

# Ethics and Your Tax Practice



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# **Ethics and Your Tax Practice**

## **INTRODUCTION**

Enrolled Agents have been in existence since the Enabling Act of 1884. Although the “Enrolled Agent” name was not designated until 1966. Their initial job was to represent citizens who sought equitable compensation for horses and other property confiscated by the United States government during the civil war. Enrolled Agents in 1884 were required to pass a standardized test and submit to a credibility check.

Much has happened since 1884 to change the duties and responsibilities of Enrolled Agents. One of the most significant for Enrolled Agents was in 1936 when Circular 230 was changed to only allow attorneys and CPA’s to represent clients before the IRS. In 1951 it became clear that this method was not producing enough representatives to meet the demand and circular 230 was revised again to allow other “qualified persons” other than attorneys and CPA’s to practice. The problem was that the test administered to determine “qualified person” was the CPA exam and the numbers who passed the exam did not increase sufficiently. Then in 1959 Circular 230 was changed again to include a special enrollment exam. On June 24 and 25<sup>th</sup> 1959 the first special Enrollment Exam was given. The exam focused on practical knowledge in federal taxation and representation. Passing the exam gave the card holders the same rights and privileges as attorneys and CPA’s. There was still no distinguishing name for this group of “qualified persons” instead they were referred to by a variety of names including enrolled tax preparer, enrolled tax practitioner, agent, representing agent and enrolled agent. In 1966 The Treasury Department established the “Enrolled Agent” designation and in 1994 they approved the EA initials to denote the Enrolled Agent title.

## **Registration (RPO) and Oversight (OPR)**

### **The New Return Preparer Office (RPO)**

David Williams, who spearheaded the implementation of the Return Preparer Initiative, has been named as Director of the new Return Preparer Office (RPO). His prior experience as the head of EFTPS gave Mr. Williams the ultimate qualifications for this office which will handle functions related to all registrations, testing, and continuing education approvals (including Enrolled Agents, beginning with the enrollment cycle in Fall of 2011). This division of IRS functions will allow OPR to focus its resources on investigation and enforcement.

### **The Office of Professional Responsibility (OPR)**

Karen Hawkins was appointed as Director of OPR in early 2009. While Ms. Hawkins became the fourth Director of OPR in as many years, she has extensive experience with representation in the private sector and seems to possess a common sense, reasonable approach to oversight. In recent months Ms. Hawkins has made it quite clear she intends to use every tool available to be

certain that practitioners are compliant and ethical, and has increasingly demonstrated that her office will vigorously pursue the truly disreputable.

In recent public appearances, Ms. Hawkins has stressed that her primary concern is a practitioner's "fitness to practice" and her main objective is to ensure practitioners abide by Circular 230.

*"David's leadership on the return preparer initiative will complement the excellent work Karen Hawkins is carrying out as Director of the Office of Professional Responsibility. This critical organization will remain a separate entity within the IRS, and I see its impact being enhanced in the future to ensure the tax professionals meet the high ethical standards that taxpayers expect, need and deserve.*

*"Indeed, it is my intention to provide Karen and her able team increased resources to investigate additional cases of improper conduct, ethical violations and other disciplinary issues involving tax professionals falling under Treasury Circular 230. I think it's fair to say that we could see an appreciable jump in the OPR case load in the foreseeable future as we work to ensure that all return preparers are serving the American people well."*

*-- IRS Commissioner Douglas H. Shulman, Keynote speech before the AICPA Fall Tax Meeting, 10-26-2010.*

## **Regulation of Tax Preparers - Timeline and Procedures**

While multiple clarifications will continue to be issued during 2011 and beyond, the integration of all tax preparers include:

With very few exceptions, all Paid Preparers must now obtain a Preparer Tax Identification Number (PTIN) before filing any 1040 series returns. The criteria specifically include "individuals who prepare all or substantially all of a tax return or claim for refund on behalf of a taxpayer for compensation." Every paid tax preparer must:

- Have their own PTIN, including non-signing employees
- Pay an annual fee for registering/renewing their PTIN (currently \$64.25)
- Pass a suitability check and be in compliance with their own taxes
- Pass a competency exam if not an EA, CPA, or Attorney

The IRS website contains the registration information and PTIN rules at:

 Website

<http://www.irs.gov/taxpros/article/0,,id=218611,00.html>

## **Competency Testing for Registered Tax Return Preparers**

All RTRP candidates are required to pass a competency exam before the end of 2013 after obtaining their "Provisional PTIN" during the initial phase (before this testing begins). Any preparer who does not obtain their PTIN prior to the implementation of the 1040 testing phase will be unable to obtain a PTIN until after they have passed the competency test. Testing is anticipated to begin in Fall 2011.

Payroll-only tax return preparers will not need to take the 1040 competency exam and for now, other tax forms filed with the Internal Revenue Service will not have specific testing requirements. An entity test may be developed in the future, but is not in the near-term IRS plan.

Enrolled Agents, CPAs, and Tax Attorneys will be exempt from this testing but preparers holding other types of certifications will not be "grandfathered" and must pass the exam.

Relief was granted in January 2011 for testing and continuing education requirements of people who do not sign a return and work in a professional firm under the supervision of an accountant, enrolled agent or lawyer. The exempted employees of these firms will still need to obtain PTINs, regardless of the CPE and testing rules.

### **Circular 230 and More**

Enrolled Agents, CPAs, Attorneys, and beginning in 2011, Registered Tax Return Preparers, must provide their services within the rules of multiple U.S. Code sections and Regulations, including:

- Treasury Department Circular 230,
- Conference and Practice Requirements (Pub 216),
- Practice Before the IRS and Power of Attorney (Pub 947),
- Limited Practice Without Enrollment (Pub 470),
- Disclosure Rules under IRC §7216 and other U.S. Code sections

### **Circular 230 - Practice before the Internal Revenue Service**

Over the years, Circular 230 has seen numerous changes; going through a major overhaul in 2005 and revised again in 2007 (printed revision date April 2008). From the very beginning, Circular 230 has been explicit about the obligation of Enrolled Agents to familiarize themselves with the rules and standards applicable to them. Now, Registered Tax Return preparers are also held to all of the same standards as other tax practitioners under Circular 230.

The Final Regulations for Circular 230 changes may be found at:

## § 10.0<sup>1</sup> Scope of part

This part contains rules governing the recognition of attorneys, certified public accountants, enrolled agents, enrolled retirement plan agents, registered tax return preparers, and other persons representing taxpayers before the Internal Revenue Service. **Subpart A** sets forth rules relating to the authority to practice before the Internal Revenue Service; **Subpart B** prescribes the duties and restrictions relating to such practice; **Subpart C** prescribes the sanctions for violating the regulations; **Subpart D** contains the rules applicable to disciplinary proceedings; and **Subpart E** contains general provisions relating to the availability of official records.

