IRS Nationwide Tax Forum 2023

Office of Professional Responsibility: A Potpourri of (Potentially Painful) Tax Professional Problems

Rev. 7/10/2023

Presenter Introduction and Presentation

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(OPR)

Important Note: During the presentation you will see the PowerPoint and hear the presenter(s). There will be attendance checks that MUST be answered when prompted to earn CE credit. Q&A will be at the end of the session as time allows (via the “Ask Question” drop-down menu). There will be a survey at the end of the webinar that MUST be answered before you log off to earn CE credit.

Today’s presentation will:

- Provide an overview of the Office of Professional Responsibility (OPR) and its role in regulating tax practitioners;
- Recognize due diligences issues and how to ensure meeting them,
- Identify standards and how to meet them,
- Cite ways to avoid incompetence and disreputable conduct,
- Recognize and avoid conflicts of interest, and
- Discuss appropriate ways to handle clients’ federal tax matters before the IRS.

Statutory and Regulatory Authority

Statutory Authority

- 31 USC §330 (1884) authorizes:
  - Regulating the practice of representatives of persons before the Department of the Treasury, including the IRS, and determinations of practitioner "fitness" to practice. (31 USC §330(a)).
  - Types of disciplinary action, including monetary penalties. (31 USC §330(b)).
  - Regulating certain appraisers. (31 USC §330(c)).
  - Setting standards for certain written advice. (31 USC §330(d)).

Fitness to Practice

- Under section 330 of Title 31, the OPR focuses on “fitness” to practice.
- Those regulated under section 330 of Title 31 must possess:
  - Good character
  - Good reputation
  - Necessary qualifications to provide valuable service to the client
  - Competency to advise and assist persons in presenting their cases

Regulated Community

- Practitioners:
  - Attorneys
  - CPAs
  - Enrolled Agents
- Others Regulated
  - Enrolled Retirement Plan Agents
  - Enrolled Actuaries
  - Annual Filing Season Program Record of Completion Holders
  - Appraisers who submit appraisals supporting tax positions

Practice before the IRS

- "Practice" before the IRS is defined as all matters under laws or regulations administered by the IRS relating to a taxpayer's rights, privileges, or liabilities. §10.2(a)(4)
  - Advocating/representing a client in an audit, before IRS Collections, and appearing before IRS Appeals
  - Preparing or filing documents for submission to the IRS
  - Corresponding and communicating to the IRS regarding a taxpayer
  - Advising clients (including emails and texts) regarding tax positions
  - Providing appraisals for tax positions
- Not *mere* tax return preparation

Regulatory and Other Authority

- 31 CFR Subtitle A, Part 10 (commonly called "Treasury Circular No. 230")
  - Originally published 1921; latest revision issued 6/9/14 (eff. 6/12/14 (TD 9668))
- 31 CFR 10.1(a)(1)
- Delegation Order 25-16 (Rev. 1)
  - Rev. Proc. 81-38
  - Rev. Proc. 2014-42

Office of Professional Responsibility & Circular 230

Office of Professional Responsibility (OPR)

- Administers the laws and regulations governing the practice of tax professionals before the IRS;
- Interprets and applies the standards of practice for tax professionals in Circular 230 fairly and equitably;
- Investigates allegations of misconduct by practitioners in their practice before the IRS and imposes disciplinary sanctions if warranted; and
- Supports the IRS's strategy to enhance enforcement of the Internal Revenue Code by ensuring tax practitioners adhere to professional standards and follow the law.

