

## Chapter 6: Ethics

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Corrections were made to this workbook through January of 2011. No subsequent modifications were made.

### RIGHT TO PRACTICE VERSUS RIGHT TO PREPARE

In a July 2009 webcast of *Tax Talk Today*, Karen Hawkins, director of the IRS Office of Professional Responsibility (OPR), pointed out that tax return preparation is not a Circular 230 governed activity. Anyone who is a tax return preparer without the right to practice before the IRS is not currently covered by Circular 230.

**Practice before the IRS** is defined in Circular 230 as:

*... all matters connected with a presentation to the Internal Revenue Service or any of its officers or employees relating to a taxpayer's rights, privileges, or liabilities under laws or regulations administered by the Internal Revenue Service. Such presentations include, but are not limited to, preparing and filing documents, corresponding and communicating with the Internal Revenue Service, rendering written advice with respect to any entity, transaction, plan or arrangement, or other plan or arrangement having a potential for tax avoidance or evasion, and representing a client at conferences, hearings and meetings.*

A person permitted to practice before the IRS (tax return practitioner) must be one of the following:

- Attorney
- CPA
- Enrolled agent
- Enrolled actuary
- Enrolled retirement plan agent

Enrolled actuaries and enrolled retirement plan agents are allowed limited representation before the IRS in matters dealing with their respective areas of expertise.

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The following table shows the different categories of tax return preparers and the current level of oversight for each:<sup>1</sup>

<b>Attorneys</b>	<b>Certified Public Accountants</b>	<b>Enrolled Agents, Enrolled Actuaries, and Enrolled Retirement Plan Agents</b>	<b>Unenrolled Tax Return Preparers</b>
Members in good standing of the bar of the highest court of a state, territory, or possession of the United States.	Persons duly qualified to practice as a certified public accountant in a state, territory, or possession of the United States.	Professionals enrolled to practice before the IRS. Enrollment requires passing an examination or presenting evidence of qualifying experience.	Other tax return preparers who, except in a limited number of states, have no minimum education or training requirements.
Regulated by state licensing authorities and, if they practice before the IRS, under Treasury Dept. Circular 230 <sup>a</sup>		Regulated by the IRS under Treasury Dept. Circular 230	Generally not regulated

<sup>a</sup> The regulations governing the practice of attorneys, certified public accountants, enrolled agents, enrolled actuaries, enrolled retirement plan agents and appraisers before the Internal Revenue Service are published in 31 CFR Part 10 and reprinted in Treasury Department Circular 230.

An **unenrolled tax return preparer** (not currently regulated under Circular 230) may represent a taxpayer before the IRS in the following **limited circumstances**:

- An individual may represent a member of his immediate family.
- A regular full-time employee of an individual employer may represent the employer.
- A general partner or a regular full-time employee of a partnership may represent the partnership.
- An officer or a regular full-time employee of a corporation, association, or organized group may represent the corporation, association, or organized group.
- A regular full-time employee of a trust, receivership, guardianship, or estate may represent the trust, receivership, guardianship, or estate.
- An officer or a regular employee of a governmental unit, agency, or authority may represent the governmental unit, agency, or authority in the course of her official duties.
- An individual may represent any individual or entity that is outside the United States before personnel of the IRS when such representation takes place outside the United States.
- An individual who prepares and signs a taxpayer's tax return as the preparer, or who prepares a tax return but is not required to sign the tax return, may represent the taxpayer before revenue agents, customer service representatives, or similar officers and employees of the IRS during an examination of the period covered by that tax return.<sup>2</sup>

Unless otherwise prescribed by regulation or notice, unenrolled tax preparers are not permitted to represent the taxpayer before appeals officers, revenue officers, counsel, or similar officers or employees of the IRS or the Department of Treasury. They are also not allowed to execute closing agreements, extend the statutory period for tax assessments or collection of tax, execute waivers, or execute claims for refund.<sup>3</sup>

<sup>1</sup> IRS Pub. 4832, *Return Preparer Review* (Dec. 2009).

<sup>2</sup> Circular 230, §10.7.

<sup>3</sup> IRS Pub. 947, *Practice before the IRS and Power of Attorney* (Apr. 2009).

Unenrolled preparers, although not accorded the same privileges as practitioners, are still subject to civil penalties for actions ranging from knowingly preparing a return that understates the taxpayer's liability to failing to sign a return or provide an identification number on a return they prepare. They are regulated by the Compliance Division of the IRS. Tax return preparers who demonstrate a pattern of misconduct may be prohibited from preparing additional returns. Some of the paid-preparer penalties under IRC §6695 are discussed later in this chapter.

## PREPARER LICENSING

Karen Hawkins stated in the July 2009 *Tax Talk Today* webcast that the tax law is so complicated that the mere preparation of a tax return involves making decisions and taking positions for the taxpayer. She questioned whether the act of preparing a tax return might become “practice” before the IRS.

Hawkins' concern was echoed by IRS Commissioner Douglas Shulman who launched the Return Preparer Review in June 2009. This review was designed to help accomplish the objective of ensuring that all tax practitioners, tax return preparers, and other third parties in the tax system adhere to professional standards and follow the law.<sup>4</sup> During the 6-month study, three public forums were held and over 500 individuals and groups submitted written comments. The results of the study indicate that the American public fully supports efforts to increase the oversight of paid tax return preparers.

The IRS believes that this increased oversight does not require additional legislation. Accordingly, the IRS intends to amend the regulations under 31 USC §330 to clarify that any person preparing a tax return for compensation is practicing before the agency and, therefore, must demonstrate good character, good reputation, and the necessary qualifications and competency to advise and assist other persons in the preparation of their federal tax returns.<sup>5</sup> Consequently, the IRS is implementing the following steps for future filing seasons:

- All individuals who are compensated for preparing, or assisting in the preparation of all, or substantially all of a federal tax return or claim for refund will be required to register with the IRS and obtain a preparer tax identification number (PTIN). These preparers will be subject to a limited tax-compliance check to ensure they have filed federal personal, employment, and business tax returns and that the tax due on those returns has been paid.
- Competency tests will be required for all paid tax return preparers except attorneys, CPAs, and enrolled agents who are active and in good standing with their respective licensing agencies.
- Ongoing continuing professional education will be required for all paid tax return preparers except attorneys, CPAs, enrolled agents, and others who are already subject to continuing education requirements.
- The ethical rules found in Circular 230 — which currently only apply to attorneys, CPAs, and enrolled agents who practice before the IRS — will be extended to all paid preparers. This expansion will allow the IRS to suspend or otherwise discipline tax return preparers who engage in unethical or disreputable conduct.<sup>6</sup>

## REGISTRATION

The IRS believes that registration of all tax return preparers will enable the IRS to collect more accurate data on return preparers. Registration will give the IRS the means to track the number of persons who prepare returns, the qualifications of the return preparers, and the number of returns each person prepares. The IRS will then be able to send targeted updates to tax return preparers who have clients that are most likely to be affected by certain changes in tax laws or IRS procedures. Additionally, registration will allow the IRS to more easily locate and review the returns prepared by a tax return preparer when instances of misconduct are detected.

<sup>4</sup> IRS Pub. 4832, *Return Preparer Review* (Dec. 2009).

<sup>5</sup> Ibid.

<sup>6</sup> IRS News Rel. IR-2010-1 (Jan. 4, 2010).

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Under current regulations, tax return preparers may provide either a social security number (SSN) or a preparer tax identification number (PTIN) on returns that they are required to sign as a paid tax return preparer. The potential use of more than one number by a tax return preparer makes it harder for the IRS to collect accurate preparer data and to identify an individual tax return preparer. Therefore, the IRS will require **all** individuals who prepare returns for compensation to register and obtain a PTIN. Tax return preparers who already have a PTIN will still be required to register. These individuals will have their PTINs revalidated and reassigned to them through the new system.<sup>7</sup> The IRS plans to charge a nonrefundable fee to register as a tax return preparer.

January 1, 2011, is the current target date for requiring all paid tax return preparers to be registered and to use a PTIN. After the initial registration, all tax return preparers will be required to provide their PTIN on all tax returns that they prepare for compensation and are required to sign. Tax return preparers who do not use a valid PTIN on tax returns or claims for refund filed after the effective date may be subject to the penalty under IRC §6695(c) unless the failure is due to reasonable cause and not willful neglect.<sup>8</sup>

Tax return preparers will be required to renew their registration and pay the applicable renewal fee annually. The fee will be \$64.25 for the first-year PTIN registration, based on two underlying costs. The IRS proposes to collect \$50 per user to pay for outreach, technology, and compliance efforts associated with the new program. A third-party vendor will receive \$14.25 per user to operate the online system and provide customer support. The amount of the fee may change in future years as the actual program costs are periodically reevaluated.<sup>9</sup>

At the time of each renewal, tax return preparers will be subject to a tax-compliance check. The tax-compliance check will consist of a limited review of the tax return preparer's filing and payment history. Tax return preparers who are not in compliance will be referred to the OPR for possible disciplinary action.

**Note.** Originally, preparers were going to have to renew their registration once every three years. Tax preparation employers complained because many preparers only work for a firm for one year, and with a 3-year registration period, an employer could possibly pay for more years than an employee actually worked for them. The 3-year period was subsequently shortened to an annual renewal.

For purposes of applying for and renewing a PTIN, the term “tax return preparer” is defined as any individual who is compensated for preparing, or assisting in the preparation of all, or substantially all of a tax return or claim for refund.<sup>10</sup> The following examples illustrate the types of individuals who are considered tax return preparers.<sup>11</sup>

**Example 1.** Zillah, an individual employed by tax return preparer Heathcliff, assists Heathcliff in answering telephone calls, making copies, inputting client tax information gathered by Heathcliff into the data fields of tax preparation software, and using the computer to file electronic tax returns prepared by Heathcliff. Although Zillah must exercise judgment regarding which data fields in the tax preparation software to use, Zillah does not exercise any discretion or independent judgment as to the clients' underlying tax positions. Zillah, therefore, merely provides clerical assistance or incidental services and is **not** a tax return preparer required to apply for a PTIN.

<sup>7</sup> IRS News Rel. IR-2010-37 (Mar. 25, 2010).

<sup>8</sup> REG-134235-08, 2010-16 IRB 596.

<sup>9</sup> IRS News Rel. IR-2010-091 (Aug. 19, 2010).

<sup>10</sup> Ibid.

<sup>11</sup> Adapted from examples in REG-134235-08, 2010-16 IRB 596.

**Example 2.** The facts are the same as in **Example 1**, except that Zillah also interviews Heathcliff's clients and obtains information needed for the preparation of tax returns. Zillah determines the amount and character of entries on the returns and whether the information provided is sufficient for purposes of preparing the returns. For at least some of Heathcliff's clients, Zillah obtains information and makes determinations that constitute all, or substantially all of the tax return. Zillah is a tax return preparer required to apply for a PTIN. Zillah is a tax return preparer even if she relies on tax preparation software to prepare the return.

**Example 3.** Caden is an employee of a firm that prepares tax returns and claims for refund of tax. Caden is responsible for preparing a Form 1040 for a client. He obtains the information necessary for completing the return during a meeting with the client. He also makes determinations about the proper application of tax law to the collected information in order to determine the client's tax liability. Caden completes the tax return and sends the completed return to employee Delilah, who reviews the return for accuracy before signing it. Both Caden and Delilah are tax return preparers required to apply for a PTIN.

**Example 4.** Edwina is an employee at a firm which prepares tax returns and claims for refund of tax. The firm is hired by a corporation to prepare its federal income tax return on Form 1120, *U.S. Corporation Income Tax Return*. Among the documentation that the corporation provides to Edwina is documentation relating to the corporation's potential eligibility to claim a recently enacted tax credit. In preparing the return, and specifically for purposes of the new tax credit, Edwina (with the corporation's consent) obtains advice from Faris, a subject-matter expert on this and similar credits. Faris advises Edwina about the corporation's entitlement to the credit and provides his calculation of the amount of the credit. Based on this advice from Faris, Edwina prepares the corporation's Form 1120 claiming the tax credit in the amount recommended by Faris. The additional credit is one of many tax credits and deductions claimed on the tax return. Determining the credit amount does not constitute preparation of all, or substantially all of the corporation's tax return.

Faris will not be considered to have prepared all, or substantially all of the corporation's tax return. Thus, Faris is **not** a tax return preparer required to apply for a PTIN. Edwina, however, is a tax return preparer required to apply for a PTIN.

## COMPETENCY TESTING

The IRS will establish competency testing for tax return preparers who are not attorneys, CPAs, or enrolled agents. Although these three categories of professionals are exempt from competency testing under the new licensing program, the IRS stated that it will consider expanding testing to those individuals if data is collected in the future that identifies a need for this testing.<sup>12</sup> Initially, two examinations will be offered for tax return preparers. The **first** test will cover Form 1040 series returns for wage and nonbusiness income. The **second** test will cover Form 1040 series returns for wage and small-business income. There will be a fee associated with the testing. Currently, the fee has not been determined.

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<sup>12</sup> IRS Pub. 4832, *Return Preparer Review* (Dec. 2009).

