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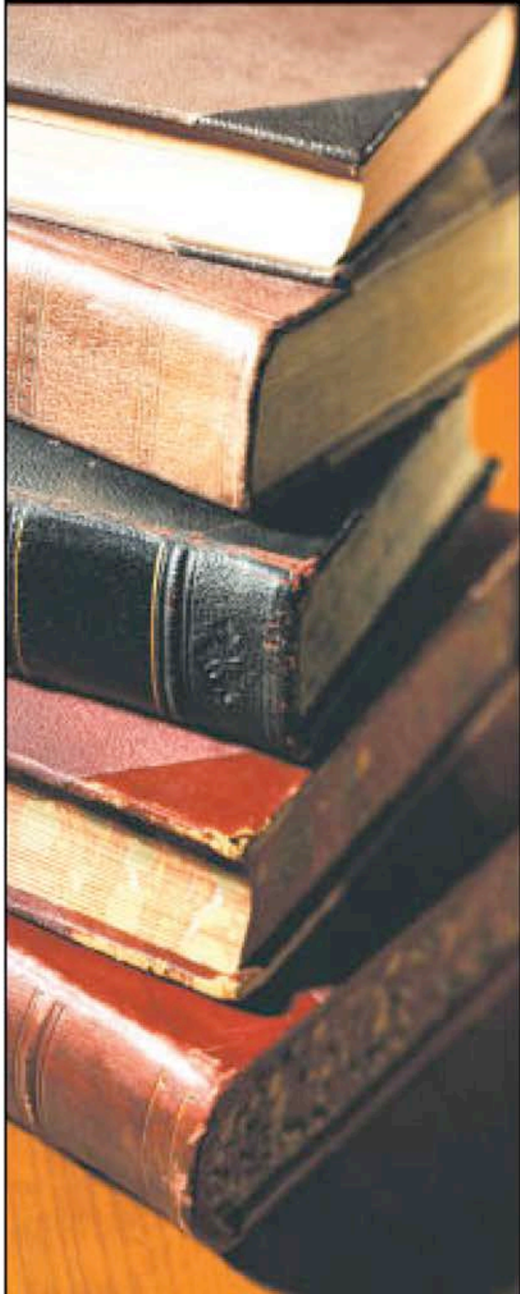

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Ethics and the Tax Professional (Course #4200L/QAS4200L)

Table of Contents

Chapter 1: IRS Circular 230

Objectives: After completing this chapter, you will be able to:

- Identify the Internal Revenue Service Requirements as outlined in Circular 230.

Introduction

The tax preparation and tax consulting industry has historically enjoyed less government regulation than the practice of accountancy. In 1995, the IRS proposed studying the concept of tax preparer registration in order to combat rising fraud in the earned income credit program. This proposal was dropped because of widespread industry opposition. Instead, the IRS increased the scrutiny applied to firms applying to file tax returns electronically. In 2010, the IRS issued regulations requiring the registration of tax preparers. Effective January 1, 2011, all paid tax return preparers are required to have a Preparer Tax Identification Number (PTIN).

The tax practice field has had less ethical guidance because of the unique relationship between the CPA and client. In an attest engagement, the CPA is ultimately responsible to the users of the client financial statements as well as to the client. In a tax engagement, the CPA is an “advocate of the taxpayer.” The courts have held that there is nothing illegal or sinister in a taxpayer arranging one’s affairs so as to pay the lowest tax legally available.

Nevertheless, CPAs in tax practice do have two sets of ethical and legal guidance which governs their tax practice. Circular 230 governs practice before the Internal Revenue Service. The AICPA has issued statements on standards for tax services. We will examine both of these items, pointing out the differences wherever relevant.

I. Circular 230

Circular 230 is published by the Treasury Department. It prescribes regulations governing the practice of attorneys, CPAs, EAs, Enrolled Actuaries, appraisers, and others before the Internal Revenue Service. Circular 230 has been amended several times recently, and more changes are proposed. The IRS is currently revising Circular 230 to extend its application to cover unenrolled tax return preparers. This course reprints and discusses most, but not all, of Circular 230.

A. EXPLANATIONS OF PROVISIONS

Tax advisors play an increasingly important role in the federal tax system, which is founded on principles of voluntary compliance. The tax system is best served when the public has confidence in the honesty and integrity of the professionals providing tax advice. To restore, promote, and maintain the public’s confidence in those individuals and firms, Circular 230 sets forth regulations and best practices applicable to all tax advisors. Circular 230 regulations are limited to practice before the IRS and do not alter or supplant other ethical standards applicable to practitioners.

B. WHAT IS NOT CONSIDERED "PRACTICE BEFORE THE IRS"

Section 10.7 of Circular 230 provides a long list of exceptions and exclusions to Circular 230. The following persons and situations are not considered "practicing before the IRS" and therefore are generally exempt from the rules we will discuss later in this course.

(a) Representing oneself – individuals may appear on their own behalf before the IRS, provided they present satisfactory identification.

(b) Participating in rulemaking – individuals may participate in rule making.

(c) Limited practice –

(1) In general. Subject to the limitations in paragraph (c)(2) of this section, an individual who is not a practitioner may represent a taxpayer before the Internal Revenue Service in the circumstances described in this paragraph (c)(1), even if the taxpayer is not present, provided the individual presents satisfactory identification and proof of his or her authority to represent the taxpayer. The circumstances described in this paragraph (c)(1) are as follows:

i. An individual may represent a member of his or her immediate family.
ii. A regular full-time employee of an individual employer may represent the employer
iii. A general partner or regular full-time employee of a partnership may represent the partnership
iv. A bona fide officer or a regular full-time employee of a corporation, association, or organized group may represent the corporation, association, or organized group
v. A regular full-time employee of a trust, receivership, guardianship, or estate may represent the trust, receivership, guardianship, or estate
vi. An officer or a regular employee of a governmental unit, agency, or authority may represent the governmental unit, agency, or authority in the course of his or her official duties.
vii. An individual may represent any individual or entity, who is outside the United States, before personnel of the Internal Revenue Service when such representation takes place outside the United States.

(2) Limitations.

i. An individual who is under suspension or disbarment from practice before the Internal Revenue Service may not engage in limited practice before the Internal Revenue Service under paragraph (c)(1) of this section.
ii. The Commissioner, or delegate, may, after notice and opportunity for a conference, deny eligibility to engage in limited practice before the Internal Revenue Service under paragraph (c)(1) of this section to any individual who has engaged in conduct that would justify a sanction under §10.50.
iii. An individual who represents a taxpayer under the authority of paragraph (c)(1) of this section is subject, to the extent of his or her authority, to such rules of general applicability regarding standards of conduct and other matters as prescribed by the Internal Revenue Service.

(d) Special appearances. The Commissioner, or delegate, may, subject to conditions deemed appropriate, authorize an individual who is not otherwise eligible to practice before the Internal Revenue Service to represent another person in a particular matter.

(e) Fiduciaries. For purposes of this part, a fiduciary (for example, a trustee, receiver, guardian, personal representative, administrator, or executor) is considered to be the taxpayer and not a representative of the taxpayer.

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

***OBSERVATION**: None of the items above in (a)-(e) are considered to be practicing before the IRS.*

Section 10.8 of Circular 230 discusses the application of Circular 230 on those that prepare tax returns and the application of the rules to other individuals as follows:

(a) 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 preparer tax identification number. Except as otherwise prescribed in forms, instructions, or other appropriate guidance, an individual must be an attorney, certified public accountant, enrolled agent, or registered tax return preparer to obtain a preparer tax identification number. Any individual who for compensation prepares or assists with the preparation of all or substantially all of a tax return or claim for refund is subject to the duties and restrictions relating to practice in subpart B, as well as subject to the sanctions for violation of the regulations in subpart C.

