SELF-STUDY CONTINUING PROFESSIONAL EDUCATION

Ethics and Responsibilities of Tax Professionals

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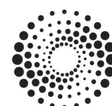

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INTRODUCTION

Ethics and Responsibilities of Tax Professionals is an interactive self-study CPE course designed to enhance your understanding of the latest issues in the field. To obtain credit, you must log on to our Online Grading System at **OnlineGrading.Thomson.com** to complete the Examination for CPE Credit by **November 30, 2011**. Complete instructions are included below and in the Testing Instructions on page 45.

Taking the Course

You are asked to read the material and, during the course, to test your comprehension of each of the learning objectives by answering self-study quiz questions. After completing each quiz, you can evaluate your progress by comparing your answers to both the correct and incorrect answers and the reason for each. References are also cited so you can go back to the text where the topic is discussed in detail. Once you are satisfied you understand the material, **answer the examination questions** and record your answer choices by logging on to our Online Grading System.

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CPE requirements are established by each state. You should check with your state board of accountancy to determine the acceptability of this course. We have been informed by the North Carolina State Board of Certified Public Accountant Examiners and the Mississippi State Board of Public Accountancy that they will not allow credit for courses included in books or periodicals.

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Log on to our Online Grading Center at **OnlineGrading.Thomson.com** to receive instant CPE credit. Click the purchase link and a list of exams will appear. You may search for the exam by selecting Gear Up/Quickfinder in the drop-down box under Brand. Payment of **$27** for the exam is accepted over a secure site using your credit card. For further instructions regarding the Online Grading Center, please refer to the Testing Instructions located at the beginning of the examination. A certificate documenting the CPE credits will be issued for each examination score of 70% or higher.

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Ethics and Responsibilities of Tax Professionals (DERTG10)

OVERVIEW

COURSE DESCRIPTION:	This interactive self-study course is designed to help the tax professional understand the rules and regulations governing the tax profession and the practical application of these rules in the daily operation of their businesses. The course illustrates the compliance requirements of Treasury Department Circular 230 as it applies to Enrolled Agents, CPAs, and attorneys in their practice before the Internal Revenue Service.
PUBLICATION/REVISION DATE:	November 2010
PREREQUISITE/ADVANCE PREPARATION:	None
CPE CREDIT:	2 QAS Hours, 2 Registry Hours Check with the state board of accountancy in the state in which you are licensed to determine if they participate in the QAS program and allow QAS CPE credit hours. This course is based on one CPE credit for each 50 minutes of study time in accordance with standards issued by NASBA. Note that some states require 100-minute contact hours for self study. You may also visit the NASBA website at **www.nasba.org** for a listing of states that accept QAS hours. **Enrolled Agents:** This CPE course is designed to enhance professional knowledge for Enrolled Agents. Gear Up is a qualified CPE Sponsor for Enrolled Agents as required by Circular 230 Section 10.6(g)(2)(ii).
FIELD OF STUDY:	Regulatory Ethics
EXPIRATION DATE:	**November 30, 2011**
KNOWLEDGE LEVEL:	Basic

LEARNING OBJECTIVES

Completion of this course will enable you to:

- Develop an ethical environment that applies the required professional responsibilities to the daily operation of return processing.
- Identify, list and apply the compliance requirements of Treasury Department Circular 230.

ADMINISTRATIVE POLICIES

For information regarding refunds and complaint resolutions, dial (800) 323-8724, select the option for Customer Service, and your questions or concerns will be promptly addressed.

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Details about our 2011 PPC and AuditWatch Conferences will be online soon! Check back for early bird registration discounts and terrific room rates for attendees at our hotel locations.

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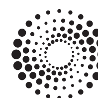

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Ethics and Responsibilities of Tax Professionals

Introduction

This course will focus on the rules that prescribe and proscribe our behavior before the IRS.

Learning Objectives

Completion of this course will enable you to:

- Develop an ethical environment that applies the required professional responsibilities to the daily operation of return processing.
- Identify, list and apply the compliance requirements of Treasury Department Circular 230.

Ethics Defined

Defining ethics and ethical behavior would seem simple. The Modern Webster Dictionary actually presents two definitions of the term *ethics*. As a noun, it is defined as “a principle of right or good or a system of such principles or values.” Ethics also appears as an adjective and is defined as “pertaining to, or dealing with ethics,” in accordance with the accepted principles of right and wrong that govern the conduct of a profession” and “treating of moral feelings, duties, or conduct.” In short, ethical behavior means, “doing the right thing.”

Ethics, also called moral philosophy, is defined in Encyclopedia Britannica as the discipline concerned with what is morally good and bad, right and wrong. The term is also applied to any system or theory of moral values or principles.

A difficulty arises, however, in attempting to define what we mean by “doing the right thing.” The source of the problem lies in the fact that each of us has a unique set of values. These values, in turn, form the basis for our personal judgments about what is the right thing to do. After all, the very essence of personal freedom lies in each individual’s right to make choices. However, individuals in a society are not completely free. Every society adopts a set of rules or laws that prescribe what it believes to be “doing the right thing.”

In a sense, we can think of laws as a set of rules that reflect the values of the society as a whole, as they have evolved up to the present time. There are some who would argue that ethical behavior is more than simply obeying the law. However, for purposes of this course, we recognize that individuals in a free society have the right to disagree about what constitutes “doing the right thing.” For this reason, this course will seldom venture beyond the basic notion that ethical conduct involves abiding by society’s rules. However, we will endeavor to help you understand that some of the ethical dilemmas that have arisen in business in recent years have been produced by behavior that was not at odds to the prevailing law but at odds with the wishes of a large part of the general population. In some of these cases, the ethical dilemmas have provided a catalyst for debate and discussion, which have eventually led to a revision in the body of the law.

Discussion of ethics predominates in business today, but this is a relatively new phenomenon. This is, in part, due to the three reasons:

1. While business errors can be forgiven, ethical errors tend to end careers and terminate future opportunities. Why is this so? Because unethical behavior eliminates trust, and without trust businesses cannot interact.

2. One of the most damaging events a business can experience is a loss of the public's confidence in its ethical standards. Again, we have several recent examples of such events in large business entities.

3. Media reports of government investigations of nonprofit organizations are influencing public perception of this sector of society.

Business ethics has also been broadly defined as "…a company's attitude and conduct toward its employees, customers, community, and shareholders." High standards of ethical behavior demand that a firm treat each party that it deals with in a fair and honest manner. A firm's commitment to business ethics can be measured by the tendency of the firm and its employees to adhere to laws and regulations relating to such factors as product safety and quality, fair employment practices, fair marketing and selling practices, the use of confidential information for personal gain, community involvement, bribery, and illegal payments to obtain business.

Also related to the question of ethics in business is the question of social responsibility. In general, corporate social responsibility means that a corporation has responsibilities to the society at large that go beyond the maximization of shareholders' wealth. In effect, it asserts that a corporation answers to a broader constituency than shareholders alone. As with most debates that center around ethical questions, there is no definitive answer and strong opinions abound. Milton Friedman, in his publication "Milton Friedman on the Social Responsibility of Corporations," takes the position that since managers are employees of the corporation, and the corporation is owned by the shareholders, the financial managers should run the corporation in such a way that shareholder wealth is maximized. He further suggests that shareholders could then decide to pass on any of the profits to deserving causes. While Friedman presents a strong case, very few corporations consistently act in this way. For example, in 1992 Bristol-Myers Squibb Co. announced it would start an ambitious program to give away heart medications to those who cannot pay for them. This announcement was in the wake of the American Heart Association report that showed that many of the nation's working poor face severe heath risks because they cannot afford heart drugs. Clearly, Bristol-Myers Squibb felt it had a social responsibility to provide this medicine to the poor at no cost—a decision with which Friedman would have no doubt disagreed.

Most firms today have strong codes of ethical behavior in place, and they also conduct training programs designed to ensure that employees understand the correct behavior in different business situations. However, it is imperative that top management be openly committed to ethical behavior and that they communicate this commitment through their own personal actions as well as through company policies, directives and punishment/reward systems.

This course will focus on the rules that prescribe and proscribe our behavior before the Internal Revenue Service. Treasury Circular 230 governs ethical conduct of CPAs as well as attorneys, enrolled agents, enrolled actuaries, and appraisers practicing before the IRS.

Circular 230

Circular 230 consists of five subparts—A, B, C, D, and E.

Subpart A describes the rules governing authority to practice before the IRS, explains who is entitled to practice before the IRS, who is eligible to practice as an enrolled agent or enrolled actuary, and how one applies for enrollment. It also discusses limited practice before the IRS that is permitted in some circumstances.

Subpart B discusses the duties and restrictions relating to practice before the IRS including requirements to disclose information to the IRS, diligence as to accuracy, fee and solicitation restrictions, conflict of interest issues and standards for advising with respect to tax return positions. It also addresses practice of law issues and tax shelter opinions.

Subpart C provides sanctions for violations of Circular 230.

