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ADP Lunch & Learn
Course Materials

Circular 230: What You Need to Know

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3. Circular 230: What You Need to Know

Learning Objectives:

Upon successful completion of this segment, you should be able to:

- Distinguish between Circular 230 and the AICPA Code of Conduct;
- Identify what actions the IRS is taking to "police" tax preparers;
- Recognize how preparers should respond to an inconsistent position on a client's return;
- Determine the impact on your practice from the rules on firm-wide responsibility.

Segment Overview:

In the good old days, anyone could prepare tax returns or give tax advice, without meeting any qualifications or competency standards. On our next segment, practitioner and instructor *Kenn Heaslip* traces how the expansion of IRS Circular 230 has led to much greater and more serious consequences for tax preparers as well as for those who supervise the preparation of returns.

Field of Study: Regulatory Ethics

Expiration Date: August 31, 2017

Course Level: Update

Course Prerequisites: Work experience in a corporate staff environment, or an introductory course in ethics

Advance Preparation: None

Recommended Accreditation:

1 hour group live
2 hours self-study

Required Reading (Self-Study):

"Supervisory Obligations under Circular 230"
By Peter S. Wilson, of McGladrey LLP
Reprinted with permission from The Tax Adviser
For additional info, go to: www.thetaxadviser.com

"New Rules and Revisions to Circular 230 and Their Effect on CPAs"
By Mary L. Blatch, James F. Bresnahan, and Gerard Schreiber
Excerpted with permission from The Tax Adviser
For complete article, go to: www.thetaxadviser.com

See page 3–11.

Video Transcript: See page 3–18.

Running Time: 35 minutes

I. Expanded Circular 230

A. Increased IRS Focus on Tax Practitioners
   1. Anyone who wants to practice before the IRS as a tax professional
      a. Must be eligible to practice
      b. Must comply with the rules of in Treasury Department Circular 230
   2. Consequences of Circular 230 violations are much greater than before
      a. Suspension or disbarment now affecting more federal tax work

B. Standards for Tax Professional Conduct
   1. IRS has issued Circular 230
   2. AICPA has their code of conduct
      a. How the CPAs should behave not just in tax but in all practices
   3. State boards of accountancy have standards
      a. Ultimate authority governing the CPA license

C. IRS Adds Updated Standards
   1. Concerned a lot about the nature of the practice
      a. Wanted to have more guidance
   2. AICPA code of conduct expanded
      a. In areas such as fees, conflicts of interest, and confidentiality

D. IRS Becoming More Proactive
   1. IRS Office of Professional Responsibility becoming more proactive
   2. Nobody has enforcement powers over non-CPAs and non-licensed professionals
      a. Expanded what the responsibilities were for everybody
      b. Circular 230 covers all people who prepare tax returns for a fee
   3. More explanatory publications on what their responsibilities are

II. Various Tax Professional Roles

A. Minimizing Tax Liability and Complying with IRS Rules
   1. If there is a way to minimize taxes that is legal preparers and practitioners can do that
   2. Sometimes conflict between what is in the best public interest and what is legal

B. Detailed Rules about Who Is a Preparer
   1. Circular 230 says anybody who is responsible for a substantial portion of the preparation of a return is a preparer
   2. Often more than one person involved – they are all preparers
   3. If you are covered under Circular 230 as a preparer
   a. You have to get a preparer tax identification (PTIN) number
   4. If you volunteering this would not be covered under Circular 230

C. PTINs
   1. Someone strictly doing data entry does not need a PTIN number
   2. Comes down to client contact
      a. Are you making decisions?

D. Continuing Education – CPEs
   1. IRS initiative aimed at registered tax return preparers or RTRPs.
      a. Not still rolling that out but would like to
   2. Wanted to require everybody with a PTIN number to have continuing education
      a. And take an exam
   3. IRS looking to have a voluntary program where people voluntarily agree to CPE

E. CPA "Privilege"
   1. In most states CPAs do not have privilege
      a. If information is requested from IRS they have to provide those documents
   2. When there is privilege given in many states it is limited

III. Conflicts of Interest

A. Circular 230 Revision Forbids Conflicts of Interest
   1. Conflict of interest – representation of one client that is directly adverse to that of another client
   2. Can also mean you represent a client in circumstances where you may be limited by your representation of another client
   3. Practitioner may continue to represent a client despite a conflict of interest
      a. If you reasonably believe that you can provide competent and diligent representation to all clients involved
   4. If you have reason to believe you have a conflict
      a. Must disclose the conflict to the client and get consent from the client

B. Conflict of Interest – Business Partnership
   1. Partnership being audited
      a. You also do tax returns for the partners
   2. Possible that one partner would be able to absorb a passive loss
      a. But the other partner cannot

C. Conflict of Interest – Married Couple
   1. Best interest of the taxpayer is not necessarily the same as the best interest of the spouse
   2. Example: second marriage
      a. Wife has a child from first marriage applying for financial aid
      b. May not be in the best interest of the spouse to file a joint return
      c. Though a joint return will result in a lower tax bill
   3. IRS has now issued separate powers of attorney

IV. Practitioner Fees

A. Fees Cannot Be Unconscionable
   1. 230 certainly addresses the issue
      a. Do not go into a tremendous amount of detail
   2. Fees cannot be unconscionable – that is a wide range
      a. Based on facts and circumstances

B. Contingent Fees
   1. 230 says that contingent fees are not allowed with a couple of exceptions
   2. Courts have ruled that contingent fees are allowed
   3. AICPA standards have specific rules about contingent fees
      a. When they are allowed and when they are not allowed
      b. Never allowed in the case of an original return

C. Exceptions Allowing Contingent Fees
   1. When an arbiter is involved or when there is authority
   2. Contingent fee allowed on an amended return
      a. Recent ruling on same-sex marriages is retroactive
      b. Same-sex couple wants to file amended return

D. Bargain Tax Preparers
   1. IRS is very concerned about advertising and solicitation by practitioners
      a. Advertise a $99 tax return but with a bunch of added fees
         i. Would be misleading and deceptive
   2. Specific penalties involved for a tax practitioner who negotiates a check made out by the IRS
      a. Subject to a $500 penalty
   3. “Exclusive” deal with an investment adviser
      a. Recommends her exclusively to his clients and she reciprocates
      b. Conflict of interest

V. Special Situations

A. Inconsistent Tax Positions
1. Example: client wants to get rid of his vacation home
   a. Enters into a 1031 exchange
   b. You know that the exchanged property has never produced rental income
2. You would be taking a position on a tax return that is inconsistent with a position previously taken
   a. Raises some red flags
3. Have to get the facts
   a. If it was rental property beforehand
      i. Recommend to your client that previous returns be amended
   b. If it was not rented you cannot take the 1031 treatment

B. Charitable Contributions
1. Do not have to "verify" accuracy of each and every contribution
   a. You are not the auditor here
2. Have to make sure that the information you have is consistent with what you know and that it is allowed
   a. Make sure client knows they need verification

C. Tax Preparer Penalties
1. Most tax practitioners view the penalty thresholds as:
   a. More likely than not – greater than 50% confidence that position will be upheld
   b. Substantial authority – greater than 40% confidence that position will be upheld
   c. Realistic possibility of success – greater than 33.3% confidence that position will be upheld
   d. Reasonable basis – approximately 20% confidence that position will be upheld

D. IRS' Voluntary Classification Settlement Program
1. Example: client owns a trucking business
   a. Treats truck drivers as independent contractors
   b. You feel they should probably be treated as employees
2. If you have come to that conclusion that they probably will not be substantiated
   a. You have to have a conversation with your client
3. IRS voluntary disclosure program
   a. You step forward with reduced penalties and easier compliance to fix the problems in the past

      "…you have a preparer issue, because you cannot be signing a return that you believe will not be substantiated on audit."