Treasury Department Circular No. 230

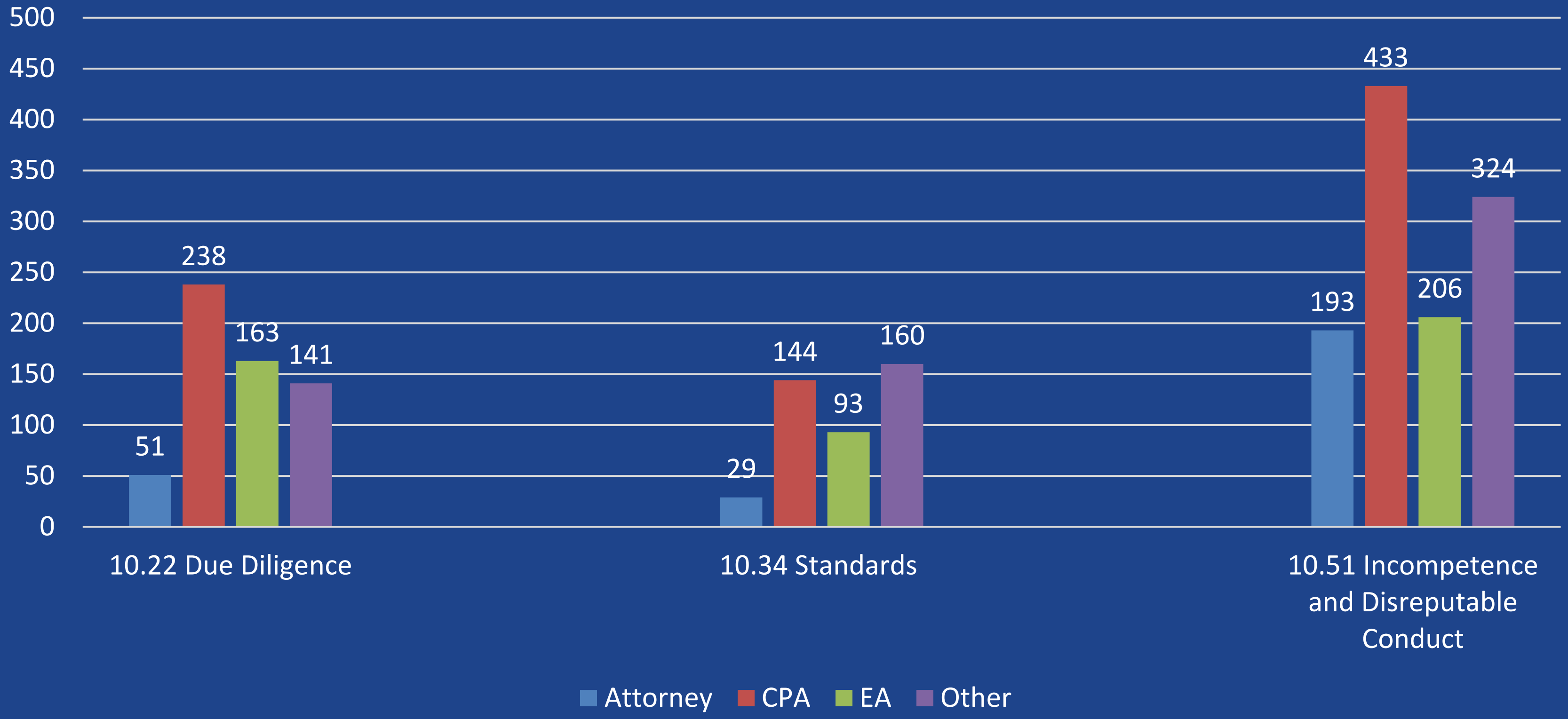
- Circular 230 contains the authorizing statute and the regulations detailing a tax professional's duties and obligations while *practicing* before the IRS.
  - Subpart A – Rules relating to the authority to practice before the IRS (licensing, renewals, continuing education);
  - Subpart B – Duties and restrictions relating to IRS practice;
  - Subpart C – Sanctions for violating Circular 230;
  - Subpart D – Rules applicable to disciplinary proceedings (due process); and
  - Subpart E – General provisions relating to the availability of official records.

Referrals to the OPR

- The OPR acts on referrals from various sources, including reports forwarded to the office by IRS field personnel.
- The OPR also receives complaints and information from state licensing authorities, other government agencies, tax practitioners, and the general public.
- The suspected misconduct reported to the OPR often involves due diligence issues, preparer penalty assessments, incompetence, erroneous representations, and bad advice.