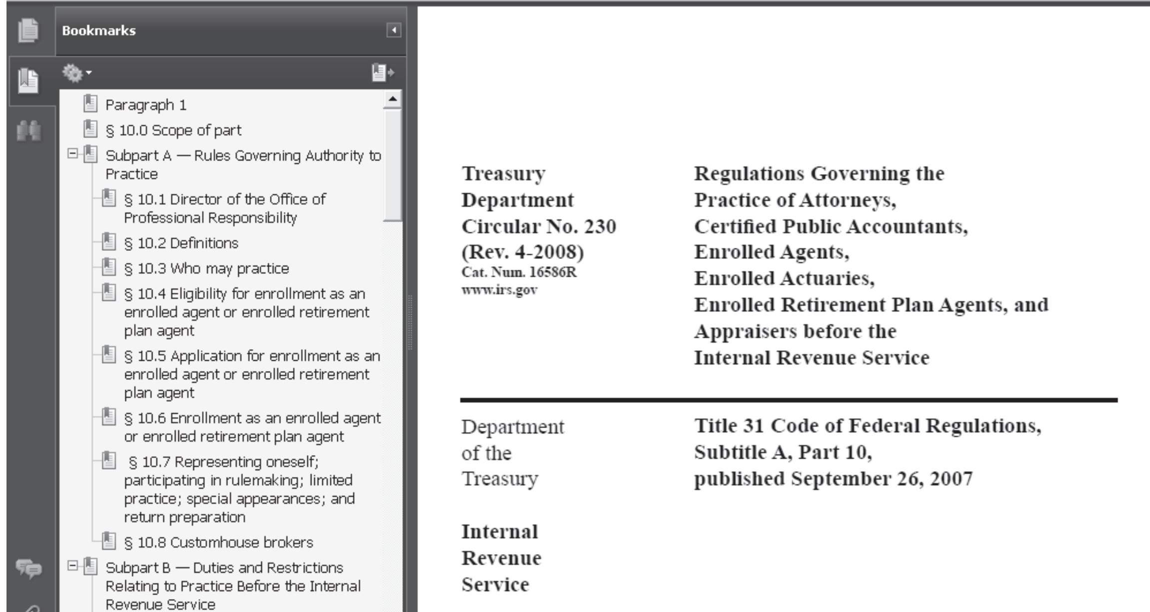
Subpart D sets forth detailed rules for the conduct of disciplinary actions and proceedings in connection with violations of Circular 230.

Subpart E contains miscellaneous procedural rules.

After completion of this course, you will have the information you need to fulfill the rules relating to ethical practice before the IRS.

To find Circular 230: Go to **www.irs.gov** and type “230” in the search box:

And this is what you get:



You will note that Circular 230 was revised as of April 2008.

Most of our time on Circular 230 will be spent on Subpart B (Duties and Restrictions Relating to Practice Before the Internal Revenue Service), Sections 10.20-10.38.

Reg §10.7. [Circular 230] Representing oneself; participating in rulemaking; limited practice; special appearances; and return preparation.

(a) Representing oneself. Individuals may appear on their own behalf before the Internal Revenue Service provided they present satisfactory identification.

(b) Participating in rulemaking. Individuals may participate in rulemaking as provided by the Administrative Procedure Act. See 5 U.S.C. 553.

(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 a 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 (including a parent, subsidiary, or other affiliated 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.

(viii) An individual who prepares and signs a taxpayer's tax return as the preparer, or who prepares a tax return but is not required (by the instructions to the tax return or regulations) to sign the tax return, may represent the taxpayer before revenue agents, customer service representatives or similar officers and employees of the Internal Revenue Service during an examination of the taxable year or period covered by that tax return, but, unless otherwise prescribed by regulation or notice, this right does not permit such individual to represent the taxpayer, regardless of the circumstances requiring representation, before appeals officers, revenue officers, Counsel or similar officers or employees of the Internal Revenue Service or the Department of Treasury.

(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 Director, after notice and opportunity for a conference, may 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 the Director of Practice prescribes.

(d) Special appearances. The Director of Practice may, subject to such conditions as he or she deems 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) Preparing tax returns and furnishing information. Any individual may prepare a tax return, 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.

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

The fact that a taxpayer can represent themselves raises several questions. Should they? What rights do they possess if they do represent themselves? Circular 230 modifies our behavior—do the taxpayers or do we have any rights? Is there flexibility in practice before the IRS? Let's turn to some IRC statutes and study together.

§ 7521 Procedures involving taxpayer interviews.

(a) Recording of interviews.

(1) Recording by taxpayer.
Any officer or employee of the Internal Revenue Service in connection with any in-person interview with any taxpayer relating to the determination or collection of any tax shall, upon advance request of such taxpayer, allow the taxpayer to make an **audio recording** of such interview at the taxpayer's own expense and with the taxpayer's own equipment.

(2) Recording by IRS officer or employee.
An officer or employee of the Internal Revenue Service may record any interview described in paragraph (1) if such officer or employee—

(A) informs the taxpayer of such recording prior to the interview, and

(B) upon request of the taxpayer, provides the taxpayer with a transcript or copy of such recording but only if the taxpayer provides reimbursement for the cost of the transcription and reproduction of such transcript or copy.

(b) Safeguards.

(1) Explanations of processes.
An officer or employee of the Internal Revenue Service shall before or at an initial interview provide to the taxpayer—

(A) in the case of an in-person interview with the taxpayer relating to the determination of any tax, an explanation of the audit process and the taxpayer's rights under such process, or

(B) in the case of an in-person interview with the taxpayer relating to the collection of any tax, an explanation of the collection process and the taxpayer's rights under such process.

(2) Right of consultation.
If the taxpayer clearly states to an officer or employee of the Internal Revenue Service at any time during any interview (other than an interview initiated by an administrative summons issued under subchapter A of chapter 78) that the taxpayer wishes to consult with an attorney, certified public accountant, enrolled agent, enrolled actuary, or any other person permitted to represent the taxpayer before the Internal Revenue Service, such officer or employee shall suspend such interview regardless of whether the taxpayer may have answered one or more questions.

(c) Representatives holding power of attorney.
Any attorney, certified public accountant, enrolled agent, enrolled actuary, or any other person permitted to represent the taxpayer before the Internal Revenue Service who is not disbarred or suspended from practice before the Internal Revenue Service and who has a written power of attorney executed by the taxpayer may be authorized by such taxpayer to represent the taxpayer in any interview described in subsection (a). An officer or employee of the Internal Revenue Service may not require a taxpayer to accompany the representative in the absence of an administrative summons issued to the taxpayer under subchapter A of chapter 78. Such an officer or employee, with the consent of the immediate supervisor of such officer or employee, may notify the taxpayer directly that such officer or employee believes such representative is responsible for unreasonable delay or hindrance of an Internal Revenue Service examination or investigation of the taxpayer.

(d) Section not to apply to certain investigations.
This section shall not apply to criminal investigations or investigations relating to the integrity of any officer or employee of the Internal Revenue Service.

Note that the recording right under 7521(a) applies only to an audio recording. Litigation Guideline Memorandum (LGM) GL-17 makes it clear that this Code Section does not extend to video recordings.

Section 7521 provides only for audio recordings of in-person taxpayer interviews. Thus, no right to make video recordings has been created. This is consistent with case law decided prior to the enactment of the statute. See, *United States v. Huene*, 745 F.2d 1216 (9th Cir. 1984), cert. denied, 472 U.S. 1027 (1985); *United States v. Black*, 804 F.2d 1416 (8th Cir. 1986). It is within the sole discretion of the Service as to the method by which an interview will be recorded so long as the method chosen adequately memorializes the proceeding. *Huene*, 745 F.2d at 1217. The Service's refusal to permit videotaping does not violate a taxpayer's Fifth Amendment due process rights when an alternate method of verbatim recording is permitted. *Black*, 804 F.2d at 1417.

IRM 4245.1(3) also provides that requests to videotape or otherwise film examination proceedings will be denied. The rationale underlying this position is that due to the increasing incidents of harassment and acts of violence directed at IRS agents and their families, particularly by militant tax protestors, creation of a videotape record, where no safeguards exist to assure the ultimate uses to which it might be put, constitutes an unacceptable risk for IRS employees. A video record can be easily circulated and shown, thus subjecting agents to increased hazards far beyond the tactics now being employed to hamper the collection of revenue. The legitimate interest of the Service in protecting the identity of its agents has been recognized by the courts. For example, in *May v. IRS*, 50 AFTR2d 82-5231 (W.D. Mo. 1982), the court held that the video portion of an instructional video recording was not subject to release under the Freedom of Information Act as to do so could subject Service personnel appearing in the video to harassment and threats by tax protestors.

Bypassing POA: As pointed out in 7521(c), a Power of Attorney can be bypassed. (See IRM 5.1.1.7.7)

It is important that we make sure the IRS does fully comply with all statutes and that our clients and we are fully aware of rights and responsibilities under IRC Sec. 7521.

IRC Sec. 7602(e). This section might be used to counter the use of financial status audits, also known as economic reality audits; or, by cynics, as “drive-by audits.”

7602(e) Limitation on examination on unreported income.
The Secretary shall not use financial status or economic reality examination techniques to determine the existence of unreported income of any taxpayer unless the Secretary has a reasonable indication that there is a likelihood of such unreported income.

Power of Attorney: Form 2848 is very easy to fill out and your tax software package might be able to complete it. See IRS Pub. 947, “Practice Before the IRS and Power of Attorney.”

Revoking a POA: The IRS website has the following guidance, which can be found at **www.irs.gov/caf** (CAF stands for Centralized Authorization File.)

Q. How long is a Power of Attorney authorization valid and how is it revoked?

A. A Power of Attorney is valid until revoked. It may be revoked by the taxpayer or withdrawn by the representative or may be superseded by the filing of a new power of attorney for the same tax and tax period. If a Power of Attorney is on the CAF and the taxpayer desires to add another representative and not replace the representative already on the record, Line 8 of Form 2848 must be checked.