      \- Kenneth Heaslip
4. If you believe that these people were in fact employees
   a. Being associated with that return can result in preparer penalties

Outline (continued)

VI. Working Within a Tax Firm

A. Common Responsibilities at a Tax Firm
   1. Everybody has a responsibility towards any work being done under their watch
   2. If you are the tax partner of a firm
      a. You are responsible for tax procedures that are happening firm-wide
   3. Even people who are not the tax partner
      a. Have responsibility at all levels below them

B. Servicing Colleague’s Client – Confidentiality
   1. A colleague’s client is applying to refinance his mortgage
      a. Colleague is on vacation, has asked you to “service” his clients
   2. Mortgage company asks for the client’s past two or three tax returns
   3. Section 7216 of the Internal Revenue Code has specific outlines as to what is confidential and what can be delivered
   4. Need to get client approval to send a copy of a tax return to a third party
      a. In a written, signed format

C. Client Confidentiality Rules
   1. AICPA has a lot of very specific rules on client confidentiality
      a. Every CPA should read them very critically
   2. Client confidential information is any information received from the client that is not otherwise available to the public
   3. Even discussing industry “average” profit margins and ratios may be prohibited
      a. If those numbers were derived from confidential client information

Group Live Option

Instructions for Segment

For additional information concerning CPE requirements, see page vi of this guide.

- As the Discussion Leader, you should introduce this video segment with words similar to the following:

  "In this segment, Kenn Heaslip traces how the expansion of IRS Circular 230 has led to much greater and more serious consequences for tax preparers as well as for those who supervise the preparation of returns."

- Show Segment 3. The transcript of this video starts on page 3–18 of this guide.
- After playing the video, use the questions provided or ones you have developed to generate discussion. The answers to our discussion questions are on page 3-8. Additional objective questions are on pages 3–9 and 3–10.
- After the discussion, complete the evaluation form on page A–1.

Discussion Questions

3. Circular 230: What You Need to Know

You may want to assign these discussion questions to individual participants before viewing the video segment.

1. Several years ago, we covered the "kinder and gentler IRS," that generally left taxpayers and tax preparers alone. To what extent have you noticed increased IRS examination of client returns? To what extent have you noticed increased IRS attention to professional conduct and discipline?

2. The new Circular 230 rules apply to very mundane tax advice as well as to abusive offshore tax shelters. In what practice situations is Circular 230 most likely to arise? To what extent can (and do) you rely on your own tax knowledge and on the counsel of your own colleagues?

3. Anecdotal evidence indicates that most IRS disciplinary actions of tax preparers involve non-filing of returns. Why does this problem exist? Why is the IRS so proactive in these situations? What are you (and your firm) doing to prevent it from occurring?

4. Some commentators – other than Kenn Heaslip – are expressing concern that tax preparers, like auditors, are being asked to "police" their practice and their clients. Do you agree with Kenn or with those expressing this concern? Why?

Discussion Questions (continued)

5. According to IRS guidance, tax preparers who “practice in small or medium-size firms should consider developing a quality-control system for tax engagements.” To what extent do you use a quality control system in your tax practice? Why or why not?

6. According to Kenn Heaslip, his firm obtains PTIN numbers from the IRS for their staff as “supervised” return preparers. To what extent do you use paraprofessionals in preparing client returns? To what extent are those staff members obtaining PTIN numbers? How is your staff affected by being treated as “supervised return preparers”?

7. We regularly provide viewers with coverage of ethical issues surrounding audit and attest engagements. Now, we’re examining those issues in the context of tax practice. Do you feel as if you have, or need to have, an understanding of the issue? To what extent should we provide continued coverage of tax ethics on an ongoing basis?

Suggested Answers to Discussion Questions

3. Circular 230: What You Need to Know

1. Several years ago, we covered the "kinder and gentler IRS," that generally left taxpayers and tax preparers alone. To what extent have you noticed increased IRS examination of client returns? To what extent have you noticed increased IRS attention to professional conduct and discipline?
   - Participant response is based on your clients, your practice and your organization, as well as on your background, perspective and experience.

2. The new Circular 230 rules apply to very mundane tax advice as well as to abusive offshore tax shelters. In what practice situations is Circular 230 most likely to arise? To what extent can (and do) you rely on your own tax knowledge and on the counsel of your own colleagues?
   - Participant response is based on your clients, your practice and your organization, as well as on your background, perspective and experience.

3. Anecdotal evidence indicates that most IRS disciplinary actions of tax preparers involve non-filing of returns. Why does this problem exist? Why is the IRS so proactive in these situations? What are you (and your firm) doing to prevent it from occurring?
   - It may be a situation where preparers justify non-filing on the fact that they are so busy year-round in preparing client returns. Or it may be a classic case where the "shoemaker's children have no shoes."
   - Participant response is based on your clients, your practice and your organization, as well as on your background, perspective and experience.

4. Some commentators – other than Kenn Heaslip – are expressing concern that tax preparers, like auditors, are being asked to "police" their practice and their clients. Do you agree with Kenn or with those expressing this concern? Why?
   - Participant response is based on your clients, your practice and your organization, as well as on your background, perspective and experience.

5. According to IRS guidance, tax preparers who "practice in small or medium-size firms should consider developing a quality-control system for tax engagements." To what extent do you use a quality control system in your tax practice? Why or why not?
   - Participant response is based on your clients, your practice and your organization, as well as on your background, perspective and experience.

6. According to Kenn Heaslip, his firm obtains PTIN numbers from the IRS for their staff as "supervised" return preparers. To what extent do you use paraprofessionals in preparing client returns? To what extent are those staff members obtaining PTIN numbers? How is your staff affected by being treated as "supervised return preparers"?
   - Participant response is based on your clients, your practice and your organization, as well as on your background, perspective and experience.

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   - Participant response is based on your clients, your practice and your organization, as well as on your background, perspective and experience.

Objective Questions

3. Circular 230: What You Need to Know

You may want to use these objective questions to test knowledge and/or to generate further discussion; **these questions are only for group live purposes.** Most of these questions are based on the video segment**, a few may be based on the required reading for self-study** that starts on page 3–11.

1. According to Kenneth Heaslip, how does Circular 230 differ from the AICPA code of conduct in terms of tax preparer responsibilities?
   a) Only Circular 230 specifically addresses tax preparer responsibilities.
   b) Circular 230 holds tax preparers to a higher professional standard than does the AICPA code of conduct.
   c) Circular 230 applies to all people who prepare tax returns for a fee.
   d) none of the above

2. Under Circular 230, which of the following would likely need a PTIN number?
   a) an intern
   b) a financial accountant who donates his time to prepare tax returns for the elderly
   c) administrative assistants
   d) junior accountants

3. What does Kenneth Heaslip note regarding the RTRP program?
   a) The courts ruled that the IRS did not have the authority to enforce the program.
   b) It has been rolled out on a voluntary basis.
   c) It will be administered to all CPAs.
   d) all of the above

4. Which of the following tax code penalty thresholds provides the LEAST level of confidence?
   a) more likely than not
   b) reasonable basis
   c) reasonable possibility of success
   d) substantial authority

5. What does Kenneth Heaslip note regarding conflicts of interest under Circular 230?
   a) Tax preparers must notify clients of conflicts of interest in writing.
   b) A client that continues to employ a tax preparer after a conflict is disclosed provides implied consent.
   c) Tax preparers may not take on clients where a conflict of interest exists.
   d) A tax preparer must obtain written consent from the client acknowledging that they are aware of the conflict of interest.

6. In the case of an inconsistent position on a client's return, the preparer should:
   a) recommend that the client amends prior returns where appropriate.
   b) no longer service the client.
   c) permit the client to take an indefensible position.
   d) notify the IRS of the inconsistent position.

7. Kenneth Heaslip notes that when it comes to tax for work done in a firm:
   a) there are no guidelines regarding fees charged by preparers.
   b) most partners benefit from accountant-client privilege.
   c) there is firm-wide responsibility for compliance with tax preparation standards.
   d) client confidentiality differs from preparer to preparer.