Practitioner Discipline – Top Violations

October 1, 2016 through September 30, 2022



Practitioner Violations – Case Study*

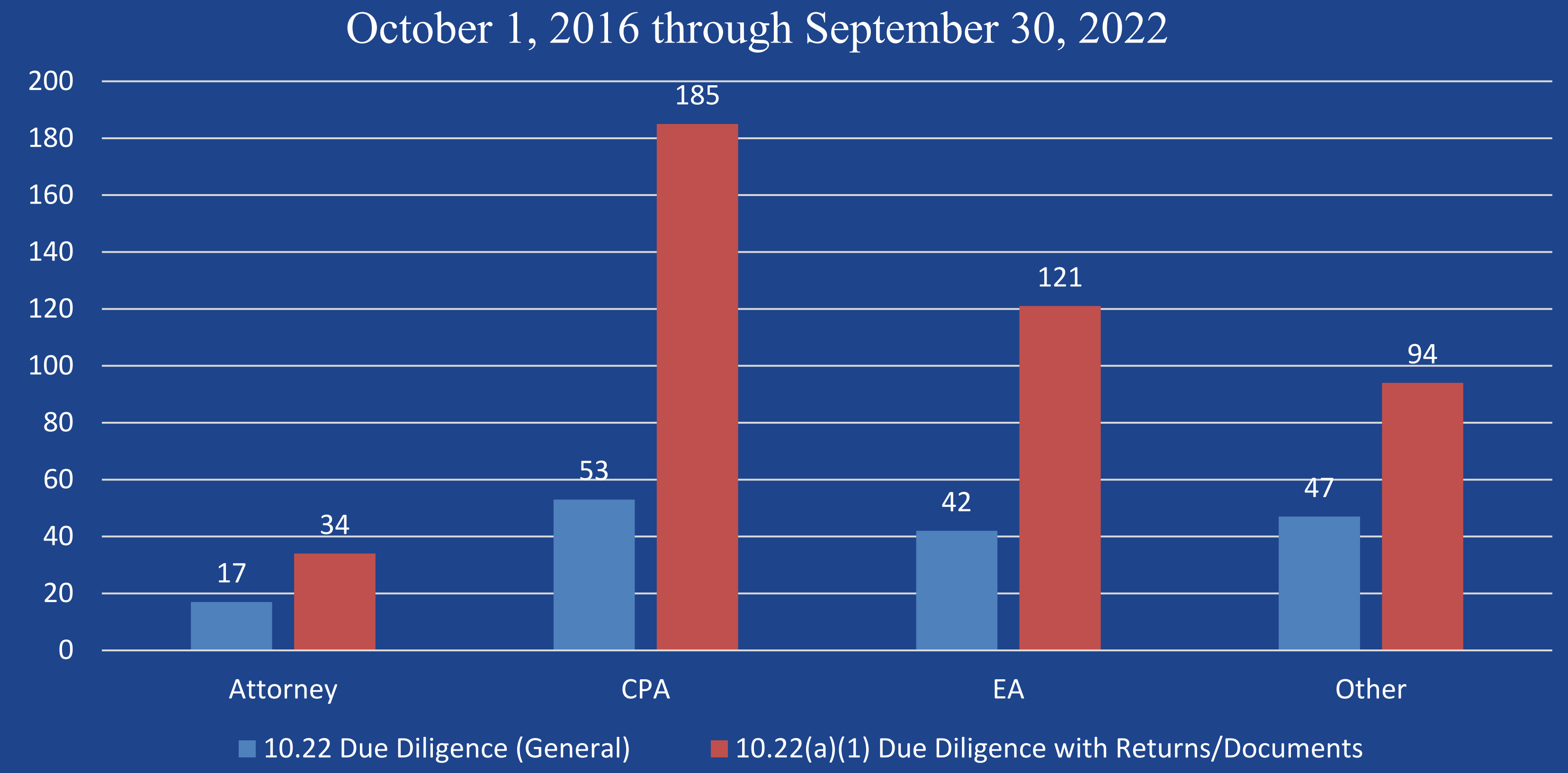
- From 1999 to 2003, Taxpayer, a CPA, resided at a home in Hermosa Beach, CA, owned by his long-time friend, Practitioner. Practitioner was an attorney, CPA, and tax return preparer.
- In 2005, Taxpayer moved to New York, where he bought a co-op unit. Taxpayers occasionally returned to the Hermosa Beach property for brief stints, including holidays.
- Taxpayer enjoyed living in Hermosa Beach so much he claimed to have bought a 32.5% interest in the Hermosa Beach property from Practitioner in 2010, financed by an interest-bearing loan from Practitioner. Taxpayer contended that Practitioner owed him $150,000.
- In 2015, after his job in New York City ended, Taxpayer moved to Minnesota. He rented out his New York property during all of 2015.

*Case Study based on facts in McCarthy v. Comm’r, T.C. Memo. 2020-74

Practitioner Violations – Case Study*

- Practitioner prepared Taxpayer's 2015 tax return reporting:
  - Taxpayer’s Minnesota address as his home;
  - Married Filing Separately (MFS) filing status;
  - Wage income, but no interest or rental income;
  - Rental loss for the New York property (Schedule E); and
  - Deduction for mortgage interest paid on the New York and Hermosa Beach properties (Schedule A). But Practitioner didn’t:
    - Confirm which property was Taxpayer’s primary residence.
    - Receive written consent from Taxpayer’s spouse about this deduction.
- During all of 2015, Practitioner rented out the Hermosa Beach property to his niece.
- The IRS examined Taxpayer’s 2015 return and made adjustments, including disallowing the mortgage interest deduction and penalties.

