

2012

School of Risk Control Excellence: Responsibilities in Tax Practice and Malpractice Risks

Diane S. Wainwright

Repository Citation

Wainwright, Diane S., "School of Risk Control Excellence: Responsibilities in Tax Practice and Malpractice Risks" (2012). *William & Mary Annual Tax Conference*. Paper 668.
<http://scholarship.law.wm.edu/tax/668>



School of Risk Control Excellence



Responsibilities in Tax Practice and Malpractice Risks

Dianne S. Wainwright, Esquire
Partner, Margolis Edelstein

Deborah K. Rood, CPA, MST
Risk Control Consulting Director, CNA

William & Mary College 58th Annual Tax
Conference
November 9, 2012

Disclaimer

The purpose of this presentation is to provide information, rather than advice or opinion. It is accurate to the best of the presenters' knowledge as of the date of the presentation. Accordingly, this presentation should not be viewed as a substitute for the guidance and recommendations of a retained professional. Any references to non-CNA Web sites are provided solely for convenience, and CNA disclaims any responsibility with respect to such Web sites.

To the extent this presentation contains any examples, please note that they are for illustrative purposes only and any similarity to actual individuals, entities, places or situations is unintentional and purely coincidental. In addition, any examples are not intended to establish any standards of care, to serve as legal advice appropriate for any particular factual situations, or to provide an acknowledgement that any given factual situation is covered under any CNA insurance policy. Please remember that only the relevant insurance policy can provide the actual terms, coverages, amounts, conditions and exclusions for an insured. All CNA products and services may not be available in all states and may be subject to change without notice.

IRS Circular 230 Notice: The discussion of U.S. federal tax law and references to any resources in this material are not intended to: (a) be used or relied upon by any taxpayer for the purpose of avoiding any federal tax penalties; (b) promote, market or recommend any products and/or services except to the extent expressly stated otherwise; or (c) be considered except in consultation with a qualified independent tax advisor who can address a taxpayer's particular circumstances.

CNA is a registered trademark of CNA Financial Corporation. Copyright © 2012 CNA. All rights reserved.





Learning Objectives

- Understand a tax practitioner's responsibilities under the professional standards
- Identify malpractice risks
- Limit risk exposure in tax engagements



Agenda

- Professional standards
 - Treasury Department Circular No. 230
 - American Institute of Certified Public Accountants (AICPA) Statements on Standards for Tax Services

- Claim statistics

- Types of claims and risk control
 - Tax advice claims
 - Tax compliance claims
 - Other tax claims
 - Estate and gift tax claims
 - Tax audits and collections claims



Tax Professional Standards

- Treasury Department Circular No. 230
- AICPA Statements on Standards for Tax Services

Discussion of Circular 230

- Available online at www.irs.gov/pub/irs-pdf/pcir230.pdf
- Regulations governing the practice before the Internal Revenue Service (IRS)
- Identifies who may practice before the IRS, including:
 - Attorneys
 - CPAs
 - Registered tax return preparers
 - Enrolled agents
 - Others
- Sets forth the rules for disciplinary procedures, and sanctions for noncompliance, including those addressing:
 - Due process with the Office of Professional Responsibility
 - Administrative hearing
 - Appeal
 - Reprimand, censure, suspension, disbarment and penalty

Discussion of Circular 230

- Practice before the IRS – Circular No. 230, § 10.2(4)* states
“Practice before the IRS comprehends **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 documents; filing documents; corresponding and communicating** with the Internal Revenue Service; rendering written advice with respect to any entity, transaction, plan or arrangement, or other plan or arrangement having a potential for tax avoidance or evasion; and **representing a client** at conferences, hearings, and meetings.”

* Subsequent citations to Circular 230 will utilize a short form and will not restate that the specific section (§) cited is found within Circular 230. Citations to other authorities will identify the statute or regulation in which the cited section is located.