(b) Preparing a tax return and furnishing information. Any individual may for compensation prepare or assist with the preparation of a tax return or claim for refund (provided the individual prepares less than substantially all of the tax return or claim for refund), appear as a witness for the taxpayer before the Internal Revenue Service, or furnish information at the request of the Internal Revenue Service or any of its officers or employees.

(c) Application of rules to other individuals. Any individual who for compensation prepares, or assists in the preparation of, all or a substantial portion of a document pertaining to any taxpayer's tax liability for submission to the Internal Revenue Service is subject to the duties and restrictions relating to practice in subpart B, as well as subject to the sanctions for violation of the regulations in subpart C. Unless otherwise a practitioner, however, an individual may not for compensation prepare, or assist in the preparation of, all or substantially all of a tax return or claim for refund, or sign tax returns and claims for refund. For purposes of this paragraph, an individual described in 26 CFR 301.7701-15(f) is not treated as having prepared all or a substantial portion of the document by reason of such assistance.

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

A CPA who is practicing before the IRS and does not fall into one of the exception categories above is subject to subpart B of Circular 230 – Duties and Restrictions relating to practice before the IRS. It is reproduced below and should be read in its entirety.

C. CIRCULAR 230: SUBPART B – DUTIES AND RESTRICTIONS RELATING TO PRACTICE BEFORE THE INTERNAL REVENUE SERVICE

Table of Contents (this subpart)

Section

SECTION 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.

OBSERVATION: *The paragraph above should be read in light of the enacted accountant-client privilege.*

OBSERVATION: *Section 10.20 requires a practitioner to respond promptly to a proper and lawful request for records and information, unless the practitioner believes in good faith and on reasonable grounds that the records or information are privileged.*

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.

OBSERVATION: *Sometimes referred to as "snitch laws" these provisions require the cooperation of those practicing before the IRS. Failure to cooperate could result in the loss of the right to practice before the IRS.*

(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.

SECTION 10.21 Knowledge of client's omission.

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

OBSERVATION: *When you sign a tax return as a paid preparer, your signature is based not only on what is presented in the return but any item that you have knowledge of.*

SECTION 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.

SECTION 10.23 Prompt disposition of pending matters.

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

EXAMPLE

Nash, CPA is representing a client under audit by the IRS. Nash believes all the factual matters of the audit could be resolved in 6-8 weeks. Nash learns that the auditor assigned to the audit is planning to retire in six months. Nash believes that if he could delay the audit by raising unreasonable objections until after the IRS agent retires, he could possibly get a better result from the new agent. Purposely delaying the conclusion of the audit until after the IRS agent retires would be a violation of Section 10.23.

OBSERVATION: *The following two sections seek to ensure that all persons will be treated equally by the IRS and that none will receive preferential treatment.*

SECTION 10.24 Assistance from 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.

SECTION 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.

OBSERVATION: *This section reflects changes to federal statutes governing post-employment restrictions applicable to former government employees.*

OBSERVATION: *The section above may impose obligations on the firms of former government employees that exceed the obligations of other practitioners.*

SECTION 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.

OBSERVATION: *Obviously, a notary may not be a party to the transaction, benefit from the transaction, or have a conflict of interest.*

SECTION 10.27 Fees.

(a) In general.

A practitioner may not charge an unconscionable fee in connection with any matter before the Internal Revenue Service.

OBSERVATION: *A practitioner may charge different rates depending upon the complexity of the issue.*

(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

OBSERVATION: *Contrary to AICPA standards, a contingent fee may not be charged on an original return even when the practitioner reasonably anticipates that the return position will be substantively reviewed by the IRS prior to filing of the 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.

SECTION 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.

OBSERVATION: *The records that must be returned are limited to those records necessary for the client to comply with his or her federal tax obligations. This rule does not apply to other records the practitioner may have.*

(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.

OBSERVATION: *A practitioner may withhold the client's current year completed tax return pending payment of fees.*

AICPA AND STATE LAW COMPARISON: This section is more restrictive than AICPA rules. However, most state accountancy laws require the immediate return of all client records while the IRS rule pertains only to tax related records.

SECTION 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;

(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 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.

Practice Pointer: Consents must be in writing and must be retained for at least 36 months after the conclusion of the engagement.

SECTION 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 or enrolled retirement plan agents, in describing their professional designation, may not utilize the term of art "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 acceptance description for registered tax return preparers is “designated as a registered tax return preparer by the Internal Revenue Service.”

OBSERVATION: *Most Boards of Accountancy have similar laws banning false and misleading statements.*

(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.

Practice Pointer: When practitioners send their clients annual income tax organizers, it is appropriate to include an engagement letter. The engagement letter should specify the responsibilities of both the practitioner and client as well as the responsibility for fees and 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, 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.

Practice Pointer: Practitioners must keep a copy of all mailers for at least 36 months.

(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.

SECTION 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.

Practice Pointer: By completing Form 2848 “Power of Attorney and Declaration of Representative,” a taxpayer may authorize their representative to receive refund checks. However, even the power of attorney specifically forbids the representative from endorsing refund checks.

SECTION 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.

SECTION 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, and 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.

SECTION 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.

SECTION 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 Sec. 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)(ii)(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 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 circumstances, on the overall federal tax treatment of the transaction(s) or matter(s) addressed in the opinion.

(4) Reliance opinion

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.

For purposes of this section, written advice, other than advice described in paragraph (b)(2)(1)(A) of this section (concerning listed transactions) or paragraph (b)(2)(1)(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 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 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 taxpayer's factual representation that a transaction has a business purpose if the representation fails to 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 findings 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 issue

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 a 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 (an 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 an 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 such opinion of the other practitioner should not be relied on. If a practitioner relies on the opinion of another practitioner, the relying practitioner 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 the 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 that with respect to one or more material 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 separately determined 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 Sec. 10.37.

(g) Effective date.

This section applies to written advice that is rendered after June 20, 2005.

SECTION 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 Sec. 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 Sec. 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 Sec. 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 the firm, that does not comply with Sec. 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.

SECTION 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.

SECTION 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 five 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.

D. CIRCULAR 230: SUBPART C – SANCTIONS FOR VIOLATION OF THE REGULATIONS

Table of Contents (this subpart)

SECTION 10.50 Sanctions.

(a) Authority to censure, suspend, or disbar.

The Secretary of the Treasury, or delegate, after notice and an opportunity for a proceeding, may censure, suspend or disbar any practitioner from practice before the Internal Revenue Service if the practitioner is shown to be incompetent or disreputable (within the meaning of Sec. 10.51), fails to comply with any regulation in this part (under the prohibited conduct standards of Sec. 10.52), or with intent to defraud, willfully and knowingly misleads or threatens a client or prospective client. Censure is a public reprimand.

OBSERVATION: *The new regulations add "censure" as a possible sanction.*

(b) Authority to disqualify.

The Secretary of the Treasury, or delegate, after due notice and opportunity for hearing, may disqualify any appraiser for a violation of these rules as applicable to appraisers.

(1) If any appraiser is disqualified pursuant to this subpart C, the appraiser is barred from presenting evidence or testimony in any administrative proceeding before the Department of Treasury or the Internal Revenue Service, unless and until authorized to do so by the Internal Revenue Service pursuant to §10.81, regardless of whether the evidence or testimony would pertain to an appraisal made prior to or after the effective date of disqualification.

(2) Any appraisal made by a disqualified appraiser after the effective date of disqualification will not have any probative effect in any administrative proceeding before the Department of the Treasury or the Internal Revenue Service. An appraisal otherwise barred from admission into evidence pursuant to this section may be admitted into evidence solely for the purpose of determining the taxpayer's reliance in good faith on such appraisal.

