

Ethics: Fixing Common Tax Problems

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Agenda

Review Applicable Rules

- Circular 230
- AICPA

Hypothetical Scenarios

- When do ethical issues arise in tax controversies
- How do the above rules apply
- Potential penalties and other ramifications

Tax Advice Standards Under Circular 230

Introduction to Circular 230

“Treasury Department Circular 230,” Title 31 Code of Federal Regulations, Subtitle A, Part 10

Governs standards of “Practice Before the IRS”

- Authority to practice before the IRS
- Duties and restrictions relating to practice before the IRS
- Sanctions for violating Circular 230
- Rules applicable to disciplinary hearings for Circular 230 violations

Circular 230 rules generally administered by IRS Office of Professional Responsibility (OPR) and Return Preparer Office (RPO)

“Practice Before the IRS”

Sec. 10.2(a)(4):“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 taxpayer's rights, privileges, or liabilities under laws or regulations administered by the Internal Revenue Service.

“Practice Before the IRS”

Such presentations include, but are not limited to, preparing documents; filing documents; corresponding and communicating with the Internal Revenue Service; rendering written advice with respect to any entity, transaction, plan or arrangement, or other plan or arrangement having a potential for tax avoidance or evasion; and representing a client at conferences, hearings, and meetings.”

“Practice Before the IRS”

Sec. 10.2(a)(6): A *tax return* includes an amended tax return and a claim for refund.

AICPA Statements on Standards for Tax Services (“SSTS”)

An additional source of guidance for the tax return preparer is the series of “Statements on Standards for Tax Services” issued by the Tax Executive Committee of the American Institute of Certified Public Accountants (AICPA). These statements are enforceable tax practice standards that apply to all AICPA members.

10.20 Information to be furnished.

- (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.**

10.20 Information to be furnished.

- (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.

10.20 Information to be furnished.

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.

10.20 Information to be furnished.

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

Privileges?

Attorney-Client

Kovel

Accountant-Client – IRC 7525

Work Product

Fifth Amendment

10.21 Knowledge of Client's Omission

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

AICPA SSTS No. 6, Knowledge of Error: Return Preparation and Administrative Proceedings

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.

AICPA SSTS No. 6, Cont.

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.

AICPA SSTS No. 6, Cont.

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.

10.22 Diligence as to Accuracy

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

- (1) In preparing or assisting in the preparation of, approving, and filing tax returns, documents, affidavits, and other papers relating to Internal Revenue Service matters;
- (2) In determining the correctness of oral or written representations made by the practitioner to the Department of the Treasury; and
- (3) In determining the correctness of oral or written representations made by the practitioner to clients with reference to any matter administered by the Internal Revenue Service.

AICPA SSTS No. 3, Procedural Aspects of Preparing Returns

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.

AICPA SSTS No. 3, Cont.

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.

AICPA SSTS No. 3, Cont.

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.

10.29 Conflicting Interests

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

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

10.29 Conflicting Interests

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

- (1) The practitioner reasonably believes that the practitioner will be able to provide competent and diligent representation to each affected client;
- (2) The representation is not prohibited by law; and
- (3) Each affected client waives the conflict of interest and gives informed consent, confirmed in writing by each affected client, at the time the existence of the conflict of interest is known by the practitioner. The confirmation may be made within a reasonable period of time after the informed consent, but in no event later than 30 days.

10.34 Standards with Respect to Tax Returns and Documents

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

- (i) Sign a tax return or claim for refund that the practitioner knows or reasonably should know contains a position that —
 - (A) Lacks a reasonable basis;
 - (B) Is an unreasonable position as described in section 6694(a)(2) of the Internal Revenue Code (Code)
 - (C) Is a willful attempt by the practitioner to understate the liability for tax or a reckless or intentional disregard of rules or regulations by the practitioner as described in section 6694(b)(2) of the Code (including the related regulations and other published guidance).

10.34 Standards with Respect to Tax Returns and Documents

- (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.

10.34 Standards with Respect to Tax Returns and Documents

(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.

AICPA SSTS No. 1, Cont.

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.

AICPA SSTS No. 1, Cont.

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) (above), a member may recommend a tax return position if the member (i) concludes that there is a reasonable basis for the position and (ii) 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 (i) the member concludes there is a reasonable basis for the position and (ii) the position is appropriately disclosed.

AICPA SSTS No. 1, Tax Return Positions, cont.

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.

AICPA SSTS No. 1, Tax Return Positions, cont.

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.

AICPA SSTS No. 1, Tax Return Positions, cont.

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.

Recommending Return Positions

IRC 6694, 31 CFR 10.34(1), SSTS No. 1,

Position must not be “unreasonable”:

- (1) The position was not supported by substantial authority;
- (2) There was not a reasonable belief that the position would more likely than not be sustained on its merits; and
- (3) The position was not adequately disclosed.

Standards

“SUBSTANTIAL AUTHORITY”

“substantial authority” has the same meaning as in the accuracy-related penalty regulations.

In addition, there is substantial authority for a position if the taxpayer is the subject of a “written determination” (a ruling, determination, or letter).

There must be substantial authority for a position on the date the return or claim for refund is deemed prepared.

“REASONABLE BELIEF”

More likely than not be sustained on its merits’ if the tax return preparer analyzes 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.”

This is a “facts and circumstances” test that looks to the preparer’s diligence, experience, and the complexity of the issues and the facts.