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The following table lists the forms that will be covered by the two tests:

## Competency Examination Content — Test 1: Wage and Nonbusiness Income

Form	Description
1040-EZ	Income Tax Return for Single and Joint Filers with No Dependents
1040-A	U.S. Individual Income Tax Return
1040A Schedules 1, 2, and 3	Interest and Ordinary Dividends for Form 1040A Filers, Child and Dependent Care Expenses for Form 1040A Filers, Credit for the Elderly or Disabled
1040	U.S. Individual Income Tax Return
1040 Schedules A, B, C-EZ, D, D-1, EIC, L, M, R, SE	Itemized Deductions, Interest and Ordinary Dividends, Net Profit from Business (Sole Proprietorship), Capital Gains and Losses, Continuation Sheet for Schedule D (Form 1040), Earned Income Credit, Standard Deduction for Certain Filers, Making Work Pay and Government Retiree Credits, Credit for the Elderly or the Disabled, Self-Employment Tax
2106EZ	Unreimbursed Employee Business Expenses
2120	Multiple Support Declaration
2441	Child and Dependent Care Expenses
2555EZ	Foreign Earned Income Exclusion
3903	Moving Expenses
4137	Unreported Tip Income
4868	Extension of Time to File
5405	First-Time Homebuyer Credit and Repayment of the Credit
8283	Noncash Charitable Contributions
8332	Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent
8379	Injured Spouse
8453	U.S. Individual Income Tax Transmittal for an IRS e-File Return
8606	Nondeductible IRAs
8812	Additional Child Tax Credit
8821	Tax Information Authorization
8859	District of Columbia First-Time Homebuyer Credit
8863	Education Credits (American Opportunity, Hope and Lifetime Learning Credits)
8867	Paid Preparer's Earned Income Credit Checklist
8879	IRS e-File Signature Authorization
8880	Credit for Qualified Retirement Savings Contributions
8888	Direct Deposit of Refund to More than One Account

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## Competency Examination Content — Test 1: Wage and Nonbusiness Income (*continued*)

Form	Description
8889	Health Savings Accounts (HSAs)
8917	Tuition and Fees Deduction
9465	Installment Agreement Request
1040-ES	Estimated Tax for Individuals
1040-X	Amended U.S. Individual Income Tax Return
1040-V	Payment Voucher
W-4/W-4P/W-4V	Employee's Withholding Allowance Certificate
W-7	Application for IRS Individual Taxpayer Identification Number
<b>Informational Forms: Income</b>	
W-2	Wage and Tax Statement
W-2G	Certain Gambling Winnings
1098	Mortgage Interest Statement
1098-E	Student Loan Interest
1098-T	Tuition Statement
1099-B	Proceeds from Broker and Barter Exchange Transactions
1099-C	Cancellation of Debt
1099-DIV	Dividends and Distributions
1099-G	Certain Government Payments
1099-INT	Interest Income
1099-MISC (box 9)	Miscellaneous Income (Payer made direct sales of \$5,000 or more of consumer products to a buyer for resale)
1099-OID	Original Issue Discount
1099-R	Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.

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## Competency Examination Content — Test 2: Wage and Small-Business Income

Form	Description
1040NR	U.S. Nonresident Alien Income Tax Return
1040PR	Planilla para la Declaracion de la Contribucion Federal sobre el Trabajo por Cuenta Propia (Incluyendo el Credito Tributario Adicional por Hijos para Residentes Bona Fide de Puerto Rico)
1040 Schedules C, E and F	Profit or Loss from Business (Sole Proprietorship), Supplemental Income and Loss, Profit or Loss From Farming
1116	Foreign Tax Credit (Individual, Estate, or Trust)
2106	Employee Business Expenses
2210	Underpayment of Estimated Tax by Individuals, Estates and Trusts
2439	Notice to Shareholder of Undistributed Long-Term Capital Gains
2555	Foreign Earned Income
3800	General Business Credit
4136	Credit for Federal Tax Paid on Fuels
4562	Depreciation and Amortization (Including Information on Listed Property)
4684	Casualties and Thefts
4797	Sales of Business Property
4835	Farm Rental Income and Expenses
4952	Investment Interest Expense Deduction
5329	Additional Taxes on Qualified Plans (including IRAs) and Other Tax-Favored Accounts
6198	At-Risk Limitations
6251	Alternative Minimum Tax — Individuals
6252	Installment Sale Income
8283	Noncash Charitable Contributions
8396	Mortgage Interest Credit
8582	Passive Activity Loss Limitations
8801	Credit for Prior Year Minimum Tax — Individuals, Estates, and Trusts
8814	Parent's Election to Report Child's Interest and Dividends
8824	Like-Kind Exchanges
8839	Qualified Adoption Expenses
8862	Information to Claim Earned Income Credit after Disallowance
8885	Health Coverage Tax Credit
8903	Domestic Production Activities Deduction
8910	Alternative Motor Vehicle Credit
8919	Uncollected Social Security and Medicare Tax on Wages
<b>Informational Forms: Income</b>	
1041 K-1	Beneficiary's Share of Income, Deductions, Credits, etc.
1065 K-1	Partner's Share of Income, Deductions, Credits, etc.
1099-A	Acquisition or Abandonment of Secured Property
1120S K-1	Shareholder's Share of Income, Deductions, Credits, etc.



The IRS plans to add a **third** competency test after the completion of the initial implementation phase. The third test will cover business-entity tax issues.

Additionally, the IRS intends to perform suitability checks when tax preparers make their initial application to take the competency examination. These suitability checks may include criminal background investigations and fingerprint checks. This procedure is in response to the comments of consumer-advocacy groups and others who expressed concerns about the character of individuals who are paid tax return preparers.

In order to minimize interruption of services to taxpayers, the IRS plans to give tax return preparers until December 31, 2013, to pass the required examination(s), **as long as they register with the IRS and obtain PTINs before testing begins**. Tax return preparers will be allowed to attempt to pass the examination as often as the examination is offered. The applicable fee must be paid for each attempt.

After testing begins, unregistered persons will be required to pass the competency test **before** they register and receive PTINs, unless they are exempted from the examination requirement by virtue of their professional credentials (i.e., CPAs, EAs, and attorneys).<sup>13</sup>

## CONTINUING PROFESSIONAL EDUCATION

The IRS will require return preparers to complete 15 hours of continuing professional education (CPE) annually. This 15-hour requirement includes three hours of federal tax law updates, two hours of ethics, and 10 hours of general federal tax law topics. Attorneys, CPAs, EAs, enrolled actuaries, and enrolled retirement plan agents are already required to obtain continuing education to retain their professional credentials; therefore, they will be exempted from the new CPE requirements.

**Note.** As of the date this book was published, the IRS had not yet announced when the annual CPE requirement will begin.

## ETHICAL STANDARDS

All signing and nonsigning tax return preparers will be required to comply with the standards of conduct found in Circular 230. The current level of authority that attorneys, CPAs, EAs, enrolled actuaries, and enrolled retirement plan agents have to practice before the IRS will not change. Tax return preparers who do not fall into one of these categories will be authorized to prepare returns and to represent a client before the IRS during an examination of any return prepared by the tax return preparer, just as they are currently permitted under §10.7 of Circular 230.

## TAX RETURN PREPARER ENFORCEMENT

The IRS intends to develop a comprehensive enforcement strategy that utilizes data collected through registration and from other sources to deal with persons who fail to comply with the new IRS paid-preparer standards. New policy guidance will be issued that addresses preparer compliance.

The IRS strategy will include identifying ways to enhance the effectiveness of traditional enforcement tools against tax return preparers. For example, the IRS plans to prioritize tax return preparer penalties in collection.

Additional enforcement tools will be incorporated into the IRS enforcement strategy. This may include the use of targeted notices that call on tax return preparers to correct instances of noncompliance. If the return preparer then corrects the noncompliance issue, the IRS may not pursue penalties. The IRS also plans more preparer visits to identify tax return preparer noncompliance. The IRS will increase OPR staffing to accommodate more investigations of tax return preparer misconduct.

<sup>13</sup> IRS Fact Sheet FS-2010-1 (Jan. 2010).

## PUBLIC AWARENESS AND SERVICE ENHANCEMENTS

The IRS believes that public awareness and support are key to the success of increased IRS oversight of tax return preparers. Accordingly, the IRS intends to conduct an extensive public awareness campaign to educate taxpayers about the new standards and requirements for tax return preparers.

The IRS plans to utilize its relationships with consumer-advocacy groups and key industry stakeholders to have them communicate the message that taxpayers should only use a tax return preparer who has met the required standards. To facilitate this process, the IRS plans to issue a searchable database on its website of tax return preparers who have met the required standards. This will be implemented at the conclusion of the initial registration and examination period.

## FREQUENTLY-ASKED QUESTIONS FROM THE IRS WEBSITE<sup>14</sup>

- 1. How will the recommendations impact owners of firms or franchises? Do the owners and their staff need to obtain a PTIN and complete testing as applicable? What if an attorney or enrolled agent or CPA signs all the returns — would the unenrolled preparers be subject to the regulations?**

All individuals compensated for preparing, or assisting in the preparation of all, or substantially all of a federal tax return or claim for refund must obtain a PTIN. If applicable, they must also successfully pass an examination.

The proposed regulations under §6109 published in the Federal Register on March 26, 2010, provide additional guidance, including examples, on who must obtain a PTIN.

- 2. If an employee of a business prepares the business' tax returns as part of his job responsibilities, will the recommendations affect him?**

**No.** An employee who prepares his employer's returns is not required to sign as a paid preparer. Accordingly, unless the employee prepares other federal tax returns for compensation, the employee will not be required to register and obtain a PTIN.

- 3. Will Accredited Council of Accountancy for Taxation (ACAT) credential holders have to pass the IRS return preparer examination and complete continuing professional education (CPE) to prepare returns?**

**Yes.** ACAT credential holders must pass the IRS exam unless they are also attorneys, CPAs, or EAs. As for CPE, they will be subject to the new requirements unless they are also attorneys, CPAs, EAs, enrolled actuaries, or enrolled retirement plan agents.

Only attorneys, CPAs, and EAs will be exempt from testing. Attorneys, CPAs, EAs, enrolled actuaries, and enrolled retirement plan agents are exempt from the return preparer continuing education requirements.

- 4. Do preparers who already have a PTIN need to take any action?**

**Yes.** All federal tax return preparers, even those who already have a PTIN, must register in the new system. This system will be available in September 2010. All preparers will need to be registered on the new system and have a PTIN prior to filing any return after December 31, 2010. As long as the IRS can validate the ownership of the existing PTIN, the same number will be reassigned once the appropriate information is provided and the user fee is paid.

- 5. Will individuals who are active attorneys, CPAs, or EAs be required to obtain a PTIN if they do not prepare all, or substantially all, or sign any tax return?**

Attorneys, CPAs, and EAs do not need to obtain a PTIN unless they prepare for compensation all, or substantially all of a federal tax return or claim for refund.

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<sup>14</sup> [www.irs.gov/taxpros/article/0,,id=218611,00.html] Accessed on Aug. 19, 2010.

## **6. When will the new regulations be implemented?**

September 1, 2010, is the current target date for an online registration system and all preparers must be registered on the new system and have a PTIN prior to filing any return after December 31, 2010. Final determination of these dates is dependent on many factors and will be widely publicized as soon as available.

Testing will not be implemented until after registration and mandatory PTIN usage are in place.

## **7. How will the new regulations affect registered or licensed public accountants? Will they have to pass a test?**

In many states, a registered or licensed public accountant (LPA) has the same rights and privileges as a CPA. Thus, an LPA in those states is eligible to practice before the IRS by virtue of their public accountant's license. These individuals will not be required to pass the IRS's return preparer examination or satisfy the CPE requirements for tax return preparers.

The following is a nonexclusive list of states in which an LPA has the same rights and privileges as a CPA: Alabama, Alaska, Arkansas, California, Colorado (registered public accountants only), Connecticut, Hawaii, Idaho, Maine, Montana, New Hampshire, New Jersey, New York, North Dakota, Ohio, Oklahoma, Pennsylvania, Rhode Island, South Dakota, Tennessee, Vermont, and West Virginia.

LPAs in the following states do not have the same rights and privileges as a CPA. Therefore, they will be required to pass the IRS's return preparer examination and satisfy the CPE requirements for tax return preparers to prepare any federal tax return for compensation (unless the LPA is an attorney or enrolled agent): Delaware, Illinois, Iowa, Kansas, Michigan, Oregon (unless the person qualified for, and applied to take, the uniform CPA examination before January 1, 2002), and South Carolina.

LPAs in other states should review the laws of the state in which they are licensed to determine whether they have the same rights and privileges as a certified public accountant.

## **8. Minnesota recognizes registered public accountants. These individuals are governed by the Minnesota Board of Accountancy, must register with the Board, pay a fee, and have continuing education (CE) requirements and ethics requirements. Will they have to pass the test?**

In general, a registered (or licensed) public accountant may practice before the IRS if the registered (or licensed) public accountant has the same rights and privileges as a CPA under state law. Although the IRS has reviewed the laws of 29 states to determine if the registered (or licensed) public accountants in those states have the same rights and privileges as a CPA, Minnesota is not one of those 29 states. Accordingly, the registered public accountants in Minnesota should review their own state laws to determine whether they have the same rights and privileges as a CPA until the Office of Professional Responsibility has an opportunity to formally consider whether Minnesota's registered public accountants are qualified to practice as CPAs.

## **9. Will there be a distinction between EAs and the new category of preparers who will be required to take the new competency test?**

**Yes.** The practice of EAs before the IRS will not be limited. The practice of the new category of preparers will be limited to preparing tax returns for compensation and representing taxpayers in examination when the return under examination was a return that they prepared.