(c) Authority to impose monetary penalty

(1) In general.

(i) The Secretary of the Treasury, or delegate, after notice and an opportunity for a proceeding, may impose a monetary penalty on any practitioner who engages in conduct subject to sanction under paragraph (a) of this section.

(ii) If the practitioner described in paragraph (c)(1)(i) of this section was acting on behalf of an employer or any firm or other entity in connection with the conduct giving rise to the penalty, the Secretary of the Treasury, or delegate, may impose a monetary penalty on the employer, firm, or entity if it knew, or reasonably should have known, of such conduct.

(2) Amount of penalty. The amount of the penalty shall not exceed the gross income derived (or to be derived) from the conduct giving rise to the penalty.

(3) Coordination with other sanctions. Subject to paragraph (c)(2) of this section

(i) Any monetary penalty imposed on a practitioner under this paragraph (c) may be in addition to or in lieu of any suspension, disbarment or censure and may be in addition to a penalty imposed on an employer, firm or other entity under paragraph (c)(1)(ii) of this section.

(ii) Any monetary penalty imposed on an employer, firm or other entity may be in addition to or in lieu of penalties imposed under paragraph (c)(1)(i) of this section.

(d) Authority to accept a practitioner's consent to sanction. The Internal Revenue Service may accept a practitioner's office of consent to be sanctioned under §10.50 in lieu of instituting or continuing a proceeding under §10.60(a).

(e) Sanctions to be imposed. The sanctions imposed by this section shall take into account all relevant facts and circumstances.

(f) Effective/applicability date. This section is applicable to conduct occurring on or after August 2, 2011, except that paragraphs (a), (b)(2), and (e) apply to conduct occurring on or after September 26, 2007, and paragraph (c) applies to prohibited conduct that occurs after October 22, 2004.

SECTION 10.51 Incompetence and disreputable conduct.

(a) Incompetence and disreputable conduct. Incompetence and disreputable conduct for which a practitioner may be sanctioned under §10.50 includes, but is not limited to--

(1) Conviction of any criminal offense under the Federal tax laws.

(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 involved renders the practitioner unfit to practice before the Internal Revenue Service.

(4) Giving false or misleading information, or participating in any way in the giving of false or misleading information to the Department of the Treasury or any officer or employee thereof, or to any tribunal authorized to pass upon Federal tax matters, in connection with any matter pending or likely to be pending before them, knowing the information to be false or misleading. Facts or other matters contained in testimony, Federal tax returns, financial statements, applications for enrollment, affidavits, declarations, and any other document or statement, written or oral, are included in the term “information.”

(5) Solicitation of employment as prohibited under §10.30, the use of false or misleading representations with intent to deceive a client or prospective client in order to procure employment, or intimating that the practitioner is able improperly to obtain special consideration or action from the Internal Revenue Service or any officer or employee thereof.

(6) Willfully failing to make a Federal tax return in violation of the Federal tax laws, or willfully evading, attempting to evade, or participating in any way in evading or attempting to evade any assessment or payment of any Federal tax.

(7) Willfully assisting, counseling, encouraging a client or prospective client in violating, or suggesting to a client or prospective client to violate, any Federal tax law, or knowingly counseling or suggesting to a client or prospective client an illegal plan to evade Federal taxes or payment thereof.

(8) Misappropriation of, or failure properly or promptly to remit, funds received from a client for the purpose of payment of taxes or other obligations due the United States.

(9) Directly or indirectly attempting to influence, or offering or agreeing to attempt to influence, the official action of any officer or employee of the Internal Revenue Service by the use of threats, false accusations, duress or coercion, by the offer of any special inducement or promise of an advantage, or by the bestowing of any gift, favor or thing of value.

(10) Disbarment or suspension from practice as an attorney, certified public accountant, public accountant or actuary by any duly constituted authority of any State, territory, or possession of the United States, including a Commonwealth, or the District of Columbia, any Federal court of record or any Federal agency, body or board.

(11) Knowingly aiding and abetting another person to practice before the Internal Revenue Service during a period of suspension, disbarment or ineligibility of such other person.

(12) Contemptuous conduct in connection with practice before the Internal Revenue Service, including the use of abusive language, making false accusations or statements, knowing them to be false or circulating or publishing malicious or libelous matter.

(13) Giving a false opinion, knowingly, recklessly, or through gross incompetence, including 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. False opinions described in this paragraph (a)(13) include those which reflect or result from a knowing misstatement of fact or law, from an assertion of a position known

to be unwarranted under existing law, from counseling or assisting in conduct known to be illegal or fraudulent, from concealing matters required by law to be revealed, or from consciously disregarding information indicating that material facts expressed in the opinion or offering material are false or misleading. For purposes of this paragraph (a)(13), reckless conduct is a highly unreasonable omission or misrepresentation involving an extreme departure from the standards of ordinary care that a practitioner should observe under the circumstances. A pattern of conduct is a factor that will be taken into account in determining whether a practitioner acted knowingly, recklessly, or through gross incompetence. Gross incompetence includes conduct that reflects gross indifference, preparation which is grossly inadequate under the circumstances, and a consistent failure to perform obligations to the client.

(14) Willfully failing to sign a tax return prepared by the practitioner when the practitioner's signature is required by the Federal tax laws unless the failure is due to reasonable cause and not due to willful neglect.

(15) Willfully disclosing or otherwise using a tax return or tax return information in a manner not authorized by the Internal Revenue Code, contrary to the order of a court of competent jurisdiction, or contrary to the order of an administrative law judge in a proceeding instituted under §10.60.

(16) Willfully failing to file on magnetic or other electronic media a tax return prepared by the practitioner when the practitioner is required to do so by the Federal tax laws unless the failure is due to reasonable cause and not due to willful neglect.

(17) Willfully preparing all or substantially all of, or signing, a tax return or claim for refund when the practitioner does not possess a current or otherwise valid preparer tax identification number or other prescribed identifying number.

(18) Willfully representing a taxpayer before an officer or employee of the Internal Revenue Service unless the practitioner is authorized to do so pursuant to this part.

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

Case Study

Disreputable Conduct

While employed by CPA firm, CPA prepared 17 income tax returns for clients who were not clients of the CPA firm. CPA used the employer's tax return preparation software and computer equipment to prepare these tax returns. CPA did not remove the employer's name from the paid preparer section of the tax returns prior to issuing these tax returns to clients. CPA billed the clients using invoices with CPA's name only and kept the fees received for these services.

CPA believed that these clients knew the CPA firm was not responsible for the tax returns even though the employer's name was displayed in the paid preparer section of the tax return.

Revised Regulations on Releasing Taxpayer Information

In early 2008, the IRS released revised regulations concerning taxpayer privacy and the release of taxpayer information with an effective date of January 1, 2009. Among the new rules:

- Generally, preparers must obtain taxpayer consent, either by paper or electronically depending on how the return is being filed, before tax return information can be disclosed to any third party or used for any purpose other than filing the return.
- If the taxpayer consents to the disclosure and use of his information, the consent must identify the intended purpose of the disclosure, identify the recipients, and describe the particular authorized disclosure or use of the information.
- Mandatory language informs individual taxpayers that they are not required to sign the consent. If they sign the consent, they can set a time period for the duration of that consent. If taxpayers fail to set a time period, the consent is valid for a maximum of one year.
- To prevent consent requests from individual taxpayers from being buried in fine print, the rules require the paper consent documents to be in 12-point type on 8½ by 11 inch paper and require electronic consent requests to be in the same type as the Web site's standard text.
- Mandatory consent from taxpayers also is required if the tax information is going to be disclosed to a tax preparer located outside the United States. This provision is intended to ensure taxpayers are informed if their tax information is being sent off-shore for return preparation. The individual taxpayer's Social Security Number also must be redacted.