## Subpart A — Rules Governing Authority to Practice

### § 10.2 Definitions

This section includes new guidance regarding what constitutes "practice before the IRS." The new regulations are clear that virtually any contact or submission to the IRS on behalf of a client, including tax preparation, *is* considered practice. Rendering tax advice (including tax planning) also falls within the scope of Circular 230 as practice before the IRS.

### Renewals for Enrolled Agents

Enrolled Agents must renew their licenses every three years and the staggered renewal dates are based on Social Security numbers. §10.6 has all the details, including what to do if a problem arises (such as late renewal, missing CPE hours, etc.).

The 2010-2011 renewal period for Enrolled Agents with Social Security numbers ending in 4, 5, and 6 (which was scheduled for November 1, 2010 through January 31, 2011) was delayed due to the lengthy process of adjusting EA renewal fees to partially compensate for PTIN fees. The renewal period is June 1, 2011 through August 31, 2011, and the new fee is \$30 for the three-year cycle. Continuing education hours remain on a calendar year, so only credit earned through December 31, 2010 should be reported. The delay does not affect enrollment status and the March 31, 2011 expiration date on current Enrollment cards has been automatically extended.

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<sup>1</sup> Numbered sections in this text refer to Circular 230 (31CFR Part 10), unless noted otherwise.

Renewal forms and continuing education guidelines for Enrolled Agents are available on the OPR website at:

 Website

<http://www.irs.gov/taxpros/agents/article/0,,id=123693,00.html>

## Continuing Education for Enrolled Agents

Circular 230 §10.6(e) sets forth the continuing professional education (CPE) requirements for Enrolled Agents:

- Enrollment year means January 1 to December 31 of each year of an enrollment cycle.
- Enrollment cycle means the three successive enrollment years preceding the effective date of renewal.
- A minimum of 72 hours of continuing education credit, including six hours of ethics or professional conduct, must be completed during each enrollment cycle.
- A minimum of 16 hours of continuing education credit, including two hours of ethics or professional conduct, must be completed during each enrollment year of an enrollment cycle.

An individual who receives initial enrollment during an enrollment cycle must complete two (2) hours of qualifying continuing education credit for each month enrolled during the enrollment cycle. Enrollment for any part of a month is considered enrollment for the entire month.

For new Enrolled Agents, a CPE Credit Chart has been developed by the IRS to clarify the proration of hours in their initial cycle. It is available on their website at:

 Website

[http://www.irs.gov/pub/irs-utl/cpe\\_chart\\_2.pdf](http://www.irs.gov/pub/irs-utl/cpe_chart_2.pdf)

Karen Hawkins recently reported that when she took the helm in 2009, the failure rate in CPE audits of Enrolled Agents was at 70%! Most of the discrepancies were due to poor recordkeeping and unqualified Sponsors (those stock brokers who professed their seminar on Retirement Plans was valid CPE). Hence Circular 230 contains some important new requirements and substantial changes have been implemented in §10.6(f), tightening up the definition of what constitutes qualifying CPE.

Under the new rules, the "qualifying sponsor" language has been replaced with "qualifying continuing education provider." The most significant change in this area for most practitioners is a requirement that CPE certificates bear a program number issued by the IRS. **Beginning in**

**2012, Certificates that do not bear a "current qualified continuing education program number" cannot be counted toward Enrolled Agent license renewal.**

The new language in § 10.6(f) says:

To qualify for continuing education credit for an enrolled agent, a course of learning must--

- (A) Be a qualifying continuing education program designed to enhance professional knowledge in Federal taxation or Federal tax related matters (programs comprised of current subject matter in Federal taxation or Federal tax related matters, including accounting, tax return preparation software, taxation, or ethics); and
- (B) Be a qualifying continuing education program consistent with the Internal Revenue Code and effective tax administration.

Although cognizant of the importance of non-tax related programs such as property tax issues, workers compensation, etc., the Service determined that allowing enrolled agents to satisfy their continuing education requirements with classes that do not have a direct nexus to federal tax law would undercut the purpose of the continuing education requirements of Circular 230.

There is a gray area regarding whether state income tax courses qualify as related to federal law. Tax courses that deal with state-only issues (such as sales tax or RDP and same-sex couples' CA returns) do not qualify for IRS hours.

Unfortunately, the guidance on what qualifies as continuing education can be tough to interpret, but interpret we must. The OPR website has posted FAQs in efforts to clarify the rules for Enrolled Agents at:

 Website

<http://www.irs.gov/taxpros/agents/article/0,,id=123418,00.html>

According to these FAQs, the individual enrolled agent must take the responsibility of determining what is acceptable. The field(s) of study must include subjects dealing with federal tax compliance, tax planning, or tax controversies. Compliance includes, among other things, tax return preparation and review, ruling requests and protests. Tax planning focuses on applying federal tax rules to prospective transactions and understanding the tax implication of unusual or complex transactions. Tax controversies involve representation during examination and collection matters.

Enrolled agents already possess certain educational and technical skills. Therefore, the objective of a sponsor in presenting acceptable continuing education programs should be to enhance or strengthen these skills and commensurate with the level of professional competence of the enrolled agent. The following types of programs do not meet this objective:

1. Courses designed to help prepare for the Special Enrollment Examination.<sup>2</sup>
2. Basic courses in the area of tax geared toward the general public with which an enrolled agent should already be familiar.
3. Programs not directly related to Federal taxation or Federal tax related matters such as, personal development, personal investments, office management, general computer software or sales-oriented presentations for office equipment and other system applications.

To determine whether a course qualifies, apply the "litmus test" below based on the requirements of Circular 230.

Ask yourself how the course would help you represent taxpayers before the Internal Revenue Service. For example, will the course enhance your understanding of Federal tax compliance, tax planning, tax controversies, the Service's rules, regulations or procedures?

- If the course would enhance your ability to represent taxpayers before the Internal Revenue Service in regard to Federal taxation or tax related matters your rationale for taking the course is consistent with Circular 230.
- If there is no connection to Federal taxation or Federal tax related matters and the course is related to issues where there would be no reason for you to represent taxpayers before the IRS the course would not meet the requirements for an enrolled agent.

Considering the emphasis on "fitness to practice", it is crucial that all CPE earned be carefully scrutinized within these parameters prior to reporting to the IRS for renewal.

### **Continuing Education Requirements for Registered Tax Return Preparers**

The education requirements for renewal for registered tax return preparers have been delayed for one year and will begin in 2012. Requirements for RTRPs are:

A minimum of 15 hours of continuing education credit, including two hours of ethics or professional conduct, three hours of Federal tax law updates, and 10 hours of Federal tax law topics, must be completed during each registration year.