## **10. How will the conditions to practice before the IRS be changed by the new regulations? Currently tax practitioners that are not attorneys, CPAs, or EAs have limited practice before the IRS.**

The new category of preparers who pass the competency test will have the same limited practice rights that an unenrolled preparer currently has.

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**11. Will there be a new designation for preparers who pass the competency test?**

**Yes.** More information regarding this new designation will be made available at a future date.

**12. Will paid tax return preparers be limited to preparing only the types of tax returns for which they successfully tested?**

**Yes.** This will include the Form 1040 series tax returns. The IRS will issue additional guidance or instructions for other tax returns.

**13. What language(s) will the competency test be available in?**

At least initially, the test will only be available in English.

**14. Will the testing be done by the same firm that administers the EA exam? Or will the IRS be doing the testing?**

The testing likely will be done by an external vendor(s). The vendor(s) is unknown at this time.

**15. Will a currently licensed CPA who is considered inactive be subject to testing?**

**Yes.** Only attorneys, CPAs, or EAs who are **active** and in good standing with their respective licensing agencies are exempt from competency testing.

**16. Will the tests be open book or resource assisted?**

Certain resources will be permitted and provided at the testing center. Information on this issue will eventually be available on the Tax Professionals page of the IRS website.

**17. The two competency tests are described as covering: (1) Wage & Nonbusiness 1040 and (2) Wage and Small Business 1040. What does small business include? And how would this impact those who prepare other business returns?**

For competency testing purposes, small business will include Form 1040 Schedules C, E, and F and various other 1040-related forms. Appendix I of the Return Preparer Review report contains a detailed list.

**Note.** The detailed list of the forms covered by the two tests can be found earlier in this chapter in the charts entitled Competency Examination Content.

Additional guidance for individuals who do not prepare any Form 1040 series returns and who are not an attorney, CPA, or EA will be provided when testing is implemented.

The IRS plans to add a third test with regard to business tax rules after the 3-year implementation phase is completed.

**18. Will the recommendations apply to individuals who only prepare payroll returns or other non-1040 series returns?**

All paid tax return preparers will be required to obtain a PTIN. If the preparer is not an attorney, CPA, or EA, the preparer will need to satisfy the competency test and continuing education requirements. The initial two tests will be for individuals who prepare Form 1040 series returns. Additional guidance for individuals who do not prepare any Form 1040 series returns and who are not an attorney, CPA, or EA will be provided when testing is implemented.

Individuals who are enrolled retirement plan agents or enrolled actuaries will be exempt from the competency test requirement if they only prepare returns within the limited practice areas of these groups.

**19. What is the required percentage to pass the competency test?**

This has not been determined. Information will eventually be available on the Tax Professionals page of the IRS website.

**20. Attorneys and CPAs in some states are not subject to CPE requirements. Will this impact the application of the proposed IRS rules for those individuals?**

**No.** The lack of CPE requirements for attorneys or CPAs in a specific state will not impact the exception. All attorneys and CPAs will be exempt from IRS CE requirements.

However, as stated in the Return Preparer Review report, the IRS believes that all tax return preparers have an obligation to stay current on the tax laws and continuing education serves to help individuals remain current and to expand their knowledge within their field of expertise. Such courses are important to tax administration given the complexity of the tax laws and the frequent changes made to the Internal Revenue Code and the rules and regulations implemented to assist in the administration of the Code.

The IRS will consider requiring CPE from additional individuals if data is collected in the future that identifies such a need. Additionally, the IRS plans to reach out to licensing authorities to encourage them to support annual CPE that includes federal tax law topics and updates and ethics for those individuals who are licensed by them and who prepare federal tax returns.

**21. Will electronic return originators (EROs) who only transmit tax returns and do not prepare returns be subject to the new review recommendations?**

**No.** Although individuals who assist in the transmission of tax returns electronically are subject to other IRS rules and regulations currently, individuals who assist in the transmission of tax returns electronically, but do not prepare for compensation all, or substantially all of a federal tax return or claim for refund, are not the focus of the recommendations in the report.

**22. Will preparers who are registered by the states of California or Oregon (California tax return preparers and Oregon licensed tax preparers/consultants) be exempt from testing and continuing education requirements?**

**No.** Only attorneys, CPAs, and EAs are exempt from testing and continuing education requirements.

**23. Who will be included in the public database of return preparers?**

At a minimum, it will include the preparers who have passed the competency exam. Other information about who will be included is not yet available. Information will eventually be available on the Tax Professionals page of the IRS website.

**24. What will happen to an unenrolled return preparer who registers with the IRS as a part of the initial registration of return preparers but does not pass the competency test within three years from the implementation date?**

The IRS will contact them proposing to deactivate their PTIN and remove them from the list of registered preparers. They will be informed of the appeals process.

**25. EAs currently pay \$125 for enrollment and renewal. Attorneys and CPAs pay similar fees to their oversight organizations. Will the fee for obtaining a PTIN be applicable to all EAs, attorneys, and CPAs in addition to their other fees?**

**Yes.** All paid tax return preparers will have to pay a fee to obtain and renew their PTINs. This fee is in addition to any fee that paid tax return preparers must pay for any other certifications or licenses they hold. Because attorneys, CPAs, and EAs are exempt from testing, they will not be required to pay the separate testing fee.

The IRS is recalculating the \$125 renewal fee for EAs. A reduced fee amount will be announced in the future.

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**26. Can preparers who don't obtain (or renew) a PTIN by January 1, 2011, still prepare returns?**

**Yes**, but only after they sign up through the new online registration system, pay the fee, and obtain (or renew) a PTIN.

**27. Will nonsigning preparers have to be disclosed on each return prepared even if another preparer reviews and signs it?**

**No.** At least initially, there is no plan to expand the paid preparer section of the return. The name of any nonsigning preparer will not be disclosed on the return, but they will still be required to have a PTIN and meet competency testing and CE requirements as applicable.

**28. When multiple paid preparers are involved in preparation and/or review of a return, who is required to sign the return?**

Treas. Regs. §§1.6695-1(b) and 301.7701-15(b)(1) provide that a signing tax return preparer is the individual tax return preparer who has the primary responsibility for the overall accuracy of the preparation of a return. The new requirements requiring all preparers to register and obtain a PTIN do not change the existing rules regarding who is the signing tax return preparer.

**29. Can multiple individuals or one office share one PTIN?**

**No.** A PTIN is an individual preparer's number. Each preparer must obtain his or her own PTIN.

**Note.** PTINS are assigned to the individual preparer. The preparer retains the same PTIN notwithstanding any change in employment.

**30. When will testing begin? What is the deadline for passing? How many attempts will an individual be allowed? How long is the exam? What is the cost?**

Testing is expected to begin in mid-2011. Those individuals who have a valid PTIN when testing begins will have until December 31, 2013, to pass the test and may take the test an unlimited number of times to pass it. There will be a fee to take the test and that fee will be due each time the individual attempts to pass the test. The IRS has not determined the amount of the fee, the length of the test, and other test details at this time. The latest information about this issue will be available on the Tax Professionals page on [www.irs.gov](http://www.irs.gov).

**31. Will the test be offered online or will a person have to go to a designated location?**

Those who need to test will need to physically go to a testing site, authenticate their identity, and take the test in person at the testing site. More information about testing, including test locations and test procedures, will be posted on the Tax Professionals page on [www.irs.gov](http://www.irs.gov) when it becomes available.

**32. Will the IRS offer study courses prior to testing?**

The IRS will provide basic information about the forms and schedules that will be covered by the return preparer examination but will not offer any preparation courses. Commercial businesses or individuals may offer preparation courses.

### 33. What is the process for becoming a qualified sponsor for continuing education?

Circular 230 section 10.6(g) outlines the current process. To qualify as a sponsor, a program presenter must:

- Be an accredited educational institution;
- Be recognized for continuing education purposes by the licensing body of any state, territory, or possession of the United States, including a Commonwealth, or the District of Columbia;
- Be recognized by the Director of the Office of Professional Responsibility as a professional organization or society whose programs include offering CPE opportunities; or
- File a sponsor agreement with the Director of the Office of Professional Responsibility and obtain approval of the program as a qualified CE program.

As part of the new oversight program, the IRS is revamping the CE approval process. Additional information will be available at a future date.

### 34. Will an SSN be required to obtain a PTIN?

Individuals generally are required to provide their SSN when they obtain a PTIN. However, the IRS is developing special procedures to allow the following individuals to obtain a PTIN without an SSN:

- a. U.S. residents who have a conscientious objection to obtaining an SSN for religious reasons, and
- b. Persons who do not reside in the United States and who are not eligible to obtain an SSN.

These individuals will be required to provide supplemental documentation to verify their identity and substantiate their eligibility for a PTIN under these specific exceptions. More guidance will be available before the PTIN requirement begins.

## ROLE OF THE OPR

The legislation creating the OPR was enacted under Title 31 of the U.S. Code. The body of regulation that has been promulgated under Title 31 is commonly referred to as Circular 230. The OPR, with guidance from Circular 230, is responsible for overseeing the ethical conduct of tax professionals in their practice before the IRS.

The OPR is a part of the Treasury and reports directly to the commissioner of the IRS. The OPR is composed of two functions: licensure/education and enforcement. The licensure and education unit administers the examination for EAs, processes applications for enrollment, and monitors CPE for EAs. Two enforcement units handle disciplinary matters and denials of applications for enrollment.

### PRACTITIONER COMPLIANCE

Karen Hawkins was appointed director of the OPR in April 2009. She acknowledges that one of her first goals is to ensure that practitioners are compliant on their own tax liabilities. As mentioned earlier, tax return preparers' compliance history will be subject to review at the time they renew their registration. Another source of referrals to the OPR is from IRS revenue agents who encounter noncompliant tax practitioners in the course of their examinations.

Hawkins intends to institute three approaches to get practitioners compliant:

1. **The Soft Letter.** This is used for practitioners that have self-corrected their instance(s) of noncompliance. The letter lets the practitioner know that the OPR is pleased that the problem has been corrected but will be watching to see if it happens again.
2. **The 60-Day Letter.** This goes to practitioners who are out of compliance from earlier years or have balances due but are currently compliant. The letter states that the practitioner has 60 days to correct the situation. The letter serves as a reprimand and tells the practitioner that if there is a problem in the future, this situation will be considered an aggravating circumstance for whatever additional discipline the practitioner might be subject to the next time.
3. **The Deferred Discipline Agreement.** This agreement says that a certain period of suspension is appropriate for the conduct. However, if the practitioner agrees to become compliant and stays compliant for five years, there will be no publicity and no sharing of the information with state agencies. If the practitioner defaults at any time during the 5-year period, the violation becomes public, and there will be an expedited proceeding under the Circular 230 provisions.<sup>15</sup>

At an American Bar Association Section of Taxation meeting, Karen Hawkins indicated that the new alternative approaches to discipline were effective. The OPR's caseload has decreased from 850 cases in April 2009 to 511 cases at the end of December 2009. Of these cases, 240 involve personal noncompliance.<sup>16</sup>

## Mandatory Referrals

When penalties are asserted against a practitioner, a mandatory referral to the OPR should be prepared in the following situations:<sup>17</sup>

- An understatement due to unrealistic positions (IRC §6694(b)) when closed agreed, sustained in Appeals, or closed unagreed without Appeals contact
- Willful or reckless conduct (IRC §6694(b)) when closed agreed, sustained in Appeals, or closed unagreed without Appeals contact
- Negotiation of check (IRC § 6695(f))
- Aiding and abetting penalties (IRC §6701) (The assessment of an aiding and abetting penalty against a tax practitioner or appraiser should mandate an automatic referral. In addition, referrals should be considered in those situations in which the aiding and abetting penalty was considered but not imposed.)
- Promoting abusive tax shelters (IRC §6700)
- Action to enjoin promoters of abusive tax shelters (IRC §§7407 and 7408)
- Injunctive action under IRC §7408 taken against an attorney, CPA, or EA

According to Hawkins, the above list contains the **technically** mandatory referrals. IRS agents and officers are free to refer anything that they think is egregious conduct to the OPR. One of the biggest mistakes practitioners can make is not responding when they are contacted by the OPR to investigate a referral made against them. Hawkins advised practitioners subject to a referral to hire counsel early in the process. The system can move very quickly toward disbarment if the situation is not dealt with properly.<sup>18</sup>

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<sup>15</sup> "OPR: A Balanced Approach," *Tax Talk Today* (July 14, 2009).

<sup>16</sup> *2010 Tax Notes Today*, Doc. 2010-1710 (Jan. 25, 2010).

<sup>17</sup> IRM 4.11.55.4.2.2.1 (2005).

<sup>18</sup> "OPR: A Balanced Approach," *Tax Talk Today* (July 14, 2009).



## Disciplinary Sanctions

The OPR announces recent disciplinary sanctions involving attorneys, CPAs, EAs, enrolled actuaries, enrolled retirement plan agents, and appraisers. These individuals are subject to the regulations governing practice before the IRS, which are published in Circular 230.