Many of these provisions are similar to recently enacted state laws.

SECTION 10.52 Violation subject to sanction.

(a) A practitioner may be sanctioned under Sec. 10.50 if the practitioner

(1) Willfully violates any of the regulations (other than §10.33) contained in this part; or

(2) Recklessly or through gross incompetence (within the meaning of §10.51(a)(13)) violates §§10.34, 10.35, 10.36 or 10.37.

(b) Effective/applicability date. This section is applicable to conduct occurring on or after September 26, 2007.

SECTION 10.53 Receipt of information concerning practitioner.

(a) Officer or employee of the Internal Revenue Service.

If an officer or employee of the Internal Revenue Service has reason to believe that a practitioner has violated any provision of this part, the officer or employee will promptly make a written report of the suspected violation. The report will explain the facts and reasons upon which the officer's or employee's belief rests, and must be submitted to the office(s) of the Internal Revenue Service responsible for administering or enforcing this part.

Practice Pointer: Be very careful what you say and do when meeting with IRS personnel. As detailed above, IRS employees are required to report any violation by a practitioner.

(b) Other persons.

Any person other than an officer or employee of the Internal Revenue Service having information of a violation of any provision of this part may make an oral or written report of the alleged violation to the office(s) of the Internal Revenue Service responsible for administering or enforcing this part or any officer or employee of the Internal Revenue Service. If the report is made to an officer or employee of the Internal Revenue Service, the officer or employee will make a written report of the suspected violation, and submit the report to the office(s) of the Internal Revenue Service responsible for administering or enforcing this part.

(c) Destruction of report.

No report made under paragraph (a) or (b) of this section shall be maintained unless retention of such record is permissible under the applicable records control schedule as approved by the National Archives and Records Administration and designated in the Internal Revenue Manual. Reports must be destroyed as soon as permissible under the applicable records control schedule.

(d) Effect on proceedings under subpart D.

The destruction of any report will not bar any proceeding under subpart D of this part, but precludes the Director of the Office of Professional Responsibility’s use of a copy of such report in a proceeding under subpart D of this part.

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

Chapter 1 – Review Questions

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. Circular 230 Section 10.22 requires a practitioner to be diligent as to accuracy in most situations. In which of the following is diligence as to accuracy <u>not</u> required:

   a) preparing tax returns
   b) year-end tax planning
   c) preparing letters to the IRS regarding a taxpayer under audit
   d) preparing amended tax returns

2. Under Circular 230 Section 10.28, a practitioner must return certain client records under various circumstances. Which of the following is true under section 10.28 regarding returning client records

   a) a practitioner may withhold the client's current year completed tax return pending payment of fees
   b) a practitioner may withhold all client records pending payment of fees
   c) a practitioner must return all client records upon request
   d) federal law gives a practitioner the right to place a lien on client records

3. Which of the following is a restriction imposed by Circular 230 Section 10.30 on solicitation and advertising:

   a) hourly fee information must be included in all ads
   b) although ads may include a fee schedule, rates can be changed at any time
   c) a copy of all direct mail advertisements must be retained for at least 36 months
   d) when accepting a new client, the practitioner must give the client a good faith estimate of the cost of the services contemplated

4. Circular 230 Section 10.51 outlines items that may constitute incompetence or disreputable conduct. All of the following would be considered disreputable conduct <u>except</u>:

   a) using abusive language with an IRS auditor in order to get the auditor to delete an item from the audit report
   b) having one's CPA license revoked for cause
   c) being subject to a preparer penalty for negligence in the preparation of a state tax return by that state's tax authority
   d) conviction of a crime relating to the filing of a state tax return

Chapter 1 – Solutions and Suggested Responses

1. A: Incorrect. Although a practitioner must exercise due diligence when preparing tax returns, tax planning alone does not entail filing anything with the IRS and is not covered under Section 10.22.

   B: Correct. Since nothing is being filed with the IRS, due diligence is not expressly required. Section 10.22 relates to items provided to the IRS.

   C: Incorrect. Although a practitioner must exercise due diligence when preparing letters to the IRS, tax planning alone does not entail filing anything with the IRS. Section 10.22 relates to items provided to the IRS.

   D: Incorrect. Although a practitioner must exercise due diligence when preparing any federal tax return, tax planning alone does not entail filing anything with the IRS. Section 10.22 relates to items provided to the IRS.

   (See page 1-6 of the course material.)

2. **A: Correct.** A completed tax return is the practitioner's work product and is not a client record.

   B: Incorrect. All client records necessary to calculate a client's federal tax liability must be returned promptly upon request. Section 10.28 does not expressly require the return of other client records allowing practitioners to consider remedies under state law.

   C: Incorrect. All client records necessary to calculate a client's federal tax liability must be returned promptly upon request. Some states permit the practitioner to withhold records that are not required to compute federal tax liability.

   D: Incorrect. All client records necessary to calculate a client's federal tax liability must be returned promptly upon request. Some states permit the practitioner to withhold records that are not required to compute federal tax liability. Federal law does not afford that option.

   (See pages 1-10 to 1-11 of the course material.)

3. A: Incorrect. Ads may include a schedule of fees, but publishing the fee schedule is not mandatory.

   B: Incorrect. Rates may not be increased for at least 30 days after the last date the fee schedule was published.

   C: Correct. In addition, a list or description of the intended recipients must also be retained for 36 months. This also applies to e-mail solicitations.

   D: Incorrect. Although sound business practices suggest the use of an engagement letter that includes fee information, Circular 230 does not require giving the client a fee estimate.

   (See pages 1-12 to 1-13 of the course material.)

4. A: Incorrect. Using abusive language with an IRS agent is unprofessional and may subject you to disciplinary action.

   B: Incorrect. Having one’s CPA license revoked is considered disreputable conduct.

   C: Correct. Section 10.51 is primarily concerned with the preparation of federal tax forms. Being assessed of a preparer penalty is not a crime, and is not considered disreputable conduct.

   D: Incorrect. Section 10.51 is primarily concerned with the preparation of federal tax forms. However, conviction of a state tax crime would be disreputable.

   (See pages 1-27 to 1-29 of the course material.)

Chapter 2: Statements on Standards for Tax Services

<u>Objectives</u>: After completing this chapter, you will be able to:

- Relate the applicable AICPA guidance to tax practices.
- Apply the AICPA standards and the IRS rules to common ethical dilemmas faced by CPAs in tax practice.

INTRODUCTION

In all tax return engagements, and especially those gray areas which challenge the CPA's judgment and integrity, the CPA has an ethical obligation to look at the AICPA's Statements on Standards for Tax Services (SSTSs). The SSTSs are intended to establish standards for tax practice and to define the CPA's responsibility to the client, the public, the Government and the accounting profession. The SSTSs are informative in nature. Prior to October 31, 2000 tax guidance was limited to the AICPA's Statements on Responsibilities in Tax Practice (SRTPs). The SRTPs and the SSTSs are generally the same except the previously voluntary standards are now enforceable. In the past, many CPAs stated that since they are not members of the AICPA, the SSTSs have no meaning to them. This is simply not true! The SSTSs increase the value of the CPA designation by setting CPAs apart from unscrupulous individuals who abuse the tax system. One good example is the recent IRS crackdown on fraud in the electronic filing of tax returns. The IRS now requires participants to submit a full set of fingerprints and consent to a background search. CPAs, because of their integrity and high ethical standards, are exempt from this burden. Practice standards are the hallmark of calling one's self a professional.