Care should be taken to ensure an authorization is revoked when it has accomplished its purpose.

Q. How do I notify the IRS of my desire to revoke an authorization?

A. A revocation statement should be submitted in writing and must contain the taxpayer's identifying information (name and taxpayer identification number), the representative or appointee's identifying information (name and CAF number), and the specific tax and tax periods covered by the revocation. The notice should be signed and dated by the party desiring the revocation.

The recommended method for quickly and efficiently accomplishing a revocation of a paper Form 2848 or 8821 is to write at the top of the authorization form (or copy of the form), the word "REVOKE" and to sign and date it. The notice of revocation should be mailed or faxed to a CAF Unit so the IRS can update its records accordingly. Care should be taken not to strike over any of the original information contained on the authorization.

Let's look at one more Code Section, which can be very helpful, before turning to Subpart B of Circular 230.

§ 7605 Time and place of examination.

(a) Time and place. The time and place of examination pursuant to the provisions of section 6420(e)(2), 6421(g)(2), 6427(j)(2), or 7602 shall be such time and place as may be fixed by the Secretary and as are reasonable under the circumstances. In the case of a summons under authority of paragraph (2) of section 7602, or under the corresponding authority of section 6420(e)(2), 6421(g)(2), or 6427(j)(2), the date fixed for appearance before the Secretary shall not be less than 10 days from the date of the summons.

(b) Restrictions on examination of taxpayer. No taxpayer shall be subjected to unnecessary examination or investigations, and only one inspection of a taxpayer's books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Secretary, after investigation, notifies the taxpayer in writing that an additional inspection is necessary.

Questions are always being raised about the time of examination and the place of examination. The rules are provided in the Regulations. Note that there is some flexibility. The regulations provide you with the information you need to succeed with a request to change the time and place of the examination.

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

This subpart contains the rules that prescribe and proscribe our behavior before the IRS.

Reg §10.20. [Circular 230] 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.

(b) To the Director of Practice. When a proper and lawful request is made by the Director of Practice, a practitioner must provide the Director of Practice with any information the practitioner has concerning an inquiry by the Director of Practice into an alleged violation of the regulations in this part by any person, and to 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.

(c) 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, or the Director of Practice, or his or her 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.

Note that 10.20 mandates submission of records “unless the practitioner believes in good faith and on reasonable grounds that the records or information are privileged.”

Internal Revenue Code Section 7525 provides for privilege:

§ 7525 Confidentiality privileges relating to taxpayer communications.

(a) Uniform application to taxpayer communications with federally authorized practitioners.

(1) General rule.
With respect to tax advice, the same common law protections of confidentiality which apply to a communication between a taxpayer and an attorney shall also apply to a communication between a taxpayer and any federally authorized tax practitioner to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney.

(2) Limitations.
Paragraph (1) may only be asserted in—

(A) any noncriminal tax matter before the Internal Revenue Service; and

(B) any noncriminal tax proceeding in Federal court brought by or against the United States.

(3) Definitions.
For purposes of this subsection —

(A) Federally authorized tax practitioner. The term “federally authorized tax practitioner” means any individual who is authorized under Federal law to practice before the Internal Revenue Service if such practice is subject to Federal regulation under section 330 of title 31, United States Code.

(B) Tax advice. The term “tax advice” means advice given by an individual with respect to a matter which is within the scope of the individual's authority to practice described in subparagraph (A).

(b) Section not to apply to communications regarding tax shelters.

Just a few comments on this topic. In the article, “The Tax Advice Privilege is Alive and Well,” by attorneys Jay L. Carlson and David A. Roman, *Tax Notes Today*, April 21, 2003, pages 399–404, the following key point is raised:

Information related to tax return preparation (return information) is usually not considered privileged for two primary reasons: (1) courts generally do not consider return preparation to be legal work; and (2) information transmitted in connection with return preparation is generally intended to be disclosed from the beginning, rather than to remain privileged.

In the following passage from the previously cited article, the seminal case of *United States v. Frederick* is discussed.

> B. The Nature of the Tax Services Provided
>
> One limitation on attorney-client privilege in the tax context is tied to the general requirement that, for the attorney-client privilege to apply, the attorney must be acting in his capacity as a legal adviser at the time the confidential information is transferred. **Many courts have found that the preparation of a tax return, even if it requires some knowledge of the law, is primarily an accounting service rather than a legal one.** See *United States v. Lawless*, 709 F.2d 485, 487 (7th Cir. 1983); *United States v. Davis*, 66 F.2d 1028, 1043 (5th Cir. 1981); *Canaday v. United States*, 354 F.2d 849, 857 (8th Cir. 1966). In *United States v. Frederick, 182 F.3d 496, 500, Doc 1999-14337 (13 original pages), 1999 TNT 74-21* (7th Cr. 1999), Chief Judge Posner explained the purpose of the rule as preventing a taxpayer from obtaining greater protection from government investigators simply by hiring a lawyer to do work that an accountant or other nonattorney tax preparer could perform. **In the KPMG decision, the court adopted the "persuasive guidance" of Judge Posner and found "the privilege does not protect communications between a tax practitioner and a client simply for the preparation of a tax return."** 2002 Dist. Lexis 24830, at *12.

Reg §10.21. [Circular 230] 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.

We started our study initially restricting ourselves to Circular 230. The AICPA has also adopted seven Statements on Standards for Tax Services, as enforceable standards. Circular 230 and the AICPA Statements on Standards for Tax Services (SSTS) both guide practitioners engaged in tax practice. Treasury Circular 230 governs the ethical conduct of CPAs as well as attorneys, enrolled agents, enrolled actuaries, and appraisers practicing before the Internal Revenue Service. The SSTSs are the ethical tax practice standards for members of the AICPA.

We will cover the SSTSs out of sequential order, tying them more clearly to the appropriate sections of Circular 230.

SSTS No. 6, "Knowledge of Error: Return Preparation and Administrative Proceedings" (effective January 10, 2010), explains our responsibilities, parallel with 10.21. It also fills in some of the gaps in Circular 230 Section 10.21. Excerpts follow:

Statement

> 4. A member should inform the taxpayer promptly upon becoming aware of an error in a previously filed return, an error in a return that is the subject of an administrative proceeding, or a taxpayer's failure to file a required return. A member also should advise the taxpayer of the potential consequences of the error and recommend the corrective measures to be taken. Such advice and recommendation may be given orally. The member is not allowed to inform the taxing authority without the taxpayer's permission, except when required by law.

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

6. If a member is representing a taxpayer in an administrative proceeding with respect to a return that contains an error of which the member is aware, the member should request the taxpayer's agreement to disclose the error to the taxing authority. Lacking such agreement, the member should consider whether to withdraw from representing the taxpayer in the administrative proceeding and whether to continue a professional or employment relationship with the taxpayer.

In examination preparation, it is very important to review the entire return and to essentially (re)work the return from scratch. It is possible that there are errors, some of which favor the client, some which do not favor the client. All matters must be disclosed to the IRS. Advocacy is part and parcel of representing a client before the IRS; dishonesty is never part of the equation.

Reg §10.22. [Circular 230] 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.

10.22 demands due diligence throughout all aspects of practice before the IRS. This is a brief section, yet one upon which much enforcement turns.

Later in this text, SSTS No. 3 and Revenue Procedure 80-40 will be covered, which speak in part to 10.22.

Reg §10.23. [Circular 230] Prompt disposition of pending matters.

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

Reg §10.24. [Circular 230] Assistance from or to disbarred or suspended persons and former Internal Revenue Service employees.

A practitioner may not, knowingly and directly or indirectly:

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

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

10.25 deals with practice by former government employees, their partners and their associates.
10.26 deals with notaries.

Reg §10.27. [Circular 230] Fees.

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

(b) Contingent fees.

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

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

(i) An original tax return; or

(ii) An amended return or claim for refund or credit where the amended return or claim for refund or credit was filed within 120 days of the taxpayer receiving a written notice of the examination of, or a written challenge to the original tax return.

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

(4) A practitioner may charge a contingent fee for services rendered in connection with any judicial proceeding arising under the Internal Revenue Code. (Notice 2008-43 language)

(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.

AICPA guidance is found in ET Section 302 (and Interpretation) and they provide a listing indicating where contingent fees would be allowed.

The following are examples, not all-inclusive, of circumstances where a contingent fee **would** be permitted:

1. Representing a client in an examination by a revenue agent of the client's federal or state income tax return.

2. Filing an amended federal or state income tax return claiming a tax refund based on a tax issue that is either the subject of a test case (involving a different taxpayer) or with respect to which the taxing authority is developing a position.

3. Filing an amended federal or state income tax return (or refund claim) claiming a tax refund in an amount greater than the threshold for review by the Joint Committee on Internal Revenue Taxation ($2 million IRC 6405(a)) or state taxing authority.

4. Requesting a refund of either overpayments of interest or penalties charged to a client's account or deposits of taxes improperly accounted for by the federal or state taxing authority in circumstances where the taxing authority has established procedures for the substantive review of such refund requests.

5. Requesting, by means of "protest" or similar document, consideration by the state or local taxing authority of a reduction in the "assessed value" of property under an established taxing authority review process for hearing all taxpayer arguments relating to assessed value.

