Ethics and Professional Responsibility for Enrolled Agents

#4525L
COURSE MATERIAL
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Chapter Objective

After completing this chapter, you should be able to:

- Identify the Internal Revenue Service Requirements as outlined in Circular 230.
- Recognize the applicable NAEA guidance on tax practice.

Introduction

The tax preparation and tax consulting industry has historically enjoyed less government regulation than the practice of accountancy. In 1995, the IRS proposed studying the concept of tax preparer registration in order to combat rising fraud in the earned income credit program. This proposal was dropped because of widespread industry opposition. Instead, the IRS increased the scrutiny applied to firms applying to file tax returns electronically. In 2010, the IRS issued regulations requiring the registration of tax preparers. Effective January 1, 2011, all paid tax return preparers are required to have a Preparer Tax Identification Number (PTIN).

The tax practice field has had less ethical guidance because of the unique relationship between the tax preparer and client. In a tax engagement, the EA is an “advocate of the taxpayer.” The courts have held that there is nothing illegal or sinister in a taxpayer arranging one’s affairs so as to pay the lowest tax legally available.

Nevertheless, EAs in tax practice do have two sets of ethical and legal guidance which governs their tax practice. Circular 230 governs practice before the Internal Revenue Service. The National Association of Enrolled Agents (NAEA) has issued rules of professional conduct. We will examine both of these items, pointing out the differences wherever relevant.

I. CIRCULAR 230

Circular 230 is published by the Treasury Department. It prescribes regulations governing the practice of attorneys, CPAs, EAs, Enrolled Actuaries, appraisers, and others before the Internal Revenue Service. Circular 230 has been amended several times recently, and more changes are proposed. The IRS is currently revising Circular 230 to extend its application to cover unenrolled tax return preparers. This course reprints and discusses most, but not all, of Circular 230.
A. EXPLANATIONS OF PROVISIONS

Tax advisors play an increasingly important role in the federal tax system, which is founded on principles of voluntary compliance. The tax system is best served when the public has confidence in the honesty and integrity of the professionals providing tax advice. To restore, promote, and maintain the public’s confidence in those individuals and firms, Circular 230 sets forth regulations and best practices applicable to all tax advisors. Circular 230 regulations are limited to practice before the IRS and do not alter or supplant other ethical standards applicable to practitioners.

B. WHAT IS NOT CONSIDERED “PRACTICE BEFORE THE IRS”

Section 10.7 of Circular 230 provides a long list of exceptions and exclusions to Circular 230. The following persons and situations are not considered “practicing before the IRS” and therefore are generally exempt from the rules we will discuss later in this course.

(a) Representing oneself – individuals may appear on their own behalf before the IRS, provided they present satisfactory identification.

(b) Participating in rulemaking – individuals may participate in rule making.

(c) Limited practice –

(1) In general. Subject to the limitations in paragraph (c)(2) of this section, an individual who is not a practitioner may represent a taxpayer before the Internal Revenue Service in the circumstances described in this paragraph (c)(1), even if the taxpayer is not present, provided the individual presents satisfactory identification and proof of his or her authority to represent the taxpayer. The circumstances described in this paragraph (c)(1) are as follows:

(i) An individual may represent a member of his or her immediate family.

(ii) A regular full-time employee of an individual employer may represent the employer.

(iii) A general partner or regular full-time employee of a partnership may represent the partnership.

(iv) A bona fide officer or a regular full-time employee of a corporation, association, or organized group may represent the corporation, association, or organized group.

(v) A regular full-time employee of a trust, receivership, guardianship, or estate may represent the trust, receivership, guardianship, or estate.

(vi) An officer or a regular employee of a governmental unit, agency, or authority may represent the governmental unit, agency, or authority in the course of his or her official duties.
(vii) An individual may represent any individual or entity, who is outside the United States, before personnel of the Internal Revenue Service when such representation takes place outside the United States.

(2) Limitations.

(i) An individual who is under suspension or disbarment from practice before the Internal Revenue Service may not engage in limited practice before the Internal Revenue Service under paragraph (c)(1) of this section.

(ii) The Commissioner, or delegate, may, after notice and opportunity for a conference, deny eligibility to engage in limited practice before the Internal Revenue Service under paragraph (c)(1) of this section to any individual who has engaged in conduct that would justify a sanction under §10.50.

(iii) An individual who represents a taxpayer under the authority of paragraph (c)(1) of this section is subject, to the extent of his or her authority, to such rules of general applicability regarding standards of conduct and other matters as prescribed by the Internal Revenue Service.

(d) Special appearances. The Commissioner, or delegate, may, subject to conditions deemed appropriate, authorize an individual who is not otherwise eligible to practice before the Internal Revenue Service to represent another person in a particular matter.

(e) Fiduciaries. For purposes of this part, a fiduciary (for example, a trustee, receiver, guardian, personal representative, administrator, or executor) is considered to be the taxpayer and not a representative of the taxpayer.

(f) Effective/applicability date. This section is applicable beginning August 2, 2011.

Observation

None of the items above in (a)-(e) are considered to be practicing before the IRS.

Section 10.8 of Circular 230 discusses the application of Circular 230 on those that prepare tax returns and the application of the rules to other individuals as follows:

(a) Preparing all or substantially all of a tax return. Any individual who for compensation prepares or assists with the preparation of all or substantially all of a tax return or claim for refund must have a preparer tax identification number. Except as otherwise prescribed in forms, instructions, or other appropriate guidance, an individual must be an attorney, certified public accountant, enrolled agent, or registered tax return preparer to obtain a preparer tax identification number. Any individual who for compensation prepares or assists with the preparation of all or substantially all of a tax return or claim for refund must have a preparer tax identification number. Except as otherwise prescribed in forms, instructions, or other appropriate guidance, an individual must be an attorney, certified public accountant, enrolled agent, or registered tax return preparer to obtain a preparer tax identification number. 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refund is subject to the duties and restrictions relating to practice in subpart B, as well as subject to the
sanctions for violation of the regulations in subpart C.

(b) Preparing a tax return and furnishing information. Any individual may for compensation prepare or
assist with the preparation of a tax return or claim for refund (provided the individual prepares less than
substantially all of the tax return or claim for refund), appear as a witness for the taxpayer before the
Internal Revenue Service, or furnish information at the request of the Internal Revenue Service or any of
its officers or employees.

(c) Application of rules to other individuals. Any individual who for compensation prepares, or assists in
the preparation of, all or a substantial portion of a document pertaining to any taxpayer’s tax liability for
submission to the Internal Revenue Service is subject to the duties and restrictions relating to practice
in subpart B, as well as subject to the sanctions for violation of the regulations in subpart C. Unless
otherwise a practitioner, however, an individual may not for compensation prepare, or assist in the
preparation of, all or substantially all of a tax return or claim for refund, or sign tax returns and claims for
refund. For purposes of this paragraph, an individual described in 26 CFR 301.7701-15(f) is not treated
as having prepared all or a substantial portion of the document by reason of such assistance.

(d) Effective/applicability date. This section is applicable beginning August 2, 2011.

An EA who is practicing before the IRS and does not fall into one of the exception categories above is
subject to subpart B of Circular 230 – Duties and Restrictions relating to practice before the IRS. It is
reproduced below and should be read in its entirety.

C. CIRCULAR 230: SUBPART B -- DUTIES AND RESTRICTIONS RELATING TO PRACTICE
BEFORE THE INTERNAL REVENUE SERVICE

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SECTION 10.20 Information to be furnished.

(a) To the Internal Revenue Service.

(1) A practitioner must, on a proper and lawful request by a duly authorized officer or employee of the Internal Revenue Service, promptly submit records or information in any matter before the Internal Revenue Service unless the practitioner believes in good faith and on reasonable grounds that the records or information are privileged.

(2) Where the requested records or information are not in the possession of, or subject to the control of, the practitioner or the practitioner’s client, the practitioner must promptly notify the requesting Internal Revenue Service officer or employee and the practitioner must provide any information that the practitioner has regarding the identity of any person who the practitioner believes may have possession or control of the requested records or information. The practitioner must make reasonable inquiry of his or her client regarding the identity of any person who may have possession or control of the requested records or information, but the practitioner is not required to make inquiry of any other person or independently verify any information provided by the practitioner’s client regarding the identity of such persons.

Observation

The paragraph above should be read in light of the enacted accountant-client privilege.
Observation

Section 10.20 requires a practitioner to respond promptly to a proper and lawful request for records and information, unless the practitioner believes in good faith and on reasonable grounds that the records or information are privileged.

When a proper and lawful request is made by a duly authorized officer or employee of the Internal Revenue Service, concerning an inquiry into an alleged violation of the regulations in this part, a practitioner must provide any information the practitioner has concerning the alleged violation and testify regarding this information in any proceeding instituted under this part, unless the practitioner believes in good faith and on reasonable grounds that the information is privileged.

Observation

Sometimes referred to as “snitch laws,” these provisions require the cooperation of those practicing before the IRS. Failure to cooperate could result in the loss of the right to practice before the IRS.

NAEA Rule 1

Members and associates will adhere to all laws and regulations that provide equal opportunity for all clients and employees regardless of race, color, religion, gender, national origin, age, handicap, sexual orientation, or any other legally protected class.

(b) Interference with a proper and lawful request for records or information.

A practitioner may not interfere, or attempt to interfere, with any proper and lawful effort by the Internal Revenue Service, its officers or employees, to obtain any record or information unless the practitioner believes in good faith and on reasonable grounds that the record or information is privileged.

SECTION 10.21 Knowledge of client’s omission.

A practitioner who, having been retained by a client with respect to a matter administered by the Internal Revenue Service, knows that the client has not complied with the revenue laws of the United States or has made an error in or omission from any return, document, affidavit, or other paper which the client submitted or executed under the revenue laws of the United States, must advise the client promptly of the fact of such noncompliance, error, or omission. The practitioner must advise the client of the consequences as provided under the Code and regulations of such noncompliance, error, or omission.
NAEA Rule 16

Members and associates will advise a client, preferably in writing, if they suspect the client may not have complied with the revenue laws or may have made an error in, or omission from, a return, document, affidavit, or other paper the client is required by law to execute.

Note: The Circular 230 requirement is more restrictive than that of the NAEA in that under Circular 230 the practitioner must advise the client of the consequences of any noncompliance, error, or omission.

Observation

When you sign a tax return as a paid preparer, your signature is based not only on what is presented in the return but any item that you have knowledge of.

SECTION 10.22 Diligence as to accuracy.

(a) In general.

A practitioner must exercise due diligence:

(1) In preparing or assisting in the preparation of, approving, and filing tax returns, documents, affidavits, and other papers relating to Internal Revenue Service matters;

(2) In determining the correctness of oral or written representations made by the practitioner to the Department of the Treasury; and

(3) In determining the correctness of oral or written representations made by the practitioner to clients with reference to any matter administered by the Internal Revenue Service.

(b) Reliance on others.

Except as modified in §§10.34 and 10.37, a practitioner will be presumed to have exercised due diligence for purposes of this section if the practitioner relies on the work product of another person and the practitioner used reasonable care in engaging, supervising, training, and evaluating the person, taking proper account of the nature of the relationship between the practitioner and the person.

Practitioners who prepare Form 1040 must inquire of their clients with sufficient detail to prepare correct responses for the two questions at the bottom of Schedule B. Penalties of up to $10,000 can apply for a simple failure to file the required forms.

(c) Effective/applicability date. Paragraph (a) of this section is applicable on September 26, 2007. Paragraph (b) of this section is applicable June 12, 2014.

SECTION 10.23 Prompt disposition of pending matters.

A practitioner may not unreasonably delay the prompt disposition of any matter before the Internal Revenue Service.

Example

Nash, EA is representing a client under audit by the IRS. Nash believes all the factual matters of the audit could be resolved in 6-8 weeks. Nash learns that the auditor assigned to the audit is planning to retire in six months. Nash believes that if he could delay the audit by raising unreasonable objections until after the IRS agent retires, he could possibly get a better result from the new agent. Purposely delaying the conclusion of the audit until after the IRS agent retires would be a violation of Section 10.23.

Observation

The following two sections seek to ensure that all persons will be treated equally by the IRS and that none will receive preferential treatment.

SECTION 10.24 Assistance from disbarred or suspended persons and former Internal Revenue Service employees.

A practitioner may not, knowingly and directly or indirectly:

(a) Accept assistance from or assist any person who is under disbarment or suspension from practice before the Internal Revenue Service if the assistance relates to a matter or matters constituting practice before the Internal Revenue Service.
(b) Accept assistance from any former government employee where the provisions of §10.25 or any federal law would be violated.

### NAEA Rule 9

Members and associates will not knowingly, directly or indirectly, professionally associate with an individual who has been suspended or disbarred.

### SECTION 10.25  Practice by former Government employees, their partners and their associates.

(a) Definitions.

For purposes of this section:

1. Assist means to act in such a way as to advise, furnish information to, or otherwise aid another person, directly or indirectly.

2. Government employee is an officer or employee of the United States or any agency of the United States, including a special Government employee as defined in 18 U.S.C. 202(a), or of the District of Columbia, or of any State, or a member of Congress or of any State legislature.

3. Member of a firm is a sole practitioner or an employee or associate thereof, or a partner, stockholder, associate, affiliate or employee of a partnership, joint venture, corporation, professional association or other affiliation of two or more practitioners who represent nongovernmental parties.

