

**Session 9: Ethical Dilemmas Facing Tax Practitioners Today**

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**I. Introduction**

- a. *“There are clear indications that professional standards have eroded in some corners of the practitioner community. Attorneys and accountants should be the pillars of our system of taxation, not the architects of its circumvention.” –Former IRS Commissioner Mark Everson*
- b. Ethical Behavior of Tax Practitioners
  - i. There are significant ethical dilemmas facing tax practitioners today. This is due, at least in part, to the inherently complicated nature of tax issues and the general attitude of society: *“The United States is conflicted about ethical behavior. Americans want people to be grounded in right behavior, but they collectively celebrate and admire people who skate close to the edge, or cross the line, on ethical behavior.”<sup>1</sup>*
  - ii. The Internal Revenue Code (the “Code”) and Treasury Circular 230 govern ethical behavior for tax practitioners.
  - iii. Lawyers and certified public accountants (“CPAs”) are also subject to the professional standards promulgated by state licensing authorities.
    - 1. Arkansas Rules of Professional Conduct
    - 2. AICPA Code of Professional Conduct (Dec. 15, 2014)
    - 3. AICPA Statements on Standards for Tax Services (Jan. 1, 2010)
- c. Keep in mind that practice before the Internal Revenue Service (“IRS”) is not limited to direct communication with the IRS.
- d. Discussion of Selected Rules Governing Ethical Behavior
  - i. Due Diligence
  - ii. Candor to the IRS
  - iii. Conflicts of Interest
  - iv. Competence
  - v. Confidentiality

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<sup>1</sup> Diane D. Fuller and Nancy K. Hyde, Establishing an Ethical Culture in a Tax Practice, THE TAX ADVISOR (Jan. 31, 2013).

**II. Enforcement of Rules Governing Ethical Behavior**

- a. Disciplinary actions result from a breach of the applicable code of conduct.
- b. The Office of Professional Responsibility (“OPR”) administers and enforces the regulations governing practice before the IRS. OPR is responsible for instituting two types of disciplinary proceedings.
  - i. Section 10.60 Disciplinary Proceedings
    - 1. Applies to practitioners,<sup>2</sup> appraisers, employers, firms and other entities
  - ii. Section 10.82 Disciplinary Proceedings for Expedited Suspension
    - 1. Applies to practitioners who within five years:
      - a. Have had a license to practice as an attorney, CPA or actuary suspended or revoked for cause;
      - b. Have been convicted of any crime under the Code, any crime involving dishonesty or breach of trust, or any felony involving conduct that renders the practitioner unfit to practice before the IRS;
      - c. After being subject to the sanction of censure or suspension, have violated conditions imposed by the OPR on their future representations; or
      - d. Have been sanctioned by a court in a civil or criminal proceeding, including suits for injunctive relief, relating to any taxpayer’s tax liability or relating to the practitioner’s own tax liability for instituting or maintaining proceedings primarily for delay, advancing frivolous or groundless arguments, or failing to pursue available administrative remedies.
- c. The Arkansas State Board of Public Accountancy (“ASPCA”), created by the Arkansas Legislature, licenses and revokes the licenses of accountants and has the responsibility to promulgate and enforce its code of conduct.

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<sup>2</sup> “Practitioners” is Circular 230’s collective term for individuals who are eligible to practice before the IRS.

- d. The AICPA created the Professional Ethics Executive Committee to provide uniform enforcement of professional standards by adjudicating disciplinary charges against state societies and AICPA members. Its decisions affect both AICPA and state society memberships.
- e. The Arkansas Supreme Court is charged with the responsibility of enforcing the Arkansas Rules of Professional Conduct. To carry out this responsibility, the Supreme Court has created the Supreme Court Committee on Professional Conduct.

### III. Where Are Disciplinary Actions Reported?

- a. OPR makes certain information from disciplinary proceedings publicly available:
  - i. Disciplinary sanctions appear in the Internal Revenue Bulletin and list name, city and state, professional designation, disciplinary sanction and effective dates. The Internal Revenue Bulletin is available at <https://www.irs.gov/tax-professionals/enrolled-actuaries/disciplinary-sanctions-internal-revenue-bulletin>.
  - ii. Final agency decisions in Circular 230 disciplinary proceedings, with identifying information of third-party taxpayers redacted, are available at <https://www.irs.gov/tax-professionals/enrolled-actuaries/final-agency-decisions>.
- b. The disciplinary actions of the American Institute of Certified Public Accountants (“AICPA”) are publicly disclosed and can be found on the AICPA website, available at <http://www.aicpa.org/forthepublic/disciplinaryactions>.
- c. The disciplinary actions of the ASBPA are semi-transparent. A summary of recently closed ASBPA disciplinary cases are published in its newsletters, which are available online at <http://www.asbpa.arkansas.gov/>. In the newsletters, the offending accountant is not referred to by name, only by case number.

