Professional Tax Practice Responsibilities

A Circular 230 Case Study

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Hypothetical

- Clients H & W - new
- You communicate only with H - a psychiatrist
- Single-member prof. LLC, elects Sched C
- Local Hospital – 2 days a week
- W - second wife, stay-at-home Mom with their first child
- H - green card from Guatemala – parents and siblings still in that country. W - US citizen
Engaged to prepare a joint personal tax return for H&W

Bookkeeper for LLC – 2 days/wk; deposits, vendor payments, bank recs, QuickBooks for financial statements

You = techie – electronic organizers, upload F/S and personal data from bookkeeper and client
Hypo (cont)

• Who’s your client?
• Will you/should you meet with H&W in person?
• Will you/should you ask for child’s SSN and birth certificate?
• What information will you request?
• Will you prepare a MFJ tax return?
• LLC P&L
  – Gross income -- $350,000
  – Expenses
    - Auto lease (BMW) - $25,000
    - 179 asset purchase - $100,000
    - Outside services - $120,000
    - T&E - $52,500
    - Supplies - $12,000
    - Rent – $120,000
Hypo (cont)

• Will you accept the QuickBooks financial statements without verification?
• Any follow-up Q’s for the bookkeeper?
Hypo (cont)

- Client Organizer Responses:
  - W-2 income = $750,000
  - Foreign bank account – “no”
  - Alimony paid - $120,000
  - Dependents - six

- Will you accept H’s organizer without question?
Hypo (cont)

What if:
Hypo (cont)

- BMW is the only family vehicle
- T&E is for 3-day seminar H attended about investment in a special “mind-meld” skull cap for use in deep trance psychiatric analysis. Location - Belize – he brought the family and they stayed for a week. He invested $100,000;
Hypo (cont)

- H owns a home in Antigua, Guatemala near his parents- stays there when he visits 4-5 times a year. Otherwise, rents daily/weekly/monthly to tourists;
- Previous contentious dispute with his ex-wife about child custody – she won; he pays $10,000/mo in child support;
- H sends $2000 a month to his sister in Guatemala to support her and her two children. Sister is a non-working, single mother-Guatemalan citizen
Hypo (cont)

Questions, now?
Hypo (cont)

• You prepare a draft joint tax return correcting for the items discussed during your review of the financial data.
• Result will be a much larger tax liability than H expected.
• H tells you he cannot pay it all at once.
Hypo (cont)

• WHO’S YOUR CLIENT(S)?
Hypo (cont)

• What advice do you give H (and W) on April 15th?
Hypo (cont)

• What advice do you give H (and W) on October 15th when he still cannot full pay?
Hypo (cont)

There’s more!
Hypo (cont)

• In August, H brings you an Audit Notice for his 2009 personal tax return which he filed jointly with his now ex-wife on October 15, 2010.

• The focus of the audit will be two investments H made that year. H paid $250,000 for each and received K-1’s at the end of the year reflecting losses of $500,000 for one, and $450,000 for the other.
Hypo (cont)

• You look at the 2009 return and see that the prior accountant deducted both losses in full offsetting LLC income of $950,000 for that year

• You ask for the investment documents and he tells you the promoters made him promise not to show them to anyone. He provides you with a tax opinion from a reputable law firm
Hypo (cont)

- The tax opinion says that H’s basis in the two investments is $500,000 and $450,000, respectively, because in addition to the cash, he signed promissory notes for the total investment.
- H is vague on details but says both investments “terminated” at the end of 2009 and he received nothing back.
Hypo (cont)

• Will you represent H in the audit?
• What considerations are there?
• What about ex-wife? What about new W?
• Who’s your client(s) now?
Hypo (cont)

– H&W have had a falling out about a separate property agreement he asked her to sign;
– W got really angry and has left him (with their son) and is back living with her parents;
– He’s optimistic they will reconcile
• What about H & W’s joint return, still on extension, for 2013?
• W (still with parents) hires her own preparer who asks you for current year’s documentation in order to determine W’s filing obligation and prepare her return, if needed.

• Can you give W’s preparer the organizer and other information, including H’s disclosures? What about 2009?
More Info?

• Office of Professional Responsibility
  1111 Constitution Ave. N.W.
  SE:OPR  Rm. 7238
  Washington, D.C. 20224

The Law

- 31 U.S.C. § 330 (1884)
- Treasury Circular No. 230 (1921)
(1) The Office of Professional Responsibility, … shall generally have responsibility for matters related to practitioner conduct and shall have exclusive responsibility for discipline, including disciplinary proceedings and sanctions…. 
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.
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
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
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
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.
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”.
10.35 - Competence

- Practitioner must possess necessary competence to engage in practice before the IRS
- Competent practice requires the knowledge, skill, thoroughness, and preparation necessary for the matter for which practitioner is engaged.
- Competence = “Be”; “Get”; “Hire”

- See ABA Model Rule 1.1, “Competence”
- AICPA Code of Professional Conduct Article V, “Due Care”
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
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
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 Re: Obligations to Client
OPR Guidance


• Guidance on Restrictions During Suspension or Disbarment:  http://www.irs.gov/pub/irs-utl/Guidance_on_Restrictions_During_Suspension_or_Disbarment.pdf
OPR Guidance (cont)

• Information (Resources) for Tax Professionals: http://www.irs.gov/Tax-Professionals/Enrolled-Agents/Information-for-Tax-Professionals
OPR Guidance (cont)