4. Particular matter involving specific parties is defined at 5 CFR 2637.201(c), or superseding post-employment regulations issued by the U.S. Office of Government Ethics.

5. Rule includes Treasury regulations, whether issued or under preparation for issuance as notices of proposed rulemaking or as Treasury decisions, revenue rulings, and revenue procedures published in the Internal Revenue Bulletin (see 26 CFR 601.601(d)(2)(ii)(b)).

(b) General rules

1. No former Government employee may, subsequent to Government employment, represent anyone in any matter administered by the Internal Revenue Service if the representation would violate 18 U.S.C. 207 or any other laws of the United States.

2. No former Government employee who personally and substantially participated in a particular matter involving specific parties may, subsequent to Government employment, represent or knowingly assist, in that particular matter, any person who is or was a specific party to that particular matter.
(3) A former Government employee who within a period of one year prior to the termination of Government employment had official responsibility for a particular matter involving specific parties may not, within two years after Government employment is ended, represent in that particular matter any person who is or was a specific party to that particular matter.

(4) No former Government employee may, within one year after Government employment is ended, communicate with or appear before, with the intent to influence, any employee of the Treasury Department in connection with the publication, withdrawal, amendment, modification, or interpretation of a rule the development of which the former Government employee participated in, or for which, within a period of one year prior to the termination of Government employment, the former government employee had official responsibility. This paragraph (b)(4) does not, however, preclude any former employee from appearing on one’s own behalf or from representing a taxpayer before the Internal Revenue Service in connection with a particular matter involving specific parties involving the application or interpretation of a rule with respect to that particular matter, provided that the representation is otherwise consistent with the other provisions of this section and the former employee does not utilize or disclose any confidential information acquired by the former employee in the development of the rule.

(c) Firm representation.

(1) No member of a firm of which a former Government employee is a member may represent or knowingly assist a person who was or is a specific party in any particular matter with respect to which the restrictions of paragraph (b)(2) of this section apply to the former Government employee, in that particular matter, unless the firm isolates the former Government employee in such a way to ensure that the former Government employee cannot assist in the representation.

(2) When isolation of a former Government employee is required under paragraph (c) (1) of this section, a statement affirming the fact of such isolation must be executed under oath by the former Government employee and by another member of the firm acting on behalf of the firm. The statement must clearly identify the firm, the former Government employee, and the particular matter(s) requiring isolation. The statement must be retained by the firm and, upon request, provided to the office(s) of the Internal Revenue Service administering or enforcing this part.

(d) Pending representation. The provisions of this regulation will govern practice by former Government employees, their partners and associates with respect to representation in particular matters involving specific parties where actual representation commenced before the effective date of this regulation.

(e) Effective/applicability date. This section is applicable beginning August 2, 2011.
SECTION 10.26  Notaries.

A practitioner may not take acknowledgments, administer oaths, certify papers, or perform any official act as a notary public with respect to any matter administered by the Internal Revenue Service and for which he or she is employed as counsel, attorney, or agent, or in which he or she may be in any way interested.

Observation

Obviously, a notary may not be a party to the transaction, benefit from the transaction, or have a conflict of interest.

SECTION 10.27  Fees.

(a) In general.

A practitioner may not charge an unconscionable fee in connection with any matter before the Internal Revenue Service.

Observation

A practitioner may charge different rates depending upon the complexity of the issue.

(b) Contingent fees.

(1) Except as provided in paragraphs (b)(2), (3), and (4) of this section, a practitioner may not charge a contingent fee for services rendered in connection with any matter before the Internal Revenue Service.

(2) A practitioner may charge a contingent fee for services rendered in connection with the Service’s examination of, or challenge to—
(i) An original tax return; or

(ii) An amended return or claim for refund or credit where the amended return or claim for refund or credit was filed within 120 days of the taxpayer receiving a written notice of the examination of, or a written challenge to the original tax return

(3) A practitioner may charge a contingent fee for services rendered in connection with a claim for credit or refund filed solely in connection with the determination of statutory interest or penalties assessed by the Internal Revenue Service.

(4) A practitioner may charge a contingent fee for services rendered in connection with any judicial proceeding arising under the Internal Revenue Code.

(c) Definitions. For purposes of this section—

(1) Contingent fee is any fee that is based, in whole or in part, on whether or not a position taken on a tax return or other filing avoids challenge by the Internal Revenue Service or is sustained either by the Internal Revenue Service or in litigation. A contingent fee includes a fee that is based on a percentage of the refund reported on a return, that is based on a percentage of the taxes saved, or that otherwise depends on the specific result attained. A contingent fee also includes any fee arrangement in which the practitioner will reimburse the client for all or a portion of the client’s fee in the event that a position taken on a tax return or other filing is challenged by the Internal Revenue Service or is not sustained, whether pursuant to an indemnity agreement, a guarantee, rescission rights, or any other arrangement with a similar effect.

(2) Matter before the Internal Revenue Service includes tax planning and advice, preparing or filing or assisting in preparing or filing returns or claims for refund or credit, and all matters connected with a presentation to the Internal Revenue Service or any of its officers or employees relating to a taxpayer’s rights, privileges, or liabilities under laws or regulations administered by the Internal Revenue Service. Such presentations include, but are not limited to, preparing and filing documents, corresponding and communicating with the Internal Revenue Service, rendering written advice with respect to any entity, transaction, plan or arrangement, and representing a client at conferences, hearings, and meetings.

(d) Effective/applicability date. This section is applicable for fee arrangements entered into after March 26, 2008.

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<td>Tax preparation or representation services will be offered as authorized by the most current provisions of Circular 230.</td>
</tr>
</tbody>
</table>
(a) In general, a practitioner must, at the request of a client, promptly return any and all records of the client that are necessary for the client to comply with his or her federal tax obligations. The practitioner may retain copies of the records returned to a client. The existence of a dispute over fees generally does not relieve the practitioner of his or her responsibility under this section. Nevertheless, if applicable state law allows or permits the retention of a client’s records by a practitioner in the case of a dispute over fees for services rendered, the practitioner need only return those records that must be attached to the taxpayer’s return. The practitioner, however, must provide the client with reasonable access to review and copy any additional records of the client retained by the practitioner under state law that are necessary for the client to comply with his or her federal tax obligations.

**Observation**

The records that must be returned are limited to those records necessary for the client to comply with his or her federal tax obligations. This rule does not apply to other records the practitioner may have.

(b) For purposes of this section – Records of the client include all documents or written or electronic materials provided to the practitioner, or obtained by the practitioner in the course of the practitioner’s representation of the client, that preexisted the retention of the practitioner by the client. The term also includes materials that were prepared by the client or a third party (not including an employee or agent of the practitioner) at any time and provided to the practitioner with respect to the subject matter of the representation. The term also includes any return, claim for refund, schedule, affidavit, appraisal or any other document prepared by the practitioner, or his or her employee or agent, that was presented to the client with respect to a prior representation if such document is necessary for the taxpayer to comply with his or her current federal tax obligations. The term does not include any return, claim for refund, schedule, affidavit, appraisal or any other document prepared by the practitioner or the practitioner’s firm, employees or agents if the practitioner is withholding such document pending the client’s performance of its contractual obligation to pay fees with respect to such document.

**Observation**

A practitioner may withhold the client’s current year completed tax return pending payment of fees.
SECTION 10.29  Conflicting interests.

(a) Except as provided by paragraph (b) of this section, a practitioner shall not represent a client before the Internal Revenue Service if the representation involves a conflict of interest. A conflict of interest exists if:

(1) The representation of one client will be directly adverse to another client; or

(2) There is a significant risk that the representation of one or more clients will be materially limited by the practitioner’s responsibilities to another client, a former client or a third person or by a personal interest of the practitioner.

(b) Notwithstanding the existence of a conflict of interest under paragraph (a) of this section, the practitioner may represent a client if:

(1) The practitioner reasonably believes that the practitioner will be able to provide competent and diligent representation to each affected client;

(2) The representation is not prohibited by law;

(3) Each affected client waives the conflict of interest and gives informed consent, confirmed in writing by each affected client, at the time the existence of the conflict of interest is known by the practitioner. The confirmation may be made within a reasonable period after the informed consent, but in no event later than 30 days.

(c) Copies of the written consents must be retained by the practitioner for at least 36 months from the date of the conclusion of the representation of the affected clients and the written consents must be provided to any officer or employee of the Internal Revenue Service on request.

(d) Effective/applicability date. This section is applicable on September 26, 2007.

Practice Pointer

Consents must be in writing and must be retained for at least 36 months after the conclusion of the engagement.
NAEA Rule 5
Members and associates will not represent conflicting interests without express written consent of all parties after full disclosure.

NAEA Rule 11
Members and associates who are engaged simultaneously in another occupation will conduct themselves in such a manner that no conflict of interest exists when rendering professional tax service or professional advice. No member or associate will accept or pay a commission for the sale or referral of products or services to a client unless they are properly licensed and all facts are fully disclosed in writing to the client. No member or associate will pay a commission or referral fee to an employee for the sale or referral of products or services to a client unless the employee is properly licensed and the facts are fully disclosed in writing to the client.

SECTION 10.30 Solicitation.

(a) Advertising and solicitation restrictions.

(1) A practitioner may not, with respect to any Internal Revenue Service matter, in any way use or participate in the use of any form of public communication or private solicitation containing a false, fraudulent, or coercive statement or claim; or a misleading or deceptive statement or claim. Enrolled agents or enrolled retirement plan agents, in describing their professional designation, may not utilize the term of art “certified” or imply an employer/employee relationship with the Internal Revenue Service. Examples of acceptable descriptions for enrolled agents are “enrolled to represent taxpayers before the Internal Revenue Service,” “enrolled to practice before the Internal Revenue Service,” and “admitted to practice before the Internal Revenue Service.” Similarly, examples of acceptable descriptions for enrolled retirement plan agents are “enrolled to represent taxpayers before the Internal Revenue Service as a retirement plan agent” and “enrolled to practice before the Internal Revenue Service as a retirement plan agent.” An example of an acceptance description for registered tax return preparers is “designated as a registered tax return preparer by the Internal Revenue Service.”

NAEA Rule 15
Members and associates will not suggest or give the impression they can obtain special consideration from governmental agencies or their representatives because of prior IRS employment.
NAEA Rule 12

Members and associates will not solicit clients in any manner prohibited by the most current provisions of Circular 230, including advertising or other forms of solicitation that present a false, misleading, or deceptive appearance.

(2) A practitioner may not make, directly or indirectly, an uninvited written or oral solicitation of employment in matters related to the Internal Revenue Service if the solicitation violates Federal or State law or other applicable rule, e.g., attorneys are precluded from making a solicitation that is prohibited by conduct rules applicable to all attorneys in their State(s) of licensure. Any lawful solicitation made by or on behalf of a practitioner eligible to practice before the Internal Revenue Service must, nevertheless, clearly identify the solicitation as such and, if applicable, identify the source of the information used in choosing the recipient.

(b) Fee information.

(1)(i) A practitioner may publish the availability of a written schedule of fees and disseminate the following fee information:

(A) Fixed fees for specific routine services.

(B) Hourly rates.

(C) Range of fees for particular services.

(D) Fee charged for an initial consultation.

(ii) Any statement of fee information concerning matters in which costs may be incurred must include a statement disclosing whether clients will be responsible for such costs.

Practice Pointer

When practitioners send their clients annual income tax organizers, it is appropriate to include an engagement letter. The engagement letter should specify the responsibilities of both the practitioner and client as well as the responsibility for fees and costs.

(2) A practitioner may charge no more than the rate(s) published under paragraph (b)(1) of this section for at least 30 calendar days after the last date on which the schedule of fees was published.
(c) Communication of fee information.

Fee information may be communicated in professional lists, telephone directories, print media, mailings, electronic mail, facsimile, hand delivered flyers, radio, television, and any other method. The method chosen, however, must not cause the communication to become untruthful, deceptive, or otherwise in violation of this part. A practitioner may not persist in attempting to contact a prospective client if the prospective client has made it known to the practitioner that he or she does not desire to be solicited. In the case of radio and television broadcasting, the broadcast must be recorded and the practitioner must retain a recording of the actual transmission. In the case of direct mail and e-commerce communications, the practitioner must retain a copy of the actual communication, along with a list or other description of persons to whom the communication was mailed or otherwise distributed. The copy must be retained by the practitioner for a period of at least 36 months from the date of the last transmission or use.

<table>
<thead>
<tr>
<th>Practice Pointer</th>
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<tr>
<td>Practitioners must keep a copy of all mailers for at least 36 months.</td>
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</table>

(d) Improper associations.

A practitioner may not, in matters related to the Internal Revenue Service, assist, or accept assistance from, any person or entity who, to the knowledge of the practitioner, obtains clients or otherwise practices in a manner forbidden under this section.

(e) Effective/applicability date. This section is applicable beginning August 2, 2011.

SECTION 10.31 Negotiation of taxpayer checks.

(a) A practitioner may not endorse or otherwise negotiate any check (including 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) issued to a client by the government in respect of a Federal tax liability.

(b) Effective/applicability date. This section is applicable beginning June 12, 2014.