The OPR has the authority to disclose the grounds for disciplinary sanctions in certain situations. These announcements of disciplinary sanctions appear in the Internal Revenue Bulletin (IRB) at the earliest practicable date. Following is a summary of the sanctions appearing in the IRB between May 2009 and April 2010:

Circular 230 Code Section Violated	Description	Number of Violations
10.22	Failure to exercise due diligence	2
10.51	Failure to file returns and/or pay taxes	26
10.51	Convicted of felony which renders practitioner unfit to practice before the IRS	1
10.51	Failure to return client tax records	1
10.22, 10.51	Improperly advising a client regarding reporting of deferred compensation	1
10.51	Failure to timely file employment tax returns and/or deposit federal employment taxes	2
10.82	Mail fraud, wire fraud, honest services fraud	2
10.82	Aiding in preparation and presentation of fraudulent return	1
10.82	Bribery and conspiracy to defraud the IRS	1
10.82	Enjoined from preparing returns that include frivolous positions	2
10.82	Fraudulent returns, statements, documents	8
10.82	Impeding the IRS, tax evasion, and making materially-false statements	2
10.82	Conspiracy with respect to public official and money laundering	1
10.82	Suspended by default decision in expedited proceeding (grounds not specified)	142
10.82	Tax evasion	5
10.82	Bank fraud, identity theft, and forged securities	1
10.82	Money laundering	1
10.82	Bribery	1
10.82	Failure to file tax returns	2
10.82	Impeding and impairing the IRS and aiding and abetting filing of false return	1
10.82	Attempting to interfere with administration of the IRS	1
10.82	Theft over \$200,000	1
10.82	Lewd and lascivious act on child	1
10.82	Grand larceny, fraud	1
10.82	False declaration in bankruptcy proceedings, bankruptcy fraud, money laundering	1

## Use of Monetary Sanctions

The American Jobs Creation Act of 2004 (AJCA) gave the IRS authority to impose monetary penalties on the employer, firm, or entity of a representative if the employer knew or should have known of the practitioner's conduct. The AJCA authorizes the imposition of monetary penalties in addition to, or in lieu of, any other sanction such as suspension, disbarment, or censure.

Although the monetary sanction has been available for matters arising after October 2004, it has yet to be used. Karen Hawkins indicated that she intends to raise the consciousness within OPR about the potential use of the penalty. It is the only sanction that OPR can apply to misconduct by firms and organizations.

Under §10.50 of Circular 230, the amount of the monetary penalty "shall not exceed the gross income derived (or to be derived) from the conduct giving rise to the penalty." A monetary penalty imposed on a practitioner may be in addition to a penalty imposed on the employer or firm.

## CIRCULAR 230

Circular 230 is the IRS guide for tax preparer regulation. It covers a broad array of regulations, ranging from who has authority to practice before the IRS to disciplinary actions for abuse of such authority. This section focuses on just a few of the rules practitioners must follow to stay in compliance. It will also cover the IRS procedures for enforcement of the rules.

### §10.21 — KNOWLEDGE OF CLIENT'S OMISSION

Section 10.21 of Circular 230 addresses situations in which the practitioner **has knowledge** that a client omitted or concealed information or made an error on a return or document that was submitted to the IRS.

#### Legal Obligation

Under this section, a practitioner who knows that a client made an error in anything submitted to the IRS must advise the client promptly of such noncompliance, error, or omission. The practitioner also must advise the client of the consequences of such noncompliance, error, or omission. Circular 230 only requires that a preparer **notify** the client. It is the client's responsibility to file any corrected tax returns.

**Example 5.** Jenna, a tax preparer, prepares the tax return of Jason. For the first time, she also prepares the return of Jason's son, Dustin. Dustin works in a factory and helps Jason with his lawncare business during busy times. Dustin mentions the work when picking up his return from Jenna but states he was paid in cash and not given any wage statement. Dustin says Jason told him not to worry about it because Jason included the payments as a miscellaneous expense.

Since Jenna is aware of the omission, she has an obligation to advise Dustin promptly of the omission and of the consequences of noncompliance. She should not release the return to Dustin until it is corrected. Jenna should also contact Jason and advise him of the knowledge of the omission and the possible consequences associated with his noncompliance.

**Observation.** It is very important that Jenna keep contemporaneous documentation of the conversations she has with Dustin and Jason, including the questions she asked, the responses received, and the course of action taken. This is part of her due-diligence requirement and will help to protect her practice in the event of any inquiries by the IRS.

#### Ethical Responsibility

In addition to their legal obligation to notify and educate clients regarding noncompliance, tax professionals also have an ethical responsibility to notify clients of any changes to the law or substantial authority that may alter any advice a preparer previously gave or documents previously prepared.

In many cases, clients are unaware of law changes unless they are alerted by their preparers. If the IRS discovers an error before an amended return is filed, the client may be subject to penalties. However, the substantial understatement penalty is avoided if the taxpayer files an amended return before the IRS notifies the taxpayer of any underreported taxes.

**Observation.** Practitioners may be vulnerable to lawsuits if they do not notify clients of tax law or substantial authority changes that may adversely affect positions they took on their clients' returns or advice they previously gave. In place of or in addition to lawsuits, clients may request that their preparers pay any resulting penalties. However, preparers may be protected from liability or IRS-imposed preparer penalties if they keep proper documentation to show that they notified their clients of any changes or omissions and that their clients made the decision whether to file amended returns.

## §10.22 — DUE DILIGENCE

Circular 230 does not define due diligence. However, it states that the tax professional is required to exercise due diligence in three areas when practicing before the IRS:

1. Assisting, approving, preparing, or filing tax returns and other documents relating to IRS matters
2. Determining the correctness of both written and oral representations made by the practitioner to the IRS
3. Determining the correctness of both written and oral representations made by the practitioner to clients with reference to any matter administered by the IRS

A practitioner is presumed to have exercised due diligence if he relies on the work product of another person. The practitioner must have used reasonable care in engaging, training, supervising, and evaluating the other person.

The IRS issued regulations defining due diligence regarding the earned income credit (EIC). The tax practitioner preparing the EIC claim **must meet all** the following due-diligence requirements:<sup>19</sup>

1. Complete Form 8867, *Paid Preparer's Earned Income Credit Checklist*, or an equivalent form, based on information either provided by the client or reasonably obtained by the preparer. Tax preparers are expected to ask, and explain as needed, each of the 19 questions designed to ensure consideration of all aspects that affect eligibility.
2. Complete the EIC worksheet in the Form 1040 series instructions, or an equivalent form. The preparer's records must reflect the information and computation method used in the EIC calculation.
3. Retain these records for three years after June 30 following the date the return was presented to the taxpayer for signature.
4. Have no knowledge (as well as no reason to know) that any information used in determining the taxpayer's eligibility for computing the EIC is incorrect. A tax practitioner cannot ignore the implication of information furnished to, or known by, the practitioner and must make reasonable inquiries if the information appears to be incorrect, inconsistent, or incomplete.

The IRS assesses most due-diligence penalties for failure to comply with the knowledge requirement (item 4 above). To comply with this requirement, the practitioner should:

- Apply a common-sense standard to information provided by the client;
- Evaluate whether the information is complete and gather any missing facts;
- Determine whether the information is consistent — identify contradictory statements and statements that the practitioner knows are false;
- Conduct a thorough interview with every client, every year;
- Ask enough questions to reasonably know the return is correct and complete; and
- Keep contemporaneous records of the questions asked and the client's responses.<sup>20</sup>

**Note.** Recognizing that the vast majority of practitioners use software to prepare tax returns, the IRS is working with software developers to implement software enhancements that could improve the quality of EIC returns, increase EIC participation for eligible taxpayers, and help preparers meet their due-diligence requirements. However, the report released by the IRS/EIC Software Developers Working Group<sup>21</sup> stresses that practitioners cannot rely solely on their software to ensure that they are complying with due-diligence requirements. Tax software is not a substitute for tax preparers' knowledge and professional responsibility.

<sup>19</sup> Treas. Reg. §1.6695-2(b).

<sup>20</sup> [www.irs.gov/pub/irs-utl/p\_4687\_final.pdf] Accessed on June 9, 2010.

<sup>21</sup> [www.eitc.irs.gov/rptoolkit/softwaredevelopers/2009report/#\_Toc240968944] Accessed on July 10, 2010.

**Example 6.** Renata is 22 years old. She visits practitioner Libby to get her tax return prepared. Renata tells Libby that she had two children, ages 10 and 11, and wants to claim the earned income credit. Libby must make reasonable inquiries regarding the relationship between Renata and the children since Renata's age seems inconsistent with the ages of the two children.

**Note.** See Problem 1, EIC Due-Diligence Update, in Chapter 5, Individual Taxpayer Problems, for more information.

## §10.27 — FEES

In general, a practitioner may not charge an unconscionable fee in connection with any matter before the IRS.

A contingent fee is any fee that is based on whether a position taken on a tax return or other filing avoids challenge by the IRS or is sustained either by the IRS or in litigation. A contingent fee includes the following:

- Fees based on a percentage of the refund reported on a return,
- Fees based on a percentage of taxes saved,
- Fees that otherwise depend on the specific result attained, and
- Fee arrangements in which the practitioner reimburses the client for all or part of the client's fee if a position taken on a tax return or other filing is challenged by the IRS.

Prior to March 27, 2008, a practitioner could not charge a contingent fee for services rendered in connection with any matter before the IRS. For fee arrangements entered into after March 26, 2008, contingent fees are allowed under the following limited circumstances:

1. The IRS's examination of or challenge to:
  - a. An original tax return
  - b. An amended return or claim for refund or credit in which the amended return or claim for refund or credit was filed within 120 days of the taxpayer receiving a written notice of the examination of, or a written challenge to the original tax return
2. A claim for credit or refund filed solely in connection with the determination of statutory interest or penalties assessed by the IRS
3. Any judicial proceeding arising under the Code

**Example 7.** Marietta doesn't think the practitioner who prepared her 2009 tax return was taking advantage of all the deductions she is entitled to. In the following year, Marietta goes to a new preparer, Rex, who was recommended by a friend. Based on his preliminary assessment, Rex states that he sees an opportunity to save an additional \$20,000 in taxes by filing an amended 2009 return due to some gray areas in the regulations. Rex indicates that his fees will be his normal hourly rate plus 20% of the additional savings in tax liability resulting from the extra work and his expertise.

If he bills as planned, Rex will violate §10.27 of Circular 230 since he would be billing a contingent fee for an amended return which was not filed after a written notice of an examination of, or challenge to, Marietta's original return.

## §10.28 — RETURN OF CLIENT RECORDS

Section 10.28 requires practitioners to **promptly** return client records upon a client's request. These records include any that are necessary for the client to meet federal tax reporting obligations. Practitioners may retain copies of any records returned to clients.

### Promptness Requirement

The regulations do not define **promptly**. It is reasonable to assume that “promptly” means in sufficient time to comply with the taxpayer's federal tax obligation. However, specific facts and circumstances must be taken into account. If the client requests the return of his records on April 15, it may be unreasonable for the practitioner to drop everything in order to promptly comply with the client's demands. However, if a client requests his records on March 1, it may be reasonable to assume that the return of the records on April 16 might be a violation of the promptness requirement of §10.28.

### Records Defined

For purposes of §10.28, **client records** include the following.

- Pre-existing written or electronic documents the client provided to the practitioner or the practitioner obtained from other sources (For example, a practitioner must return copies of the client's previously-filed tax returns, regardless of whether the client provided them to the practitioner or the practitioner requested them from a former preparer.)
- Materials that were prepared by the client or a third party and given to the preparer to assist in preparation of the client's return, such as a spreadsheet of capital gains and losses provided by the client's stockbroker (Practitioners are **not** required to return material prepared by an agent or employee of the practitioner's firm. For example, the practitioner would not have to give the client a capital-gains spreadsheet prepared by the practitioner's colleague from information provided by the client; however, any records provided by the client would have to be returned.)
- Any returns, schedules, appraisals, or other documents prepared by the practitioner or his employee and presented to the client as part of a **prior** engagement, **if** the documents are necessary to prepare the current return (For example, a practitioner would be required to provide the client with a detailed depreciation schedule prepared for a prior return, if the depreciation schedule is required to prepare the current return.)

**Example 8.** Ben brings all the information necessary to prepare his Schedule C and personal tax return to Leona. Later, Ben calls to see how much he owes Leona but does not come in to pick up the return until six months later. He tells Leona's receptionist that he does not want the return, only his original papers, and he does not pay.

Leona is obligated under §10.28 to promptly return any and all records that are necessary for Ben to comply with his federal tax obligations. Leona does not have to provide Ben with the current depreciation schedule that she prepared as part of the Schedule C work. Leona may also retain copies of the records. She must provide Ben with any return or other documents prepared and **previously** presented to Ben for a **prior** representation if the document is necessary for him to comply with current federal tax obligations.

### Fee Disputes

Section 10.28 does not generally allow practitioners to withhold client **records** when a client has not paid his fees. However, if applicable state law allows practitioners to retain records in the event of fee disputes, §10.28 only requires the practitioner to return records that must be **attached** to the client's return. In this event, the practitioner must provide the client with reasonable access to review and copy any additional records retained by the preparer that are necessary for the client to comply with federal tax obligations.

**Client records do not include** any return, schedule, appraisal, or other document prepared by the practitioner or his firm if the practitioner is withholding the document pending the client's performance of his contractual obligation to pay fees **related to that document**.

## Noncompliance Penalties

If a practitioner refuses to return records as required by Circular 230 or applicable state law, the IRS can censure or suspend the preparer from practice. Some states also impose monetary penalties.