Objective Questions (continued)

8. According to the required reading, Section 10.36 of Circular 230:
   a) is aimed at individual practitioners.
   b) applies to those individuals who are responsible for overseeing their firms' federal tax practices.
   c) establishes a 'one size fits all' approach to compliance.
   d) requires tax ethics training for firms with 50 or more employees.

9. Which of the following would represent an 'unreasonable position' under Circular 230?
   a) tax avoidance transactions not satisfying the more likely than not standard
   b) undisclosed positions without substantial authority
   c) disclosed positions without a reasonable basis
   d) all of the above

10. With respect to Section 10.31 of Circular 230, the required reading notes that:
    a) it was updated to better reflect today's electronic environment.
    b) this section applies only to practitioners that prepare tax returns.
    c) fraudulent activity was not the impetus behind changes to the guidance.
    d) practitioners may accept payment from the IRS on behalf of their clients.

Self-Study Option

Instructions for Segment

When taking a CPA Report segment on a self-study basis, an individual earns CPE credit by doing the following:

1. Viewing the video (approximately 30–35 minutes). The transcript of this video starts on page 3–18 of this guide.
2. Completing the Required Reading (approximately 25–30 minutes). The Required Reading for this segment starts below.
3. Completing the online steps (approximately 35–45 minutes). **Please see pages iii to v at the beginning of this guide for instructions on completing these steps.**

Required Reading (Self-Study)

SUPERVISORY OBLIGATIONS UNDER CIRCULAR 230

By Peter S. Wilson, of McGladrey LLP
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For additional info, go to:
www.thetaxadviser.com

When Circular 230 was amended in June 2014 (T.D. 9668), a major change dealt with the standards for written advice. Much of the commentary addressed the repeal of the "covered opinion" rules of former Section 10.35, the imposition of the competence standard of new Section 10.35, Competence, and the modifications to the provisions governing written tax advice in Section 10.37, Requirements for Written Advice. Another change that received less publicity should also be of significant interest to CPAs who oversee their firm's tax practice – the expansion of supervisory obligations under Circular 230, Section 10.36, Procedures to Ensure Compliance.

History

For many years, Circular 230, Regulations Governing Practice Before the Internal Revenue Service (31 C.F.R. Part 10), focused almost exclusively on the conduct of the individual practitioner. But that began to change in 2004, when Congress amended the statutory authority for Circular 230 (31 U.S.C. §330) to permit the imposition of a monetary penalty on the practitioner's employer if the practitioner was acting on behalf of the employer and the employer knew, or should have known, that the covered practitioner's conduct violated Circular 230.

Responding to the statutory change, the IRS adopted Circular 230, Section 10.36, in 2005. It required practitioners who had or shared principal authority and responsibility for a firm's federal tax advice practice to take reasonable steps to ensure that the firm had adequate procedures for compliance with the (now repealed) covered-opinion rules by the firm's members, associates, and employees. In 2011, Section 10.36 was modified to extend similar obligations to those practitioners who had or shared principal authority and responsibility for overseeing a firm's federal tax return preparation practice. Section 10.36 was amended again in 2014 to impose obligations on practitioners who oversee their firm's federal tax practice to take reasonable steps to ensure adequate procedures for its members, associates, and employees to comply with their obligations under subparts A, B, and C of Circular 230.

Obligations Under Section 10.36

The supervisory obligations under Section 10.36 extend to any individual subject to Circular 230 who has or shares principal authority and responsibility for overseeing his or her firm's federal tax practice, including tax return preparation, tax advice, and preparation of other documents for submission to the IRS.

If a firm does not identify the person or persons with that authority and responsibility, the IRS may identify one or more individuals responsible for compliance with Section 10.36. Since CPA firms use a variety of management structures, determining who is subject to Section 10.36 will necessarily depend on the firm's particular facts and circumstances.

A practitioner subject to Section 10.36 effectively has three obligations:

- Take reasonable steps to ensure that the firm has adequate procedures in effect for its members, associates, and employees for compliance with Circular 230 obligations (Circular 230, §10.36(a));
- Take reasonable steps to ensure that those firm procedures are properly followed (Circular 230, §10.36(b)(2)); and
- Take prompt remedial action when that practitioner knows or should know that one or more of the firm's members, associates, or employees are or have engaged in a pattern or practice that violates Circular 230 in connection with their practice with the firm (Circular 230, §10.36(b)(3)).

Section 10.36 covers all obligations of a firm's members, associates, and employees under Circular 230, subparts A, B, and C. Not only must the supervising practitioners have their firms adopt appropriate procedures to address the subpart B requirements relating to matters such as due diligence, competence, conflicts of interest, written tax advice, return positions, and client records, but they must also consider procedures to address the matters constituting disreputable conduct under subpart C. Circular 230, Section 10.51(a), defines as disreputable conduct failure to comply with subpart B obligations, as well as failure to meet other obligations under the Internal Revenue Code or other applicable laws such as:

- Conviction of any federal tax crime, any criminal offense involving dishonesty or breach of trust, or any felony under federal or state law when the conduct involved renders the practitioner unfit to practice before the IRS (Circular 230, §§10.51(a)(1)–(3));
- Giving false or misleading information to a Treasury Department officer or employee or to any tribunal authorized to pass upon federal tax matters (Circular 230, §10.51(a)(4));
- Willful failure to file a return or attempting to evade payment of federal taxes (Circular 230, §10.51(a)(6));
- Contemptuous conduct in practice before the IRS, including abusive language, false accusations, or publishing malicious or libelous matter (Circular 230, §10.51(a)(12));
- Willful failure to sign a tax return prepared by the practitioner when required (unless due to reasonable cause) (Circular 230, §10.51(a)(14));
- Willfully disclosing or using tax return information in a manner not authorized by the Internal Revenue Code (e.g., Sec. 7216) (Circular 230, §10.51(a)(15));

- Willful failure to e-file when required (Circular 230, §10.51(a)(16)); and
- Preparing all or substantially all of a federal tax return when the practitioner does not have a valid preparer tax identification number (PTIN) (Circular 230, §10.51(a)(17)).

With respect to the failure of a member, associate, or employee to file his or her own returns and pay taxes due, the IRS recognizes that these obligations are an individual responsibility and that a firm's responsibility for such individual compliance is limited. But the IRS also believes that firm management should not ignore noncompliance with these obligations by any practitioner 9668). Interestingly, a significant number of OPR sanctions against Circular 230 practitioners involve failure by the practitioners to file income and payroll tax returns for themselves and their practices.

Suggestions for Supervising Practitioners

The IRS has acknowledged that requiring procedures to ensure compliance encourages "firms to self-regulate without the burden often associated with a rigid, one-size-fits-all approach" (T.D. 9668). Thus, determining which steps are "reasonable" and which procedures are "adequate" will necessarily take into consideration a firm's particular facts and circumstances – firm size, nature of its tax practice, and characteristics of its clients. A procedure that is adequate for a small firm representing individuals and small businesses may be wholly inadequate for a large firm providing tax advice to multinational corporations. For example, a small firm may choose to require a second CPA to review written tax advice to a client, while a large firm may require consultation with an "opinion committee" or with designated subject matter experts. A small firm may rely on external Circular 230 training for its CPAs, while a larger firm may present proprietary Circular 230 training that integrates with the firm's policies. Large firms may conduct formal practice reviews to assess compliance with firm policies and procedures, but a less formal process may suffice for a firm that has only a few CPAs. In each case, the adoption of any particular procedure should be based on a supervising practitioner's determination that the procedure will ensure Circular 230 compliance by the firm's members, associates, and employees.