<table>
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<tr>
<th>Observation</th>
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<tr>
<td>The prohibition on negotiating taxpayer refund checks applies to all persons representing the taxpayer, not just the tax return preparer. The rule was modified to include the current practice of direct deposit as opposed to only applying to the endorsement of a physical check.</td>
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</tbody>
</table>
Example 1

Bob and John own a used car dealership that advertises “No car over $6,000” and “We finance anyone.” One technique Bob and John have used for many years is to use a customer’s tax refund as the down payment or even the bulk of the payment on a car purchase and loan. Bob offers to prepare a customer’s tax return at no cost if the refund is used towards the purchase of a qualified car. Most of the returns Bob prepares claim a large earned income credit. In order to ensure payment for the car, Bob directs the customer’s refund to be sent via direct deposit to the dealership’s business checking account that John oversees.

Although, you can probably spot numerous potential ethical issues in this scenario, the updated rule on negotiating tax refund checks would prohibit the direct deposit of the client’s tax refund into the car dealer/tax preparer’s bank account.

Example 2

Bill is representing a client before the IRS for the audit of a prior year tax return. Bill did not prepare the original tax return. The audit results in a refund as the original return omitted a large tax credit. Bill wants to ensure that he gets paid for all the time representing the client. Under the old Section 10.31, Bill could have argued that the prohibition on endorsing refund checks did not apply to him since he did not prepare the original tax return. The revised rule clarifies that Bill may not negotiate the client’s refund check.

Practice Pointer

By completing Form 2848 “Power of Attorney and Declaration of Representative,” a taxpayer may authorize their representative to receive refund checks. However, even the power of attorney specifically forbids the representative from endorsing refund checks.

SECTION 10.32 Practice of law.

Nothing in the regulations in this part may be construed as authorizing persons not members of the bar to practice law.

SECTION 10.33 Best practices for tax advisors.

(a) Best practices. Tax advisors should provide clients with the highest quality representation concerning federal tax issues by adhering to best practices in providing advice and in preparing or assisting in
the preparation of a submission to the Internal Revenue Service. In addition to compliance with the standards of practice provided elsewhere in this part, best practices include the following:

(1) Communicating clearly with the client regarding the terms of the engagement. For example, the advisor should determine the client's expected purpose for and use of the advice and should have a clear understanding with the client regarding the form and scope of the advice or assistance to be rendered.

(2) Establishing the facts, determining which facts are relevant, and evaluating the reasonableness of any assumptions or representations, relating the applicable law (including potentially applicable judicial doctrines) to the relevant facts, and arriving at a conclusion supported by the law and the facts.

(3) Advising the client regarding the import of the conclusions reached, including, for example, whether a taxpayer may avoid accuracy-related penalties under the Internal Revenue Code if a taxpayer acts in reliance on the advice.

(4) Acting fairly and with integrity in practice before the Internal Revenue Service.

(b) Procedures to ensure best practices for tax advisors. Tax advisors with responsibility for overseeing a firm's practice of providing advice concerning federal tax issues or of preparing or assisting in the preparation of submissions to the Internal Revenue Service should take reasonable steps to ensure that the firm's procedures for all members, associates, and employees are consistent with the best practices set forth in paragraph (a) of this section.

(c) Applicability date. This section is effective after June 20, 2005.

SECTION 10.34 Standards with respect to tax returns and documents, affidavits and other papers.

(a) Tax returns.

(1) A practitioner may not willfully, recklessly, or through gross incompetence —

(i) Sign a tax return or claim for refund that the practitioner knows or reasonably should know contains a position that —

(A) Lacks a reasonable basis;

(B) Is an unreasonable position as described in Section 6694(a)(2) of the Internal Revenue Code (Code) (including the related regulations and other published guidance); or

(C) Is a willful attempt by the practitioner to understate the liability for tax or a reckless or intentional disregard of rules or regulations by the practitioner as described in Section 6694(b)(2) of the Code (including the related regulations and other published guidance).
(ii) 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 as described in Section 6694(a)(2) of the Code (including the related regulations and other published guidance); or

(C) Is a willful attempt by the practitioner to understate the liability for tax or a reckless or intentional disregard of rules or regulations by the practitioner as described in Section 6694(b)(2) of the Code (including the related regulations and other published guidance).

(2) A pattern of conduct is a factor that will be taken into account in determining whether a practitioner acted willfully, recklessly, or through gross incompetence.

(b) Documents, affidavits and other papers

(1) A practitioner may not advise a client to take a position on a document, affidavit or other paper submitted to the Internal Revenue Service unless the position is not frivolous.

(2) A practitioner may not advise a client to submit a document, affidavit or other paper to the Internal Revenue Service

(i) The purpose of which is to delay or impede the administration of the federal tax laws;

(ii) That is frivolous; or

(iii) That contains or omits information in a manner that demonstrates an intentional disregard of a rule or regulation unless the practitioner also advises the client to submit a document that evidences a good faith challenge to the rule or regulation.

(c) Advising clients on potential penalties.

(1) A practitioner must inform a client of any penalties that are reasonably likely to apply to the client with respect to

(i) A position taken on a tax return if—

(A) The practitioner advised the client with respect to the position; or

(B) The practitioner prepared or signed the tax return; and

(ii) Any document, affidavit or other paper submitted to the Internal Revenue Service.
(2) The practitioner also must inform the client of any opportunity to avoid any such penalties by disclosure, if relevant, and of the requirements for adequate disclosure.

(3) This paragraph (c) applies even if the practitioner is not subject to a penalty under the Internal Revenue Code with respect to the position or with respect to the document, affidavit or other paper submitted.

(d) Relying on information furnished by clients. A practitioner advising a client to take a position on a tax return, document, affidavit or other paper submitted to the Internal Revenue Service, or preparing or signing a tax return as a preparer, generally may rely in good faith without verification upon information furnished by the client. The practitioner may not, however, ignore the implications of information furnished to, or actually known by, the practitioner, and must make reasonable inquiries if the information as furnished appears to be incorrect, inconsistent with an important fact or another factual assumption, or incomplete.

(e) Effective/applicability date. Paragraph (a) of this section is applicable for returns or claims for refund filed or advice provided beginning August 2, 2011. Paragraphs (b) through (d) of this section are applicable to tax returns, documents, affidavits and other papers filed on or after September 26, 2007.

### NAEA Rule 8

Members and associates will take a position on a tax return favorable to their clients only if there is substantial authority that the position will be sustained on its merits, unless the position is disclosed and there is at least a reasonable basis for it. If applicable law is unsettled, or the application of law to the facts in a given situation is uncertain, members and associates must explain the probable effects of various alternatives to their clients who must make the final decision as to the position taken.

### SECTION 10.35 Competence.

(a) 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.

(b) Effective/applicability date. This section is applicable beginning June 12, 2014.

### Observation

Whether consultation and/or research are adequate to make a practitioner competent in a particular situation depends on the facts and circumstances of the particular situation.
SECTION 10.36  Procedures to ensure compliance.

(a) Any individual subject to the provisions of this part who has (or individuals who have or share) principal authority and responsibility for overseeing a firm's practice governed by this part, including the provision of advice concerning Federal tax matters and preparation of tax returns, claims for refund, or other documents for submission to the Internal Revenue Service, must take reasonable steps to ensure that the firm has adequate procedures in effect for all members, associates, and employees for purposes of complying with subparts A, B, and C of this part, as applicable. In the absence of a person or persons identified by the firm as having the principal authority and responsibility described in this paragraph, the Internal Revenue Service may identify one or more individuals subject to the provisions of this part responsible for compliance with the requirements of this section.

(b) Any such individual who has (or such individuals who have or share) principal authority as described in paragraph (a) of this section will be subject to discipline for failing to comply with the requirements of this section if--

(1) The individual through willfulness, recklessness, or gross incompetence does not take reasonable steps to ensure that the firm has adequate procedures to comply with this part, as applicable, and one or more individuals who are members of, associated with, or employed by, the firm are, or have, engaged in a pattern or practice, in connection with their practice with the firm, of failing to comply with this part, as applicable;

(2) The individual through willfulness, recklessness, or gross incompetence does not take reasonable steps to ensure that firm procedures in effect are properly followed, and one or more individuals who are members of, associated with, or employed by, the firm are, or have, engaged in a pattern or practice, in connection with their practice with the firm, of failing to comply with this part, as applicable; or

(3) The individual knows or should know that one or more individuals who are members of, associated with, or employed by, the firm are, or have, engaged in a pattern or practice, in connection with their practice with the firm, that does not comply with this part, as applicable, and the individual, through willfulness, recklessness, or gross incompetence fails to take prompt action to correct the noncompliance.

(c) Effective/applicability date. This section is applicable beginning June 12, 2014.
Observation

This provision is important for a number of reasons. First, it places the first layer of responsibility on the firm as part of a “self-regulatory” environment. Second, it puts certain individuals on notice that they could be subject to individual disciplinary actions based on the actions of others in the firm. The individual will be responsible to ensure:

1. The firm has procedures in place to ensure compliance with Circular 230;
2. The firm follows the requisite procedures; and
3. Individuals in the firm do not engage in a pattern and practice of disregarding the provisions of Circular 230.

In essence, the IRS is making certain individuals at the firm into enforcers.

SECTION 10.37 Requirements for written advice.

(a) Requirements. (1) A practitioner may give written advice (including by means of electronic communication) concerning one or more Federal tax matters subject to the requirements in paragraph (a)(2) of this section. Government submissions on matters of general policy are not considered written advice on a Federal tax matter for purposes of this section. Continuing education presentations provided to an audience solely for the purpose of enhancing practitioners’ professional knowledge on Federal tax matters are not considered written advice on a Federal tax matter for purposes of this section. The preceding sentence does not apply to presentations marketing or promoting transactions.

(2) The practitioner must--

(i) Base the written advice on reasonable factual and legal assumptions (including assumptions as to future events);
(ii) Reasonably consider all relevant facts and circumstances that the practitioner knows or reasonably should know;
(iii) Use reasonable efforts to identify and ascertain the facts relevant to written advice on each Federal tax matter;
(iv) Not rely upon representations, statements, findings, or agreements (including projections, financial forecasts, or appraisals) of the taxpayer or any other person if reliance on them would be unreasonable;
(v) Relate applicable law and authorities to facts; and
(vi) Not, in evaluating a Federal tax matter, take into account the possibility that a tax return will not be audited or that a matter will not be raised on audit.
(3) Reliance on representations, statements, findings, or agreements is unreasonable if the practitioner knows or reasonably should know that one or more representations or assumptions on which any representation is based are incorrect, incomplete, or inconsistent.

(b) Reliance on advice of others. A practitioner may only rely on the advice of another person if the advice was reasonable and the reliance is in good faith considering all the facts and circumstances. Reliance is not reasonable when—

(1) The practitioner knows or reasonably should know that the opinion of the other person should not be relied on;

(2) The practitioner knows or reasonably should know that the other person is not competent or lacks the necessary qualifications to provide the advice; or

(3) The practitioner knows or reasonably should know that the other person has a conflict of interest in violation of the rules described in this part.

(c) Standard of review. (1) In evaluating whether a practitioner giving written advice concerning one or more Federal tax matters complied with the requirements of this section, the Commissioner, or delegate, will apply a reasonable practitioner standard, considering all facts and circumstances, including, but not limited to, the scope of the engagement and the type and specificity of the advice sought by the client.

(2) In the case of an opinion the practitioner knows or has reason to know will be used or referred to by a person other than the practitioner (or a person who is a member of, associated with, or employed by the practitioner’s firm) in promoting, marketing, or recommending to one or more taxpayers a partnership or other entity, investment plan or arrangement a significant purpose of which is the avoidance or evasion of any tax imposed by the Internal Revenue Code, the Commissioner, or delegate, will apply a reasonable practitioner standard, considering all facts and circumstances, with emphasis given to the additional risk caused by the practitioner’s lack of knowledge of the taxpayer’s particular circumstances, when determining whether a practitioner has failed to comply with this section.

(d) Federal tax matter. A Federal tax matter, as used in this section, is any matter concerning the application or interpretation of—

(1) A revenue provision as defined in Section 6110(i)(1)(B) of the Internal Revenue Code;

(2) Any provision of law impacting a person’s obligations under the internal revenue laws and regulations, including but not limited to the person’s liability to pay tax or obligation to file returns; or

(3) Any other law or regulation administered by the Internal Revenue Service.

(e) Effective/applicability date. This section is applicable to written advice rendered after June 12, 2014.
Observations

#1 - The new rule relies on much more of a “facts and circumstances” approach.

#2 - The new rule no longer requires written advice to describe any particular piece of information or analysis. However, the IRS encourages practitioners to describe all relevant facts, law, analysis, and assumptions in appropriate circumstances. The determination of whether a practitioner complied with this rule will be based on all facts and circumstances, including whether it was appropriate to describe all relevant facts, law, analysis, and assumptions in a piece of written tax advice.

Goodbye Circular 230 Disclaimers

Many practitioners currently use a Circular 230 disclaimer at the conclusion of every email to remove the communication from the covered opinion rules in former §10.35. This disclaimer was included whether or not the email contained any tax advice. The removal of former §10.35 eliminates the detailed provisions concerning covered opinions and disclosures in written opinions. Because the new §10.37 does not include a disclosure provision, the Circular 230 disclaimer is simply not needed.

SECTION 10.38 Establishment of Advisory Committees.

(a) Advisory committees.

