Chapter 2: Ethics

Corrections were made to this workbook through January of 2013. No subsequent modifications were made.

The Secretary of the Treasury is responsible for appointing the director of the Office of Professional Responsibility (OPR).[1] The OPR director regulates tax professionals who fall under the guidelines of Circular 230, *Regulations Governing Practice before the Internal Revenue Service*. Because violations of Circular 230 are subject to severe penalties, every tax professional must be familiar with its contents. A copy can be downloaded at **www.irs.gov/pub/irs-utl/pcir230.pdf.** A portion of Circular 230, containing sections 10.20 through 10.38, is included at the end of this chapter.

The actions of tax professionals are governed by the rules of Circular 230. Sometimes, it is difficult to determine how various situations might be evaluated in terms of these provisions. This chapter describes various scenarios and discusses them in terms of Circular 230 rules.

Readers of this chapter will notice that there is no specific order to how the scenarios are presented. Some of the scenarios address issues that pertain to multiple sections of Circular 230.

The readers should put themselves in the place of the tax practitioner presented in each scenario. They should ask three basic questions.

1. What is the main issue?
2. What is the potential Circular 230 violation?
3. In dealing with the client, what can be done to minimize or prevent a Circular 230 violation?

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[1] Circular 230, §10.1.

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While Circular 230 provides guidelines for the tax practitioner, there remain many gray areas. Unfortunately, many of the ethical dilemmas a practitioner faces are not definitively addressed in Circular 230. In addition, the tax practitioner may be subject to additional ethics rules, such as those for CPAs or lawyers. These may have different or even conflicting requirements from Circular 230 rules. The discussion of each of the following scenarios pertains to possible Circular 230 violations. Whether there is an actual violation depends on the facts and circumstances.

To assist the reader, §10.2 of Circular 230 defines the terminology used throughout the publication.

SCENARIO 1

Scenario 1A. A client comes into a tax preparer's office. While the two are chatting, Monica, the client, tells Erin, the preparer, that she went to a ball game the previous night and Ted was officiating. Monica said that Ted did a horrible job and should be fired. Ted is also Erin's client and she recalls that she has never seen any officiating fees reported on Ted's return.

Discussion. What should she do?

Section 10.22 of Circular 230 states, "A preparer must exercise due diligence in preparing or assisting in the preparation of, approving, and filing tax returns, documents, affidavits, and other papers relating to Internal Revenue Service matters." To some, this implies the preparer has only a few choices in this situation.

1. Confront Ted about not reporting the income.
2. Refuse to prepare the return.
3. Arbitrarily include an officiating amount.
4. Forget hearing about Ted officiating a game.
5. Tell Ted that she heard he was horrible at officiating.

Before making a decision, there are a number of considerations. The first is determining what constitutes "due diligence." This term is never defined in Circular 230. Due diligence could be interpreted as asking certain key questions, such as "Is this all of your income?"

The only safe harbor provided for due diligence in Circular 230 is in §10.22(b), which reads as follows.

> *. . . a practitioner will be presumed to have exercised due diligence for purposes of this section if the practitioner relies on the work product of another person and the practitioner used reasonable care in engaging, supervising, training, and evaluating the person, taking proper account of the nature of the relationship between the practitioner and the person.*

Section 10.22, *Diligence as to Accuracy,* allows the preparer to take information provided by others (such as on a Schedule K-1) at face value without auditing the return that created the Schedule K-1.

In general, due diligence is defined as a measure of prudence, responsibility, and diligence that is expected from, and ordinarily exercised by, a reasonable and prudent person under the circumstances.[2] However, this still does not indicate what the preparer should do when they suspect unreported income.

In **Scenario 1A,** the evidence of officiating is only hearsay. Maybe Ted was not the official. Maybe he officiates on a volunteer basis. The preparer probably has not violated any part of Circular 230 by not mentioning the conversation to Ted.

> **Scenario 1B.** The tax preparer is a CPA whose children are involved in athletics. She sees Ted officiating at a basketball game. Ted comes in to have his return prepared. He does not report any officiating income.

In this situation, the preparer **knows** Ted officiates ball games. She should ask Ted if he has any other income. If Ted says there is no additional income, should the preparer tell him she saw him officiating a game and she believes that officials are normally paid for their services? Suppose the client says he was not paid? If a second official for the same game comes to the preparer and reports payment for the game, what should the preparer do then?

Section 10.34(d), *Standards with respect to tax returns and documents, affidavits, and other papers,* may provide an answer to **Scenario 1B.** "A preparer… generally may rely in good faith without verification upon information furnished by the client." On the surface, this provision indicates that the preparer can take her client's information at face value. Although this may be where the preparer wants to stop reading, they should read the entire section.

> **Scenario 1C.** As the preparer sorts through the information Ted gave her, she finds a check stub for $250 that indicates it was for officiating a ballgame.
>
> **Discussion.** Does this change what the preparer should do?

Section 10.34(d) further states the following.

> *The practitioner may not, however, ignore the implications of information furnished to, or actually known by, the practitioner, and must make reasonable inquiries if the information as furnished appears to be incorrect, inconsistent with an important fact or another factual assumption, or incomplete.*

Neither §§10.22 nor 10.34(d) implies the preparer should call the athletic commission and ask if payment was made. However, to protect against a Circular 230 violation, the preparer should place a note in Ted's file that documents the questions she asked him and his responses. Depending on all of the facts and circumstances, this might be a situation in which the preparer should terminate the engagement. For instance, suppose Ted responded, "Yes, I was paid, but I did not receive any Form 1099 or other record of the payment and I am not going to report the income." Is the preparer in violation of Circular 230? Section 10.21 says the preparer must notify the taxpayer of the omission and the possible consequences of the omission. The preparer may want to terminate the engagement if the taxpayer does not report the income.

2. [www.businessdictionary.com/definition/due-diligence.html]. Accessed on Jul. 11, 2012.

SCENARIO 2

Scenario 2A. Ed Selles calls his tax preparer Frank at home late one evening. He says he is thinking about selling a rental property but does not want to pay any income tax. Frank briefly suggests that Ed consider a like-kind exchange.

Discussion. How much advice should Frank give Ed?

If Frank is a registered tax return preparer (RTRP), he **may** already be in violation of Circular 230. Section 10.3, *Who may practice,* states the following.

Practice as a registered tax return preparer is limited to preparing and signing tax returns and claims for refund, and other documents for submission to the Internal Revenue Service.[3] *. . . A registered tax return preparer's authorization to practice under this part also does not include the authority to provide tax advice to a client or another person except as necessary to prepare a tax return, claim for refund, or other document intended to be submitted to the Internal Revenue Service.*[4]

Because Frank only offered preliminary advice, it is not being used in the preparation of a tax return. While there is some doubt as to whether the preparer is in violation, §10.3 is a matter of concern for some practitioners. The ambiguity of this section was addressed by an IRS FAQ:[5]

How much tax advice can registered tax return preparers give to clients? (posted 2/27/12)

Section 10.3(f)(3) of Circular 230 provides that a registered tax return preparer's authorization to practice "does not include the authority to provide tax advice to a client or another person except as necessary to prepare a tax return, claim for refund, or other document intended to be submitted to the Internal Revenue Service." The IRS received comments after the final regulations were published suggesting that this language is ambiguous. To clarify, the IRS interprets this provision to permit registered tax return preparers to provide advice to a client that is reasonably necessary to prepare a tax return, claim for refund, or other document intended to be submitted to the Internal Revenue Service for a current or future tax period, regardless of whether the client has engaged the registered tax return preparer to prepare the tax return, claim for refund or other document for the tax period.

Note. Section 10.3(f)(4) subjects RTRPs to the same provisions as attorneys, CPAs, and enrolled agents.

Scenario 2B. Frank thinks about Ed's call the remainder of the evening. He decides to send Ed some additional information regarding IRC §1031 the next morning. Frank's email to Ed gives a condensed version of the requirement for a §1031 exchange. However, it does not define what qualifies as like-kind property.

When Frank decides to send an email to Ed, he should consider the implication of §10.35, *Requirements for covered opinions.* The purpose of §10.35 is to regulate the opinions given by accountants and attorneys to their clients. These opinions are generally provided to wealthy clients who are concerned about whether a transaction is considered illegal or abusive by the IRS. Section 10.35 provides the standards for "covered opinions." A covered opinion includes written advice that concerns one or more federal tax issues that arise from one of the following.

1. A listed transaction (The IRS identifies tax avoidance transactions and publishes them on a regular basis.)
2. Any plan or arrangement that has the principal purpose of avoiding or evading tax

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3. Circular 230, §10.3(f)(2).
4. Circular 230, §10.3(f)(3).
5. [www.irs.gov/taxpros/article/0,,id=239685,00.html] Accessed on Aug. 9, 2012.

3. Any arrangement or plan with a significant purpose of tax avoidance or evasion if the written advice is one of the following.
   a. A reliance opinion
   b. A marketed opinion
   c. Subject to confidentiality
   d. Subject to contractual protection

Most tax preparers are never involved with a covered opinion. However, §10.35 **covers all written advice** given to clients. A "reliance opinion" is written advice that concludes that it is more likely than not that one or more significant federal tax issues will be resolved in the taxpayer's favor.

Circular 230 states that written advice is not treated as a reliance opinion if the author discloses in the advice that it is not written for the purpose of avoiding penalties.

The IRS released Treasury Decision (TD) 9201 on May 18, 2005, which further modified the rules on covered opinions. The Treasury Decision defined the following three exceptions to a covered opinion.

1. Written advice after a tax return is filed
2. Advice provided by the taxpayer's in-house counsel
3. Negative advice, which includes advising the client that the IRS is not likely to resolve an issue in the taxpayer's favor

In order to protect themselves from a Circular 230 violation, most tax professionals now include a disclaimer on all their written tax advice.

A sample disclaimer might incorporate language such as the following.

- The advice only pertains to what is discussed and does not address additional issues.
- The advice was not written for the purpose of the recipient's avoiding penalties under IRC §6662(d).

TD 9201 requires the disclaimer to be **prominently** disclosed. An item is prominently disclosed if it is readily apparent to a reader of the written advice. Whether an item is readily apparent depends on the facts and circumstances surrounding the written advice including, but not limited to, the sophistication of the taxpayer and the length of the written advice. At a minimum, to be prominently disclosed, an item must be set forth in a separate section (and not in a footnote) in a typeface that is the same size or larger than the typeface of any discussion of the facts or law in the written advice.

Scenario 2C. On April 13, Ed brings his records into Frank's office. Ed tells Frank that he took his advice and engaged in a like-kind exchange. Ed sold the rental property and then purchased an airplane. Frank promptly tells Ed this does not qualify under IRC §1031 and he will owe taxes on the $1 million gain on the sale. Ed is furious and tells Frank the error is his fault because Ed relied on Frank's advice. Ed further tells Frank that he had better find a way to make the transaction qualify or he would hear from Ed's lawyer. Furthermore, Ed will be in on the 15th to pick up the completed return. Ed then storms out of the office. Shortly thereafter, Frank cancels the remaining appointments for the day and heads to his favorite bar to ask the bartender for advice. The bartender was a tax attorney before he was disbarred.

When analyzing the problem, the bartender asks what the chances are that the IRS will ever raise the issue if an exchange is reported and the newly acquired airplane is called a portable rental house. Frank knows that in 2010 less than 1.1% of individual tax returns were audited.

Before Frank completes Ed's return, he should consider the consequences of a Circular 230 violation. One consideration is §10.22, *Diligence as to accuracy.* Section 10.22 requires the preparer to exercise due diligence in preparing or assisting in the preparation of tax returns.

Although due diligence is not defined in Circular 230, there is a safe harbor that permits a preparer to rely on information provided by others.[6] This does not help in this scenario because Frank, as the preparer, was the person that provided the information. In fact, it is not the information that is the problem but the lack of information.

IRS agents are trained that a violation of due diligence involves more than making a simple error but is less serious than reckless or willful misconduct. In tax preparation, due diligence requires the preparer to use reasonable methods to comply with the tax laws.

The bartender is a former tax attorney. Frank might try to argue that he was relying on the bartender's information that the return would not be audited. However, this is not a legitimate defense for a Circular 230 violation.

In connection with Frank's discussion with the bartender, as long as Frank does not mention the client's name, he is probably not in violation of confidentiality rules. He is only asking advice in a hypothetical situation.

Section 10.24 prohibits a preparer from receiving assistance from a disbarred or suspended person or a former IRS employee. Frank is arguably not violating this section because the bartender was not giving advice on a specific tax return. He was just stating his opinion based on a hypothetical situation.

Section 10.51, *Incompetence and disreputable conduct*, is another concern. A preparer cannot willfully assist, counsel, or encourage a client to violate federal tax law.

In this scenario, Frank must either insist that he prepare the return correctly or he must terminate the engagement. Although this may result in the client filing a suit for incompetence, a violation of Circular 230 also has severe consequences.

> **Note.** This is a situation that should be easy for the preparer to resolve. There should be documentation for both the purchase and the sale and there should be descriptions of the properties. A legitimate like-kind exchange will include appropriate documents. As a tax professional, compliance with due diligence standards requires the conscientious preparer to request these documents.

Section 10.37, *Requirements for other written advice,* also applies. It states:

> *A practitioner must not give written advice (including electronic communications) concerning one or more Federal tax issues 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, does not consider all relevant facts that the practitioner knows or should know, or, in evaluating a Federal tax issue, takes into account the possibility that a return will not be audited, that an issue will not be raised in audit, or that an issue will be resolved through settlement if raised.*

Frank should not make his return preparation decision based on the possibility that the client may never get audited.

6. Circular 230, §10.22(b).

SCENARIO 3

Scenario 3A. Chuck and Pot Roste have been Bryan's clients for many years. They run a small farm where they produce organic beef, which is sold through their farm market. They have been raising the cattle for six years and have never shown a profit. In 2011, they lost $30,000, the largest loss incurred to date. Bryan is concerned that an IRS revenue agent would classify this as a hobby operation if the return were audited.

Discussion. What should Bryan do?

In keeping with the requirements of §10.22, *Diligence as to accuracy,* Bryan's first task is to determine if the farm operation is actually a hobby. When questioning the Rostes, he learns that they purchased a load of grain that was not organically produced. They had six animals die and, in addition, they lost their organic certification. All of these events combined might be considered an extenuating circumstance that would help defend the position that the farm is not a hobby.

On the other hand, this is the sixth consecutive year of losses. The prior losses were $3,000, $10,000, $12,000, $18,000, and $25,000. Bryan is aware that because the Rostes did not make a profit in three out of five years, they have to prove that they have an "activity engaged in for profit." However, there are numerous court cases in which the taxpayer did not meet the three-out-of-five-years test and the courts ruled the operations were not hobbies.[7]

When making a determination as to whether an activity is engaged in for profit, the courts use nine factors. While no one factor is determinative, the preponderance of evidence must weigh in favor of the taxpayer. The factors are as follows.[8]

1. The manner in which the taxpayer carries on the activity
2. The expertise or experience of the taxpayer's advisors
3. The time and effort the taxpayer expends on the activity
4. The expectations that the assets used in the activity may appreciate in value
5. The success of the taxpayer in carrying on other similar or dissimilar activities
6. The taxpayer's history of losses from the activity
7. The amount of occasional profits earned from the activity
8. The taxpayer's financial status
9. The elements of personal pleasure or recreation derived from the activity

Bryan knows certain facts that may answer some of these questions.

- The Rostes have combined W-2 wages of $250,000.
- Mr. Roste is a self-employed architect.
- Mrs. Roste is a dietician.
- Mr. and Mrs. Roste began the cattle operation when they moved to the country six years ago.
- Neither of the Rostes have a farm background.
- The Rostes brought only a sheet of notepaper to the tax interview listing total income and deductions.

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7. *J.L. Dennis v. Comm'r*, TC Memo 2010-216 (Oct. 5, 2010); *N.J. Calarco v. Comm'r*, TC Summ. Op. 2004-94 (Jul. 20, 2004); *Dennis A. Pryor v. Comm'r,* TC Memo 1991-109 (Mar. 14, 1991).

8. Treas. Reg. §1.183-2(b).

Bryan is very concerned about whether the business is a for-profit operation. He asks the Rostes if they have a business plan. He is told they do not, but they will prepare one next year.

