



Where the Wild Things Aren't: Ethical Teamwork in Tax Practice

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***“The night Max wore his wolf suit
and made mischief of one kind/ and another/
his mother called him ‘WILD THING’
and Max said ‘I’LL EAT YOU UP!’
so he was sent to bed without eating anything.”***

Maurice Sendak, *Where the Wild Things Are* (1963)

Tax Ethics: An Overview

Ethical Standards set by:

- Internal Revenue Code & Treasury Regulations
- Circular 230
- Ethics Rules - State professional licensing organizations

Tax Team Hypothetical

Tax Team Hypothetical

Surviving Spouse is the surviving spouse of Decedent and Executor of the Estate of Decedent.

Surviving Spouse hires attorney Attorney and certified public accountant CPA to help administer the Estate and to prepare and file an estate tax return.

Surviving Spouse is also working with one of Decedent's original accountants, Accountant, who is helping Surviving Spouse determine what assets Decedent owned at death.

Partner is a member of Attorney's law firm and is also a tax attorney.

Tax Team Hypothetical: The Characters

Attorney (1)

- Licensed by the West Virginia State Bar
- Specializes in wealth transfer taxes
- Member of Law Firm

Tax Team Hypothetical: The Characters

CPA (2)

- Licensed by the West Virginia Board of Accountancy
- Specializes in wealth transfer taxes

Tax Team Hypothetical: The Characters

Accountant (3)

- Has degree in accounting
- Working to be a CPA
- No specialty yet

Tax Team Hypothetical: The Characters

Partner (4)

- Licensed by the West Virginia State Bar
- Specializes in wealth transfer taxes
- Member of Law Firm

***“And now,’ cried Max,
“let the wild rumpus start!””***

Internal Revenue Code & Treasury Regulations: IRC §6694

IRC §6694 - *Nota Bene* -

We're talking about I.R.C. §6694. Watch out for other penalties, like:

- “Administrative wrongdoing” (IRC §6695)
- Promoting abusive tax shelters (IRC §6700)
- Aiding and abetting understatement of tax liability (IRC §6701)

IRC §6694 - Generally

§6694(a): Penalty for an understatement due to an *unreasonable* position imposed on tax return preparer.

§6694(b): Penalty for an understatement due to the *willful or reckless conduct* of a tax return preparer.

IRC §6694 - Who is a Tax Return Preparer?

Per IRC §7701(a)(36)(A):

The term “tax return preparer” means any person who prepares for compensation, or who employs one or more persons to prepare for compensation, any return of tax imposed by this title or any claim for refund of tax imposed by this title. For purposes of the preceding sentence, the preparation of a substantial portion of a return or claim for refund shall be treated as if it were the preparation of such return or claim for refund.

IRC §6694 - Who is a Tax Return Preparer? (cont.)

- Tax Return Preparers can be *signing* or *nonsigning*.
- Note: Penalties imposed on person(s) with primary responsibility for the position.
 - One person per firm
 - May be more than one person responsible if more than one firm involved
 - May be imposed on the individual and the firm

IRC §6694 - Signing vs. Nonsigning

- *Signing* tax return preparer

The person who has the primary responsibility for the overall substantive accuracy of the preparation of such return or claim for refund.

- *Nonsigning* tax return preparer

A person (not a signing tax return preparer) who prepares all or a substantial portion of the tax return with respect to events that have occurred at the time the advice is rendered.

IRC §6694 - Primary Responsibility

- Signing tax return preparer *at a firm* is primarily responsible for all of the return.
- But: Nonsigning tax return preparer *at that firm* can be primarily responsible for a position on the return if:
 - No signing tax return preparer at the firm, and
 - Either:
 - Nonsigning tax return preparer was primarily responsible for that position *or*
 - He/She had overall supervisory responsibility for the position at issue

IRC §6694 - Tax Team Hypotheticals!

Attorney provides legal advice to CPA regarding the date of death value of House on Decedent's estate tax return. CPA uses this advice when listing the value of House on the estate tax return. The value of House constitutes a substantial portion of the estate tax return. Attorney, however, does not prepare any other portion of the estate tax return. CPA prepares the rest of the estate tax return and signs it.

Is Attorney a tax return preparer? Is CPA?