Practitioner Discipline – 10.22 Violations



§10.22 Diligence as to Accuracy

Tax practitioners who practice before the IRS have a dual responsibility with the IRS to ensure the fair and correct administration of the tax laws.

due dil-i-gence

— *reasonable steps taken by a person to satisfy a legal requirement*

§10.22 Exercise Due Diligence

- A practitioner must exercise due diligence in –
  - Preparing or assisting in the preparation of, approving, and filing tax returns, documents, affidavits, and other papers relating to IRS matters;
  - Determining the correctness of oral or written representations made by the practitioner to the Department of the Treasury and to clients regarding any matter administered by the IRS.

§10.22 Due Diligence: Info from Clients

- Relying on information furnished by clients (§10.34(d))
  - Generally, may rely in good faith without verification upon information furnished by the client.
  - Can not ignore the implications of information furnished to or actually known by the practitioner.
  - Must make reasonable inquiries if the information furnished appears incorrect, incomplete, or inconsistent with other facts or assumptions.
- Willful blindness violates a practitioner's due diligence responsibilities under Circular 230.

§10.22 Due Diligence: Info from 3rd Party

- Reliance on another professional's work (§10.34(d))
  - May rely on their work unless you have reason to question it.
    - No willful blindness!
  - Under the safe harbor provision in 10.22, deemed to have exercised reasonable due diligence if used reasonable care in selecting, engaging, supervising, training, overseeing, or evaluating the individual's work relying upon.
    - Reasonable care is based on facts and circumstances.

§10.22 Due Diligence: Best Practices

- To ensure you exercise your due diligence responsibilities, best practices (§10.35) should include:
  - Using an engagement agreement with provisions that set forth the client's and tax practitioner's mutual responsibilities.
  - Obtaining copies of a new client's prior years IRS-filed tax returns–at a minimum, obtain the most recent IRS-filed tax return, if possible.
  - Tailoring client tax information organizers to ensure correct and complete information is gathered.

§10.22 Due Diligence: Best Practices (Cont.)

- Ask questions of the client and make reasonable inquiries if the information being given appears incorrect, inconsistent, or incomplete.
- Contemporaneously document questions and taxpayer responses.
  - No Circular 230 requirement regarding documenting information receive from clients and others. Still, it's good practice to maintain a written record of such communications—can assist during an IRS examination or alleged malpractice claims.
- Confirm the taxpayer has maintained appropriate substantiation to support deductions or tax treatments.

§10.22 Due Diligence: Best Practices (Cont.)

- Obtain appropriate and sufficient information to determine the correct reporting of items on the return (e.g., income, deductions, credits, etc.) and compliance with tax laws.
  - If an estimate must be used (e.g., lost record), critical to maintain a record of how the estimate was determined to substantiate the position on the return and as a defense against penalties and sanctions.
- Think "substantial authority" or "reasonable basis" with disclosure (i.e., Form 8275).
- Don't take unnecessary risks or be cute; loss of livelihood and damage to reputation and integrity is not worth it.

§10.22 Due Diligence: Best Practices for EITC

- Earned Income Tax Credit (EITC) is an area ripe for abuse, and the IRS is actively auditing and assessing IRC §6695(g) penalties.
  - IRC §6695(g) Failure to be diligent in determining eligibility for certain tax benefits

    Any person who is a tax return preparer with respect to any return or claim for refund who fails to comply with due diligence requirements imposed by the Secretary by regulations with respect to determining—

    (1) eligibility to file as a head of household . . . on the return, or

    (2) eligibility for, or the amount of, the credit allowable by section 24, 25A(a)(1), or 32,

    shall pay a penalty of $500 for each such failure.
- Form 8867, *Paid Preparers Checklist* (See Exhibit 1)
  - Failure to keep a copy of form 8867 may lead to penalties being assessed
  - Penalty of $500.00 for each such failure

