresponding box if you are interested, provide the information requested below, and sign and date this consent to the use of your tax return information.	
I, Joe Smith, authorize ABC Tax Services to use the information I provided to ABC Tax Service during the preparation of my tax return for 2009 to determine whether to offer me an opportunity to invest in an IRA.	
<input type="checkbox"/> I consent.	
Signature: _____	
Date: _____	
If you believe your tax return information has been disclosed or used improperly in a manner unauthorized by law or without your permission, you may contact the Treasury Inspector General for Tax Administration (TIGTA) by telephone at 1-800-366-4484, or by e-mail at complaints@tigta.treas.gov .	

2009 Workbook

Consent to Disclosure of Tax Return Information

ABC Tax Service
111 Main Street
Anytown, Iowa 55555

December 1, 2009

Joe Smith
20 Broadway
Anytown, IA, 55555

Dear Joe,

Consent to Disclosure of Tax Return Information

Federal law requires this consent form be provided to you. Unless authorized by law, we cannot disclose, without your consent, your tax return information to third parties for purposes other than the preparation and filing of your tax return. If you consent to the disclosure of your tax return information, federal law may not protect your tax return information from further use or distribution.

You are not required to complete this form. If we obtain your signature on this form by conditioning our services on your consent, your consent will not be valid. If you agree to the disclosure of your tax return information, your consent is valid for the amount of time that you specify. If you do not specify the duration of your consent, your consent is valid for one year.

You have indicated that you are interested in obtaining information on IRAs. To provide you with this information, ABC Tax Service must forward your tax return information as indicated below to the bank that provides this service.

If you would like ABC Tax Service to disclose your tax return information to the bank providing this service, please check the corresponding box for the service in which you are interested, provide the information requested below, and sign and date your consent to the disclosure of your tax return information.

I, John Smith, authorize ABC Tax Service to disclose to First Bank that portion of my tax return information for 2009 that is necessary for First Bank to contact me and provide information about obtaining an IRA or altering my contribution to an IRA for 2009.

I consent.

Signature: _____

Date: _____

If you believe your tax return information has been disclosed or used improperly in a manner unauthorized by law or without your permission, you may contact the Treasury Inspector General for Tax Administration (TIGTA) by telephone at 1-800-366-4484, or by e-mail at complaints@tigta.treas.gov.

PERMISSIBLE DISCLOSURES WITHOUT TAXPAYER CONSENT²⁰

If disclosure is required, the permission statement must be obtained prior to releasing the return to the client. The law permits disclosure in certain cases without the taxpayer's consent in the following 12 situations:

1. **Disclosure to the IRS.**
2. **Disclosure for preparation of a taxpayer's return.** If a taxpayer furnishes information to a return preparer located within the United States, that preparer may give the information to another tax preparer as long as that preparer is a member of the same firm²¹ and is also located within the United States. If the other preparer is a member of the same firm but is located outside of the United States, the taxpayer's consent prior to any disclosure is required.

If the taxpayer initially furnishes the tax return information to a preparer located outside the United States, the preparer may give the information to another member of the same firm without the taxpayer's consent.

Example 23. Teresa is a client of Neverest Tax Advisers, which is a tax return preparer. Eugene, an employee of Neverest's Iowa office, receives the information from Teresa for use in preparing her income tax return. Eugene discloses the information to Paula, an employee in Neverest's Kansas office. Paula uses the information to process Teresa's return. Neverest is not required to obtain Teresa's consent because Paula and Eugene are both employed by the same firm located within the United States.

3. **Disclosure to other tax preparers.** A tax return preparer may disclose tax information to another preparer that is not a member of the same firm as long as that preparer is located in the United States. However, the use of the information is limited. The preparer receiving the information may not provide substantive determinations or advice affecting the tax liability reported by the taxpayer. A substantive determination involves an analysis, interpretation, or application of the law.

Authorized disclosures include one preparer disclosing information to another preparer for the purpose of having a second preparer transfer that information to and compute the tax liability on a taxpayer's tax return by means of electronic, mechanical, or other form of tax return processing service. It also includes disclosures to an authorized IRS *e-file* provider for the purpose of electronically filing the return.

Example 24. Adam, an employee at Neverest Tax Advisers, receives information from Teresa for Neverest's use in preparing her income tax return. Adam forwards the return information to Bartholomew, an employee at another firm, to obtain advice on the issue of whether Teresa may claim the deduction for a certain business expense. Adam is required to receive Teresa's prior consent before disclosing her information to Bartholomew. Bartholomew's services involve a substantive determination affecting the tax liability that Teresa will report.

4. **Disclosure to related taxpayers.** In preparing a return for a second taxpayer, a preparer may use and disclose (but only to that second taxpayer) certain information from another taxpayer under the following conditions:
 - a. The information is in the exact form in which it appears on the return of the first taxpayer, **and**
 - b. All three of the following must apply:
 - i. The second taxpayer is related to the first taxpayer,
 - ii. The first taxpayer's tax interest in the information is not adverse to the second taxpayer's tax interest in the information, and
 - iii. The first taxpayer has not expressly prohibited the disclosure or use.

A taxpayer is related to another taxpayer if they are husband and wife, child and parent, grandchild and grandparents, partner and partnership, trust or estate and beneficiary, trust or estate and fiduciary, corporation and shareholder, or members of a controlled group of corporations.

²⁰ Rev. Proc. 2008-35 (July 21, 2008).

²¹ Firm member meaning employer, employee, or partner relationship.