To promote and maintain the public’s confidence in tax advisors, the Internal Revenue Service is authorized to establish one or more advisory committees composed of at least five individuals authorized to practice before the Internal Revenue Service. Membership of an advisory committee must be balanced among those who practice as attorneys, accountants, enrolled agents, enrolled actuaries, enrolled retirement plan agents, and registered tax return preparers. Under procedures prescribed by the Internal Revenue Service, an advisory committee may review and make general recommendations regarding the practices, procedures, and policies of the offices described in §10.1.

(b) Effective date.

This section is applicable beginning August 2, 2011.

D. CIRCULAR 230: SUBPART C – SANCTIONS FOR VIOLATION OF THE REGULATIONS

Table of Contents (this subpart)

10.50 Sanctions

10.51 Incompetence and disreputable conduct
10.52 Violations subject to sanction

10.53 Receipt of information concerning practitioner

SECTION 10.50 Sanctions.

(a) Authority to censure, suspend, or disbar.

The Secretary of the Treasury, or delegate, after notice and an opportunity for a proceeding, may censure, suspend or disbar any practitioner from practice before the Internal Revenue Service if the practitioner is shown to be incompetent or disreputable (within the meaning of Sec. 10.51), fails to comply with any regulation in this part (under the prohibited conduct standards of Sec. 10.52), or with intent to defraud, willfully and knowingly misleads or threatens a client or prospective client. Censure is a public reprimand.

(b) Authority to disqualify.

The Secretary of the Treasury, or delegate, after due notice and opportunity for hearing, may disqualify any appraiser for a violation of these rules as applicable to appraisers.

(1) If any appraiser is disqualified pursuant to this subpart C, the appraiser is barred from presenting evidence or testimony in any administrative proceeding before the Department of Treasury or the Internal Revenue Service, unless and until authorized to do so by the Internal Revenue Service pursuant to §10.81, regardless of whether the evidence or testimony would pertain to an appraisal made prior to or after the effective date of disqualification.

(2) Any appraisal made by a disqualified appraiser after the effective date of disqualification will not have any probative effect in any administrative proceeding before the Department of the Treasury or the Internal Revenue Service. An appraisal otherwise barred from admission into evidence pursuant to this section may be admitted into evidence solely for the purpose of determining the taxpayer’s reliance in good faith on such appraisal.

(c) Authority to impose monetary penalty

(1) In general

(i) The Secretary of the Treasury, or delegate, after notice and an opportunity for a proceeding, may impose a monetary penalty on any practitioner who engages in conduct subject to sanction under paragraph (a) of this section.

Observation

The new regulations add “censure” as a possible sanction.
(ii) If the practitioner described in paragraph (c)(1)(i) of this section was acting on behalf of an employer or any firm or other entity in connection with the conduct giving rise to the penalty, the Secretary of the Treasury, or delegate, may impose a monetary penalty on the employer, firm, or entity if it knew, or reasonably should have known, of such conduct.

(2) Amount of penalty. The amount of the penalty shall not exceed the gross income derived (or to be derived) from the conduct giving rise to the penalty.

(3) Coordination with other sanctions. Subject to paragraph (c)(2) of this section

(i) Any monetary penalty imposed on a practitioner under this paragraph (c) may be in addition to or in lieu of any suspension, disbarment or censure and may be in addition to a penalty imposed on an employer, firm or other entity under paragraph (c)(1)(ii) of this section.

(ii) Any monetary penalty imposed on an employer, firm or other entity may be in addition to or in lieu of penalties imposed under paragraph (c)(1)(i) of this section.

(d) Authority to accept a practitioner’s consent to sanction. The Internal Revenue Service may accept a practitioner’s office of consent to be sanctioned under §10.50 in lieu of instituting or continuing a proceeding under §10.60(a).

(e) Sanctions to be imposed. The sanctions imposed by this section shall take into account all relevant facts and circumstances.

(f) Effective/applicability date. This section is applicable to conduct occurring on or after August 2, 2011, except that paragraphs (a), (b)(2), and (e) apply to conduct occurring on or after September 26, 2007, and paragraph (c) applies to prohibited conduct that occurs after October 22, 2004.

SECTION 10.51 Incompetence and disreputable conduct.

(a) Incompetence and disreputable conduct. Incompetence and disreputable conduct for which a practitioner may be sanctioned under §10.50 includes, but is not limited to--

(1) Conviction of any criminal offense under the Federal tax laws.

(2) Conviction of any criminal offense involving dishonesty or breach of trust.

(3) Conviction of any felony under Federal or State law for which the conduct involved renders the practitioner unfit to practice before the Internal Revenue Service.

(4) Giving false or misleading information, or participating in any way in the giving of false or misleading information to the Department of the Treasury or any officer or employee thereof, or to any tribunal authorized to pass upon Federal tax matters, in connection with any matter pending or likely to be pending before them, knowing the information to be false or misleading. Facts or other matters contained in testimony, Federal tax
returns, financial statements, applications for enrollment, affidavits, declarations, and any other document or statement, written or oral, are included in the term “information.”

(5) Solicitation of employment as prohibited under §10.30, the use of false or misleading representations with intent to deceive a client or prospective client in order to procure employment, or intimating that the practitioner is able improperly to obtain special consideration or action from the Internal Revenue Service or any officer or employee thereof.

(6) Willfully failing to make a Federal tax return in violation of the Federal tax laws, or willfully evading, attempting to evade, or participating in any way in evading or attempting to evade any assessment or payment of any Federal tax.

**Observation**

In an article published in the NAEA Journal, then OPR Director Brien Downing stated that the service actively pursues cases of EA non filing.

(7) Willfully assisting, counseling, encouraging a client or prospective client in violating, or suggesting to a client or prospective client to violate, any Federal tax law, or knowingly counseling or suggesting to a client or prospective client an illegal plan to evade Federal taxes or payment thereof.

(8) Misappropriation of, or failure properly or promptly to remit, funds received from a client for the purpose of payment of taxes or other obligations due the United States.

(9) Directly or indirectly attempting to influence, or offering or agreeing to attempt to influence, the official action of any officer or employee of the Internal Revenue Service by the use of threats, false accusations, duress or coercion, by the offer of any special inducement or promise of an advantage, or by the bestowing of any gift, favor or thing of value.

(10) Disbarment or suspension from practice as an attorney, certified public accountant, public accountant or actuary by any duly constituted authority of any State, territory, or possession of the United States, including a Commonwealth, or the District of Columbia, any Federal court of record or any Federal agency, body or board.

(11) Knowingly aiding and abetting another person to practice before the Internal Revenue Service during a period of suspension, disbarment or ineligibility of such other person.

(12) Contemptuous conduct in connection with practice before the Internal Revenue Service, including the use of abusive language, making false accusations or statements,
knowing them to be false or circulating or publishing malicious or libelous matter.

(13) Giving a false opinion, knowingly, recklessly, or through gross incompetence, including an opinion which is intentionally or recklessly misleading, or engaging in a pattern of providing incompetent opinions on questions arising under the Federal tax laws. False opinions described in this paragraph (a)(13) include those which reflect or result from a knowing misstatement of fact or law, from an assertion of a position known to be unwarranted under existing law, from counseling or assisting in conduct known to be illegal or fraudulent, from concealing matters required by law to be revealed, or from consciously disregarding information indicating that material facts expressed in the opinion or offering material are false or misleading. For purposes of this paragraph (a)(13), reckless conduct is a highly unreasonable omission or misrepresentation involving an extreme departure from the standards of ordinary care that a practitioner should observe under the circumstances. A pattern of conduct is a factor that will be taken into account in determining whether a practitioner acted knowingly, recklessly, or through gross incompetence. Gross incompetence includes conduct that reflects gross indifference, preparation which is grossly inadequate under the circumstances, and a consistent failure to perform obligations to the client.

<table>
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<th>NAEA Rule 13</th>
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<tr>
<td>Members and associates will undertake only those tax matters which the member or associate, or the member’s or associate’s firm, can reasonably expect to complete with professional competence. Members and associates will obtain sufficient relevant data to provide a reasonable basis for conclusions or recommendations as required to complete the task.</td>
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<th>NAEA Rule 14</th>
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<td>Members and associates should be considerate and courteous in dealing with representatives of governmental agencies. In practice, members and associates are required to provide all information required by a statute or regulations when formally requested by the authorized governmental agency.</td>
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</table>

(14) Willfully failing to sign a tax return prepared by the practitioner when the practitioner’s signature is required by the Federal tax laws unless the failure is due to reasonable cause and not due to willful neglect.

(15) Willfully disclosing or otherwise using a tax return or tax return information in a manner not authorized by the Internal Revenue Code, contrary to the order of a court of competent jurisdiction, or contrary to the order of an administrative law judge in a proceeding instituted under §10.60.
(16) Willfully failing to file on magnetic or other electronic media a tax return prepared by the practitioner when the practitioner is required to do so by the Federal tax laws unless the failure is due to reasonable cause and not due to willful neglect.

(17) Willfully preparing all or substantially all of, or signing, a tax return or claim for refund when the practitioner does not possess a current or otherwise valid preparer tax identification number or other prescribed identifying number.

(18) Willfully representing a taxpayer before an officer or employee of the Internal Revenue Service unless the practitioner is authorized to do so pursuant to this part.

(b) Effective/applicability date. This section is applicable beginning August 2, 2011.

**DISREPUTABLE CONDUCT**

The following are actual examples of disreputable conduct taken from IRS disciplinary cases:

- Failure to file a U.S. individual income tax return for the tax years 2001 through 2006.
- Preparing 2013 tax returns without a Preparer Tax Identification Number (PTIN).
- Failure to respond to a June 27, 2012 Request for Information.
- Respondent used a contingent fee structure based upon the expected income tax refunds for client returns prepared using the Form 2555 Position.
- Respondent charged unconscionable fees for preparation of tax returns using the Form 2555 Position.
- Respondent represented as facts to IRS Criminal Agents items that he knew to be false.
- Respondent threatened lawsuits for damages, and lawsuits against IRS employees, personally, for unauthorized collection actions that Respondent alleged would be avoided if the IRS accepted the taxpayer’s settlement offer to pay 20% of the assessed tax.
- Respondent signed, and submitted to the IRS, a Power of Attorney (“Form 2848”) for taxpayer clients that listed both the Respondent and an unenrolled individual as the two representatives.
- Respondent obstructed the IRS examination and collection activities for clients whose returns were prepared with the Form 2555 Position.
- Respondent sold and implemented a number of tax shelters and executed a number of tax opinion letters on behalf of respondent’s firm, which contributed to the failure of providing the respondent’s clients with competent tax guidance.
- Between 2002 and 2009, respondent committed 5 counts of bank fraud and 3 counts of mail fraud for over $2 million.
Case Study: Disreputable Conduct

While employed, EA prepared 17 income tax returns for clients who were not clients of the employer. EA used the employer's tax return preparation software and computer equipment to prepare these tax returns. EA did not remove the employer's name from the paid preparer section of the tax returns prior to issuing these tax returns to clients. EA billed the clients using invoices with EA's name only and kept the fees received for these services.

EA believed that these clients knew the employer was not responsible for the tax returns even though the employer's name was displayed in the paid preparer section of the tax return.

Practice Pointer: Revised Regulations on Releasing Taxpayer Information

In 2008, the IRS released revised regulations concerning taxpayer privacy and the release of taxpayer information with an effective date of January 1, 2009. In 2013, Revenue Procedure 2013-14 was released, supplementing the regulations and providing additional guidance to tax return preparers regarding the form and content of taxpayer consents to disclose and consents to use tax return information, effective as of January 14, 2013. The effective date was extended to January 1, 2014 by Revenue Procedure 2013-19.

In general terms, a taxpayer's consent to each separate disclosure or separate use of tax return information must be contained on a separate written document, which can be furnished on paper or electronically. The consent may be included as an attachment to an engagement letter.

SECTION 10.52 Violation subject to sanction.

(a) A practitioner may be sanctioned under Sec. 10.50 if the practitioner

(1) Willfully violates any of the regulations (other than §10.33) contained in this part; or

(2) Recklessly or through gross incompetence (within the meaning of §10.51(a)(13)) violates §§10.34, 10.35, 10.36 or 10.37.

(b) Effective/applicability date. This section is applicable to conduct occurring on or after September 26, 2007.

SECTION 10.53 Receipt of information concerning practitioner.

(a) Officer or employee of the Internal Revenue Service.

If an officer or employee of the Internal Revenue Service has reason to believe that a practitioner has violated any provision of this part, the officer or employee will promptly make a written report of the
suspected violation. The report will explain the facts and reasons upon which the officer’s or employee’s belief rests, and must be submitted to the office(s) of the Internal Revenue Service responsible for administering or enforcing this part.

Practice Pointer

Be very careful what you say and do when meeting with IRS personnel. As detailed above, IRS employees are required to report any violation by a practitioner.

(b) Other persons.

Any person other than an officer or employee of the Internal Revenue Service having information of a violation of any provision of this part may make an oral or written report of the alleged violation to the office(s) of the Internal Revenue Service responsible for administering or enforcing this part or any officer or employee of the Internal Revenue Service. If the report is made to an officer or employee of the Internal Revenue Service, the officer or employee will make a written report of the suspected violation, and submit the report to the office(s) of the Internal Revenue Service responsible for administering or enforcing this part.

(c) Destruction of report.