To qualify for continuing education credit for a registered tax return preparer, a course of learning must--

- (A) Be a qualifying continuing education program designed to enhance professional knowledge in Federal taxation or Federal tax related matters (programs comprised of current subject matter in Federal taxation or Federal tax related matters, including accounting, tax return preparation software, taxation, or ethics); and

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<sup>2</sup> §10.6(f) does allow Enrolled Agents to establish eligibility for renewal by achieving a passing score on each part of the Special Enrollment Examination during the three year period prior to renewal; plus completing a minimum of 16 hours of qualifying continuing education during the last year of an enrollment cycle.

(B) Be a qualifying continuing education program consistent with the Internal Revenue Code and effective tax administration.

(2) Qualifying programs--(i) Formal programs. A formal program qualifies as a continuing education program if it--

(A) Requires attendance and provides each attendee with a certificate of attendance;

(B) Is conducted by a qualified instructor, discussion leader, or speaker (in other words, a person whose background, training, education, and experience is appropriate for instructing or leading a discussion on the subject matter of the particular program);

(C) Provides or requires a written outline, textbook, or suitable electronic educational materials; and

(D) Satisfies the requirements established for a qualified continuing education program pursuant to §10.9.

(ii) Correspondence or individual study programs (including taped programs). Qualifying continuing education programs include correspondence or individual study programs that are conducted by continuing education providers and completed on an individual basis by the enrolled individual. The allowable credit hours for such programs will be measured on a basis comparable to the measurement of a seminar or course for credit in an accredited educational institution. Such programs qualify as continuing education programs only if they--

(A) Require registration of the participants by the continuing education provider;

(B) Provide a means for measuring successful completion by the participants (for example, a written examination), including the issuance of a certificate of completion by the continuing education provider;

(C) Provide a written outline, textbook, or suitable electronic educational materials; and

(D) Satisfy the requirements established for a qualified continuing education program pursuant to §10.9.

***Important to Note:***

CTEC is also changing its continuing education requirements in response to these new federal rules. Beginning in January 2012, CRTPs will need 5 hours of CA state tax education in addition to the 15 hours as prescribed by the IRS. The CTEC renewals/reporting year will continue to end on October 31.

**CPE for hours worked as instructors and authors**

The current Circular 230 regulations authorize continuing education credit to be awarded for hours relating to work as an instructor, discussion leader, or speaker at an education program, as well as hours for authoring articles, books, or other publications on Federal taxation or Federal tax-related matters. In 2010 and prior years, teaching could count for up to 50 percent of the continuing education requirement during an enrollment cycle.

The Final Regulations do not allow any CPE hours for writing and limit CPE credit to six hours per year for teaching. One hour of continuing education credit will still be awarded for each

contact hour completed as an instructor, discussion leader, or speaker at an educational program that meets all other continuing education requirements and a maximum of two hours of continuing education credit will be awarded for preparation time for each contact hour completed as an instructor, discussion leader, or speaker at such programs.

As always, CPE earned as an instructor will only count the first time the course is given during an enrollment cycle or registration year.

### **Ethics requirement – 2 Hours every year**

Ethics education requirements have been compulsory for Circular 230 practitioners and CTEC registered preparers for many years while the vast majority of tax preparers elsewhere had no prescribed education requirements, much less, mandatory ethics coursework. Beginning in 2012, Registered Tax Preparers will be required to complete two hours of ethics education annually as part of the requisite of 15 hours of CPE.

Qualifying ethics courses should be designed for the tax professional and cover ethical issues that arise in a tax practice. For example, courses that review Treasury Circular 230 would qualify. To be even more specific, this course fulfills Enrolled Agents' requirement for this year.

### **Renewal recordkeeping requirements for retaining CPE records**

**Beginning in 2011**, Enrolled Agents applying for renewal must retain CPE records for **four** years following the date of renewal (yes, this means keeping all records up to seven years). In 2012, the same four-year retention requirement will apply to registered tax return preparers so CPE records should be kept for up to five years (since their renewal cycle will be annual).

Per §10.6 (h), such information includes:

- i. The name of the sponsoring organization;
- ii. The location of the program;
- iii. The title of the program, qualified program number, and description of its content;
- iv. Written outlines, course syllabi, textbook, and/or electronic materials provided or required for the course;
- v. The dates attended;
- vi. The credit hours claimed;
- vii. The name(s) of the instructor(s), discussion leader(s), or speaker(s), if appropriate; and
- viii. The certificate of completion and/or signed statement of the hours of attendance obtained from the continuing education provider.

## **CPE Waiver**

Waiver from the continuing education requirements may be granted based on health, military duty, or a variety of other compelling reasons. A request for waiver must be made to the IRS during the normal renewal application period.

## **Inactive Enrollment Status**

Individuals who fail to file a timely application for renewal may be placed on a roster of inactive enrolled individuals. Fortunately, there are procedures available to rectify this problem, but during the period of inactive status, individuals lose all rights and privileges of enrollment, including the ability to use their EA designation (and cannot state or even imply they are enrolled).

## **Circular 230 Application to "Other Individuals"**

New language in §10.8 incorporates other individuals (i.e. employees of "Offer Mills") who were previously beyond the OPR grasp. Section 10.8(c) reads:

Any Individual who for compensation prepares, or assists in the preparation of, all or a substantial portion of a document pertaining to any taxpayer's tax liability for submission to the Internal Revenue Service is subject to the duties and restrictions relating to practice in subpart B, as well as subject to the sanctions for violation of the regulations in subpart C.

## **Subpart B — Duties and Restrictions Relating to Practice Before the IRS**

Enforcement trends and pronouncements out of OPR give a clear picture of their priorities and "Back to Basics of Circular 230" is this year's buzz-phrase. Beyond the general concern with "fitness and suitability to practice," Karen Hawkins has been refining the direction of OPR enforcement activities and has recently pointed to these areas of interest:

- Due Diligence
- Conflicts of Interest
- Solicitation
- Taking Positions that lack Reasonable Basis (under IRC §6694)
- Assistance To or From Disbarred Persons
- Negotiation of Taxpayer Refunds

Obviously, practitioners' thorough knowledge of obligations under Circular 230, Subpart B is vital and compelling.

## **§ 10.20 Information to be furnished**

### *(a) To the Internal Revenue Service.*

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

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

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

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

## **Privilege**

Sounding like such a great idea at the time, limited privilege was afforded to all federally authorized practitioners in the IRS Restructuring and Reform Act of 1998 (RRA98), which created IRC §7525. Privilege is a double-edged sword, and a sharp one at that. Publication 947 states: The confidentiality protection applies to communications that would be considered privileged if they were between the taxpayer and an attorney and that relate to:

- Noncriminal tax matters before the IRS, or
- Noncriminal tax proceedings brought in federal court by or against the United States.