5. **Disclosure due to a court order.** Disclosure without the consent of the taxpayer is permitted if the disclosure is made because of any one of the following documents:
 - The order of any court of record — federal, state, or local
 - A subpoena issued by a grand jury — federal or state
 - A subpoena issued by the United States Congress
 - An administrative order, demand, summons, or subpoena that is issued in the performance of its official duties by certain state and federal agencies
 - A written request from a professional association's ethics committee or board investigating the ethical conduct of the tax return preparer
 - A written request from the Public Company Accounting Oversight Board in connection with certain inspections
6. **Disclosure for obtaining legal advice.** A tax preparer may disclose tax return information to an attorney for purposes of securing legal advice. She may also disclose to an employee of the Treasury Department for use in connection with an investigation of the preparer and any officer of the court for use in connection with proceedings involving the preparer.
7. **Disclosure to taxpayer's fiduciary.** If, after furnishing tax return information to a preparer, the taxpayer dies or becomes incompetent, insolvent, or bankrupt, or the taxpayer's assets are placed in conservatorship or receivership, the preparer may disclose the information to the duly-appointed fiduciary of the taxpayer or his estate, or to the duly-authorized agent of the fiduciary.
8. **Disclosure for payment of tax preparation services.** A preparer may use and disclose tax return information that the taxpayer provides to the preparer for payment of preparation services to the extent necessary to process or collect the payment. For example, if the taxpayer gives the preparer a credit card to pay for preparation services, the preparer may disclose the taxpayer's name, credit card number, credit card expiration date, and the amount due for preparation services to the credit card company. Any tax return information that the taxpayer did not give the preparer for purposes of making payment may not be used or disclosed without the taxpayer's prior written consent.
9. **Lists for solicitation of tax return business.** A tax return preparer may compile and maintain a separate list containing solely the names, addresses, e-mail addresses, and phone numbers of taxpayers whose tax returns the preparer has prepared or processed. This list may be used by the compiler solely to contact the taxpayers on the list for the purpose of providing tax information or additional tax return preparation services. The compiler may not transfer the list, or any part of the list, to another person unless the transfer takes place in conjunction with the sale or other disposition of the compiler's tax return preparation business.
10. **Disclosure for quality or peer reviews.** To the extent necessary to accomplish quality or peer review, tax return information may be disclosed without consent. The review must be conducted only by attorneys, CPAs, EAs, or enrolled actuaries who are eligible to practice before the IRS. The information may also be disclosed to persons who provide administrative or support services to the person conducting the review. Information gathered in the review may be used only for purposes of the review. No tax return information identifying a taxpayer may be disclosed in any evaluation reports or recommendations that are accessible to persons other than the reviewer or the preparer being reviewed. The preparer being reviewed should maintain a record of the review including the information reviewed and the identity of the person conducting the review. After completion of the review, no documents containing information that may identify any taxpayer by name or identification number may be retained by the reviewer or the reviewer's support personnel. Any person, including support personnel, receiving tax return information in connection with the review is considered a tax return preparer for purposes of §7216.

- 11. Disclosure to report the commission of a crime.** IRC §7216 does not apply to disclosure of any tax return information to the proper state, federal, or local officials in order to inform them of activities that may constitute, or have constituted, a violation of any criminal law or to assist the official in investigating or prosecuting a violation of criminal law. A disclosure made in a bona fide but mistaken belief that the activities constituted a violation of criminal law is not subject to §7216.
- 12. Disclosure due to tax preparer's incapacity or death.** In the event of incapacity or death of a tax return preparer, disclosure of tax return information may be made for the purposes of assisting the preparer or his legal representative in operating the business. A person receiving tax return information in this circumstance is considered a return preparer for purposes of §7216.

IRC §7216 Checklist

The following checklist is designed to help tax practitioners comply with the rules for §7216:

- Do all employees understand when disclosure and use of tax information consents are required?
- Are the mandatory statements for use in disclosure and use consents readily available?
- Is the consent statement a separate document and not part of the engagement letter?
- If the statement is furnished on paper, is the paper size 8½ x 11 or larger and is the text in at least 12-point font?
- If the consent is furnished electronically, is the text at least as large as the other text on the website?
- Is the following information contained in the consent statements?
 - Name of the tax preparer
 - Name of the taxpayer
 - Intended purpose of the disclosure
 - Specific information to be disclosed
 - Specific recipient of the disclosed information
- If the consent is for the use of tax information, is the specific use (product or service being solicited) stated?
- Is the consent signed by the taxpayer?
- Is the consent dated?
- If the consent is electronic, are the requirements for an electronic signature followed?
- For multiple consents, is the taxpayer able to mark the acceptance or rejection of each specific disclosure or use?
- Is there a taxpayer signature on each specific consent?
- Are the consents for disclosure and use on separate forms?
- Was the consent signed and dated prior to giving the client the completed return?
- If the disclosure is to send the tax information outside of the United States is the taxpayer's social security number redacted?
- If client lists are maintained, do they only contain the names, addresses, email addresses, and telephone numbers of the clients?
- Is there a "tickler file" that identifies when consent documents expire?
- Is the taxpayer given a copy of the signed consent at the time it is signed?

CONFLICT OF INTEREST

Tax preparers subject to the requirements of Circular 230 must be aware of the conflict-of-interest rules contained in Section 10.29. Although attorneys and CPAs must also abide by conflict-of-interest rules defined by their professional organizations, when dealing with the IRS, Circular 230 rules take precedence.

Section 10.29 defines a conflict of interest as a situation in which the representation of one client is directly adverse to another client. It also includes situations in which there is a significant risk that the representation of one or more clients is materially limited by the practitioner's responsibilities to another client, a former client or a third person, or by a personal interest of the practitioner.

The practitioner may represent a client if he reasonably believes that he is able to provide competent and diligent representation. However, the representation must not be prohibited by law and each affected client must waive the conflict of interest and give informed consent. The consent must be confirmed in writing by each client at the time the existence of the conflict is known by the practitioner. This written confirmation may be made within a reasonable period after the informed consent but in no event later than 30 days.

Copies of written consents must be retained by the practitioner for at least 36 months from the date of the conclusion of the representation of the affected clients and must be provided to any officer or employee of the IRS upon request.

TYPES OF CONFLICTS

There are three basic types of conflicts that can create problems for a tax professional.

Conflicts between Clients

In small towns, a tax practitioner can serve a large percentage of the population. The preparer provides services for clients and their relatives, neighbors, and associates. A possible conflict can exist between a current client and a former client.

Example 25. Preparer Smith provides accounting, consulting, and tax services for Joe's Hardware. Joe is considering purchasing a building from Larry Landowner in order to expand his business. Joe asks for Smith's advice in determining a fair price for the building. Larry was a former client of Smith. Smith knows the price that Larry paid for the building two years ago, and he thinks the proposed selling price is entirely too high. Smith should excuse himself from providing the advice because of a potential conflict of interest.

Example 26. Preparer Jolene prepared the joint tax returns of Ted and Alice Arnold. The Arnolds obtained a divorce in 2008. The IRS recently notified the Arnolds that their 2007 tax return is under audit. They ask Jolene if she will handle the audit. During the audit, the IRS discovers substantial unreported income. Alice tells Jolene she had no idea Ted had a gambling problem and failed to report the gambling income.

Knowing this could turn into an innocent spouse case, Jolene should recuse herself from the audit and insist the Arnolds find separate representation.

Frequently there are conflicts between two current clients.

Example 27. Mutt and Jeff are both clients of preparer Doris. Mutt comes to Doris and asks for advice in whether to form an LLC with Jeff. Doris knows Jeff is involved in two possible lawsuits that could cause Jeff to file bankruptcy. Assuming Mutt does not know of these pending lawsuits, Doris has a conflict of interest if she cautions Mutt about going into business with Jeff.

Example 28. Preparer Lilly has a client that is an S corporation. She also individually represents the three shareholders of the corporation. While preparing the corporation return, Lilly finds a \$20,000 check made payable to one of the shareholders. Lilly has a conflict of interest between the shareholders related to advising the corporation whether to classify the check as compensation or a distribution.

Example 29. Preparer Barney has been filing tax returns for Mr. and Mrs. Flintstone for many years. Fred Flintstone met with Barney in January 2009 and asked that a joint return be filed. Shortly thereafter, an attorney for Wilma Flintstone contacted Barney and informed him that Wilma will refuse to sign a joint return because a divorce is in process. Barney now has a conflict.

Conflicts between Advocates and Witnesses

A tax preparer must be careful in being an expert witness in a case involving a client. It is possible that the preparer might answer a question while under oath that could be detrimental to the client's case. A jury could have difficulty in determining the validity of the preparer's testimony and distinguishing whether he was representing the client or serving as the expert witness.

Conflicts between Preparer and Client

Having a business dealing with a client can create a conflict of interest.

Example 30. Preparer Edith agrees to help her client Sally form a corporation. Edith agrees to take 5% of the stock of the new company in exchange for her services. Advising the client on whether this should be common or preferred stock could present a conflict.

Example 31. Preparer Fred owns a 50-unit apartment complex. His client, Herman, wishes to purchase the apartments as an investment in order to shelter a portion of his income. Knowing that **if** the allocation of asset values is **beneficial** to the **seller**, it is **detrimental** to the **buyer**, Fred should insist Herman find other representation.

Waiver

When the preparer and client determine that a conflict is not present, the client must sign a waiver acknowledging a conflict could exist but agrees to use the services of the preparer anyway. The consent must fully disclose the nature of the potential conflict. The consent should also discuss results that could occur with any adverse representation.

The consent should discuss any implications of common representation and suggest reasonable alternatives. If confidentiality prevents the preparer from making full disclosure of the conflict, he must not accept the engagement.

The conflict of interest consent must be in writing and be based on all facts and circumstances regarding the engagement.

Circular 230 is silent on situations that prevent a preparer from representing a client because of a conflict. If there are multiple preparers in the firm, and they do not have a conflict, no guidance is given regarding whether they are allowed to prepare the return.

CLIENT NOTIFICATION

Tax practitioners often want to know what information needs to be in certain client notification letters. The following examples were obtained from CFS Tax Correspondence 2009 and are reprinted with permission.²²

CONFLICT OF INTEREST BETWEEN RELATED TAXPAYERS

Dear **[Client: Salutation]**,

In the past, this office prepared tax returns for you and your ex-spouse. While it was very satisfying for me to prepare your taxes in the past, I will be unable to do so in the future. From a professional point of view, if I prepared both of your returns, there would be a conflict of interest.

It has been a pleasure serving you. Good luck in the future.

Sincerely,

UNDERSTANDING PROPOSED ENGAGEMENT

Dear **[Client: Salutation]**,

This letter confirms our understanding of the terms of our engagement and the nature and extent of the services which I will provide.

I will prepare your federal and state income tax returns from information that you will furnish. I will make no audit or other verification of the data you submit, although I may ask you for clarification of some of the information. In accumulating your tax information, it is important that you understand the Internal Revenue and state recordkeeping requirements. Taxing authorities, by regulation, require you to both maintain and retain information substantiating all items reported on your returns. Requirements for documentation are especially important for deductions of travel, entertainment, auto, and computer use. Should you have any questions on what will satisfy these requirements, I will be happy to advise you. These records must be kept by you for a minimum of three (3) years.

I will use my judgment in resolving questions when the tax law is unclear or when there may be different interpretations of the law. I will resolve such questions in your favor if there is reasonable justification for such a position.

Your returns, of course, are subject to review by the taxing authorities. However, just because your return is selected does not mean there is a problem. In your interest, it is advisable to contact me immediately upon receiving correspondence from either taxing agency. I will be available upon request to represent you and will render additional invoice(s) for the time expended.

If there is an error on the returns prepared from your data, the preparer is not liable for the payment of the additional taxes that would have been properly due on the original returns or the interest charged by the taxing agency, since you have had use of the money.

Fees for my services will be computed according to the "Schedule of Minimum Charges" dated **[insert date]**. In most cases, fees are due upon completion of the work. I do, however, reserve the right to ask for retainer fees to be paid in advance of work done.

Any bookkeeping or payroll services will be specific to the client: all terms and conditions will be addressed separately of any and all tax services. Work is neither audited nor verified. If this engagement letter correctly expresses your understanding of the nature, scope and terms of the services which I am to provide, please indicate your agreement by signing and dating this letter in the spaces provided below and returning it to us.

Thank you,

²² Since 1989, CFS Tax Software, Inc., has been a developer of affordable tax planning and utility software designed by — and for — tax professionals. CFS produces many powerful — yet easy-to-use and affordable — tax utility programs, including *TaxTools (over 350 utilities)* and *Payroll System (W2/1099, E-file, 941/940, Payroll Corrector, LivePayroll)*, both of which are the most widely used programs of their kind in the tax profession and have both received top marks from CPA Software News.

REJECTION OF A PROPOSED ENGAGEMENT

Dear **[Client: Salutation]**,

We enjoyed meeting with you and **[insert name]** on **[insert date]**. We are pleased that your company would consider our firm for your tax and accounting needs.

After considering your business needs, we do not feel able to adequately respond to your accounting and tax concerns. Please do not consider this a commentary on your business, but rather a reflection of our inability to serve your needs.

During our meeting, we discussed possible tax and accounting strategies that you might consider. Because our discussion was made without a thorough knowledge of your company, you should not rely upon any advice we presented during our meeting.

Thank you again for the opportunity to meet with you. We wish you success in your future pursuits.

Sincerely,

ACCEPTING PROPOSED ENGAGEMENT

Dear **[Client: Salutation]**,

This letter is written to confirm our understanding of the terms of our engagement and the nature and extent of the income tax services we will provide.

We will prepare your individual federal (and state) income tax returns for the year ended **[insert date]**. We will not audit or verify the data you submit to us; however, we may ask you to clarify some of the information. We will be available to assist and guide you in gathering the necessary information by furnishing you with questionnaires and/or worksheets, and by answering your questions.

It is your responsibility to provide all the information necessary to complete your tax returns. You should retain all the documents, receipts, and canceled checks and other records to substantiate the items of income and deductible expenses that are claimed on your return. Since you have the final responsibility for the information on your income tax returns, we highly recommend that you review the tax returns carefully before signing and filing them.

Fees for our services will be at our standard form rates. Additionally, we will be entitled to reimbursement for extra expenses that may include extra copies of returns and rerun fees. Our invoices are due and payable upon presentation.

Your returns are subject to review by taxing authorities. Should an examination occur, we will be available to represent you at an additional fee. If any interest or penalties are assessed, they will be your responsibility.

If a question arises interpreting tax law, and a conflict exists between the taxing authority's interpretation of the law and other supportable positions, we will use our professional judgment in resolving these issues. Whenever possible, we will resolve said questions in your favor.

If the foregoing is in accordance with your understanding of the terms and conditions of our engagement, please sign where indicated on the enclosed copy of this letter and return it to our offices.

We wish to express our appreciation for this opportunity to work with you, and we are always available to discuss or clarify any part of this engagement letter with you.

[Tax Practitioner]

Read and Accepted by:

_____ **[Client: Company contact/Taxpayer name]**

_____ Date Signed

_____ **[Client: Spouse's complete name]**

_____ Date Signed

FIRING AN EXISTING CLIENT

Dear **[Client: Salutation]**,

Effective **[insert date]**, we can no longer service your account. We have come to this decision with great reluctance. We are resigning because **[insert reason (e.g., your continued failure to pay our fee for services in a timely manner; we have a conflict of interest between your company and other clients; our continuing staffing problems have made it impossible to serve your needs; we are changing the types of services we will offer in the future; we are concerned about your failure to act upon the recommendations we have made in the past; our desire to decrease the number of clients we will serve in the future)]**.

We wish to remind you that we will not be performing any services for you after **[insert date]**, and that there may be tax returns, elections, or other compliance matters for which you are now responsible. We recommend that you immediately obtain a new accountant, and we will fully cooperate in providing information to your new accountant when your unpaid balance of **[insert amount]** is paid in full. In addition, we require the return of the written authorization below, signed by you, to release any information to your new accounting firm. Without your written authorization, we are prohibited by our professional code of conduct from disclosing or discussing confidential client matters with anyone outside our firm.