Discussion of Circular 230

- § 10.20 – Information to be furnished to the IRS
 - Unless the practitioner believes in good faith and on reasonable grounds that the information is privileged, the practitioner is required to:
 - Promptly submit records or information
 - Notify the IRS promptly if information is not in the practitioner's possession or control
 - Provide information on alleged violation and testify
 - Not interfere with proper/lawful request
- IRC § 7525 – Confidentiality Privileges Relating to Taxpayer Communications
 - General rule regarding taxpayer and practitioner privilege
 - Exceptions exist

Discussion of Circular 230

- § 10.21 – Knowledge of client’s omission
 - Advise client promptly of:
 - Any non-compliance with tax law
 - Any error in or omission from, any document submitted to the IRS
 - The consequences of such noncompliance, error or omission

Discussion of Circular 230

- § 10.22 – Diligence as to accuracy
 - A practitioner must exercise due diligence in:
 - Preparing or assisting in the preparation, approving and filing of tax returns, documents, affidavits, and other papers
 - Determining correctness of oral or written representations
 - Due diligence will be presumed if the practitioner relied on the work product of another person and used reasonable care in engaging, supervising, training, and evaluating that other person
 - The practitioner will take into account the nature of the relationship with the other person

Discussion of Circular 230

- § 10.28 – Return of client’s records
 - Practitioners:
 - Must return client records at the client’s request
 - Own their workpapers
 - May retain copies of client records
 - In the event of a fee dispute:
 - The practitioner is not generally relieved of his or her responsibility to return client records
 - Some withholding of records may be permissible under state law, however, the practitioner must:
 - Return records required to be attached to the tax return
 - Allow the client reasonable access to review and/or copy records in order to comply with federal tax law

Discussion of Circular 230

- § 10.29 – Conflicting interests
 - A practitioner shall not represent a client if such representation would be:
 - Directly adverse to another client
 - Materially limited by responsibility to another client
 - A practitioner may represent both parties, in spite of the conflict, if:
 - He or she is able to provide competent and diligent representation to both parties
 - He or she is not prohibited from doing so by law
 - Each affected client:
 - Waives the conflict of interest and
 - Gives informed written consent within 30 days

Discussion of Circular 230

- § 10.33 – Best practices for tax advisors
 - Tax advisors should provide clients with the highest quality representation by:
 - Communicating terms of engagement clearly
 - Establishing the facts, evaluating the reasonableness of assumptions and representations, applying the law to the facts, and arriving at a conclusion supported by the law and facts
 - Advising the client regarding accuracy-related penalty if the taxpayer acts in reliance on advice received
 - Acting fairly and with integrity
 - Taking reasonable steps to ensure firm's procedures are consistent with best practices

Discussion of Circular 230

- § 10.34 – Standards with respect to tax returns and documents, affidavits and other papers
 - A practitioner may not willfully, recklessly, or through gross incompetence:
 - Sign a return or refund claim, advise a tax position, or prepare a portion of a return or refund claim that:
 - Lacks a reasonable basis
 - Is an unreasonable position (IRC § 6694(a)(2)) or
 - Is a willful attempt to understate the tax liability or reckless or intentional disregard of rules or regulations

Discussion of Circular 230

- § 10.35 – Requirements for covered opinions
 - “A *covered opinion* is written advice (including electronic communications) by a practitioner concerning one or more federal tax issues arising from ...”
 - A transaction that is the same or similar to:
 - A tax avoidance transaction
 - An identified listed transaction
 - A principal purpose of tax avoidance or evasion
 - Covered opinions must comply with several requirements

Discussion of Circular 230

- § 10.35 – Requirements for covered opinions, *cont.*
 - A covered opinion does not include
 - Written advice that is:
 - A reliance opinion (one with a more likely than not degree of confidence)
 - Exception – prominent disclosure
 - A marketed opinion
 - Subject to conditions of confidentiality
 - Subject to contractual protection