In fulfilling their obligations under Section 10.36, supervising practitioners should consider periodically reviewing Circular 230 to consider and evaluate the procedures they have in place to address the various Circular 230 obligations of their members, associates, and employees. When a firm adopts a particular procedure, these supervising practitioners should consider whether it should be required by a formal policy. To promote compliance, all firm tax practice policies should be in writing and be made readily available to all firm employees. And policies should be periodically reviewed and evaluated for compliance and effectiveness in promoting the objectives of Section 10.36.

One of the most important steps to promote Circular 230 compliance is to set the right "tone" for the firm and its tax practitioners and other employees. Supervising practitioners should make clear that the firm expects all its members, associates, and employees to understand and satisfy their professional obligations under Circular 230 and AICPA standards. Requiring tax ethics training can reinforce these expectations and remind employees of the firm's procedures that promote Circular 230 compliance. And the firm's more experienced practitioners should be encouraged to mentor younger professionals in ethics and professionalism just as they do in other areas of tax practice. (For additional thoughts on setting an ethical culture, see Fuller and Hyde, "Establishing an Ethical Culture in a Tax Practice," The Tax Adviser (February 2013).)

Perhaps the most difficult responsibility under Section 10.36 is taking appropriate remedial action upon discovering Circular 230 noncompliance. Most supervising practitioners would like to believe that noncompliance would never happen in their firm, but lapses in judgment and ethics can happen anywhere. It is important for supervising practitioners to be attentive to ethics issues to identify potential noncompliance as soon as possible. Once issues are identified, they should act decisively to mitigate any adverse impact on clients or the firm and to prevent any recurrence of the offending behavior. Determining the appropriate remedial actions will, of course, depend on specific facts and circumstances, but instances of significant noncompliance should prompt reconsideration of the firm's policies and procedures and whether they need to be revised.

Finally, supervising practitioners should consider documenting the steps they have taken to address Circular 230 compliance, why they believe those steps are reasonable, and how they plan to monitor whether those steps are effective. This documentation will not only provide evidence of their attempts to comply with Section 10.36, but it will also provide a framework for periodically reviewing the firm's policies and procedures to assure Circular 230 compliance. Supervising practitioners who cannot demonstrate reasonable efforts toward meeting their Section 10.36 obligations will have an increased risk of professional discipline if one of their employees violates Circular 230.

Conclusion

The expansion of Circular 230, Section 10.36, imposes new responsibilities on CPAs and others who oversee their firms' federal tax practice. Section 10.36 should prompt supervising practitioners and their firms to adopt policies and procedures, monitor compliance, and address noncompliance, all with a view toward promoting the high standards of ethics and professionalism that are the hallmark of the CPA profession.

NEW RULES AND REVISIONS TO CIRCULAR 230 AND THEIR EFFECT ON CPAs

By Mary L. Blatch, James F. Bresnahan, and Gerard Schreiber
Excerpted with permission from The Tax Adviser
For complete article, go to: www.thetaxadviser.com

On June 12, 2014, Treasury and the IRS issued final regulations amending Treasury Circular 230, Regulations Governing Practice Before the Internal Revenue Service (31 C.F.R. Part 10). These changes will have a significant effect on many aspects of tax practice. This article discusses the technical provisions and how the revisions could affect existing tax practice procedures and the management of tax practices.

Overview of Historical Developments Leading to the Revisions

It is beyond the scope of this article to address all the amending changes to Circular 230 that have been enacted over the last two decades. However, two changes are worth noting. Heightened concern about the use of tax opinion letters in abusive tax transactions led to the 2004 amendments, including the addition of Section 10.35, the covered opinion rules. Legislative expansion of the Sec. 6694 preparer penalty rules necessitated amending the Sec. 6694 regulations and the corresponding provisions in Circular 230 (§10.34) that addressed preparer responsibilities.

Effect on Practitioners

The new rules on written tax advice relax the rigid rules that applied to covered opinions, but other rules that govern tax advice continue unchanged. For instance, standards for tax return positions under Section 10.34(b) of Circular 230 are not affected. Tax return preparers, including non-signing preparers, may not sign a return or advise the client to take a position that either lacks a reasonable basis or is an unreasonable position under Sec. 6694(a)(2).

Unreasonable positions include (1) disclosed positions without a reasonable basis; (2) undisclosed positions without substantial authority; and (3) positions relating to tax shelters and reportable tax avoidance transactions not satisfying the more-likely-than-not standard. 8 Further, both oral and written advice not satisfying these standards can subject the practitioner to discipline under Circular 230, Section 10.51.

Also unaffected by the revisions is the practitioner's due-diligence obligation under Section 10.22 of Circular 230 and Sec. 6694, and the reasonable-cause and good-faith regulations under Sec. 6694. The revisions to Circular 230 also do not change the general maxim that tax advisers are not required to audit or verify information clients, other third parties, and advisers provide, unless there is a reason to do so. Nonetheless, recognizing situations requiring more diligence will be instrumental to satisfying the Circular 230, Section 10.37 reasonable practitioner standard. Knowing when to dig further will also be important for satisfying the new Circular 230, Section 10.35 competency standard discussed below.

Consider Whether Limiting Language Is Appropriate

As described above, the new rules eliminated the required use of prominent disclosures. The preamble states that Treasury and the IRS expect the revisions will eliminate the use of a Circular 230 disclaimer in email and other writing. The preamble also makes it clear that the rules do not prohibit the use of "an appropriate statement describing any reasonable and accurate limitations of the advice rendered to the client." Thus, it is the practitioner's responsibility to determine what limiting language, if any, is appropriate in a document providing written advice or in a standard email footer or notice.

Whether a Circular 230 legend in the standard email footer or notice should be replaced with some other limiting language has been the subject of discussion since the revisions have been released. While providing substantive advice in email text is not necessarily a best practice, it is often difficult to avoid because clients expect prompt responses to urgent matters, and occasionally providing a separate document is practically impossible. Because emails tend to be more informal, some practitioners are replacing the legend with some other limiting or cautionary language regarding tax advice that may be included in the email. Others have removed the Circular 230 disclaimer without replacing it with anything. In deciding whether to replace the Circular 230 disclaimer in email, practitioners should consider how the email is likely to be used. Any disclaimer should balance the need to protect the practitioner from harm that could result from a client's overreliance on the email message, with the need to avoid harming the client by prohibiting the client from relying on any advice in an email message.

Email messages, like all written tax advice, will be judged on the "reasonable practitioner" standard. This determination will be based on the particular facts and circumstances. As indicated by Karen Hawkins, the director of the Office of Professional Responsibility (OPR), during an IRS Circular 230 webinar on June 25, 2014, the new standard is not supposed to hinder email correspondence, but requires practitioners to exercise good judgment when doing so. For instance, if a practitioner receives an email asking the practitioner to confirm that brother and sister corporations can merge under state law and qualify for tax-free reorganization, a "that's OK" reply may not pass muster under Circular 230. A more thorough response is needed.

Section 10.35, Competence

The revised Circular 230 includes a new Section 10.35 titled Competence, which states:

A practitioner must possess the necessary competence to engage in practice before the Internal Revenue Service. Competent practice requires the appropriate level of knowledge, skill, thoroughness, and preparation necessary for the matter for which the practitioner is engaged. A practitioner may become competent for the matter for which the practitioner has been engaged through various methods, such as consulting with experts in the relevant area or studying the relevant law.

While a competence standard may exist in other settings, such as standard-of-care analyses in litigation or in some professional regulatory ethics rules, this is the first time that Circular 230 has imposed an affirmative competence standard on covered practitioners. Section 10.51 has made incompetence and disreputable behavior conduct for which sanctions may be imposed. The focus in Section 10.51 in the past has been on bad behavior as part of an engagement or in other areas of the practitioner's life that discredit the individual, not individual professional competence per se. As can be seen in the above passage, this new section creates an affirmative duty to be competent in engaging in practice before the IRS. This new section should be read in light of Section 10.22, Diligence as to Accuracy, and determinations under Section 10.51, Incompetence and Disreputable Conduct, under which a practitioner may be sanctioned for incompetent conduct.