We appreciate the opportunity to have served you in previous years, and wish you success in your future pursuits.

Sincerely,

[Preparer: User Configured Preparer Signature]

CONSENT FOR DISCLOSURE OF INFORMATION

Federal law requires this consent form be provided to you. Unless authorized by law, we cannot disclose, without your consent, your tax return information to third parties for purposes other than the preparation and filing of your tax return. If you consent to the disclosure of your tax return information, Federal law may not protect your tax return information from further use or distribution.

You are not required to complete this form. If we obtain your signature on this form by conditioning our services on your consent, your consent will not be valid. If you agree to the disclosure of your tax return information, your consent is valid for the amount of time that you specify. If you do not specify the duration of your consent, your consent is valid for one year.

Authorization

I/We, authorize your firm to release our tax returns, tax information and tax-related documents as detailed below to the following person and/or institution:

Name: _____
 Organization: _____
 Address: _____
 City, State, Zip: _____
 Telephone: _____ FAX: _____ e-mail: _____

Duration of this consent for the purposes marked below (one year if blank):

- Mortgage or Rent Application
- Life Insurance
- Loan Application (Auto, Personal, Student, Refinancing)
- IRA or Investment Advice
- Other: _____

Specific tax documents and information to be released:

- Any information which is requested
- Only a copy of my tax return for the following year(s):
- Only the following specific information:

Client's name	Signature	Date
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Spouse's name	Signature	Date
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If you believe your tax return information has been disclosed or used improperly in a manner unauthorized by law or without your permission, you may contact the Treasury Inspector General for Tax Administration (TIGTA) by telephone at 1-800-366-4484, or by email at complaints@tigta.treas.gov.

PROSPECTIVE CLIENT SCREENING

Using a checklist to refer to when interviewing a potential client is a good practice for a tax preparer. This can help the preparer determine whether to accept the engagement. In addition to the obvious questions such as name and address, the preparer should query the client regarding the following:

1. What services are you expecting? (tax, bookkeeping, representation, payroll, etc.)
2. When will you provide us with information so we can provide the requested service(s)?
3. When do you expect to receive the results of our work?
4. May we file for an extension on your return if necessary?
5. Are you currently being, or have you ever been audited by the IRS or a state or local taxing authority?
6. If so, what were the issues and the result of the audit?
7. Why are you changing preparers?
8. Are you involved in any pending litigation as either plaintiff or defendant in a lawsuit with an accountant?
9. Is it okay for me to contact your prior accountant? Does he have your written permission to share information with me?
10. Will you provide us with three years of prior returns to review?
11. Why are you considering me as your tax preparer?
12. Who referred you to me?
13. What criteria are you using to select a preparer?
14. Who might present a conflict of interest?
15. Have you ever been charged with a violation of federal, state, or local law?
16. Is this a new business?
17. What type of records will you provide for tax preparation?
18. Are there any special technical aspects to your return?

The preparer should ask himself the following:

1. Am I qualified to handle the engagement?
2. Do I have any doubts that the client will remain in business?
3. Is there anything about the engagement that makes me uncomfortable?

OPR RESPONSIBILITY UPDATE

The OPR enforces the regulations governing the practice of attorneys, CPAs, EAs, enrolled actuaries, enrolled retirement plan agents, and appraisers before the IRS as set forth in Circular 230.

The mission of the OPR is “to set, communicate and enforce standards of competence, integrity and conduct among Circular 230 professionals.”²³

NEW DIRECTOR

On March 3, 2009, the OPR announced Karen Hawkins, Esq., as its new director. Ms. Hawkins was previously employed outside the IRS, even though she has worked with the IRS for a number of years. She has been active in tax litigation. Because of her efforts, Congress clarified the availability of judicial review for innocent spouse cases.

In addition to practicing law for 25 years, Ms. Hawkins was a member of the Information Reporting Program Advisory Committee (IRPAC), which provides the IRS with an organized public forum for discussion of relevant tax administration issues.

GUIDE TO SANCTIONS

On May 7, 2009, the OPR released guidance on how sanctions are applied to violations of Circular 230 regulations. The document is listed as an attachment to the Internal Revenue Manual and is titled *Exhibit ___ Office of Professional Responsibility Guide to Sanctions* (Guide).

The OPR is given the authority to sanction tax preparers for violations of 31 C.F.R. Part 10 by 31 U.S.C. §330, which states the following:

The Secretary of the Treasury may . . .

regulate the practice of representatives of persons before the Department of Treasury; and . . .

after notice and opportunity for a proceeding, the Secretary may suspend or disbar from practice before the Department, or censure, a representative who —

- 1. is incompetent;*
- 2. is disreputable;*
- 3. violates regulations prescribed under this section; or*
- 4. with intent to defraud, willfully and knowingly misleads or threatens the person being represented or a prospective person to be represented.*

The guide is designed to correct misconduct. It states that the proposed remedial sanction in each case must be fair, equitable, and impartial. Its purpose should not be to punish but to correct and motivate the individual to adhere to his duties under Circular 230.

Before considering a corrective sanction, the OPR staff reviews and analyzes all evidence. They then choose a sanction that is reasonable and appropriate for the circumstances. The Guide is not intended to establish rigid standards or to imply that a greater or lesser corrective sanction is inappropriate.