Another reason for understanding and adhering to the SSTSs is that the public demands it. The SSTSs are often referred to by plaintiffs' attorneys in prosecuting a tax malpractice case. Accordingly, adhering to these standards can help you avoid the courtroom and could result in discounts on your malpractice insurance premiums. The SSTSs are reproduced here for your education and convenience.

I. <u>Statements on Standards for Tax Services (SSTSs)</u>

A. SSTS-1 TAX RETURN POSITIONS

SSTS-1 describes the overall standard that a CPA should use when doing tax planning and when preparing tax returns. SSTS-1 is very similar to the crux of Circular 230. It is referred to as the "Realistic Possibility Standard".

<u>SSTS-1</u>

I. With respect to the tax return positions, a CPA should comply with the following standards:

   a. A CPA should not recommend a tax return position or prepare or sign a tax return taking a position unless the CPA has a good-faith belief that the position has at least a realistic possibility of being sustained administratively or judicially on its merits if challenged.

b. Notwithstanding paragraph a, a CPA may recommend a tax return position if the CPA: 1) concludes that there is a reasonable basis for the position, and 2) advises the taxpayer to appropriately disclose that position. Notwithstanding paragraph a, a member may prepare or sign a tax return that reflects a position if: 1) the member concludes there is a reasonable basis for the position, and 2) the position is appropriately disclosed.

II. The CPA should not recommend a tax return position that:

a. Exploits the audit selection process; or
b. Serves as a mere “arguing” position advanced solely to obtain leverage in negotiation with a taxing authority.

III. A CPA has both the right and responsibility to be an advocate for the client with respect to any positions satisfying the aforementioned standards.

How to Apply SSTS-1 to Your Tax Practice

I. Our self-assessment tax system will function only if taxpayers file returns that are true, correct and complete. A tax return is primarily a taxpayer’s statement of facts. Accordingly, the taxpayer has the final responsibility for all omissions and misstatements.

II. CPAs in tax practice have a duty to the tax system as well as to their clients. However, taxpayers have no obligation to pay more taxes than their lowest legal tax. The CPA’s highest duty is to the client in assisting the client achieve the lowest legal tax.

III. The standards require that a CPA in good faith believe that either:

a. The position is warranted in existing law, or;
b. Can be supported by a good faith argument for an extension, modification or reversal of existing law.

The CPA may reasonably reach the conclusion that a position is warranted based on:

a. IRS general counsel memoranda
b. Private letter rulings
c. Treaties
d. A general explanation of a tax act prepared by the joint committee on taxation.

The above sources meet this standard even if they do not meet the Section 6661 test of “authority.” All that is required to meet this standard is a good faith belief that the standard is met <u>when the return is filed</u>.

IV. When a CPA believes that two or more positions meet the standards above, the CPA may discuss with the client:

a. A relative likelihood that the different positions could cause the client’s tax return to be examined;
b. The relative likelihood that any position would be challenged in an audit.

NOTE: The IRS issues a revenue procedure annually which details what constitutes "adequate disclosure." Although the IRS determination of adequate disclosure is not controlling for purposes of SSTSs, it is nevertheless a good "safety net" that can be relied upon. See, for example, Rev. Proc. 2003-77.

V. What if the position the client wants to use could result in a taxpayer penalty?

The CPA should do the following:

a. Discuss with the client the possibility that a penalty could be assessed.
b. Advise the client that penalties are cumulative and are in addition to interest.
c. Discuss the benefits of voluntary disclosure of the position on the tax return. Inform the client that voluntary disclosure could mitigate the likelihood of penalties being imposed. The client should also be advised that disclosure would reduce the chances of the statute of limitations being extended from three years to six years.

Examples Under SSTS-1 Interpretation A-2

The following examples deal with general fact patterns. Accordingly, the application of the guidance discussed in the General Interpretation section to variations in such general facts or to particular facts or circumstances may lead to different conclusions. In each illustration there is no authority other than that indicated.

> **Example 1.** A taxpayer has engaged in a transaction that is adversely affected by a new statutory provision. Prior law supports a position favorable to the taxpayer. The taxpayer believes, and the member concurs, that the new statute is inequitable as applied to the taxpayer's situation. The statute is constitutional, clearly drafted, and unambiguous. The legislative history discussing the new statute contains general comments that do not specifically address the taxpayer's situation.
>
> **Conclusion.** The member should recommend the return position supported by the new statute. A position contrary to a constitutional, clear, and unambiguous statute would ordinarily be considered a frivolous position.
>
> **Example 2.** The facts are the same as in Example 1 except that the legislative history discussing the new statute specifically addresses the taxpayer's situation and supports a position favorable to the taxpayer.
>
> **Conclusion.** In a case where the statute is clearly and unambiguously against the taxpayer's position but a contrary position exists based on legislative history specifically addressing the taxpayer's situation, a return position based either on the statutory language or on the legislative history satisfies the realistic possibility standard.

Example 3. The facts are the same as in Example 1 except that the legislative history can be interpreted to provide some evidence or authority in support of the taxpayer's position; however, the legislative history does not specifically address the situation.

Conclusion. In a case where the statute is clear and unambiguous, a contrary position based on an interpretation of the legislative history that does not explicitly address the taxpayer's situation does not meet the realistic possibility standard. However, because the legislative history provides some support or evidence for the taxpayer's position, such a return position is not frivolous. A member may recommend the position to the taxpayer if the member also recommends appropriate disclosure.

Example 4. A taxpayer is faced with an issue involving the interpretation of a new statute. Following its passage, the statute was widely recognized to contain a drafting error, and a technical correction proposal has been introduced. The taxing authority issues a pronouncement indicating how it will administer the provision. The pronouncement interprets the statute in accordance with the proposed technical correction.

Conclusion. Return positions based on either the existing statutory language or the taxing authority pronouncement satisfy the realistic possibility standard.

Example 5. The facts are the same as in illustration 4 except that no taxing authority pronouncement has been issued.

Conclusion. In the absence of a taxing authority pronouncement interpreting the statute in accordance with the technical correction, only a return position based on the existing statutory language will meet the realistic possibility standard. A return position based on the proposed correction may be recommended if it is appropriately disclosed, since it is not frivolous.

Example 6. A taxpayer is seeking advice from a member regarding a recently amended statute. The member has reviewed the statute, the legislative history that specifically addresses the issue, and a recently published notice issued by the taxing authority. The member has concluded in good faith that, based on the statute and the legislative history, the taxing authority's position as stated in the notice does not reflect legislative intent.

Conclusion. The member may recommend the position supported by the statute and the legislative history because it meets the realistic possibility standard.

Example 7. The facts are the same as in Example 6 except that the taxing authority pronouncement is a temporary regulation.

Conclusion. In determining whether the position meets the realistic possibility standard, a member should determine the weight to be given the regulation by analyzing factors such as whether the regulation is legislative or interpretative, or if it is inconsistent with the statute. If a member concludes that the position does not meet the realistic possibility standard, because it is not frivolous, the position may nevertheless be recommended if the member also recommends appropriate disclosure.

Example 8. A tax form published by a taxing authority is incorrect, but completion of the form as published provides a benefit to the taxpayer. The member knows that the taxing authority has published an announcement acknowledging the error.

Conclusion. In these circumstances, a return position in accordance with the published form is a frivolous position.

Example 9. A taxpayer wants to take a position that a member has concluded is frivolous. The taxpayer maintains that even if the taxing authority examines the return, the issue will not be raised.

Conclusion. The member should not consider the likelihood of audit or detection when determining whether the realistic possibility standard has been met. The member should not prepare or sign a return that contains a frivolous position even if it is disclosed.