§10.22 Due Diligence: Best Practices for ERC

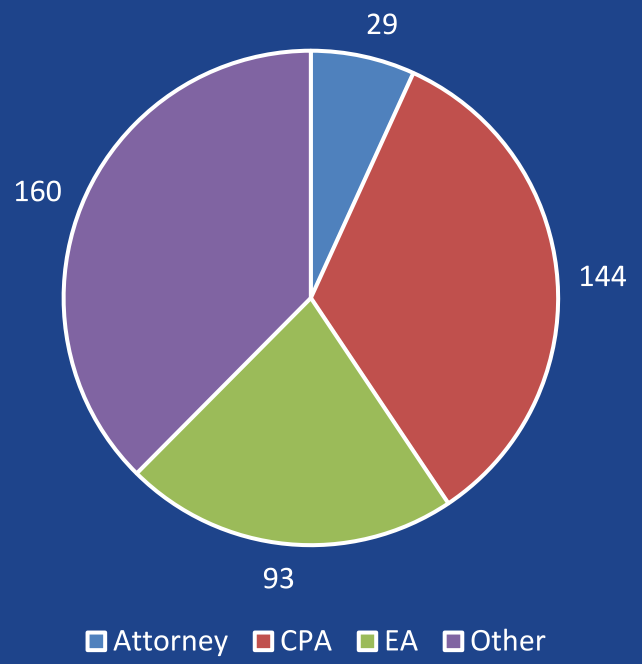
- Employee Retention Credit (ERC) is a refundable credit for businesses that continued to pay employees during shutdown due to the COVID-19 pandemic or had significant declines in gross receipts from Mar. 13, 2020 to Dec. 31, 2021.
- Eligible businesses that experienced a decline in gross receipts or were closed due to government order and didn't claim the ERC when they filed their original return can take advantage of the credit by filing adjusted employment tax returns.
- The ERC has been amended three times since it was enacted. Look at IRS.gov webpage for guidance on properly claiming the ERC.
- The IRS is actively auditing and conducting criminal investigations of false ERC claims.

§10.22 Due Diligence – Case Study

- In our Case Study, did the Practitioner display due diligence in reporting the mortgage interest deductions (IRC §163(a)) on the New York and Hermosa Beach properties on Taxpayer's 2015 return?
  - Practitioner did not confirm with Taxpayer which property, New York or Hermosa Beach, was Taxpayer's primary residence.
  - Practitioner knew Taxpayer's filing status was MFS but did not verify that Taxpayer and his wife had consented in writing under IRC §163(h)(4)(A)(ii)(II) to allow Taxpayer to take mortgage interest deductions for both residences.

Practitioner Discipline – 10.34 Violations

October 1, 2016 through September 30, 2022



§10.34(a) Standards for Tax Returns

- A practitioner may not sign a tax return or advise a position on a tax return willfully, recklessly, or through gross incompetence if it:
  - Lacks reasonable basis
  - Claims an unreasonable position
  - Is a willful attempt to understate liability
  - Is takes a position that is reckless or an intentional disregard of rules and regulations
- Patterns matter!

Standards for Tax Returns

Tax Return Position

Reasonable Basis (25%)

When a reasonable and well-informed analysis by a person knowledgeable in tax law concludes, there is at least a 25% likelihood that a position would be upheld on its merits. It MUST be paired with disclosure.

Realistic Possibility of Success (33%)

When a reasonable and well-informed analysis by a person knowledgeable in tax law concludes, there is at least an approximately one-in-three likelihood that a position would be upheld on its merits.