Discussion of Circular 230

- § 10.36 – Procedures to ensure compliance
 - Any person with principal authority/responsibility for oversight over:
 - The providing of advice in covered opinions
 - Must ensure firm has adequate procedures to comply with § 10.35
 - The preparation of tax returns and other documents
 - Must ensure firm has adequate procedures to comply with Circular 230
 - A person with oversight authority/responsibility is subject to discipline for failure to comply

Statements on Standards For Tax Services

- Tax Services (TS) § 100 – Tax Return Positions (TRP)
 - The practitioner:
 - Should not recommend a TRP, prepare or sign a return taking a TRP
 - Unless it has at least a realistic possibility of being sustained administratively or judicially on its merits, if challenged
 - To exploit the audit selection process
 - To obtain leverage in negotiation with tax authorities
 - Should advise the taxpayer:
 - Of potential penalty consequences
 - To avoid penalties through disclosure
 - May recommend a TRP, prepare or sign a return taking a TRP if:
 - It has a reasonable basis
 - The taxpayer is advised to appropriately disclose it

Statements on Standards For Tax Services

- TS § 300 – Certain Procedural Aspects of Preparing Returns
 - The practitioner:
 - May in good faith, without verification, rely on information provided by the taxpayer or third parties
 - Should make reasonable inquiries if information appears to be
 - Incorrect, incomplete, or inconsistent on its face or other facts that are known to the practitioner
 - Should make inquiries of the taxpayer
 - Regarding the taxpayer's maintenance of books and records to substantiate deduction or tax treatment
 - Should consider information known from another taxpayer's return

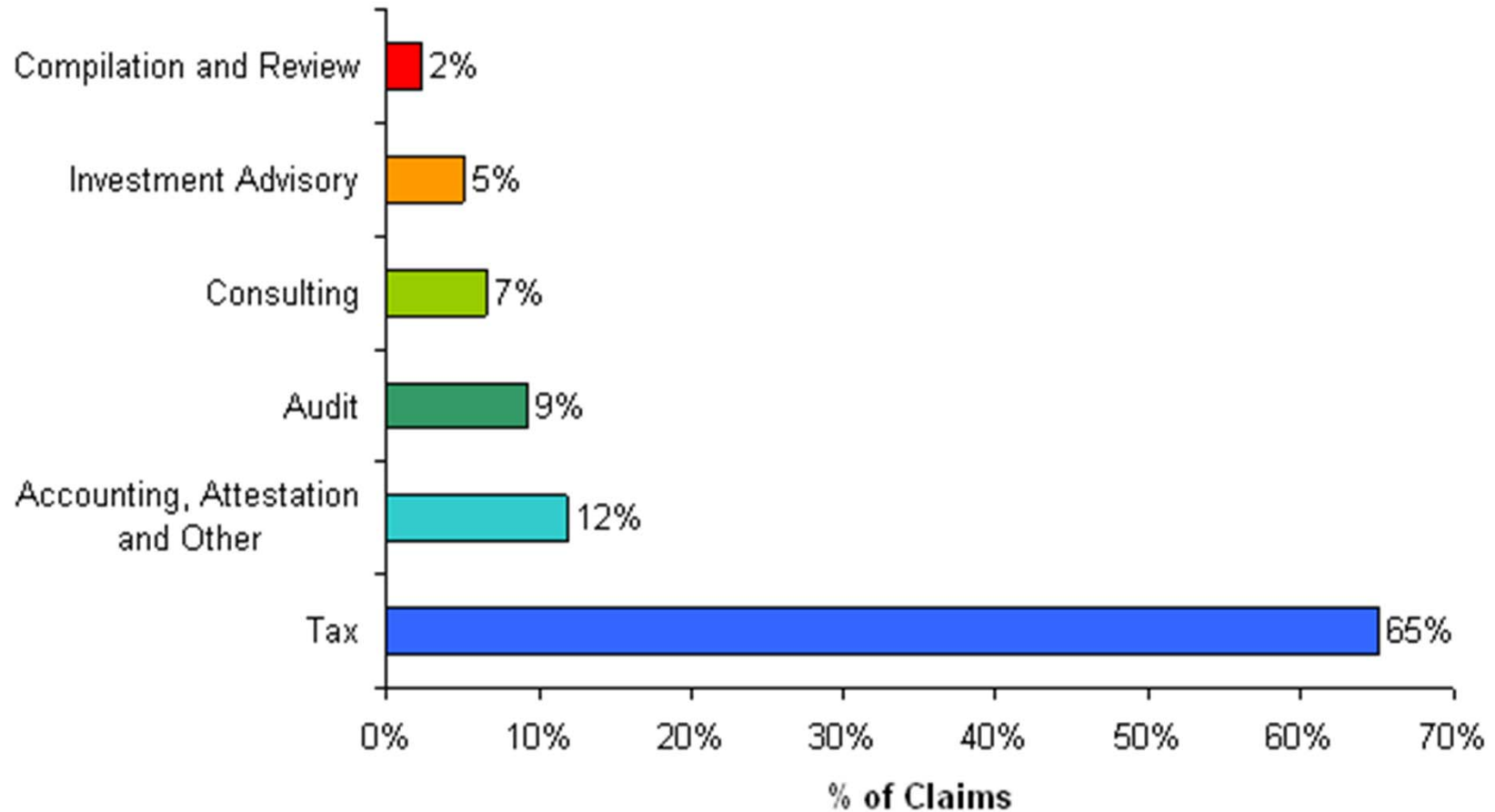
Statements on Standards For Tax Services

- TS § 600 – Knowledge of Error: Return Preparation and Administrative Proceedings
 - The practitioner should:
 - Inform taxpayer promptly of:
 - Errors in a prior year returns
 - Errors in returns under audit or appeal
 - Failure to file a required return
 - Advise of potential consequences
 - Recommend corrective measures
 - Not inform taxing authority without permission, unless required by law

Statements on Standards For Tax Services

- TS § 600 – Knowledge of Error: Return Preparation and Administrative Proceedings, *cont.*
 - The practitioner should:
 - Consider withdrawing if
 - The taxpayer will not amend return for error on prior year's return
 - Ensure error is not repeated on current year's return
 - Obtain taxpayer's permission to disclose the error to a tax authority during audit or appeal

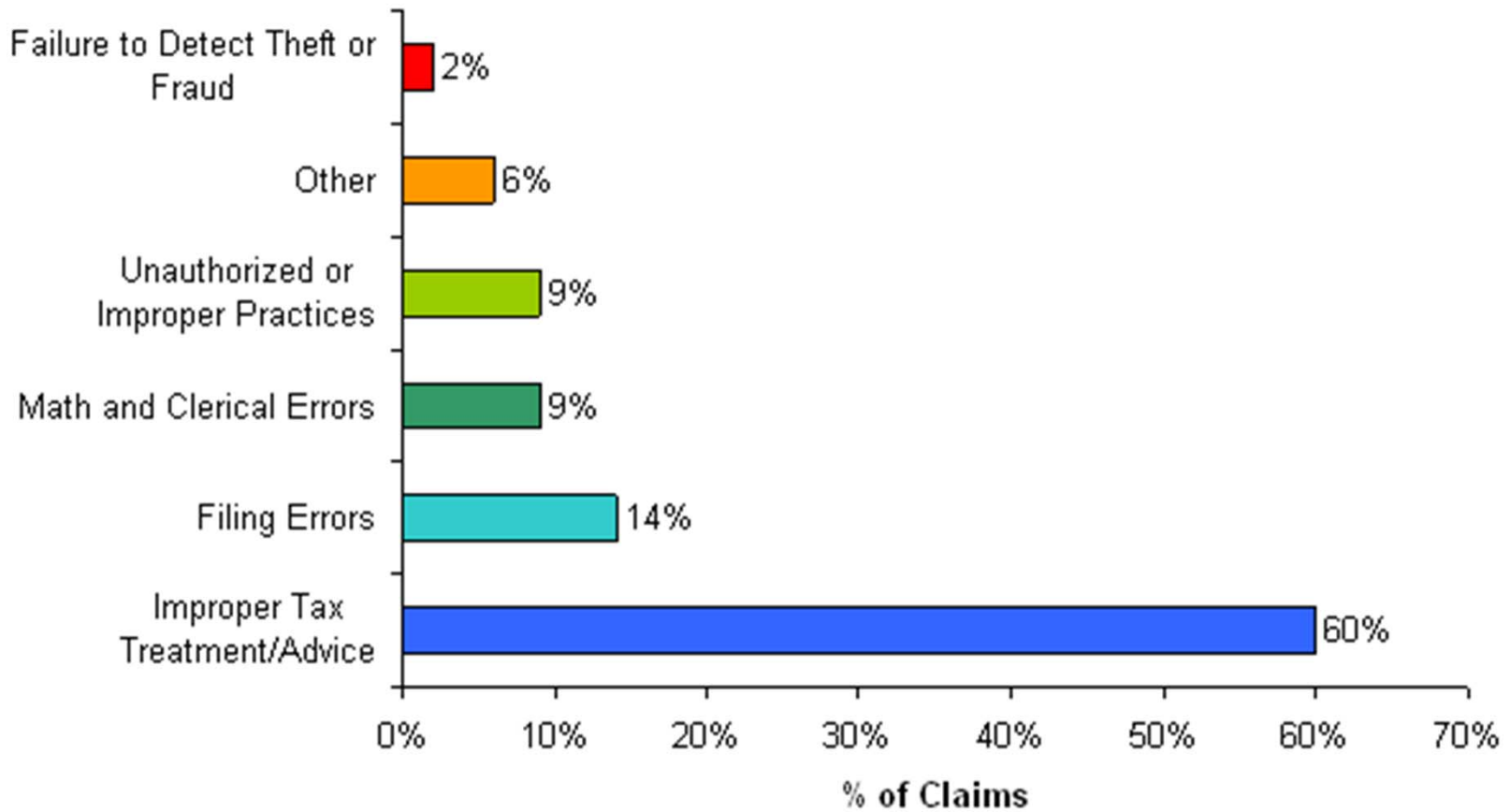
Claims Statistics - 2011 Claims by Area of Practice