- d. The American Bar Association and various state bar associations have long publicly disclosed disciplinary actions taken against attorneys. For approximately fifteen (15) years, disciplinary actions of the Arkansas Supreme Court Committee on Professional Conduct have been publicly distributed each Thursday for the preceding week. The disciplinary actions are available online at <https://courts.arkansas.gov/administration/professional-conduct/opinions>. Disciplinary actions are also published in the *Arkansas Lawyer*, the quarterly magazine published by the Arkansas Bar Association.

#### IV. Due Diligence

- a. Circular 230, § 10.22 Diligence As to Accuracy
- i. Practitioners must exercise due diligence in preparing or assisting in the preparation of returns and documents relating to IRS matters and in determining the correctness of representations made by the practitioner to the IRS and to the client.
  - ii. Except as provided in §§ 10.34, 10.35 and 10.37, practitioners are presumed to have exercised due diligence when relying upon the work product of others if the practitioner used reasonable care in engaging, supervising, training and evaluating the person.
- b. According to Karen Hawkins, the Former Director of the IRS Office of Professional Responsibility, “[t]he purpose in conducting due diligence is to investigate facts, circumstances, and actors sufficiently to enable one’s self, or those being advised, to make informed decisions about actions to be taken.”<sup>3</sup>
- i. Tax practitioners should ask probing, detailed questions about the client’s facts, situation, goals and intentions.
  - ii. Blindly accepting the client’s representations without asking such questions is unlikely to satisfy the requirements of § 10.22.
- c. AICPA Statement on Standards for Tax Services, No. 2, *Answers to Questions on Returns*
- i. “A member should make a reasonable effort to obtain from the taxpayer the information necessary to provide appropriate answers to all questions on a tax return before signing as preparer.”

<sup>3</sup> Karen L. Hawkins, *Ethics in the Eye of the Beholder: What Conduct is Most Likely to Result in Discipline Under Circular 230?*, MAIN STREET PRACTITIONER (Jun. 28, 2016).

- ii. An answer to a question on a tax return should not be omitted “merely because it might prove disadvantageous to a taxpayer.”
- d. AICPA Statement on Standards for Tax Services, No. 3, *Certain Procedural Aspects of Preparing Returns*<sup>4</sup>
  - i. Members may rely on information provided by the taxpayer or by third parties without independent verification unless the information furnished appears to be incorrect, incomplete or inconsistent.
  - ii. Members should inquire as to whether the taxpayer is meeting conditions imposed by tax law concerning the tax treatment of an item.
  - iii. Members should consider information actually known from other sources if necessary to properly prepare the return.
- e. Arkansas Rules of Professional Conduct, Rule 1.3
  - i. “A lawyer shall act with reasonable diligence and promptness in representing a client.”
- f. Walker Decision from the Office of Professional Responsibility (2013)
  - i. In this case, an enrolled agent was disbarred for failure to provide documentation to support certain deductions reflected on Schedule C of returns she prepared, assisted in the preparation of, approved or filed. As a result of examination, the Schedule C deductions were disallowed, which resulted in an upward adjustment to the taxpayers’ stated income and additional tax, penalties and interest. The enrolled agent was also assessed tax return preparer penalties as a result of her “willful violation” of § 10.22(a).

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<sup>4</sup> This guidance is taken directly from § 1.6694-1(e) of the Treasury Regulations.

**V. Candor to the IRS**

- a. Circular 230, § 10.20 Information Requested by the IRS
  - i. Upon request by the IRS, the practitioner must promptly:
    - 1. Submit non-privileged records and information to the IRS;
    - 2. If the requested records and information are not in the practitioner's possession or control, notify the IRS of the location of the requested records and information in the possession or control of others; and
    - 3. Make reasonable inquiries of the client regarding the location of requested records and information in the possession of others.
  - ii. The practitioner is not required to inquire of others or independently verify information provided by the client regarding the identity of persons in possession or control of requested documents.
- b. Circular 230, § 10.21 Knowledge of Client's Omission
  - i. If a practitioner knows the client has made an error in or omission from any return or other tax-related document submitted to the IRS the practitioner must:
    - 1. Advise the client of the fact of such error or omission, and
    - 2. Advise the client of the potential consequences of the error or omission under the Code or Treasury Regulations.
- c. AICPA Statement on Standards for Tax Services, No. 6, Knowledge of Error: Return Preparation and Administrative Proceedings
  - i. Mirrors § 10.21 of Circular 10.21
  - ii. Members are not allowed to inform the taxing authority of the client's error or omission without the taxpayer's permission, except where required by law.
- d. Circular 230, § 10.33(a)(4) Best Practices for Tax Advisors
  - i. "Act fairly and with integrity in practice before the Internal Revenue Service."
- e. Circular 230 § 10.34 Standards with Respect to Tax Returns and Documents, Affidavits and Other Papers
  - i. A practitioner may not willfully, recklessly or through gross incompetence:
    - 1. Sign or advise a client to take a position on a return or claim for refund that the practitioner knows or reasonably should know contains a position that lacks a reasonable basis, is an unreasonable

