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# Professional Tax Practice Responsibilities

## A Circular 230 Case Study



5/22/2012



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# Hypothetical

Clients H & W

You communicate only with H who is a psychiatrist

Professional S-Corp

W - second wife with new-born son, occasionally helps in office for no pay

Office in home – separate wing-spacious

Vacation home- Vancouver, BC





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# Hypo (cont.)

You prepare the return for the S-corp  
and the joint personal tax return

Bookkeeper – 3 days/wk; deposits,  
vendor payments, bank recs, QuickBks

You – techie – electronic organizers,  
upload F/S and personal data from  
client,





# Hypo (cont.)

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Gross income -- \$950,000

Expenses

- Auto lease - \$1,000
- Staff wages - \$50,000
- Shareholder salary - \$50,000
- Outside services - \$220,000 (subst'l incr.)
- Payroll taxes accrued - \$40,000 (new)
- Legal fees - \$25,000 (new)
- T&E - \$22,500
- Cable - \$2,400
- Landscaping - \$6,000
- Utilities - \$4,800
- Supplies - \$12,000
- Insurance - \$25,000





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# Hypo (cont.)

Can you accept the bookkeeper's financial information without verification?





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# Hypo (cont.)

## Client Organizer Responses:

- Foreign bank account – “no”
- Alimony paid - \$120,000
- W-2 from S-corp, prepared by bookkeeper, reflects \$50,000 salary, \$1,500 social security tax, \$5,000 FIT withheld, and \$750 Medicare tax





# Hypo (cont.)

Can you accept H's completed organizer without verification?  
Any issues on the W-2?

**What if:**

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# Hypo (cont.)

H characterizes expenses for bookkeeper;

P/R accrual = salary withheld; not paid over;

Canadian bank account:

- One time \$250,000 for downpayment
- Small mortgage
- < \$5,000 “most of the time”





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# Hypo (cont.)

Contentious dispute with his ex-wife about their property division; court ordered additional \$220,000 from H to Ex to equalize asset division

Legal fee – “mostly” dispute with Ex; “maybe” some for separate property agreement

Box seats for 3 Professional Teams – entertains potential referral sources





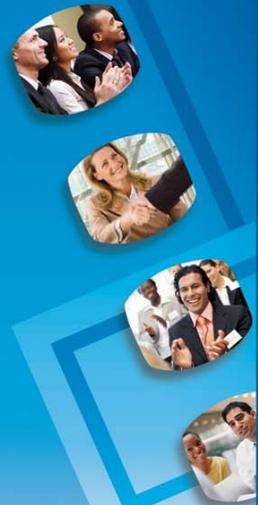
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# Hypo (cont.)

Now what? Any Follow-up Questions?

What duties do you owe and to whom?





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# Hypo (cont.)

You prevail on H “to do the right thing” on this year’s return resulting in a large tax liability on the joint return when the S-corp net distributable income passes through to the 1040. H tells you he cannot pay it all at once.





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# Hypo (cont.)

What advice do you give H on April 15th?

What advice do you give H on October 15th when he still cannot full pay?





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# Hypo (cont.)

## There's more!

Year before last- H left HMO and started his own practice.

Expended substantial sums on building out the wing of his house that now serves as his office

Prior to build-out, H spent time and money exploring other locations for his practice, losing \$50,000 by failing to exercise an option to purchase a property on which to build his office





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# Hypo (cont.)

At client's request, you treated as many of these expenses as possible as currently deductible on the S-corp return for that year

You also deducted the cost of forming the S-corp.





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# Hypo (cont.)

Audit Notice for S-corp March 15 tax return

IDR requests:

- Supporting documentation for: legal fees, the auto lease, the outside services, the T&E, landscaping, alimony and insurance;
- Copies of the prior year return for the corp;
- The current and prior year returns for H&W;
- Copies of the forms 940 and 941 for current and prior year





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# Hypo (cont.)

H discloses:

- Landscaping and insurance amounts are 100% of actual, not a percentage attributed to his home office
- When he finally asked W to sign the separate property agreement, she got really angry and has left him and is back living with her parents
- He’s “pretty sure” they’ll be able to work things out; but it has been an additional distraction for him.





# Hypo (cont.)

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Who can/should you represent in the corporate audit?

What about H & W's joint return (still on extension)?





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# Hypo (cont.)

Bonus Question:

W hires her own preparer who asks you for prior year's tax returns and current year's documentation in order to determine W's filing obligation and prepare the return.

Can you give W's preparer the organizer and other information, including H's disclosures?





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# Complaints or Inquiries?