While the last sentence of the new section ("A practitioner may become competent . . .") dispelled many concerns in the comment letters that the new standard would not allow practitioners to become competent by consulting with other practitioners or through research and study on the particular subject, the final version of Section 10.35 did not address the majority of these concerns. It places the burden on the practitioner. The IRS has informally indicated that the language "may become competent" suggests the relevant time for determining competency is not when the engagement is accepted but when the services are performed.

Section 10.31, Negotiation of Taxpayer Checks

Section 10.31, Negotiation of Taxpayer Checks, was updated to better reflect the current electronic environment in which practitioners and the IRS operate. The former Section 10.31 was a simple provision indicating that "a practitioner who prepares tax returns may not endorse or otherwise negotiate any check issued to a client by the government in respect of a Federal tax liability." The revised Section 10.31 makes two changes. First, it clarifies that the section applies to any practitioner, not just a practitioner who prepares tax returns. Second, it expands the scope of "endorse or otherwise negotiate any check" to include "directing or accepting payment by any means, electronic or otherwise, into an account owned or controlled by the practitioner or any firm or other entity with whom the practitioner is associated." In the proposed regulations, the IRS explained that this clarification was aimed at a small number of "unscrupulous preparers and practitioners" who were manipulating electronic refunds to defraud their clients and the IRS.20. The authors anticipate that this provision will affect preparers who provide financial products for their clients. In the past, the client may have been able to negotiate a refund check to compensate for these products, but this change precludes that approach and will require the taxpayer to deposit the check and pay for the financial services in separate transactions.

Section 10.82, Expedited Suspension

Section 10.82 provides the IRS with an expedited suspension procedure for tax practitioners who engage in certain stipulated egregious behavior. One area of growing concern for the IRS in recent years has been practitioners who fail to satisfy their own tax return filing obligations. Section 10.51(a)(6) indicates that willfully failing to file is incompetent and disreputable conduct. To sanction a practitioner under Section 10.51, however, OPR must follow the rules contained in subpart D, including formal proceedings, conferences, service of complaint, and so on. Before amendment, Section 10.82 did not specifically address nonfiling. The 2014 amendments have changed that. As the preamble indicates, "practitioners demonstrating this high level of disregard for the Federal tax system are unfit to represent others who are making a good faith attempt to comply with their own Federal tax obligations."

The revisions add specific language to Section 10.82 indicating that a practitioner will have demonstrated a pattern of "willful disreputable conduct" by:

- Failing to file annual federal tax returns, in violation of federal tax laws, for four of the five years immediately preceding the institution of a proceeding against the practitioner, and remaining noncompliant with any of the practitioner's federal tax filing obligations at the time of the notice of suspension; or

- Failing to file federal tax returns required "more frequently than annually" for five of the seven tax years immediately preceding the institution of a proceeding against the practitioner, and remaining noncompliant with any of the practitioner's federal tax filing obligations at the time of the notice of suspension.

The addition of this language gives OPR the ability to move faster in sanctioning practitioners. Language in this section has also changed from a "complaint" against the practitioner to a "show cause order," and the "answer" has been changed to a "response."

The final regulations clarify that OPR has exclusive jurisdiction within the IRS for disciplining and sanctioning tax practitioners.

Conclusion

The 2014 revisions to Circular 230 bring both clarity and uncertainty to the regulatory environment in which tax practitioners operate. The significant changes in the area of written advice offer welcome relief from prior rules and should enable practitioners to more readily comply with the standards. With this new freedom, however, comes new responsibility for the tax practitioner to determine the format of advice that is appropriate for the scope and context of the advice being proffered. The addition of an undefined competency standard and the expanded scope of IRS oversight of a firm's tax practice procedures could provide challenges for practitioners until further experience and guidance is developed. Practitioners would be well-advised to study these rules carefully in the context of their existing firm procedures to ensure that the risk of noncompliance is minimized.

Video Transcript

3. Circular 230: What You Need to Know

SURRAN:	In the good old days, anyone could prepare tax returns or give tax advice, without meeting any qualifications or competency standards. While that has changed over the few years, two things remain unchanged: anyone who wants to practice before the IRS as a tax professional:
	One, must be eligible to practice; and Two, must comply with the rules of practice found in Treasury Department Circular 230.
	In fact, over the past few years, the IRS has increasingly focused on both the conduct and the competency of tax practitioners. As a result, the consequences of Circular 230 violations are much greater than before, with a suspension or disbarment now affecting more federal tax work for a client beyond preparing – and signing – a client's income tax returns.
	According to many observers, fueling the controversy over practitioner behavior is the loss of tax revenue from the so-called "tax gap," and the seeming increase in fraudulent activity, as well as the increased publicity given to tax shelter abuses. Let's find out how this increased scrutiny is affecting tax professionals.
QUINLAN:	Joining us is Kenneth Heaslip, who is director of operations at Loscalzo Associates. Thanks for joining us this month, Kenn.
HEASLIP:	It is great to be here, Mike. It is good to see you.
QUINLAN:	Let me start with a baseline question, Kenn: what are the standards that govern the behavior of conduct for tax professionals?
HEASLIP:	Well, there are several standards that do govern behavior and conduct.
	The IRS has issued Circular 230, which is what their standards are. And then, Mike, the AICPA has their code of conduct, which will say how the CPAs are going to behave not just in tax but in all practices.
	But it certainly includes tax. And then they also have separate standards for tax practitioners.
	And also the state boards of accountancy have standards. Obviously, they are the ultimate authority in governing the CPA license. For the most part, they will expect CPAs to adhere to the standards of the profession. And in the case of a tax practice, the standards of the profession are those of the AICPA and the Circular 230 of the IRS.
QUINLAN:	It's interesting that you mention "Circular 230," Kenn. Whenever we've discussed that guidance on this program in the past, it was almost always in relation to positions taken on income tax returns. To what extent has the IRS extended that circular, and expanded its guidance, in recent years?
HEASLIP:	Last year, the IRS came out with some more updated standards on the Circular 230. They were concerned a lot about the nature of the practice and what it was doing.

They wanted to have not only more guidance, but they also wanted to expand the guidance as to what practitioners needed to know and what their responsibilities were.

Having gone as far as they went, the AICPA even goes further in some cases. Tax practitioners in general are one class of preparers. But we also have non-CPAs and nonprofessionals preparing returns. And the AICPA believes that the professionals needed a higher standard.

So, their code of conduct has expanded in areas such as fees, conflicts of interest, and confidentiality in terms of information.

And the responsibilities of CPAs go beyond what the IRS expects of tax preparers.

QUINLAN: For many years, I recall that the IRS Director of Practice relied on the state boards of accountancy – along with the state bar associations and other state regulators – to govern the conduct of tax professionals. He felt that he could rely on each jurisdiction to enforce its own rules. I'm curious: is the Service, with their Office of Professional Responsibility, becoming more proactive in this area?

HEASLIP: Yes, Mike, they are. And they feel it is necessary because while the boards of accountancy have good jurisdiction in standards and enforcement powers over CPAs, there is really nobody who has enforcement powers over non-CPAs and non-licensed professionals. So, they had to expand what the responsibilities were for everybody – not just CPAs, attorneys and enrolled agents – but also for everybody. So, Circular 230 does cover all people who prepare tax returns for a fee.

The IRS is being a lot more proactive these days. And by executing Circular 230, they have an education program as to what the preparer's responsibilities are. They also have a lot more publications.

Not only Circular 230, but also explanatory publications on what their responsibilities are. Their website has a lot of videos on these responsibilities. And the other thing they have done is, they have taken the auditors in the field and had their auditors report back on this. So, if there is an issue that comes up in an audit, they do not have to have a referral to the board of accountancy to be investigated and acted upon by the board.