- position, is a willful attempt to understate the tax liability or is a reckless or intentional disregard of the rules or regulations;
2. Take, or advise a client to take, a frivolous position in any document submitted to the IRS;
  3. Submit, or advise a client to submit, any document for the purpose of delaying or impeding the administration of the tax laws;
  4. Submit or advise a client to submit, any document that contains or omits information suggesting an intentional disregard of the law unless supported by a good-faith challenge to a statute or regulation.
- f. Arkansas Rules of Professional Conduct, Rule 3.3(a)
- i. A lawyer shall not knowingly:
    1. Make a false statement of fact or law to a tribunal; or fail to correct a false statement of material fact or law previously made to the tribunal by the lawyer;
    2. Fail to disclose to the tribunal legal authority in the controlling jurisdiction known to the lawyer to be directly adverse to the position of the client and not disclosed by opposing counsel;
    3. Offer evidence that the lawyer knows to be false;
  - ii. The IRS is an administrative agency included in the definition of “tribunal.”
- g. ABA Section of Taxation Issues Statement 1999-1
- i. Counsel’s knowledge that IRS has made a computational error of tax, penalty or interest in the client’s favor is a client confidence, which generally may not be disclosed without the client’s consent, unless otherwise provided in the Model Rules or by other law. The lawyer, however, cannot engage in conduct that is dishonest.
    1. Counsel must disclose an error to the court in a docket case where the parties are required to document the amount of the client’s tax liability or overpayment because counsel cannot file a document with the court that contains an incorrect deficiency or overpayment without making a false statement to the court.
    2. A lawyer must disclose a clear arithmetic or clerical calculation error (but not a conceptual error that is dependent upon the application or interpretation of a Code section for which a reasonable dispute

could exist) the amount of which is not de minimis to the IRS, if there exists express or implied authority from the client to make the disclosure.

## VI. Conflicts of Interest

- a. Circular 230, § 10.27 Fees
  - i. Unconscionable fees for matters before the IRS are not permitted.
  - ii. Contingent fees are not permitted unless such fees are for services rendered in connection with an IRS challenge to an original tax return, an IRS challenge to an amended return or refund claim filed within 120 days of receipt of IRS examination notice, a refund claim regarding assessed interest or penalties, or judicial proceedings arising under the Code.
  - iii. See IRS Notice 2008-43 for more information on permissible fee structures.
- b. Circular 230, § 10.29 Conflicting Interests<sup>5</sup>
  - i. A practitioner may not represent a client before the IRS if the representation involves a “conflict of interest.”
  - ii. A “conflict of interest” exists if:
    1. The representation of one client is 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 by a personal interest of the practitioner.
  - iii. Notwithstanding a conflict of interest, the practitioner may represent a client if:
    1. The practitioner reasonably believes that he or she is able to provide competent and diligent representation to each affected client;
    2. The representation is not prohibited by law; and
    3. Each affected client waives the conflict of interest and signs a written, informed consent within a reasonable period of time after the practitioner learns of the conflict but in no event later than thirty (30) days after the conflict is known by the practitioner.

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<sup>5</sup> See also Arkansas Rules of Professional Conduct, Rule 1.7.



- c. AICPA Code of Professional Conduct, Section 1.110.010 Conflicts of Interest for Members in Public Practice
  - i. .02 A conflict of interest creates adverse interest and self-interest threats to the member's compliance with the "Integrity and Objectivity Rule" [1.100.001]. For example, threats may be created when
    - 1. The member or the member's firm provides a professional service related to a particular matter involving two or more clients whose interests with respect to that matter are in conflict, or
    - 2. The interests of the member or the member's firm with respect to a particular matter and the interests of the client for whom the member or the member's firm provides a professional service related to that matter are in conflict.
  - ii. Disclosure to the client and other appropriate parties and their consent to perform professional services is required by Section 1.110.010.12 when a conflict of interest exists.
  - iii. Section 1.110.010.18 incorporates Circular 230 requirements concerning written consent by a client when a conflict of interest exists.
- d. Arkansas Rules of Professional Conduct, Rule 1.8(a), (b)
  - i. Limits lawyer's ability to enter into business transactions with a client or knowingly acquire ownership, possessory, security or other pecuniary interests adverse to a client
  - ii. Prohibits lawyer from using information relating to the representation of a client to the disadvantage of the client unless the client gives informed consent in writing

## VII. Competence

- a. Circular 230, § 10.35(a) Competence
  - i. Practitioner must be competent to engage in practice before the IRS.
  - ii. Competent practice requires the appropriate level of knowledge, skill, thoroughness, and preparation necessary for the matter for which the practitioner is engaged.
- b. Circular 230, § 10.51 Incompetence or Disreputable Conduct Subject to Sanctions
  - i. Giving any false or misleading information, or participating in any way in the giving of false or misleading information the IRS.