If Bryan allows the Rostes to claim the $30,000 loss, could he be in violation of any provision of Circular 230? The IRS might determine that Bryan is in violation of §10.34, *Standards with respect to tax returns and documents, affadavits, and other papers*. This section prohibits a practitioner from signing a return containing a position that lacks a reasonable basis. If the IRS determines that there is no exception to the three-out-of-five-years rule, Bryan could be in violation.

Bryan could argue that he performed his due diligence by reviewing the taxpayers' facts and circumstances relative to the nine factors. He could also cite cases such as the following.

- *Ryberg v. Comm'r* (TC Summ. Op. 2012-24, Mar. 12, 2012) is a case in which the court agreed that the taxpayers ran their horse breeding venture in a business-like manner and the loss was due to unforeseen circumstances.
- *Weller v. Comm'r* (TC Memo 2011-224, Sep. 20, 2011) is a case in which a glider pilot and instructor won his case by proving the glider business was full-time on the weekends and he ran the operation in a business-like manner. He secured clients through his website.
- *Stromatt v. Comm'r* (TC Summ. Op. 2011-42, Apr. 6, 2011) is a case in which the taxpayers had a farming operation. The court ruled that, although the operation suffered losses, it was an activity engaged in for profit. This was the ruling even though the taxpayers had no prior farming experience, occasional profits were small, and the couple had substantial income from other sources.

Scenario 3B. When the Rostes bring their tax information to Bryan in 2012, there are no records of any cattle business. When Bryan questions the Rostes, he is told they got out of the cattle business because there was no profit in it. Bryan asks what they did with the cattle on hand. The Rostes said they sold the cattle at the beginning of the year. When Bryan asks about cattle expenses, the Rostes tell him there were none. When Bryan tells the Rostes they have to report the cattle sales, they tell him that there were no profits and they were only recouping some of their prior losses.

Discussion. What should Bryan report on the return?

This is similar to **Scenario 1C.** Although Bryan is not required to audit the taxpayers' records, he cannot ignore the implications of information actually known by him.

Defending Bryan against a §10.22 violation (diligence as to accuracy) would be extremely difficult. The clients told him that there was a sale and that money was received. Not wanting to pay income tax on the sale is not a §10.22 defense. The preparer has to consider that if the clients are audited and the revenue agent finds the sale, the clients might say, "We told our preparer about the sale but he did not report it on the return."

If the Rostes refuse to report the income, Bryan should terminate the engagement.

Scenario 3C. In **Scenario 3B,** Bryan declined the engagement. Chuck returns the following year and presents Bryan with a tax return prepared by a different firm. When reviewing the return, Bryan notices that the cattle sales were not reported.

Discussion. What should he do?

This scenario presents a different problem for the preparer. Section 10.21, *Knowledge of client's omission,* requires the preparer to inform the client of the omission and the possible consequences of not complying with the Code and regulations because of the omission.

Not only could the omission result in penalties and interest, if the omission constitutes more than 25% of the gross income stated in the return, the statute of limitations can be extended from three years to six years.[9]

9. IRC §6501(e).

It is not necessary for Bryan to decline the engagement or to require the client to file an amended return. However, Bryan might consider whether this is the type of client he wishes to serve.

Scenario 3D. This scenario changes some of the facts of **Scenario 3B.** Chuck Roste visits Bryan in 2012 and tells him that he and Pot are divorced and Chuck will file as single. His records do not include the cattle operation. When questioned, Chuck says Pot got the cattle as part of the divorce settlement.

Discussion. Does this change anything Bryan should do?

There is nothing in Circular 230 that requires Bryan to call Pot for confirmation on receiving the cattle in the divorce settlement. In fact, Bryan might be in violation of IRC §7216(a) if he does so. Bryan cannot disclose any information furnished to him for, or in connection with, the preparation of a return. Even telling Pot that he is preparing Chuck's return could be a violation of confidentiality. If he violates confidentiality, Bryan could be subject to a $1,000 fine.[10] However, there are exceptions to the rule if the release of information is in connection with one of the following events.

- There is a court order to release the information.[11]
- The information is released in relation to the preparation of a return for a person to whom the information relates.[12]
- The information is released to other tax preparers within the same firm, which is located in the United States.[13]
- The information is released to another tax preparer located in the United States if that preparer is assisting in the preparation of the return.[14]
- The information is released to a related person, the taxpayer's interest in the information is not adverse to the related person's interest in the information, and the taxpayer has not expressly prohibited the disclosure.[15]
- The information is released to a fiduciary of the taxpayer upon the death of the taxpayer.[16]
- The release of information is due to the tax preparer's death or incapacity.[17]
- The information is released to the IRS.[18]

Note. This is not an all-inclusive list.

10. IRC §7216(a)(2).
11. Treas. Reg. §301.7216-2(c).
12. IRC §7216(b)(2).
13. Treas. Reg. §301.7216-2(e)(1).
14. Treas. Reg. §301.7216-2(h).
15. Treas. Reg. §301.7216-2(b)(1).
16. Treas. Reg. §301.7216-2(j).
17. Treas. Reg. §301-7216-2(p).
18. Treas. Reg. §301.7216-2(a).

Scenario 3E. Two years later, Chuck and Pot enter Bryan's office with a letter from the IRS informing them that their joint return is being audited. They ask Bryan to handle the audit.

Discussion. If he accepts the engagement, does this subject Bryan to any potential violations of Circular 230?

In this scenario, §10.29, *Conflicting interests,* applies in two different ways. Chuck and Pot could have conflicting interests between the two of them. They could also be in conflict with Bryan's interests as the tax preparer.

The first conflict arises because Chuck and Pot are now divorced. If the audit results in an additional tax liability, the Rostes are jointly and severally liable. If one of the taxpayers makes an innocent spouse claim, Bryan can be involved in a situation in which his actions may benefit only one of the taxpayers. In this situation, he would not be adequately representing the other taxpayer.

In the Rostes' business, Pot kept the records of the cattle operation and she took 10% of all sales and deposited the income into her bank account without Chuck's knowledge. If the IRS auditor discovers this and Pot is unable to pay the IRS, Chuck will be liable for the additional tax, penalty, and interest. For a divorced individual to qualify under the innocent spouse provisions of IRC §6015(c), they must be divorced or legally separated from the individual they filed the joint return with or not have been a member of the same household at any time during the 12-month period ending on the date of the innocent spouse election.

The second possible conflict of interest is between the preparer and the Rostes. If the revenue agent challenges the farm loss as a hobby loss and wins the challenge, a preparer penalty may be assessed under IRC §6662 (accuracy-related penalty). This penalty is the lesser of $1,000 or 50% of the income derived from preparing the return. It can be assessed if the possibility that the farm operation could be considered a hobby was not disclosed or there is no substantial authority for the position taken on the tax return.

Therefore, Bryan has two possible situations in which he could face conflicting interests. In the first, he could be in violation of §10.29, *Conflicting interests*. In the second, he could be in violation of IRC §6662.

Circular 230 defines a conflict of interest as the representation of one client when it is directly adverse to another client. There is also a possible conflict if the representation of a client is materially limited by the preparer's responsibilities to another client, a former client, a third person, or by the personal interests of the preparer.

Even if there is a conflict of interest, the preparer can represent the client(s) if all the following conditions are satisfied.

- The preparer believes competent and diligent representation to each affected client is possible.
- The representation is not prohibited by law.
- Each affected client waives the conflict of interest and gives informed consent that is confirmed in writing by each affected client at the time the existence of the conflict of interest is known by the preparer.

Copies of the written consent must be retained by the preparer for at least 36 months from the date of the conclusion of the representation. Copies of the written consent(s) must be furnished to the IRS upon request.

Based on all the facts set forth in **Scenario 3E,** Bryan should seriously consider declining the audit engagement.

SCENARIO 4

Grace Period prepares the 2010 return for Joe. Joe is an investor in an LLC which passed through a substantial loss for the year. Even though this is a passive activity, Joe was able to utilize the loss due to his other passive income.

The following year Sam asks Grace to represent him in an audit of his 2010 return. Sam is also an investor in the same LLC. However, in 2010, Sam took the position that this was not a passive investment in order to deduct the loss. The IRS contends that it is passive and Sam wants Grace to argue his position for him. The level of participation for both Joe and Sam is the same.

Discussion. Is there a conflict of interest if Grace represents Sam in an audit?

This is another §10.29, *Conflicting interests,* situation. By successfully representing Sam, Grace is admitting she made a wrong decision in preparing Joe's return. Therefore, Grace should decline the engagement.

Practitioners can frequently find themselves in conflict-of-interest situations. This can occur in situations such as the following.

- Representing two current clients with differing interests or a client with an interest different from that of a prior client
- Serving as a witness for a client (This may prejudice the opposing party by creating confusion about the practitioner's role in the case. Is the preparer serving as a representative or as a witness?)
- Entering into a business deal with a client, which may raise the issue of whether the preparer is trying to get the best deal for themselves or their client
- Entering into a business deal that competes with a client (For example, the practitioner has a client in the construction industry who asks for advice on how much to bid for a government contract. However, the practitioner is also an investor in a company competing for the same contract. If the client loses the bid, the client could argue that the preparer suggested an uncompetitive bid to ensure the client would not receive the contract.)

SCENARIO 5

Gail Force is a tax preparer in a small town. Some of her clients tell her that another preparer gets large refunds for their friends. Gail asks them whether the friends will allow her to review their returns. Upon review, Gail finds the other practitioner is preparing fraudulent returns. These individuals ask Gail to prepare amended returns. Gail would like to notify the IRS about the fraudulent preparer.

Discussion. What should Gail do?

Gail is in a difficult position. If she tells the IRS about the fraudulent returns, she is divulging information she found on returns. This could possibly be a violation of IRC §7216. Although it is doubtful that the IRS would take this position, it is possible.

IRC §7623(a) describes a "whistleblower" provision that allows the government to make payments to people who report individuals or businesses that have underpayments of tax, or who violate Internal Revenue laws or are conniving to do so. Reward payments are based on the amount collected as a result of the information presented. The award can range from 15% to 30% of the amount collected. The amount of the reward depends on the extent to which the "whistleblower" contributed to the collection action. Gail could recommend that the clients notify the IRS about the fraudulent returns, but then she would not be entitled to any reward money. Circular 230 does not have a prohibition similar to §7216.

Information regarding violations can be submitted in person to a criminal investigation office. If the information is submitted in person, the informant should record the date the information was presented and the name of the person to whom the information was given.[19] The information can also be submitted on Form 3949-A, *Information Referral,* and sent to:

Internal Revenue Service
Fresno, CA 93888

No unauthorized person will be advised of the identity of the informant.[20]

If the information results in a successful prosecution, the informant must file a formal claim to receive the reward. The claim is filed on Form 211, *Application for a Reward for Original Information,* and must be signed by the informant.

In its 2010 report to Congress, the IRS Whistleblower Office reported a substantial increase in activity. The following table was included in the report.[21]

Amounts Collected and Awards Paid under §7623(a) FY 2005–2010

	2006	2007	2008	2009	2010
Cases received	4,295	2,751	3,704	5,678 [a]	7,577
Awards paid	220	227	198	110	97
Collections over $2 million	NA	12	8	5	9
Total amount of awards paid [b]	$ 24,184,458	$ 13,600,205	$ 22,370,756	$ 5,851,608	$ 18,746,327
Amounts collected	258,590,435	181,784,287	155,985,834	206,032,872	464,695,459

[a] The implementation of a new case management information system included changes in the way the IRS recorded submissions under §7623(a). The IRS cannot determine the extent to which this change was a factor in the higher number of cases received after the new system was implemented in FY 2009.
[b] The amount of awards paid includes both fully-paid awards and partially-paid awards. In FY 2010, 17 informants received partial payments totaling $13 million.

SCENARIO 6

Scenario 6A. Jacob Slader owes the IRS thousands of dollars of back taxes. He goes into a CPA office and asks how he can delay collection action. The CPA, Lou, suggests filing an offer in compromise (OIC) or filing for bankruptcy.

Discussion. Is this a violation of Circular 230?

Section 10.34(b)(2)(i) of Circular 230 prohibits a preparer from advising a client to submit a document for the purpose of impeding or delaying the administration of federal tax laws. Based on the facts given, Lou is in violation of §10.34(b)(2)(i) if he suggested an OIC or bankruptcy as options to use to delay collection. However, if Lou suggested these options as an initial discussion with Jacob with a view to resolving Jacob's tax problems, Lou would not be in violation of Circular 230. Both of the methods he advises are appropriate in certain situations.

19. Treas. Reg. §301.7623-1(d).

20. Treas. Reg. §301.7623-1(e).

21. [www.irs.gov/pub/whistleblower/annual_report_to_congress_fy_2010.pdf] Accessed on Mar. 16, 2012.

The IRS cannot levy the taxpayer's property while the OIC is pending or for 30 days after a rejection. Because an OIC can take from six months to two years to be accepted or denied, the client avoids collection pressure from the IRS. To apply for an OIC, the taxpayer must submit Form 656, *Offer in Compromise;* Form 433-A, *Collection Information Statement for Wage Earners and Self-Employed Individuals;* or Form 433-B, *Collection Information Statement for Businesses*. These forms list the income and expenses of the taxpayers. However, there are certain limitations for expenses that cannot be exceeded.

After the IRS evaluates the information shown on the forms, it determines whether it is in the government's best interest to accept a payment of less than the full amount owed or to require the taxpayer to make installment payments.

> **Note.** Detailed information on offers in compromise can be found in Chapter 3 of the 2011 *University of Illinois Federal Tax Workbook.*

Scenario 6B. Use the same facts as **Scenario 6A,** except Jacob tells Lou that he has substantial annual income and liquid assets. He can easily pay the tax debts, however, he does not want to.

Because Lou now knows about the substantial income and liquid assets, he should be aware that an OIC would very likely be rejected. If Lou recommends an OIC, he may arguably be advising Jacob to use the OIC for the sole purpose of delaying the collection of the tax.

The IRS can assess a penalty for providing a statement with false information. This applies to all forms, including Forms 656, 433-A, and 433-B. The penalty can be up to $100,000, with imprisonment of up to five years.[22] The penalty can be assessed to either the taxpayer or the tax preparer, depending on who knowingly completed the erroneous form.

Scenario 6C. Use the same facts as **Scenario 6B,** except Lou suggests to Jacob that he transfer the property to his daughter.

If Jacob makes the transfer and files for an OIC, he commits perjury when he signs the perjury statement signature box on page 4 of Form 433-A. In addition, question 16 on Form 433-A asks if any property was transferred at less than full value in the past 10 years.

Under federal law, perjury is a felony and can result in a fine and a prison sentence of up to five years.[23] Jacob could strike the jurat (the "under penalties of perjury") statement that precedes the signature line. However, if the jurat is altered in any way, it casts doubt on the accuracy of the return, which can cause the entire return to be invalid.[24]

Jacob realizes that if he discloses that he transferred property to his daughter, the OIC will be denied.

Scenario 6D. Use the same facts as **Scenario 6C,** except Lou prepares and notarizes the transfer documents.

Lou is in major trouble. He cannot argue that he did not know about the real estate when he prepared the Forms 433-A and 656 for Jacob. He is in violation of §10.21 because he has knowledge of Lou's omission. He may also be in violation of §10.34 because he signed a document that he knew was incorrect.

22. IRC §7201.
23. 18 USC §1621; 28 USC §1746.
24. *L.G. Sloan v Comm'r*, 53 F.3d 799 (7th Cir., 1995).

SCENARIO 7

Scenario 7A. Gerry Attrick has been Penny Pincher's client for many years. In 2010, he purchased an excavator to use in his construction business. Because he had a large profit, the excavator was written off using 100% bonus depreciation. In January 2011, Gerry asks Penny how much tax he would owe if he sold the excavator for $50,000. Penny reminds him that there is no remaining basis in the equipment and the entire sale price would be ordinary income.

When completing Arthur Ritus's 2011 return, Arthur tells Penny he purchased an excavator in January for $45,000. He told Penny that he paid cash because the seller wanted $60,000 if the purchase was paid by check. Penny asks who sold the excavator to Arthur, and he tells her it was Gerry. Penny asks Arthur if he has documentation for the purchase price. He tells Penny that Gerry signed a paper indicating the excavator was paid for in full.

Discussion. Should Penny have any concerns about deducting the excavator on Arthur's return?

There is no issue with the deduction, assuming all the depreciation rules are followed. The client stated that he has documentation of the payment from the seller.

Scenario 7B. Use the same facts as **Scenario 7A.** Arthur asks Penny to deduct the excavator using 100% bonus depreciation.

Discussion. Can she take the deduction?

This becomes a little more complicated. Because Gerry Attrick claimed bonus depreciation on the excavator in 2010, it does not meet the definition of "new," which is required for bonus depreciation. If she took the deduction and is challenged by the IRS, Penny might argue that she is not in violation of §10.22, *Diligence as to accuracy,* because she thought there could be another Gerry with an excavator and that she had done her due diligence. If she tries to protect herself from §10.21, *Knowledge of client's omission,* and warns Arthur of the possible penalty, she admits she knew about the deduction she took on Gerry's 2010 return.

Scenario 7C. Later in the season, Gerry visits Penny's office. He tells her that he has closed his business. When Penny asks what happened to the equipment, he says he is waiting to sell it in the following year.

Discussion. What is Penny's responsibility based on the information she obtained in **Scenario 7A?**

Penny certainly needs to advise Gerry that any omitted income will result in penalties and interest if found in an audit. This would avoid a §10.21 violation. However, if Penny tells Gerry she has another client who told her the excavator was sold, she would be in violation of IRC §7216 because she is disclosing information obtained from a tax return. This puts Penny in a perilous position and she may want to resign from the engagement.

There are other reasons that Penny might want to resign from the engagement. If Gerry is lying about the excavator, what other income could he be hiding?

SCENARIO 8

Scenario 8A. Art Decoh and his three children live with Art's parents. His only earned income for the year was from mowing lawns, for which his father is the major customer (90% of the income). The income Art reports ($13,725) just happens to be in the "sweet spot" for the highest earned income credit (EIC). Art tells his tax preparer that his father pays all of the mowing expenses and therefore he is not claiming any.

Discussion. What are the tax preparer's due diligence requirements for EIC purposes?

This situation should be handled carefully. Did the father give Art a Form W-2? It is doubtful because this is a personal expense and a W-2 is not necessary. Is $13,725 a reasonable amount for the work performed? Even if Art mowed once a week for the entire year, it would amount to $264 per week. Was payment actually made? Did the father take the personal exemption for his grandchildren? The preparer needs to ask Art all the questions listed on Form 8867, *Paid Preparer's Earned Income Credit Checklist*. This might be a situation in which the preparer should ask Art to actually sign the Form 8867 indicating the answers are correct.

Scenario 8B. Use the same facts as **Scenario 8A,** except Art and the children do not live with the father.

Discussion. Does this change the answer?

Although this makes it more likely that Art can claim the EIC, it does not prove the amount of income is correct. It is absolutely imperative that the preparer correctly completes the Form 8867, submits a copy with the tax return, and keeps a copy in the client's file. The penalty for each failure to comply with due diligence requirements is $500 for returns required to be filed after December 31, 2011.[25] If all the questions were asked and answers were given, the preparer has probably fulfilled their responsibility under §10.22, *Diligence as to accuracy.*

Scenario 8C. Use the same facts as **Scenario 8B,** but the preparer knows that no Form W-2 was issued. Art tells the preparer that he earned $3,000 from the mowing business. The preparer informs Art that if he had an additional $10,725 of income he would receive a higher EIC. Art thinks a minute and remembers that he did not report the $10,725 his father paid him for mowing the lawn.

Discussion. Does this create any additional problems for the preparer?

This certainly makes it sound as if Art is trying to maximize the EIC by reporting phantom income. Based on the facts given, the preparer should decline the engagement.

> **Note.** For returns filed after December 31, 2011, tax preparers must attach a completed Form 8867 to each return that claims the EIC.

If the preparer is actually suggesting that the client add phantom income, he is subject to IRC §6701 (aiding and abetting understatement). A tax return preparer will pay a penalty if all of the following apply.

- The preparer aids or assists in, procures, or advises on the preparation of any portion of a return.
- The preparer knows that portion of the return will be used in connection with any matter arising under the Internal Revenue laws.
- The preparer knows that portion of the return will result in an understatement of tax liability.

The penalty is $1,000 unless the return is a corporate return, in which case the penalty is $10,000. The penalty applies regardless of whether the taxpayer knows about the violation. If the corporation is an S corporation, it does not pay income tax. Consequently, one court held that the penalty was only $1,000, although it was assessed for each Schedule K-1 issued.[26]

25. [www.eitc.irs.gov/rptoolkit/dd/consequences] Accessed on Apr. 24, 2012.

26. *James E. Mitchell v. U.S.,* 977 F.2d 1318 (9th Cir., 1992).

SCENARIO 9

Joe and Wendy Williams have been Melanie's clients for many years. They ask Melanie to prepare a tax return for their daughter Stephanie. They mention that Stephanie does not work outside the home and that she has three children. Stephanie meets with Melanie separately and produces social security cards for the three children, all of whom have last names that are different from hers. She also produces a handwritten Form 1099-MISC, *Miscellaneous Income,* issued by an individual with a social security number entered as the payor's federal identification number. Box 7 of the Form 1099-MISC reports $12,750 of nonemployee compensation. Melanie asks Stephanie what services she provided. Stephanie explains that she performed babysitting and housekeeping services. Stephanie also produces a Form 1098-T, *Tuition Statement,* which indicates she is a full-time student at a local community college and paid tuition of $3,200.

Discussion. What concerns should Melanie have?

This is another scenario that deals with §10.22, *Diligence as to accuracy.* Before asking any questions, Melanie should consider the issues that concern her. These issues include the following.

1. How is Stephanie supporting three children on an income of $12,750, while also paying $3,200 in tuition plus the cost of books, supplies, and travel expenses to and from college?
2. The parents said Stephanie did not work outside of the home.
3. Is the person employing Stephanie required to furnish a Form 1099? If so, why is it handwritten?
4. Is Stephanie entitled to a child care credit?

Discussion. What questions should Melanie ask?

Section 10.22 requires the preparer to ask the clients for an explanation of any concerns. This is more important than ever because the penalty for failure to exercise due diligence in determining the eligibility for the EIC has increased from $100 to $500 per return.[27] Melanie must adhere to the preparer EIC due diligence requirements, which include obtaining the necessary information to complete Form 8867, *Paid Preparer's Earned Income Credit Checklist.*

The questions listed above are valid questions and should be asked. Melanie can tell Stephanie that these are questions that the IRS would ask in an audit. As a preparer, the purpose in asking these questions is to determine whether the entries on the tax return are correct rather than running the risk of having the items reversed in an IRS audit. Based on the answers provided, the preparer may determine that there are other tax deductions or credits for which Stephanie is eligible.

Question 4 relating to whether Stephanie is eligible for a child care credit is a question all employed taxpayers with young children should be asked.

Discussion. Should Melanie prepare Stephanie's return?

The decision about whether Melanie should prepare Stephanie's return is a difficult one. Although there is no tangible proof Stephanie is lying, the facts certainly indicate she may not be telling the whole truth. Melanie's decision should be partly based on the answers Stephanie gives to Melanie's questions. Section 10.22 indicates due diligence is exercised when the preparer asks the appropriate questions.

If Stephanie's answers are truthful, then it is unlikely the IRS will prevail in court for asserting a preparer penalty. It is also unlikely the IRS will make a referral to the OPR. Because there might be some doubt about truthfulness, Melanie should have Stephanie sign the Form 8867.

27. IRC §6695(g).

Discussion. If Melanie refuses the engagement, will she lose the parents as clients?

Melanie is in an awkward position. If she refuses the engagement, the parents might change preparers. Melanie is prohibited from telling them why she refused to prepare Stephanie's return because she would violate confidentiality. If Melanie completes the engagement and Stephanie's return is later audited and found to be erroneous, the parents might blame Melanie for not initially challenging the return. The fear of losing the parents as clients should not deter Melanie from doing what is required to comply with Circular 230.

SCENARIO 10

Theo meets with a new client, Peter, in September 2011. Peter was referred to Theo by one of his friends who told him that "Theo is the best tax person around." Peter tells Theo that he believes his business is an S corporation but he does not have a copy of last year's return nor does he remember if an extension was filed this past March. He produces a handwritten piece of paper with income and expenses listed on it. Peter's information shows a net profit for the year of $50,000. When Theo asks what Peter's checkbook balance was at the end of last year, he states that he thinks it was about $100. When Theo asks if Peter was paid any wages last year, he states that his brother-in-law told him that a person who has an S corporation doesn't have to be paid wages. In Peter's presence, Theo accesses the Secretary of State's website and learns that Peter's corporation existed but it was involuntarily dissolved three years ago. Peter tells Theo that the corporation owns a building, four trucks, and land worth about $500,000.

Discussion. What should Theo do?

This is not necessarily an ethics issue as much as it is a procedural issue. It becomes an ethics issue if Theo makes the wrong decisions. For example, Theo must understand how the IRS will treat the return if it is no longer recognized under state law.

According to the IRS, the core test of corporate existence for federal income taxation purposes is a matter of federal law.[28] Therefore, whether an organization is taxed as a corporation is determined by federal law. It does not matter if the business is recognized as a corporation under state law.[29]

Because some information is missing, Theo should obtain a power of attorney and request a transcript of IRS filings and activity. This will determine if there are outstanding returns and if the business filed as an S corporation.

If Theo has any doubts about the accuracy of the records that Peter presented, he should request a copy of the books and records. He might even want to prepare a bank reconciliation if the deposits do not appear to match the income reported.

Theo should plan to spend a substantial amount of time before he can prepare the current year's return. He should give the client an estimate of the cost and consider asking for a retainer.

After all of the above factors are considered, Peter may decide to take his business elsewhere, which may actually be a relief to Theo.

Discussion. Should Theo prepare the return based on the information provided?

Based on the above facts, Theo should seriously consider declining the engagement. However, if he believes the client is simply ignorant of the tax law, is willing to pay for the time required to straighten out the mess, and believes the client will not create the same problems in the future, he could accept the engagement.

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28. Ltr. Rul. 200806006 (Nov. 7, 2007).

29. Treas. Reg. §301.7701-1(a)(1).

Discussion. Should Theo recommend reinstating the corporation?

Before Theo can determine the appropriate type of entity for his client, many additional facts are necessary.

1. Is the client willing to properly manage an entity or should he operate as a sole proprietorship?
2. Is an S corporation recommended for liability purposes or would an LLC taxed as a disregarded entity be a more practical solution?
3. Is self-employment tax an issue if the client is paid a "reasonable" salary by the S corporation?

> **Note.** In Illinois, a corporation can be reinstated if the corporate name is still available.

Discussion. Should Theo request bank statements?

Based on the details given, it seems appropriate for the preparer to request bank statements.

Discussion. What should Theo do about the payroll issues?

Because no wages were paid, there is no payroll tax liability. However, Theo should advise Peter that the IRS may reclassify part of the distributions as wages.[30] The client should begin taking a reasonable salary and comply with the payroll tax laws.

SCENARIO 11

Madison has a tax return finalized and ready to go on April 17, 2012. Her client Jayden calls and tells her that he will be there right at 5 p.m., and he asks her not to close the office early. When he arrives, Madison presents the return and the client signs the e-file authorization forms. There is a balance due on the federal return. Madison also presents her bill, but Jayden tells her that he forgot his checkbook.

Discussion. Can Madison refuse to file the return?

There is nothing in Circular 230 that requires a preparer to work for free. If the client has not paid for the work performed and has not received the return, it still belongs to the preparer. Section 10.28, *Return of client records,* only requires a preparer to return the records supplied by the client or that are required to file a return.

Discussion. Can Madison refuse to give Jayden his records if he demands them?

Section 10.28 states that a practitioner must, at the request of a client, promptly return any and all records necessary for the client to meet their tax obligations. A dispute over fees does not relieve the preparer of this obligation. If state law allows or permits the retention of a client's records by a practitioner due to a fee dispute, the practitioner must only return those records that must be attached to the taxpayer's return. However, the practitioner must provide the client with reasonable access to review and copy any additional records retained by the practitioner that are necessary under state law for the client to comply with their federal tax obligations.

Not all states have laws on the ownership of work papers. In some states, the rules are by regulation and not by statute.

30. Circular 230, §10.21.

Circular 230 defines records as:

> *. . . all documents or written or electronic materials provided to the practitioner, or obtained by the practitioner in the course of the practitioner's representation of the client, that preexisted the retention of the practitioner by the client. The term also includes materials that were prepared by the client or a third party . . . at any time and provided to the practitioner with respect to the subject matter of the representation. The term also includes any return, claim for refund, schedule, affidavit, appraisal or any other document prepared by the practitioner, or his or her employee or agent, that was presented to the client . . .* [31]

Discussion. The taxpayer received and reviewed the tax return, and signed Form 8879, *IRS e-file Signature Authorization.* Is the taxpayer required to file the return regardless of whether fees were paid?

The preparer has three days to file the Form 8879 even if the client did not pay the preparer. In this scenario, Form 8879 should be filed on or before April 17, unless an extension is filed.

SCENARIO 12

Aydan and Brooklyn Taylor go to Elijah's office to get their tax return prepared. Aydan works for a local manufacturing facility and Brooklyn works part-time at a convenience store on the weekends. When Elijah asks about any other income, Aydan replies that there is no other income. Elijah completes the tax return.

A few weeks later, Olivia and Logan visit Elijah's office. When he asks if they have any daycare expenses, Olivia says that she needs to call the sitter. She proceeds to call the "sitter," who she mentions is Brooklyn Taylor. When Olivia gets off the phone, she says "How do you like that; I pay her over $10,000 a year and she refuses to give me her identification number so I can take a credit on my tax return. Not only that, but my cousin also pays her a huge amount."

Discussion. How does Elijah advise Olivia and Logan about the credit?

In certain situations, a taxpayer can claim the child care credit without the provider's identification number. However, when the IRS checks with the provider, they may be penalized and subsequently refuse to provide services for the taxpayer in the future.

Any person who is required to furnish a provider's identification number must request the information from the provider.[32] This is done by using Form W-9, *Request for Taxpayer Identification Number and Certification.* The request is sent to the provider's last known address. The request must state that the identification number is required by law. If the provider does not furnish the identification number, the taxpayer must report whatever information is available (such as the name and address) and attach a signed affidavit explaining the provider's refusal. The credit is allowed only if the taxpayer can show they exercised due diligence in trying to obtain the identification number.[33]

Discussion. What should Elijah do about the return he prepared for Aydan and Brooklyn that he now knows is incorrect?

This question is covered by §10.21, *Knowledge of client's omission.* At the time the return was prepared, Elijah had no knowledge of Brooklyn's daycare business. Now that he knows about the business, he is required to notify the clients about the consequences of the omitted income. He cannot tell where he obtained the information because he would be in violation of IRC §7216.

31. Circular 230, §10.28(b).

32. IRC §6109(a)(3).

33. IRC §21(e)(9).

SCENARIO 13

On April 16, 2012, Bill E. and Nan E. Gote go to Travis's office to have their tax return prepared. Travis is a CPA and has never met Bill or Nan before. They bring their tax papers and give them to Travis. Travis asks for a copy of the prior year's return, but they do not have it with them. They tell Travis they will bring it when they come in the next day to pick up their completed return. Travis completes the return from the information provided. Travis leaves the office at 4:00 p.m. on April 17 and leaves the Gotes' completed return with the receptionist. Travis instructs the receptionist to obtain the signatures for Form 8879, *IRS e-file Signature Authorization,* the money for the preparation fee, and then submit the return electronically.

Travis returns to his office on April 30 after taking a well-deserved vacation. He finds the Gotes' 2010 return on his desk. He notices that they had substantial income from a Schedule C business in 2010. There is no evidence the business was sold and there were numerous assets shown on the depreciation schedule.

The 2011 return has been accepted by the IRS. Travis calls the Gotes to ask about the Schedule C business and they tell him not to worry about it.

Discussion. What should Travis do?

Because Travis does not know if the business existed in 2011, there is not much he can do. He has probably complied with the due diligence requirements of §10.22 by inquiring about the business. He is also required under §10.21, *Knowledge of client's omission,* to tell the Gotes that there may be substantial penalties and interest if there are inaccuracies on the return. However, if he wants to retain them as future clients, he has to be careful how he frames this conversation.

Travis definitely needs to document the discussion in his file. If the Gotes are audited by the IRS and the auditor determines that income was omitted from the business, the Gotes are likely to blame Travis for the omission. Travis may want to consider not preparing any future returns for the Gotes.

Discussion. Should Travis notify the IRS of the suspected omission?

Travis should not notify the IRS. First, Travis is not certain that any omission actually exists. Second, disclosure of information from a client tax return could subject Travis to a penalty under IRC §7216.

SCENARIO 14

Maria is an EA who is the accountant for Hokie Partnership. She is also the accountant for the two partners — Homer, who owns 70% of the partnership, and Kie, who owns 30%. Homer asks Maria if she will help advise him because he is in financial difficulties. He would like to creatively finance some of the large debts he has accumulated. He asks that she not discuss his problems with Kie.

Discussion. What are the Circular 230 issues with this request?

As the accountant for the partnership and both partners, Maria is required to give equal treatment to both partners regardless of their ownership percentage. Therefore, both partners have the right to the same information. If Maria is concerned that disclosing information to Kie would violate her confidentiality obligations to Homer, she has a potential conflict-of-interest issue.

Section 10.29 deals with conflicting interests. Because both Homer and Kie are general partners, they have joint and several liability. This means that if Homer files bankruptcy, it could result in the failure of Hokie Partnership and Kie would be liable for any unpaid debts. Maria should tell Homer to go elsewhere for advice. Because Maria has additional information, she should withdraw from all engagements, and she should consider contacting her attorney or liability insurance carrier for advice.

Discussion. How could Maria have prevented this problem?

Any time a tax professional enters into an engagement with a partnership and its partners or an S corporation and its shareholders, they should have the parties sign a conflict-of-interest statement. As soon as a possible conflict is discovered, the practitioner should obtain the written consent of every individual indicating that it is acceptable to continue the representation. The consent must be confirmed in writing, signed, and received by the practitioner within 30 days from the time they are notified of the conflict. The signed copies must be retained for at least 36 months from the date the representation concludes.

In Maria's situation, she should obtain a signed statement at the beginning of the engagement with the partnership, which provides consent for her to represent the partnership and each of the partners.

There may be times when advice given to one partner could be detrimental to the other partner or the partnership. It is acceptable to represent all the parties, but if a potential conflict arises, each concerned party must sign a conflict waiver. The conflict waiver should specify what the potential conflict is and how the interests of the individuals may conflict.

Discussion. If Maria is a member of a large firm, should she ask one of the other members to represent Homer?

Circular 230 does not address this issue, except for the restrictions set forth in §10.25 on former government employees. However, the attorney rules of conduct[34] prevent members in the same firm from representing conflicting interests. The rules for a CPA[35] are not as strict regarding members of the same firm representing partners with conflicting interests. However, a CPA in such a situation should be very familiar with the rules in order to prevent an inadvertent violation.

Discussion. Maria obtained the appropriate signed consents and waivers. Could there be other problems?

Yes, if the situation has a negative outcome, Kie could sue Maria. Kie could claim he did not provide informed consent because he was not aware of what the waiver said or how it could affect him. This is the main reason that Maria should not represent Homer in his financial problems.

SCENARIO 15

Darrell's long-time friend and client Shifty Nogood wants to finance a new car purchase. Shifty owns a heating and air conditioning repair business. In August, he visits Darrell's office and requests that he prepare a pro forma return showing what he would owe in taxes if he had an additional $50,000 of income. Shifty asks Darrell to put it on actual federal income tax forms so that he can fully understand the outcome.

Darrell is concerned that Shifty may be using the pro forma return to justify his loan.

Discussion. Should Darrell prepare the pro forma return?

Because this is not a return that Shifty will submit to the IRS, this situation is not a Circular 230 issue. However, Darrell's name will be on the return as the preparer. Therefore, any inappropriate use could reflect on him.

Discussion. If Darrell stamps the return "For discussion purposes only," does that solve his problem?

It probably does; however, Shifty could take the pro forma return and copy it onto forms he downloads from the Internet. This is not something Darrell can control. However, Darrell needs to remember this when he prepares next year's return. If Shifty is willing to give a false document to a lender, he may be likely to give a false document to the IRS.

34. American Bar Association, *Rules of Professional Conduct,* Model Rule 1.10.

35. American Institute of CPAs, *Code of Professional Conduct,* Rule 102-2.

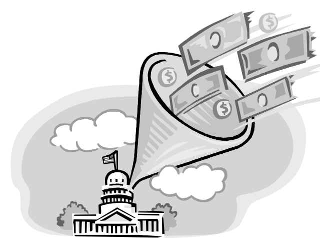
SCENARIO 16

Instant Refund Service ran the following ad in the local newspaper. In addition, the firm made "robo calls" soliciting business. They also paid a student to put flyers on the windshields of cars at a shopping center parking lot. They even used door hangers in the lower income sections of the town. They were surprised when the IRS called and said they had to stop running the ad because they were in violation of Circular 230. What sections of Circular 230 does the ad violate?

This could be you. All of our clients get big refunds!

We were judged best by the IRS.
Small refund – small fee; Large refund – moderate fee
Guaranteed not to be audited.
No-questions-asked refunds, just bring us your information.
Get your refund on the spot.
Have your return prepared by an IRS employee.
IRS is giving away money. See us for your share.
Call for an appointment or stop in anytime.

Instant Refund Service
20 Money Lane
Hometown, USA
800-URMONEY



It is apparent that Instant Refund Service is in violation of several sections of Circular 230, including the following.

- Section 10.22 addresses due diligence. Based on the advertising, the firm is not performing due diligence by failing to ask questions to determine if there is any additional income that should be reported.
- Section 10.27 covers fees. The advertising implies that Instant Refund Service is billing based on the amount of the refund, which would be a contingency fee and is a violation of Circular 230.
- Section 10.31 deals with negotiating a client's refund check. The advertising could lead a person to believe the firm is having the refund checks deposited in the firm's bank account. If the taxpayer receives their money on the spot, the tax preparer has to be doing something to ensure they receive repayment rather than the client.
- Section 10.30 addresses solicitation. A preparer is not allowed to indicate that they have any special relationship with the IRS. In addition, the ad implies that IRS employees are preparing the returns.
- Section 10.30 prohibits a preparer from making uninvited written or oral solicitations related to tax matters if the solicitation violates federal or state law. The "robo calls" could be in violation of the "do not call" registry used by many people.

SCENARIO 17

Scenario 17A. Carole Ling brings her self-prepared return to tax professional Alma Best for review before filing. After a 5-minute cursory review, Alma tells Carol that she found an error and, for 50% of the tax savings, she will prepare a new return.

Discussion. The new return saved Carole $10,000. Is a $5,000 fee reasonable?

Carole is probably happy with the savings and may be willing to pay Alma the fee. Carole agrees to pay Alma $100 more to electronically file her return. Carole signs Form 8879, *IRS e-file Signature Authorization,* and Alma transmits the return to the IRS.

Alma is in violation of §10.27, *Fees.* This is not a situation in which Circular 230 allows a contingency fee. Not only is this a contingency fee, but it may also be an unconscionable fee. Whether it is unconscionable could depend on what Alma would have charged if Carole had asked her to prepare the original return. Making a case that a fee is unconscionable is very difficult for the IRS. There are no set rules on how much preparers can charge. It depends on the complexity of the return as well as the location of the preparer.

Scenario 17B. Carole wonders how she could have made such an error on the return she took to Alma. Upon review of the return, she discovers that Alma included a Schedule C for Carole's "business" as an artist. The Schedule C reported a loss of $60,000, which offsets Carole's wages of $70,000. Carole is not an artist and has no artistic ability; therefore, she does not have and never has had this type of business.

Discussion. What should Carole do?

Obviously, Carole should file an amended return. As the taxpayer, she has the final responsibility for the accuracy of the return. Carole may decide to report Alma to the IRS as a fraudulent tax return preparer. She can do this by calling the local IRS office or filing Form 3949-A, as discussed in **Scenario 5.**

SCENARIO 18

Scenario 18A. Arthur Mometer will celebrate his 80th birthday in 2012. He has decided to sell his tax practice. A prospective buyer wants to review the files before he makes an offer on the practice.

Discussion. Is this a violation of IRC §7216 (disclosure consent requrements)?

Arthur knows that a violation of §7216 for disclosing any information furnished by a client in connection with preparing a return can result in a penalty of up to $1,000 and imprisonment for up to one year. Arthur does not have to be overly concerned because he can compile a list of his clients, which can be transferred in conjunction with the sale of his business.[36] He must, however, obtain a written agreement from the prospective buyer that requires confidentiality of the tax return information disclosed and prohibits its use for any reason other than that related to the sale of the business.[37]

36. Temp. Treas. Reg. §301.7216-2T(n).

37. Ibid.

Although the American Institute of Certified Public Accountants has ethical standards on the sale of a practice, Circular 230 is silent as to how a seller should handle the due diligence process that a prospective buyer may require. The assumption is that the IRS would use the same type of standards they use for a peer review. The disclosure is only allowed to the extent necessary to accomplish the review. Any information gathered in the review may only be used for purposes of the review. No tax return information identifying a taxpayer may be disclosed in any evaluation reports that may be accessible to any persons other than the reviewer and the person being reviewed. The return preparer being reviewed must maintain records including the information reviewed and the identity of the person(s) conducting the review. After the completion of the review, no documents containing information that may identify any taxpayer by name or identification number may be retained by a reviewer.[38]

Scenario 18B. Arthur dies before he sells the tax practice. His death occurs on April 1, 2012, while Arthur has 250 returns in the process of being completed.

Discussion. What options do Arthur's heirs have?

If the heirs hire another preparer to complete the returns, the information can be disclosed to them without obtaining the consent of the taxpayers. In the event of the incapacity or death of a tax return preparer, disclosure of tax return information may be made for the purpose of assisting the tax return preparer or their legal representative in operating the business.[39]

SCENARIO 19

Millie calls her tax return preparer, Ashlee, and asks her to take a copy of Millie's tax return to the bank next door. Millie also wants Ashlee to send the return to an automobile dealer in order to receive a special discount for a program they are running.

Discussion. Is this a violation of Circular 230?

Ashlee must obtain Millie's written consent in order to give the return to the bank.[40] She must obtain a separate written consent to give the return to the automobile dealer. Each consent form must be signed and contain the following information.[41]

1. The name of the tax return preparer
2. The name of the taxpayer
3. The purpose for which the consent is being furnished
4. The date on which the consent is signed
5. A statement that the tax return information may not be disclosed or used by the tax return preparer for any purpose other than what is stated in the consent
6. A statement that the taxpayer consents to the disclosure or use of the information for the purpose described in number 3 above

38. Temp. Treas. Reg. §301.7216-2T(p)(1).
39. Treas. Reg. §301.7216-2(r).
40. Treas. Reg. §301.7216-3.
41. Treas. Reg. §301.7216-3(b).

SCENARIO 20

Scenario 20A. Devon is both an EA and a CFP. As a CFP, he sells both life insurance and mutual funds. While he is preparing the return of Batson and Dee Belfry, Devon sees a need for both life insurance and a retirement plan.

Discussion. What must Devon do to comply with Circular 230?

Before Devon can discuss either of these products, he must obtain the Belfrys' consent. The Belfrys must sign two consent forms, one for the life insurance and the other for the mutual funds. If these consents are not obtained before Devon makes his "pitch," he is in violation of Treas. Reg. §301.7216-3.

Scenario 20B. Later in the year, Devon becomes the representative for another mutual fund. He believes this mutual fund is a good investment for the Belfrys.

Discussion. Is there anything he must do before presenting the idea to Batson and Dee?

Because Devon did not make his sales pitch for both mutual funds at the same time, he must obtain another consent form for the new mutual fund.[42]

SCENARIO 21

Scenario 21A. Frieda, a CPA, is way behind in completing her clients' tax returns. Her son Freddie comes home from college over spring break. He has just completed a tax course in college. He offers to help Frieda catch up.

Discussion. Is there anything wrong with Freddie helping Frieda prepare returns?

Freddie could be categorized as a "supervised preparer." This allows him to prepare returns, but Frieda must review and sign each return. Freddie must obtain a preparer tax identification number (PTIN) and pass the tax compliance check. To apply for his PTIN, he must provide the following information.[43]

- Name, address, and date of birth
- Explanation for any felony conviction
- Explanation for any problems with his U.S. tax obligations
- His supervisor's PTIN

A supervised preparer is an individual who does not sign and is not required to sign a tax return as a paid preparer but is:

- Employed by an attorney or CPA firm, or
- Is employed by other recognized firms that are at least owned by attorneys, CPAs, or enrolled agents, and
- Who are supervised by an attorney, CPA, EA, enrolled retirement plan agent, or enrolled actuary who signs the returns prepared by the supervised preparer as a paid tax return preparer.[44]

The chart on the following page summarizes the various types of tax preparers and their requirements.[45]

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42. Treas. Reg. §301.7216-3(a)(3)(i)(B).
43. [www.irs.gov/taxpros/article/0,,id=227720,00.html] Accessed on Apr. 25, 2012.
44. IRS Notice 2011-6, 2011-3 IRB 315.
45. [www.irs.gov/taxpros/article/0,,id=246202,00.html] Accessed on May 2, 2012.

Category	PTIN	Tax Compliance Check	Background Check	IRS Test	Continuing Education	Practice Rights
Enrolled agents [a]	Yes	Yes	Proposals pending	Yes (special enrollment exam)	72 hours every 3 years	Unlimited
Registered tax return preparers [b]	Yes	Yes	Proposals pending	Yes (RTRP test)	15 hours per year	Limited
CPAs [c]	Yes	Yes	Proposals pending	No	Varies	Unlimited
Attorneys [c]	Yes	Yes	Proposals pending	No	Varies	Unlimited
Supervised preparers [d]	Yes	Yes	Proposals pending	No	No	Limited
Non-1040 preparers [e]	Yes	Yes	Proposals pending	No	No	Limited

[a] Enrolled agents have passed a 3-part, comprehensive IRS exam covering individual and business returns. They must adhere to ethical standards and complete 72 hours of continuing education courses every three years. EAs have unlimited practice rights before the IRS, which means they can represent clients for any tax matter.

[b] RTRPs have passed an IRS test establishing minimal competency. The test covers only individual income tax returns (Form 1040). They must adhere to ethical standards. They must also complete 15 hours of continuing education each year. RTRPs have limited practice rights before the IRS, which means they can represent clients in only certain circumstances.

[c] CPAs and attorneys have unlimited practice rights before the IRS.

[d] To determine who is considered a supervised preparer, view the fact sheet located at www.irs.gov/taxpros/article/0,,id=243337,00.html.

[e] If only Forms 1040-PR and 1040-SS are prepared, the preparer is considered a non-1040 preparer.

Scenario 21B. Frieda was sick and at the doctor's office when a valued client came to pick up her return. The client was on her way to China for a vacation. Frieda prepared the return but had neither reviewed it nor signed it. The return was of a type that could not be electronically filed.

Discussion. What are the alternatives?

A tax preparer who is required by regulations to sign a return and fails to do so can be subject to a $50 penalty per unsigned return up to a maximum of $25,000 per year.[46] A signature is required for any tax return or amended tax return filed on behalf of a taxpayer. Freddie has not taken the competence exam and is only a supervised preparer. He is not allowed to sign the return.[47]

If the tax preparer is not available to sign the tax return, a substitute preparer may sign. However, they must review the information received by the original preparer as well as the return that was prepared. When they sign the return, they are accepting the liability of being the tax preparer.

Discussion. What happens if the client takes the return prepared by Frieda and copies the information onto blank forms? Is Frieda still considered to be the preparer and, if so, does she have a signature requirement?

Frieda is still "on the hook" for being the preparer. She is the person that made the tax decisions related to the information the client presented. A preparer cannot avoid the requirement to sign a return by, for example, sending "statements" or "drafts" of the return to a taxpayer. However, a preparer who makes a bona fide effort to sign a return will not be penalized for not doing so if the taxpayer disregards the preparer's attempts to present a signed return to the taxpayer.[48]

46. IRC §6695(b).

47. Treas. Reg. §1.6695-1(b)(1) and Example 4 of Treas. Reg. §1.6695-1(b)(3).

48. Rev. Rul. 84-3, 1984-1 CB 264.

SCENARIO 22

Scenario 22A. Ree Tyree decides he wants to be a volunteer tax return preparer at the local senior center. He wants to know if he needs a PTIN or is required to take a competency test.

