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& OLSEN**

ETHICAL CONSIDERATIONS FOR THE TAX PRACTITIONER

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TAX PRACTICE

TAX PRACTICE COVERS THREE GENERAL AREAS:

- 🌀 Planning
- 🌀 Compliance
- 🌀 Controversy

WHAT DO YOU SEE IN THIS SKETCH?



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SKETCH?



WHAT DO YOU SEE IN THIS SKETCH?



WHAT DO YOU SEE IN THIS PICTURE?



WHAT DOES THIS EXERCISE HAVE TO DO WITH THE ETHICAL ISSUES WE MIGHT FACE IN TAX PRACTICE?

- **Are all ethical issues a Tax Practitioner may face the same?**
- **Do all Tax Practitioners see or approach all the ethical issues the same?**
- **Are all tax ethics issues black and white?**
- **What would be the best practices when approaching ethical issues you will face in your Tax Practice?**

EVOLUTION OF IRS CIRCULAR 230

- ❶ The ABA initially drafted Formal Opinion 346 (Rev., Jan. 29, 1982). This opinion address standards for preparing opinions addressing tax minimization.
- ❷ The ABA Model Rules of Professional Conduct provide the other ethical standards that attorney's must abide by in engaging in tax practice.
- ❸ Formal Opinion 346 and the Model Rules impose on attorneys almost all the rules contained IRS Circular 230. I think that the same observation can be made with the applicable rules for Accountants. IRS Circular 230 provides all the ethical rules Tax Practitioners must follow when practicing before the IRS.
- ❹ See Dianna C. Blankenship & Edward B. Hymson, *The Evolution of the American Bar Association Ethics Rules into the Internal Revenue Service Circular 230 Rules*, 18 S.L.J. (2008).

ACCURACY RELATED PENALTIES

IRC § 6662: Taxpayer accuracy related penalties.

IRC § 6694: Tax Return Preparer accuracy related penalties.

I.C. § 63-3046: Idaho taxpayer accuracy related penalties.

**Hierarchy of tax return accuracy related standards, from highest to lowest ,
are as follows:**

- ⊗ More Likely Than Not
- ⊗ Substantial Authority
- ⊗ Realistic Possibility
- ⊗ Reasonable Basis
- ⊗ Not Frivolous

See ABA Tax Section Committee on Standards of Practice, Standard of Tax Practice Statement 2000-1 good discussion of standards.



RULES GOVERNING THE TAX PRACTITIONER

ATTORNEYS:

- Idaho State Bar Rules of Professional Conduct (modeled after ABA Model Rules of Professional Conduct)
- Rules of Idaho Board of Tax Appeals (Rule 35: must act in an ethical respectful and courteous manner)
- The United States Tax Court Rules of Practice and Procedure (Rule 201: must conduct practice in accordance with letter and spirit of ABA Model Rules of Professional Conduct)
- IRS Circular 230
- IRC § 6694 (return preparer penalties)/IC § 63-3046 (taxpayer negligence/substantial understatement penalties)

ACCOUNTANTS:

- Idaho Board of Accountancy Rules of Professional Conduct (Incorporate AICPA, NASBA, and PCABO Standards)
- IRS Circular 230
- IRC § 6694 (return preparer penalties)/IC § 63-3046 (taxpayer negligence/substantial understatement penalties)



ATTORNEYS' DUTIES

IRPC 1.2(d): A lawyer shall not counsel or assist a client in commission criminal or fraudulent conduct.

IRPC 1.6 (a) & (b): A lawyer cannot reveal client confidential information, unless consent or otherwise required. A lawyer may reveal client confidential information to prevent client from committing crime or prevent substantial injury to financial interests or property of another.

IRPC 1.7: Conflict of Interest Rules for Current Clients

IRPC 1.9: Duties for Former Clients



ATTORNEYS' DUTIES CONT.

IRPC 1.16(a)(1): A lawyer shall withdraw from representation of a client where the representation would result in violation of the rules of professional conduct or other law.

IRPC 3.1: “A lawyer shall not bring or defend a proceeding, or assert or controvert an issue therein, unless there is a basis in law or fact for doing so that is not frivolous, which includes a good faith argument for an extension, modification or reversal of existing law.”

IRPC 4.1: During the course of representation a lawyer cannot knowingly make a false statement of material fact or law or fail to disclose a material fact when disclosure is necessary to avoid assisting in a criminal or fraudulent act by a client, unless prohibited by rule 1.6.

ATTORNEYS' DUTIES CONT.

IRPC 8.4: It is professional misconduct for a lawyer to:

- ⊗ Violate or attempt to violate the rules of professional conduct
- ⊗ Engage in conduct involving dishonesty, fraud, deceit or misrepresentation
- ⊗ Engage in conduct that is prejudicial to the administration of justice

ABA Formal Opinion 85-352:

- ⊗ “A lawyer may advise reporting a position on a tax return so long as the lawyer believes in good faith that the position is warranted in existing law or can be supported by a good faith argument for the extension, modification or reversal of existing law and there is some realistic possibility of success if the matter is litigated.”
- ⊗ “Realistic Possibility of Success” is interpreted as a position having a likelihood of success closely approximating one in three or one-third.
- ⊗ A lawyer should inform the client about the potential penalties and other legal consequences should the client take the position on the return so advised.

ABA Tax Section: Standard of Tax Practice Statement 2000-1 (discusses whether differences in federal accuracy related penalties applicable to taxpayers and lawyers create conflicts of interest with client under Rule 1.7(a)(2)).



ACCOUNTANTS' DUTIES

Rule 400.02: Acceptance of practice privileges or licensure establishes an affirmative obligation to be diligent in the performance of professional services and to be fair and honest in relations with clients, fellow practitioners and the public.