No report made under paragraph (a) or (b) of this section shall be maintained unless retention of such record is permissible under the applicable records control schedule as approved by the National Archives and Records Administration and designated in the Internal Revenue Manual. Reports must be destroyed as soon as permissible under the applicable records control schedule.

(d) Effect on proceedings under subpart D.

The destruction of any report will not bar any proceeding under subpart D of this part, but precludes the Director of the Office of Professional Responsibility’s use of a copy of such report in a proceeding under subpart D of this part.

(e) Effective/applicability date. This section is applicable beginning August 2, 2011.

RECENT CHANGES TO CIRCULAR 230

On June 12, 2014 the following changes to Circular 230 became effective:

- The complex rule governing “Covered Opinions” under §10.35 has been eliminated, while the rule on written opinions under §10.37 has been expanded.
- Under §10.36, an individual with principal authority for overseeing a firm’s federal tax practice must take reasonable steps to ensure that the firm has adequate procedures in place to comply with Circular 230.
• Practitioners must exercise competence when representing persons before the IRS. Competence may be obtained in a number of ways.

• The rule on the expedited suspension of a practitioner’s IRS practice rights has been expanded to include the failure of a practitioner to file a return in four of the previous five years.

• The prohibition on practitioners negotiating taxpayer refund checks is expanded to include electronic payments, including the direct deposit of tax refunds into a practitioner’s account.

• The Office of Professional Responsibility has exclusive responsibility with the IRS for matters related to practitioner discipline.

THE TAXPAYER BILL OF RIGHTS

For some time now, some members of Congress have been advocating for a Taxpayer Bill of Rights. Although Congress has not acted on this matter, the IRS has. In 2014, the IRS took administrative action to issue a Taxpayer Bill of Rights. While impressive looking on its face, the new Bill of Rights is simply a restatement of previously existing rights into a single document. The IRS has issued Publication 1 that is summarized as follows.

• The right to be informed.

• The right to quality service.

• The right to pay no more than the correct amount of tax.

• The right to challenge the IRS’s position and be heard.

• The right to appeal an IRS decision in an independent forum.

• The right to finality.

• The right to privacy.

• The right to confidentiality.

• The right to retain representation.

• The right to a fair and just tax system.

Although, these rights are not new, they merit attention here since taxpayers may perceive them as new rights.
CHAPTER 1: TEST YOUR KNOWLEDGE

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter (assignment). They are included as an additional tool to enhance your learning experience, and do not need to be submitted in order to receive CPE credit.

We recommend that you answer each question and then compare your response to the suggested solutions on the following page(s) before answering the final exam questions related to this chapter (assignment).

1. Which of the following is correct regarding ethical guidance and the tax professional:
   A. tax preparers first level of responsibility is to the IRS
   B. taxpayers may not arrange one’s affairs to pay the lowest tax legally available
   C. EAs in tax practice do not have any specific guidance that governs their tax practice
   D. tax preparers have registration requirements

2. Bob Jones, Inc. is a new small business client that has asked you to prepare its current year tax return. Upon interviewing the client, you determine that the client has not filed several prior year tax returns. According to Circular 230, what should you do:
   A. notify the IRS of this failure
   B. advise the client promptly of the fact of noncompliance and notify the IRS if the client refuses to file
   C. advise the client promptly of the fact of noncompliance
   D. ignore the fact of non-filing provided the current year return is filed timely

3. Which of the following is true regarding when a contingent fee is permitted by the IRS:
   A. there are no restrictions on contingent fees
   B. contingent fees are allowed on original tax returns
   C. contingent fees are allowed when representing a client under audit
   D. contingent fees are never allowed
4. According to Circular 230, Section 10.36, which of the following is correct regarding procedures to ensure compliance:

A. it places the first layer of responsibility on the individual as part of a “self-regulatory” environment

B. it makes an individual of a firm into an enforcer of Circular 230

C. it provides that only firms, and not individuals of a firm, can be subject to disciplinary action for failing to comply with Circular 230

D. the provision is ineffective
**CHAPTER 1: SOLUTIONS AND SUGGESTED RESPONSES**

Below are the solutions and suggested responses for the questions on the previous page(s). If you choose an incorrect answer, you should review the pages as indicated for each question to ensure comprehension of the material.

<table>
<thead>
<tr>
<th>Question</th>
<th>Incorrect</th>
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<th>Incorrect</th>
<th>Correct</th>
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<td>1.</td>
<td>A.</td>
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<td>C.</td>
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<tr>
<td>A.</td>
<td>Incorrect. In a tax engagement, the EA is an “advocate of the taxpayer,” not the IRS.</td>
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<td>B.</td>
<td>Incorrect. The courts have held that there is nothing illegal or sinister in a taxpayer arranging one’s affairs so as to pay the lowest tax legally available.</td>
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<td>C.</td>
<td>Incorrect. EAs in tax practice have two sets of ethical and legal guidance which govern their tax practice: (1) IRS Circular 230, and (2) the NAEA rules of professional conduct.</td>
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<td>D.</td>
<td>CORRECT. All paid tax return preparers are required to have a Preparer Tax Identification Number (PTIN) as of January 1, 2011.</td>
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<tr>
<td>A.</td>
<td>Incorrect. Practitioners have no obligation to notify the IRS.</td>
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<td>B.</td>
<td>Incorrect. Practitioners are prohibited from notifying the IRS even if the client refuses to take corrective action.</td>
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<td>C.</td>
<td>CORRECT. A practitioner must notify the client of the noncompliance.</td>
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<td>D.</td>
<td>Incorrect. A practitioner may not ignore the noncompliance.</td>
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<td>(See page 6 of the course material.)</td>
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<td>D.</td>
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<td>A.</td>
<td>Incorrect. Section 10.27 indicates when contingent fees are not permitted.</td>
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<td>B.</td>
<td>Incorrect. Contingent fees for preparing original tax returns are never permitted by the IRS.</td>
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<td>C.</td>
<td>CORRECT. When representing a client under audit, there is little incentive for the practitioner to misstate income and play the “audit lottery.”</td>
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<td>D.</td>
<td>Incorrect. The IRS prohibits contingent fees on original tax returns and most amended returns while permitting contingent fee arrangements in many other situations.</td>
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<td>(See pages 11 to 12 of the course material.)</td>
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| **4.** | **A.** Incorrect. Section 10.36 places the first layer of responsibility on the firm, not the individual, as part of a “self-regulatory” environment.  

**B.** **CORRECT.** An individual of a firm is responsible to ensure the firm has procedures in place to ensure compliance with Circular 230, the firm follows the requisite procedures, and individuals in the firm do not engage in a pattern and practice of disregarding the provisions of Circular 230.  

**C.** Incorrect. The provision puts certain individuals on notice that they could be subject to individual disciplinary actions based on the action of others in the firm.  

**D.** Incorrect. The provision became effective on June 12, 2014.  

*(See pages 22 to 23 of the course material.)*
The National Association of Enrolled Agents (NAEA) has issued two sets of ethical guidance for Enrolled Agents. The Code of Ethics is a broad conceptual framework of ethical concepts. The Rules of Professional Conduct are more specific in that each rule tends to relate to a specific action. The rules follow closely and expand upon the legal requirements of Circular 230.

I. CODE OF ETHICS

1. Members and associates will, in personal and public life, strive to enhance the status of enrolled agents (EAs) and promote their qualifications to serve the public.

2. Members and associates will demonstrate honesty, integrity and objectivity in all of their professional actions and relationships.

3. Members and associates will continually strive to improve upon their competence to practice by keeping informed and educated about tax practice and representation.

4. Members and associates will maintain the confidentiality of professional relationships.

5. Members and associates will support all efforts to advance the reputation and prestige of the EA license.

6. Members and associates will comply with the most current provisions of Treasury Department Circular 230 and the NAEA Code of Ethics and Rules of Professional Conduct.

7. Members and associates will not knowingly misrepresent or omit information when preparing or approving and filing tax returns, documents, affidavits, and other papers relating to Internal Revenue Service (IRS) matters. If a client insists on the misrepresentation or omission, the member or associate should withdraw and refuse to prepare the return or other documents.
II. RULES OF PROFESSIONAL CONDUCT

1. Members and associates will adhere to all laws and regulations that provide equal opportunity for all clients and employees regardless of race, color, religion, gender, national origin, age, handicap, sexual orientation or any other legally protected class.

2. Members and associates will maintain a confidential relationship between themselves and their clients or former clients, disclosing confidential information only when authorized or legally obligated to do so. Members and associates will instruct employees that information acquired in their duties is confidential and will ensure that confidentiality is maintained.

3. Members and associates will promptly submit requested information to the IRS and will not interfere with lawful efforts by the IRS to obtain any record or information, unless the member or associate believes, in good faith and on reasonable grounds, that the information is privileged.

4. Only members may designate themselves as “Members(s) of the National Association of Enrolled Agents.” Only associates may designate themselves as “Associate(s) of the National Association of Enrolled Agents.”

5. Members and associates will not represent conflicting interests without express written consent of all parties after full disclosure.

6. Members and associates will not allow their related business interests to affect representation of a client and must immediately disclose their interests when referring a client to another firm or enterprise for services.

7. Members and associates will refuse any gift, favor, or hospitality that would influence or appear to influence their actions.

8. Members and associates will take a position on a tax return favorable to their clients only if there is substantial authority that the position will be sustained on its merits, unless the position is disclosed and there is at least a reasonable basis for it. If applicable law is unsettled, or the application of law to the facts in a given situation is uncertain, members and associates must explain the probable effects of various alternatives to their clients who make the final decision as to the position taken.

9. Members and associates will not knowingly, directly or indirectly, professionally associate with an individual who has been suspended or disbarred.

10. Members and associates will avoid any appearance of impropriety when paying or accepting a commission to obtain a client, or to refer products or services.

11. Members and associates who are engaged simultaneously in another occupation will conduct themselves in such a manner that no conflict of interest exists when rendering professional tax service or professional advice. No member or associate will accept or
pay a commission for the sale or referral of products or services to a client unless they are properly licensed and all facts are fully disclosed in writing to the client. No member or associate will pay a commission or referral fee to an employee for the sale or referral of products or services to a client unless the employee is properly licensed and the facts are fully disclosed in writing to the client.

12. Members and associates will not solicit clients in any manner prohibited by the most current provisions of Circular 230, including advertising or other forms of solicitation that present a false, misleading, or deceptive appearance.

13. Members and associates will undertake only those tax matters which the member or associate, or the member’s or associate’s firm, can reasonably expect to complete with professional competence. Members and associates will obtain sufficient relevant data to provide a reasonable basis for conclusions or recommendations as required to complete the task.

14. Members and associates should be considerate and courteous in dealing with representatives of governmental agencies. In practice, members and associates are required to provide all information required by a statute or regulations when formally requested by the authorized governmental agency.

15. Members and associates will not suggest or give the impression they can obtain special consideration from governmental agencies or their representatives because of prior IRS employment.

16. Members and associates will advise a client, preferably in writing, if they suspect the client may not have complied with the revenue laws or may have made an error in, or omission from, a return, document, affidavit, or other paper the client is required by law to execute.

17. Members and associates will not represent a client, or will withdraw from client representation that has commenced, if:

   a. The representation will result in violation of the rules of professional conduct or the law,
   b. The member’s or associate’s physical or mental condition materially impairs his/her ability to represent the client,
   c. The client persists in a course of action involving the member’s or associate’s services that the member or associate believes is criminal or fraudulent,
   d. The client has used the member’s or associate’s services to perpetrate a crime or fraud, or
   e. The member or associate is discharged.
18. Members and associates may withdraw from representing a client if:
   a. The client insists on pursuing an objective that the member or associate considers imprudent,
   b. The client fails substantially to fulfill an obligation to the member or associate regarding the member’s or associate’s services and has been given reasonable warning that the member or associate will withdraw unless the obligation is fulfilled,
   c. The representation will result in an unreasonable financial burden on the member or associate,
   d. The representation has been rendered unreasonably difficult by the client, or
   e. Other good cause for withdrawal exists.

19. If representation is terminated, a member or associate will take reasonable steps to protect the former client’s interests including providing reasonable notice to allow retention of another practitioner, surrendering papers and property to which the client is entitled, and refunding unearned advance fees.

20. Members and associates will return to the client or former client all records or other data the client provided.

21. Tax preparation services will be offered as authorized by the most current provisions of Circular 230.
CHAPTER 2: TEST YOUR KNOWLEDGE

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter (assignment). They are included as an additional tool to enhance your learning experience and do not need to be submitted in order to receive CPE credit.

We recommend that you answer each question and then compare your response to the suggested solutions on the following page(s) before answering the final exam questions related to this chapter (assignment).