### §10.29 — CONFLICT OF INTEREST

Section 10.29 prohibits a practitioner from representing taxpayers with conflicting interests before the IRS. Common situations in which conflicts may arise include representation of former spouses, business partners, and officers of a closely-held corporation. These situations require analysis of the nature of the conflict, its impact on the preparer's ability to adequately represent all the clients, and full disclosure to the clients before obtaining consent. However, the practitioner may represent both taxpayers if the nature of the conflict is fully disclosed and the express consent of all directly interested parties is obtained.

Circular 230 requires clients to provide signed written consent related to the conflict of interest. The documentation must be completed within 30 days of the informed consent and retained by the practitioner for at least 36 months after concluding the representation.

The regulations clarify that **all affected clients must provide written consents** to the practitioner. The practitioner may prepare a client letter outlining the conflict, as well as possible implications, and submit the letter to the clients to countersign. A verbal consent followed by a confirmatory letter authored by the practitioner does not satisfy §10.29 unless the letter is countersigned by the client. The regulations allow the written confirmation to be made within a reasonable period after the informed consent, but not later than 30 days.

**Example 9.** An LLC constructed two retail strip malls. The LLC's two members contributed cash, land, and labor for their membership interests. The malls were subsequently sold, resulting in a profit for both members. The IRS notified the company that it intends to audit the LLC return for the year of sale, including the calculation of each member's basis. Cassie Washington, EA, prepared the original return. Before meeting with the IRS auditor, Cassie should write a letter to both members, outlining the possible conflicts involved with representing the LLC in the audit and obtain the signatures of both members for her files.

## Identifying Conflicts

A conflict of interest exists when there is a **significant risk** that representation of multiple parties would limit the practitioner's ability to represent each of the parties with competence and diligence. It is almost impossible to assess and disclose all potential conflicts of interest. Practitioners must balance their need to remain alert to situations requiring informed consent while also exercising caution to avoid violating client privacy in obtaining informed consents.

Conflicts of interest may arise without the practitioner's awareness. When deciding whether to accept a client engagement, preparers should probe potential clients to identify possible conflicts. A suggested question might be "How did you hear about our office?" If the client was referred, the practitioner may wish to inquire further to determine whether representation might present a possible conflict.

For partnerships, the practitioner should know whether he is representing all partners. When preparing partnership returns, practitioners have an obligation to treat all partners the same. If one partner is a client and another is not, there may be a temptation to favor the client partner. The same issue holds true for S corporations, trusts, and estates.

Additional conflicts may arise when representing both landlord and tenant or when representing merchants and their major clients.

## §10.33 — BEST PRACTICES

Section 10.33 is intended to convey goals of best practices to which tax practitioners should aspire and not to impart mandatory rules of conduct. Violations of §10.33 do not subject practitioners to sanctions; however, tax professionals are encouraged to uphold the following standards:

- Communicating clearly with the client regarding the terms of the engagement (For example, the advisor should determine the client's expected purpose for and use of the advice and should have a clear understanding with the client regarding the form and scope of the advice or assistance to be rendered.)
- Establishing the facts, determining which facts are relevant, evaluating the reasonableness of any assumptions or representations, relating the applicable law (including potentially applicable judicial doctrines) to the relevant facts, and arriving at a conclusion supported by the law and the facts
- Advising the client regarding the significance of the conclusions reached, including, for example, whether a taxpayer may avoid accuracy-related penalties under the Code if a taxpayer takes action based on the advice
- Acting fairly and with integrity in practice before the IRS

## §10.34 — STANDARDS FOR TAX RETURNS AND DOCUMENTS, AFFIDAVITS, AND OTHER PAPERS

Section 10.34 prohibits a practitioner from advising a client to submit a document to the IRS that contains or omits information that intentionally disregards a rule or regulation, unless the practitioner also advises the client to submit a document that shows a good-faith challenge to the rule or regulation.

The regulations prohibit a practitioner from advising a client to take a frivolous position. A practitioner cannot advise the client to submit a document that:

- Is intended to delay action,
- Is frivolous, or
- Contains or omits information in a manner that demonstrates intentional disregard for the law.

For factual matters, the regulations allow practitioners to rely on taxpayer-provided information related to tax returns, documents, affidavits, and other papers, unless the information appears to be incorrect, is inconsistent with an important fact or factual assumption, or is incomplete. These standards supplement the existing requirement in §10.22 that practitioners exercise due diligence in preparing tax returns and other documents relating to IRS matters.

**Example 10.** Sydney owes the IRS \$18,000 on her 2005 income tax return. The IRS has a lien on her property and is threatening to foreclose. Her tax preparer, Lindsey, advises Sydney to file an offer in compromise, knowing this will delay any collection action. Sydney would be able to pay the costs associated with submitting an OIC but does not currently have sufficient funds to pay the entire amount owed the IRS. Lindsey is fairly certain that the IRS will not accept this offer because of Sydney's income and assets.

Because Lindsey strongly suspects Sydney will not qualify for the offer, the purpose of filing the offer appears to be to delay collection actions. Under the §10.34 regulations, the IRS might characterize this as a stall tactic.

**Note.** On August 19, 2010, the IRS issued proposed regulations to amend Circular 230.<sup>22</sup> The proposed changes to §10.34 state that a practitioner may not willfully, recklessly, or through gross incompetence, sign or prepare a portion of a tax return or claim for refund or advise a client to take a position on a tax return or claim for refund that the practitioner knows or reasonably should know contains a position that:

1. Lacks a reasonable basis,
2. Is an unreasonable position as described in §6694(a)(2), or
3. Is a willful attempt by the practitioner to understate the liability for tax or a reckless or intentional disregard of rules or regulations by the practitioner as described in §6694(b)(2).

<sup>22</sup> REG-138637-07, IR-2010-091 (Aug. 19, 2010).

## §10.35 — COVERED OPINION STANDARDS

This standard was drafted to combat the serious abuses of the system by some legal and accounting professionals in the '90s. The focus of this section is to better regulate the advice given by accountants and attorneys to their clients who are concerned with whether the IRS might consider a transaction illegal or abusive. Unfortunately, the regulations of §10.35 place an additional burden on conscientious tax practitioners.

**Covered opinions** are the types of opinions given to clients who are seeking advice from tax professionals in order to “cover” themselves from fraud-related penalties. Covered opinions include written tax advice arising from:

1. Any transaction on the IRS’s list of tax avoidance schemes;
2. Any plan, scheme, entity, or arrangement that has a **principal** purpose of avoiding or evading tax; or
3. Any plan, scheme, entity, or arrangement that has a **significant** purpose of avoiding or evading tax if the written advice is:
  - a. A reliance opinion,
  - b. A marketed opinion,
  - c. Subject to confidentiality, or
  - d. Subject to contractual protection.

It is important to distinguish between principal purpose and significant purpose when determining whether or not an opinion is covered. **Principal purpose** is defined as a “purpose that exceeds any other purpose.” If the **only** reason a client would follow the practitioner’s advice is to get out of paying taxes, the principal-purpose test is met.

A practitioner can escape the distinction of rendering a covered opinion if he is merely giving advice in accordance with Congressionally-sanctioned tax breaks.<sup>23</sup> So, if the practitioner is advising a client regarding a sound business practice that has a side benefit of tax avoidance, he is presumably free from the burden of §10.35. But if he is giving advice solely to escape taxes, he is presumably rendering a covered opinion and is subject to §10.35.

A **reliance opinion** is one that a practitioner’s clients can rely on with a good degree of certainty. Reliance opinions include written advice concluding, at a confidence level of at least more likely than not, that one or more significant federal tax issues will be resolved in the taxpayer’s favor. However, written advice is generally **not** treated as a reliance opinion if it is disclosed within the written advice that the advice was not intended, and cannot be used, for the purpose of avoiding penalties.

A **marketed opinion** is written advice given by a practitioner who knows that it will be used to sell someone on a tax avoidance scheme — a partnership or other entity, investment plan, or arrangement designed to get out of paying taxes. A marketed opinion can escape the distinction of being labeled a covered opinion if the practitioner prominently discloses in writing that the taxpayer cannot use the advice to avoid a penalty, whether the advice was written to sell something, and that the taxpayer should seek the advice of an independent tax advisor (presumably, one that is willing to cover his opinion).

Other exceptions to a covered opinion include, but are not limited to:

- Preliminary advice that will be followed up on during the course of the engagement,
- Advice prepared and provided after a tax return is filed,
- Advice provided by in-house counsel,
- Advice that is nonfrivolous and has a realistic possibility of success because it is reasonable and/or backed by substantial authority, and
- Negative advice (telling the client he is going to lose).

<sup>23</sup> Circular 230 §10.35(b)(10).



The following writings would probably **not** be considered covered opinions:

- Handouts distributed by a CPA during a presentation
- A cover letter sent by a practitioner with the client's estimated tax vouchers

According to former OPR Director Cono Namorato, tax practitioners should be “providing good, solid, correct tax advice, not penalty protection.” Namorato further advises practitioners, “... if you want to engage in that area, if you want to play in that ballpark, then comply with the standard set out in §10.35.”<sup>24</sup>

If a client insists that the practitioner “play in the ballpark,” the following steps are required to comply with the standards of §10.35:

1. **State the facts.** The practitioner must use reasonable efforts to determine the facts and decide which ones are important to the client's situation. The practitioner cannot presume any facts based on wild guesses or incorrect or incomplete suppositions or predictions of future events.

The practitioner must identify and consider all relevant facts when preparing a covered opinion for the client. In separate sections of a written document, the practitioner must:

- Identify all assumed facts; and
  - Identify all of the taxpayer's factual representations, statements, or findings that were relied upon.
2. **Relate the facts.** Using sound reasoning, the practitioner should explain to the client (in writing) how the facts gathered relate to the Code and any applicable judicial doctrines. The practitioner cannot assume that any significant federal tax issue will be favorably resolved, except in limited scope opinions<sup>25</sup> or when relying on the opinion of another trustworthy practitioner.<sup>26</sup> The practitioner must not base his opinion on wild arguments or unreasonable conclusions.
  3. **Evaluate the significance of the facts to federal tax law.** Except for limited scope opinions or relying on the opinion of other reliable practitioners, the practitioner is required to consider all significant federal tax issues when rendering a covered opinion. The practitioner must provide a conclusion about the taxpayer's odds of prevailing on the merits of the case for each tax issue identified.

If the practitioner is unable to reach a conclusion, this must be stated. The practitioner must describe the reasons for each conclusion, including an analysis of all the relevant facts, or state the reasons he is unable to reach a conclusion. If the practitioner cannot give the client better than 50:50 odds of success — a “more-likely-than-not” standard — he must include a disclosure such as the one below:

Pursuant to Circular 230 Regulations, any federal tax advice contained in this communication or attachment is not intended or written to be used, and may not be used, for the purpose of avoiding tax-related penalties or promoting, marketing, or recommending to another party any tax-related matters addressed herein.

The disclosures required by §10.35 give taxpayers requesting covered opinions appropriate information on any relevant matter that may have influenced the practitioner in writing the opinion, such as referral fees or arrangements, or the practitioner's involvement in promoting a tax avoidance scheme. Disclosures also address the scope of the opinion, such as opinions which are narrowly focused on only one tax issue, or the opinion's probability of success.

<sup>24</sup> “IRS Office of Professional Responsibility Overview,” *Tax Talk Today* (May 10, 2005).

<sup>25</sup> Circular 230 §10.35 (c)(3)(v).

<sup>26</sup> Circular 230 §10.35 (d).

## §10.36 — PROCEDURES TO ENSURE COMPLIANCE

Section 10.36 takes the enforcement of §10.35 to the company level. This subsection makes practitioner(s) who have principal authority for a firm's practice liable for the failure of any subordinates or peers to comply with the rules governing covered opinions. Principal authorities must take reasonable steps to ensure all individuals associated with their practice are aware of and comply with §10.35.

If the supervising practitioner is derelict in his duties due to his obstinacy, carelessness, or ineptitude, he can be subject to disciplinary proceedings. He is also held accountable for the actions of others in his firm if he knew, or should have known, that they were violating §10.35 and he was negligent in correcting their actions.<sup>27</sup>

**Note.** Section 10.36 of the proposed regulations<sup>27</sup> provides that firm management with principal authority and responsibility for overseeing a firm's practice of preparing tax returns, claims for refunds, and other documents filed with the IRS must take reasonable steps to ensure that the firm has adequate procedures in effect for purposes of complying with Circular 230.

## §10.37 — STANDARDS FOR OTHER WRITTEN ADVICE TO CLIENTS

Most tax preparers do not engage in providing the tax-shelter type opinions covered by §10.35. However, all practitioners are subject to the rules of §10.37, which encompass **all written tax advice** rendered to clients, even routine tax advice. This section is meant to hold practitioners to a higher standard when offering advice that, if followed, could cause clients to incur a penalty. **There is no opt-out provision for §10.37.**

The rules of §10.37 are similar to the rules of §10.35, only not as specific. Unlike the section on covered opinions, §10.37 does not require practitioners to describe the relevant facts, including assumptions and representations, the application of the law to those facts, or the practitioner's conclusion about the law and the facts.

Section 10.37 prohibits practitioners from giving written advice, including electronic communications, if the practitioner:

- Bases the written advice on unreasonable factual or legal assumptions (including assumptions as to future events);
- Unreasonably relies upon representations, statements, findings, or agreements of the taxpayer or any other person;
- Fails to consider all relevant facts that the practitioner knows or should know; or
- Takes into account the possibility that a tax return will not be audited, that an issue will not be raised on audit, or that an issue will be settled if raised on audit.