6. Representing a client in connection with obtaining a private letter ruling or influencing the drafting of a regulation or statute.

The following is an example of a circumstance where a contingent fee would **not** be permitted:

> Preparing an amended federal or state income tax return for a client claiming a refund of taxes because a deduction was inadvertently omitted from the return originally filed. There is no question as to the propriety of the deduction; rather the claim is filed to correct an omission.

Reg §10.28. [Circular 230] Return of client's records.

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

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

Reg §10.29. [Circular 230] Conflicting interests.

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

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

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

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

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

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

(3) Each affected client waives the conflict of interest and gives informed consent, confirmed in writing by each affected client, at the time the existence of the conflict of interest is known by the practitioner. The confirmation may be made within a reasonable period 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.

Effective/Applicability Date: This section is applicable on September 26, 2007.

Rule 102, Integrity and Objectivity, of the AICPA *Code of Professional Conduct* requires that the CPA maintain objectivity when performing all professional services, and AICPA Interpretation 102-2, “Conflicts of Interest,” in the AICPA *Code of Professional Conduct*, addresses potential conflicts of interest and provides some examples of situations that may constitute a conflict of interest or otherwise impair an accountant’s objectivity in providing personal financial planning and/or tax services.

Be careful with conflicts of interest. Consider speaking to your malpractice carrier and/or attorney if in doubt.

Reg §10.30. [Circular 230] 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 or 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 “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.”

(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 practitioner eligible to practice before the Internal Revenue Service must, nevertheless, clearly identify the solicitation as such and, if applicable, identify the source of the information used in choosing the recipient.

(b) Fee information.

(1)

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

(A) Fixed fees for specific routine services.

(B) Hourly rates.

(C) Range of fees for particular services.

(D) Fee charged for an initial consultation.

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

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

(c) Communication of fee information. Fee information may be communicated in professional lists, telephone directories, print media, mailings, electronic mail, facsimile, hand delivered flyers, radio, television, and any other method. The method chosen, however, must not cause the communication to become untruthful, deceptive, or otherwise in violation of this part. A practitioner may not persist in attempting to contact a prospective client if the prospective client has made it known to the practitioner that he or she does not desire to be solicited. In the case of radio and television broadcasting, the broadcast must be recorded and the practitioner must retain a recording of the actual transmission. In the case of direct mail and e-commerce communications, the practitioner must retain a copy of the actual communication, along with a list or other description of persons to whom the communication was mailed or otherwise distributed. The copy must be retained by the practitioner for a period of at least 36 months from the date of the last transmission or use.

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

AICPA guidance can be found in AICPA Ethics Rule 502.

Reg §10.31. [Circular 230] 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.

Reg §10.32. [Circular 230] Practice of law.

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

The following, 10.33, is an aspirational standard. It sets the bar for tax practice, indicating to us what we should endeavor to achieve in our practice. These standards are worded in a general fashion; yet, if these standards are implemented, the following more labyrinth sections of Circular 230 will be complied with. As such, let's spend some time with 10.33. It will make an easier go of 10.34, 10.35, 10.36, and 10.37. It will also make more sense of IRC 6694, which we will turn to momentarily.

Reg § 10.33. [Circular 230] 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.

Engagement Letter: Consider using an engagement letter. Check with your malpractice carrier for appropriate language.

(2) Establishing the facts, determining which facts are relevant, evaluating the reasonableness of any assumptions or representations, relating the applicable law (including potentially applicable judicial doctrines) to the relevant facts, and arriving at a conclusion supported by the law and the facts.

FIRAC: The basics of tax research will be returned to over and over in subsequent sections of Circular 230. So, be sure to FIRAC. Here is what FIRAC stands for:

FACTS
ISSUE
RULE OF LAW
ANALYSIS/ARGUMENT
CONCLUSION

If you FIRAC, you have done your job and have met the aspirational standards as well as the standards promulgated under 10.34, 10.35, 10.36 10.37, and IRC 6694. You will see the importance of FIRAC as we continue to delve into Circular 230.

(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.

Conclusions Reached: Under FIRAC, you will, of course, come to a conclusion. Every research issue is a question. Is this deductible? Is this taxable? Is this taxed as ordinary income? Is this taxed as capital gain? Can this gain be realized but not recognized? Is this expense a capital expense? Over what period can it be recovered? Yes, a question ought to have an answer. And the answer is the conclusion.

There is also an emphasis on penalty avoidance disclosure. Much of this comes from the tax shelter mindset, where taxpayers believe that they can avoid penalties if their accountant has put their “blessing” on the return. As will be seen in 10.35, a large part of that statute is to wean taxpayers away from relying upon accountant’s advice as penalty protection.

If FIRAC is adhered to and the conclusion is sound, penalty consideration should not be a major concern. Still, 10.33 would have the accountant provide not only the conclusion but also the extent to which the taxpayer may avoid accuracy-related penalties under the Internal Revenue Code if a taxpayer acts in reliance on the advice.

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

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

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

10.33 is not enforceable. However, as an aspirational standard, it is what we ought to aim for as a profession.

Internal Revenue Code Section 6694 is critical to place in context with 10.33, 10.34, 10.35, 10.36, and 10.37.

§ 6694 Understatement of taxpayer's liability by tax return preparer.

(a) Understatement due to unreasonable positions.

(1) In general.
If a tax return preparer—

(A) prepares any return or claim of refund with respect to which any part of an understatement of liability is due to a position described in paragraph (2), and

(B) knew (or reasonably should have known) of the position, such tax return preparer shall pay a penalty with respect to each such return or claim in an amount equal to the greater of $1,000 or 50% of the income derived (or to be derived) by the tax return preparer with respect to the return or claim.

(2) Unreasonable position.

(A) In general. Except as otherwise provided in this paragraph, a position is described in this paragraph unless there is or was substantial authority for the position.

(B) Disclosed positions. If the position was disclosed as provided in section 6662(d)(2)(B)(ii)(I) and is not a position to which subparagraph (C) applies, the position is described in this paragraph unless there is a reasonable basis for the position.

(C) Tax shelters and reportable transactions. If the position is with respect to a tax shelter (as defined in section 6662(d)(2)(C)(ii)) or a reportable transaction to which section 6662A applies, the position is described in this paragraph unless it is reasonable to believe that the position would more likely than not be sustained on its merits.

(3) Reasonable cause exception.
No penalty shall be imposed under this subsection if it is shown that there is reasonable cause for the understatement and the tax return preparer acted in good faith.

(b) Understatement due to willful or reckless conduct.

(1) In general.
Any tax return preparer who prepares any return or claim for refund with respect to which any part of an understatement of liability is due to a conduct described in paragraph (2) shall pay a penalty with respect to each such return or claim in an amount equal to the greater of—

(A) $5,000, or

(B) 50% of the income derived (or to be derived) by the tax return preparer with respect to the return or claim.

(2) Willful or reckless conduct.
Conduct described in this paragraph is conduct by the tax return preparer which is—

(A) a willful attempt in any manner to understate the liability for tax on the return or claim, or

(B) a reckless or intentional disregard of rules or regulations.

(3) Reduction in penalty.
The amount of any penalty payable by any person by reason of this subsection for any return or claim for refund shall be reduced by the amount of the penalty paid by such person by reason of subsection (a).

(d) Abatement of penalty where taxpayer's liability not understated.
If at any time there is a final administrative determination or a final judicial decision that there was no understatement of liability in the case of any return or claim for refund with respect to which a penalty under subsection (a) or (b) has been assessed, such assessment shall be abated, and if any portion of such penalty has been paid the amount so paid shall be refunded to the person who made such payment as an overpayment of tax without regard to any period of limitations which, but for this subsection, would apply to the making of such refund.

(e) Understatement of liability defined.
For purposes of this section, the term “understatement of liability” means any understatement of the net amount payable with respect to any tax imposed by this title or any overstatement of the net amount creditable or refundable with respect to any such tax. Except as otherwise provided in subsection (d), the determination of whether or not there is an understatement of liability shall be made without regard to any administrative or judicial action involving the taxpayer.

(f) Cross reference.
For definition of tax return preparer, see section 7701(a)(36).

Bottom Line: No penalty if you have substantial authority. What does this mean? It means that you spent time with FIRAC, and you did sufficient research. We will explore the literature on this.

In a sense, IRC 6694 and 10.33 and 10.34 all blend together into one gigantic bit of advice—Before you take a position on a tax return, do the work. Think. Research. Look it up. In short, do the work. Our work is never passive. Never.

How do we know if we have substantial authority?

FIRAC—

Facts.

Issue.

Rule of Law.

Analysis/Argument

Conclusion.

Let us look to the definition of authorities:

1.6662-4(d) Substantial authority.