Example 10. A statute is passed requiring the capitalization of certain expenditures. The taxpayer believes, and the member concurs, that to comply fully, the taxpayer will need to acquire new computer hardware and software and implement a number of new accounting procedures. The taxpayer and member agree that the costs of full compliance will be significantly greater than the resulting increase in tax due under the new provision. Because of these cost considerations, the taxpayer makes no effort to comply. The taxpayer wants the member to prepare and sign a return on which the new requirement is simply ignored.

Conclusion. The return position desired by the taxpayer is frivolous, and the member should neither prepare nor sign the return.

Example 11. The facts are the same as in Example 10 except that a taxpayer has made a good-faith effort to comply with the law by calculating an estimate of expenditures to be capitalized under the new provision.

Conclusion. In this situation, the realistic possibility standard has been met. When using estimates in the preparation of a return, a member should refer to SSTS No. 4, Use of Estimates.

Example 12. On a given issue, a member has located and weighed two authorities concerning the treatment of a particular expenditure. A taxing authority has issued an administrative ruling that required the expenditure to be capitalized and amortized over several years. On the other hand, a court opinion permitted the current deduction of the expenditure. The member has concluded that these are the relevant authorities, considered the source of both authorities, and concluded that both are persuasive and relevant.

Conclusion. The realistic possibility standard is met by either position.

Example 13. A tax statute is silent on the treatment of an item under the statute. However, the legislative history explaining the statute directs the taxing authority to issue regulations that will require a specific treatment of the item. No regulations have been issued at the time the member must recommend a position on the tax treatment of the item.

Conclusion. The member may recommend the position supported by the legislative history because it meets the realistic possibility standard.

Example 14. A taxpayer wants to take a position that a member concludes meets the realistic possibility standard based on an assumption regarding an underlying nontax legal issue. The member recommends that the taxpayer seek advice from its legal counsel, and the taxpayer's attorney gives an opinion on the nontax legal issue.

Conclusion. A member may in general rely on a legal opinion on a nontax legal issue. A member should, however, use professional judgment when relying on a legal opinion. If, on its face, the opinion of the taxpayer's attorney appears to be unreasonable, unsubstantiated, or unwarranted, a member should consult his or her attorney before relying on the opinion.

Example 15. A taxpayer has obtained from its attorney an opinion on the tax treatment of an item and requests that a member rely on the opinion.

Conclusion. The authorities on which a member may rely include well-reasoned sources of tax analysis. If a member is satisfied about the source, relevance, and persuasiveness of the legal opinion, a member may rely on that opinion when determining whether the realistic possibility standard has been met.

B. SSTS-2 ANSWERS TO QUESTIONS ON RETURNS

SSTS-2 outlines when a CPA may sign a client's tax return as a paid preparer when one or more questions on the return have been left blank. The term "questions" means "requests for information on the return, in the instructions, or in the regulations whether or not stated in the form of a question."

SSTS-2

A preparer should make a reasonable effort to obtain from the client, and provide, appropriate answers to all questions on a tax return before signing as a preparer.

Questions on tax returns are not of uniform importance and often are not applicable to a particular taxpayer. A preparer must make a reasonable effort to obtain all of the requested information. The AICPA gives three reasons for the CPA to want to comply:

a. "The question may be of importance in determining taxable income or loss, or the tax liability shown on the return."
b. A request for information may require a disclosure necessary for a complete return or to avoid penalties.
c. "The CPA must sign the preparer's declaration stating that the return is true, correct and complete."

Nevertheless, reasonable grounds may exist for omitting an answer. The AICPA gives several examples of when a question may be omitted:

a. "The information is not readily available and the answer is not significant in terms of taxable income or loss, or the tax liability shown on the return."
b. "Genuine uncertainty exists regarding the meaning of the question in relation to the particular return."
c. "The answer to the question is voluminous; in such cases, assurance should be given on the return that the data will be supplied upon examination."

When reasonable grounds exist for omitting an answer, the CPA is not required to state on the return the reason for the omission. However, the CPA must "consider whether the omission may cause the return to be deemed incomplete or result in penalties."

The mere fact that an answer to a question may be detrimental to the client (e.g. triggering an audit) does not justify omitting an answer.

C. SSTS-3 CERTAIN PROCEDURAL ASPECTS OF PREPARING RETURNS

SSTS-3 outlines the "responsibility of the preparer to examine or verify certain supporting data or to consider information related to another client when preparing a client's tax return." In other words, does the information pass the CPA reasonableness test?

SSTS-3

I. In preparing or signing a return, the CPA may in good faith rely without verification upon information furnished by the client or by third parties. However, the CPA should not ignore the implications of information furnished and should make reasonable inquiries if the information furnished appears to be incorrect, incomplete, or inconsistent either on its face or on the basis of other facts known to the CPA. In this connection, the CPA should refer to the client's returns for prior years whenever feasible.

II. Where the Internal Revenue Code or income tax regulations impose a condition with respect to deductibility or other tax treatment of an item (such as taxpayer maintenance of books and records or substantiating documentation to support the reported deduction or tax treatment), the CPA should make appropriate inquiries to determine to his or her satisfaction whether such condition has been met.

III. The individual CPA who is required to sign the return should consider information actually known to that CPA from the tax return of another client when preparing a tax return if the information is relevant to that tax return, its consideration is necessary to properly prepare that tax return, and use of such information does not violate any law or rule relating to confidentiality.

The paid preparer must sign the declaration on the tax return that the information therein is true, correct and complete "based on all information of which the preparer has any knowledge". This applies to information supplied by third parties to the CPA. The preparer is not required to examine or verify supporting data. A preparer may rely on client supplied data unless it appears to be incomplete, incorrect or inconsistent.

The AICPA explanation states "the CPA should encourage the client to provide supporting data where appropriate". This allows the CPA to consider all of the relevant data when looking for additional deductions. It also allows the CPA to "tie out" information to 1099 Series information returns and avoid bothersome IRS notices in the future.

When reviewing K-1s from pass-through entities the CPA may advise the client to further investigate his dealings with the pass-through entity. However, "the CPA may accept the information provided by the pass-through entity without further inquiry unless there is reason to believe it is incorrect, incomplete, or inconsistent…".

The AICPA recommends that CPAs make good use of prior year tax returns. By analyzing the client's current tax situation with that reported on prior year returns, the CPA can avoid the omission or duplication of items. Reviewing prior year returns also aids in reporting similar items on a consistent basis.

From a practical standpoint this comparison is very easy. Most tax preparation programs print multi-year comparisons of tax return line items. Utilizing such a feature will not only aid your compliance with the ethical standards but will help you identify "missed deductions."

D. SSTS-4 USE OF ESTIMATES

SSTS-4 details when and under what circumstances client estimates may be used in preparing tax returns. "The CPA may advise on estimates used in the preparation of a tax return, but responsibility for estimated data is that of the client". The client should provide the estimated data. Appraisals are not considered estimates.

SSTS-4

A CPA may prepare tax returns using the taxpayer's estimates if it is impracticable to obtain exact data, and the estimated amounts are reasonable under the facts and circumstances known to the CPA. When the taxpayer's estimates are used, they should be presented in such a manner as to avoid the implication of greater accuracy than exists.

Accounting requires the exercise of judgment and at times the use of approximations based on judgment. The exercise of such judgment is not considered an "estimate" for purposes of this statement. The AICPA cites, for example, year-end income and expense accruals as judgment items, not estimates.

When it is necessary to use estimates, the "estimated amounts should not be presented in a manner that provides a misleading impression as to the degree of factual accuracy." This can be illustrated by the client who estimated his business auto mileage as 30,000 miles but says use 29,958 miles so that "it looks more accurate."