- ii. Use of misleading representations with the intent to deceive a client or prospective client in order to procure employment.
- iii. Contemptuous conduct in connection with IRS practice, including the use of abusive language, making false accusations or statements, knowing them to be false, or circulating or publishing malicious or libelous matter.
- iv. Giving false opinions, 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.
- v. Unauthorized disclosure or use of tax return information.
- c. A tax practitioner is not required to be all knowing, but he or she should be “self-aware enough to know when to research or study a subject before giving advice or interacting with IRS personnel.”<sup>6</sup>
- d. The appropriate standard is the objectively reasonable tax professional.
- e. AICPA Code of Professional Conduct, Section 0.300.060, Due Care
  - i. .01 Due care principle. A member should observe the profession’s technical and ethical standards, strive continually to improve competence and the quality of services, and discharge professional responsibility to the best of the member’s ability.
  - ii. .04 Competence represents the attainment and maintenance of a level of understanding and knowledge that enables a member to render services with facility and acumen. It also establishes the limitations of a member’s capabilities by dictating that consultation or referral may be required when a professional engagement exceeds the personal competence of a member or a member’s firm. Each member is responsible for assessing his or her own competence of evaluating whether education, experience, and judgment are adequate for the responsibility assumed.

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<sup>6</sup> Hawkins, *supra* note 2.

- f. AICPA Statement on Standards for Tax Services, No. 1, Tax Return Positions
  - i. “A member should not recommend a tax return position or prepare or sign a tax return taking a position unless the member has a good-faith belief that the position has at least a realistic possibility of being sustained administratively or judicially on its merits if challenged.”<sup>7</sup>
  - ii. “A member should not recommend a tax return position or prepare or sign a tax return reflecting a position that the member knows (a) exploits the audit selection process of a taxing authority, or (b) serves as a mere arguing position advanced solely to obtain leverage in a negotiation with a taxing authority.”
- g. Arkansas Rules of Professional Conduct, Rule 1.1
  - i. “A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation necessary for the representation.”

## VIII. Confidentiality

- a. I.R.C. § 7216: Disclosure or Use of Information by Preparers of Returns
  - i. Return preparers who “knowingly or recklessly” make unauthorized disclosures or use of “information furnished . . . in connection with, the preparation of any . . . return” are subject to criminal sanctions (i.e., imprisonment) under § 7216.
- b. I.R.C. § 6713: Disclosure or Use of Information by Preparers of Returns
  - i. Any unauthorized disclosure or use of information provided to a return preparer will subject the return preparer to monetary penalties under § 6713.
- c. I.R.C. § 7525
  - i. Section 7525 of the Code extends the common law protections of confidentiality applicable to communication between a taxpayer and his or her attorney (i.e., privilege) to communications between a taxpayer and an authorized tax practitioner, except in criminal tax matters.
- d. AICPA Code of Professional Conduct, Section 1.700.001 Confidential Client Information Rule

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<sup>7</sup> There is an exception to this general rule if the member concludes that there is a reasonable basis for the position and the position is adequately disclosed.

- i. .01 A member in public practice shall not disclose any confidential client information with the specific consent of the client.
- e. AICPA Code of Professional Conduct, Section 0.400 Definitions
  - i. .09 Any information obtained from the client that is not available to the public should be considered confidential client information.
- f. Arkansas Rules of Professional Conduct, Rule 1.6(a)
  - i. A lawyer shall not reveal information relating to representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted under the specifically enumerated provisions of Rule 1.6(b) (related to prevention and mitigation of criminal acts and to ensure compliance with the rules and other laws).

## **IX. Hypotheticals for Discussion**

- a. Todd is a registered tax return preparer who received a request from the IRS for certain records substantiating deductions taken on his client's tax return for the year before Todd began preparing the client's tax return. Todd doesn't have the requested records and believes the IRS has made a mistake by directing their request to him instead of to the client or his former tax return preparer. Based on those factors, he decided to ignore the request.
- b. Brenda, a registered tax return preparer, is preparing the federal income tax return and associated documents for her client. In the information the client provided, the client noted that he owns three houses that he rents to tenants. However, the income information he supplied showed rental income only from two of the rental units. The client offhandedly indicated he had a "special arrangement" with respect to the third rental unit. Upon further questioning, Brenda learned that the tenant in the third unit was a local attorney who, in lieu of rent, provided certain legal services to her client that included a review of rental agreements, submission of various legal documents to the city and performance of other personal and business legal work.
- c. In reviewing the client's records, