

Tax Practice Ethics & Quality Control

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REGULATION OF CPA'S TAX PRACTICE IN MOST STATES

- State Accountancy Regulations
- Treasury Department Regulations and
- Internal Revenue Code Provisions
- AICPA Statements on Standards for Tax Services
- State Society of CPAs Code of Professional Conduct

State Accountancy Regulations

- Know the source of authority for your State
- Accountancy Regulations
- Know how to apply any provisions regarding unprofessional conduct to your tax practice
- Know how State Regulations relate to other guidance
- Be familiar with disciplinary actions resulting from disregard of the Regulations
- Know how to interpret and apply the rules to your tax practice

A Common Definition of Unprofessional Conduct (1)

- Willful or grossly negligent failure to comply with substantive provisions of Federal, State or local laws, rules or regulations governing the practice of the profession.
- Exercising undue influence to exploit the client for your, or a third party's, financial gain.
- Receiving or paying fees for referral of a client, directly or indirectly, to or from a person not licensed to practice public accounting

Unprofessional Conduct (2)

- Conduct that indicates moral unfitness to practice public accounting.
- Failing to return client records
- Delegating professional responsibilities to someone not qualified to perform them.
- False or misleading advertising.

Unprofessional Conduct (3)

- Offering or rendering services for a contingent fee to a client for whom your firm performs attest services
- Permitting an unlicensed person to share in the income of your firm.
- Failing to respond to notices from the State Board of Accountancy

Circular 230(2)

- Duties and restrictions (Subpart B)
- Promptly provide information requested by IRS(10.20)
- Advise client promptly of error or omission in tax return and consequences of failure to correct(10.21)
- Exercise “due diligence” as to accuracy of representations to IRS(10.22)
 - When relying on others must show reasonable care in engaging, supervising, training, and evaluating the person
- Do not unreasonably delay prompt disposition of any matter before IRS(10.23)

Circular 230(3)

- Duties and restrictions (continued):
 - No assistance from disbarred persons(10.24)
 - No assistance from former government employee on matter she or he worked on in an official capacity while employed by IRS(10.25)
 - Cannot notarize documents you will present to IRS on behalf of client(10.26)
 - Fees(10.27)
 - No unconscionable fees
 - No contingent fee for advice as to return position or return preparation

Circular 230(4)

- Duties and restrictions (continued):
 - At request of client must promptly return all records of the client needed for tax compliance(10.28)
 - No conflicts of interest without written waiver(10.29)
 - No false, misleading or deceptive advertising(10.30)
 - Cannot endorse or negotiate refund check(10.31)
 - No unauthorized practice of law(10.32)
 - Should adhere to “Best Practices” (described)(10.33)
 - Tax return positions must have “realistic possibility of success”(10.34)
 - Tax shelter opinions must meet enumerated standards(10.35)

Circular 230(5)

- Duties and restrictions (continued):
 - Person responsible for overseeing tax practice must ensure compliance with best practices(10.36)
 - Any written advice must meet standards(10.37)
- Actions for which a practitioner may be fined, censured, or suspended)(Subpart C)
 - A criminal offense under the revenue laws or any offense involving dishonesty or breach of trust
 - Knowingly giving false information in connection with federal tax matters
 - Soliciting employment by false or deceptive advertising

Circular 230(6)

- Actions for which a practitioner may be disciplined (continued)
 - Willfully failing to file a tax return, evading or attempting to evade any federal tax
 - Mishandling client funds
 - Attempting to influence IRS employees by threat or favors
 - Being disbarred or suspended by your profession
 - Knowingly aiding a disbarred or suspended practitioner to practice before the IRS

Circular 230(7)

- Actions for which a practitioner may be disciplined (continued)
 - Using abusive language, knowingly making false accusations, circulating malicious or libelous material, or engaging in “contemptuous conduct”
 - Giving a false opinion knowingly, recklessly, or through gross incompetence
 - Following a pattern of providing incompetent opinions

IRC Sec. 7216

- Prohibits Disclosure or use of taxpayer information for any purpose without written permission.
- Rev. Proc. 2008-35 gives model language for permission to use or disclose information from 1040 series filer.
- If you would not have information but for preparation of a tax return, you may not use it for any purpose without permission.

Confidentiality Privilege – IRC Sec. 7525

- Extends limited privilege of confidentiality to communications between federally authorized tax practitioners and their clients
 - Applies to communications relating to seeking or giving tax advice
 - Does not apply to:
 - information for preparation of tax returns
 - communications relating to tax shelters
 - criminal matters

Preparer Penalties

- IRC Sec. 6694 (as of 7/14/09)
 - Greater of \$1,000 or 50% of fee for understatement due to position that did not have substantial authority, a reasonable basis (with disclosure), or was frivolous
 - Greater of \$5,000 or 50% of fee for willful understatement of liability, or reckless or intentional disregard of rules or regulations
 - Final Regs 12/22/08
 - OPR intends to use the penalty !

A Word About Disclosure

- Form 8275 must be used to disclose tax return position that does not have “substantial authority” (up from “realistic possibility of success”)
- No amount of disclosure will protect the preparer if the position is frivolous or does not meet a “reasonable basis” standard

Unreasonable Position

- The preparer knew or should have known of the position
- No reasonable belief the position could “more likely than not” be sustained on its merits
- The position was not disclosed or there was no reasonable basis for the position

Preparer Penalties(2)

- IRC Sec. 6701
 - \$1,000 for aiding and abetting an understatement of tax in a non-corporate return
 - \$10,000 for aiding and abetting an understatement of tax in a corporate return
 - These penalties apply to ANY return and have been assessed on payroll tax returns, when an accountant was responsible for a scheme to under report compensation paid to a business owner/employee, and on the false W-2 forms given to the owner/employee

Preparer Penalties(3)

- IRC Sec. 6695
 - \$50 for each failure, to a maximum \$25,000
 - Failure to furnish copy of return to taxpayer
 - Failure to sign return as preparer
 - Failure to include preparer's ID number
 - Failure to keep records of returns prepared as required by IRC Sec. 6107
 - Lack of due diligence in determining a client's eligibility for the earned income credit

Preparer Penalties(4)

- Other penalty provisions
 - IRC Sec. 6060 and Reg. 1.6060-1
 - \$50 per failure, up to \$25,000 maximum for failure to keep records of preparers employed to prepare returns
 - IRC Sec. 6713
 - \$250 for each improper disclosure , up to \$10,000 maximum

Other Penalties

- Section 6707—failure by material advisor to furnish information regarding reportable transactions
 - Reportable transaction:
 - \$50,000
 - Listed Transaction:
 - \$200,000 or 50% of Gross Income from transaction, whichever greater

Willfulness, Recklessness, or Intentional Disregard

- Willful = deliberate disregard of information furnished by the taxpayer in order to understate the taxpayer's tax liability.
- Reckless = little or no effort to determine the correct position, when a reasonable preparer would have made an effort.
- Intentional Disregard = taking a position that is contrary to a rule or regulation that the preparer knows of or should know of.

Aiding and Abetting

- Aiding, assisting, or giving advice concerning preparation of any return or claim for refund, with knowledge that the position will create an "understatement" of the liability of another person

AICPA Statements on Standards for Tax Services

- Enforceable ethical standards that govern an AICPA member's entire tax practice
- Standards 1-8 (Adopted)
- Standard 9 (Proposed and Withdrawn)
- Two interpretations of Standard Number 1
- "Realistic possibility" standard same as Treasury Circular 230, Section 10.34(a)
- Duty to examine data same as Treasury Circular 230, Section 10.34(c)

AICPA Statements on Standards for Tax Services

- Revised version to be applicable 1/1/10
- “Redlined” copy is available from www.aicpa.org
- New reliance standard mandates compliance with any and all regulations of the taxing jurisdiction
- Applies to CPAs in both public and private employment.

Realistic Possibility of Success

Number 1

At least a one in three chance of prevailing on the merits if all the facts are known to a person knowledgeable about the tax law

Interpretation #1-1 – Realistic possibility standard explained and illustrated

Interpretation #1-2 – Proper conduct of Tax Planning practice, work required to be documented . . . Puts more responsibility for determining reasonableness of return position on CPA tax advisor.

Other Standards

- **Number 2** – Answers to questions on returns – all questions should be answered unless an exception applies. Forms are “questions” for this purpose and all forms must be filed.
- **Number 3** – OK to rely on client’s information UNLESS that information appears incorrect. AICPA member has duty to investigate questionable items
- **Number 4** – OK to use estimates in certain situations if properly disclosed (Conflict with preamble to Sec. 6694 Regulations)

Other Standards (2)

- **Number 5** – Not required to continue a position agreed to in settlement of previous exam
- **Number 6** – Discovery of error in filed return must be communicated to client together with possible exposure to penalties
- **Number 7** – Discovery of error in return during preparation for examination must be communicated to client together. CPA may not inform taxing authority without client approval
- 6 and 7 will be combined in revised Standards

Other Standards (3)

- **Number 8** – (New Number 7) Form and content of advice to tax client should be in writing for matters that are:
 - important
 - unusual, or
 - complicated.
 - Seven point checklist to help you decide on form of advice in old rules.
 - Eleven point checklist in revised Standard

Other Standards (4)

- Number 9 (**proposed**)*** – Quality Control - requires any AICPA member responsible for tax compliance - - public accounting or “industry” - - to implement a system of quality control that encompasses organizational structure, policies, and procedures in order to provide reasonable assurance that the tax practice or function complies with professional standards (the other 8 discussed above). [*** **Withdrawn 1/07 in favor of education campaign encouraging voluntary QC programs in firms**]

Most State Society Codes of Professional Conduct

- Rules apply to ALL services performed
- Practice of public accounting includes tax services
- Tax practice requires “integrity and objectivity”
- Usually prohibit contingent fees, compatible with Circular 230

Most State Society Codes of Professional Conduct (2)

- Failure to return a client’s records on demand is a “discreditable act,” or unprofessional conduct
- False or misleading advertising is prohibited
- Commissions and similar fees may be permitted with disclosure, but rule on integrity and objectivity continues to apply

Case Studies

- *Schneider v. U.S.* – preparer had a duty to inquire when client’s information was suspect. Only one person in a firm can be the preparer - - the person signing the return.
- *Sorenson v. H & R Block* – unlicensed preparer has only a contractual duty to protect client information. Sharing info with IRS was not basis for recovery in lawsuit.

Case Studies (2)

- *Brockhouse v. U.S.* – Preparer of both returns had a duty to be sure interest paid to shareholder and deducted in corporate return was reported as income in shareholder's return
- *Ward v. Ambach, Commissioner* – Failure to promptly return client records resulted in \$10,000 fine and one year suspension for New York licensed public accountant

Case Studies (3)

- *Panchal v. Commissioner of Education* – CPA convicted of offering a false instrument for filing in Maryland cannot qualify to be licensed in New York . . . Didn't have "good moral character."
- *James Joseph Hager, Convicted of Operating a Motor Vehicle While Under the Influence of Alcohol*, a class E felony (in New York). Penalty: Indefinite suspension, and upon termination of suspension - probation for 2 years, and 100 hours of public service.

Case Studies (4)

- David E. Wills, License to practice as a Certified Public Accountant suspended indefinitely until State Board receives notice that he has made full payment of all arrears of support established by the Order of the Family Court to be due.