The AICPA points out that disclosing that an estimate was used in a return is usually not required. However, there are unusual circumstances where such disclosure is needed to avoid misleading the IRS regarding the degree of accuracy of the return.

Some examples of unusual circumstances include the following:

a. The taxpayer has died or is ill at the time the return must be filed.
b. The taxpayer has not received a K-1 for a flow-through entity at the time the tax return is to be filed. Consider filing Form 8082.
c. There is litigation pending (for example, a bankruptcy proceeding) that bears on the return.
d. Fire, computer failure, or natural disaster has destroyed the relevant records.

E. SSTS-5 DEPARTURE FROM A POSITION PREVIOUSLY CONCLUDED IN AN ADMINISTRATIVE PROCEEDING OR COURT DECISION

When may a CPA recommend a tax return position that departs from a court decision or IRS ruling?

SSTS-5 provides surprising guidance. Remember, SSTS-1 provides that a CPA's primary duty is to his client.

SSTS-5

The position to be taken concerning the tax treatment of an item in the preparation or signing of a tax return should be based upon the facts and the law as they are evaluated at the time the return is prepared or signed by the CPA. Unless the taxpayer is bound to a specified treatment in the later year, such as by a formal closing agreement, the treatment of an item as part of concluding an administrative proceeding or as part of a court decision does not restrict the CPA from recommending a different tax treatment in a later year's return. Therefore, if the CPA follows the standards in SSTS-1, the CPA may recommend a tax return position, prepare, or sign a tax return that departs from the treatment of an item as concluded in an administrative proceeding or a court decision with respect to a prior return of the taxpayer.

The IRS as well as most CPAs strive for consistency in the treatment of similar items in different years. SSTS-5 notes that there are many valid reasons why a CPA could recommend a position that differs from that agreed to in prior years with the IRS. Perhaps the taxpayer lacked the required documentation to substantiate a deduction in the prior year. The taxpayer may have simply given in to IRS upon audit to avoid the time and expense of litigation. Also, more favorable court cases or administrative rulings may have occurred. However, the AICPA warns:

The consent in an earlier administrative proceeding and the existence of an unfavorable court decision are factors that the CPA should consider in evaluating whether the standards in SSTS-1 are met.

F. SSTS-6 KNOWLEDGE OF ERROR: RETURN PREPARATION AND ADMINISTRATIVE PROCEEDINGS

SSTS-6 considers the applicable standards for a CPA who becomes aware of:

a. An error in a taxpayer's previously filed tax return;
b. An error in a return that is under audit; or
c. A taxpayer's failure to file a required tax return.

An error includes anything that would fail to meet the standards of SSTS-1. An error also includes a position taken on a prior year's tax return that no longer meets SSTS-1 due to changes in legislation, judicial decisions or regulations. An error does not include immaterial items. SSTS-6 applies to errors on returns prepared by other preparers.

SSTS-6

The CPA should inform the client promptly upon becoming aware of an error in a previously filed return or upon becoming aware of client's failure to file a required return. The CPA should recommend the corrective measures to be taken. Such recommendation may be given orally. The CPA is not obligated to inform the Internal Revenue Service, and the CPA may not do so without the client's permission, except where required by law.

If the CPA is requested to prepare the current year's return and the client has not taken appropriate action to correct an error in the prior year's return, the CPA should consider whether to withdraw from preparing the return and whether to continue a professional relationship with the client. If the CPA does prepare such current year's return, the CPA should take reasonable steps to ensure that the error is not repeated.

When the CPA discovers an error in a prior return, the AICPA advises that:

a. The CPA should advise the client of the error and the measures to be taken. It is the client's responsibility to decide whether to correct the error.
b. In cases where the IRS could assert the charge of fraud, the CPA should advise the client to consult legal counsel.
c. The CPA should take reasonable steps to ensure that the error is not repeated.
d. If the tax return is under audit, the CPA should ask for permission to disclose the error.
e. If the CPA believes that fraud has occurred, the CPA should advise the taxpayer to consult with an attorney before taking any action.

The author believes that great care should be taken with clients who refuse to correct errors or particularly to file required returns. The simple reason is that if they are content with cheating the government, what will keep them from cheating you? Do yourself a favor and consider withdrawing from the engagement.

G. SSTS-7 FORM AND CONTENT OF ADVICE TO CLIENTS (FORMERLY SSTS-8)

SSTS-7 details "standards concerning certain aspects of providing tax advice to a client and considers the circumstances when subsequent developments affect advice previously provided."

SSTS-7

In providing tax advice to a client, the CPA should use professional judgment to ensure that the advice given reflects competence and appropriately serves the client's needs. The CPA is not required to follow a standard format or guidelines in communicating written or oral advice to a client, but must comply with Circular 230 standards.

In advising or consulting with a client on tax matters, the CPA should assume that the advice will affect the manner in which the matters or transactions considered ultimately will be reported or disclosed on the client's tax return. Thus, for all tax advice the CPA gives to a client, the CPA should follow the standards in SSTS-1 relating to tax return positions. The CPA should also consider disclosure standards and potential penalty consequences.

A CPA has no obligation to communicate with a taxpayer when subsequent developments affect advice previously provided with respect to significant matters, except while assisting a taxpayer in implementing procedures or plans associated with the advice provided or when a member undertakes this obligation by specific agreement.

Because the range of services and advice is so extensive, no uniform set of guidelines or format can be established. Written advice is generally better than oral advice. However, the CPA should use prudent judgment and common sense in deciding how to communicate advice.

II. IRS Sanctions

The Internal Revenue Code and Regulations contain a number of provisions that impose criminal, civil, and regulatory sanctions on tax practitioners.

Of the approximately 150 penalty provisions a CPA could run afoul of, one of the most relevant is section 6694. Section 6694 provides for a penalty of the greater of $1,000 or 50% of the income derived from the return against the preparer for each return involving an understatement of tax liability due to a position taken on a return for which there is not a realistic possibility of being sustained on its merits ($5,000 or 50% if the understatement was caused by the preparer's willful or reckless conduct). This penalty does not apply if the preparer acted in good faith. For a discussion of what constitutes "good faith", see Rev. Proc. 80-40. Better yet – follow the advice in this course.

Chapter 2 – Review Questions

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. SSTS-2 provides examples of reasonable grounds for omitting an answer on a client's tax return. Which of the following is <u>not</u> one of the examples:

   a) the information is not readily available and the answer is not significant in terms of taxable income or loss, or the tax liability shown on the return
   b) genuine uncertainty exists regarding the meaning of the question in relation to the particular return
   c) the answer to the question may be detrimental to the client
   d) the answer to the question is voluminous

2. SSTS No. 4 provides guidance on the use of estimates. Which of the following is the most correct use of an estimate under SSTS-4:

   a) a client does not keep a car mileage log but believes he drove about 20,000 miles last year and that about half of the mileage is business related. He asks his CPA to report 10,086 miles as business miles so that the estimate looks more like an accurate record of the actual mileage
   b) an accrual basis taxpayer calculates accrued expenses totaling $4,280
   c) a charitable donation is supported by an appraisal which states the value of the donated items as $5,840
   d) a taxpayer held an interest-bearing account at a bank for a few months at the beginning of the year but received less than $10 of interest and did not receive a Form 1099. The taxpayer estimates based on the time period, amount in the account, and the interest rate earned that he should have received $8 in interest

Chapter 2 – Solutions and Suggested Responses

1. A: Incorrect. This is an example of when a question may be omitted. The CPA must consider whether the omission may cause the return to be incomplete.

   B: Incorrect. The CPA is not required to state on the return the reason for the omission.

   C: Correct. For instance, the mere fact that the answer may trigger an audit is not adequate justification.