The most crucial rules to keep in mind when privilege is an issue are:

- Privilege 'belongs' to the Taxpayer; the client controls what is privileged
- The privilege must be asserted; it is not automatic
- Privilege only applies to representation activities, *not* tax preparation
- Any accidental breach of privileged communications waives all privilege
- Asserting privilege will lead to referral to IRS Counsel and potentially draw the interest of the Criminal Investigation arm of the IRS

***Important to Note***

*Privilege is not applicable to RTRP communications. The Final Regulations note: "...practitioner privilege generally does not apply to communications between a taxpayer and a registered tax return preparer because the advice a registered tax return preparer provides ordinarily is intended to be reflected on a tax return and is not intended to be confidential or privileged."*

**§ 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.

The bottom line is: when a practitioner finds a problem with a prior return or other document submitted to the IRS, it must be **promptly** reported to the client. Penalties or other ramifications, as well as the potential remedies, must be clearly communicated, no matter who created the problem.

**§ 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.

***Practice Tip***

*The question often comes up, “How far must I go to fulfill my obligations of accuracy, when preparing a tax return?”*

*The answer is, until you feel comfortable that the information is accurate. This does not mean a full audit of each tax return is necessary, but in some cases, more information should be requested of the client to satisfy **any** doubt as to the validity of their information. A simple approach that works every time is to utilize the “IRS Sting” method; imagine the person across the desk from you is an IRS agent, keen to observe your principles.*

(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.

**§ 10.23 Prompt disposition of pending matters**

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

Recently updated in numerous sections of the Internal Revenue Manual (IRM), referrals from IRS employees are being aggressively sought by OPR for practitioner delays. In addition to OPR sanctions for violating §10.23, the practitioner will also find that their Power of Attorney has been legally bypassed by the IRS. The resulting contact from the IRS can create very unpleasant consequences for clients and certainly increases the practitioner’s potential for being sued.

**§ 10.24 Assistance from or to disbarred or suspended persons and former IRS 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.

***Important to Note!***

Although this section was not modified in the latest revisions to Circular 230, a significant change has occurred, nonetheless. Prior to August 2011, practitioners who had been disbarred or suspended could continue to work as "shadow preparers" during the period they were precluded from representing taxpayers before the IRS. With Registered Tax Return Preparers' incorporation into Circular 230, sanctions will affect all activity, including tax preparation.

Disciplinary actions are listed in the Internal Revenue Bulletin (IRB) on a regular basis and should be reviewed occasionally to be certain no colleagues or associates appear on the list. The disciplinary announcements in the IRB are accessible through the OPR website at:

 Website

<http://www.irs.gov/taxpros/agents/article/0,,id=131857,00.html>

## § 10.27 Fees

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

(b) *Contingent fees*—(1) Except as provided in paragraphs (b)(2), (3), (4), and (5) 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 Internal Revenue Service's examination of, or challenge to—

(i) An original tax return; or

(ii) An amended return or claim for refund or credit filed before the taxpayer received a written notice of examination of, or a written challenge to, the original tax return; or filed no later than 120 days after the receipt of such written notice or written challenge. The 120 days is computed from the earlier of a written notice of the examination, if any, or a written challenge to the original 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 a claim under section 7623 of the Internal Revenue Code.

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

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

(1) *Contingent fee* is any fee that is based, in whole or in part, on whether or not a position taken on a tax return or other filing avoids challenge by the Internal Revenue Service or is sustained either by the Internal Revenue Service or in litigation. A contingent fee includes a fee that is based on a percentage of the refund reported on a return, that is based on a percentage of the taxes saved, or that otherwise depends on the specific tax 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.

The determining factor in an acceptable contingent fee engagement is whether the issue will be subjected to thorough IRS scrutiny, such as in examination appeals or penalty abatement requests.

#### **§ 10.28 Return of client's records**

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

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

🚫\* **Caution:** the reference to “materials that were prepared by the client” **INCLUDES** any "Organizer" forms which your firm supplied and the client completed. In the case of a fee dispute, the client **DOES NOT** have rights to any materials you created without receiving compensation (such as workpapers, spreadsheets, research, etc.).

## § 10.29 Conflicting interests

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

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

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

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

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

This is an area of particular concern because it is easy to overlook. If a practitioner is not constantly alert for signs that a conflict might exist, they risk discovering the fact well into the engagement, when it may be too late to back out without irreparable damage. Such is the case with divorcing clients or business relationships that are winding down. No matter how amicable, when people part ways with money and legal issues at stake, they are always in conflict.

Additionally, this is a priority issue for OPR in the coming months and years. The IRS is actively pursuing cases where a practitioner's interests are competing with those of their client. The classic example is while representing a client in audit, a practitioner may be confronted with a need to defend their own competence and motives regarding the original return preparation or tax advice given to the client. Anytime a need for self-preservation arises, a conflict exists whether

acted upon or not. A conversation and waiver is required with your client whenever you feel yourself "tempering" communications based on self-preservation or personal interest.

### **§ 10.30 Solicitation**

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

This section also prohibits unwanted, persistent contacts of prospective clients and bars 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.*

### **§ 10.31 Negotiation of taxpayer checks**

Although brief and unchanged by the new regulations, this section has emerged as a big issue for OPR, constituting a large percentage of the complaints they receive. **Negotiating taxpayer checks includes electronic transfers**, so taking preparation fees by splitting a taxpayer's refund and sending "your" portion to your bank account is absolutely forbidden, even if the taxpayer requests or suggests it. Note: this provision has been around since the original *Horse Act of 1884*, hence OPR's spotlight on "back to basics with Circular 230."

### **§ 10.33 Best practices for tax advisors**

(a) *Best practices.* Tax advisors should provide clients with the highest quality representation concerning Federal tax issues by adhering to best practices in providing advice and in preparing or assisting in the preparation of a submission to the Internal Revenue Service. In addition to

compliance with the standards of practice provided elsewhere in this part, best practices include the following:

(1) Communicating clearly with the client regarding the terms of the engagement. For example, the advisor should determine the client's expected purpose for and use of the advice and should have a clear understanding with the client regarding the form and scope of the advice or assistance to be rendered.