Certain individuals are not considered tax return preparers. These include the following.[49]

- Employees of the IRS performing official duties
- Any individual who provides assistance under a Volunteer Income Tax Assistance (VITA) program established by the IRS, but only for those returns prepared as part of the VITA program
- The organization sponsoring or administering the VITA program
- Any individual who provides tax counseling for the elderly under an established program, but only for returns prepared under that program
- The organization sponsoring or administering an established elderly program
- An individual who provides tax assistance as part of a qualified Low-Income Taxpayer Clinic (LITC) but only for those returns prepared as part of the LITC program
- The organization sponsoring or administering an established LITC program
- An individual providing only typing, reproduction, or mechanical assistance in the preparation of a return
- An individual preparing a return for an employer for whom they work
- An individual preparing a return for a trust or estate if they are the fiduciary, officer, or employee of the entity
- A person who prepares a return for a taxpayer with no explicit or implicit agreement for compensation, even if the person receives an insubstantial gift, return service, or favor

Discussion. Does this mean that any individual who is not considered a tax return preparer under Treas. Reg. §301.7701-15(f) can prepare a fraudulent return with no recourse from the IRS?

Although preparers volunteering for VITA or an LITC program are not required to have a PTIN, like all preparers, they are prohibited from preparing fraudulent tax returns.[50] Fraudulent actions are covered under many sections of the Code of Federal Regulations. This includes the anti-money-laundering provisions of Title 31.

Scenario 22B. Ree's neighbor knows that Ree is a retired CPA. He asks Ree to help him complete Form 8283, *Noncash Charitable Contributions*. If Ree does not prepare substantially all of the return, a PTIN is not required even if the neighbor gives Ree a bottle of wine for his efforts.[51]

Section 10.8 defines preparing all or substantially all of a tax return. Any individual who for compensation prepares or assists with the preparation of all or substantially all of a tax return or claim for refund must have a PTIN. Also, the individual must be a CPA, attorney, EA, or RTRP (as of January 1, 2014).

49. Treas. Reg. §301.7701-15(f).

50. IRC §7206(2).

51. Circular 230, §10.8.

SCENARIO 23

Shirley, an EA, is working on a particularly difficult tax return. There is an item on the return that she has never encountered before. She knows George has experience with this type of situation. Unfortunately, George was disbarred from practicing before the IRS two years ago.

Discussion. Can Shirley ask for George's assistance?

A practitioner may not knowingly accept assistance from or assist any person who is under disbarment or suspension from practice before the IRS if the assistance relates to a matter constituting practice before the IRS.[52] Practice before the IRS is defined in Circular 230 as all matters connected with a presentation to the IRS relating to a taxpayer's rights, privileges, or liabilities under laws or regulations administered by the IRS.[53] If Shirley seeks George's expertise and she knows he is disbarred, she is in violation of §10.24(a). Additionally, George is also obligated to refrain from providing Shirley with any assistance while he is disbarred.

SCENARIO 24

Debbie recently retired from the IRS. She was the lead attorney in the Chief Counsel's office for a specific tax shelter. Debbie was asked to represent a taxpayer who is being audited for issues related to that same tax shelter.

Discussion. May Debbie accept this engagement?

Section 10.25, *Practice by former government employees, their partners, and their associates,* regulates what a former IRS employee may do. Former IRS employees are prohibited from representing or assisting taxpayers in matters related to their former government employment. "Assist," in this context is defined as acting in such a way as to advise, furnish information to, or otherwise aid another person, directly or indirectly. Section 10.25(b) places a lifetime ban on assisting a specific party in a particular matter if they personally or substantially participated in that matter as a government employee.

To understand the prohibition, one must look at 18 USC §207. This prohibits any former U.S. government employee from communicating with or appearing before any government employee and attempting to influence on behalf of another person on a particular matter:

- In which the United States is a party or has a direct or substantial interest,
- In which the former employee participated personally or substantially as an officer or employee, and
- That involved a specific party or parties at the time of such participation.

Some acts have a 2-year restriction while others have a 1-year restriction under 18 USC §207.

A former government employee who was substantially involved in developing a regulation is prohibited from ever appearing for a client and arguing that the regulation is invalid.

Discussion. Does this mean that a former IRS employee cannot take a position with a CPA firm after retiring from the IRS?

No member of a firm of which a former government employee is a member may represent or knowingly assist a person who was or is a specific party in any matter in which the former government employee participated unless the former government employee is isolated from the matter. When isolating the former government employee, a statement affirming the fact of the isolation must be executed under oath by the former government employee and by another member of the firm acting on behalf of the firm.

52. Circular 230, §10.24.

53. Circular 230, §10.2(a)(4).

SCENARIO 25

Tax attorney Reggie Mente stepped over the line when representing a client before the Tax Court. He called the IRS auditor offensive names. He was reported to the Office of Professional Responsibility.

Discussion. Should Reggie be concerned about the actions that the OPR might take?

Section 10.50 of Circular 230 allows the OPR to censure, suspend, or disbar incompetent or disreputable tax practitioners. The OPR can also sanction a practitioner if they fail to comply with regulations or willfully and knowingly mislead or threaten a client or prospective client with the intent to defraud.

Initially, Reggie will receive a letter from the OPR asking for his view of the situation. Depending on his response, the investigation by the OPR may cease. However, if the OPR believes this is part of an ongoing problem, they may continue with the investigation. When that occurs, the matter is assigned to an attorney within the OPR who will thoroughly investigate the complaint. Reggie will have an opportunity to defend his actions either in person or via a telephone conference. If the OPR believes further action should be taken as a result of the investigation, Reggie has the right to appeal.

Censure is the least severe punishment the OPR can administer. It consists of publicly reprimanding the practitioner. The IRS publishes the censured practitioner's name in an Internal Revenue Bulletin and lists the reason for the action. Unlike the other forms of punishment, censure does not prohibit the practitioner from practicing before the IRS. However, the OPR may subject the practitioner's future representations to conditions designed to promote high standards of conduct. An actual suspension is more likely to occur than a censure.

In a recent Internal Revenue Bulletin, 24 practitioners were listed as being suspended.[54] The suspensions ranged from an indefinite period of time to 48 months. One practitioner was disbarred for violating §10.20 for failure to provide the information requested, §10.51 for submission of false or misleading information to the OPR, and failure to file income tax returns.

Taxpayers may not be represented before the IRS by a suspended practitioner during the term of suspension. A disbarred practitioner is not permanently ineligible to represent taxpayers before the IRS. Under §10.81, they may petition for reinstatement after five years. Reinstatement is not granted unless the IRS is satisfied that the petitioner is not likely to engage in conduct thereafter that is contrary to regulations and that reinstatement would not be contrary to the public's interest.

Section 10.51 defines incompetence and disreputable conduct. It includes, **but is not limited to,** the following acts.

1. Conviction of any criminal offense under the revenue laws of the United States
2. Conviction of any criminal offense involving dishonesty or breach of trust
3. Conviction of any felony under federal or state law for which the conduct renders the practitioner unfit to practice before the IRS
4. Knowingly giving false or misleading information or participating in giving any false or misleading information to the Department of Treasury or its employees or officers (Information includes facts or matters included in testimony, federal tax returns, financial statements, applications for enrollment, affidavits, declarations, or any other document or statement, written or oral.)
5. Solicitation of employment as prohibited under §10.30, using false or misleading representations with the intent to deceive a client or prospective client in order to procure employment, or intimating that the practitioner is able to improperly obtain special consideration from the IRS

54. IRB 2012-7 (Feb. 13, 2012).

6. Willfully failing to file a federal tax return or willfully evading or attempting to evade payment of federal income tax
7. Misappropriation of or failure to promptly or properly remit funds received from a client for the purpose of the payment of taxes
8. Directly or indirectly attempting to influence, or offering or agreeing to attempt to influence, the official action of an IRS officer or employee (This can occur by the use of threats, false accusations, duress or coercion, as well as offering any special inducement or promise of advantage or by bestowing any gift, favor, or thing of value.)
9. Disbarment or suspension from practice by any constituted authority of any state
10. Knowingly aiding and abetting another person in practice before the IRS during a period of suspension, disbarment, or ineligibility of such person
11. Contemptuous conduct in connection with practice before the IRS (This includes the use of abusive language, making false accusations and statements, knowing them to be false, or circulating or publishing malicious or libelous matter.)
12. Giving a false opinion knowingly, recklessly, or through gross incompetence (This includes an opinion which is intentionally or recklessly misleading, or engaging in a pattern of providing incompetent opinions on questions arising under the federal tax laws.)
13. Failing to adhere to IRS guidelines regarding the electronic submission of tax returns for clients.

Section 10.52 further discusses the violations that are subject to sanction. They include:

1. A practitioner who willfully violates any of the regulations listed in Circular 230 other than 10.33, or
2. Reckless or gross incompetence that violates §§10.34, 10.35, 10.36, or 10.37. Gross incompetence is defined in §10.51(a)(13) and includes conduct that reflects gross indifference, preparation which is grossly inadequate under the circumstances, and a consistent failure to perform obligations to the client.

SCENARIO 26

Attorney Bie Law is representing the Chrystal and Tiffany Glass Partnership in an IRS audit. The auditor requested certain papers that will be detrimental to the partnership's case. Bie has heard that the revenue agent is about to retire. He hopes that if he delays giving the documents to the auditor, a new auditor will be assigned to the case who might not find the incriminating issue.

Discussion. Can this cause a problem for Bie?

Section 10.23, *Prompt disposition of pending matters,* states that a practitioner may not unreasonably delay the prompt disposition of any matter before the IRS. The issue is how to define "unreasonable." There is nothing in the provision that indicates the practitioner must drop everything and immediately provide the information to the IRS. There can be personal and other business matters that need to take priority. However, the practitioner should make the IRS agent aware that there will be a delay in complying with their request.

Delaying the submission of information to the revenue agent because the practitioner is hoping the agent will forget about the request is a violation of §10.23.

SCENARIO 27

Scenario 27A. CPA Hardnose refuses to comply with an IRS document request for his client's records. He believes these records are privileged and he does not have to give them to the IRS.

Discussion. Can this create a problem for CPA Hardnose?

Section 10.20(a)(1) requires a practitioner to respond to a proper and lawful request by an authorized employee of the IRS. A practitioner must promptly submit records or information in any matter before the IRS unless they believe it is privileged information. The issue is the definition of "privileged information." An accountant is not covered by the same rules as an attorney.

Congress gave the tax practitioner the authority to withhold privileged information in the Internal Revenue Service Restructuring and Reform Act of 1998. However, the scope of privileged information was somewhat reduced by the American Jobs Creation Act of 2004 when IRC §7525 was amended so that it does not apply to written communications involving tax shelters.

To maintain privilege, the practitioner must be a federally authorized tax practitioner (FATP).[55] This means the practitioner must be authorized to practice before the IRS. This includes attorneys, CPAs, and EAs, but does not include the new RTRP designation. Privileged information is "tax advice," which is advice given by the practitioner to the client about a matter that is in the scope of the individual's authority to practice.[56]

Generally, the privilege protects communications made after July 21, 1998. Until October 22, 2004, this privilege was available for communications with an FATP regarding participation in a tax shelter (with the exception of certain communications about participation in a tax shelter by a corporation). The American Jobs Creation Act of 2004 amended the privilege so that it no longer applies to any communications regarding tax shelter participation.[57]

Furthermore, the privilege is not available in criminal proceedings or state law matters and only applies to tax advice and not to business advice. For instance, the privilege applies to advice given regarding the likelihood a transaction would qualify under §1031 as a like-kind exchange but not to advice given regarding the preparation of a business plan. Also, privilege does not apply if the advice has been shared by the client with a third party because it is no longer confidential information.

Scenario 27B. CPA Hardnose does not have the information the auditor is requesting. Therefore, he ignores the request.

Discussion. Is this a problem?

Section 10.20(a)(2) states that if the records are not in the possession of the tax practitioner but the practitioner knows who has the records, the identity of that person must be made known to the auditor. If the practitioner does not know where the records are, they must ask the client where the records are located and that information must be given to the auditor. The practitioner does not have to obtain the records but is only required to tell the auditor of their location. Refusal to comply with the request is a violation of Circular 230. The practitioner is not required to make inquiry of any other person or independently verify any information provided by the client regarding the identity of the person named by the client.

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55. IRC §7525(a)(3)(A).

56. IRC §7525(a)(3)(B).

57. IRC §7525(b) as amended by American Jobs Creation Act of 2004 (HR 4520).

Scenario 27C. The director of OPR received a complaint regarding Hardnose and requests that he furnish information regarding the allegations that were made. Hardnose is busy and ignores the request.

Discussion. Is this a problem?

A practitioner should never ignore a request from the OPR. The OPR director will take the refusal into consideration when ruling on the allegation. The practitioner should carefully consider whether to testify or not. The testimony can generally be given in person or by conference call. In addition, because the allegation can result in suspension or disbarment, the practitioner should consider retaining legal counsel.

SCENARIO 28

CPA Schultz is representing Charlie Brown in a tax audit. The IRS requested a document that Schultz thinks should be notarized. Accordingly, he notarizes the document.

Discussion. Does this create a problem for Schultz?

Section 10.26 prohibits a practitioner from taking acknowledgements, administering oaths, certifying papers, or performing any official act as a notary public for any matter for which they are employed as counsel, attorney, or agent if they have an interest in the issue.

SCENARIO 29

Grace Full calls Sanchez, an EA, to find out the amount of her tax preparation fee. Sanchez emails the quote to Grace the next day. Later, Sanchez learns that his software vendor is adding state sales tax to the fees they charge. When Sanchez quoted a fee to Grace, he did not add the sales tax fee.

Discussion. Is Sanchez required to abide by the quote he gave Grace?

This question falls under §10.30(2)(b). Circular 230 allows a practitioner to publish a written fee schedule and disseminate the following fee information.

- Fixed fees for specific routine services
- Hourly rates
- Range of fees for particular services
- Fees charged for initial consultation

Any statement of fee information concerning matters in which costs may be incurred must include a statement disclosing whether clients will be responsible for these costs. A practitioner may charge no more than the published rates for at least 30 days after the last date the fee schedule was published.

Circular 230 states that fee information may be communicated in professional lists, telephone directories, print media, mailings, electronic mail, facsimile, hand-delivered flyers, radio, television, and any other method. However, the method chosen must not cause the communication to become untruthful, deceptive, or otherwise in violation of the Circular 230 rules.

Whether Sanchez would violate §10.30 by adding sales tax is not clear. He only quoted a fee to Grace. He has not published the fee for all returns. Therefore, an argument can be made that it would not be a violation.

SCENARIO 30

Liddy Gates has just passed the EA exam. She can now represent clients before the IRS in the same manner as if she were an attorney. Liddy has a client who has a disagreement with the IRS. She believes if they take the case to the Tax Court, they can win.

Discussion. Can Liddy represent the client in the Tax Court?

Practice before the IRS is defined in Section 10.2(4), which includes representation of a taxpayer at conferences, hearings, and meetings. However, practice within the Tax Court requires the practitioner to be a member of the bar of the Tax Court. Membership in the Tax Court bar is limited to attorneys that have applied for membership and to nonattorneys who have passed a rigorous examination. Pass rates for the Tax Court bar examination are typically in the 5–10% range. The successful candidate must have passed the entire examination in one sitting with a score of 70% or better. The examination lasts for four hours and consists of four parts.

1. Tax Court rules of practice and procedure (25% of exam)
2. Substantive taxation (40% of exam)
3. Evidence (25% of exam)
4. Legal ethics (10% of exam)

The examination is given once every two years and is scheduled to be given again in November 2012.

Discussion. Although Liddy cannot represent her client before the Tax Court, can she participate in the hearing?

The Tax Court is a public forum. Therefore, anyone can attend. Liddy can be called as a witness for her client, or she can attend as an advisor for the attorney. However, she cannot serve as counsel for her client.

SCENARIO 31

Sly Fox has always disliked the IRS. He decided that he can save other individuals thousands of dollars of tax by preparing their tax returns. He learns that he must have a PTIN and he completes and mails in the application.