Office of Professional Responsibility

1111 Constitution Ave. N.W.

SE:OPR Rm. 7238

Washington, D.C. 20224

For more info on OPR, Circular 230 and  
Disciplined Practitioners visit:

[www.irs.gov/irs/article/0,,id=175512,00.html](http://www.irs.gov/irs/article/0,,id=175512,00.html)





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# Relevant Circular 230 Resource Material

Appendix





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# The Law

31 U.S.C. §330 (1884)

31 C.F.R. Part 10 (cir. 1886)

Treasury Circular No. 230 (1921)

Online at [www.irs.gov/pub/irs-pdf/pcir230.pdf](http://www.irs.gov/pub/irs-pdf/pcir230.pdf)





# Key Circular 230 Provisions

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Diligence as to Accuracy (10.22)

Assistance From/To Disciplined  
Practitioner (10.24)

Conflicting Interests (10.29)

Taxpayer Refunds (10.31)

Due Diligence Standards for Returns and  
Other Docs (10.34)





# Key Circular 230 Provisions Cont.

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Procedures to Ensure Compliance  
(10.36(b))

Giving False or Misleading Info to IRS  
(10.51(a)(4))

Assisting, Counseling, encouraging  
Taxpayer Violations of Tax Law or  
Taxpayer Evasion (10.51(a)(7))

Contemptuous conduct (10.51(a)(12))





# Diligence as to Accuracy (10.22)

Must exercise Due Diligence in:

- Preparing, approving and filing tax returns, documents, affidavits etc. relating to IRS matters.
- Determining correctness of oral/written representations made to the client or to Treasury personnel.

Reliance on Another's Work Product?  
With Reasonable Care.

Know Your Client.

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# Standards for Tax Returns

## Section 10.34(a)

May not sign a tax return or advise a position on a tax return, willfully, recklessly, or through gross incompetence if:

- Lacks reasonable basis
- Unreasonable position (6694(a)(2))
- Willful attempt to understate liability (6694(b)(2)(A))
- Reckless, intentional disregard of rules and regulations (6694(b)(2)(B))

Patterns matter

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# Standards for Documents and Other Papers- 10.34(b)

May not advise taking Positions that are Frivolous.

May not advise Submissions:

- to delay or impede tax administration
- that are frivolous
- Containing or omitting information that demonstrates an intentional disregard of rules or regulations.

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# Penalties and Client Reliance- 10.34(c), (d)

Must Advise Client of Potential Penalties and their Avoidance through Disclosure (10.34(c))

Reliance on Client Information in good faith, without verification, is OK, but...

- Cannot ignore implications of other information furnished
- Cannot ignore actual knowledge
- Must make reasonable inquiries for incorrect, inconsistent information (10.34(d))

No Willful Blindness.

No “Don’t ask, don’t tell”.

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# Conflicting Interests- 10.29

One client interest directly adverse to another  
Significant risk of material limitation

– By Responsibilities to

Another client,

Former client,

Third person

**OR PERSONAL INTEREST OF THE  
PRACTITIONER**





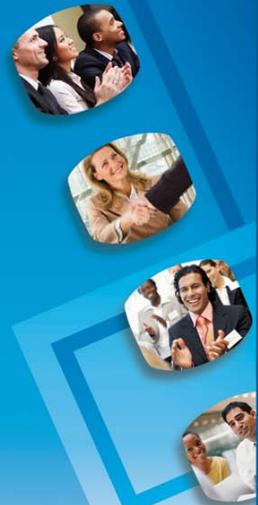
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# Conflicts (cont.)

May represent if:

- Reasonable belief in ability to provide competent, diligent representation to each affected client
- Not legally prohibited
- EACH affected client waives conflict, gives **INFORMED** consent – in writing at the time conflict is known





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# Giving False or Misleading Info (10.51(a)(4))

No participating in any way in giving false/misleading info to the Dept. of Treasury or any officer/employee thereof

Includes:

- Testimony
- Federal tax returns
- Financial statements
- Applications
- Affidavits, declarations, and any other document or statement, written or oral





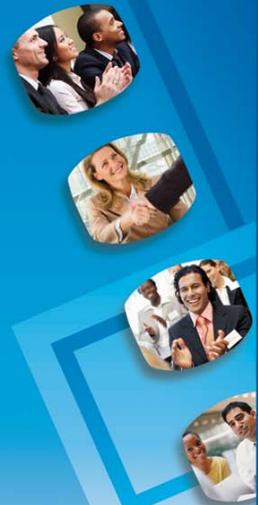
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# Willfully Assisting an Illegal Plan to Evade Taxes or Payment (10.51(a)(7))

Willfully assisting, counseling, encouraging, suggesting to a client/prospective client:

- An illegal plan to evade Federal taxes or payment thereof
- Violation of any Federal tax law





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# False Opinions 10.51(a)(13)

Knowingly, recklessly or through gross incompetence

- Intentionally or recklessly misleading
- Pattern of incompetent opinions
- Concealing matters required to be revealed

Reckless:

- Highly unreasonable omission
- Extreme departure from standard of care
- Patterns matter

Gross Incompetence:

- Grossly Indifferent Conduct, Inadequate Preparation
- Consistent Failure Regarding Obligations to Client