IRC §6694 - Tax Team Hypotheticals! (cont.)

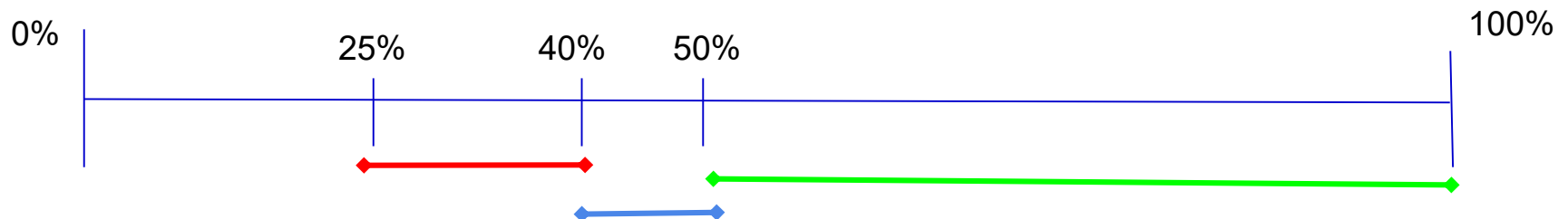
Attorney provides advice to Surviving Spouse concerning the non-inclusion of an inter vivos irrevocable trust created by Decedent in Decedent's Estate for purposes of the estate tax return. In preparation for providing that advice, Attorney seeks advice regarding the proper treatment of the item from Partner. Partner provides advice on the non-inclusion of the irrevocable trust upon which Attorney relies. Partner's advice is reflected on the estate tax return. The IRS challenges the non-inclusion, which results in an understatement of estate tax liability. Who is subject to penalties?

Option 1: Attorney signs the estate tax return.

Option 2: CPA signs the estate tax return

IRC §6694 - What is a Reasonable Position?

- Need to take a *reasonable* position to avoid penalty under IRC §6694(a)
- What is reasonable? A position for which there is *substantial authority* (40%-50%)
 - Adequately disclosed positions? *Reasonable basis* (25%-40%)
 - Tax shelter/reportable transaction? *More likely than not* (51%+)



IRC §6694 - Substantial Authority

- An objective standard involving an analysis of the law and application of the law to relevant facts.
- Weight of the authorities supporting the treatment is substantial in relation to the weight of authorities supporting contrary treatment.
- Weight of authority determined “in light of the pertinent facts and circumstances” and depends on the authority’s relevance and persuasiveness.

IRC §6694 - Weight of Authority

- Questions to consider:
 - Is the authority materially distinguishable on its facts or otherwise inapplicable to the issue at hand?
 - Does the authority merely state a conclusion or does it reach its conclusion by cogently relating the applicable law to pertinent facts?
- The weight of authority also depends on the type of document providing the authority.

IRC §6694 - Weight of Authority (cont.) - Types

- Internal Revenue Code
- Treasury Regulations and other regulations (proposed, temporary and final)
- Revenue Rulings; Revenue Procedures
- Tax treaties
- Court cases
- Congressional intent
- General Explanations (Joint Committee on Taxation's Blue Book)
- Private letter rulings; technical advice memoranda issued after October 31, 1976
- Actions on decisions and general counsel memoranda issued after March 12, 1981
- Internal Revenue Service information or press releases
- Notices, announcements and other administrative pronouncements published by the Service in the Internal Revenue Bulletin.

IRC §6694 - Weight of Authority (cont.)

- Sometimes there is no authority -- or very little authority available.
- If certain types of authority are absent, then substantial authority may exist even if the position is supported only by a well-reasoned construction of the applicable statutory provision.

IRC §6694 - Adequate Disclosures

- A signing tax return preparer adequately discloses a position by:
 - Disclosing it on a Form 8275 or 8275-R attached to the return;
 - Disclosing it on the tax return per an applicable revenue procedure; or
 - Providing the taxpayer with the prepared tax return that includes the disclosure.

IRC §6694 - Adequate Disclosures (cont.)

- A nonsigning tax return preparer adequately discloses a position by:
 - Disclosing it on a Form 8275 or 8275-R attached to the return; or
 - Disclosing it on the tax return per an applicable revenue procedure.

IRC §6694 - Adequate Disclosures (cont.)

- If the nonsigning tax return preparer *provides advice to a taxpayer*, he/she adequately discloses by:
 - Advising the taxpayer that penalties could apply to the position (if relevant) and of the standards for disclosure (to the extent applicable) to avoid the penalty; and
 - Contemporaneously documenting the advice in his or her files.

IRC §6694 - Adequate Disclosures (cont.)

- If the nonsigning tax return preparer *provides advice to another tax return preparer*, he/she adequately discloses by:
 - Advising the other tax return preparer that disclosure may be required;
 - Contemporaneously documenting the advice in his or her files; and
 - The tax return preparer complies.

IRC §6694 - Tax Team Hypotheticals!

- CPA is preparing the estate tax return and intends to sign it. A particular position taken on the estate tax return does not have substantial authority, although there is a reasonable basis for the position. The position is not a tax shelter or a reportable transaction per §6662A. What should CPA do?

IRC §6694 - Tax Team Hypotheticals!

- Same facts as above, but Surviving Spouse signs and files the tax return without disclosing the position. The IRS later challenges the position taken on the tax return, resulting in an understatement of liability. Will CPA be subject to penalty?

IRC §6694 - Tax Team Hypotheticals!

- Attorney will not be signing the estate tax return. Attorney advises Surviving Spouse concerning the proper treatment of some complex entries on estate tax return. Attorney has reason to know that the tax attributable to the entries is a substantial portion of the tax required to be shown on the tax return within the meaning of §301.7701-15(b)(3), Proc. & Admin. Regs. When providing the advice, Attorney concludes that one position (not relating to a tax shelter or reportable transaction) does not have substantial authority, although the position meets the reasonable basis standard. What should Attorney do?

Circular 230

Circular 230: Generally

- What is Circular 230?
- Circular 230 applies to *representatives* who practice before the IRS and Treasury Department.

Circular 230: Representative, defined

“Representative” is defined broadly to include:

- Lawyers
- Certified public accountants
- Enrolled agents, enrolled actuaries, enrolled retirement plan agents
- Individuals who are a family member/employee of the taxpayer
- Appraisers
- Government officers/employees
- Former government officers/employee

Circular 230: Practice Before the IRS, defined

“Practice Before the IRS” is defined broadly to mean all matters connected with a presentation to the Internal Revenue Service relating to a taxpayer’s rights, privileges, or liabilities under laws or regulations administered by the Internal Revenue Service.

Examples:

- Preparing/filing documents;
- Corresponding and communicating with the Internal Revenue Service;
- Rendering written advice; and
- Representing a client at conferences, hearings, and meetings.

Circular 230: How to Practice Before the IRS?

- A lawyer or CPA may practice if they are in good standing with the IRS.
- To practice, they must file a written declaration (e.g., a Form 2848) stating that:
 - They are qualified as an attorney or CPA
 - They are authorized to represent the taxpayer.
- Exception: If rendering written advice, generally no need to file a written declaration with the IRS.

Circular 230: Tax Team Hypothetical!

Who is subject to Circular 230? What is needed to Practice before the IRS?

- Attorney?
- CPA?
- Accountant?
- Partner?

Circular 230: Duties & Responsibilities

- Sanctions (censure, suspend, disbar; monetary penalties) if Representative willfully violates -- or, in some cases, recklessly or through gross incompetence violates -- Circular 230

Circular 230: Duties & Responsibilities

- Also, cannot engage in “incompetence and disreputable conduct.”
 - Knowingly provide false or misleading information to the IRS/Treasury Department
 - Knowingly help disbarred/suspended person to practice before the IRS
 - Knowingly/recklessly/through gross incompetence give a false opinion
 - Engage in a pattern of providing incompetent opinions on questions arising under the Federal tax laws

Circular 230: Duties & Responsibilities (cont.)

- Cir. 230 §10.21: Knowledge of client's omission
- Cir. 230 §10.22: Diligence as to accuracy
- Cir. 230 §10.29: Conflicting interests
- Cir. 230 §10.34*: Standard with respect to tax returns and documents, affidavits, and other papers
- Cir. 230 §10.37*: Requirements for written advice
- Bonus: Cir. 230 §10.33: Best practices

Circular 230 §10.21: Knowledge of client's omission

A practitioner who learns of a client's noncompliance or error/omission on a document submitted by the client to the IRS must advise the client of the noncompliance or error/omission.