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

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

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

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

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

The new regulations bring this section back into alignment with IRC §6694 after some unintentional consequences from Congress created chaos during the last update of Circular 230:

- (a) Tax returns. (1) A practitioner may not willfully, recklessly, or through gross incompetence--
- (i) Sign a tax return or claim for refund that the practitioner knows or reasonably should know contains a position that--
- (A) Lacks a reasonable basis;
  - (B) Is an unreasonable position as described in section 6694(a)(2) of the Internal Revenue Code (Code) (including the related regulations and other published guidance); or
  - (C) Is a willful attempt by the practitioner to understate the liability for tax or a reckless or intentional disregard of rules or regulations by the practitioner as described in section 6694(b)(2) of the Code (including the related regulations and other published guidance).
- (ii) Advise a client to take a position on a tax return or claim for refund, or prepare a portion of a tax return or claim for refund containing a position, that--
- (A) Lacks a reasonable basis;
  - (B) Is an unreasonable position as described in section 6694(a)(2) of the Code (including the related regulations and other published guidance); or
  - (C) Is a willful attempt by the practitioner to understate the liability for tax or a reckless or intentional disregard of rules or regulations by the practitioner as described in section 6694(b)(2) of the Code (including the related regulations and other published guidance).
- (2) A pattern of conduct is a factor that will be taken into account in determining whether a practitioner acted willfully, recklessly, or through gross incompetence.
- (b) *Documents, affidavits and other papers* —

- (1) A practitioner may not advise a client to take a position on a document, affidavit or other paper submitted to the Internal Revenue Service unless the position is not frivolous.
- (2) A practitioner may not advise a client to submit a document, affidavit or other paper to the Internal Revenue Service —
- (i) The purpose of which is to delay or impede the administration of the Federal tax laws;
  - (ii) That is frivolous; or
  - (iii) That contains or omits information in a manner that demonstrates an intentional disregard of a rule or regulation unless the practitioner also advises the client to submit a document that evidences a good faith challenge to the rule or regulation.
- (c) *Advising clients on potential penalties* —
- (1) A practitioner must inform a client of any penalties that are reasonably likely to apply to the client with respect to —
- (i) A position taken on a tax return if —
    - (A) The practitioner advised the client with respect to the position; or
    - (B) The practitioner prepared or signed the tax return; and
  - (ii) Any document, affidavit or other paper submitted to the Internal Revenue Service.
- (2) The practitioner also must inform the client of any opportunity to avoid any such penalties by disclosure, if relevant, and of the requirements for adequate disclosure.
- (3) This paragraph (c) applies even if the practitioner is not subject to a penalty under the Internal Revenue Code with respect to the position or with respect to the document, affidavit or other paper submitted.

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

### **§ 10.36 Procedures to ensure compliance**

- (a) *Requirements for covered opinions.* Any practitioner who has (or practitioners who have or share) principal authority and responsibility for overseeing a firm's practice of providing advice concerning Federal tax issues must take reasonable steps to ensure that the firm has adequate procedures in effect for all members, associates, and employees for purposes of complying with §10.35. Any such practitioner will be subject to discipline for failing to comply with the requirements of this paragraph if —
- (1) The practitioner through willfulness, recklessness, or gross incompetence does not take reasonable steps to ensure that the firm has adequate procedures to comply with §10.35, and one or more individuals who are members of, associated with, or employed

by, the firm are, or have engaged in a pattern or practice, in connection with their practice with the firm, of failing to comply with §10.35; or

(2) The practitioner knows or should know that one or more individuals who are members of, associated with, or employed by, the firm are, or have, engaged in a pattern or practice, in connection with their practice with the firm, that does not comply with §10.35 and the practitioner, through willfulness, recklessness, or gross incompetence, fails to take prompt action to correct the noncompliance.

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

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

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

### **§ 10.37 Requirements for other written advice**

(a) *Requirements.* A practitioner must not give written advice (including electronic communications) concerning one or more Federal tax issues if the practitioner bases the written advice on unreasonable factual or legal assumptions (including assumptions as to future events), unreasonably relies upon representations, statements, findings or agreements of the taxpayer or any other person, does not consider all relevant facts that the practitioner knows or should know, or, in evaluating a Federal tax issue, takes into account the possibility that a tax return will not be audited, that an issue will not be raised on audit, or that an issue will be resolved through settlement if raised.

## **Subpart C — Sanctions for Violation of the Regulations**

### **§ 10.50 Sanctions**

This section gives OPR authority to censure, suspend, or disbar any practitioner from practice before the Internal Revenue Service if the practitioner is shown to be incompetent or disreputable, fails to comply with any prohibited conduct standards, or with intent to defraud, willfully and knowingly misleads or threatens a client or prospective client. Censure is a public

reprimand. Monetary penalties may also be assessed to individuals and/or firms who violate these provisions.

Recent disciplinary actions can be found on OPR's website at:

 Website

<http://www.irs.gov/taxpros/agents/article/0,,id=177688,00.html>

## **Willfulness**

Administrative Law Judges (ALJ) who adjudicate proceedings brought by OPR have consistently applied the definition of "willful" as "a voluntary, intentional violation of a known legal duty." It might be characterized as behavior that goes beyond 'negligence', but falls far short of 'fraudulent'.

## **§ 10.51 Incompetence and disreputable conduct**

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

- (1) Conviction of any criminal offense under the Federal tax laws.
- (2) Conviction of any criminal offense involving dishonesty or breach of trust.
- (3) Conviction of any felony under Federal or State law for which the conduct involved renders the practitioner unfit to practice before the Internal Revenue Service.
- (4) Giving false or misleading information, or participating in any way in the giving of false or misleading information to the Department of the Treasury or any officer or employee thereof, or to any tribunal authorized to pass upon Federal tax matters, in connection with any matter pending or likely to be pending before them, knowing the information to be false or misleading. Facts or other matters contained in testimony, Federal tax returns, financial statements, applications for enrollment, affidavits, declarations, and any other document or statement, written or oral, are included in the term "information."
- (5) Solicitation of employment as prohibited under §10.30, the use of false or misleading representations with intent to deceive a client or prospective client in order to procure employment, or intimating that the practitioner is able improperly to obtain special consideration or action from the Internal Revenue Service or any officer or employee thereof.
- (6) Willfully failing to make a Federal tax return in violation of the Federal tax laws, or willfully evading, attempting to evade, or participating in any way in evading or attempting to evade any assessment or payment of any Federal tax.
- (7) Willfully assisting, counseling, encouraging a client or prospective client in violating, or suggesting to a client or prospective client to violate, any Federal tax law, or

knowingly counseling or suggesting to a client or prospective client an illegal plan to evade Federal taxes or payment thereof.

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

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

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

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

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

(13) Giving a false opinion, knowingly, recklessly, or through gross incompetence, including an opinion which is intentionally or recklessly misleading, or engaging in a pattern of providing incompetent opinions on questions arising under the Federal tax laws. False opinions described in this paragraph (a) (13) include those which reflect or result from a knowing misstatement of fact or law, from an assertion of a position known to be unwarranted under existing law, from counseling or assisting in conduct known to be illegal or fraudulent, from concealing matters required by law to be revealed, or from consciously disregarding information indicating that material facts expressed in the opinion or offering material are false or misleading. For purposes of this paragraph (a) (13), reckless conduct is a highly unreasonable omission or misrepresentation involving an extreme departure from the standards of ordinary care that a practitioner should observe under the circumstances. A pattern of conduct is a factor that will be taken into account in determining whether a practitioner acted knowingly, recklessly, or through gross incompetence. Gross incompetence includes conduct that reflects gross indifference, preparation which is grossly inadequate under the circumstances, and a consistent failure to perform obligations to the client.