1. Which of the following is true regarding the ethical guidance issued by the National Association of Enrolled Agents (NAEA):

   A. the NAEA has issued three sets of ethical guidance
   B. the Rules of Professional Conduct are a broad conceptual framework
   C. the Code of Ethics is more specific than the Rules of Professional Conduct
   D. the Rules of Professional Conduct follow closely and expand upon the legal requirements of Circular 230

2. In preparing the tax return for Nash Plumbing, Inc., you notice a large deduction for “consulting services.” You ask your client to explain this deduction and he explains it represents gifts he purchased for his wife to make up for him being on call and having to work at odd hours. You know that no 1099 or W-2 is issued for these “services” nor is any of this income reflected on your client’s personal tax return. Your client states that “everyone” in this industry does this. The deduction is equivalent to 20% of net income. What action should you take according to NAEA Rule 8:

   A. sign the return since NAEA Rule 8 states your primary duty is to your client
   B. notify the IRS immediately
   C. sign the return and recommend that the client file an amended return after tax season
   D. not sign the return unless the client agrees not to claim the frivolous deduction
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</table>
| **1.** | **A.** Incorrect. The NAEA has issued two, not three, sets of ethical guidance for Enrolled Agents: (1) the Code of Ethics, and (2) the Rules of Professional Conduct.  
B. Incorrect. The Code of Ethics is a broad conceptual framework. The Rules of Professional Conduct are more detailed.  
C. Incorrect. The Rules of Professional Conduct are more specific than the Code of Ethics.  
D. **CORRECT.** In some situations, the Circular 230 has greater restrictions or is more detailed than the Rules.  
(See page 39 of the course material.) |
| **2.** | **A.** Incorrect. NAEA Rule 8 applies to tax return positions.  
B. Incorrect. A practitioner may not notify the IRS under any circumstances.  
C. Incorrect. A practitioner may not sign a false return even if he believes an amended return will later be filed.  
D. **CORRECT.** A practitioner may not sign a return containing a frivolous deduction.  
(See page 40 of the course material.) |
Chapter Objectives

After completing this chapter, you should be able to:

• Identify types of conduct that may result in discipline under Circular 230.
• Recognize abusive tax shelters and abusive trusts.

I. IRS SANCTIONS

The Internal Revenue Code and Regulations contain a number of provisions that impose criminal, civil, and regulatory sanctions on tax practitioners.

Of the approximately 150 penalty provisions a tax professional could run afoul of, one of the most relevant is section 6694. Section 6694 provides for a penalty against the preparer for each return involving an understatement of tax liability due to certain positions taken on a return.

The Treasury Department and the Internal Revenue Service issued Notice 2008-13 that implemented the current law that expanded the tax return preparer penalty and heightened the standards of conduct that must be met by tax return preparers in order to avoid that penalty.

For undisclosed positions on a tax return, the new law replaced the realistic possibility standard with a requirement that there be a reasonable belief that the tax treatment of the position would more likely than not be sustained on its merits. In cases in which the taxpayer discloses the position on the tax return, the notice implements the new law that states there must be a reasonable basis for the tax treatment of the position taken on the tax return.


Practitioners who violate the rules of Circular 230 are referred to the Office of Professional Responsibility for disciplinary action. The sanctions for violating the rules under Circular 230 can be severe, including suspension, censure, or disbarment from practice before the Service, as well as impose monetary penalties. The Office of the Director of Practice (now known as the Office of Professional Responsibility) published scenarios of conduct that may result in discipline under Circular 230. The scenarios represent composites of actual fact patterns that were brought to the attention of the then Director of Practice.

Scenario No. 1: Taking Unwarranted Deductions

The practitioner was engaged to prepare a doctor’s tax return. The doctor indicated he hoped substantial deductions could be taken for the use of his car in his practice. Without investigating further, the practitioner prepared the return with deductions for various automobile expenses. Upon audit, the
doctor’s “business use” of the automobile turned out to be nothing more than commuting between his home and office.

The practitioner was charged with violating Circular 230 section 10.22(a) (lack of due diligence in preparing tax returns) and section 10.51(b) (giving false information to the IRS). The practitioner argued that he was entitled to rely in good faith on client information but was unable to cite any authority for deduction of commuting expenses. Consequently, he was found guilty of giving false information under section 10.51(b).

**Scenario No. 2: Contemptuous Conduct**

In this scenario, the practitioner discussed his client’s case with a revenue officer over the phone. Upon being advised that his client could still expect enforcement action, the practitioner said, “How about my coming down there and jerking you around for a while?” The practitioner also said he “would not mind kicking down the door.” He called back later that day to apologize.

His actions were found to violate the section 10.51(i) rule against contemptuous conduct, including use of abusive language. However, since this was an isolated incident after many years of IRS practice, the practitioner was simply reprimanded and given a warning regarding future conduct.

**Scenario No. 3: Lack of Due Diligence**

The practitioner reviewed and signed a client return prepared by an employee. The employee had accepted without question that several client trips had been for business and had therefore deducted the related expenses. In fact, the client had no substantiation of any business purpose. The practitioner stated the employee had failed to follow office policy which required obtaining substantiation for claimed business trips.

The Director of Practice considered whether the practitioner had violated the section 10.22(a) due diligence rule and the section 10.51(b) rule against giving false information to the IRS. Since the office had a policy requiring client substantiation for business trips and since the practitioner did not have a history of preparing inaccurate returns, the Director concluded he did not knowingly submit false information. However, he was found to have failed to exercise “due diligence.”

**Scenario No. 4: Knowledge of Client Mistake**

Based on a conversation, the practitioner understood the client to be legally separated and thus prepared a return using single filing status. Later, the practitioner learned that while the client and spouse had come to terms on a separation agreement, they were not actually legally separated under a decree of divorce or separate maintenance. In other words, they were still married for federal income tax purposes. The client had declined to file an amended return in a prior year, so the practitioner felt he would decline to do so in this situation as well. Therefore, the practitioner did not inform the client that his filing status was incorrect and that an amended return was in order.

This was found to be a violation of section 10.21 of Circular 230, which requires advising the client of the problem when the practitioner becomes aware of an error or omission in a return. It’s unclear if the practitioner was actually suspended or disbarred or just reprimanded as a result of this incident.
II. EARNED INCOME TAX CREDIT DUE DILIGENCE

The Earned Income Tax Credit (EITC) due diligence requirement, enacted by Congress over a decade ago, was designed to reduce errors on returns claiming the EITC, most of which are prepared by tax professionals. The IRS created Form 8867, Paid Preparer’s Earned Income Credit Checklist, to help preparers meet the requirement by obtaining eligibility information from their clients. Preparers have been required to keep copies of the form, or comparable documentation, which is subject to review by the IRS.

To help ensure compliance with the law and that eligible taxpayers receive the right credit amount, the regulations require preparers, effective January 1, 2012, to file the Form 8867 with each return claiming the EITC. The regulations also reflect congressional action to increase the penalty for noncompliance with the due diligence requirement to $500.

III. ABUSIVE TAX SHELTERS / ABUSIVE TRUSTS

There has been a lot of talk regarding abusive tax shelters. The IRS has announced time and again that they are cracking down on abusive tax shelters and abusive trusts. As a professional, you need to know the facts since some of your clients will be approached. Following are materials put out by the IRS on abusive tax shelters and abusive trusts.

A. DEFINITION OF AN ABUSIVE TAX SHELTER ARRANGEMENT

While there is no hard and fast definition of abusive tax shelter arrangements, typically they are promoted by the promise of tax benefits with no meaningful change in the taxpayer’s control over or benefit from the taxpayer’s income or assets. The promised benefits may include reduction or elimination of income subject to tax; deductions for personal expenses paid by the trust or other entity; depreciation deductions of an owner’s personal residence and furnishings; a stepped-up basis for property transferred to the trust or other entity; the reduction or elimination of self-employment taxes; and the reduction or elimination of gift and estate taxes. These promised benefits are inconsistent with the tax rules.

B. FREQUENTLY ASKED TRUST QUESTIONS

Q. What is a trust?

A. A trust is a legal entity created under state or common law, whereby a “trustee” holds property for the benefit of some other person called a “beneficiary.” If a trustee attempts to hold property for his own benefit, the transfer is generally treated as a fraudulent conveyance under state law and is not recognized for federal income tax purposes.

Q. What is a grantor of a trust?

A. The term “grantor” refers to an individual who establishes or funds the trust (with property, money, or any other asset). Common synonyms are settlor, creator and trustor.
Q. What laws control trust taxation?

A. For all trusts, the Internal Revenue Code controls federal income tax consequences. Whether a trust is valid or invalid under state law, the common law, or any other law generally does not impact federal income taxation.

Q. I have been told that trusts are a legal method of paying personal expenses with “before-tax” dollars, reducing personal tax liability, or avoiding income or employment taxes. Is this true?

A. No. Many trust arrangements have been held by the courts to be shams with no economic substance. The income and expenses of such arrangements are attributed to the actual earner of the income, typically the individual grantor or other individual on whom the trust depends for the production of income or the providing of services.

Q. I have been told that I can assign income to a trust and I will not be taxed on that income. Is this true?

A. No. Contrary to the claims of the promoters who sell such arrangements, trusts are not a legal method of paying personal expenses with “before-tax” dollars, reducing one’s personal tax liability, or avoiding income or employment taxes. Rather, ALL income is taxable unless there is a specific statutory provision excluding it; there is no such provision in the trust area. The Internal Revenue Service is presently auditing numerous trust arrangements to determine whether they reflect economic reality and comply with the requirements of the Internal Revenue Code.

Since the IRS does not give legal advice, we suggest that you seek competent, independent legal assistance in determining exactly how your income should be reported and your taxes paid.

Q. Do pure trusts or contract trusts have a requirement to file federal income tax returns?

A. The terms of “Pure Trust” or “Contract Trust” are not used in the Internal Revenue Code, and entities under such names will be classified as an entity recognized under the Internal Revenue Code. In any event, all trusts have the same responsibility to report income and pay tax on it. The filing requirements vary with the type of trust.

Q. Do foreign trusts have a United States reporting requirement?

A. Many entities called “foreign trusts” are not considered to be “foreign” under the law. If a trust has one or more United States persons having the authority to control substantial decisions of the trust or if a United States court can exercise jurisdiction over the administration of the trust, it will be considered a “domestic” trust and treated under normal rules of taxation. If the trust is truly a “foreign” entity with all of its actual assets outside of the United States, it must file a Form 1040NR and Form 3520.

Q. What is a business trust?

A. Most trusts are used for the protection or conservation of property (e.g., decedent’s estate, trust for minor children, bankruptcy estate, etc.). However, sometimes an actual business is operated in the form of a trust, rather than as a partnership, corporation or sole proprietorship.
Q. How is a business trust taxed?

A. Business trusts are taxed according to the economic reality of the business. If the trust is a sham or façade with no economic reality, it will be ignored and the tax liability will be placed directly on the individual who formed the trust. If the trust has only one individual who funded it and operates it, it will generally be treated as a sole proprietorship. If it has two or more individuals who control it (i.e., if it resembles a partnership), it will generally be treated as a partnership. If the trust is registered as a corporation under state or federal statutes, it will be treated as a corporation.

Q. Will the use of a business trust avoid Estate Taxes?

A. If the trust is a sham or façade with no economic reality, it will be ignored and the tax liability will be placed directly on the individual who formed the trust. This includes Estate Taxes.

Q. What are the federal income tax reporting requirements for business trusts?

A. They depend on the economic reality of the arrangement, not on what the business is called.

If the trust actually operates as a sole proprietorship, the income and expenses should be reported on the Schedule C of the Form 1040 of the individual who actually owns and operates it.

If the trust actually operates as a partnership, the income and expenses should be reported on a Form 1065, U.S. Partnership Income Tax Return, and passed through to the partners on the Schedule K-1.

If the trust has been granted a corporate charter under any state or federal law, then it should report its income and expenses on a Form 1120, U.S. Corporation Income Tax Return or a Form 1120S, U.S. Small Business Corporation Income Tax Return.

If it is actually operated as a “Trust” pursuant to the requirements of the Internal Revenue Code, then it should file a Form 1041, U.S. Fiduciary Income Tax Return.

Q. How does a trust compute its income tax liability?

A. A trust computes its income tax liability in much the same way that an individual does and is allowed most of the credits and deductions that an individual is allowed. Similarly, DEDUCTIONS NOT ALLOWED TO INDIVIDUALS ARE NOT ALLOWED TO TRUSTS. For example, personal living expenses such as food, utilities, recreational expenses, children’s education, depreciation of one’s personal residence, etc. are not allowed as a trust deduction any more than as an individual deduction.

Trusts are also required to prepare a Schedule K-1 for their beneficiaries, showing them the amounts distributed by the trust to them. These amounts must be reported on the beneficiaries’ individual returns. More information about trust taxation can be found in the IRS Instructions for the Form 1041.

Q. Are monetary contributions to a charitable trust deductible?

A. To be deductible, a contribution must be made for “charitable” purposes and made to an entity recognized as a charitable entity by the Internal Revenue Service. Thus, amounts paid for tuition at a church school would not be deductible because they are for an educational purpose, not a charitable
purpose. Similarly, amounts paid by an individual to a charity established by that individual are likely not deductible because the entity has not been registered as a charitable organization with the Internal Revenue Service.

Q. What is a Grantor Trust?

A. “Grantor Trust” is a term used in the Internal Revenue Code to describe any trust over which the Grantor or other owner retains the power to control or direct the trust’s income or assets. If a Grantor retains certain powers over or benefits in a trust, the income of the trust will be taxed to the grantor rather than to the trust.

Q. How is a revocable trust taxed?

A. A revocable trust may be revoked and is considered a Grantor Trust thus the revocable trust is taxed to the grantor rather than to the trust.

C. WHAT DO THE COURTS SAY ABOUT ABUSIVE TRUSTS?

Assignment of Income in General

In 1930, the United States Supreme Court said that income that has been assigned to another entity is taxable to the one who assigns it. In this case, a married attorney assigned half of his salary and fees to his wife, so as to split his income and qualify for a lower tax bracket. The IRS of that era taxed all income to him at the higher rate. The Supreme Court upheld the Government’s position, stating that the “tax could not be escaped by anticipatory arrangements and contracts however skillfully devised.”