Each case is considered separately and dealt with on its own merits. Mitigating factors are considered before deciding on a sanction. If there are multiple offenses or offenses that violate more than one section of Circular 230, more severe sanctions are considered even though this may be a first violation.

²³ IRS Pub. 4693, *Office of Professional Responsibility Who We Are; What We Do* (June 2008).

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Generally, a reprimand or censure is used when that type of sanction is all that is needed to correct the behavior. Reprimands and censures are used when the suspension period is six months or less. Suspensions of more than 24 months may be used when the suspension is necessary to communicate the severity of the violation. When the practitioner is perpetrating ongoing harm to the taxpayer community, or when multiple violations indicate a lack of fitness to practice, suspensions of more than 24 months may be issued. Disbarment is sought when suspension of at least five years is appropriate.

Mitigating Factors

The following mitigating factors are listed in the guide. They are neither given equal weight nor do they apply in all cases.

1. In tax noncompliance cases, the violation is corrected before contact with the IRS.
2. In tax noncompliance cases, the violation is corrected before contact with the OPR.
3. In tax noncompliance cases, correction is initiated within a reasonably short period after contact with the OPR.
4. Illness, incapacitation, or personal hardship directly correlates to the action or inaction that violates Circular 230.
5. Illness, incapacitation, or personal hardship of the family or others close to the practitioner directly correlates to the action or inaction that violates Circular 230.
6. Personal or professional financial distress correlates to nonpayment of Form 941 employment tax obligations.
7. Extrinsic circumstances such as natural disasters directly correlate to the action or inaction that violates Circular 230.
8. There is a recognition of the action or inaction that violated Circular 230 and a commitment to future compliance.
9. For firms, there is a commitment to establish internal controls to prevent recurrences of the violation.
10. Measures were in effect prior to the misconduct and/or were put into place after the misconduct in order to prevent future violations.
11. Age of allegations.

Aggravating Factors

The following are the aggravating factors listed in the guide:

1. Failure to respond to OPR contact.
2. For tax noncompliance cases, failure to correct the issue after contact from the IRS.
3. For tax noncompliance cases, failure to correct the issue after contact by the OPR.
4. For tax noncompliance cases, there are multiple tax issues related to noncompliance on multiple types of forms in the same tax period, including penalties.
5. For tax noncompliance cases, the sum of money that is at issue.
6. Motive, especially those indicating personal gain.
7. Pattern of action or inaction that violated Circular 230.
8. Assertion of legal arguments that were previously ruled frivolous by courts of law.
9. Confrontational behavior that falls outside the bounds of a zealous defense.
10. Previous incidents of Circular 230 violation.
11. The number of offenses.
12. Failure to understand or recognize that actions constituted a violation of Circular 230.
13. Negative effect on tax administration.

Suspension Table

The guide also provides examples of violations and possible sanctions.

Offense	Circular 230 Section	Range of Suspension
Form 1040 late filed at time of OPR contact	Section 10.51(a)(6)	2–4 months for each late-filed Form 1040. If a Form 1040 has or had a balance past due and/or penalties, then 4 months for each Form 1040 late filed with a past due balance, but no increase when financial hardship has affected the ability to pay.
Form 1040 nonfiled at time of OPR contact	Section 10.51(a)(6)	4–6 months for each nonfiled Form 1040. If a Form 1040 has or had a balance past due and/or penalties, then 6 months for each nonfiled Form 1040 with a balance, but no increase when financial hardship has affected ability to pay.
Form 941 late filed at time of OPR contact	Section 10.51(a)(6)	2–4 months for each late-filed Form 941. If a Form 941 has or had a balance past due and/or penalties, then 4 months for each late-filed Form 941 with a balance, but NO CONSIDERATION is made for financial hardship or ability to pay.
Form 941 nonfiled at time of OPR contact	Section 10.51(a)(6)	4–6 months for each nonfiled Form 941. If a Form 941 has or had a balance past due and/or penalties, then 6 months for each nonfiled Form 941 with a balance, but NO CONSIDERATION is made for financial hardship or ability to pay.
Form 940 late filed at time of OPR contact	Section 10.51(a)(6)	1–2 months for each late-filed Form 940. If a Form 940 has or had a balance due, then 2 months for each late-filed Form 940 with a balance, but no increase when financial hardship has affected ability to pay.
Form 940 nonfiled at time of OPR contact	Section 10.51(a)(6)	2–4 months for each nonfiled Form 940. If a Form 940 has or had a balance due, then 4 months for each nonfiled Form 940 with a balance, but no increase when financial hardship has affected the ability to pay.

Note. For late-filed or nonfiled Forms 1040 or Forms 940, if four or more years are involved, multiply the base determination for those late-filed or nonfiled 1040s or 940s by two. It is within the discretion of the enforcement attorney to not apply the multiplier when there is mitigation directly correlating to charged years. For late-filed or nonfiled Forms 941, if eight or more quarters are involved, multiply the base determination for those late-filed or nonfiled 941s by two. It is within the discretion of the enforcement attorney to not apply the multiplier when there is mitigation directly correlating to charged years.

FORM 8554, APPLICATION FOR RENEWAL OF ENROLLMENT TO PRACTICE BEFORE THE INTERNAL REVENUE SERVICE

Effective December 1, 2008, EAs can also file Form 8554 and pay to renew their EA status online. Payment is made at www.Pay.gov. This is a fast, efficient way to renew their status online.