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

(15) Willfully disclosing or otherwise using a tax return or tax return information in a manner not authorized by the Internal Revenue Code, contrary to the order of a court of

competent jurisdiction, or contrary to the order of an administrative law judge in a proceeding instituted under §10.60.

***The New Regulations add the following three actions under this section:***

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

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

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

**§ 10.52 Violations subject to sanction**

(a) A practitioner may be sanctioned under §10.50 if the practitioner —

- (1) Willfully violates any of the regulations (other than §10.33) contained in this part; or
- (2) Recklessly or through gross incompetence (within the meaning of §10.51(a) (13)) violates § 10.34, 10.35, 10.36 or 10.37.

**Recent Cases Indicate New Enforcement Trends**

Historically, the majority of sanctions on practitioners have been for failure to file their own tax returns under §10.51(6) or expedited proceedings under §10.82 due to court or licensing board reprimands. More recently, the public releases from OPR are a clear sign they are serious about investigating and pursuing violations of other sections of Circular 230.

Michael McCall, an attorney in Washington State, was suspended for 24 months for giving a false opinion. Unlike a false "covered opinion" involving abusive, intentional disregard of tax law, he was sanctioned for his incompetence and failing to exercise due diligence in writing an opinion for a legitimate municipality in their issuance of sewer bonds. McCall failed to perform due diligence under Circular 230, section 10.22, with respect to transactional matters related to the bond issuance (*IR-2010-57 dated May 5, 2010*).

Tim W. Kaskey, CPA was recently disbarred after he failed to make reasonable inquiries when preparing tax returns and for failing to exercise due diligence to determine the correctness of representations made by taxpayers, a corporation and its married shareholders (under §10.22). Kaskey defended against the due diligence allegations by arguing that his clients had misrepresented their income to him. The Appellate Authority observed that there was “a great deal of evidence reflecting the lack of due diligence by [Kaskey] in the preparation of these returns...[and that] “it was inconceivable that [the individual taxpayers] could pay their living expenses based on the income reported on their returns.”

Taken directly from the IRS Information Release: “This is yet another decision highlighting that practitioners have a duty to the system as well as to their clients. Practitioners who do not take this duty seriously can expect to be held accountable,” said Office of Professional Responsibility (OPR) Director Karen L. Hawkins....Kaskey’s misconduct included a failure to comply with the requirement to advise clients of potential penalties and any opportunities to avoid such penalties by disclosure contained in Circular 230, former section 10.34(c). “Practitioners who think OPR isn’t serious about due diligence should take heed,” added OPR Director Hawkins. “Practitioners may not ignore the implications of information already known, and must make reasonable inquiries if the information furnished by a client appears to be incorrect, inconsistent, or incomplete.” (*IR-2010-82, July 6, 2010*)

The OPR website now publicizes details of sanctions and contains numerous cases which act as a warning to those tempted to violate or ignore Circular 230. The full Final Agency Decisions are accessible at:

 Website

<http://www.irs.gov/taxpros/actuaries/article/0,,id=183923,00.html>

In addition to OPR's disciplinary actions, new "Examples of Abusive Return Preparer Investigations" are publicized and offer some valuable insights on "what NOT to do" as a tax preparer. The level of stupidity evident in some of the cases borders on humorous, until one thinks about the impacts on the taxpayers they victimize.

Brief summaries of these recent court cases can be accessed at:

 Website

<http://www.irs.gov/compliance/enforcement/article/0,,id=213764,00.html>

While they do provide enlightening reading, these cases also serve as indicators of the trends in IRS compliance activities. Some noteworthy observations:

- the sheer volume of prosecuted cases is somewhat startling (when compared to past DOJ news releases),
- they are **not** limited to large-scale evil-doers, and
- all involve more than one year of prison time.

A few choice examples of these preparer cases are printed in Appendix A

Karen Hawkins, Director OPR and author of *Office of Professional Responsibility & Circular 230: Overview, Procedures and Priorities*, conducted an IRS Webinar and Talk at Golden Gate University on October 27, 2010. Ms. Hawkins is concerned particularly about:

- Practitioner's trustworthiness
- Confidentiality of taxpayer's information
- Practitioners being professional

### **OPR Complaint Process**

- Sources of complaints:
  1. From IRS divisions and employees
  2. Other government agencies
  3. Tax practitioners
  4. Private citizens
  
- Disciplinary Approaches
  - Issuance of a "Soft Letter" (compliance and conduct)
  - Issuance of a "Soft 60-Day Letter" (compliance)
  - Issuance of a Notice of Allegation (conduct)
  - Deferred Disciplinary Agreement (both)
  - Issue Notice of Allegation
    - A report of suspected misconduct was forwarded to this office
    - The report suggests that you may have violated one or more regulations governing practice before the IRS
    - Allegations include.....
    - OPR will begin an investigation
    - If you possess relevant information which you believe will help resolve the allegation(s), please submit it now.
  
- Deferred Disciplinary Agreement
  - Practitioner Offers and Consents to Agreement in Lieu of a Disciplinary Proceeding Being Instituted or Continued.
  - Practitioner Admits to Relevant Violations of Circular 230.
  - Practitioner Offers Consent to Suspension.
  - OPR Accepts Offer and Agrees to Refrain from Imposing and Publicizing the Terms of Suspension, Contingent On:
    - Stay in Compliance for 5 years
    - Withdraw All Outstanding Forms 2848 within 60 days
    - Agree Not to Submit Any Forms 2848 to the IRS or attempt to practice before the IRS
    - If Default, Expedited Suspension Procedures of Section 10.82 apply.
  
- What Types of Sanctions may be Imposed?
  - Letter of Reprimand (private - may include "soft letter")

- Censure (published)
- Suspension (6 - 59 months)
- Disbarment (minimum 60 months; must then petition to Director to return to practice)

## **Beyond Circular 230: IRC §7216 - Disclosure or Use of Information**

### **(a) General rule**

Any person who is engaged in the business of preparing, or providing services in connection with the preparation of, returns of the tax imposed by chapter 1, or any person who for compensation prepares any such return for any other person, and who knowingly or recklessly—

- (1) discloses any information furnished to him for, or in connection with, the preparation of any such return, or
- (2) uses any such information for any purpose other than to prepare, or assist in preparing, any such return, shall be guilty of a misdemeanor, and, upon conviction thereof, shall be fined not more than \$1,000, or imprisoned not more than 1 year, or both, together with the costs of prosecution.

### **(b) Exceptions**

#### **(1) Disclosure**

Subsection (a) shall not apply to a disclosure of information if such disclosure is made—

- (A) pursuant to any other provision of this title, or
- (B) pursuant to an order of a court.