   D: Incorrect. In such cases, assurance should be given on the return that the data will be supplied upon examination.

   (See page 2-7 of the course material.)

2. A: Incorrect. Estimated amounts should not be presented in a misleading manner that implies accuracy. The taxpayer's estimate should likely be reported as 10,000 business miles.

   B: Incorrect. Year-end income and expense accruals are considered judgment items not estimates, and may be reported as calculated.

   C: Incorrect. The reliance on an appraisal is not an estimate. Appraisals are based on the opinion and judgment of the appraiser but are not considered estimates.

   D: Correct. A client generated estimate such as this one is permitted under SSTS-4. The estimate is both reasonable and not misleading.

   (See page 2-9 of the course material.)

Glossary of Ethics Terms

The terms included in this glossary are related to the ethics area in general, but may not be specifically used in this material. They are provided for greater clarification and educational purpose.

TERM	DEFINITION
Alternative Practice Structures (APS)	A nontraditional structure for the practice of public accounting in which a traditional CPA firm engaged in auditing and other attestation services might be closely aligned with another organization, public or private, that performs other professional services (e.g., tax and consulting).
American Institute of Certified Public Accountants (AICPA)	The national professional organization for all certified public accountants (CPAs).
Client's records	Any accounting or other records belonging to the client that were given to the member by, or on behalf of, the client.
Close relative	Close relatives are the member's nondependent children (including grandchildren and stepchildren), brothers and sisters, grandparents, parents, and parents-in-law. Spouses of any of the above are also close relatives. The SEC definition of close relatives expands the above to include a spouse's brothers and sisters and their spouses.
Code of Professional Conduct (the Code)	The Code was adopted by the membership of the AICPA to provide guidance and rules to all members on various ethics requirements. The Code consists of: 1) Principles, 2) Rules, 3) Interpretations, and 4) Ethics Rulings.
Conflict of interest	A conflict of interest may occur if a member performs a professional service for a client or employer, and the member or his or her firm has a relationship with another person, entity, product, or service that could, in the member's professional judgment, be viewed by the client, employer, or other appropriate parties as impairing the member's objectivity.
Consulting process	The analytical approach applied in performing a consulting service. The process typically involved some combination of the following: • Determining the client's objective • Fact-finding • Defining problems or opportunities • Evaluating alternatives • Formulating proposed actions • Communicating results • Implementing • Following up

Consulting services	Professional services that use the practitioner’s technical skills, education, observations, experiences, and knowledge of the consulting process.
Contingent fee	A fee for performing any service in which the amount of the fee (or whether a fee will be paid) depends on the results of the service.
Direct financial interest	A direct financial interest is created when a member invests in a client entity.
Disqualifying services	Term used to refer to the following services, which when performed for a client prohibit the member from accepting a contingent fee or commission: a. An audit or a review of a financial statement. b. An examination of prospective financial information. c. A compilation of a financial statement expected to be used by third parties except when the compilation report discloses a lack of independence.
Ethics Rulings	Part of the Code of Professional Conduct. Rulings summarize the application of rules and interpretations to a particular set of factual circumstances.
Firm	A form of organization permitted by state law or regulation whose characteristics conform to resolutions of Council that is engaged in the practice of public accounting, including the individual owners thereof.
Former practitioner	A proprietor, partner, shareholder or equivalent of a firm, who leaves by resignation, termination, retirement, or sale of all or part of the practice.
Holding out as a CPA	Includes any action initiated by a member, whether or not in public practice, that informs others of his or her status as a CPA.
Independence in appearance	If there are circumstances that a reasonable person might believe are likely to impair independence, the CPA is not independent in appearance. To be recognized as independent, the auditor must be free from any obligation to or interest in the client, its management, or its owners.
Independence in fact	To be independent in fact (mental independence), the CPA must have integrity and objectivity. If there is evidence that independence is actually lacking, the auditor is not independent in fact.
Indirect financial interest	An indirect financial interest is created when a member invests in a nonclient entity that has a financial interest in a client.
Integrity	An element of character fundamental to professional recognition. It is the quality from which public trust derives and the benchmark against which a member must ultimately test all decisions.

Internal audit outsourcing	Internal audit outsourcing involves performing audit procedures that are generally of the type considered to be extensions of audit scope applied in the audit of financial statements. Examples of such procedures might include confirming receivables, analyzing fluctuations in account balances, and testing and evaluating the effectiveness of controls.
Interpretations of rules of conduct	Part of the Code of Professional Conduct. Interpretations are pronouncements issued by the AICPA’s Division of Professional Ethics to provide guidelines concerning the scope and application of the rules of conduct.
Joint closely held business investment	An investment that is subject to control by the member, or the member’s firm, client or its officers, directors, or principal stockholders, or any combination of the above.
Joint Ethics Enforcement Program (JEEP)	The AICPA and most state societies cooperate in the Joint Ethics Enforcement Program (JEEP) in bringing enforcement actions against their members.
Member	In its broadest sense, “member” is a term used to describe a member, associate member, or international associate of the AICPA. All members must adhere to the AICPA’s Code of Professional Conduct. For the purposes of applying the independence rules, the term “member” identifies the people in a CPA firm and their spouses, dependents, and cohabitants who are subject to the independence requirements.
Multidisciplinary practices (MDP)	Arrangements in which CPAs share fees with attorneys or other professionals.
National Association of State Boards of Accountancy (NASBA)	A voluntary organization composed of the state boards of accountancy. It promotes communication, coordination, and uniformity among state boards.
Objectivity	The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest. Objectivity is a state of mind, a quality that lends value to a member’s services.
Period of professional engagement	The period of engagement starts when the member begins the service requiring independence and ends upon termination of the relationship (by the member or the client) or, if later, when the report is issued. The period does not stop when the report is issued and restart with the beginning of the next engagement. The period of engagement typically covers many periods.

Practice of public accounting	According to the Code of Professional Conduct, the practice of public accounting consists of the performance for a client, by a member or a member's firm, while holding out as CPAs, of the professional services of accounting, tax, personal financial planning, litigation support services, and those professional services for which standards are promulgated by bodies designated by Council, such as Statements of Financial Accounting Standards, Statements on Auditing Standards, Statements on Standards for Accounting and Review Services, Statements on Standards for Consulting Services, Statements on Standards for Tax Services, Statements of Governmental Accounting Standards, and Statements on Standards for Attestation Engagements. However, a member or member's firm, while holding out as CPAs, is not considered to be in the practice of public accounting if the member or the member's firm does not perform, for any client, any of the professional services described in the preceding paragraph.
Principles	Positive statements of responsibility in the Code of Professional Conduct that provide the framework for the rules, which govern performance.
Professional services	Includes all services performed by a member while holding out as a CPA.
Rules	Broad but specific descriptions of conduct that would violate the responsibilities stated in the principles in the Code of Professional Conduct.
Securities and Exchange Commission (SEC)	A federal government regulatory agency with responsibility for administering the federal securities laws.
State boards of accountancy	State government regulatory organizations. Each state government issues a license to practice within the particular state under that state's accountancy statute.
State societies of CPAs	Voluntary organizations of CPAs within each individual state.
Statements on Standards for Tax Services (SSTS)	SSTS superseded and replaced the AICPA's Statements on Responsibilities in Tax Practice (SRTP). They are enforceable standards of conduct for tax practice under the Code of Professional Conduct.
Unpaid fees	Fees for: 1) audit, and 2) other professional services that relate to certain prior periods that are delinquent as of the date the current year's audit engagement begins, if the client is an SEC registrant, or the date the audit report is issued for non-SEC clients (i.e., AICPA rule).
Yellow Book	Governmental Auditing Standards issued by the Government Accountability Office.

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