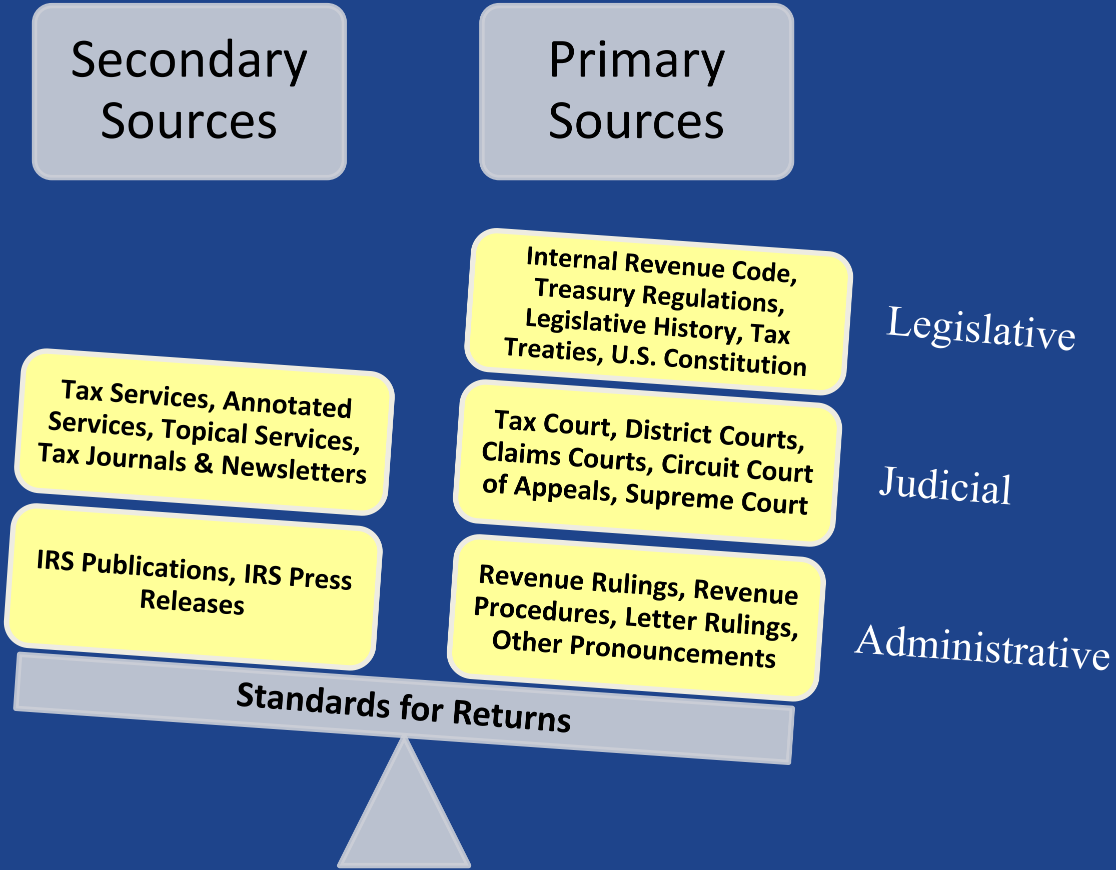
Substantial Authority

When a reasonable and well-informed analysis by a person knowledgeable in tax law concludes there is at least a greater than 40% but less than 50% likelihood, a position would be upheld on its merits.

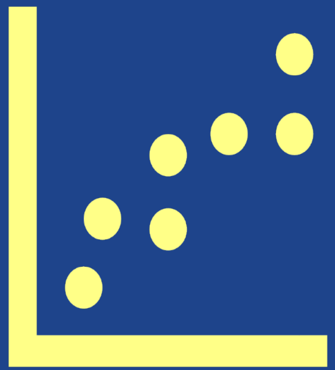
More Likely Than Not (>51%)

When a reasonable and well-informed analysis by a person knowledgeable in tax law concludes, there is at least a greater than 50% likelihood a position would be upheld on its merits.

Basis for Standards



§10.34(b) Standards for Documents and Other Papers



- A practitioner may not advise taking frivolous positions
- A practitioner may not advise submissions:
  - Made to delay or impede tax administration,
  - That are frivolous, or
  - Contain or omit information that demonstrates an intentional disregard of rules or regulations
- Patterns matter again!

§10.34(c) Standards and Advising Clients on Penalties

- Must advise the client of potential penalty exposure regarding:
  - A position taken on the return if the practitioner advised the client regarding the position OR the practitioner prepared or signed the return
  - Any document, affidavit, or other paper submitted to the IRS
- Must also advise the client of penalty avoidance through disclosure.