The scope of the engagement and the type and specificity of the advice sought by the client, in addition to all the other facts and circumstances, are considered when determining whether a practitioner has failed to comply with the requirements of §10.37. A practitioner is held to a higher standard if he knows the written advice he is giving will be used by other taxpayers in evaluating transactions with a significant purpose of tax avoidance or evasion.

## §10.50 — SANCTIONS

The American Jobs Creation Act of 2004 (AJCA) gave the IRS authority to impose monetary penalties on an employer, firm, or entity of a representative if the employer knew or should have known of the practitioner's incompetency or disreputable conduct.

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<sup>27</sup> REG-138637-07, IR-2010-091 (Aug. 19, 2010).

The regulations, in accordance with AJCA, authorize the imposition of monetary penalties in addition to, or in lieu of, any other sanction. The IRS also may now disqualify an appraiser who violates Circular 230 after due notice and an opportunity for a hearing. This disqualification may occur with or without a monetary penalty against the appraiser.

The IRS can impose various sanctions on tax professionals under §10.50 of Circular 230. These include censure, suspension, and disbarment. These sanctions can be applied for:

- Incompetence or disreputable behavior,
- Failure to comply with regulations, or
- Willfully and knowingly misleading or threatening a client or prospective client, with intent to defraud.

## **§10.51 — INCOMPETENCE AND DISREPUTABLE CONDUCT**

Section 10.51 defines disreputable conduct that can result in sanctions under §10.50.

There are 15 **primary** reasons the IRS could begin enforcement action against a practitioner:

1. Conviction of a criminal offense under the tax laws
2. Conviction of a criminal offense involving dishonesty or breach of trust
3. Conviction of any felony under federal or state law which would render the practitioner unfit to practice before the IRS
4. Knowingly giving false and misleading information to the Department of Treasury in connection with a pending or likely-to-be-pending tax matter (Facts or other matters contained in testimony, federal tax returns, financial statements, applications for enrollment, affidavits, declarations, and any other document or statement, written or oral, are included in the term “information.”)
5. Solicitation of employment by the use of false or misleading representations with intent to deceive a client or prospective client in order to procure employment, or intimating that the practitioner is able improperly to obtain special consideration or action from the IRS
6. Willfully failing to file a federal tax return or willfully evading or attempting to evade any assessment or payment of federal tax
7. Willfully assisting, counseling, or encouraging a client or prospective client to violate any federal tax law, or knowingly counseling or suggesting to a client or prospective client an illegal plan to evade federal taxes
8. Misappropriating or failing to promptly remit client funds for payment of taxes or other obligations to the IRS
9. Bribing or threatening an IRS employee in an attempt to receive favorable treatment
10. Disbarment or suspension from practice as an attorney, CPA, public accountant, or actuary by any state or any federal court, agency, or body
11. Knowingly aiding and abetting another person to practice before the IRS while under suspension or disbarment
12. Engaging in contemptuous conduct in connection with practice before the IRS, including the use of abusive language, knowingly making false accusations or statements, or circulating or publishing malicious or libelous matter
13. Giving a false opinion, knowingly, recklessly, or through gross incompetence, that is intentionally or recklessly misleading on questions regarding federal tax laws
14. Willfully failing to sign a tax return when the practitioner’s signature is required by federal tax laws
15. Willfully disclosing or using tax return information in a manner not authorized by the Code

**Note.** The proposed regulations<sup>28</sup> add the following to the list of primary reasons that the IRS could begin enforcement action against a practitioner:

- Willfully failing to file on electronic media a tax return prepared by the practitioner when the practitioner is required to do so by the federal tax laws (unless the failure is due to reasonable cause and not due to willful neglect)
- Willfully preparing all or substantially all, or signing as a compensated tax return preparer, a tax return or claim for refund when the practitioner does not possess a current or otherwise valid PTIN or other prescribed identifying number
- Willfully representing a taxpayer before an officer or employee of the IRS unless the practitioner is authorized to do so under Circular 230.

## PROPOSED CIRCULAR 230 REVISIONS

On August 19, 2010, the IRS released proposed regulations<sup>29</sup> to amend Circular 230. The proposed regulations generally would extend the current regulations that apply to attorneys, CPAs, EAs, enrolled actuaries, and enrolled retirement plan agents to all tax return preparers, including currently unenrolled tax return preparers.

The proposed regulations would clarify the definition of practice, establish a new registered tax return preparer designation and the eligibility requirements for becoming a registered tax return preparer, revamp standards for the preparing of tax returns, revise rules regarding continuing education providers, and amend multiple other sections of Circular 230.<sup>30</sup>

A brief description of the most significant of the proposed modifications (other than those covered in the preceding section) follows.

### §10.2 — DEFINITIONS

Under the current definition of practice, preparing a tax return or claim for refund constitutes practice before the IRS. Likewise, a person who files a tax return or claim for refund prepared by someone else is engaged in practice before the IRS. Some tax professionals have suggested that they are not engaged in practice before the IRS unless they both prepare and file a tax return or claim for refund. Accordingly, the proposed regulations revise §10.2(a)(4) to specifically clarify that either preparing or filing a document may constitute practice before the IRS.

Section 10.2 (a)(8) of the proposed changes to Circular 230 clarifies that the definition of tax return preparer is the same as the meaning in IRC §7701(a)(36), which states:

*The term "tax return preparer" means any person who prepares for compensation, or who employs one or more persons to prepare for compensation, any return of tax imposed by this title or any claim for refund of tax imposed by this title. For purposes of the preceding sentence, the preparation of a substantial portion of a return or claim for refund shall be treated as if it were the preparation of such return or claim for refund.*

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<sup>28</sup> Ibid.

<sup>29</sup> Ibid.

<sup>30</sup> IRS News Rel. IR-2010-091 (Aug. 19, 2010).

## §10.3 — WHO MAY PRACTICE

The proposed regulations establish a new **registered tax return preparer** designation. A registered tax return preparer is a practitioner who has limited practice authority before the IRS. Practice for a registered tax return preparer is limited to preparing tax returns, claims for refund, and other documents for submission to the IRS. A registered tax return preparer may:

- Prepare, or assist in the preparation of all, or substantially all of a tax return or claim for refund that is commensurate with the level of competence that the registered tax return preparer has demonstrated by written examination
- Sign tax returns, claims for refund, and other documents as the preparer, commensurate with the level of demonstrated competence
- Represent taxpayers before revenue agents, customer service representatives, or similar officers and employees of the IRS during an examination if the registered tax return preparer signed the tax return or claim for refund for the taxable year under examination

Registered tax return preparers may not:

- Represent taxpayers before appeals officers, revenue officers, counsel, or similar officers and employees of the IRS
- Provide tax advice except as necessary to prepare a tax return, claim for refund, or other document intended to be submitted to the IRS

The conduct of the registered tax return preparer will be subject to the standards of conduct in Circular 230.

## §10.4 — ELIGIBILITY

This section sets forth the requirements to become a registered tax return preparer. These provisions were described in the “Preparer Licensing” section of this chapter.

## §10.5 — APPLICATION FOR ENROLLMENT

This section explains the procedures for application to become a registered tax return preparer, which generally are consistent with the procedures currently utilized for EAs and enrolled retirement plan agents. The proposed regulations permit the IRS to change the application procedures for registered tax return preparers.

Once an application to become a registered tax return preparer is approved, the IRS issues a registration card or certificate to each individual. Each card or certificate is valid for the period stated on the card or certificate.

## §10.6 — TERM AND RENEWAL

Section 10.6 of the proposed regulations sets forth the procedures for registered tax return preparers to renew their applications to practice before the IRS. The completion of continuing education (CE) requirements is a condition for renewal.

**Note.** The CE requirements are explained earlier in this chapter, in the “Preparer Licensing” section.

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Section 10.6 of the current regulations authorizes CE credit to be awarded for hours relating to work as an instructor, discussion leader, or speaker at an education program, as well as hours for authoring articles, books, or other publications of federal tax-related matters. Currently, the maximum credit for instruction and preparation cannot exceed 50% of the CE requirement for an enrollment cycle. The proposed regulations **reduce** the maximum credit for instruction and preparation to four hours annually of the CE requirement. The proposed regulations also **remove** the ability to receive CE hours for authoring books, articles, or other publications.

Each individual applying for renewal must retain the following qualifying CE credit information for four years following the date of renewal:

1. Name of the sponsoring organization
2. Location of the program
3. Title of the program, qualified program number, and description of its content
4. Written outlines, course syllabi, textbook, and/or electronic materials provided or required for the course
5. Dates attended
6. Credit hours claimed
7. Names of the instructors, discussion leaders, or speakers, if applicable
8. Certificate of completion and/or signed statement of the hours of attendance obtained from the CE provider

## **§10.9 — CONTINUING EDUCATION PROGRAMS**

Under this section of the proposed regulations, providers of CE courses are required to maintain records and education material concerning their programs and the individuals who attend them. They also must obtain approval of each program to be qualified as a CE program.

## **§10.30 — SOLICITATION**

The proposed regulations provide that a practitioner may not use or participate in the use of any form of public communication or private solicitation that contains a false, fraudulent, coercive, misleading, or deceptive statement or claim related to any IRS matter. Registered tax return preparers may not use the term “certified” or imply an employer/employee relationship with the IRS in describing their professional designation.

## **IRC §7216: DISCLOSURE OR USE OF INFORMATION BY PREPARERS**

In January 2008, the IRS and Treasury Department issued regulations under IRC §7216 which were applicable to disclosures or uses of tax return information after January 1, 2009. The regulations provided that tax return preparers could use certain limited tax return information for the purposes of compiling, maintaining, and using lists for the solicitation of tax return business. The regulations also describe limited circumstances when a tax return preparer was allowed to use tax return information to produce statistical compilations and when the preparer could use or disclose the produced statistical compilation without written consent.

The IRS and Treasury Department issued Notice 2009-13 in February 2009, in order to provide interim guidance relating to the disclosure and use of statistical compilations of anonymous tax return information. Notice 2009-13 set forth rules used by the IRS and Treasury Department during 2009 while they considered whether the interim guidance should be adopted or further amended.

## NEW §7216 GUIDANCE

On December 29, 2009, the IRS issued TD 9478, which contains final and temporary regulations pertaining to the disclosure and use of tax return information by tax return preparers. These regulations provide updated guidance to tax return preparers regarding the following:

- The use of information related to lists for solicitation of tax return business,
- The disclosure or use of statistical compilations of data by a tax return preparer, and
- The disclosure or use of information regarding conflict reviews.

These temporary regulations supersede the interim guidance provided by Notice 2009-13.

### Use of Information for Solicitation of Tax Return Business

The IRS and Treasury Department will amend the regulations under IRC §7216 to provide a limited expansion of the data that tax return preparers can use and include in lists for tax return business without obtaining taxpayer consent. Such lists for solicitation of tax return business may not be used to solicit business unrelated to tax return preparation.

Under current regulations, a tax return preparer is allowed to compile and maintain a list for solicitation of tax return business consisting only of the names, addresses, email addresses, and phone numbers of taxpayers whose tax returns have been prepared or processed by the preparer.<sup>31</sup> The IRS and Treasury Department are amending the regulations to expand the information that may be compiled and maintained to include taxpayer entity classification or type and taxpayer income tax return form number.<sup>32</sup>

The revised regulations clarify that the tax return preparer may use this list to contact taxpayers on the list for the purpose of offering tax information and general business or economic information or analysis for educational purposes, or soliciting additional tax return preparation services to the taxpayers. It is contemplated that “offering tax information” includes explanations of current developments in tax law.<sup>33</sup> A tax return preparer can use a variety of methods to contact taxpayers, including direct contact, newsletters, and email.<sup>34</sup>

**Example 11.** Tessa is a tax return preparer whose office is located in northern Illinois. Tessa prepares income tax returns for taxpayers who live in Illinois, Wisconsin, Michigan, and Indiana. Tessa maintains a list of taxpayer clients which contains the names, addresses, email addresses, phone numbers, entity classification, and income tax form number for each client. To ensure that her clients only receive the information updates that are relevant to them, Tessa uses this list to direct her outreach efforts towards clients by zip code and income tax return form number. Tessa is allowed to use the list information in this manner without obtaining taxpayer consent because she is providing tax information for educational or informational purposes, provided she does not use the announcements to solicit business that is unrelated to tax preparation.

**Example 12.** Tessa, from **Example 11**, provides monthly newsletters to all of her taxpayer clients. The newsletters contain federal income tax updates and are delivered to her clients by email or postal mail. When Tessa hires a new employee, she announces the new employee in the monthly newsletter. Each announcement includes a photograph of the new employee, the employee’s name, qualifications, and employment responsibilities. Tessa is allowed to include the new employee announcements because this is considered tax information for educational or informational purposes, provided the announcements do not contain solicitations for business that is unrelated to tax preparation.<sup>35</sup>

<sup>31</sup> TD 9478, 2010-4 IRB.

<sup>32</sup> Temp. Treas. Reg. §301.7216-2T(n)(1).

<sup>33</sup> TD 9478, 2010-4 IRB.

<sup>34</sup> Rev. Rul. 2010-4, 2010-4 IRB.

<sup>35</sup> These two examples were adapted from Temp. Treas. Reg. §301.7216-2T(n)(2).