(2) Substantial authority standard. The substantial authority standard is an objective standard involving an analysis of the law and application of the law to relevant facts. The substantial authority standard is less stringent than the more likely than not standard (the standard that is met when there is a greater than 50% likelihood of the position being upheld), but more stringent than the reasonable basis standard as defined in §1.6662-3(b)(3). (These regulations

state: *Reasonable basis.* Reasonable basis is a relatively high standard of tax reporting, that is, significantly higher than not frivolous or not patently improper. The reasonable basis standard is not satisfied by a return position that is merely arguable or that is merely a colorable claim. If a return position is reasonably based on one or more of the authorities set forth in §1.6662-4(d)(3)(iii) (taking into account the relevance and persuasiveness of the authorities, and subsequent developments), the return position will generally satisfy the reasonable basis standard even though it may not satisfy the substantial authority standard as defined in § 1.6662- 4(d)(2). (See §1.6662-4(d)(3)(ii) for rules with respect to relevance, persuasiveness, subsequent developments, and use of a well-reasoned construction of an applicable statutory provision for purposes of the substantial understatement penalty.) In addition, the reasonable cause and good faith exception in §1.6664-4 may provide relief from the penalty for negligence or disregard of rules or regulations, even if a return position does not satisfy the reasonable basis standard.) **The possibility that a return will not be audited or, if audited, that an item will not be raised on audit, is not relevant in determining whether the substantial authority standard (or the reasonable basis standard) is satisfied.**

(3) Determination of whether substantial authority is present.

(i) Evaluation of authorities. There is substantial authority for the tax treatment of an item only if the weight of the authorities supporting the treatment is substantial in relation to the weight of authorities supporting contrary treatment. All authorities relevant to the tax treatment of an item, including the authorities contrary to the treatment, are taken into account in determining whether substantial authority exists. The weight of authorities is determined in light of the pertinent facts and circumstances in the manner prescribed by paragraph (d)(3)(ii) of this section. There may be substantial authority for more than one position with respect to the same item. Because the substantial authority standard is an objective standard, the taxpayer's belief that there is substantial authority for the tax treatment of an item is not relevant in determining whether there is substantial authority for that treatment.

(ii) Nature of analysis. The weight accorded an authority depends on its relevance and persuasiveness, and the type of document providing the authority. For example, a case or revenue ruling having some facts in common with the tax treatment at issue is not particularly relevant if the authority is materially distinguishable on its facts, or is otherwise inapplicable to the tax treatment at issue. An authority that merely states a conclusion ordinarily is less persuasive than one that reaches its conclusion by cogently relating the applicable law to pertinent facts. The weight of an authority from which information has been deleted, such as a private letter ruling, is diminished to the extent that the deleted information may have affected the authority's conclusions. The type of document also must be considered. For example, a revenue ruling is accorded greater weight than a private letter ruling addressing the same issue. An older private letter ruling, technical advice memorandum, general counsel memorandum or action on decision generally must be accorded less weight than a more recent one. Any document described in the preceding sentence that is more than 10 years old generally is accorded very little weight. However, the persuasiveness and relevance of a document, viewed in light of subsequent developments, should be taken into account along with the age of the document. There may be substantial authority for the tax treatment of an item despite the absence of certain types of authority. Thus, a taxpayer may have substantial authority for a position that is supported only by a well-reasoned construction of the applicable statutory provision.

(iii) Types of authority. Except in cases described in paragraph (d)(3)(iv) of this section concerning written determinations, only the following are authority for purposes of determining whether there is substantial authority for the tax treatment of an item: applicable provisions of the Internal Revenue Code and other statutory provisions; proposed, temporary and final regulations construing such statutes; revenue rulings and revenue procedures; tax treaties and regulations thereunder, and Treasury Department and other official explanations of such treaties; court cases; congressional intent as reflected in committee reports, joint explanatory statements of managers included in conference committee reports, and floor statements made prior to enactment by one of a bill's managers; General Explanations of tax legislation prepared by the Joint Committee on Taxation (the Blue Book); private letter rulings and technical advice memoranda issued after October 31, 1976; actions on decisions and general counsel memoranda issued after March 12, 1981 (as well as general counsel memoranda published in pre-1955 volumes of the Cumulative Bulletin); Internal Revenue Service information or press releases; and notices, announcements and other administrative pronouncements published by the Service in the Internal Revenue Bulletin. Conclusions reached in treatises, legal periodicals, legal opinions or opinions rendered by tax professionals are not authority. The authorities underlying such expressions of opinion where applicable to the facts of a particular case, however, may give rise to substantial authority for the tax treatment of an item. Notwithstanding the preceding list of authorities, an authority does not continue to be an authority to the extent it is overruled or modified, implicitly or explicitly, by a body with the power to overrule or modify the earlier authority. In the case of court decisions, for example, a district court opinion on an issue is not an authority if overruled or reversed by the United States Court of Appeals for such district. However, a Tax Court opinion is not considered to be overruled or modified by court of appeals to which a taxpayer does not have a right of appeal, unless the Tax Court adopts the holding of the court of appeals. Similarly, a private letter ruling is not authority if revoked or if inconsistent with a subsequent proposed regulation, revenue ruling or other administrative pronouncement published in the Internal Revenue Bulletin.

Reasonable basis. Reasonable basis is a relatively high standard of tax reporting, that is, significantly higher than not frivolous or not patently improper. The reasonable basis standard is not satisfied by a return position that is merely arguable or that is merely a colorable claim. If a return position is reasonably based on one or more of the authorities set forth in §1.6662-4(d)(3)(iii) (taking into account the relevance and persuasiveness of the authorities, and subsequent developments), the return position will generally satisfy the reasonable basis standard even though it may not satisfy the substantial authority standard as defined in §1.6662-4(d)(2). (See §1.6662-4(d)(3)(ii) for rules with respect to relevance, persuasiveness, subsequent developments, and use of a well-reasoned construction of an applicable statutory provision for purposes of the substantial understatement penalty.) In addition, the reasonable cause and good faith exception in §1.6664-4 may provide relief from the penalty for negligence or disregard of rules or regulations, even if a return position does not satisfy the reasonable basis standard.

Research Essentials: Once you review the facts and ask a question, you have the F and the I of FIRAC. You then R, research the rule of law, and A, analyze and argue, and then C, conclude, decide. You research by going to the law: the IRC, Regs, Rev. Procs, Rev. Ruls, and court cases.

If all of this is not enough, there exist dozens of pages of guidance through SSTS No. 1, "Tax Return Positions," and Interpretations 1-1 and 1-2. These documents can be found at **www.aicpa.org**.

Statement

4. A member should determine and comply with the standards, if any, that are imposed by the applicable taxing authority with respect to recommending a tax return position, or preparing or signing a tax return.

5. If the applicable taxing authority has no written standards with respect to recommending a tax return position or preparing or signing a tax return, or if its standards are lower than the standards set forth in this paragraph, the following standards will apply:

a. A member should not recommend a tax return position or prepare or sign a tax return taking a position unless the member 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 5*a*, a member may *recommend a tax return position* if the member (1) concludes that there is a reasonable basis for the position and (2) advises the taxpayer to appropriately disclose that position. Notwithstanding paragraph 5*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.

6. When recommending a tax return position or when preparing or signing a tax return on which a position is taken, a member should, when relevant, advise the taxpayer regarding potential penalty consequences of such tax return position and the opportunity, if any, to avoid such penalties through disclosure.

7. A member should not recommend a tax return position or prepare or sign a tax return reflecting a position that the member knows:

a. exploits the audit selection process of a taxing authority, or

b. serves as a mere arguing position advanced solely to obtain leverage in a negotiation with a taxing authority.

8. When recommending a tax return position, a member has both the right and the responsibility to be an advocate for the taxpayer with respect to any position satisfying the aforementioned standards.

> While tax work involves advocacy, it is a measured, grounded advocacy. Measured and grounded by FIRAC.

SSTS Interpretation 1-1 (there are no current proposed revisions on this) has many examples.

Before we get to those examples, FIRAC as prime methodology is explored.

In determining whether a realistic possibility exists, a member should do all of the following:

- Establish relevant background facts.
- Distill the appropriate questions from those facts.
- Search for authoritative answers to those questions.
- Resolve the questions by weighing the authorities uncovered by that search.
- Arrive at a conclusion supported by the authorities.

Two examples from Interpretation 1-1:

Example 1: 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.

SSTS No. 4, described later, does permit the use of estimates in some tax preparation.

Example 2: 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. (This refers to the earlier 1 in 3 chance under the older version of 10.34.)

Reg §10.34. [Circular 230] Standards with respect to tax returns and documents, affidavits and other papers.

(a) [Reserved].

(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.

10.34(d) is very similar to Revenue Procedure 80-40.

The penalty under section 6694(a) of the Code generally will not apply where a preparer in good faith relies without verification upon information furnished by the taxpayer. Thus, the preparer is not required to audit, examine or review books and records, business operations, or documents or other evidence in order to verify independently the taxpayer's information.

However, the preparer may not ignore the implications of information furnished to the preparer or which was actually known by the preparer. The preparer shall make reasonable inquiries if the information as furnished appears to be incorrect or incomplete. Additionally, some sections of the Code require the existence of specific facts and circumstances, such as maintenance of specific documents, before a deduction may properly be claimed. The preparer shall make appropriate inquiries to determine the existence of facts and circumstances required by a Code section or regulations as a condition to claiming a deduction.

AICPA SSTS No. 3, "Certain Procedural Aspects of Preparing Returns," also speaks to this.

Excerpts follow:

Statement

2. In preparing or signing a return, a member may in good faith rely, without verification, on information furnished by the taxpayer or by third parties. However, a member 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 member. Further, a member should refer to the taxpayer's returns for one or more prior years whenever feasible.

3. If the tax law or 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, a member should make appropriate inquiries to determine to the member's satisfaction whether such condition has been met.

4. When preparing a tax return, a member should consider information actually known to that member from the tax return of another taxpayer if the information is relevant to that tax return and its consideration is necessary to properly prepare that tax return. In using such information, a member should consider any limitations imposed by any law or rule relating to confidentiality.