CHANGE OF ADDRESS

It is extremely important that EAs advise the IRS when changing their address. Providing a new address on the Form 1040, or other form, does not necessarily get to the Office of Practitioner Enrollment (OPE) in Detroit, Michigan. No one should assume that OPE has any address information other than what EAs personally send to the IRS. Consequently, if EAs miss their renewal because they did not get mail from the IRS, it is not considered a mitigating circumstance that the IRS did not have the latest address information.

An EA must send address-change notification to the address specified by the director of OPR. This notice must contain the EA's name, prior address, new address, SSN or TIN, and date.

PROFESSIONAL RESPONSIBILITY AND THE REPORT OF FOREIGN BANK AND FINANCIAL ACCOUNTS

There have been some questions about professional responsibility and the Report of Foreign Bank and Financial Accounts (FBAR). The FBAR, TD F 90-22.1, is not a tax return. It is an information report required under the Bank Secrecy Act (BSA), 31 U.S.C. 5314, and related regulations 31 C.F.R. 103.24 and 103.27. Related records are required under 31 C.F.R. 103.24 and 103.32, and they are referenced in U.S. tax returns. These tax returns request information about the existence of foreign financial accounts in which the filer of the tax return has a financial interest, or over which the filer has signature or other authority. If the response to the leading question is "yes," then the tax return filer is prompted to file an FBAR.

In 2003, the IRS was delegated responsibility for assessing penalties for failure to file this report. In 2004, Congress substantially increased penalties for failure to file the FBAR and created a nonwillfulness penalty of up to \$10,000 for individuals as well as other entities. As a result, there is increased interest in compliance.

Some FBAR nonfilers are blaming their preparers for the failure to file — stating that they have reasonable cause for failure to file because the practitioners did not ask about or explain the foreign financial account part of the return. Accordingly, practitioners have expressed concerns about their legal responsibilities with respect to this form.

Practitioners must comply with the FBAR filing rules. For example, failure to timely file required tax or information returns, including FBARs, must be disclosed on Form 8554 when the EA renews his enrollment.

A practitioner must comply with FBAR rules as part of his due diligence obligation under Section 10.22 of Circular 230:

Section 10.22 Diligence as to Accuracy.

In general. A practitioner must exercise due diligence —

- 1. In preparing or assisting in the preparation of, approving, and filing returns, documents, affidavits, and other papers relating to Internal Revenue Service matters;*
- 2. In determining the correctness of oral or written representations made by the practitioner to the Department of the Treasury; and*
- 3. In determining the correctness of oral or written representations made by the practitioner to clients with reference to any matter administered by the Internal Revenue Service.*

Due diligence does not require that the practitioner "audit" his client. However, it does require that a practitioner make reasonable inquiries when a client provides information that suggests possible participation in overseas transactions or accounts subject to FBAR requirements. A practitioner may rely on information provided by a client in good faith. However, he may not ignore implications learned from information provided or actually known. The practitioner is also required to advise a client of potential penalties likely to apply to a position taken, such as failing to abide by FBAR requirements. The practitioner must make reasonable inquiries if information appears incorrect, inconsistent with an important fact or factual assumption, or is incomplete.

Inquiries about the FBAR filing requirements may be resolved by reading "FAQs Regarding Report of Foreign Bank and Financial Accounts (FBAR)," and other FBAR information available on the IRS website at www.irs.gov. Specific questions and comments may be emailed to the following address: FBARquestions@irs.gov. Questions concerning the EA's ethical obligations may be addressed to the Office of Professional Responsibility at opr@irs.gov.

KNOWLEDGE OF ERRORS

Occasionally, a tax preparer reviews the income tax return of new clients and discovers errors that were made in its preparation. If the error benefits the client, it is an easy decision to notify the client and prepare an amended tax return. However, if the error benefits the government, the decision may be more difficult.

Many clients prefer to take the “wait and see” approach. If the IRS finds the error, they pay the additional tax and any accompanying penalties and interest. Treasury regulations do not require filing an amended return if an error is discovered. The regulations indicate that an amended return **should** be filed, but do not use the words “shall or must.”

... if a taxpayer ascertains that an item should have been included in gross income in a prior taxable year, he should, if within the period of limitation, file an amended return and pay any additional tax due. Similarly, if a taxpayer ascertains that an item was improperly included in gross income in a prior taxable year, he should, if within the period of limitation, file claim for credit or refund of any overpayment of tax arising therefrom.²⁴

Unfortunately, the tax preparer that discovers the error must not take that approach.

Circular 230 section 10.21 requires the practitioner to notify the taxpayer of the error.

Section 10.21 Knowledge of Client's Omission.

A practitioner who, having been retained by a client with respect to a matter administered by the Internal Revenue Service, knows that the client has not complied with the revenue laws of the United States or has made an error in or omission from any return, document, affidavit, or other paper which the client submitted or executed under the revenue laws of the United States, must advise the client promptly of the fact of such noncompliance, error, or omission. The practitioner must advise the client of the consequences as provided under the Code and regulations of such noncompliance, error, or omission.

The American Institute of Certified Public Accountants (AICPA) takes a similar stance in its Code of Ethics. If a tax preparer discovers any error, other than one that has an insignificant effect on the tax liability, the preparer must inform the client promptly. The same is true if the preparer discovers the taxpayer has failed to file a required tax return.

The preparer must recommend the erroneous return be corrected or the unfiled return be filed. The AICPA Statement on Standards for Tax Services (SSTS) allows the practitioner to notify the client verbally and does not require the practitioner to notify the tax authority. In fact, the practitioner must have the taxpayer's permission to notify the tax authority. If the error or failure could result in a fraud or criminal misconduct charge, the practitioner should advise the taxpayer to seek legal counsel.²⁵

If the taxpayer was notified regarding the error or failure to file and did not correct the situation with an amended return or filing the required return, the practitioner may want to withdraw from the engagement to prepare the current year's return.