§10.34(a) Standards for Tax Returns and Best Practices

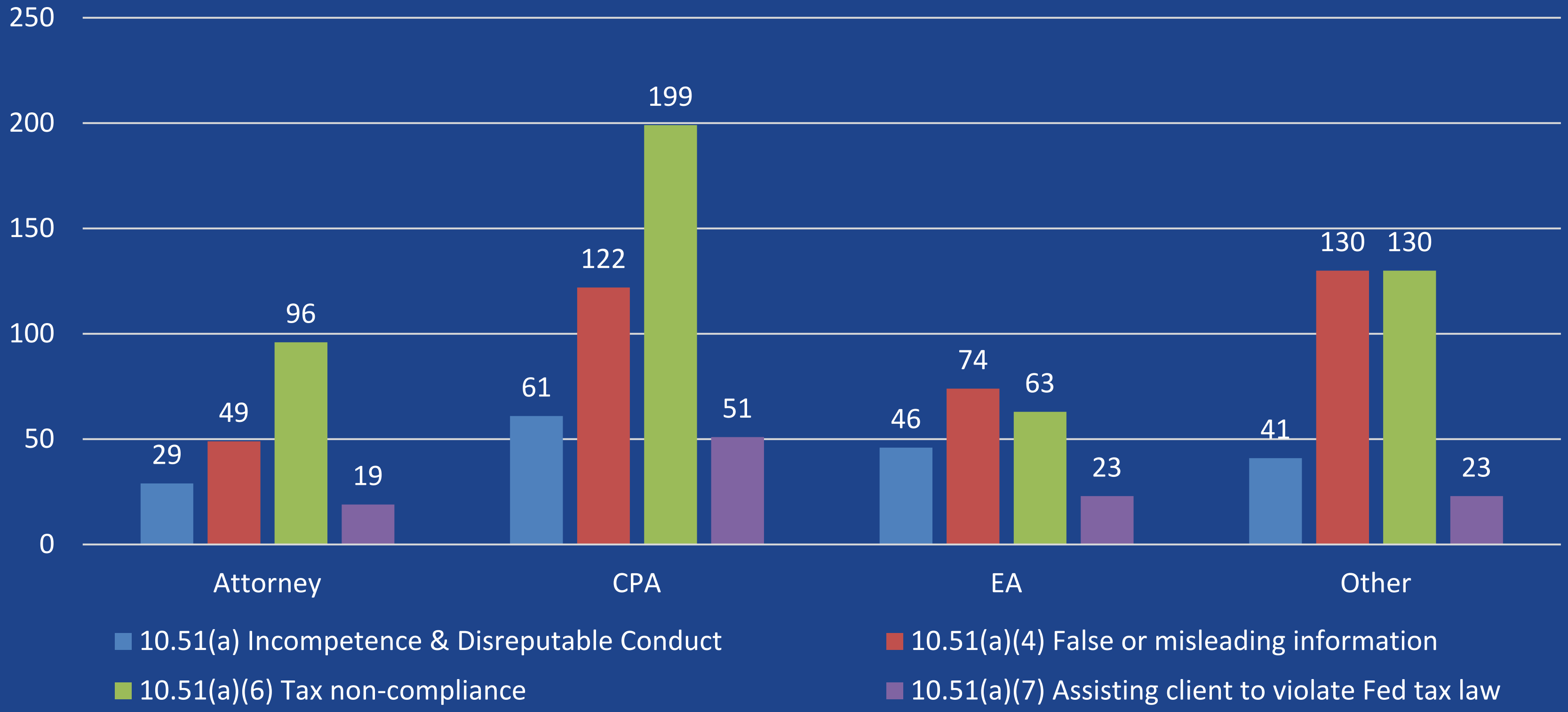
- Think "substantial authority" or "reasonable basis" <u>with</u> disclosure
  - Form 8275, *Disclosure Statement*
- Don't take unnecessary risks—loss of livelihood and damage to reputation and integrity is not worth it.
- Know your duty regarding an error or omission on a client’s return (§10.21).

§10.34(a) Standards for Tax Returns – Case Study

- In our Case Study, did Practitioner meet the reasonable basis standard when preparing, signing and filing Taxpayer's 2015 return reflecting the mortgage interest deduction for the Hermosa Beach property?
  - Practitioner, who owned the Hermosa Beach property (or owned at least 67.5%), rented out this property to his niece during *all* of 2015.
    - Shouldn't he have known that Taxpayer was not using that property as a second home in 2015?

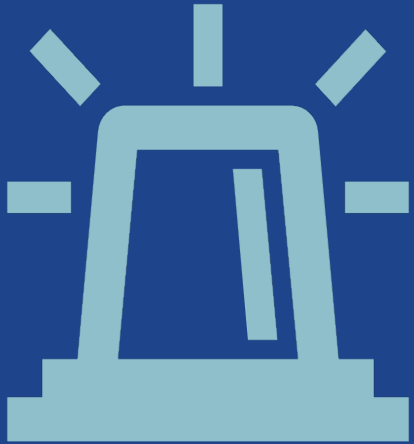
Practitioner Discipline – 10.51 Violations

October 1, 2016 through September 30, 2022



§10.51(a) Incompetence and Disreputable Conduct

- Circular 230, §10.51(a) is a general provision under which a practitioner may be sanctioned for <u>incompetence</u> and <u>disreputable conduct.</u>



§10.51(a) – Incompetence

- Incompetence
  - A practitioner must have the knowledge, skill, thoroughness, and preparation necessary for the matter for which the practitioner is engaged. (§10.35)
    - Know when you are <u>not</u> competent
    - Can provide competent representation by researching and educating oneself on the issue or consulting with another tax professional who has established competence in the field.

§10.51(a) Incompetence (cont.)

- A practitioner's failure to meet standards of professional care may prejudice a client's rights by failing to:
  - Meet important filing deadlines imposed by applicable tax statutes;
  - Conduct the necessary research on applicable authorities;
  - Comply with a duty imposed by other ethical responsibilities.

§10.51(a) Incompetence (cont.)