10.35, 10.36, and 10.37 coming up essentially deal with tax shelters. But because tax shelters and their promoters are so crafty, the definitions found in 10.35 are expansive. Before turning briefly to 10.35, dealing with covered opinions, let's turn to 10.37. 10.37 deals with rules pertaining to written advice. If the written advice is on a covered opinion, you must also comply with 10.35. It is important to note that the foundation is explained in 10.37.

Reg § 10.37. [Circular 230] Requirements for other written advice.

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

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

10.37 mandates that written advice cannot be given unless the practitioner bases the written advice on reasonable factual or legal assumptions. If you think about 10.37 and have followed the tax shelter history, you will realize that 10.37 is aiming at telling practitioners that they cannot issue opinion letters based on unreasonable factual or legal assumptions.

Now let us turn to 10.35. Understand that 10.35 is issued to fight the abusive tax shelters.

It basically states that if a written opinion is a covered opinion, then FIRAC must be followed, albeit in a more completely documented format. That is the short of it.

Subpart C (Sanctions for Violation of the Regulations), Subpart D (Rules Applicable to Disciplinary Proceedings) and Subpart E (General Provisions) are important to the OPR in that they detail punishment for violation of the regulations. It is our hope that our focus on Subpart B and the attendant literature provides you with the guidance so that you can and do obey the laws and so that disciplinary actions will not come your way. We do want to focus on examples of behavior that lead to punishment and provide some other fascinating glimpses into this area.

Here are two of the earlier scenarios of disciplinary actions, which are still valuable.

Scenarios of Disciplinary Actions for Enrolled Agents From the Office of Director of Practice

SCENARIO 1

A practitioner was engaged by a physician to prepare the physician's individual income tax return. When the physician delivered his records, he commented to the practitioner that he hoped he could take a substantial deduction for using his car in his practice. The practitioner did not ask for further substantiation and, on the tax return submitted to the IRS, deducted various automobile expenses: depreciation, insurance, maintenance, gas, and oil. When the tax return was audited, the physician explained to the IRS auditor that he considered his car to be used in his practice because he drove it between his home and office.

Conclusion—False Statements

Thereafter, the Director called the practitioner's attention to possible violations of Circular 230: lack of due diligence in preparing tax returns in violation of section 10.22(a); and giving false information to the Treasury Department in violation of section 10.51(b). The practitioner asserted that he was entitled to place good faith reliance on his client's information. However, the practitioner could not cite any authoritative exception to the general rule that commuting expenses are not deductible. Consequently, the Director considered the practitioner to be in violation of section 10.51(b).

SCENARIO 2

A practitioner called an IRS revenue officer to discuss his client's case. The revenue officer, after listening to the practitioner's comments, stated that the client could still expect enforcement action. Whereupon, the practitioner said, *"How about my coming down there and jerking you around for a while?"* He added he *"would not mind kicking down the door."* The revenue officer terminated the call and notified IRS' Inspection Service. Later in the day, the practitioner called back to apologize.

Conclusion—Contemptuous Conduct

The Director contacted the practitioner with regard to possible violations of Circular 230: attempting to influence an IRS employee's official action by use of a threat, a violation of section 10.51(f); and contemptuous conduct consisting of abusive language, a violation of section 10.51(i). In response, the practitioner offered little in the way of explanation, stating that he had simply lost his temper. The Director determined that the practitioner's statements constituted contemptuous conduct in violation of section 10.51(i). Since this was the only such instance involving the practitioner in many years of IRS practice, and in view of the quick apology, the Director determined that a reprimand, with a warning as to future conduct, was the appropriate sanction.

Subpart D (Rules Applicable to Disciplinary Proceedings) can be found in Circular 230. The illustrations of disciplinary actions stated above should give you a good picture of what is involved. Subpart D covers 10.60-10.82. Subpart E (General Provisions) can also be found in Circular 230 and contains sections 10.90-10.93.

AICPA SSTSs

We have previously covered **SSTS No. 1**, “Tax Return Positions,” in discussion of IRC 6694, 10.33, 10.34, 10.35, and 10.37. In that discussion, we also covered Interpretations 1-1 and 1-2.

SSTS No. 2, “Answers to Questions on Returns,” simply states that we ought to try to answer questions on the return forms.

However, the AICPA states:

> Reasonable grounds may exist for omitting an answer to a question applicable to a taxpayer. For example, reasonable grounds may include the following:
>
> 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, a statement should be made on the return that the data will be supplied upon examination.

A member should not omit an answer merely because it might prove disadvantageous to a taxpayer.

SSTS No. 3, “Certain Procedural Aspects of Preparing Returns,” was covered in our discussion of 10.34. It parallels Revenue Procedure 80-40.

SSTS No. 4, “Use of Estimates,” indicates that estimates can be used “if it is not practical to obtain exact data and if the member determines that the estimates are reasonable based on the facts and circumstances known to the member. If the taxpayer’s estimates are used, they should be presented in a manner that does not imply greater accuracy than exists.”

When the taxpayer's records do not accurately reflect information related to small expenditures, accuracy in recording some data may be difficult to achieve. Therefore, the use of estimates by a taxpayer in determining the amount to be deducted for such items may be appropriate.

When records are missing or precise information about a transaction is not available at the time the return must be filed, a member may prepare a tax return using a taxpayer's estimates of the missing data.

Estimated amounts should not be presented in a manner that provides a misleading impression about the degree of factual accuracy.

Specific disclosure that an estimate is used for an item in the return is not generally required; however, such disclosure should be made in unusual circumstances where nondisclosure might mislead the taxing authority regarding the degree of accuracy of the return as a whole. Some examples of unusual circumstances include the following:

- A taxpayer has died or is ill at the time the return must be filed.
- A taxpayer has not received a Schedule K-1 for a pass-through entity at the time the tax return is to be filed.
- There is litigation pending (for example, a bankruptcy proceeding) that bears on the return.
- Fire or computer failure has destroyed the relevant records.

SSTS No. 5, “Departure from a Position Previously Concluded in an Administrative Proceeding or Court Decision,” asserts that all facts and circumstances and law for the current year must be reviewed. Back to FIRAC.

If an administrative proceeding or court decision has resulted in a determination concerning a specific tax treatment of an item in a prior year’s return, a member will usually recommend this same tax treatment in subsequent years. However, departures from consistent treatment may be justified under such circumstances as the following:

a. Taxing authorities tend to act consistently in the disposition of an item that was the subject of a prior administrative proceeding but generally are not bound to do so. Similarly, a taxpayer is not bound to follow the tax treatment of an item as consented to in an earlier administrative proceeding.

b. The determination in the administrative proceeding or the court’s decision may have been caused by a lack of documentation. Supporting data for the later year may be appropriate.

c. A taxpayer may have yielded in the administrative proceeding for settlement purposes or not appealed the court decision, even though the position met the standards in SSTS No. 1.

d. Court decisions, rulings, or other authorities that are more favorable to a taxpayer's current position may have developed since the prior administrative proceeding was concluded or the prior court decision was rendered.

SSTS No. 6, "Knowledge of Error: Return Preparation and Administrative Proceedings" was reviewed earlier, in discussion with 10.21, Knowledge of client's omission.

SSTS No. 7, "Form and Content of Advice to Taxpayers," provides very general guidelines as to how to provide guidance. They state:

> Tax advice is recognized as a valuable service provided by members. The form of advice may be oral or written and the subject matter may range from the routine to complex. Because the range of advice is so extensive and because advice should meet the specific needs of a taxpayer, neither a standard format nor guidelines for communicating or documenting advice to the taxpayer can be established to cover all situations.

In closing: Chan Yu, one of the enforcement attorneys in the OPR, gave a speech at the IRS Nationwide Tax Forum in 2007. Her speech, titled "Circular 230—Do The Right Thing," has the following quote: "You know, we're very familiar with the duty to the client, and that obviously is one of a zealous advocate."

You can be a zealous advocate. Absolutely. And you should do it in full compliance with Circular 230. It can and should be done. And that's the final word.

Self-Study Quiz

Determine the best answer for each question below. Then check your answers with the correct answers in the following section.

1. Which subpart of Circular 230 addresses the rules governing authority to practice before the IRS?

   a. Subpart A.

   b. Subpart B.

   c. Subpart C.

   d. Subpart D.

2. Ellen Taxpayer is scheduled for a taxpayer interview with Ima Agent of the IRS next month. Code Section 7521 lists the procedures involving such taxpayer interviews. Of the scenarios below, which one is accurate with regards to this section?

   a. Either Ellen Taxpayer or Ima Agent may record the interview without notice.

   b. Ellen Taxpayer must accompany her representative, even though she signed a written power of attorney, to the interview.

   c. Ellen Taxpayer can make a video recording of the interview as long as she brings her own equipment.

   d. During the interview, Ima Agent must suspend the interview if Ellen Taxpayer expresses her desire to consult with her attorney.

3. While Sandra Dee is preparing Dan Jay's tax return she reviews his tax return from the previous year. During this review, Sandra, realizes that Dan deducted real estate taxes on Schedule A that he did not pay until this year. What is Sandra's responsibility to Dan concerning this discovered error?

   a. Sandra must issue a written statement to Dan; detailing the findings and recommendations along with the consequences the taxpayer would face should he choose not to make the correction to the return.

   b. Sandra must inform Dan of the findings and recommendations along with the consequences the taxpayer would face should he choose not to make the correction to the return.

   c. Sandra is obligated to inform the IRS if Dan chooses not to correct the error.