A Supreme Court case states that a taxpayer **should** file an amended return in the case of an error.²⁶ Consequently, the tax advisor must advise the client of the error discovered on a previously-filed return.

²⁴ Treas. Reg. §1.451-1(a).

²⁵ American Institute of Certified Public Accountants Statement of Standards for Tax Services No. 6.

²⁶ *Ernest Badaracco, Sr. et al., Petitioners v. Comm'r*, 104 S.Ct. 756, 464 US 386 (Jan. 17, 1984).

Determining whether to file an amended return may be a difficult decision for some clients. This is especially true if the 3-year statute of limitations expired on the incorrect return.²⁷ There are no time limitations on an amended tax return.²⁸ Consequently, if an amended return is filed and the IRS determines the originally-filed return was fraudulent, the 75% fraud penalty could be applied.²⁹

Tax preparers also need to advise the taxpayer on the error's effect on future returns. The IRS can assess a penalty on a tax preparer for knowingly aiding and abetting a client in understating his tax liability.³⁰ The amount of the penalty is \$1,000 for an individual return and \$10,000 for a corporation return.³¹ This penalty could be assessed if the tax practitioner prepares a subsequent return knowing he is using incorrect information because of the previous return.

Example 32. John Knowital discovers he failed to make an election to forgo a \$100,000 NOL carryback on his client's return. When he prepared the subsequent year's return, he used the entire amount of the NOL, even though a portion would have been lost if it was carried back properly. If discovered by the IRS, John could be subject to a IRC §6701 penalty.

Example 33. Margaret Megamoney gifted her daughter \$40,000 in 2007. In 2009, she gifted her son \$40,000. If these gifts are not reported on a timely-filed Form 709, *United States Gift (and Generation-Skipping Transfer) Tax Return*, the amount of her unified credit will be overstated at her death when the Form 706, *U.S. Estate Tax Return*, is filed. If the unreported gifts are discovered during the audit of the Form 706, the IRS will assess failure-to-file penalties on both the unfiled 2007 and 2009 Forms 709. The penalty will be calculated back to the date they should have been filed. If it is determined the tax preparer knew Margaret was claiming an erroneous unified credit, he could be assessed a §6701 penalty.

A tax preparer may decide to make the correction pertaining to a previously-filed return on the current year's return. This is not an acceptable solution, even if the correction is in favor of the government.

Effect in current taxable year of improperly accounting for a liability in a prior taxable year. — *Each year's return should be complete in itself, and taxpayers shall ascertain the facts necessary to make a correct return. The expenses, liabilities, or loss of one year generally cannot be used to reduce the income of a subsequent year. A taxpayer may not take into account in a return for a subsequent taxable year liabilities that, under the taxpayer's method of accounting, should have been taken into account in a prior taxable year. If a taxpayer ascertains that a liability should have been taken into account in a prior taxable year, the taxpayer should, if within the period of limitation, file a claim for credit or refund of any overpayment of tax arising therefrom. Similarly, if a taxpayer ascertains that a liability was improperly taken into account in a prior taxable year, the taxpayer should, if within the period of limitation, file an amended return and pay any additional tax due.*³²

TAX BENEFIT RULE

Gross income does not include income attributable to the recovery during the taxable year of any amount deducted in any prior taxable year to the extent the amount did not reduce the tax in the prior year.³³ If a refund is received in the same year as the taxes are paid, the refund must reduce the deduction.

²⁷ IRC §6501(a).

²⁸ *Ernest Badaracco, Sr. et al., Petitioners v. Comm'r*, 104 S.Ct. 756, 464 US 386 (Jan. 17, 1984).

²⁹ IRC §6663(a).

³⁰ IRC §6701(a)(1).

³¹ IRC §6701(b).

³² Treas. Reg. §1.461-1(a)(3).

³³ IRC §111(a).

To compute the amount of recovery to include in gross income, the taxpayer must recompute her tax liability for the year the deduction was taken as if the deduction was not taken. The increase in tax in the recomputed year must then be added to income in the recovery year.

Example 34. Sandra claimed a \$5,000 medical deduction on her 2007 income tax return. However, the total medical deductions failed to exceed 7.5% of her adjusted gross income. In 2009, the hospital discovered it overbilled Sandra in 2007 and refunded \$1,500. Because Sandra was unable to utilize any of the 2007 medical deduction, the refund is excluded from her 2009 gross income.

CLIENT FILES

Because of the possibility of a preparer penalty or the possibility of a client lawsuit, it is important for a tax preparer to retain important information in his client files. It is good practice to establish a permanent client file in order to avoid destroying documents that are important for a current or future year's return, even if the statute of limitations has expired for the year the document was collected.

Items to include in the permanent file include:

- Copies of contracts, partnership agreements, articles of incorporation, trust documents, and other documents that may be applicable to a future year tax return;
- Copies of elections made on previous returns;
- Engagement letters;
- Letters acknowledging the termination of an engagement;
- Disclosures made on returns;
- Forms required by the IRS such as the EITC checklist;
- Basis calculations such as the basis in a principal residence;
- All documents related to a real estate like-kind exchange;
- Appraisals used to determine basis;
- Gift tax returns; and
- Taxpayer disclosure consents.

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