- Incompetence can include failing to recognize or comply with ethical responsibilities regarding conflicts of interest.
  - Section 10.29 provides that a conflict of interest exists if:
    - One client's interest directly adverse to another,
    - Significant risk of material limitation by responsibilities to another client, former client, third person, OR
    - By the personal interest of the practitioner.
  - However, you may represent if you reasonably believe in your ability to provide competent, diligent representation to each affected client, not legally prohibited, and each affected client waives conflict by giving informed consent in writing at the time conflict is known.

§10.51(a) Disreputable Conduct

- Disreputable conduct includes:
  - Conviction of any criminal offense under Federal tax laws (§10.51(a)(1)).
  - Conviction of any criminal offense involving dishonesty or breach of trust (§10.51(a)(2)).
  - Conviction of any felony under Federal or State law where the conduct involved renders the practitioner unfit to practice (§10.51(a)(3)).
  - Disbarment or suspension from practice as an attorney or CPA (§10.51(a)(10), §10.82(b)(1)).
  - Conviction of any crime under Title 26, any crime involving dishonesty or breach of trust, or any felony that renders the practitioner unfit to practice (§10.82(b)(2)).

§10.51(a)(4) Giving False or Misleading Information

- When interacting with tax authorities, a practitioner must not participate in any manner in giving false or misleading information to the Treasury or any officer/employee.
  - Testimony
  - Tax returns
  - Financial statements
  - Applications
  - Affidavits, declarations, and any other document or statement (written or oral)

§10.51(a) Disreputable Conduct – Case Study

- In our Case Study, assume Practitioner handled the IRS examination of Taxpayer's 2015 return.
  - To support his ownership claim of 32.5% of the Hermosa Beach property and that he paid mortgage interest to Practitioner in 2015, Taxpayer gave Practitioner a "deed of trust" for the property and a promissory note for the purported sale.
  - Practitioner, the other party to the "sale," knows he didn't sign/give the deed of trust for partial ownership of the property to Taxpayer, did not enter into a promissory note with Taxpayer, nor receive any income (with interest) from Taxpayer in 2015
- If Practitioner gives the deed of trust and promissory note to the IRS to substantiate Taxpayer's ownership of the Hermosa Beach property and mortgage interest payments, has Practitioner violated Section 10.51(a)(4) by giving false or misleading information to the IRS?

§10.51(a)(6) Willful Noncompliance by Practitioner

- 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.
    - When a referral is made to OPR, the practitioner's tax compliance is always checked.

§10.51(a)(7) Willful Assistance with Violation of Federal Tax Laws

- When interacting with clients, a practitioner must not willfully assist, counsel, encourage, or suggest to a client/prospective client:
  - An illegal plan to evade Federal taxes or payment thereof
  - Violation of any Federal tax law

§10.51(a) Disreputable Conduct – Case Study

- In our Case Study, assume Practitioner suggests Taxpayer claim he owned part of the Hermosa Beach property to take an extra mortgage interest expense deduction to reduce Taxpayer's 2015 taxes. Further, assume Practitioner states he can create bogus documents (e.g., deed of trust, promissory note, etc.) to "paper the file" if the IRS challenges the mortgage interest deduction.
- Has Practitioner violated Section 10.51(a)(7)?
  - Would it make a difference if Practitioner did not prepare or sign the return but instead had an associate in his office prepare, file, and sign it?
  - Would it make a difference if Taxpayer agreed to Practitioner's plan?

Contact Information, Referrals, and Resources

Contact & Referrals to OPR

- Office of Professional Responsibility
  1111 Constitution Ave., NW
  SE:OPR Rm. 7238
  Washington, DC 20224
  Efax: (855) 814-1722

- Visit http://www.irs.gov/ and search "Circular 230 Tax Professionals"

- Referrals
  - To make a referral regarding a return preparer, use Form 14157.
  - For practitioners covered under Circular 230, you can send a fax to OPR's eFax.

Resources

- Publications & Forms
  - Treasury Department Circular No. 230 (Rev. 6-2014)
  - Pub. 947, *Practice Before the IRS and Power of Attorney*
  - Form 2848, *Power of Attorney and Declaration of Representative*
  - Form 8275, *Disclosure Statement*
  - Form 8867, *Paid Preparer's Due Diligence Checklist*
  - *Rights and Responsibilities of Practitioners in Circular 230 Disciplinary Cases*
  - *Guidance on Restrictions During Suspension or Disbarment from Practice Before the Internal Revenue Service*
- OPR Website
  - Sign up for OPR Alerts