4. Per Reg.§10.22, a practitioner must exercise due diligence in all of the following situations **except:**

   a. Filing tax returns.

   b. Filing an amended tax return.

   c. Tax planning.

5. Which of the following statements regarding ethical accounting methods is correct?

   a. A tax practitioner can refuse to return client records until the client pays the fee due.

   b. A tax practitioner can charge his client any amount of fee to practice before the IRS.

   c. A tax practitioner must assure prompt disposition of pending matters.

   d. A tax practitioner may accept a client's refund check as payment for tax preparation.

6. Sally Ann, a tax practitioner, has prepared Mr. and Mrs. Smith's joint tax return for years. This year when Mrs. Smith comes to her tax appointment, she tells Sally Ann that she and Mr. Smith are divorcing. Next week, Mr. Smith comes in to have his tax return prepared. What action should Sally Ann take?

   a. Sally Ann should recommend that Mr. Smith seek the assistance of another tax preparer.

   b. Sally Ann, when asked by Mr. Smith if Mrs. Smith was in this year, responds yes.

   c. Sally Ann should not prepare either tax return until the divorce is settled.

   d. Sally Ann can prepare both tax returns.

7. In deciding whether a position will be considered in compliance, which standard below is the most stringent?

   a. Substantial authority standard.

   b. More likely than not standard.

   c. Reasonable basis standard.

8. In determining whether substantial authority is present, which of the following generally has the greatest weight of authority?

   a. A 1998 private letter ruling.

   b. A 2008 technical advice memorandum.

9. Which practitioner below is acting within the scope of Circular 230 Reg §10.34 with respect to tax returns and documents, affidavits and other papers, and Reg §10.37 requirements for other written advice?

    a. Cindy advises her client to submit a document to the IRS in order to delay them from acting.

    b. Cathy informs her client of penalties that may reasonably apply to a position on a tax return signed by Cathy.

    c. Christy thinks her client's information appears to be incorrect, but relies in good faith without verifying the information.

    d. Carmen sends her client an email with advice based on some legal future event assumptions.

10. Which regulation is included in the Statements on Standards for Tax Services?

    a. Taxpayer information that appears to be incomplete or inconsistent should be ignored.

    b. An estimate that is reasonable and consistent under the taxpayer's circumstances is allowed.

    c. The IRS can be notified of an error discovered in a previously filed return without client consent.

    d. An audit resulting in an adjustment to the client's tax return two years prior, controls current year preparation.

Self-Study Answers

This section provides the correct answers to the self-study quiz. If you answered a question incorrectly, reread the appropriate material. **(References are in parentheses.)**

1. Which subpart of Circular 230 addresses the rules governing authority to practice before the IRS? **(Page 3)**

   a. Subpart A. [This answer is correct. Subpart A describes the rules governing authority to practice before the IRS, and explains who is entitled to practice before the IRS.]

   b. Subpart B. [This answer is incorrect. Subpart B discusses the duties and restrictions relating to practice before the IRS including requirements to disclose information to the IRS.]

   c. Subpart C. [This answer is incorrect. Subpart C provides sanctions for violations of Circular 230.]

   d. Subpart D. [This answer is incorrect. Subpart D details the rules for the conduct of disciplinary actions and proceedings in connection with violations of Circular 230.]

2. Ellen Taxpayer is scheduled for a taxpayer interview with Ima Agent of the IRS next month. Code Section 7521 lists the procedures involving such taxpayer interviews. Of the scenarios below, which one is accurate with regards to this section? **(Page 7)**

   a. Either Ellen Taxpayer or Ima Agent may record the interview without notice. [This answer is incorrect. Both the taxpayer and the IRS employee must give advance notice to the other if they are going to tape the interview. If it is the taxpayer's request, it must be at the taxpayer's own expense and with the taxpayer's own equipment. If it is the IRS employee taping the interview, the taxpayer can request a copy of such recording, but at the taxpayer's own cost.]

   b. Ellen Taxpayer must accompany her representative, even though she signed a written power of attorney, to the interview. [This answer is incorrect. An officer or employee of the Internal Revenue Service may not require a taxpayer to accompany the representative in the absence of an administrative summons issued to the taxpayer under subchapter A of chapter 78.]

   c. Ellen Taxpayer can make a video recording of the interview as long as she brings her own equipment. [This answer is incorrect. The recording right under 7521(a) applies only to an audio recording. Litigation Guideline Memorandum (LGM) GL-17 makes it clear that this Code Section does not extend to video recordings.]

   d. During the interview, Ima Agent must suspend the interview if Ellen Taxpayer expresses her desire to consult with her attorney. [This answer is correct. The IRS officer or employee shall suspend the interview regardless of whether the taxpayer may have answered one or more questions.]

3. While Sandra Dee is preparing Dan Jay's tax return she reviews his tax return from the previous year. During this review, Sandra, realizes that Dan deducted real estate taxes on Schedule A that he did not pay until this year. What is Sandra's responsibility to Dan concerning this discovered error? **(Page 12)**

   a. Sandra must issue a written statement to Dan; detailing the findings and recommendations along with the consequences the taxpayer would face should he choose not to make the correction to the return. [This answer is incorrect. Sandra is not obligated to issue a written statement to Dan about the error. Sandra should document the situation in writing regardless of Dan's choice to amend or not. The documentation should remain in Dan's file.]

   b. Sandra must inform Dan of the findings and recommendations along with the consequences the taxpayer would face should he choose not to make the correction to the return. [This answer is correct. Sandra is obligated to all of these actions. She does not need to inform Dan in writing. If Dan chooses not to correct the error, Sandra needs to inform Dan of the findings and recommendations along with the consequences he faces by choosing not to make the correction.]

   c. Sandra is obligated to inform the IRS if Dan chooses not to correct the error. [This answer is incorrect. Sandra is not obligated to inform the IRS and may not do so without the taxpayer's permission. It is the client's responsibility to decide whether to correct the error.]

4. Per Reg.§10.22, a practitioner must exercise due diligence in all of the following situations **except: (Page 13)**

   a. Filing tax returns. [This answer is incorrect. A practitioner must exercise due diligence when preparing and filing tax returns with the IRS.]

   b. Filing an amended tax return. [This answer is incorrect. A practitioner is required to exercise due diligence when preparing and filing an amended tax return with the IRS.]

   c. Tax planning. [This answer is correct. Tax planning does not require filing documents related to IRS matters.]

5. Which of the following statements regarding ethical accounting methods is correct? **(Page 13)**

   a. A tax practitioner can refuse to return client records until the client pays the fee due. [This answer is incorrect. If the client requests his records, a tax practitioner cannot refuse to return the records due to any dispute over fees. The practitioner should return the records promptly.]

   b. A tax practitioner can charge his client any amount of fee to practice before the IRS. [This answer is incorrect. In general, a practitioner may not charge unconscionable fees in connection with any matter before the IRS.]

c. A tax practitioner must assure prompt disposition of pending matters. [This answer is correct. According to Reg §10.23, a tax practitioner may not unreasonably delay the prompt disposition of any matter before the IRS.]

d. A tax practitioner may accept a client's refund check as payment for tax preparation. [This answer is incorrect. Tax practitioners cannot negotiate a check issued to a taxpayer by the IRS and made in respect of income taxes.]

6. Sally Ann, a tax practitioner, has prepared Mr. and Mrs. Smith's joint tax return for years. This year when Mrs. Smith comes to her tax appointment, she tells Sally Ann that she and Mr. Smith are divorcing. Next week, Mr. Smith comes in to have his tax return prepared. What action should Sally Ann take? **(Page 16)**

a. Sally Ann should recommend that Mr. Smith seek the assistance of another tax preparer. [This answer is correct. If Sally Ann is preparing Mrs. Smith's tax return, due to conflicting interests, she should ask Mr. Smith to go elsewhere.]

b. Sally Ann, when asked by Mr. Smith if Mrs. Smith was in this year, responds yes. [This answer is incorrect. Sally Ann, as a tax preparer, is bound by law not to discuss advice she provided to anyone whether they were a client or not.]

c. Sally Ann should not prepare either tax return until the divorce is settled. [This answer is incorrect. Sally Ann can prepare Mrs. Smith's return even though there is a divorce.]

d. Sally Ann can prepare both tax returns. [This answer is incorrect. Sally Ann cannot prepare both tax returns due to a conflict of interest between clients.]

7. In deciding whether a position will be considered in compliance, which standard below is the most stringent? **(Page 22)**

a. Substantial authority standard. [This answer is incorrect. An objective standard involves an analysis of the law and application of the law to the relevant facts. It is less stringent than one of the standards, but more stringent than the other.]

b. More likely than not standard. [This answer is correct. There can be a reasonable belief that the position would more likely than not be sustained on its merits if the tax return preparer after analyzing the pertinent facts and authorities, and in reliance upon that analysis, reasonably concludes in good faith that the position has a greater than 50% likelihood of being sustained on its merits. A return position can be taken as long as it fulfills the reasonable belief that the position would more likely than not be sustained on its merits. This standard is more stringent than the substantial authority standard and the reasonable basis standard.]

c. Reasonable basis standard. [This answer is incorrect. You can meet the reasonable basis standard, if you meet the tests for adequate disclosure. There is a standard that is more stringent than this one.]