A tax return preparer may not transfer the compiled taxpayer list to any other person unless the transfer takes place in conjunction with the sale or other disposition of the tax return preparation business.<sup>36</sup> The regulations clarify that tax return information made available to a potential purchaser for due diligence purposes constitutes a disclosure, rather than a transfer, of that information.

## Use of Auxiliary Service Providers

The regulations under §7216 define “tax return preparer” as including “any person who is engaged in the business of providing auxiliary services in connection with the preparation of tax returns...”<sup>37</sup> A person who is engaged in the business of providing auxiliary services in connection with the preparation of tax returns is one who holds himself out to tax return preparers or taxpayers as a person who performs auxiliary services.<sup>38</sup> For example, third-party service providers who create, publish, or distribute newsletters, bulletins, or similar publications on tax-related subjects typically represent themselves to tax professionals as persons who perform services auxiliary to tax return preparation.<sup>39</sup>

A tax return preparer may disclose tax return information to another tax return preparer located in the United States to obtain auxiliary services that are not substantive determinations affecting the tax liability reported by taxpayers. This disclosure may occur without taxpayer consent.<sup>40</sup>

**Example 13.** Tax return preparer Catie engages third-party service provider Quantum Tax Facts Co. to publish both paper and electronic monthly newsletters containing educational tax information, tax tips, tax law updates, and direct solicitation for Catie’s tax return preparation business. Catie discloses to Quantum the names and mailing addresses of clients for whom she does not have email addresses. Quantum then prints those names and mailing addresses onto the paper newsletters it produces for Catie. Quantum provides Catie with the completed newsletters in paper and electronic format, and Catie then distributes them to her tax return preparation clients, using a list that contains taxpayer names, addresses, and email addresses.<sup>41</sup>

Auxiliary service providers also include professional liability insurance carriers who offer liability coverage for claims or potential claims that directly relate to the tax returns prepared or processed by the insured tax return preparers.<sup>42</sup> A professional liability insurance carrier may require the tax return preparer to disclose information such as client names, descriptions of the services provided to the named clients, tax return information describing the circumstances of the claim, and copies of relevant tax returns. Disclosure of such information is permitted without taxpayer consent, if the information is necessary in order to obtain the services provided by the professional liability insurance carrier.

## Disclosure of Statistical Compilations of Tax Return Information

Notice 2009-13 provided interim guidance on disclosures of anonymous statistical compilations of tax return information occurring after February 8, 2009. Under these guidelines, statistical compilations can be disclosed without taxpayer consent if the purpose of the disclosure is in support of the tax preparation business. The release of the statistical information can sometimes be useful from a public-policy perspective. In some cases, groups such as the Volunteer Income Tax Assistance (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 previous regulations, this was a prohibited disclosure.

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<sup>36</sup> Temp. Treas. Reg. §301.7216-2T(n)(1).

<sup>37</sup> Treas. Reg. §301.7216-1(b)(2)(i)(B).

<sup>38</sup> Treas. Reg. §301.7216-1(b)(2)(iii).

<sup>39</sup> Rev. Rul. 2010-4, 2010-4 IRB.

<sup>40</sup> Treas. Reg. §301.7216-2(d)(1).

<sup>41</sup> Adapted from example in Rev. Rul. 2010-4, 2010-4 IRB.

<sup>42</sup> Rev. Rul. 2010-5, 2010-4 IRB.



In response to public comments received concerning Notice 2009-13 provisions, the IRS and Treasury Department decided to amend Treas. Reg. §301.7216-2(o). Temporary regulations were issued that allow a tax return preparer to disclose statistical compilations of tax return information without taxpayer consent for additional limited purposes.<sup>43</sup>

Tax return preparers are now allowed to use anonymous statistical data for marketing purposes and to assist taxpayers in making informed choices about tax return preparers. Marketing and advertising is allowed, provided it is not false, misleading, or unduly influential.<sup>44</sup> However, disclosure of statistics that identify dollar amounts of refunds, credits, or deductions is prohibited.

Any disclosure of a statistical compilation, other than to satisfy reporting requirements or in conjunction with the disposition of a tax return business, must be in a form which cannot be associated with a particular taxpayer. The data disclosed may not be from a group of less than 10 tax returns.<sup>45</sup>

The temporary regulations continue to permit groups such as the VITA program to compile statistical information in order to comply with reporting requirements in connection with grants. Such information may be disclosed in order to comply with financial accounting or regulatory reporting requirements whether or not the data is anonymous or discloses information from fewer than 10 tax returns.<sup>46</sup>

**Example 14.** Miles is a tax return preparer who works in the VITA program. In 2010, in support of his tax return preparation business, Miles submits a grant application to a charitable foundation to fund his operations providing free tax return preparation services to low- and moderate-income families. In support of this request, Miles includes anonymous statistical data from spreadsheet cells containing data from 10 or more tax returns showing that, in 2009, Miles provided services to 500 taxpayers, that 95% of the taxpayer population served by Miles received the EIC, and that the average amount of the EIC received was \$3,300. Despite the fact that this information constitutes an average credit amount, Miles may disclose the information to the charitable foundation because disclosures made in support of fundraising activities conducted by VITA programs and other organizations described in IRC §501(c) in direct support are allowed under the regulations.<sup>47</sup>

## Use of Information for Conflict-of-Interest Reviews

Temporary regulations under §7216 clarify that tax return preparers may use and disclose tax return information in order to accomplish conflict reviews.<sup>48</sup> A conflict review allows tax return preparers to fulfill legal and ethical requirements to identify and avoid client conflicts of interest. They may be undertaken to comply with the requirements established by any federal, state, or local law, agency, board, or commission, or by a professional association ethics committee or board. Conflicts of interest may arise when a tax return preparer is employed by another tax return preparer or tax return preparation business, or when a tax return preparer is considering engaging a new client.

Disclosures of tax return information in conjunction with conflict reviews are allowed without taxpayer consent. However, only the disclosures necessary to accomplish the review are permissible. For example, if the only information needed to allow the conflict review to be completed is the names of taxpayers, then the tax return preparer shall not disclose any tax return information other than the taxpayers' names.

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<sup>43</sup> TD 9478, 2010-4 IRB.

<sup>44</sup> Temp. Treas. Reg. §301.7216-2T(o)(1).

<sup>45</sup> Previous regulations required a group of at least 25 tax returns. See Notice 2009-13, 2009-21 IRB (Feb. 9, 2009).

<sup>46</sup> Temp. Treas. Reg. §301.7216-2T(o)(1).

<sup>47</sup> Temp. Treas. Reg. §301.7216-2T(o)(2).

<sup>48</sup> Temp. Treas. Reg. §301.7216-2T(p)(2).

## ADEQUATE DISCLOSURE

IRC §6662 imposes a 20% penalty on any portion of an underpayment of tax required to be shown on a return. The penalty rate is 40% in the case of gross valuation misstatements. An understatement of income tax is considered substantial if the amount of the understatement exceeds the greater of 10% of the amount of tax required to be shown on the return or \$5,000.<sup>49</sup> For corporations (other than S corporations or personal holding companies), there is a substantial understatement if the amount of the understatement exceeds the lesser of:

1. 10% of the tax required to be shown on the return (or, if greater, \$10,000), or
2. \$10 million.<sup>50</sup>

IRC §6694(a) imposes a penalty on a tax return preparer for filing a return or claim for refund reflecting an understatement of liability due to an unreasonable position of which the tax return preparer knew or reasonably should have known. The penalty for each such return or claim for refund is \$1,000 or 50% of the income derived or expected to be derived with respect to the return or claim.

A position is generally treated as unreasonable unless:

- There is or was substantial authority for the position, or
- There was a reasonable basis for the position and it was properly disclosed in the return or in a statement attached to the return.<sup>51</sup>

If the position relates to a tax shelter or a reportable transaction to which §6662A applies, the position is treated as unreasonable if it is not reasonable to believe that the position would more likely than not be sustained on its merits.

Rev. Proc. 2010-15 updates guidance for determining when disclosure is adequate for the purposes of reducing the understatement of income tax under §6662(d) and avoiding the preparer penalty under §6694(a). The following steps are required to comply with Rev. Proc. 2010-15:

1. Additional disclosure of facts or positions taken is unnecessary for purposes of reducing any understatement of income tax, provided that the forms and attachments are completed clearly and in accordance with their instructions.
2. The money amounts entered on the forms must be verifiable. A number is verifiable if the taxpayer can prove the origin of the amount upon audit. The taxpayer must also demonstrate good faith in entering that number on the applicable form.
3. Additional disclosure may be necessary when the understatement arises from a transaction between related parties. If an entry may present a legal issue or controversy because of a related-party transaction, then that transaction and the relationship must be disclosed on Form 8275, *Disclosure Statement*, or Form 8275-R, *Regulation Disclosure Statement*.
4. When the amount of an item is listed on a line that does not have a preprinted description (such as under an "Other Expense" category), the taxpayer must clearly identify the item by including a description on that line. For example, to disclose a bad debt for a sole proprietorship, the words "bad debt" must be written or typed on the line of Schedule C that shows the amount of the bad debt. Also, for Schedule M-3 (Form 1120), Part II, line 25 (other income (loss) items with differences) or Part III, line 35 (other expense/deduction items with differences), the entry must provide descriptive language — for example, "Cost of noncompete agreement deductible not capitalizable." If space limitations on a form do not allow for an adequate description, the description must be continued on an attachment.

<sup>49</sup> IRC §6662(d)(1)(A).

<sup>50</sup> IRC §6662(d)(1)(B).

<sup>51</sup> Rev. Proc. 2010-15, 2010-7 IRB.

5. Although a taxpayer may meet the literal disclosure requirements of Rev. Proc. 2010-15, the disclosure will not prevent an accuracy-related penalty under §6662 if the item or position on the return:
  - a. Does not have a reasonable basis,
  - b. Is attributable to a tax shelter item, or
  - c. Is not properly substantiated or the taxpayer failed to keep adequate books and records related to the item or position.
6. Disclosure will have no effect for purposes of the tax preparer penalty under §6694(a) if the position is related to a tax shelter or a reportable transaction to which §6662A applies.

Rev. Proc. 2010-15 lists the information necessary to meet the adequate disclosure provisions when:

- Completing Form 1040, Schedule A, *Itemized Deductions*;
- Reporting certain trade or business expenses;
- Reporting differences in book and income tax reporting;
- Reporting foreign tax items; and
- Reporting other items, including moving expenses, employee business expenses, fuels credit, and investment credit.

## SIGNING REQUIREMENTS

The individual tax return preparer who has primary responsibility for the overall substantive accuracy of the tax return or claim for refund is the signing tax return preparer. A nonsigning tax return preparer, on the other hand, is any tax return preparer who is not a signing preparer but who prepares all or a substantial portion of a return or claim for refund.<sup>52</sup>

IRC §6695(b) says that any person who is required to sign a tax return or claim for refund as a tax return preparer and who fails to comply with the regulations is subject to a penalty of \$50 for each such failure with a maximum of \$25,000 per person imposed with respect to each calendar year. This penalty may be abated if the failure to sign is due to reasonable cause and not willful neglect and is effective for tax returns and claims for refund prepared after May 25, 2007.<sup>53</sup>

**Example 15.** Anson Legal Services employs Bianca, a lawyer, to prepare clients' estate tax returns and claims for refund of taxes. Anson is hired by Cassandra to prepare a federal estate tax return. Anson assigns Bianca to prepare the return. Bianca obtains the information necessary for completing the return from Cassandra and makes determinations regarding the proper application of the tax laws to such information in order to determine the estate's tax liability. Bianca then forwards such information to Dexon, a computer tax service that performs the mathematical computations and prints the return by means of computer processing. Dexon then sends the completed estate tax return to Bianca who reviews the accuracy of the return. Bianca is the individual tax return preparer who is primarily responsible for the overall accuracy of the estate tax return. She must sign the return as tax return preparer in order to avoid the §6695(b) penalty.<sup>54</sup>

<sup>52</sup> Treas. Reg. §301.7701-15(b)(1)-(2).

<sup>53</sup> Rev. Proc. 2009-11, 2009-3 IRB.

<sup>54</sup> Example adapted from Treas. Reg. §1.6695-1(b)(4).

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Rev. Proc. 2009-11 lists all forms that are considered a return or claim for refund for purposes of §6694. It also lists all forms that require a return preparer's signature in order to avoid a §6695(b) penalty. The list is categorized into the following types:

- Income tax returns
- Estate and gift tax returns
- Employment tax returns
- Miscellaneous excise tax returns
- Alcohol, tobacco, and other excise taxes
- Information returns and other documents

The revenue procedure is effective for all forms, tax returns, amended tax returns, and claims for refund filed after January 1, 2009.

A signing tax return preparer must sign the tax return or claim for refund after it is completed and before it is presented to the taxpayer for signature. For electronically-signed tax returns, the return need not be signed prior to presenting a completed copy to the taxpayer. However, the signing tax return preparer must provide all information that will be transmitted as the electronically-signed tax return to the taxpayer along with a Form 8879, *IRS e-file Signature Authorization*, or other applicable IRS e-file signature form.<sup>55</sup>

Tax return preparers may use a rubber stamp, mechanical device, or computer software program to sign original returns, amended returns, and requests for extensions. These alternative signing methods must include either a facsimile of the preparer's signature or the preparer's printed name. Tax return preparers utilizing one of these alternative means are personally responsible for affixing their signatures to returns or requests for extension. The alternative signing methods are not to be used for other types of documents which currently require manual signatures, such as elections, applications for changes in accounting method, powers of attorney, or consent forms.<sup>56</sup>

If the signing tax return preparer is unavailable to sign the return or claim for refund, another tax return preparer may sign provided that the entire preparation of the return or claim for refund is reviewed prior to signing.