#### **(2) Use**

Subsection (a) shall not apply to the use of information in the preparation of, or in connection with the preparation of, State and local tax returns and declarations of estimated tax of the person to whom the information relates.

#### **(3) Regulations**

Subsection (a) shall not apply to a disclosure or use of information which is permitted by regulations prescribed by the Secretary under this section. Such regulations shall permit (subject to such conditions as such regulations shall provide) the disclosure or use of information for quality or peer reviews.

**Rev. Proc. 2008-35** details the very specific consent rules under which practitioners may disclose client information to ANYONE outside of the firm under engagement. Thanks to questionable and/or downright disreputable actions of a few, all practitioners are required to obtain burdensome disclosure consents from clients.

The disclosure rules do not apply to information that must be gathered to prepare a tax return, so merely clarifying tax information from the issuer of a K-1 or sharing information with a spouse's preparer to complete a "Married Filing Separately" return still requires client consent but falls outside of this requirement.

Anything disclosed outside of (or after) tax preparation is strictly forbidden. This means in order to speak to your client's stockbroker about tax planning, before you write a mortgage letter, or send a copy of a tax return to any third party at the request of your client, you must follow the VERY specific language and format as detailed in this Revenue Procedure.

In addition, every time a client requests a practitioner's interaction with any outside entity or individual, a new consent letter must be completed and signed before going forward. Specific, mandatory language included in **Rev. Proc 2008-35** is required and can be found on the IRS website at:



Website

<http://www.irs.gov/efile/article/0,,id=201520,00.html>

This is only one of the many boilerplate consent documents in Rev. Proc. 2008-35.

## CONSENT FOR DISCLOSURE OF TAX INFORMATION

Federal law requires this consent form be provided to you. Unless authorized by law, we cannot disclose, without your consent, your tax return information to third parties for purposes other than the preparation and filing of your tax return and, in certain limited circumstances, for purposes involving tax return preparation. If you consent to the disclosure of your tax return information, Federal law may not protect your tax return information from further use or distribution.

You are not required to complete this form. Because our ability to disclose your tax return information to another tax return preparer affects the service that we provide to you and its cost, we may decline to provide you with service or change the terms of service that we provide to you if you do not sign this form. If you agree to the disclosure of your tax return information, your consent is valid for the amount of time that you specify. If you do not specify the duration of your consent, your consent is valid for one year.

Duration of consent (optional): One Year

I, \_\_\_\_\_, authorize \_\_\_\_\_ to disclose any and all tax information to \_\_\_\_\_ for the purpose of \_\_\_\_\_.

Note: If there are multiple reasons for requesting disclosures they may all be listed in one consent form. See Revenue Procedure 2008-35, section 6 for examples.

If you believe your tax return information has been disclosed or used improperly in a manner unauthorized by law or without your permission, you may contact the Treasury Inspector General for Tax Administration (TIGTA) by telephone at 1-800-366-4484, or by email at [complaints@tigta.treas.gov](mailto:complaints@tigta.treas.gov).

Taxpayer Signature: \_\_\_\_\_ Date: \_\_\_\_\_

While these rules generate huge burdens on our practices, failure to follow the rules can generate equally huge penalties; up to one year in prison and \$1,000, **in addition to** civil penalties under §6713 which are \$250 per disclosure, up to \$10,000 per year.

Additional guidance is provided in **Rev. Rul. 2010-4** which clarifies that penalties do not apply if information is used to provide information to clients about tax changes (e.g. via client newsletters). The key factors in this ruling are that newsletters provide help with tax compliance and clients reasonably expect that their tax preparer will contact them if tax planning

opportunities (or hazards) are on the horizon. Rev. Rul. 2010-4 also allows limited disclosure of client information to third-party contractors who provide tax newsletter services and of course, *they* are prohibited from using the information for any other purpose.

**Rev. Rul. 2010-5** further expands the exceptions to include disclosures to professional liability insurance carriers and others for the purpose of investigating and evaluating claims (and potential claims) made against the practitioner.

### **Gramm-Leach-Bliley**

This is the law that requires annual disclosure of a financial service provider's privacy policy. While CPAs were able to garner an exemption from these rules, Enrolled Agents and tax preparers are still required to inform clients about the use of their non-public information *every* year.

Under the Gramm-Leach-Bliley Act of 1999, tax firms must comply with three objectives...

- Ensure the security and confidentiality of their client's information.
- Protect against any anticipated threats or hazards to the security or integrity of such information.
- Protect against unauthorized access to or use of such information that could result in substantial harm or inconvenience to any client.

### **Red Flags Rule**

IRS Publication 4557 details the steps that tax preparers should take to secure their clients' data and has a great checklist to help protect the vast amounts of private information in our offices. More information is available at:

 Website

<http://www.ftc.gov/bcp/edu/microsites/redflagsrule/faqs.shtm>

The importance of utilizing the advance planning tools under the Red Flags Rule is not only crucial, it can save a firm hundreds of hours and thousands of dollars down the road.

### **Sarbanes-Oxley**

Sarbanes-Oxley (also known as SOX) established the Public Company Accounting Oversight Board, or PCAOB, which is charged with oversight of accounting firms as auditors of public companies. The Act also covers internal control assessment, and enhanced financial disclosure which affects tax practices as well.

## **FTC “Debt Relief Services” Rules**

The Federal Trade Commission (FTC) has released new regulations, which include tax relief services under the Telemarketing Sales Rule. The regulations, which went into effect on October 27, 2010, impact the ability to collect payments (retainers) prior to completion of services. Beyond the Best Practices contained in §10.33 of Circular 230, representation engagements may necessitate additional exploratory work be done prior to requesting a retainer and/or reevaluation of billing methods and refund policies.

There are many exemptions and the vast majority of Enrolled Agents and CPAs will not be impacted. Face-to-face meetings are the most notable exemption, as the rules are meant to curtail the practice of luring clients through advertising and then "sealing the deal" over the phone or internet without actually providing services. Another relevant issue is that these rules only apply to unsecured debt and tax debt is secured when assessed, whether a lien has been recorded or not. The conventional wisdom is that FTC, hoping to snag disreputable "Offer mills" under this rule, has reserved judgment on the nature of assessed taxes.