8. In determining whether substantial authority is present, which of the following generally has the greatest weight of authority? **(Page 23)**

    a. A 1998 private letter ruling. [This answer is incorrect. Any private letter ruling, technical advice memorandum, general counsel memorandum or action on decision that is more than 10 years old generally is given very little weight.]

    b. A 2008 technical advice memorandum. [This answer is correct. An older private letter ruling, technical advice memorandum, general counsel memorandum or action on decision generally must be accorded less weight than a more recent one.]

9. Which practitioner below is acting within the scope of Circular 230 Reg §10.34 with respect to tax returns and documents, affidavits and other papers, and Reg §10.37 requirements for other written advice? **(Page 27)**

    a. Cindy advises her client to submit a document to the IRS in order to delay them from acting. [This answer is incorrect. When the purpose of which is to delay or impede the administration of the Federal tax laws, a practitioner may not advise a client to submit a document, affidavit or other paper to the IRS.]

    b. Cathy informs her client of penalties that may reasonably apply to a position on a tax return signed by Cathy. [This answer is correct. A practitioner must inform a client of any penalties that are reasonably likely to apply to the client with respect to a position taken on a tax return if the practitioner prepared or signed the tax return.]

    c. Christy thinks her client’s information appears to be incorrect, but relies in good faith without verifying the information. [This answer is incorrect. Generally, a tax practitioner may rely in good faith without verification upon information furnished by the client. However, in this case, the practitioner may not ignore the implications of information furnished to the practitioner since the information appears to be incorrect. The practitioner should make reasonable inquiries concerning this information.]

    d. Carmen sends her client an email with advice based on some legal future event assumptions. [This answer is incorrect. Electronic communications are included in written advice. A practitioner must not give written advice 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).]

10. Which regulation is included in the Statements on Standards for Tax Services? **(Page 31)**

    a. Taxpayer information that appears to be incomplete or inconsistent should be ignored. [This answer is incorrect. SSTS No. 3, “Certain Procedural Aspects of Preparing Returns,” says that a member may rely on information provided by the client, but must not ignore information that appears to be incomplete, inconsistent, or contrary to facts known by the member.]

b. An estimate that is reasonable and consistent under the taxpayer's circumstances is allowed. [This answer is correct. SSTS No. 4, "Use of Estimates," indicates that CPAs may use data estimates on the prepared return if it is not possible or impractical to obtain exact data.]

c. The IRS can be notified of an error discovered in a previously filed return without client consent. [This answer is incorrect. SSTS No. 6, "Knowledge of Error: Return Preparation," states that the member is not obligated to inform the taxing authority, and they should not notify the IRS without the client's permission unless required by law.]

d. An audit resulting in an adjustment to the client's tax return two years prior, controls current year preparation.[This answer is incorrect. SSTS No. 5, "Departure From a Position Previously Concluded in an Administrative Proceeding or Course Decision," indicates that a position taken on a return is determined on a yearly basis. All facts and circumstances and law must be reviewed for current year preparation.]

Glossary

Adequate Disclosure – Sufficient revelation of facts or reasons for a position involving the preparation of a tax return.

American Institute of Certified Public Accountants (AICPA) – An organization headquartered in New York whose members are certified public accountants. This organization provides educational and industry updates to the members. The AICPA is responsible for the administration of the CPA examination taken by individuals who wish to acquire the CPA credential.

Attorney – Any person who is a member in good standing of the bar of the highest court of any State, territory, or possession of the United States, including a Commonwealth or the District of Columbia.

Audits – An examination of a taxpayer's books and records performed by the Internal Revenue Service.

CPA – Any person who is duly qualified to practice as a certified public accountant in any State, territory, or possession of the United States, including a Commonwealth or the District of Columbia.

Director of Office of Professional Responsibility – An individual assigned to enforce the rules and regulations for tax professionals.

Disbarred – To be deprived of the right to practice before the Internal Revenue Service—applies to an attorney's loss of privileges to practice law as well.

Due Diligence – The practice of assuring correctness in tax preparation through thorough tax client interviews. Thoroughly completing the proper worksheet and forms will aid in assuring compliance.

Enrolled Actuary – A person who is enrolled by the Joint Board for the Enrollment of Actuaries. Enrolled actuaries are enrolled to practice in areas regarding pension plans. This classification was established in the Employment Retirement Income Security Act (ERISA) of 1974.

Enrolled Agent – A person who is qualified to practice before the Internal Revenue Service Enrolled agents have passed a two-day IRS examination or have worked in a technical area of the IRS for at least five years.

Ethics – Standards of conduct and moral judgment. The system of morals of an individual person.

Frivolous – Lacking in substantial correctness or containing information that is knowingly incorrect. An attempt to evade taxes.

Internal Revenue Code (IRC) – Legislation passed by Congress that specifies what income is to be taxed, how it is to be taxed, and what deductions may be taken from taxable income.

Internal Revenue Service (IRS) – The agency (which is a division of the Department of the Treasury) that is responsible for the administration and collection of federal taxes.

Practice before the Internal Revenue Service – Comprehends all matters connected with a presentation to the Internal Revenue Service or any of its officers or employees relating to a taxpayers rights, privileges, or liabilities under laws or regulations administered by the Internal Revenue Service." Practice includes, but is not limited to, preparing and filing documents, corresponding and communicating with the Internal Revenue Service, and representing a client at conferences, hearings, and meetings.

Practitioner – An individual who practices a profession.

Professional Conduct – Competent, honest, and ethical behavior.

Realistic Possibility – A tax position is considered to have a realistic possibility of being sustained on its merits if the position has at least a one in three, or greater, likelihood of being sustained if challenged by the Internal Revenue Service.

Suspended Persons – An individual who has been ordered to cease practicing within the realm of the tax industry.

Tax Court – A judicial system designed specifically for tax laws.

Tax Preparer – One who prepares tax returns for individuals, companies, trusts, or non-profit organizations.

Tax Professional – One who prepares tax returns for individuals, companies, trusts, or non-profit organizations.

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1. Section 7521 provides for which of the following?

    a. Audio recordings of in-person taxpayer interviews.

    b. Video recordings of in-person taxpayer interviews.

    c. Audio and video recordings of in-person taxpayer interviews.

    d. Do not select this answer choice.

2. Kelly filed a Power of Attorney allowing Kevin to represent her before the IRS concerning her 2010 income tax return. When will the power of attorney no longer be valid?

    a. Twelve months after signing it.

    b. After December 31, 2011.

    c. When either Kelly or Kevin revoke it.

    d. When Kelly files a new power of attorney for her 2011 income tax return.

3. When can a practitioner charge a contingent fee for a matter before the Internal Revenue Service?

    a. Never.

    b. In connection with the Service's examination of an original tax return.

    c. In connection with the Service's challenge to an amended return where it was filed within 90 days of the taxpayer receiving written notice of the challenge.

    d. For preparation of an amended federal tax return claiming a refund of taxes due to a deduction being inadvertently omitted from the original filed return.

4. In advertising her firm, Sally wanted to catch the attention of customers. Of the following phrases, which one would **not** be acceptable?

    a. "Certified as an Enrolled Agent with the IRS."

    b. "Enrolled to represent taxpayers before the Internal Revenue Service."

    c. "Admitted to practice before the Internal Revenue Service."

    d. Do not select this answer choice.

5. Tom is considering using an engagement letter to provide his tax preparation clients with a higher quality of representation. To which best practice is Tom adhering?

    a. Client advisement of conclusions reached.

    b. FIRAC.

    c. Clear communication regarding form and scope.

    d. Fair practice, with integrity, before the IRS.

6. Bill is a tax return preparer. He understated the tax liability due to an unreasonable position for which he received a fee of $2,800. What is the penalty?

    a. $0.

    b. $1,000.

    c. $1,400.

    d. $2,800.

7. A practitioner may generally rely in good faith on information provided by the client even if the information as furnished appears to be incorrect.

    a. True.

    b. False.

    c. Do not select this answer choice.

    d. Do not select this answer choice.

8. Below are scenarios of individuals who engaged practitioners to prepare their individual income tax return. Each scenario describes activity on the practitioner's part that could result in disciplinary action from the IRS. Which of the following might be considered contemptuous conduct by the IRS?

    a. Taking an automobile expense deduction of depreciation, insurance, maintenance, gas, and oil without asking for substantiation of the use of the vehicle.

    b. Threatening an IRS revenue officer over the phone while discussing his client's case.

    c. Signing off on a tax return prepared by the practitioner's employee who took a business trip deduction without inquiring into the nature of the trips or asking for more substantiation.

    d. Cancelling five conferences with an IRS agent by voice mail the morning of the conference within five months due to "prior commitments" or "scheduling problems."

9. According to the AICPA, which item below does **not** qualify as reasonable grounds for omitting an answer to a question applicable to a taxpayer?

   a. A voluminous answer that will not fit on return.

   b. Uncertainty that is genuine concerning the meaning of the question in relation to the return.

   c. Answer would prove disadvantageous to the taxpayer.

   d. Information for the answer is not readily available and the question is immaterial to the return.

10. Under which scenario should the use of an estimate on an individual income tax return be disclosed?

    a. Pending litigation might bear on the return.

    b. Taxpayer's records do not accurately reflect information related to small expenditures.

    c. Records are missing at the time the return must be filed.

    d. The precise information about a particular transaction is not available at the time the return must be filed.