Discusssion. What can Sly expect?

Normally, Sly would not have any problems if he passes the compliance and suitability checks that are required for every applicant. However, with Sly's attitude, one might wonder if he can pass the compliance check.

1. Has Sly filed all his tax returns?
2. Does he have any unpaid tax liability?

Sly must also pass the suitability check, to determine if he engaged in any conduct that would justify suspension or disbarment under §10.51. This type of conduct includes the following.

1. **Criminal.** Conviction of any criminal offense under the federal tax laws
2. **Stealing.** Conviction of any criminal offense involving dishonesty or breach of trust
3. **Felony.** Conviction of any felony under federal or state law pertaining to conduct which renders the practitioner unfit to practice before the IRS
4. **Lying.** Giving false or misleading information to the Department of Treasury or its employees
5. **False advertising.** Using false or misleading statements when soliciting employment from a potential client

6. **Nonfiler.** Willfully failing to file a federal tax return, willfully evading or attempting to evade, or in any way participating in such a scheme
7. **Enabler.** Willfully assisting, counseling, or encouraging a client or prospective client to violate any federal tax law, or knowingly counsel or suggest an illegal plan to evade taxes
8. **Theft.** Misappropriation of or failure to properly or promptly remit funds received from a client for purposes of payment of taxes or other obligations due to the United States
9. **Bribe.** Directly or indirectly attempting to influence any official of the IRS by use of threats, false accusations, duress, or coercion by the offer of any special inducement or gift
10. **Disbarment.** Disbarment or suspension from practice
11. **Assisting.** Knowingly aiding and abetting another person to practice before the IRS during a period of suspension, disbarment, or ineligibility of that person
12. **Contempt.** Contemptuous conduct in connection with practice before the IRS
13. **Misleading.** Giving a false opinion either knowingly, recklessly, or through gross incompetence with the intent to mislead
14. **Signature.** Willfully failing to sign a tax return prepared by the practitioner when the signature is required
15. **Disclosure.** Willfully disclosing or using tax return information in a manner not authorized by the Code
16. **Electronic filing.** Willfully failing to electronically file a tax return when required to do so
17. **PTIN.** Willfully preparing all or substantially all of a tax return, or signing it, without possessing a valid PTIN
18. **Representation.** Willfully representing a taxpayer without being authorized to do so

SCENARIO 32

Scenario 32A. Al and Ben are brothers and equal shareholders in AB Landscaping, Inc. (ABL). ABL is a C corporation that Al and Ben established in 2009. Al contributed $100,000 of cash and Ben contributed equipment with a fair market value (FMV) of $100,000, consisting of a dump truck, van, tractors, lawn mowers, a small bulldozer, trailers, and other assorted items. During 2009, the corporation purchased a large home at 45 Main Street from a customer who was in financial distress, making the home a corporate asset. The FMV of the home is $200,000.

Frank, who recently became an RTRP, prepares the tax returns each year for Al, Ben, and ABL. He claimed depreciation on the equipment contributed by Ben to ABL.

In 2011, the IRS examined ABL's 2009 and 2010 tax returns and other records, such as the corporate minute book. Frank accepts the engagement to handle the audit. The IRS determines the following.

- Ben's $100,000 of contributed equipment is not adequately documented and the basis cannot be determined. The deemed basis is therefore zero. Although there was a collection of various receipts totaling $100,000 for some items of equipment, the IRS was not satisfied that these receipts were for the contributed equipment. No VIN numbers were listed for any of the vehicles nor serial numbers for any of the contributed items. The basis amount of $100,000 seemed excessively high for the type of equipment contributed. The IRS noted that it was not possible to trace any receipt to any particular item of equipment contributed by Ben to ABL.
- The past depreciation deductions on the equipment are disallowed on ABL's Forms 1120 for 2009 and 2010.

- The IRS searched the local land registry office and found that Ben purchased the home at 45 Main Street from ABL for a price of $1 in late 2010. The IRS indicated that this resulted in a constructive dividend to Ben in the amount of $199,999 in the 2010 tax year.
- Because the asset basis is zero for the assets Ben contributed, Ben's stock basis is also zero. The IRS accordingly sent Ben notices of deficiency for 2010 regarding the tax liability on corporate distributions he received.

The corporate attorney decides to litigate the basis and constructive dividend issues in Tax Court. The attorney contacts Frank and asks him to testify as an expert witness on the issue of the adequacy of the basis documentation. The attorney indicates that if Frank does so, he will receive 25% of the tax savings if the case is won.

Discussion. Are there any problems for Frank?

Nothing in Circular 230 prevents Frank from testifying as a witness. However, if Frank believes that the documentation is inadequate, he must consider the consequences of testifying under oath to defend his client and the position on the returns taken in connection with the basis amount. Section 10.22, *Diligence as to accuracy*, indicates a practitioner must determine the correctness of oral and written representations made to the Department of Treasury. Based on the evidence described in the scenario, Frank should not even consider appearing as a witness for the clients.

Section 10.27, *Fees*, places some limitations on what services a practitioner can provide in return for a contingent fee. If Frank decides to serve as a witness, it appears a contingent fee under his circumstances is acceptable under §10.27(b)(4).

Frank has serious conflict considerations. The corporation and both shareholders are clients. Litigation may cause conflicting interests between the two shareholders. If Frank defends a position on the corporation tax return, it may cause negative tax consequences for one or both shareholders. Under §10.29, Frank cannot represent a client if the representation involves a conflict of interest unless he reasonably believes that he can provide competent and diligent representation to each affected client. Section 10.29(b)(3) gives Frank the option of obtaining a waiver and informed consent from the clients. Because one of the clients is a corporation with Al and Ben as the shareholders, it may be difficult for Frank to predict the outcomes for Al and Ben to the degree needed for their informed consent, particularly in a litigation setting. Because Al and Ben must give consent for themselves as well as for the corporation, they may not be able to fully appreciate how their interests may diverge from one another in the course of the lawsuit.

Frank also has a conflict between his interests and those of the corporation and shareholders. The IRS may determine that Frank did not meet the due diligence requirements because he did not ask for more documentation when he determined the basis of the contributed assets was $100,000. If he is faced with a preparer penalty, he may be tempted to blame the clients for giving him erroneous information.

Scenario 32B. The Tax Court rules as follows on the case in **Scenario 32A.**

- The basis documentation for Ben's contributed equipment is inadequate. As a result, the IRS's view that the basis is zero is appropriate.
- The depreciation deductions on the equipment are disallowed for 2009 and 2010.
- Ben's 2010 purchase of the home for $1 from the corporation when the home had an FMV of $200,000 resulted in a constructive dividend to Ben in the amount of $199,999.

The attorney calls Frank to let him know the outcome of the case and that the case will be published in a few months. Later that same day, Charles arrives for an appointment with Frank. Charles tells Frank that he has discussed the possibility of purchasing a one-third interest in ABL with Al and Ben. The price agreed upon is one-third of the total assets shown on the latest cost-basis balance sheet. Charles tells Frank that he felt that meeting with Frank was a good idea because Frank was the CPA for the business and probably could give him some insight. Charles shows Frank the balance sheet that Frank prepared when he drafted the most recent set of financial statements for ABL.

Discussion. Does meeting with Charles present more problems for Frank?

Frank prepared the balance sheet based on information that was accurate at the time of preparation. Even though he knows that major balance sheet revisions are necessary due to the Tax Court's ruling, he cannot discuss the matter with Charles without the consent of the corporation and its shareholders. IRC §7216 provides possible civil and criminal penalties if Frank knowingly or recklessly discloses to Charles any tax information furnished in connection with tax returns for Al, Ben, or ABL, or uses that information for any purposes other than to prepare a return. IRC §6713 provides for further monetary penalties for the same offense.

However, a Tax Court ruling is public information. It could be argued that the Tax Court's ruling, even though not yet published, is outside the scope of information covered by IRC §§7216 and 6713. Frank's best option is to not provide any details to Charles about his clients' tax situation and to advise Charles to seek his own tax and/or legal advisor in connection with the purchase of an interest in ABL. Representing Charles in the share purchase is a conflict situation and is likely to violate §10.29. Frank should also correct Charles's mistaken belief that he is a CPA when in fact he is an RTRP.

Scenario 32C. Frank meets with Al and Ben in April 2012 in connection with the preparation of the 2011 tax return for ABL and their personal returns. Frank discusses the implications of the Tax Court's holding on the basis issue with Al and Ben. He explains that because Ben has a zero share basis, a distribution he received in 2010 as well as the constructive dividend the Tax Court ruled on will create substantial tax liability in connection with the 2010 tax year. Al mentions that during 2011, he loaned ABL a significant amount of money to cover the anticipated taxes owed on the disallowed depreciation deductions for 2009 and 2010. The funds came from a joint bank account that the two brothers have maintained for several years. Frank suggests it would be simple to change the paperwork on the loan to indicate that Ben loaned the money. This would provide Ben with some debt basis that might help his 2010 tax situation. Al and Ben ask Frank if he would assist with redrafting the paperwork.

Discussion. If Frank has already entered the loan in the corporation books as a loan from Al, would this create a problem for Frank?

This would create a due diligence problem for Frank. He would be assisting a client in a fraudulent transaction.

SCENARIO 33

Scenario 33A. Sandy is representing her client Hal in an audit. Sandy asks Hal for all the records requested by the revenue agent. In reviewing the records, Sandy discovers there are sales receipts in excess of the amounts reported on the return.

What should Sandy do?

Section 10.21, *Knowledge of client's omission*, requires Sandy to promptly tell Hal about the omission and inform him of the tax consequences. She should also consider the implications of §10.22, *Diligence as to accuracy*, which says she cannot make false statements to the IRS. Section 10.20 states that she must deliver requested information promptly. If she removes the receipts for the unreported income, she is not delivering all the requested information. Sandy delivers all the information and hopes the agent will not notice the discrepancy.

Scenario 33B. What if the auditor asks Sandy if she believes Hal reported all his income? How should Sandy respond?

Section 10.51(a)(4) prohibits Sandy from giving erroneous or misleading information. If Sandy says she believes all the income was reported on the return but knows of the unreported income, she is in violation.

Scenario 33C. If this were your client, what would you do?

The safe solution for Sandy is to tell Hal that she must report the income or withdraw from the audit.

APPENDIX: CIRCULAR 230 SECTIONS 10.20 THROUGH 10.38

The following pages reprint Circular 230 sections 10.20 through 10.38, as published in August of 2011.

Subpart B — Duties and Restrictions Relating to Practice Before the Internal Revenue Service

§ 10.20 Information to be furnished.

(a) *To the Internal Revenue Service.*

(1) A practitioner must, on a proper and lawful request by a duly authorized officer or employee of the Internal Revenue Service, promptly submit records or information in any matter before the Internal Revenue Service unless the practitioner believes in good faith and on reasonable grounds that the records or information are privileged.

(2) Where the requested records or information are not in the possession of, or subject to the control of, the practitioner or the practitioner's client, the practitioner must promptly notify the requesting Internal Revenue Service officer or employee and the practitioner must provide any information that the practitioner has regarding the identity of any person who the practitioner believes may have possession or control of the requested records or information. The practitioner must make reasonable inquiry of his or her client regarding the identity of any person who may have possession or control of the requested records or information, but the practitioner is not required to make inquiry of any other person or independently verify any information provided by the practitioner's client regarding the identity of such persons.

(3) When a proper and lawful request is made by a duly authorized officer or employee of the Internal Revenue Service, concerning an inquiry into an alleged violation of the regulations in this part, a practitioner must provide any information the practitioner has concerning the alleged violation and testify regarding this information in any proceeding instituted under this part, unless the practitioner believes in good faith and on reasonable grounds that the information is privileged.

(b) *Interference with a proper and lawful request for records or information.* A practitioner may not interfere, or attempt to interfere, with any proper and lawful effort by the Internal Revenue Service, its officers or employees, to obtain any record or information unless the practitioner believes in good faith and on reasonable grounds that the record or information is privileged.

(c) *Effective/applicability date.* This section is applicable beginning August 2, 2011.

§ 10.21 Knowledge of client's omission.

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

§ 10.22 Diligence as to accuracy.

(a) *In general.* A practitioner must exercise due diligence —

(1) In preparing or assisting in the preparation of, approving, and filing tax returns, documents, affidavits, and other papers relating to Internal Revenue Service matters;

(2) In determining the correctness of oral or written representations made by the practitioner to the Department of the Treasury; and

(3) In determining the correctness of oral or written representations made by the practitioner to clients with reference to any matter administered by the Internal Revenue Service.

(b) *Reliance on others.* Except as provided in §§ 10.34, 10.35 and 10.37, a practitioner will be presumed to have exercised due diligence for purposes of this section if the practitioner relies on the work product of another person and the practitioner used reasonable care in engaging, supervising, training, and evaluating the person, taking proper account of the nature of the relationship between the practitioner and the person.

(c) *Effective/applicability date.* This section is applicable on September 26, 2007.

§ 10.23 Prompt disposition of pending matters.

A practitioner may not unreasonably delay the prompt disposition of any matter before the Internal Revenue Service.

§ 10.24 Assistance from or to disbarred or suspended persons and former Internal Revenue Service employees.

A practitioner may not, knowingly and directly or indirectly:

(a) Accept assistance from or assist any person who is under disbarment or suspension from practice before the Internal Revenue Service if the assistance relates to a matter or matters constituting practice before the Internal Revenue Service.

(b) Accept assistance from any former government employee where the provisions of § 10.25 or any Federal law would be violated.

§ 10.25 Practice by former government employees, their partners and their associates.

(a) *Definitions.* For purposes of this section —

(1) *Assist* means to act in such a way as to advise, furnish information to, or otherwise aid another person, directly, or indirectly.

(2) *Government employee* is an officer or employee of the United States or any agency of the United States, including a special Government employee as defined in *18 U.S.C. 202(a)*, or of the District of Columbia, or of any State, or a member of Congress or of any State legislature.

(3) *Member of a firm* is a sole practitioner or an employee or associate thereof, or a partner, stockholder, associate, affiliate or employee of a partnership, joint venture, corporation, professional association or other affiliation of two or more practitioners who represent nongovernmental parties.

(4) *Particular matter involving specific parties* is defined at 5 CFR 2637.201(c), or superseding post-employment regulations issued by the U.S. Office of Government Ethics.

(5) *Rule* includes Treasury regulations, whether issued or under preparation for issuance as notices of proposed rulemaking or as Treasury decisions, revenue rulings, and revenue procedures published in the Internal Revenue Bulletin (see *26 CFR 601.601(d)(2)(ii)(b)*).

(b) *General rules* —

(1) No former Government employee may, subsequent to Government employment, represent anyone in any matter administered by the Internal Revenue Service if the representation would violate *18 U.S.C. 207* or any other laws of the United States.

(2) No former Government employee who personally and substantially participated in a particular matter involving specific parties may, subsequent to Government employment, represent or knowingly assist, in that particular matter, any person who is or was a specific party to that particular matter.

(3) A former Government employee who within a period of one year prior to the termination of Government employment had official responsibility for a particular matter involving specific parties may not, within two years after Government employment is ended, represent in that particular matter any person who is or was a specific party to that particular matter.

(4) No former Government employee may, within one year after Government employment is ended, communicate with or appear before, with the intent to influence, any employee of the Treasury Department in connection with the publication, withdrawal, amendment, modification, or interpretation of a rule the development of which the former Government employee participated in, or for which, within a period of one year prior to the termination of Government employment, the former government employee had official responsibility. This paragraph (b)(4) does not, however, preclude any former employee from appearing on one's own behalf or from representing a taxpayer before the Internal Revenue Service in connection with a particular matter involving specific parties involving the application or interpretation of

a rule with respect to that particular matter, provided that the representation is otherwise consistent with the other provisions of this section and the former employee does not utilize or disclose any confidential information acquired by the former employee in the development of the rule.

(c) *Firm representation* —

(1) No member of a firm of which a former Government employee is a member may represent or knowingly assist a person who was or is a specific party in any particular matter with respect to which the restrictions of paragraph (b)(2) of this section apply to the former Government employee, in that particular matter, unless the firm isolates the former Government employee in such a way to ensure that the former Government employee cannot assist in the representation.