CNA Claim Database - 2011



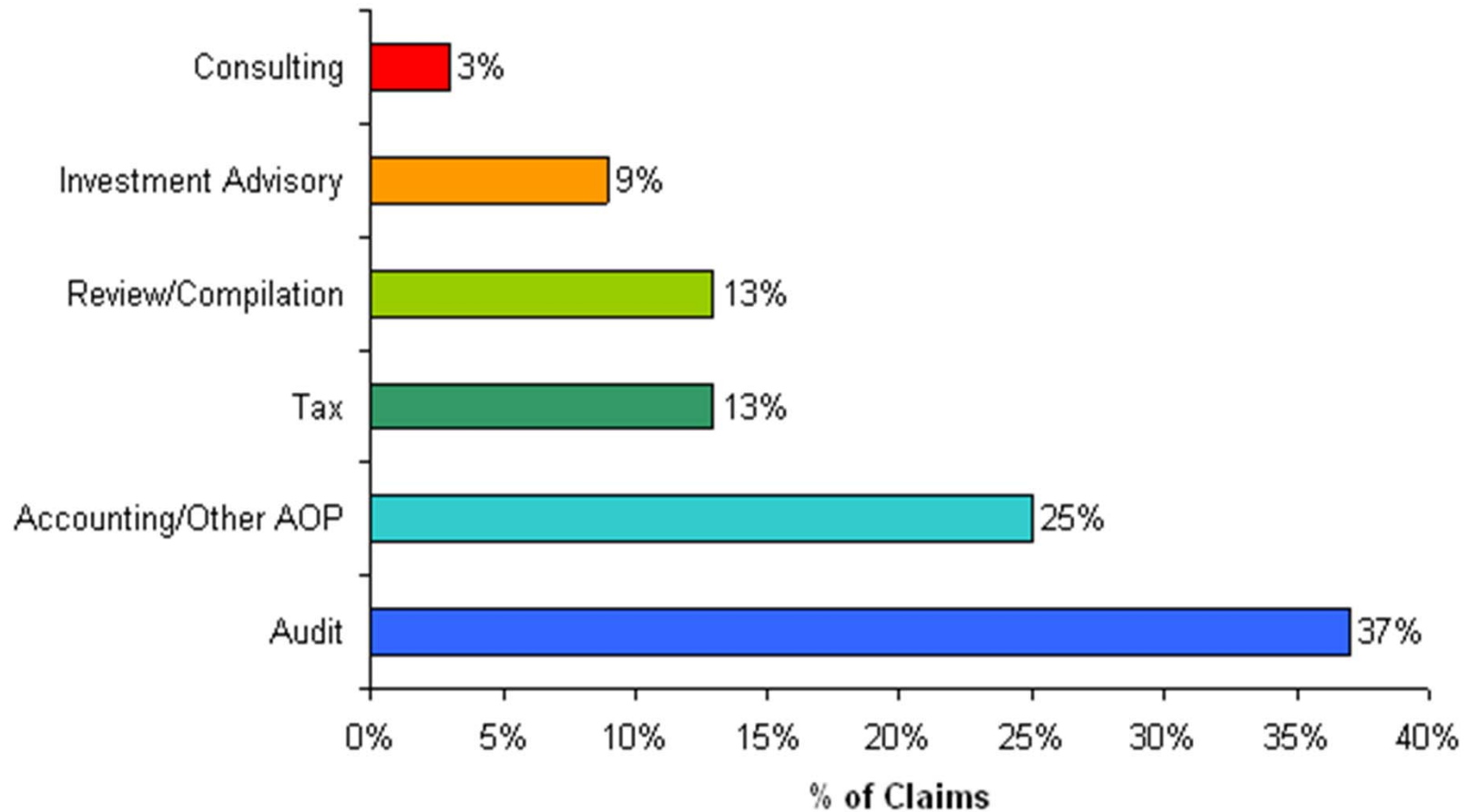
Claims Statistics - 2011 Tax Claims by Cause of Loss



CNA Claim Database - 2011



Claims Statistics - 2011 Theft and Fraud Claims



CNA Claim Database - 2011





Tax Claims

- Tax advice claims
- Tax compliance claims
- Other tax claims
- Estate and gift tax claims
- Tax audit and collections claims



Tax Advice Claims

- Incorrect tax advice
- Failure to advise



Incorrect Tax Advice Claims – Risk Control

- Understand purpose of engagement
 - Ask questions to put in proper context
- Provide all advice in writing

Failure to Advise Claims – Risk Control

- The engagement letter should:
 - Identify the services to be provided
 - Discuss scope limitations
 - If the scope of the engagement changes, add an addendum or issue a new engagement letter
 - Identify the client's responsibilities
 - The client should only rely on written tax advice
 - Address the fee structure

Failure to Advise Claims – Risk Control

- Knowledge of issue
 - Become knowledgeable in the particular tax area to recognize issues
 - Seek advice from specialist
- Knowledge of client
 - Advise client of other tax issues
 - This may represent an opportunity to provide additional services
- Maintain contact throughout the year
 - “What’s new with the business?”
- Be aware of other tax implications
- Document discussions



Tax Compliance Claims

- Errors in a new client's prior returns (Circular No. 230 § 10.21 and TS § 600)
- Filing errors
- Computational errors
- Missed elections or incorrect elections made
- Miscellaneous errors and omissions