A "Consumer Alert" with more detailed information is available on the FTC website at:



Website

<http://www.ftc.gov/bcp/edu/pubs/consumer/alerts/alt189.shtm>

## **APPENDIX A – Abusive Tax Return Preparer Investigations**

These recent cases illustrate the IRS' zero tolerance on fraud:

### **California Tax Return Preparer Sentenced for Tax Fraud**

On July 19, 2010, in San Jose, Calif., Lydia Hernandez, the owner of Lydia Hernandez Tax Services, in Salinas, was sentenced to 15 months in prison, to be followed by three years of supervised release, and ordered to pay \$35,433 in restitution for tax evasion and aiding and assisting in the preparation of false tax returns. According to the plea agreement, Hernandez prepared 39 income tax returns on behalf of 13 clients for the 2002 through 2005 tax years. She admitted that she prepared false returns for those clients to reduce their taxable income and obtain a bigger refund for them than they were entitled to receive. For some clients, Hernandez filed a false Schedule C, deducting items such as gifts, dry cleaning, cell phone expenses, gym membership fees, and union dues, even though she knew those items were not deductible. Hernandez also falsified the amount of deductions for state and local taxes and filed false depreciation and mileage deductions on behalf of her clients. Hernandez admitted that, for the 2004 tax year, she underreported her business income by \$51,129 on her individual income tax returns.

### **Sacramento Accountant Sentenced To 234 Months in \$13.5 Million Ponzi Scheme**

On May 28, 2010, in Sacramento, Calif., William Murray, of Sacramento, was sentenced to 234 months in prison, to be followed by three years of supervised release for mail fraud and interference with tax administration in a Ponzi scheme. He was also ordered to pay \$10,375 in restitution to 118 victims of his scheme. According to his March 9, 2010, guilty plea, Murray stole approximately \$13,357,133 from more than 50 clients between 2001 and 2009. He told clients to write checks to accounts under his control so that he could pay taxes or invest money on their behalf. In fact, he spent millions of dollars in client money on his own lifestyle. He bought himself houses, a classic car, a fleet of limousines, jewelry, and other luxury items. Murray changed his clients' addresses to his own, so that they would not receive the IRS's demands for payment on their delinquent taxes. As demands for payment arrived from clients and the IRS, Murray's fraud became a Ponzi scheme. He used \$3,507,502 in later clients' money to pay off demands associated with earlier clients. Murray's sentence provides for the forfeiture of all of his remaining property, the disclosure of his bank account information to his victims, and a full disclosure of all of his financial affairs.

### **Former IRS Revenue Officer Sentenced to Prison in Scheme to File False Tax Returns**

On July 7, 2010, in Los Angeles, Calif., Anthony Pendleton, a former IRS Revenue Officer, was sentenced to 41 months in federal prison, to be followed by three years of supervised release, after being convicted of conspiracy to defraud the United States by filing tax returns that fraudulently sought tax refunds. Pendleton was also ordered to pay restitution totaling \$179,037 to the Internal Revenue Service. According to court papers, Pendleton, along with co-conspirators Christopher Edwards and Asha Lenard, conspired to file false claims for tax refunds with the IRS. The three, while working at Pendleton's tax preparation business, Payless Tax Services in Inglewood, California, submitted tax returns for individuals claiming refunds they were not entitled to receive. The claims for refunds included, among other things, falsified employment income and dependents. During the execution of a search warrant at Payless Tax Service, investigators recovered various documents and records related to the crime. Among the documents recovered was one entitled "Payless Tax Fee Schedule 2003," which detailed how much Payless charged to prepare returns for clients using children that are not dependents (\$499 2 kids / \$250 1 kid) and prepare returns for clients with no W-2's (50 percent of refund amount).

On September 30, 2010, in Los Angeles, Calif., Christopher Edwards and Asha Lenard were sentenced to prison for conspiracy to defraud the United States by filing tax returns that fraudulently sought tax refunds. Edwards was sentenced to 12 months and one day in prison, three years of supervised release, and was ordered to pay \$161,129 in restitution to the Internal Revenue Service. Lenard was sentenced to three years of probation, to include four months of home confinement, and was also ordered to pay \$161,129 in restitution to the Internal Revenue Service. Both had previously pleaded guilty to the charge of conspiracy.

## APPENDIX B - Real-World Dilemmas

### Real-World Dilemma – Colleague Conundrum

You have a colleague (let's say, a CPA) who refers representation work to you because he only prepares tax returns and he LIKES it that way. You hear from a mutual client that the CPA is behind in filing his own tax returns, and in fact, has been suspended in the past for it. What Would You Do?

*As long as he's been reinstated, you are safe regarding the prior sanction, since you didn't know about it. You'll want to keep an eye on disciplinary actions listed in the IRB and should not accept any tax related assistance from him during any period he is suspended or disbarred in the future! You can, however, accept referrals from the CPA, as long as he does not assist you in the engagement while suspended/disbarred. Also, if OPR comes knocking to ask about your business relationship or request copies of work produced in conjunction with the CPA, you must comply under §10.20.*

### Real-World Dilemma - The Trifecta of Discomfort

You are representing Andrea, the 21-year old daughter of an old friend and client, on the audit of her 2008 tax return. After meeting with the auditor who indicates a probable no-change, you call Andrea to ask about two minor items on the Information Document Request (IDR). In tears, Andrea blurts out that she lied to you; she didn't report all of her income but has no records and no idea how much she received "under the table." She is ashamed of herself and begs you not to tell the auditor or her dad.

Right after you speak with Andrea, her father (who is paying for your representation services) calls you to ask, "what's going on with Andrea's audit?" What Would You Do?

*§10.21 and §10.34 dictate that you must advise Andrea of the potential consequences of the omission (as best you can). Privilege applies since she asked you not to tell the auditor, so if the auditor subsequently asks if there is any unreported income, you must assert privilege per §10.20 (since Andrea "owns" the privilege, you should explain the consequences and any other possible options; she may change her mind).*

*Dad cannot be given any information without a consent signed by Andrea under §7216.*

### Real-World Dilemma - The Quadruple Whammy

You are representing a hopelessly disorganized client in an IRS audit and twice you had to postpone the initial meeting with the auditor due to a series of family crises. Now you have all of the records and an appointment to meet on Monday morning. After spending all weekend compiling and checking the documents, you get a call on your cell phone from the client on Sunday night to see if you need anything more. She indicates that she can get additional receipts if necessary and then indicates that some of the records she gave you previously were "fake," but she talked to her *brother-in-law* who assured her that this information was a "privileged communication", so she trusts that you won't tell the auditor. What Would You Do?

*With this new information, you cannot submit the falsified records under §10.51. You also cannot rely on the information provided by the taxpayer under §10.22 and §10.34. The necessity to delay the meeting again could create problems with §10.23 but typically, the IRS will not assume willful delay if the practitioner stays in contact. A call to the auditor to postpone may result in some ill will but will not likely result in the bypass of your Power of Attorney and/or violation of the prompt disposition requirement.*

*Assuming no criminal investigation involvement and that you're eventually satisfied with the resolution of the erroneous records issue, you can continue to represent but due to the client's request you must assert privilege (IRC §7525) when the auditor asks the right question. Again, explaining the consequences of asserting privilege may cause the client to have a change of heart...or firing the client is always an option.*