Lucas v. Earl, 281 U.S. 111 (1930)

Trust Income Taxable to the Individual Controlling the Trust

In this 1940 case, the Supreme Court determined that trust income is taxable to the person who actually controls that trust. In this case, an individual made a formal transfer of assets into certain trusts, thus splitting his income and qualifying for a lower tax rate. The IRS taxed all income to him, inasmuch as he retained control over the trust assets. The Supreme Court held that the Treasury could tax income to the original owner even though he had made a “formal” transfer into a trust, since the tax law was concerned with the substance of the transaction, rather than its form.

Clifford v. Helvering, 309 U.S. 331 (1940)

Business and Home Transferred to a Trust

This 1980 case holds that a trust set up by individuals to avoid taxes was devoid of economic reality and was to be treated as a nullity for federal income tax purposes. In this case, the taxpayers transferred all of their business and personal assets, including husband’s dental equipment, his lifetime services, and all remuneration therefrom, to a family trust established under the Educational Scientific Publishers (ESP) promotion, under which they were the only trustees. Petitioners continued to use their home and personal assets, and husband continued to use his office and dental equipment in his practice. Husband continued to receive all of the gross income from his dental practice and deposited it in his
personal account. Petitioners then paid 80 percent of the gross income from the dental practice to the trust as a “fee.” The Tax Court held that the trust was devoid of economic reality and is to be treated as a nullity for Federal income tax purposes.

Markosian v. Commissioner, 73 T.C. 1235 (1980)

Transfers to Foreign Trusts

This case holds that foreign trusts set up by taxpayers to avoid taxes on income from properties in the United States were invalid for tax purposes. The Zmudas formed several trusts under the American Law Association promotion and transferred US real personal property (including real estate sales contracts) into those trusts, in return for units of beneficial interest. Since the ultimate ostensible holders of the property were foreign trusts, the individuals claimed that they had no gross income and, thus, no tax liability. The Tax Court held that the trusts were shams, inasmuch as the Zmudas had simply restructured the form in which they held their property, without giving up control over that property. The Tax Court determined the ostensible trust income was actually the individuals' income, claimed deductions for creating the trusts were disallowed for lack of business purpose, and penalties were imposed. The Ninth Circuit affirmed.

Zmuda v. Commissioner, 731 F.2d 1417 (9th Cir. 1984), aff’g 79 T.C. 714 (1982)

Use of Multiple Trusts Including a Charitable Trust

This case held that trusts created by the taxpayers should be disregarded because they were shams. The taxpayers established a multi-trust scheme promoted by the Heritage Assurance Group/Bartoli, transferred their business and services into the trusts, and used the trusts to pay personal expenses while reporting no income because the excess amounts went into a charitable trust under the scheme. Petitioners, who were represented by Joe Izen in the trial, controlled all entities. The Tax Court held that the scheme lacked economic substance, taxed the income to the individuals, and imposed accuracy-related penalties.

Muhich v. Commissioner, T.C. Memo. 1999-192

Promoter of Trust Scheme That Included Deducting Personal Living Expenses

In this case, an injunction was issued against a trust promoter. Tax shelter promoter Henkel (Estate Preservation Services) made numerous false statements in connection with supposed tax benefits of trusts he sold, including stepped-up basis without recognition of gain, deductibility of personal living expenses, etc. District Court issued injunction against him and company; Ninth Circuit affirmed.

Estate Preservation Services, United States v., 38 F. Supp. 2d 846 (E.D. Ca 1998), aff’d, 202 F.3d 1093 (9th Cir. 2000)

Promoter Convicted of Conspiracy to Defraud the United States

Noske and related defendants were convicted of conspiracy to defraud the United States and conspiracy to evade income taxes in a scheme involving the use of bogus trusts and “tax-exempt” corporations
to fragment and hide income and assets. As well as affirming the convictions, the Eighth Circuit held that the imposition of criminal penalties in addition to the civil fine (of $490, 174 under I.R.C. § 6700 for promoting abusive tax shelters) did not constitute double jeopardy; thus, the defendants were subject to both the civil and criminal penalties, as well as any income taxes due.

United States v. Noske, 117 F.3d 1053 (8th Cir. 1997)

Summary

If the promotion you are considering sounds too good to be true it may be an abusive tax shelter. Look to see if any of the following red flags exist.

- Never pay taxes again
- Deduct the cost of your personal residence
- Deduct the cost of your child's education
- The IRS doesn't want you to know about this
- So new, your tax professional doesn't even know about it
- Multiple trusts, partnerships or other entities are involved
- Share/borrow EITC dependents

If one or more of these red flags exist, you should consult a tax professional not involved in promoting the investment or contact the IRS to determine how it will treat such a promotion. It's worth your time to learn more about the legal/tax consequences of the promotion you are considering investing in. The penalties, interest, and legal costs associated with an abusive tax promotion are significant (and these are in addition to the tax due and fees you paid for the promotion).

IV. IRS DIRTY DOZEN TAX SCAMS FOR 2015

IR-2015-26, Feb. 9, 2015

WASHINGTON — The Internal Revenue Service wrapped up the 2015 “Dirty Dozen” list of tax scams today with a warning to taxpayers about aggressive telephone scams continuing coast-to-coast during the early weeks of this year’s filing season.

The aggressive, threatening phone calls from scam artists continue to be seen on a daily basis in states across the nation. The IRS urged taxpayers not give out money or personal financial information as a result of these phone calls or from emails claiming to be from the IRS.

Phone scams and email phishing schemes are among the “Dirty Dozen” tax scams the IRS highlighted, for the first time, on 12 straight business days from Jan. 22 to Feb. 6. The IRS has also set up a special section on IRS.gov highlighting these 12 schemes for taxpayers.
“We are doing everything we can to help taxpayers avoid scams as the tax season continues,” said IRS Commissioner John Koskinen. “Whether it’s a phone scam or scheme to steal a taxpayer’s identity, there are simple steps to take to help stop these con artists. We urge taxpayers to visit IRS.gov for more information and to be wary of these dozen tax scams.”

Illegal scams can lead to significant penalties and interest for taxpayers, as well as possible criminal prosecution. IRS Criminal Investigation works closely with the Department of Justice (DOJ) to shutdown scams and prosecute the criminals behind them. Taxpayers should remember that they are legally responsible for what is on their tax returns even if it is prepared by someone else. Make sure the preparer you hire is up to the task. For more see the Choosing a Tax Professional page.

For the first time, here is a recap of this year’s “Dirty Dozen” scams:

- **Phone Scams:** Aggressive and threatening phone calls by criminals impersonating IRS agents remains an ongoing threat to taxpayers. The IRS has seen a surge of these phone scams in recent months as scam artists threaten police arrest, deportation, license revocation and other things. The IRS reminds taxpayers to guard against all sorts of con games that arise during any filing season. (IR-2015-5)

- **Phishing:** Taxpayers need to be on guard against fake emails or websites looking to steal personal information. The IRS will not send you an email about a bill or refund out of the blue. Don’t click on one claiming to be from the IRS that takes you by surprise. Taxpayers should be wary of clicking on strange emails and websites. They may be scams to steal your personal information. (IR-2015-6)

- **Identity Theft:** Taxpayers need to watch out for identity theft especially around tax time. The IRS continues to aggressively pursue the criminals that file fraudulent returns using someone else’s Social Security number. The IRS is making progress on this front but taxpayers still need to be extremely careful and do everything they can to avoid becoming a victim. (IR-2015-7)

- **Return Preparer Fraud:** Taxpayers need to be on the lookout for unscrupulous return preparers. The vast majority of tax professionals provide honest high-quality service. But there are some dishonest preparers who set up shop each filing season to perpetrate refund fraud, identity theft and other scams that hurt taxpayers. Return preparers are a vital part of the U.S. tax system. About 60 percent of taxpayers use tax professionals to prepare their returns. (IR-2015-8)

- **Offshore Tax Avoidance:** The recent string of successful enforcement actions against offshore tax cheats and the financial organizations that help them shows that it’s a bad bet to hide money and income offshore. Taxpayers are best served by coming in voluntarily and getting their taxes and filing requirements in order. The IRS offers the Offshore Voluntary Disclosure Program (OVDP) to help people get their taxes in order. (IR-2015-09)
• **Inflated Refund Claims:** Taxpayers need to be on the lookout for anyone promising inflated refunds. Taxpayers should be wary of anyone who asks them to sign a blank return, promise a big refund before looking at their records, or charge fees based on a percentage of the refund. Scam artists use flyers, advertisements, phony store fronts and word of mouth via community groups and churches in seeking victims. (IR-2015-12)

• **Fake Charities:** Taxpayers should be on guard against groups masquerading as charitable organizations to attract donations from unsuspecting contributors. Contributors should take a few extra minutes to ensure their hard-earned money goes to legitimate and currently eligible charities. IRS.gov has the tools taxpayers need to check out the status of charitable organizations. Be wary of charities with names that are similar to familiar or nationally known organizations. (IR-2015-16)

• **Hiding Income with Fake Documents:** Hiding taxable income by filing false Form 1099s or other fake documents is a scam that taxpayers should always avoid and guard against. The mere suggestion of falsifying documents to reduce tax bills or inflate tax refunds is a huge red flag when using a paid tax return preparer. Taxpayers are legally responsible for what is on their returns regardless of who prepares the returns. (IR-2015-18)

• **Abusive Tax Shelters:** Taxpayers should avoid using abusive tax structures to avoid paying taxes. The IRS is committed to stopping complex tax avoidance schemes and the people who create and sell them. The vast majority of taxpayers pay their fair share, and everyone should be on the lookout for people peddling tax shelters that sound too good to be true. When in doubt, taxpayers should seek an independent opinion regarding complex products they are offered. (IR-2015-19)

• **Falsifying Income to Claim Credits:** Taxpayers should avoid inventing income to erroneously claim tax credits. Taxpayers are sometimes talked into doing this by scam artists. Taxpayers are best served by filing the most-accurate return possible because they are legally responsible for what is on their return. (IR-2015-20)

• **Excessive Claims for Fuel Tax Credits:** Taxpayers need to avoid improper claims for fuel tax credits. The fuel tax credit is generally limited to off-highway business use, including use in farming. Consequently, the credit is not available to most taxpayers. But yet, the IRS routinely finds unscrupulous preparers who have enticed sizable groups of taxpayers to erroneously claim the credit to inflate their refunds. (IR-2015-21)

• **Frivolous Tax Arguments:** Taxpayers should avoid using frivolous tax arguments to avoid paying their taxes. Promoters of frivolous schemes encourage taxpayers to make unreasonable and outlandish claims to avoid paying the taxes they owe. These arguments are wrong and have been thrown out of court. While taxpayers have the right to contest their tax liabilities in court, no one has the right to disobey the law or disregard their responsibility to pay taxes. The penalty for filing a frivolous tax return is $5,000. (IR-2015-23)
V. RETURN PREPARER ENFORCEMENT PROGRAM

The IRS Criminal Investigation Return Preparer Program (RPP) was implemented in 1996, and established procedures to foster compliance by identifying, investigating and prosecuting abuse return preparers. The program was developed to enhance compliance in the return-preparer community by engaging in enforcement actions and/or asserting appropriate civil penalties against unscrupulous or incompetent return preparers. This is a significant problem for both the IRS and its taxpayers. Abusive return preparers frequently prepare bad returns for large numbers of taxpayers who, at best, are stuck with paying additional taxes and interest and at worse, depending on culpability, are subject to penalties and maybe even criminal prosecution. In fiscal year 2014, the program had 193 convictions of unscrupulous preparers with an average of 28 months incarceration.

A. EXAMPLES OF ABUSIVE RETURN PREPARER INVESTIGATIONS

The following examples of abusive return preparer fraud investigations are excerpts from public record documents on file in the court records in the judicial district in which the cases were prosecuted.

Connecticut Tax Preparer Sentenced for Preparing and Filing False Tax Returns

On Aug. 3, 2015, in Bridgeport, Connecticut, Mr. N, of Shelton, was sentenced to 36 months in prison and one year of supervised release. On Dec. 4, 2014, Mr. N pleaded guilty to aiding and assisting the filing of a false tax return. Mr. N, while operating a tax preparation business based in Shelton, falsely reported expenses, deductions and credits on numerous clients' tax returns without his clients' knowledge or consent. In interviews, 11 of Mr. N's clients stated that Mr. N had falsified their returns. In addition, as part of an undercover operation, an agent simply dropped off his Form W-2 at Mr. N's business, provided his name and some identifying information, such as his social security number, and left. With the information provided, the undercover agent was only entitled to a refund of $632; however, the return was prepared falsely and generated a refund of $3,235. Mr. N is required to pay back taxes, penalties and interest related to the false tax returns he prepared during the 2007 through 2011 tax years for the 11 individuals who were interviewed as part of the investigation. The tax loss attributed to those false returns is approximately $240,196.