Rule 400.05: All persons associated with the accountant, whether under the accountant's supervision or control or his partners or shareholders, are responsible for complying with the rules.

Rule 400.4: The rules apply to all professional services provided by an accountant, including *tax* and management services.



ACCOUNTANTS' DUTIES, CONT.

Rules 400.01 & 402: Duty not to disclose to third parties client confidential information unless consent is obtained or exceptions apply. This is consistent with AICPA Rule 301.



ACCOUNTANTS' DUTIES, CONT.

AICPA Statements on Standards of Tax Services ("Standards") No. 1, Tax Return Positions:

- CPA must determine and comply with applicable standards of taxing authority.
- If no applicable standards then, CPA must conform to the following:
 - CPA should not recommend a tax return position or prepare or sign a return taking a position unless the member has a good faith belief that position has a realistic possibility of being sustained.
 - CPA may recommend a tax return position if there is a reasonable basis for the position and advises the taxpayer to appropriately disclose the position on his return.

ACCOUNTANTS' DUTIES, CONT.

AICPA Standard No. 1 Continued:

- When advising on tax return positions taken, CPA should advise taxpayer regarding potential penalty consequences of the position and ability, if any, to avoid such penalties through disclosure.
- CPA should not recommend a tax return position or prepare or sign a tax return asserting a position that the CPA knows exploits the audit lottery or is arguing a position solely to gain leverage in negotiations with a taxing authority.

ACCOUNTANTS' DUTIES, CONT.

AICPA Standard No. 6—Knowledge of Error: Return Preparation and Administrative Proceedings:

- ⦿ CPA should inform taxpayer upon becoming aware of error in a previously filed return, a return that is subject of an audit, or the failure to file the required return. CPA should advise of the consequence of the error and recommend correction. CPA cannot inform the taxing authority without the taxpayers permission or except as required by law.
- ⦿ If CPA is requested to prepare the current year's return and error has not been corrected, CPA should consider withdrawing from preparing return or from the professional relationship.
- ⦿ If CPA discovers the error on a return during an audit, CPA must request the taxpayer's agreement to disclose the error. In absence of such agreement, the CPA should consider withdrawing from representing the taxpayer in the administrative proceeding and whether to continue the professional relationship with the taxpayer.

AICPA Ethical Rulings 391.3 (Information to Successor Accountant About Tax Irregularities after Withdrawal)



IRS CIRCULAR 230 DUTIES

- **Duty to promptly submit records or information upon IRS request, unless Practitioner believes in good faith that information is privileged. 31 CFR § 10.20.**
- **When practitioner knows that a client has not complied with revenue laws or has made an error in or omission from any return, document, affidavit or other paper which was submitted, he must advise the client about the non-compliance, error or omission. The practitioner must advise client of the consequences under the IRC and regulations of the noncompliance, error or omission. 31 CFR § 10.21.**
- **Duty to exercise due diligence—(1) in preparing and submitting filings; (2) in determining correctness of oral or written representations by Practitioner to IRS; and (3) in determining correctness of oral or written communications by practitioner to clients with reference to any matter administered by IRS. 31 CFR § 10.22(a).**

IRS CIRCULAR 230 DUTIES CONT.

Standards with respect to Returns and Documents, Affidavits and other Papers:

- Practitioner may not willfully, recklessly or through gross incompetence:
 - Sign a tax return or claim for refund that the practitioner knows or has reason to know contains a position that (a) lacks a reasonable basis, (b) is an unreasonable under IRC § 6694(a)(2) or (c) is a willful attempt by the practitioner to understate the liability for tax or a reckless or intentional disregard of the rules and regulations as described in § 6694(b)(2). 31 CFR § 10.34(a)(1)(i).
 - Advise a client to take a position on a tax return or claim for refund, or prepare a portion of a tax return or claim for refund containing a position that (a) lacks a reasonable basis, (b) is an unreasonable position under IRC § 6694(a)(2), or (c) is a willful attempt by the practitioner to understate the liability for tax or a reckless or intentional disregard of the rules and regulations as described in § 6694(b)(2). *Id.* § 10.34(a)(1)(ii).

IRS CIRCULAR 230 DUTIES CONT.

Penalties if a Tax Practitioner Violates the Circular 230 Standards:

- ❶ After notice and opportunity for a proceeding, the Secretary may censure, suspend, or disbar any practitioner, if (1) the practitioner is shown to be incompetent or disreputable, fails to comply with any regulation regarding the standards of conduct, with the intent to defraud, willfully and knowingly misleads or threatens a client or prospective client or (2) willfully or through recklessness or gross negligence violates the Circular 230 standards. 31 CFR §§10.50(a) & 10.52(a).
- ❷ After notice and opportunity for a proceeding, the Secretary can impose a monetary penalty on any practitioner who engages in conduct subject to sanction. *Id.* § 10.50(c).
- ❸ Section 10.51(a) a nonexclusive list of incompetent and disreputable conduct.



DO TAXPAYERS HAVE A LEGAL DUTY TO FILE AN AMENDED RETURN UPON THE DISCOVERY OF AN ERROR?

- Generally no, see *Badaracco v. Commissioner*, 464 U.S. 386 (1984) (IRC does not require a taxpayer's filing of an amended return; amended return is a creature of administrative origin and grace).

DISCUSSION AND APPLICATION OF ETHICAL STANDARDS

**BANISTER V. DEPT. OF TREASURY, Doc. No. 5:10-cv-02764
(N.D. Cal. 2011) (disbarment of accountant).**

HYPOTHETICAL SITUATIONS:

SEE HAND OUT



QUESTIONS?

THANK YOU!