(2) When isolation of a former Government employee is required under paragraph (c)(1) of this section, a statement affirming the fact of such isolation must be executed under oath by the former Government employee and by another member of the firm acting on behalf of the firm. The statement must clearly identify the firm, the former Government employee, and the particular matter(s) requiring isolation. The statement must be retained by the firm and, upon request, provided to the office(s) of the Internal Revenue Service administering or enforcing this part.

(d) *Pending representation.* The provisions of this regulation will govern practice by former Government employees, their partners and associates with respect to representation in particular matters involving specific parties where actual representation commenced before the effective date of this regulation.

(e) *Effective/applicability date.* This section is applicable beginning August 2, 2011.

§ 10.26 Notaries.

A practitioner may not take acknowledgments, administer oaths, certify papers, or perform any official act as a notary public with respect to any matter administered by the Internal Revenue Service and for which he or she is employed as counsel, attorney, or agent, or in which he or she may be in any way interested.

§ 10.27 Fees.

(a) *In general.* A practitioner may not charge an unconscionable fee in connection with any matter before the Internal Revenue Service.

(b) *Contingent fees* —

(1) Except as provided in paragraphs (b)(2), (3), and (4) of this section, a practitioner may not charge a contingent fee for services rendered in connection with any matter before the Internal Revenue Service.

(2) A practitioner may charge a contingent fee for services rendered in connection with the Service's examination of, or challenge to —

(i) An original tax return; or

(ii) An amended return or claim for refund or credit where 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.

(3) A practitioner may charge a contingent fee for services rendered in connection with a claim for credit or refund filed solely in connection with the determination of statutory interest or penalties assessed by the Internal Revenue Service.

(4) A practitioner may charge a contingent fee for services rendered in connection with any judicial proceeding arising under the Internal Revenue Code.

(c) *Definitions.* For purposes of this section —

(1) *Contingent fee* is any fee that is based, in whole or in part, on whether or not a position taken on a tax return or other filing avoids challenge by the Internal Revenue Service or is sustained either by the Internal Revenue Service or in litigation. A contingent fee includes a fee that is based on a percentage of the refund reported on a return, that is based on a percentage of the taxes saved, or that otherwise depends on the specific result attained. A contingent fee also includes any fee arrangement in which the practitioner will reimburse the client for all or a portion of the client's fee in the event that a position taken on a tax return or other filing

is challenged by the Internal Revenue Service or is not sustained, whether pursuant to an indemnity agreement, a guarantee, rescission rights, or any other arrangement with a similar effect.

(2) *Matter before the Internal Revenue Service* includes tax planning and advice, preparing or filing or assisting in preparing or filing returns or claims for refund or credit, and 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, and representing a client at conferences, hearings, and meetings.

(d) *Effective/applicability date.* This section is applicable for fee arrangements entered into after March 26, 2008.

§ 10.28 Return of client's records.

(a) In general, a practitioner must, at the request of a client, promptly return any and all records of the client that are necessary for the client to comply with his or her Federal tax obligations. The practitioner may retain copies of the records returned to a client. The existence of a dispute over fees generally does not relieve the practitioner of his or her responsibility under this section. Nevertheless, if applicable state law allows or permits the retention of a client's records by a practitioner in the case of a dispute over fees for services rendered, the practitioner need only return those records that must be attached to the taxpayer's return. The practitioner, however, must provide the client with reasonable access to review and copy any additional records of the client retained by the practitioner under state law that are necessary for the client to comply with his or her Federal tax obligations.

(b) For purposes of this section — Records of the client include all documents or written or electronic materials provided to the practitioner, or obtained by the practitioner in the course of the practitioner's representation of the client, that preexisted the retention of the practitioner by the client. The term also includes materials that were prepared by the client or a third party (not including an employee or agent of the practitioner) at any time and provided to the practitioner with respect to the subject matter of the representation. The term also includes any return, claim for refund, schedule, affidavit, appraisal or any other document prepared by the practitioner, or his or her employee or agent, that was presented to the client with respect to a prior representation if such document is necessary for the taxpayer to comply with his or her current Federal tax obligations. The term does not include any return, claim for refund, schedule, affidavit, appraisal or any other document prepared by the practitioner or the practitioner's firm, employees or agents if the practitioner is withholding such document pending the client's performance of its contractual obligation to pay fees with respect to such document.

§ 10.29 Conflicting interests.

(a) Except as provided by paragraph (b) of this section, a practitioner shall not represent a client before the Internal Revenue Service if the representation involves a conflict of interest. A conflict of interest exists if —

(1) The representation of one client will be directly adverse to another client; or

(2) There is a significant risk that the representation of one or more clients will be materially limited by the practitioner's responsibilities to another client, a former client or a third person, or by a personal interest of the practitioner.

(b) Notwithstanding the existence of a conflict of interest under paragraph (a) of this section, the practitioner may represent a client if —

(1) The practitioner reasonably believes that the practitioner will be able to provide competent and diligent representation to each affected client;

(2) The representation is not prohibited by law; and

(3) Each affected client waives the conflict of interest and gives informed consent, confirmed

in writing by each affected client, at the time the existence of the conflict of interest is known by the practitioner. The confirmation may be made within a reasonable period of time after the informed consent, but in no event later than 30 days.

(c) Copies of the written consents must be retained by the practitioner for at least 36 months from the date of the conclusion of the representation of the affected clients, and the written consents must be provided to any officer or employee of the Internal Revenue Service on request.

(d) *Effective/applicability date.* This section is applicable on September 26, 2007.

§ 10.30 Solicitation.

(a) *Advertising and solicitation restrictions.*

(1) A practitioner may not, with respect to any Internal Revenue Service matter, in any way use or participate in the use of any form of public communication or private solicitation containing a false, fraudulent, or coercive statement or claim; or a misleading or deceptive statement or claim. Enrolled agents, enrolled retirement plan agents, or registered tax return preparers, in describing their professional designation, may not utilize the term "certified" or imply an employer/employee relationship with the Internal Revenue Service. Examples of acceptable descriptions for enrolled agents are "enrolled to represent taxpayers before the Internal Revenue Service," "enrolled to practice before the Internal Revenue Service," and "admitted to practice before the Internal Revenue Service." Similarly, examples of acceptable descriptions for enrolled retirement plan agents are "enrolled to represent taxpayers before the Internal Revenue Service as a retirement plan agent" and "enrolled to practice before the Internal Revenue Service as a retirement plan agent." An example of an acceptable description for registered tax return preparers is "designated as a registered tax return preparer by the Internal Revenue Service."

(2) A practitioner may not make, directly or indirectly, an uninvited written or oral solicitation of employment in matters related to the Internal Revenue Service if the solicitation violates Federal or State law or other applicable rule, e.g., attorneys are precluded from making a solicitation that is prohibited by conduct rules applicable to all attorneys in their State(s) of licensure. Any lawful solicitation made by or on behalf of a practitioner eligible to practice before the Internal Revenue Service must, nevertheless, clearly identify the solicitation as such and, if applicable, identify the source of the information used in choosing the recipient.

(b) *Fee information.*

(1)(i) A practitioner may publish the availability of a written schedule of fees and disseminate the following fee information —

(A) Fixed fees for specific routine services.

(B) Hourly rates.

(C) Range of fees for particular services.

(D) Fee charged for an initial consultation.

(ii) Any statement of fee information concerning matters in which costs may be incurred must include a statement disclosing whether clients will be responsible for such costs.

(2) A practitioner may charge no more than the rate(s) published under paragraph (b)(1) of this section for at least 30 calendar days after the last date on which the schedule of fees was published.

(c) *Communication of fee information.* Fee information may be communicated in professional lists, telephone directories, print media, mailings, and electronic mail, facsimile, hand delivered flyers, radio, television, and any other method. The method chosen, however, must not cause the communication to become untruthful, deceptive, or otherwise in violation of this part. A practitioner may not persist in attempting to contact a prospective client if the prospective client has made it known to the practitioner that he or she does not desire to be solicited. In the case of radio and television broadcasting, the broadcast must be recorded and the practitioner must retain a recording of the actual transmission. In the case of direct mail and e-commerce communications, the practitioner must retain a copy of the actual communication, along with a list or other description of persons to whom the communication was mailed or otherwise distributed.

The copy must be retained by the practitioner for a period of at least 36 months from the date of the last transmission or use.

(d) *Improper associations.* A practitioner may not, in matters related to the Internal Revenue Service, assist, or accept assistance from, any person or entity who, to the knowledge of the practitioner, obtains clients or otherwise practices in a manner forbidden under this section.

(e) *Effective/applicability date.* This section is applicable beginning August 2, 2011.

(Approved by the Office of Management and Budget under Control No. 1545-1726)

§ 10.31 Negotiation of taxpayer checks.

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

§ 10.32 Practice of law.

Nothing in the regulations in this part may be construed as authorizing persons not members of the bar to practice law.

§ 10.33 Best practices for tax advisors.

(a) *Best practices.* Tax advisors should provide clients with the highest quality representation concerning Federal tax issues by adhering to best practices in providing advice and in preparing or assisting in the preparation of a submission to the Internal Revenue Service. In addition to compliance with the standards of practice provided elsewhere in this part, best practices include the following:

(1) 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.

(2) 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.

(3) Advising the client regarding the import of the conclusions reached, including, for example, whether a taxpayer may avoid accuracy-related penalties under the Internal Revenue Code if a taxpayer acts in reliance on the advice.

(4) Acting fairly and with integrity in practice before the Internal Revenue Service.

(b) *Procedures to ensure best practices for tax advisors.* Tax advisors with responsibility for overseeing a firm's practice of providing advice concerning Federal tax issues or of preparing or assisting in the preparation of submissions to the Internal Revenue Service should take reasonable steps to ensure that the firm's procedures for all members, associates, and employees are consistent with the best practices set forth in paragraph (a) of this section.

(c) *Applicability date.* This section is effective after June 20, 2005.

§ 10.34 Standards with respect to tax returns and documents, affidavits and other papers.

(a) *Tax returns*.

(1) A practitioner may not willfully, recklessly, or through gross incompetence —

(i) Sign a tax return or claim for refund that the practitioner knows or reasonably should know contains a position that —

(A) Lacks a reasonable basis;

(B) Is an unreasonable position as described in section 6694(a)(2) of the Internal Revenue Code (Code) (including the related regulations and other published guidance); or

(C) 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 section 6694(b)(2) of the Code (including the related regulations and other published guidance).

(ii) Advise a client to take a position on a tax return or claim for refund, or prepare a portion of a tax return or claim for refund containing a position, that —

(A) Lacks a reasonable basis;

(B) Is an unreasonable position as described in section 6694(a)(2) of the Code (including the related regulations and other published guidance); or

(C) 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 section 6694(b)(2) of the Code (including the related regulations and other published guidance).

(2) A pattern of conduct is a factor that will be taken into account in determining whether a practitioner acted willfully, recklessly, or through gross incompetence.

(b) *Documents, affidavits and other papers* —

(1) A practitioner may not advise a client to take a position on a document, affidavit or other paper submitted to the Internal Revenue Service unless the position is not frivolous.

(2) A practitioner may not advise a client to submit a document, affidavit or other paper to the Internal Revenue Service —

(i) The purpose of which is to delay or impede the administration of the Federal tax laws;

(ii) That is frivolous; or

(iii) That contains or omits information in a manner that demonstrates an intentional disregard of a rule or regulation unless the practitioner also advises the client to submit a document that evidences a good faith challenge to the rule or regulation.

(c) *Advising clients on potential penalties* —

(1) A practitioner must inform a client of any penalties that are reasonably likely to apply to the client with respect to —

(i) A position taken on a tax return if —

(A) The practitioner advised the client with respect to the position; or

(B) The practitioner prepared or signed the tax return; and

(ii) Any document, affidavit or other paper submitted to the Internal Revenue Service.

(2) The practitioner also must inform the client of any opportunity to avoid any such penalties by disclosure, if relevant, and of the requirements for adequate disclosure.

(3) This paragraph (c) applies even if the practitioner is not subject to a penalty under the Internal Revenue Code with respect to the position or with respect to the document, affidavit or other paper submitted.

(d) *Relying on information furnished by clients.* A practitioner advising a client to take a position on a tax return, document, affidavit or other paper submitted to the Internal Revenue Service, or preparing or signing a tax return as a preparer, generally may rely in good faith without verification upon information furnished by the client. The practitioner may not, however, ignore the implications of information furnished to, or actually known by, the practitioner, and must make reasonable inquiries if the information as furnished appears to be incorrect, inconsistent with an important fact or another factual assumption, or incomplete.

(e) *Effective/applicability date.* Paragraph (a) of this section is applicable for returns or claims for refund filed, or advice provided, beginning August 2, 2011. Paragraphs (b) through (d) of this section are applicable to tax returns, documents, affidavits, and other papers filed on or after September 26, 2007.

§ 10.35 Requirements for covered opinions.

(a) A practitioner who provides a covered opinion shall comply with the standards of practice in this section.

(b) *Definitions.* For purposes of this subpart —

(1) *A practitioner* includes any individual described in §10.2(a)(5).

(2) *Covered opinion* —

(i) *In general.* A *covered opinion* is written advice (including electronic communications) by a practitioner concerning one or more Federal tax issues arising from —

(A) A transaction that is the same as or substantially similar to a transaction that, at the time the advice is rendered, the Internal Revenue Service has determined to be a tax avoidance transaction and identified by published guidance as a listed transaction under 26 CFR 1.6011-4(b)(2);

(B) Any partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, the principal purpose of which is the avoidance or evasion of any tax imposed by the Internal Revenue Code; or

(C) Any partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, a significant purpose of which is the avoidance or evasion of any tax imposed by the Internal Revenue Code if the written advice —

(1) Is a *reliance opinion*;

(2) Is a *marketed opinion*;

(3) Is subject to *conditions of confidentiality*; or

(4) Is subject to *contractual protection*.

(ii) *Excluded advice.* A *covered opinion* does not include —

(A) Written advice provided to a client during the course of an engagement if a practitioner is reasonably expected to provide subsequent written advice to the client that satisfies the requirements of this section;

(B) Written advice, other than advice described in paragraph (b)(2)(i)(A) of this section (concerning listed transactions) or paragraph (b)(2)(i)(B) of this section (concerning the principal purpose of avoidance or evasion) that —

(1) Concerns the qualification of a qualified plan;

(2) Is a *State or local bond opinion*; or

(3) Is included in documents required to be filed with the Securities and Exchange Commission.

(C) Written advice prepared for and provided to a taxpayer, solely for use by that taxpayer, after the taxpayer has filed a tax return with the Internal Revenue Service reflecting the tax benefits of the transaction. The preceding sentence does not apply if the practitioner knows or has reason to know that the written advice will be relied upon by the taxpayer to take a position on a tax return (including for these purposes an amended return that claims tax benefits not reported on a previously filed return) filed after the date on which the advice is provided to the taxpayer;

(D) Written advice provided to an employer by a practitioner in that practitioner's capacity as an employee of that employer solely for purposes of determining the tax liability of the employer; or

(E) Written advice that does not resolve a Federal tax issue in the taxpayer's favor, unless the advice reaches a conclusion favorable to the taxpayer at any confidence level (e.g., not frivolous, realistic possibility of success, reasonable basis or substantial authority) with respect to that issue. If written advice concerns more than one Federal tax issue, the advice must comply with the requirements of paragraph (c) of this section with respect to any Federal tax issue not described in the preceding sentence.

(3) *A Federal tax issue* is a question concerning the Federal tax treatment of an item of income, gain, loss, deduction, or credit, the existence or absence of a taxable transfer of property, or the value of property for Federal tax purposes. For purposes of this subpart, a *Federal tax issue* is significant if the Internal Revenue Service has a reasonable basis for a successful challenge and its resolution could have a significant impact, whether beneficial or adverse and under any reasonably foreseeable circumstance, on the overall Federal tax treatment of the transaction(s) or matter(s) addressed in the opinion.

(4) *Reliance opinion* —

(i) Written advice is a *reliance opinion* if the advice concludes at a confidence level of at least more likely than not a greater than 50 percent likelihood) that one or more significant Federal tax issues would be resolved in the taxpayer's favor.