And they have their own authority to have it come to them internally to be investigated and acted upon within the IRS.

QUINLAN: Since you mentioned "advisers," Kenn, most of the tax professionals that I know fill two roles for their clients. On one hand, they're tax planners. They're aggressively figuring out ways to minimize tax liability. On the other hand, they're preparing a return in compliance with the IRS rules. With its new rules, is the IRS trying to get practitioners to choose one role or the other?

HEASLIP: No, Mike, they are not. The tax planning role is important to taxes at all levels, and to the legal filing and paying of taxes. And if there is a way to minimize taxes that is legal, preparers and practitioners certainly can exercise that.

Sometimes, there is a conflict between what is in the best public interest and what is legal. And the courts and the IRS have always said that as long as it is legal, you can pursue that. And it would be up to Congress or IRS to issue regulations to close to the gap between that.

The practitioner is really dedicated for his client to have the minimum tax that is legal. And there is no reason any taxpayer should pay more than they legally have to owe.

QUINLAN: Just about everybody who's viewing today's program is interested in taxes. But how do we know if they're involved in return preparation? Are there detailed rules about who is a preparer and what is involved in assisting in the preparation of a return?

HEASLIP: Yes, Mike, there are a lot of detailed rules. It is important when you have Circular 230 to determine who is subject to Circular 230.

And they have taken a fairly broad definition saying: anybody who is responsible for a substantial portion of the preparation of a return. That could be through advising, or it could be through actually preparing a return.

And when you look at a firm, there is often times more than one person.

It is a partner. It could be a manager. It could even be a staff member, or a junior accountant, who is taking the information that is provided by the client and putting that in the tax return or putting it in their software. So, they are all preparers.

And if you are covered under Circular 230 as a preparer, then you have to get a preparer tax identification (PTIN) number. And again, it is not just a signer of the return. Anybody who is a preparer has to get a PTIN number. And for some firms, this means everybody.

And another thing that is important to note is that the Circular 230 only covers paid preparers.

So, if you are doing advising or if you are part of a volunteer VITA program or a volunteer at a senior citizen program and you are giving advice, this would not be covered under Circular 230.

QUINLAN: Let me ask you about one of my friends. He uses interns in his tax practice. I get the feeling that they mostly do a lot of data entry. Would they be required to get a PTIN?

HEASLIP: Well, Mike, the answer is no. If they are strictly doing data entry and they are an intern, then you do not need a PTIN number. The regulations are a little bit quiet as to who is an intern versus a clerical person. But really what it comes down to is client contact.

To what extent do you have client contact and are you working with the clients? Are you making decisions? But if you are simply data processing, making photocopies, and things of that sort, then you do not need a PTIN number and you are not covered under Circular 230.

QUINLAN: We've been discussing the Service's enforcement and compliance efforts with so-called "enrolled" tax professionals: accountants, attorneys, and enrolled agents. When you were here a few years ago, the IRS was rolling out an initiative aimed at so-called registered tax return preparers, or RTRPs. I'm curious, Kenn: are they still rolling that out?

HEASLIP: The quick answer is no. The long answer is they would like to. A couple of years ago, when the IRS was looking at who is preparing returns, they really wanted to have under their umbrella everybody who is preparing returns.

And they have done that through the PTIN program.

But they wanted to go a step further and say that everybody with a PTIN number has to have continuing education and has to take an exam. And they were willing to exempt attorneys and CPAs and enrolled agents, because they had already gone through a comprehensive qualifying process. But people who did not have that – the corner storefront preparer or the person working out of his living room – they did want that person to take CPE before preparing. Unfortunately for the IRS, there was a challenge in the courts. And the courts ruled that the IRS does not have the authority to do that. So, while some of that information still exists in Circular 230, it is not enforceable based on court decisions.

The IRS would like Congress to come and give them that authority. But the IRS is looking to have a voluntary program where people can voluntarily agree to CPE. Whether there is a test or not has yet to be determined. But then, if they do this on a voluntary basis, they will be given a designation of Registered Tax Return Preparer.

That has been controversial from the professional community in that they – the professional community, and the AICPA in particular – has said that that will confuse the public. Registered Tax Return Preparer may lead people to believe the person is more qualified than they really are.

QUINLAN: I know that federal law does not grant "privilege" to CPAs, Kenn. Does that mean that you've always got to submit your clients' records and documents to the IRS? And what about in those states that have their own privilege laws?

HEASLIP: Mike, that is a good question because there has been a lot of talk about privilege. As a general rule, and in most states, the CPAs do not have privilege. If information is requested, or if they are knowledgeable about something and are asked, they have to provide those documents.

And when there is privilege given in many states, the privilege is only limited privilege.

But the rules are that, if the IRS does request information, you have to promptly deliver the information.

QUINLAN: Thanks, Kenn. We'll return to your commentary in a minute.

SURRAN: As Kenn Heaslip indicated, IRS Circular 230 contains the ethical rules that govern practice before the IRS. Over the past decade, these rules have been revised a number of times. The purpose behind most of these revisions has been to encourage practitioners to engage in quality and appropriate tax practice. As an example, recent revisions to Circular 230 forbid federal tax practitioners – which, obviously, includes CPAs – from having conflicts of interest. Conflicts of interest are defined as representation of one client that is directly adverse to that of another client. It can also mean you represent a client in circumstances where you may be limited by your representation of another client, a former client, a third party, or by your own personal interest.

Of course, a practitioner may continue to represent a client – despite a conflict of interest – if you reasonably believe that you can provide competent and diligent representation to each affected client and if all affected clients waive the conflict by giving their informed written consent.

Of course, violation of Circular 230 may expose a practitioner to sanction by the IRS Office of Professional Responsibility. And, as a member of his own state's Board of Accountancy, Kenn Heaslip is also aware of those potential ramifications that may be imposed. In addition, Circular 230 may be used in a lawsuit for damages filed by a client in connection with asserted errors and omissions.

As a result, tax professionals have a strong interest in understanding the standards to which they will be held under Circular 230.

QUINLAN: As you pointed out, Kenn, there may be differences in professional standards in areas like privilege. But what about conflicts? Didn't Circular 230 come up with new rules on conflicts of interest?

HEASLIP: Yes, Mike, they did. It was very important to them to have that because a tax professional has conflicts almost every day. A lot of people believe conflicts are bad, but they are not bad. A fact of the business community is how you deal with the conflicts that become important.

So, what the Circular 230 does is it says that if you have reason to believe you have a conflict, you must disclose the conflict to the client and get consent from the client.

It does not have to be in writing, although certainly the malpractice insurance companies would say that that disclosure should be in writing in order to document that you have made the disclosure. But once you have that disclosure, the client's written consent, I do not believe, is important. Some people do.

But I think if you disclose it to the client, and the client continues to employ you, that is an implied consent.

QUINLAN: I suppose you can think of a number of situations, such as those clarified by the AICPA, where these conflicts might occur, whether it's a business partnership or a marriage partnership.

HEASLIP: Yes, Mike, conflicts can occur in very simple situations. For example, you represent a partnership that is being audited and you also do tax returns for the partners. It is very possible that one partner would, for example, if there is a passive loss situation, be able to absorb a passive loss where the other partner cannot. So, it is material to one, and may not be to the other, or it may involve allocating income differently between the partners. So, if you represent the individuals as well as the partnership, how you determine that partnership audit certainly can affect your other clients in a positive or negative way.

Another situation which is very common is a married couple.

The best interest of the taxpayer is not necessarily the same as the best interest of the spouse, because they are not always the same. An example I like to use is that you have a second marriage. And from the first marriage, let's say, the wife has a child who is going for financial aid. It may not be in the best interest of the spouse to file a joint return because they can qualify for more financial aid without the taxpayer's income. Whereas, a joint return will result in a lower tax bill, but separate returns will result in more financial aid for the child.