**Example 16.** Patton's Accounting employs Cameron, Samuel, and Tanisha to prepare gift tax returns for taxpayers. After Cameron and Samuel have collected the information from a taxpayer and applied the tax laws to the information, the return form is completed by a computer service. On the day the returns prepared by Cameron and Samuel are ready for their signatures, Cameron is away from the city for a week on another assignment and Samuel is working at another office in the same city. Tanisha may sign the gift tax returns prepared by Cameron, provided that Tanisha reviews the information obtained by Cameron relative to the taxpayer and reviews the preparation of each return prepared by him. Tanisha may not sign the returns prepared by Samuel because Samuel is available.<sup>57</sup>

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<sup>55</sup> Treas. Reg. §1.6695-1(b)(1)-(2).

<sup>56</sup> IRS Notice 2004-54, 2004-33 IRB.

<sup>57</sup> Adapted from Treas. Reg. §1.6695-1(b)(4).

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A signing tax return preparer must furnish an identification number identifying the preparer, his employer, or both, as may be prescribed on a return or claim for refund after it is completed and before it is presented to the taxpayer.<sup>58</sup> Failure to furnish the identification number may result in a penalty of \$50 for each failure, up to a maximum of \$25,000 per person per calendar year. The penalty may be abated if the failure is due to reasonable cause and not willful neglect.<sup>59</sup>

**Note.** Under the new preparer licensing requirements discussed earlier in this chapter, the required identification number for an individual will be the PTIN.

## ETHICAL DILEMMA SCENARIOS

Tax preparers are often faced with ethical dilemmas in their day-to-day tax practice. Responses to these issues vary from person to person depending on factors such as age, education, professional stature, and locale. The following ethical dilemmas are designed to provoke thought and discussion. When evaluating the dilemma, consider the following questions:

- What are the issues of the situation (e.g., conflict of interest, due diligence, Circular 230 or IRC provisions)?
- What are the factors to consider in the situation (e.g., who is affected by the situation, what alternatives are available to those who must resolve the dilemma, what are the consequences of each alternative)?
- What is the appropriate action in the situation?

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**SITUATION #:** \_\_\_\_\_

What are the issues?

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Who is affected, what alternatives are available, and what are their consequences?

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What is the appropriate action?

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<sup>58</sup> IRC §6109(a)(4).

<sup>59</sup> Treas. Reg. §1.6695-1(c)(1).

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**SITUATION #:** \_\_\_\_\_

What are the issues?

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Who is affected, what alternatives are available, and what are their consequences?

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What is the appropriate action?

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## SITUATION 1

Alda Hyde is a CPA. Her client, Victor Frees, presents her with a Form 1099-MISC indicating he earned \$601 from the Summertime Ice Company. Alda learns that Victor earned this income from delivering ice locally to vendors at a 3-day festival. While preparing his Schedule C, Victor informs Alda that he drove his personal vehicle 11,000 miles while delivering ice that weekend.

Alda is fairly certain Victor meant to report only 1,100 miles instead of 11,000 miles. However, when she suggests to him that perhaps he miscalculated his mileage, Victor insists that he drove 11,000 miles. What should Alda do?

## SITUATION 2

Ken Peters is the managing director for his firm's tax practice. He inadvertently receives an email communication written by Mack, one of his practitioner-employees, to his old college roommate, Jocko. Peters notices the email contains tax advice so he reads it.

Jocko is seeking advice from Mack regarding how much he can deduct as a charitable contribution if he donates his old letter jacket to the college booster club. Mack's reply indicates that the jacket should be very valuable since Jocko used to be a star football player. Mack states the jacket would probably sell for \$1,000 or more on eBay.

Should Peters take any action after intercepting this email?

## SITUATION 3

For the past two years, Jesse Johns has gone to Ana Yu, an EA, to get his tax return prepared. In 2010, Jesse brings his Form W-2 from Bahama Mama Cycle Shop and a Form 1099-INT to Ana. Although these are the same types of documents that Jesse brought in the previous two years, Ana inquires whether he had any other income for the tax year. Jesse tells her that he did not have any other income.

Ana's next client, Sylvie Madison, mentions that she ran into Jesse as he was leaving. Sylvie tells Ana that she has had all her car repairs done by Jesse for several years. "He is so much cheaper than a 'regular' body shop since he works out of his home."

Ana does not respond to Sylvie's comments but this is the first knowledge she had that Jesse had another business that he was not reporting on his tax return.

What should Ana do?

## SITUATION 4

Justin Timberline makes an appointment in 2011 to have his tax return prepared by Jack Whittaker, the managing member of Whittaker and Associates, LLC. Justin had his prior years' tax returns prepared elsewhere, so he brings his 2009 tax return to his appointment with Jack. As Jack reviews the 2009 return, he notices that Justin had been married during the year and that he had income reported on a Schedule C. Justin tells Jack his former wife, Jessica Reel, has custody of their two children but that he is entitled to the dependency exemptions. He further says that she took over the business and holds all its assets. According to Justin, these matters were agreed to in the divorce settlement. Jack asks Justin for a copy of the divorce settlement, which Justin agrees to provide.

The next day, Jack learns that Justin's ex-wife Jessica also made an appointment with one of the other professionals at Jack's firm to have her 2010 tax return prepared.

What action should Jack take?

## SITUATION 5

Zef Phyr visits CPA Latricia Kennedy in June 2010 after receiving a notice from the IRS. The notice states that Zef's return for 2006 is delinquent and includes a 2006 tax return prepared by the IRS. Zef admits to Latricia that he had received several IRS notices previously which he ignored. Zef is 28 and confesses that he has never filed a tax return. He worked for his father from age 18 to age 24, where he was paid "under the table." Zef then took a job with a company that makes beer pong tables, which issued annual Forms W-2 to him.

Zef wants Latricia to help him file tax returns for 2006 up to the present to "get the IRS off his back." However, he does not think it is necessary to file returns for years prior to 2006 since the IRS "would have no way of knowing" how much income he had for those years.

What should Latricia do?

## ETHICAL DILEMMAS DISCUSSION AND SUGGESTIONS

### SITUATION 1

Alda Hyde is a CPA. Her client, Victor Frees, presents her with a Form 1099-MISC indicating he earned \$601 from the Summertime Ice Company. Alda learns that Victor earned this income from delivering ice locally to vendors at a 3-day festival. While preparing his Schedule C, Victor informs Alda that he drove his personal vehicle 11,000 miles while delivering ice that weekend.

Alda is fairly certain Victor meant to report only 1,100 miles instead of 11,000 miles. However, when she suggests to him that perhaps he miscalculated his mileage, Victor insists that he drove 11,000 miles. What should Alda do?

**Issue.** The issue is whether Alda is using correct data to prepare Victor's tax return.

**Factors to Consider.** Although §10.34 of Circular 230 relieves practitioners from the duty to audit their clients, it does not relieve them from the responsibility for making reasonable inquiries when facts and circumstances indicate something is amiss.

In the situation presented here, Alda determines that Victor would have to have driven an average of 3,667 miles per day, or over 152 miles each hour for 72 straight hours, in order to substantiate the number of miles he claims to have driven. By illustrating these facts to Victor, Alda may be able to convince him that he made an error in reporting his mileage to her.

**Appropriate Action.** If Victor continues to insist that he drove 11,000 miles, Alda would have to forgo preparing his return, since his claim would not satisfy the realistic possibility standard of §10.34.

## SITUATION 2

Ken Peters is the managing director for his firm's tax practice. He inadvertently receives an email communication written by Mack, one of his practitioner-employees, to his old college roommate, Jocko. Peters notices the email contains tax advice so he reads it.

Jocko is seeking advice from Mack regarding how much he can deduct as a charitable contribution if he donates his old letter jacket to the college booster club. Mack's reply indicates that the jacket should be very valuable since Jocko used to be a star football player. Mack states the jacket would probably sell for \$1,000 or more on eBay.

Should Peters take any action after intercepting this email?

**Issue.** What is Ken Peters' responsibility with regard to practitioners under his authority?

**Factors to Consider.** As principal overseer of his firm's tax practice, Peters has a responsibility for ensuring that the practitioners under his authority comply with §10.35 of Circular 230. Since Peters was aware that Mack dispensed written advice regarding a federal tax matter, he should take reasonable steps to ensure that Mack is aware of the §10.35 disclosure requirements. Failure to take action to ensure his firm's employees comply with §10.35 could subject Peters to disciplinary action.

Peters should also discuss the implications of Mack's suggestion of a specific dollar amount for the value of the jacket, since Jocko may have relied on the professional opinion of his friend and deducted \$1,000 as his contribution to the booster club.

**Appropriate Action.** Mack should suggest that Jocko seek the opinion of a qualified appraiser and advise Jocko of his need to obtain a written receipt for his donation to the booster club.

## SITUATION 3

For the past two years, Jesse Johns has gone to Ana Yu, an EA, to get his tax return prepared. In 2010, Jesse brings his Form W-2 from Bahama Mama Cycle Shop and a Form 1099-INT to Ana. Although these are the same types of documents that Jesse brought in the previous two years, Ana inquires whether he had any other income for the tax year. Jesse tells her that he did not have any other income.

Ana's next client, Sylvie Madison, mentions that she ran into Jesse as he was leaving. Sylvie tells Ana that she has had all her car repairs done by Jesse for several years. "He is so much cheaper than a 'regular' body shop since he works out of his home."

Ana does not respond to Sylvie's comments but this is the first knowledge she had that Jesse had another business that he was not reporting on his tax return.

What should Ana do?

**Issue.** What is the appropriate course of action for Ana to take with respect to the information she inadvertently obtained from Sylvie?

**Factors to Consider.** Although Ana cannot be certain that Sylvie is giving her correct information about Jesse's side business, she has an obligation to discuss the matter with Jesse. Under §10.21 of Circular 230, Ana must advise Jesse of the consequences of errors or omissions on his tax return.

**Appropriate Action.** If Jesse refuses to report the additional income on his 2009 tax return and amend his prior years' returns, Ana should refuse to prepare Jesse's 2009 return. Circular 230 requires that a preparer **notify** the client. It is the client's responsibility to file any corrected tax returns.



## SITUATION 4

Justin Timberline makes an appointment in 2011 to have his tax return prepared by Jack Whittaker, the managing member of Whittaker and Associates, LLC. Justin had his prior years' tax returns prepared elsewhere, so he brings his 2009 tax return to his appointment with Jack. As Jack reviews the 2009 return, he notices that Justin had been married during the year and that he had income reported on a Schedule C. Justin tells Jack his former wife, Jessica Reel, has custody of their two children but that he is entitled to the dependency exemptions. He further says that she took over the business and holds all its assets. According to Justin, these matters were agreed to in the divorce settlement. Jack asks Justin for a copy of the divorce settlement, which Justin agrees to provide.

The next day, Jack learns that Justin's ex-wife Jessica also made an appointment with one of the other professionals at Jack's firm to have her 2010 tax return prepared.

What action should Jack take?

**Issue.** Does a conflict of interest exist if Jack's firm prepares both Justin's and Jessica's tax returns?

**Factors to Consider.** A potential conflict of interest can arise when preparing returns for both Justin and Jessica since numerous issues can create opposing interests for divorced couples, such as the allocation of estimated tax payments, NOL and passive loss carryforwards, the classification of alimony payments, and possible innocent spouse claims.

Since the couple had children together, many more issues can arise. Determining who will receive the dependency deductions along with the child tax credit, education credits, and child care credit can create conflict.

**Appropriate Action.** Jack's firm may prepare returns for both Justin and Jessica if he informs both of them about the potentially conflicting situation and obtains the signature of both parties granting consent for Jack and his associate to prepare both returns. However, Jack may wish to represent only one party to lessen his firm's potential for conflict.

## SITUATION 5

Zef Phyr visits CPA Latricia Kennedy in June 2010 after receiving a notice from the IRS. The notice states that Zef's return for 2006 is delinquent and includes a 2006 tax return prepared by the IRS. Zef admits to Latricia that he had received several IRS notices previously which he ignored. Zef is 28 and confesses that he has never filed a tax return. He worked for his father from age 18 to age 24, where he was paid "under the table." Zef then took a job with a company that makes beer pong tables, which issued annual Forms W-2 to him.

Zef wants Latricia to help him file tax returns for 2006 up to the present to "get the IRS off his back." However, he does not think it is necessary to file returns for years prior to 2006 since the IRS "would have no way of knowing" how much income he had for those years.

What should Latricia do?

**Issue.** Since Latricia has knowledge that Zef has not filed returns for years prior to 2006, what are her obligations with respect to that information?

**Factors to Consider.** The statute of limitations for the IRS to assess and collect any outstanding balances does not start until a return has been filed. The longer that Zef delays filing his delinquent returns, the larger the late-filing penalties and interest charges will grow. Latricia must make certain that Zef is aware of these facts.

Under §10.21 of Circular 230, a practitioner who is aware of her client's noncompliance and/or omission of anything submitted to the IRS must advise the client promptly of the consequences of the noncompliance, error, or omission.

**Appropriate Action.** Latricia can prepare Zef's returns for 2006 and forward. She has no obligation with respect to the earlier years beyond notifying Zef of the potential ramifications of not filing those returns.

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