Circular 230 §10.22: Diligence as to accuracy

Practitioners must exercise due diligence (1) in preparing/assisting with filing documents relating to IRS matters and (2) in determining correctness of representations (oral and written) made by the practitioner to the Treasury or made with respect to any matter administered by the IRS.

Presumption of due diligence if the practitioner is relying on the work product of another, as long as the practitioner used reasonable care in engaging, supervising, training, evaluating the person.

Circular 230 §10.29: Conflicting Interests

If a conflict of interest exists, the practitioner may nonetheless represent a client before the IRS if, among other things, each affected client waives the conflict, confirmed in writing by each affected client.

Circular 230 §10.34*: Standard with respect to tax returns and documents, affidavits, and other papers

For tax returns

- Cannot sign a tax return/claim for refund if you know (or should know) it contains a position that (1) lacks reasonable basis, (2) is an unreasonable position, (3) is a willful attempt to understate tax liability, or (4) is a reckless or intentional disregard of rules.
- Cannot advise a client to take such a position or prepare a portion of a tax return/claim for refund that contains such a position.

Circular 230 §10.34*: Standard with respect to tax returns and documents, affidavits, and other papers (cont.)

For other documents:

- May only advise a client to take non-frivolous positions, and
- May not advise a client to submit documents that:
 - Intend to delay or impede the administration of Federal tax laws
 - Are frivolous, or
 - Contain or omit information that demonstrates an intentional disregard of a rule or regulation (unless the practitioner advises the client to submit a document showing a good faith challenge to the rule or regulation).

Circular 230 §10.34*: Standard with respect to tax returns and documents, affidavits, and other papers (cont.)

For all documents:

- Must inform the client of:
 - Any penalties that are reasonably likely to apply to the client with respect to a position taken on a tax return with which the practitioner is associated, and
 - Any opportunity to avoid penalties by disclosure and the requirements of adequate disclosure.
- May rely in good faith (without verification) upon information furnished by the client.

Circular 230 §10.37*: Requirements for written advice

- Written advice may be given, but only if:
 - It is reasonable (based on reasonable factual and legal assumptions; reasonably considers all relevant facts and circumstances known or should be known; reasonable efforts to identify relevant facts).
 - No unreasonable reliance on representations, statements, findings or agreements;
 - Applicable law and authority are related to facts; and
 - The possibility of audit and the possibility of the matter being raised on audit are taken into account.
- May reasonably rely on the advice of another if the advice is reasonable and the reliance is in good faith.

Circular 230 §10.33: Best practices

Provide highest quality representation by:

- Communicating clearly with the client regarding the terms of the engagement.
- Establishing the facts, determining what assumptions are reasonable, and coming to a conclusion based on relevant law.
- Advising the client on the importance of the conclusions reached.
- Acting fairly and with integrity.

Circular 230: Tax Team Hypotheticals

- How can Attorney, CPA, Accountant, and Partner meet the standards in Circular 230 §10.22 (regarding diligence as to accuracy)?
- How can Attorney, CPA, Accountant, and Partner meet the standards in Circular 230 §10.34 (regarding standards with respect to tax returns and other papers) and in Circular 230 §10.37 (regarding requirements for written advice)?
- What other Circular 230 duties and restrictions do Attorney, CPA, Accountant, and Partner each need to particularly consider?

Conclusion

Ethical Teamwork: Don't Be a Wild Thing

You, as a member of a team of tax professionals, need to be keenly aware of your role in the project:

- Are you a tax return preparer? If so, are you a signing tax return preparer or a nonsigning tax return preparer?
- Are you even practicing before the IRS?

You will often have different ethical duties and requirements under the Internal Revenue Code and Circular 230 depending on those answers.

***“And when he came
to the place where the wild things are
they roared their terrible roars
and gnashed their terrible teeth/
and rolled their terrible eyes
and showed their terrible claws/
till Max said ‘BE STILL!’
and tamed them with the magic trick”***

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