Adequate Disclosure

Provide the taxpayer with a return that included the disclosure;
OR

Advise the taxpayer of the penalty standards applicable to the taxpayer under § 6662, and contemporaneously document the advice.

Reasonable Cause and Good Faith

Penalties/Circ. 230 sanctions will not be imposed if, considering all of the facts and circumstances, the understatement was due to reasonable cause and the preparer acted in good faith.

Reasonable Cause – Factors

1. The nature of the error.
2. The frequency of the error.
3. The materiality of the error.
4. The preparer's normal office practice
5. The preparer's reliance on the work of another preparer
6. The preparer's good faith and reasonable reliance on generally accepted administrative or industry practice.

Recommending Challenged Tax Position – SSTS No 5

A determination in an administrative proceeding or court decision does not restrict a member from recommending a different tax position in a later year's return **unless** the taxpayer is bound to a specified treatment in such year, such as where the taxpayer has signed a formal closing agreement.

May continue with prior position where the determination was caused by a lack of documentation but there is adequate supporting data for the later year, the position satisfied SSTS No. 1, but the taxpayer chose to settle for other reasons, or more favorable authority has developed since the determination.

Hypothetical Scenarios

Scenario #1- Claiming Too Many Employee Exemptions

Your client Employer asks you whether it can accept from an employee a Form W-4, Employee's Withholding Allowance Certificate, claiming numerous exemptions.

The employee has made no oral or written statement to the employer indicating that the Form W-4 is false. Nevertheless, Employer has reason to believe it is false.

Scenario #1- Claiming Too Many Employee Exemptions

10.20 Information to be Furnished

10.21 Knowledge of Client's Omission/SSTS No. 6

10.22 Diligence as to Accuracy/SSTS No. 3

10.29 Conflicting Interests

10.34 Standards with Respect to Tax Returns and Documents/SSTS No.1

Scenario #2 – Household Workers

Client hires a full-time maid. Client treats the maid as an independent contractor, claiming that Client does not control the maid's schedule.

Client claims no Form 1099 is due to the IRS because Client is not in a trade or business.

Client does not withhold any taxes from the payments to the maid.

Scenario #2 – Household Workers

10.20 Information to be Furnished

10.21 Knowledge of Client's Omission/SSTS No. 6

10.22 Diligence as to Accuracy/SSTS No. 3

10.34 Standards with Respect to Tax Returns and Documents/SSTS No. 1

Scenario #3 – Correcting Forms W-2 & Employment Tax Returns

Your client, Employer, discovers that certain employees' Forms W-2 underreport the employees' taxable income.

The error is not discovered until May of the following tax year.

Employer's federal employment tax returns are also incorrect.

Scenario #3 – Correcting Forms W-2 & Employment Tax Returns

10.20 Information to be Furnished

10.21 Knowledge of Client's Omission/SSTS No. 6

10.22 Diligence as to Accuracy/SSTS No. 3

10.29 Conflicting Interests

10.34 Standards with Respect to Tax Returns and Documents/SSTS No. 1

Scenario #4 – Settlement Payments

Client settles a lawsuit with its employer. The settlement agreement states that Client will receive payments for compensatory damages.

Employer states that it will provide a Form 1099 for the payments to Client, not a Form W-2. Employer will not withhold taxes from the payment to Client.

Client agrees and will report consistently on tax returns.

Scenario #4 – Settlement Payments

10.20 Information to be Furnished

10.21 Knowledge of Client's Omission/SSTS No. 6

10.22 Diligence as to Accuracy/SSTS No. 3

10.34 Standards with Respect to Tax Returns and Documents/SSTS No. 1

Scenario #5 – Collection

Client's enterprise has fallen behind on employment tax withholding obligations and client is concerned about the IRS assessing trust fund recovery penalties under I.R.C. § 6672.

Your client then asks you whether you would recommend that he transfer his assets to a family member so that the IRS cannot collect against him.

What advice is appropriate planning and what crosses the line?

Scenario #6 – Other non-tax non-compliance

In the course of your discussions with Client about employment tax issues, you discover that many employees are not only not being paid “on the books,” but are illegally working in the United States.

What are your ethical obligations regarding the labor/immigration law violations?

Is this Criminal?

26 U.S.C. § 7201: Tax evasion (can include evasion of payment)

26 U.S.C. § 7203: Willful failure to file return, supply information, or pay tax

26 U.S.C. § 7206(2): Aiding and abetting the filing of a false return

26 U.S.C. § 7212: Attempt to interfere with administration of Internal Revenue Laws

18 U.S.C. § 371: Conspiracy to defraud the IRS

18 U.S.C. § 1001: False statement to a federal official

Criminal Intent in Tax: Willfulness

Intentional

Violation of

Known

Legal Duty

Comments from IRS & DOJ re Employment Tax Enforcement

excerpts from Tax Analysts, June 8, 2015, Nathan Richman, report from NYU Tax Controversy Forum

Caroline D. Ciruolo, acting assistant attorney general in the Tax Division: The IRS and the Tax Division are increasing their focus on criminal enforcement of employment tax issues.

Thomas E. Bishop, assistant special agent in charge, IRS Criminal Investigation Division, New York: the IRS will look for intent in the use of withheld but unpaid employment tax funds for personal purposes, not limited to lavish lifestyles, and the IRS will look at employers who fail to pay over employment taxes and still try to take the employment tax credit.