And so, the interests of the spouses are not perfectly aligned. For that reason, the IRS has now issued separate powers of attorney. Whereas we used to have the same powers of attorney for the taxpayer and the spouse, we now have separate powers of attorney.

And that is just the IRS recognizing that there could be separate interests between them.

QUINLAN: I'm curious, Kenn. Does Circular 230 say anything about the fees that tax practitioners charge? Or is that strictly between the client and the preparer?

HEASLIP: Well, Circular 230 certainly addresses the issue. They do not go into a tremendous amount of detail on it. But what they say is that the fees cannot be unconscionable, and that is a wide range. It is based on facts and circumstances. It could be based on geography: a fee charged in a metropolitan area may be different than in a rural area.

And that threshold is probably more based on the legal facts and circumstances than any bright-line test.

QUINLAN: I seem to recall that there are some times when contingent fees are permitted, and sometimes when they're not. Is there any way to know when they're okay?

HEASLIP: Well, Mike, Circular 230, as written, says that contingent fees are not allowed with a couple of exceptions. That has been challenged in the courts, and the courts have ruled that contingent fees are allowed. And a lot of the articles that have been written in the press have said that contingent fees are now allowed, based on the court decisions. However, they are not addressing AICPA standards.

AICPA standards do have specific rules about contingent fees: when they are allowed and when they are not allowed. They are never allowed in the case of an original return. When you are preparing a return, and say, "I'll take a certain percentage of refunds," for example, which is the most common contingent fee that people have talked about. But on an amended return, as a general rule, they are not allowed.

But there are some exceptions. And most of the exceptions are when there is an arbiter involved or when there is authority.

An example of an exception to when a contingent fee would be allowed in an amended return would be based on the recent ruling on same-sex marriages. Prior to the ruling, married couples of the same sex were not allowed to file a joint return.

And the Supreme Court ruled that they are legally married. It does not matter if they are married in one state, and residing in another state that does not recognize it. They are legally married and they can file a joint return. And the ruling was retroactive.

So, if you – as a firm – said that we would like to take our same-sex couples and, if there is a refund opportunity here, and prepare an amended return to get a refund, you would be allowed in that case to charge based on a contingent fee. Because the determination of the refund is not based on you, it is based on a court decision, in this particular case, the Windsor decision, which allowed for the IRS to accept same-sex couples' returns and changed the filing status of the return.

Obviously, if there are any other changes made to the return at the time of the amendment, that may preclude a contingent fee in that case.

QUINLAN: That makes sense. But the subject of "fees" can also involve "solicitation," can't it? I mean, what about the individual who advertises that he'll prepare any Form 1040 for $99? But he neglects to mention that he also charges a mandatory filing fee?

HEASLIP: Well, Mike, the IRS is very concerned about the advertising and the solicitation being done by practitioners. The bait-and-switch type of tactics is not really allowed.

So, if you were to advertise a $99 tax return, but then there are going to be a bunch of added fees – a filing fee, a processing fee or that $99 only covers Page 1 of the 1040, not Page 2 – that would be misleading and deceptive.

And they are not allowed when they are misleading and deceptive.

QUINLAN: That same tax preparer – the one who "only" charges $99 – also insists that the client's refund checks be sent to him. This way, he can "take" his fee, and deposit the rest into the client's account. Is that playing by the rules?

HEASLIP: Well, Mike, I can certainly appreciate when a practitioner is not getting paid, and the client is getting a refund, the temptation to say: "Listen, why don't we have your refund come to me?" Accounting software allows you to take the refund and to allocate it any way you want. However, the tax law does not.

There are specific penalties involved for a tax practitioner who negotiates a check that is made out by the IRS. So, if simply taking the refund and having it deposited into the practitioners account, or if the client gives a refund check and endorses it over to the practitioner, that would be in violation of the law. And it is subject to a $500 penalty for anybody who does that.

So, there are certainly a lot of good reasons to do that and a lot of honest reasons to do it. However, the IRS has just said, "You're not allowed to do it," and Congress has said it through penalties.

QUINLAN: You probably won't be surprised, Kenn, but that same tax preparer has an "exclusive" deal with an investment adviser. He recommends her exclusively to his clients, and she reciprocates about him with her clients. That doesn't violate Circular 230, does it?

HEASLIP: Well, Circular 230, Mike, certainly covers conflicts of interest, and this is a conflict of interest. But it does not go as far in your example of exclusive agreements with people and things of that sort. There are certainly a lot of preparers out there who are preparing and recommending mortgage loans through the same company and things of that sort, and the AICPA is concerned with that.

So, in the AICPA code of conduct, they have said that a conflict of interest by definition is when the practitioner's interests conflict with the taxpayer's interests or the client's interest.

So, if it is in the practitioner's interest to recommend a certain vendor or a certain consultant to the client, so that they can get reciprocity and get more business. And this would be under the conflict of interest rules of the AICPA, which would mandate that if you do have such an agreement, you would have to disclose that agreement to your client and get consent from the client.

QUINLAN: Now, I know tax preparers aren't supposed to sign a return that he or she knows is unreasonable. So, what about the situation where you've prepared the return for a client for a couple of years? The return does not include a Schedule E because he does not have any rental income.

This year, that client wants to get rid of his vacation home.

So, he enters into a 1031 exchange. And the escrow agent or the title company gives the client a letter saying they've completed a like-kind exchange. But you know that the exchanged property, supposedly held for investment purposes, has never been rented out or produced any rental income. What are you supposed to do in this situation?

HEASLIP: Well, Mike, it is not unusual for the facts to change over years when you have a client. And in this particular case, you have a property which to the client's advantage was to be treated as a second home or a vacation home.

And if the client is claiming rental income or whatever, not telling you about it simply because they did not want to pay tax on that rent or maybe they were using it themselves. But then they find out when they sell the property or, in this case, exchange the property, it would be to their tax advantage to say it was an investment property and that they were collecting rents.

So, if you are engaged to do this, you are taking a position on a tax return that is inconsistent with a position that had been taken prior to this. And, certainly, that not only raises some red flags, but it also certainly raises some issues that you have to discuss with your client.

You are going to get the facts. And if you find out that, in fact, it was rental property beforehand, you have to recommend to your client that previous returns have to be amended. Or, if you find that it was not rented, in which case you cannot take the 1031 treatment because it is not allowed by law.

QUINLAN: Well, just about every client comes to their preparer with a list of charitable contributions he or she made during the year. Does this mean they're supposed to start "verifying" the accuracy of each and every contribution before it can be deducted? You know, asking for copies of substantiation letters from the charity.

HEASLIP: No, Mike, you are not the auditor here. You do not have to get verification. You do not have to get substantiation. I have certainly talked a lot of practitioners who, as a matter of practice, want that. But you do not have to have it.

But what you do have to do is, you do have to make sure that the information you have is consistent with what you know and that it is allowed.

So, if a client says that they gave $10,000 to the United Way and they tell you that they have receipts and they have verification of that, it is certainly an allowable deduction. If the client said that they gave a $500 donation to the local PBA, that is a different story, because the PBA is not a charitable organization. And it is your responsibility to notify the client that that is not a charitable deduction, and you could not take that deduction on the tax return. But you do not have to verify everything. What I do in my practice is that in my organizer is a questionnaire.

I actually put a question on there and I make sure as clear as possible to the client where I say "The IRS requires that you have receipts, verification or canceled checks for your charitable deductions. Do you have them?"

And if the client says no, then we have a discussion about that. Oftentimes, a client will then get them and they will change the numbers they gave me. Or in many cases they say, "Well, then don't take the deduction. I don't have the receipt."

SURRAN: As Kenn Heaslip pointed out, the IRS is devoting more efforts to encourage compliance with the tax law – by practitioners and others.

There is an expectation that preparers are going to be more proactive in identifying errors on returns and are going to be responsible for many taxpayer positions. In that context, there are several different thresholds for tax preparer penalties in the tax code.