Tax Compliance Claims – Risk Control

- Promote tax quality control policies and monitor compliance
- Invest in pre-tax season preparation
- Tax season quality controls
- Tax practice quality controls
 - CNA guide and articles
 - *Pre-tax Season Checklist* – available at www.cpai.com
 - *Tax Quality Control for Small CPA Firms - A Risk Control Perspective* – available to CNA policy holders at www.cpai.com



Other Tax Claims

- Mishandling of client documents
- Failure to detect theft

Other Tax Claims – Risk Control

- Mishandling of client documents
 - Safeguard originals and return to client immediately
 - Obtain client consent before disclosure or use
- Professional standards on confidentiality
 - IRC § 7216 - Disclosure or Use of Information by Preparers of Returns
 - Regulations § 301.7216-1, § 301.7216-2, and § 301.7216-3
 - Revenue Procedure 2008-35
 - Revenue Rulings
 - AICPA ET § 301 – Confidential Client Information
 - No disclosure of confidential client information without specific client consent
 - State Board of Accountancy rules

Other Tax Claims – Risk Control

- Failure to detect theft
 - Include scope limitations in the engagement letter, such as:
 - "Our engagement does not include any procedures designed to detect errors, fraud, or theft; and, our engagement cannot be relied upon to detect or disclose them."
 - "The services will be performed based on information you provide to us. We will not verify or audit this information."

Other Tax Claims – Risk Control

- Failure to detect theft, *cont.*
 - If you see something suspicious or unusual:
 - Inform client management of the facts, unless management is the culprit
 - Document the discussion
 - If the findings implicate management, then inform persons charged with governance
 - Recommend the client consult with counsel and investigate
 - Communicate only the facts: no conjecture to avoid a defamation suit

Other Tax Claims – Risk Control

- Failure to detect theft, *cont.*
 - Consider the impact on the client's tax liability
 - Do not initiate an investigation on the client's behalf
 - Engagement creep
 - Not qualified to investigate
 - Resign if the client is the culprit and there is no oversight
 - Consult with your professional liability insurer



Estate and Gift Tax Claims

- Inexperience
- Improper planning advice
- Undefined responsibilities
- Large late filing and late payment penalties

Tax Audit and Collections Claims

- Dissatisfaction with settlement terms and consequences
 - Inexperience
 - Unfamiliar with tax authority practice and procedures
- Poor communication and documentation
 - Did not inform client or obtain client's approval before settlement
- Complexity of issue
 - Accepts unfavorable settlement due to inadequate analysis
- Criminal exposure
 - Fails to ask agent if audit is part of a criminal investigation
 - Fails to advise client to consult with attorney if criminal

Tax Audit and Collections Claims – Risk Control

- Existing client
 - Review prior year returns for:
 - Errors
 - Improper advice on tax positions because they:
 - Lack a reasonable basis
 - Did not meet the required higher standard
 - Report problems to professional liability insurer as potential claims
 - Conflict of interest exists if there are errors or improper advice was provided

Tax Audit and Collections Claims – Risk Control

- Prospective/New client
 - Contact predecessor
 - Assess the client's integrity
 - Did the client follow the predecessor's advice?
 - Review prior year returns before accepting engagement
 - Obtain a retainer



Tax Audit and Collections Claims – Risk Control

- Advise client to consult with an attorney on criminal exposure
- Manage expectations
- Documentation

Summary

- More tax claims than all other claims combined
- Know the professional standards
- A few risk control strategies include:
 - Documentation, including engagement letters
 - Do not ignore problems – they must be addressed
 - If the firm does not have the proper experience, find an expert
- AICPA Code of Professional Conduct at <http://www.aicpa.org/Research/Standards/CodeofConduct/Pages/default.aspx>
- CNA policy holders should review:
 - Sample engagement letters at https://www.cpai.com/members/Supplement_Engagement_Letters.jsp
 - *Tax Quality Control – A Risk Control Perspective* at https://www.cpai.com/pdfs/Tax_Quality_Control_-_A_Risk_Control_Perspective_FINAL_CHANGE_TITLE_111711.pdf