California Tax Return Preparer Sentenced for Tax Fraud

On July 31, 2015, in Oakland, California, Mr. S, of Hayward, was sentenced to 24 months in prison, one year of supervised release and ordered to pay $124,528 in restitution to the IRS. Mr. S pleaded guilty to aiding and assisting in the preparation of false tax returns. For tax years 2009 through 2011, Mr. S prepared false tax returns claiming both false and ineligible deductions and credits for clients. By including these items on his clients' tax returns, he caused the IRS to issue inflated tax refunds of at least $130,435. On Nov. 14, 2012, during a search warrant at Mr. S's residence, he told IRS Special Agents that he knowingly prepared false tax returns in order to obtain returning customers. Following the execution of the search warrant and his statement to IRS-CI Special Agents, Mr. S instructed one of his clients to submit both false and ineligible information to an IRS Revenue Agent during the audit of his 2010 income tax return, in order to justify the false and ineligible business expenses Mr. S reported on the client's 2010 tax return.
Louisiana Tax Preparer Sentenced for Tax Fraud

On July 28, 2015, in Shreveport, Louisiana, Ms. C, of Bossier City, was sentenced to 21 months in prison, three years of supervised release and ordered to pay $84,147 in restitution. Ms. C pleaded guilty on March 19, 2015, to making and filing a false tax return. Ms. C prepared and filed a fraudulent tax return on or about Jan. 24, 2012 by adding education credits to which she was not entitled.

B. SECTION 7216 UPDATED RULES FOR TAX PREPARERS

Regulations under Internal Revenue Code Section 7216, Disclosure or Use of Tax Information by Preparers of Returns, became effective January 1, 2009. The regulations updated regulations that were substantially unchanged since the 1970s, and give taxpayers greater control over their personal tax return information. The statute limits tax return preparers’ use and disclosure of information obtained during the return preparation process to activities directly related to the preparation of the return. The regulations describe how preparers, with the informed written consent of taxpayers, may use or disclose return information for other purposes. The regulations also describe specific and limited exceptions that allow a preparer to use or disclose return information without the consent of taxpayers.

Revenue Procedure 2013-14 supplements the regulations, and provides guidance to tax return preparers regarding the form and content of taxpayer consents to disclose and consents to use tax return information with respect to taxpayers filing a return in the Form 1040 series under section 301.7216-3. This revenue procedure modifies and supersedes Revenue Procedure 2008-35, and was effective as of January 14, 2013. The effective date was extended to January 1, 2014 by Revenue Procedure 2013-19.

According to Revenue Procedure 2013-14, generally, a taxpayer’s consent to each separate disclosure or separate use of tax return information must be contained on a separate written document, which can be furnished on paper or electronically. The consent may be included as an attachment to an engagement letter.

If the consent is furnished on paper, it must be provided on one or more sheets of 8 ½ by 11 inch or larger paper, and all text must be in at least 12-point type. If the consent is furnished electronically, it must be provided on one or more computer screens, all text on each screen must pertain solely to the disclosure, and the size of the text must be at least the same size as, or larger than, the normal or standard body text used by the website.

The consents must contain certain mandatory statements, including:

- Consent to disclose tax return information in a context other than tax return preparation or auxiliary services;
- Consent to disclose tax return information in tax return preparation or auxiliary services context; and
- Consent to use tax return information.

All consents must contain the following statement:
"If you believe your tax return information has been disclosed or used improperly in a manner unauthorized by law or without your permission, you may contact the Treasury Inspector General for Tax Administration (TIGTA) by telephone at 1-800-366-4484, or by email at complaints@tigta.treas.gov."

If the tax return information is to be disclosed to a tax return preparer outside of the United States, the taxpayer’s consent is required prior to any disclosure, and must contain mandatory language that varies based on whether or not the taxpayer’s social security number is included in the information being disclosed.

All consents must require the taxpayer’s affirmative consent to a tax return preparer’s disclosure or use of tax return information. An opt-out consent (i.e., one in which the taxpayer is required to remove or deselect disclosures or uses that the taxpayer does not wish to be made) is not permitted.

All consents to disclose or use tax information must be signed by the taxpayer. For consents on paper, the taxpayer’s consent must contain a handwritten signature. For electronic consents, the taxpayer must sign the consent by one of the following methods:

- Assign a personal identification number (PIN) that is at least 5 characters long. The taxpayer must affirmatively enter the PIN for the electronic signature to be valid;
- Have the taxpayer type in the taxpayer’s name and then hit “enter” to authorize the consent. The taxpayer must affirmatively type the taxpayer’s name for the electronic consent to be valid; or
- Any other manner in which the taxpayer affirmatively enters 5 or more characters unique to the taxpayer that the tax return preparer used to verify the taxpayer’s identity.

A tax return preparer may not alter a consent form after the taxpayer has signed the document. Therefore, a tax return preparer may not present a taxpayer with a consent form containing blank spaces for the purpose of completing the spaces after the taxpayer has signed the document.

If a consent authorizes the disclosure of a copy of the taxpayer’s entire tax return or all information contained within a return, the consent must provide that the taxpayer has the ability to request a more limited disclosure of tax return information as the taxpayer may direct.

A tax return preparer located within the United States, including any territory or possession of the United States, may disclose a taxpayer’s SSN to a tax return preparer located outside of the United States or any territory or possession of the United States with the taxpayer’s consent only when both the tax return preparer located within the United States and the tax return preparer located outside of the United States maintain an adequate data protection safeguard at the time the taxpayer’s consent is obtained and when making the disclosure. An adequate data protection safeguard is a management-approved and implemented security program, policy, and practice that includes administrative, technical, and physical safeguards to protect tax return information from misuse, unauthorized access, or disclosure and that meets or conforms to one or more of the privacy or data security frameworks described in the revenue procedure.
The following question is designed to ensure that you have a complete understanding of the information presented in the chapter (assignment). It is included as an additional tool to enhance your learning experience and does not need to be submitted in order to receive CPE credit.

We recommend that you answer the question and then compare your response to the suggested solution on the following page before answering the final exam question(s) related to this chapter (assignment).

**1. All of the following are correct regarding abusive tax shelter arrangements except:**

   A. they have no hard and fast definition
   
   B. they promise benefits that may include a reduction or elimination of income subject to tax
   
   C. they promise benefits that are inconsistent with the tax rules
   
   D. they require a meaningful change in the taxpayer’s control over his or her assets
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| **1.** | **A.** Incorrect. Abusive tax shelter arrangements are not specifically defined.  
B. Incorrect. Other potential benefits include deductions for personal expenses paid by the trust or other entity, depreciation deductions of an owner’s personal residence and furnishings, a stepped-up basis for property transferred to the trust or other entity, and the reduction or elimination of gift and estate taxes.  
C. Incorrect. The promised benefits from abusive tax shelter arrangements do not agree with the legal tax rules.  
D. **CORRECT.** Abusive tax shelter arrangements generally promise benefits with no meaningful change in the taxpayer’s control over or benefit from the taxpayer’s income or assets.  
(See page 49 of the course material.) |

Below is the solution and suggested responses for the question on the previous page. If you choose an incorrect answer, you should review the page(s) as indicated for the question to ensure comprehension of the material.
Alternative Practice Structures (APS) - A nontraditional structure for the practice of public accounting in which a traditional CPA firm engaged in auditing and other attestation services might be closely aligned with another organization, public or private, that performs other professional services (e.g., tax and consulting).

American Institute of Certified Public Accountants (AICPA) - The national professional organization for all certified public accountants (CPAs).

Client’s records - Any accounting or other records belonging to the client that were given to the member by, or on behalf of, the client.

Close relative - Close relatives are the member’s nondependent children (including grandchildren and stepchildren), brothers and sisters, grandparents, parents, and parents-in-law. Spouses of any of the above are also close relatives. The SEC definition of close relatives expands the above to include a spouse’s brothers and sisters and their spouses.

Code of Professional Conduct (the Code) - The Code was adopted by the membership of the AICPA to provide guidance and rules to all members on various ethics requirements. The Code consists of: 1) Principles, 2) Rules, 3) Interpretations, and 4) Ethics Rulings.

Conflict of interest - A conflict of interest may occur if a member performs a professional service for a client or employer, and the member or his or her firm has a relationship with another person, entity, product, or service that could, in the member’s professional judgment, be viewed by the client, employer, or other appropriate parties as impairing the member’s objectivity.

Consulting services - Professional services that use the practitioner’s technical skills, education, observations, experiences, and knowledge of the consulting process.

Contingent fee - A fee for performing any service in which the amount of the fee (or whether a fee will be paid) depends on the results of the service.

Direct financial interest - A direct financial interest is created when a member invests in a client entity.

Disqualifying services - Term used to refer to the following services, which when performed for a client prohibit the member from accepting a contingent fee or commission: (a) An audit or a review of a financial statement; (b) An examination of prospective financial information; (c) A compilation of a financial statement expected to be used by third parties except when the compilation report discloses a lack of independence.

Ethics Rulings - Part of the Code of Professional Conduct. Rulings summarize the application of rules and interpretations to a particular set of factual circumstances.
**Firm** - A form of organization permitted by state law or regulation whose characteristics conform to resolutions of Council that is engaged in the practice of public accounting, including the individual owners thereof.

**Former practitioner** - A proprietor, partner, shareholder or equivalent of a firm, who leaves by resignation, termination, retirement, or sale of all or part of the practice.

**Holding out as a CPA** - Includes any action initiated by a member, whether or not in public practice, that informs others of his or her status as a CPA.

**Independence in appearance** - If there are circumstances that a reasonable person might believe are likely to impair independence, the CPA is not independent in appearance. To be recognized as independent, the auditor must be free from any obligation to or interest in the client, its management, or its owners.

**Independence in fact** - To be independent in fact (mental independence), the CPA must have integrity and objectivity. If there is evidence that independence is actually lacking, the auditor is not independent in fact.

**Indirect financial interest** - An indirect financial interest is created when a member invests in a nonclient entity that has a financial interest in a client.

**Integrity** - An element of character fundamental to professional recognition. It is the quality from which public trust derives and the benchmark against which a member must ultimately test all decisions.

**Internal audit outsourcing** - Internal audit outsourcing involves performing audit procedures that are generally of the type considered to be extensions of audit scope applied in the audit of financial statements. Examples of such procedures might include confirming receivables, analyzing fluctuations in account balances, and testing and evaluating the effectiveness of controls.

**Interpretations of rules of conduct** - Part of the Code of Professional Conduct. Interpretations are pronouncements issued by the AICPA's Division of Professional Ethics to provide guidelines concerning the scope and application of the rules of conduct.

**Joint closely held business investment** - An investment that is subject to control by the member, or the member’s firm, client or its officers, directors, or principal stockholders, or any combination of the above.

**Joint Ethics Enforcement Program (JEEP)** - The AICPA and most state societies cooperate in the Joint Ethics Enforcement Program (JEEP) in bringing enforcement actions against their members.

**Member** - In its broadest sense, “member” is a term used to describe a member, associate member, or international associate of the AICPA. All members must adhere to the AICPA’s Code of Professional Conduct. For the purposes of applying the independence rules, the term “member” identifies the people in a CPA firm and their spouses, dependents, and cohabitants who are subject to the independence requirements.
Multidisciplinary practices (MDP) - Arrangements in which CPAs share fees with attorneys or other professionals.

National Association of State Boards of Accountancy (NASBA) - A voluntary organization composed of the state boards of accountancy. It promotes communication, coordination, and uniformity among state boards.

Objectivity - The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest. Objectivity is a state of mind, a quality that lends value to a member’s services.

Period of professional engagement - The period of engagement starts when the member begins the service requiring independence and ends upon termination of the relationship (by the member or the client) or, if later, when the report is issued. The period does not stop when the report is issued and restart with the beginning of the next engagement. The period of engagement typically covers many periods.

Practice of public accounting - According to the Code of Professional Conduct, the practice of public accounting consists of the performance for a client, by a member or a member’s firm, while holding out as CPAs, of the professional services of accounting, tax, personal financial planning, litigation support services, and those professional services for which standards are promulgated by bodies designated by Council, such as Statements of Financial Accounting Standards, Statements on Auditing Standards, Statements on Standards for Accounting and Review Services, Statements on Standards for Consulting Services, Statements on Standards for Tax Services, Statements of Governmental Accounting Standards, and Statements on Standards for Attestation Engagements. However, a member or member’s firm, while holding out as CPAs, is not considered to be in the practice of public accounting if the member or the member’s firm does not perform, for any client, any of the professional services described in the preceding paragraph.

Principles - Positive statements of responsibility in the Code of Professional Conduct that provide the framework for the rules, which govern performance.

Professional services - Includes all services performed by a member while holding out as a CPA.

Rules - Broad but specific descriptions of conduct that would violate the responsibilities stated in the principles in the Code of Professional Conduct.

Securities and Exchange Commission (SEC) - A federal government regulatory agency with responsibility for administering the federal securities laws.

State boards of accountancy - State government regulatory organizations. Each state government issues a license to practice within the particular state under that state’s accountancy statute.

State societies of CPAs - Voluntary organizations of CPAs within each individual state.
Statements on Standards for Tax Services (SSTS) - SSTS superseded and replaced the AICPA's Statements on Responsibilities in Tax Practice (SRTP). They are enforceable standards of conduct for tax practice under the Code of Professional Conduct.

Unpaid fees - Fees for: 1) audit, and 2) other professional services that relate to certain prior periods that are delinquent as of the date the current year’s audit engagement begins, if the client is an SEC registrant, or the date the audit report is issued for non-SEC clients (i.e., AICPA rule).

Yellow Book - Governmental Auditing Standards issued by the Government Accountability Office.
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