(ii) For purposes of this section, written advice, other than advice described in paragraph (b)(2)(i)(A) of this section (concerning listed transactions) or paragraph (b)(2)(i)(B) of this section (concerning the principal purpose of avoidance or evasion), is not treated as a *reliance opinion* if the practitioner prominently discloses in the written advice that it was not intended or written by the practitioner to be used, and that it cannot be used by the taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer.

(5) *Marketed opinion* —

(i) Written advice is a *marketed opinion* if the practitioner knows or has reason to know that the written advice will be used or referred to by a person other than the practitioner (or a person who is a member of, associated with, or employed by the practitioner's firm) in promoting, marketing or recommending a partnership or other entity, investment plan or arrangement to one or more taxpayer(s).

(ii) For purposes of this section, written advice, other than advice described in paragraph (b)(2)(i)(A) of this section (concerning listed transactions) or paragraph (b)(2)(i)(B) of this section (concerning the principal purpose of avoidance or evasion), is not treated as a *marketed opinion* if the practitioner prominently discloses in the written advice that —

(A) The advice was not intended or written by the practitioner to be used, and that it cannot be used by any taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer;

(B) The advice was written to support the promotion or marketing of the transaction(s) or matter(s) addressed by the written advice; and

(C) The taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor.

(6) *Conditions of confidentiality.* Written advice is subject to *conditions of confidentiality* if the practitioner imposes on one or more recipients of the written advice a limitation on disclosure of the tax treatment or tax structure of the transaction and the limitation on disclosure protects the confidentiality of that practitioner's tax strategies, regardless of whether the limitation on disclosure is legally binding. A claim that a transaction is proprietary or exclusive is not a limitation on disclosure if the practitioner confirms to all recipients of the written advice that there is no limitation on disclosure of the tax treatment or tax structure of the transaction that is the subject of the written advice.

(7) *Contractual protection.* Written advice is subject to *contractual protection* if the taxpayer has the right to a full or partial refund of fees paid to the practitioner (or a person who is a member of, associated with, or employed by the practitioner's firm) if all or a part of the intended tax consequences from the matters addressed in the written advice are not sustained, or if the fees paid to the practitioner (or a person who is a member of, associated with, or employed by the practitioner's firm) are contingent on the taxpayer's realization of tax benefits from the transaction. All the facts and circumstances relating to the matters addressed in the written advice will be considered when determining whether a fee is refundable or contingent, including the right to reimbursements of amounts that the parties to a transaction have not designated as fees or any agreement to provide services without reasonable compensation.

(8) *Prominently disclosed.* An item is *prominently disclosed* if it is readily apparent to a reader of the written advice. Whether an item is readily apparent will depend on the facts and circumstances surrounding the written advice including, but not limited to, the sophistication of the taxpayer and the length of the written advice. At a minimum, to be prominently disclosed an item must be set forth in a separate section (and not in a footnote) in a typeface that is the same size or larger than the typeface of any discussion of the facts or law in the written advice.

(9) *State or local bond opinion.* A *State or local bond opinion* is written advice with respect to a *Federal tax issue* included in any materials delivered to a purchaser of a State or local bond in connection with the issuance of the bond in a public or private offering, including an official statement (if one is prepared), that concerns only the excludability of interest on a State or local bond from gross income under section 103 of the Internal Revenue Code, the application of section 55 of the Internal Revenue Code to a State or local bond, the status of a State or local bond as a qualified tax-exempt obligation under section 265 (b)(3) of the Internal Revenue Code, the status of a State or local bond as a qualified zone academy bond under section 1397E of the Internal Revenue Code, or any combination of the above.

(10) *The principal purpose.* For purposes of this section, the principal purpose of a partnership or other entity, investment plan or arrangement, or other

plan or arrangement is the avoidance or evasion of any tax imposed by the Internal Revenue Code if that purpose exceeds any other purpose. The principal purpose of a partnership or other entity, investment plan or arrangement, or other plan or arrangement is not to avoid or evade Federal tax if that partnership, entity, plan or arrangement has as its purpose the claiming of tax benefits in a manner consistent with the statute and Congressional purpose. A partnership, entity, plan or arrangement may have a significant purpose of avoidance or evasion even though it does not have the principal purpose of avoidance or evasion under this paragraph (b)(10).

(c) *Requirements for covered opinions.* A practitioner providing a *covered opinion* must comply with each of the following requirements.

(1) *Factual matters.*

(i) The practitioner must use reasonable efforts to identify and ascertain the facts, which may relate to future events if a transaction is prospective or proposed, and to determine which facts are relevant. The opinion must identify and consider all facts that the practitioner determines to be relevant.

(ii) The practitioner must not base the opinion on any unreasonable factual assumptions (including assumptions as to future events). An unreasonable factual assumption includes a factual assumption that the practitioner knows or should know is incorrect or incomplete. For example, it is unreasonable to assume that a transaction has a business purpose or that a transaction is potentially profitable apart from tax benefits. A factual assumption includes reliance on a projection, financial forecast or appraisal. It is unreasonable for a practitioner to rely on a projection, financial forecast or appraisal if the practitioner knows or should know that the projection, financial forecast or appraisal is incorrect or incomplete or was prepared by a person lacking the skills or qualifications necessary to prepare such projection, financial forecast or appraisal. The opinion must identify in a separate section all factual assumptions relied upon by the practitioner.

(iii) The practitioner must not base the opinion on any unreasonable factual representations, statements or findings or of the taxpayer or any other person. An unreasonable factual representation includes a factual representation that the practitioner knows or should know is incorrect or incomplete. For example, a practitioner may not rely on a factual representation that a transaction has a business purpose if the representation does not include a specific description of the business purpose or the practitioner knows or should know that the representation is incorrect or incomplete. The opinion must identify in a separate section all factual representations, statements or finds of the taxpayer relied upon by the practitioner.

(2) *Relate law to facts.*

(i) The opinion must relate the applicable law (including potentially applicable judicial doctrines) to the relevant facts.

(ii) The practitioner must not assume the favorable resolution of any significant Federal tax issue except as provided in paragraphs (c)(3)(v) and (d) of this section, or otherwise base an opinion on any unreasonable legal assumptions, representations, or conclusions.

(iii) The opinion must not contain internally inconsistent legal analyses or conclusions.

(3) *Evaluation of significant Federal tax issues* —

(i) *In general.* The opinion must consider all significant Federal tax issues except as provided in paragraphs (c)(3)(v) and (d) of this section.

(ii) *Conclusion as to each significant Federal tax issues.* The opinion must provide the practitioner's conclusion as to the likelihood that the taxpayer will prevail on the merits with respect to each significant Federal tax issue considered in the opinion. If the practitioner is unable to reach a conclusion with respect to one or more of those issues, the opinion must state that the practitioner is unable to reach a conclusion with respect to those issues. The opinion must describe the reasons for the conclusions, including the facts and analysis supporting the conclusions, or describe the reasons that the practitioner is unable to reach a conclusion as to one or more issues. If the practitioner fails to reach a conclusion at the confidence level of at least more likely than not with respect to one or more significant Federal tax issues considered, the opinion must include the appropriate disclosure(s) required under paragraph (e) of this section.

(iii) *Evaluation based on chances of success on the merits.* In evaluating the significant Federal tax issues addressed in the opinion, the practitioner must not take 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 resolved through settlement if raised.

(iv) *Marketed opinions.* In the case of a *marketed opinion*, the opinion must provide the practitioner's conclusion that the taxpayer will prevail on the merits at a confidence level of at least more likely than not with respect to each significant Federal tax issue. If the practitioner is unable to reach a more likely than not conclusion with respect to each significant Federal tax issue, the practitioner must not provide the marketed opinion, but may provide written advice that satisfies the requirements in paragraph (b)(5)(ii) of this section.

(v) *Limited scope opinions.* (A) The practitioner may provide an opinion that considers less than all of the significant Federal tax issues if —

(1) The practitioner and the taxpayer agree that the scope of the opinion and the taxpayer's potential reliance on the opinion for purposes of avoiding penalties that may be imposed on the taxpayer are limited to the Federal tax issue(s) addressed in the opinion;

(2) The opinion is not advice described in paragraph (b)(2)(i)(A) of this section (concerning listed transactions), paragraph (b)(2)(i)(B) of this section (concerning the principal purpose of avoidance or evasion) or paragraph (b)(5) of this section (a *marketed opinion*); and

(3) The opinion includes the appropriate disclosure(s) required under paragraph (e) of this section.

(B) A practitioner may make reasonable assumptions regarding the favorable resolution of a Federal tax issue (as assumed issue) for purposes of providing an opinion on less than all of the significant Federal tax issues as provided in this paragraph (c)(3)(v). The opinion must identify in a separate section all issues for which the practitioner assumed a favorable resolution.

(4) *Overall conclusion.*

(i) The opinion must provide the practitioner's overall conclusion as to the likelihood that the Federal tax treatment of the transaction or matter that is the subject of the opinion is the proper treatment and the reasons for that conclusion. If the practitioner is unable to reach an overall conclusion, the opinion must state that the practitioner is unable to reach and overall conclusion and describe the reasons for the practitioner's inability to reach a conclusion.

(ii) In the case of a *marketed opinion*, the opinion must provide the practitioner's overall conclusion that the Federal tax treatment of the transaction or matter that is the subject of the opinion is the proper treatment at a confidence level of at least more likely than not.

(d) *Competence to provide opinion; reliance on opinions of others.*

(1) The practitioner must be knowledgeable in all of the aspects of Federal tax law relevant to the opinion being rendered, except that the practitioner may rely on the opinion of another practitioner with respect to one or more significant Federal tax issues, unless the practitioner knows or should know that the opinion of the other practitioner should not be relied on. If a practitioner relies on the opinion of another practitioner, the relying practitioner's opinion must identify the other opinion and set forth the conclusions reached in the other opinion.

(2) The practitioner must be satisfied that the combined analysis of the opinions, taken as a whole, and the overall conclusion, if any, satisfy the requirements of this section.

(e) *Required disclosures.* A covered opinion must contain all of the following disclosures that apply —

(1) *Relationship between promoter and practitioner.* An opinion must prominently disclose the existence of —

(i) Any compensation arrangement, such as a referral fee or a fee-sharing arrangement, between the practitioner (or the practitioner's firm or any person who is a member of, associated with, or employed by the practitioner's firm) and any person (other than the client for whom the opinion is prepared) with respect to promoting, marketing or recommending the entity, plan, or arrangement (or a substantially similar arrangement) that is the subject of the opinion; or

(ii) Any referral agreement between the practitioner (or the practitioner's firm or any person who is a member of, associated with, or employed by the practitioner's firm) and a person (other than the client for whom the opinion is prepared) engaged in promoting, marketing or recommending the entity, plan, or arrangement (or a substantially similar arrangement) that is the subject of the opinion.

(2) *Marketed opinions.* A *marketed opinion* must prominently disclose that —

(i) The opinion was written to support the promotion or marketing of the transaction(s) or matter(s) addressed in the opinion; and

(ii) The taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor.

(3) *Limited scope opinions.* A limited scope opinion must prominently disclose that —

(i) The opinion is limited to the one or more Federal tax issues addressed in the opinion;

(ii) Additional issues may exist that could affect the Federal tax treatment of the transaction or matter that is the subject of the opinion and the opinion does not consider or provide a conclusion with respect to any additional issues; and

(iii) With respect to any significant Federal tax issues outside the limited scope of the opinion, the opinion was not written, and cannot be used by the taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer.

(4) *Opinions that fail to reach a more likely than not conclusion.* An opinion that does not reach a conclusion at a confidence level of at least more likely than not with respect to a significant Federal tax issue must prominently disclose that —

(i) The opinion does not reach a conclusion at a confidence level of at least more likely than not with respect to one or more significant Federal tax issues addressed by the opinion; and

(ii) With respect to those significant Federal tax issues, the opinion was not written, and cannot be used by the taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer.

(5) *Advice regarding required disclosures.* In the case of any disclosure required under this section, the practitioner may not provide advice to any person that is contrary to or inconsistent with the required disclosure.

(f) *Effect of opinion that meets these standards* —

(1) *In general.* An opinion that meets the requirements of this section satisfies the practitioner's responsibilities under this section, but the persuasiveness of the opinion with regard to the tax issues in question and the taxpayer's good faith reliance on the opinion will be determined separately under applicable provisions of the law and regulations.

(2) *Standards for other written advice.* A practitioner who provides written advice that is not a covered opinion for purposes of this section is subject to the requirements of §10.37.

(g) *Effective date.* This section applies to written advice that is rendered after June 20, 2005.

§ 10.36 Procedures to ensure compliance.

(a) *Requirements for covered opinions.* Any practitioner who has (or practitioners who have or share) principal authority and responsibility for overseeing a firm's practice of providing advice concerning Federal tax issues must take reasonable steps to ensure that the firm has adequate procedures in effect for all members, associates, and employees for purposes of complying with §10.35. Any such practitioner will be subject to discipline for failing to comply with the requirements of this paragraph if —

(1) The practitioner through willfulness, recklessness, or gross incompetence does not take reasonable steps to ensure that the firm has adequate procedures to comply with §10.35, and one or more individuals who are members of, associated with, or employed by, the firm are, or have engaged in a pattern or practice, in connection with their practice with the firm, of failing to comply with §10.35; or

(2) The practitioner knows or should know that one or more individuals who are members of, associated with, or employed by, the firm are, or have, engaged in a pattern or practice, in connection with

their practice with the firm, that does not comply with §10.35 and the practitioner, through willfulness, recklessness, or gross incompetence, fails to take prompt action to correct the noncompliance.

(b) *Requirements for tax returns and other documents*. Any practitioner who has (or practitioners who have or share) principal authority and responsibility for overseeing a firm's practice of preparing tax returns, claims for refunds, or other documents for submission to the Internal Revenue Service must take reasonable steps to ensure that the firm has adequate procedures in effect for all members, associates, and employees for purposes of complying with Circular 230. Any practitioner who has (or practitioners who have or share) this principal authority will be subject to discipline for failing to comply with the requirements of this paragraph if —

(1) The practitioner through willfulness, recklessness, or gross incompetence does not take reasonable steps to ensure that the firm has adequate procedures to comply with Circular 230, and one or more individuals who are members of, associated with, or employed by, the firm are, or have, engaged in a pattern or practice, in connection with their practice with the firm, of failing to comply with Circular 230; or

(2) The practitioner knows or should know that one or more individuals who are members of, associated with, or employed by, the firm are, or have, engaged in a pattern or practice, in connection with their practice with the firm, that does not comply with Circular 230, and the practitioner, through willfulness, recklessness, or gross incompetence fails to take prompt action to correct the noncompliance.

(c) *Effective date.* This section is applicable beginning August 2, 2011.

§ 10.37 Requirements for other written advice.

(a) *Requirements.* A practitioner must not give written advice (including electronic communications) concerning one or more Federal tax issues 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, does not consider all relevant facts that the practitioner knows or should know, or, in evaluating a Federal tax issue, 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 resolved through settlement if raised. All facts and circumstances, including the scope of the engagement and the type and specificity of the advice sought by the client will be considered in determining whether a practitioner has failed to comply with this section. In the case of an opinion the practitioner knows or has reason to know will be used or referred to by a person other than the practitioner (or a person who is a member of, associated with, or employed by the practitioner's firm) in promoting, marketing or recommending to one or more taxpayers a partnership or other entity, investment plan or arrangement a significant purpose of which is the avoidance or evasion of any tax imposed by the Internal Revenue Code, the determination of whether a practitioner has failed to comply with this section will be made on the basis of a heightened standard of care because of the greater risk caused by the practitioner's lack of knowledge of the taxpayer's particular circumstances.

(b) *Effective date.* This section applies to written advice that is rendered after June 20, 2005.

§ 10.38 Establishment of advisory committees.

(a) *Advisory committees.* To promote and maintain the public's confidence in tax advisors, the Internal Revenue Service is authorized to establish one or more advisory committees composed of at least six individuals authorized to practice before the Internal Revenue Service. Membership of an advisory committee must be balanced among those who practice as attorneys, accountants, enrolled agents, enrolled actuaries, enrolled retirement plan agents, and registered tax return preparers. Under procedures prescribed by the Internal Revenue Service, an advisory committee may review and make general recommendations regarding the practices, procedures, and policies of the offices described in §10.1.

(b) *Effective date.* This section is applicable beginning August 2, 2011.