Most tax practitioners view the penalty thresholds as:

-“More likely than not,” means greater than fifty percent confidence that a position will be upheld;

-“Substantial authority” means greater than forty percent confidence that a position will be upheld;

-“Realistic possibility of success,” means greater than 33.3 percent confidence that a position will be upheld; and

-“Reasonable basis,” means there is approximately 20 percent confidence that a position will be upheld.

QUINLAN: You mentioned that the Service is more serious about tax preparer penalties, Kenn. In that context, I’ve heard about “substantial authority” and “reasonable basis” and other thresholds that are used for penalties. How do you keep them all straight?

HEASLIP: It is difficult to keep them straight, Mike. Because when Congress passes the laws, it is IRC sec. 6694 that imposes a lot of these penalties. They do say, in some cases, that the threshold for the preparer is “substantial authority.” In other cases, they will say you have to have a “reasonable basis.” Sometimes, they will say “more likely than not,” but they never really fully define it.

QUINLAN: Since we’re both from New Jersey, Kenn, let me ask you about another hypothetical client who owns a trucking business.

He treats his truck drivers as independent contractors.

You look at the facts and circumstances and you decide that, in the ideal world, they should probably be treated as employees. However, the fact is that the client has never been audited – not by the IRS, not by the state unemployment insurance, not by worker’s compensation. And the fact is that the client is unlikely to ever be audited. On the one hand, I suppose you can tell the client about the IRS’ Voluntary Classification Settlement Program. On the other hand, does that mean that you can sign his return again this year, as you always do?

HEASLIP: Well, Mike, if you have come to that conclusion that they probably will not be substantiated, then you do have to have a conversation with your client. Certainly, the IRS, knowing this issue, has a voluntary disclosure program where you step forward with reduced penalties and easier compliance to fix the problems in the past.

However, you do have to be aware of the fact that, if the client does not want to go that route and wants to continue to treat these drivers as independent contractors, then you have a preparer issue, because you cannot be signing a return that you believe will not be substantiated on audit. And if you believe that these people were in fact employees and not independent contractors, then being associated with a return can result the preparer penalties.

QUINLAN: What about the fact that you did sign the return last year and the year before, indicating that they were independent contractors? Is that potentially an admission that you've been signing returns for which you didn't have a realistic position?

HEASLIP: Well, Mike, it is certainly a big concern that you have signed a return in the past that later on proves to be incorrect. And what do you do? And the threshold is at the point you sign the return. So, if you were not aware of the facts at that point and you signed the return in good faith without being aware, you are probably not going to be held responsible. But, certainly, now that you are aware of it, it is your responsibility to advise the client to go back and amend the returns and to fix the problem through a voluntary disclosure or some other procedure.

QUINLAN: Of course, many of our viewers – like you – practice as part of a firm. To what extent, Kenn, do tax practitioners need to be concerned by the compliance "stance" of their colleagues and the other people within their own firm?

HEASLIP: Well, Mike, I think everybody has a responsibility towards any work that is being done under their watch, that they are looking at, or that they are responsible for. So, if you are the tax partner of a firm and you are responsible for tax procedures that are happening firm-wide, then you do have a responsibility for everything that is happening in the firm, to make sure that they are done properly and within the rules of the firm. There are a lot of standards outside the tax standards, such as quality control standards of a firm, that you have that responsibility for.

But even people who are not the tax partner, such as anybody who is preparing a return, has a responsibility at all levels below them. If they have a junior accountant or a staff member preparing work, you do have responsibility to review the work papers and to make sure that it is in compliance with the rules.

QUINLAN: One of your colleagues has a client who's applying to refinance his mortgage. Your colleague is on vacation, but has asked you to "service" his clients while he's gone. A mortgage company calls up and asks for the client's past two or three tax returns. Can you just send the returns to them quickly and electronically?

HEASLIP: No, Mike, this could apply to your colleague who is on vacation, or could apply to just a secretary, who gets that phone call that says "I need a copy of the return."

My mortgage company, my insurance company, people are asking for it, financial aid for my kids, etc. And most firms are client-sensitive: they want to satisfy the client, they want to help the client, and they know from a confidentiality point that is okay. However, what a lot of people are not aware of is that Section 7216 of the Internal Revenue Code has specific outlines as to what is confidential and what can be delivered. And it is a very voluminous and very far reaching code section, and the regulations go very far as well. But within those regulations are the rules that, if you want to send a copy of a tax return to a third party, such as a bank or a creditor or something, then you need the client's written consent. And there are a lot of rules as what that consent needs and they go pretty far.

They have to say the purpose of the consent and the fact that this consent expires within a certain amount of time. They even go into the detail of no smaller than 12-point font or 8½ x 11 paper.

So, you do have to comply with that in a written, signed format. And most of the time, an email will not suffice giving you permission. It must be in that format. The IRS does not give us that format, but they tell us what has to be included in that format.

QUINLAN: Since you mentioned a "consent" form, Kenn, let me ask you: where do those sample consent forms come from?

HEASLIP: Since the IRS has not given a form on this, the AICPA has developed a team to give a toolkit on that. And you go to the AICPA website, you just put in the search engine "7216," and they have a lot of sample forms in Word format.

I do not suggest changing that format because some of the things there which you may believe are unnecessary are, in fact, there because the regulation provides it. One example would be the phone number of the IRS. Why would any reasonable person want to give the client the phone number of the IRS? And the reason is because the regulation requires that phone number be there.

QUINLAN: Sometimes, Kenn, it's more than consent to a disclosure. Aren't there also AICPA rules about maintaining client confidentiality?

HEASLIP: Client confidentiality is a professional standard that everybody should be adhering to. But, Mike, the AICPA has a lot of very specific rules on client confidentiality. These were updated within the last five years. I believe they are very far reaching and that every CPA should read them. And read them very critically, because client confidential information is simply defined as any information received from the client that is not otherwise available to the public. So, if it is not available to the public, if they cannot find it on a website, a publication or somewhere, then it is confidential. And the CPA has to be very careful about disclosing that information to anybody.

QUINLAN: I know someone who "specializes" in serving businesses in a certain industry. Because of his experience, he knows a lot about that industry. Can he talk about what are industry "average" profit margins and ratios with his clients?

HEASLIP: Well, Mike, we do that a lot and it seems harmless. But if you look at the rules by the AICPA, the answer is, "No, you can't do that." Because if those ratios and if those numbers were derived from confidential client information – even not giving the client name or, as the AICPA calls it, "de-identifying the client" – it is not adequate to maintain that confidentiality. Again, going back to any information received from the client not available to the public.

And if that data was developed from information received from the client, de-identifying would not be enough. And you are not allowed to use that information, and to publish it, and to give it to anybody other than the client. And if you are aggregating multiple clients, you are not allowed to do that. I might want to add that all confidential information can be disclosed with permission of the client. So, if you do have this data, and you think it is useful to all your clients, you can pull it together and get permission of the client, in which case then you would be allowed to do it.

QUINLAN: As I expected, Kenn, you've covered a lot of ground for us today. If our viewers could take one thought away from this program, what would you like that to be?

HEASLIP: Well, Mike, the biggest takeaway is that you cannot take tax preparer responsibilities lightly. This is something everybody in the firm needs to be aware of: the partners who are signing the returns; the people who are preparing returns; and even the lowest-level staff people who are preparing it.

Because what is in that return is subject to the rules and regulations of the IRS. Each person is subject to it, and the firm in general is subject to these rules. So, these rules have to be followed by everybody.

And I may have mentioned it: even the audit people. Because if the audit people are giving any sort of tax advice in an off-the-cuff way or if they are doing anything, then it is possible that they will be subject to these rules as well.

QUINLAN: Loscalzo Associates' Kenneth Heaslip, thanks for bringing us up-to-date.

HEASLIP: You are welcome, Mike. It was great to see you and I hope to see you again soon.