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# Emerging Issues in Tax Practice Due Diligence



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# Circular 230 Provisions

- Due Diligence as to Accuracy (10.22)
- Due Diligence Standards for Returns and Other Submissions (10.34)
- Competence (10.35)
- Due Diligence for Written Advice (10.37)

# 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? Only With Reasonable Care.

# Due Diligence for Tax Returns

## § 10.34(a)

- May not sign a tax return or advise a position on a tax return, 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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# Due Diligence for Documents and Other Papers § 10.34(b)

- May not advise Positions that are Frivolous in submissions.
- 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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# Disclosure re: Unreasonable Positions § 10.34(c)

- Advised position?
- Prepared or signed return?
- Submitting docs/other papers to IRS?
- Then-
  - Must Advise Client of Potential Penalties and their Avoidance through Disclosure

# Reliance on Client

## § 10.34(d)

- 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 or incomplete information
- No Willful Blindness



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# Competence § 10.35

- A practitioner must possess the necessary competence to engage in practice before the Internal Revenue Service. Competent practice requires the knowledge, skill, thoroughness, and preparation necessary for the matter for which the practitioner is engaged.
- You must know when you are NOT competent

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# Due Diligence for Written Advice

## § 10.37

- Reasonable factual and legal assumptions
- Reasonably consider all relevant facts
- Reasonable efforts to identify and ascertain the relevant facts
- No unreasonable reliance on representations, statements, findings, or agreements = know or should know based on incorrect, incomplete, inconsistent representation/assumption



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# § 10.37 (Cont.)

- Apply applicable law to relevant facts
- No audit lottery positions or advice
- Reliance on advice of another? OK, if the advice was reasonable and the reliance is in good faith considering all the facts and circumstances
  - Reliance = unreasonable, if other
    - Is not reliable
    - Is incompetent
    - Has a conflict (10.29)
- Applies to All federal tax matters



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# APPENDIX



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# FBAR

- Client Communication is Key
- Know the Facts
  - Foreign account or financial assets?
    - Existence and Valuations
- Know the Law
  - Bank Secrecy Act
  - IRC 6038



# FBAR (cont.)

- Know the Process
  - 1040 Schedule B/FinCEN Form 114
  - Form 8938
  - Timing
- Subsequent Discoveries

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# ACA

- Client Communication is Key
- Know the Facts – Ask more Questions than you think you Should
  - Who’s “in the family”?
  - Qualifying coverage or Exemption?
  - Forms 1095, 1095-A, W-2



# ACA (cont.)

- Know the Law
  - <http://www.irs.gov/ACA>
  - Pub 5209 (Individuals)
  - Pubs 5200, 5196, 5208, 5215, 5165 (employers)



# ACA (cont.)

- Know the Process
  - MarketPlace vs. IRS info
  - Premium Tax Credit and Advance Payments Reconciliation – Form 8962
  - Delays in implementation- watch IRS ACA resource page



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# Advising the Marijuana Industry

- Federal Law-
  - Controlled Substances Act
  - IRC 280E
  - C.H.A.M.P. - 128 T.C. 173 (2007)
  - OLIVE – 139 T.C. 19 (2012)



# Marijuana (cont.)

- State Law
  - Medical
  - Recreational
- Advising
  - Grower
  - Dispenser

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# Marijuana (cont.)

- Peripheral Business activities
- Return Preparation
  - COGS
    - IRS CCA 201504011 (Jan. 23, 2015)
    - 2015 WL 279714; 2014 IRS CCA LEXIS 138
  - IRC 280E
  - Case Law

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# Microcaptives

- Legitimate purpose: create insurance coverage for non-traditional coverage
- Illegitimate purpose: closely held; off-shore/on-shore - coverage for implausible, ordinary or esoteric risks; exorbitant premiums; traditional commercial coverage

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# Microcaptives (cont.)

- IRS Dirty Dozen for 2015
- Promoter involvement
- Abusive tactics:
  - Poorly drafted insurance “binders”

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# Microcaptives (cont.)

- Annual premium = amount of deduction needed to reduce business income that year, or
- Total premium maxes at \$1.2 for full IRC 831(b) advantage
- Missing substantiation for premium level/underwriting coverage

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# Microcaptives (cont.)

- Promoter = microcaptive manager for hefty fee
- Vermont = state of choice
- 38 other states with favorable laws
- Know your Client's Relevant Facts
- Know the Law

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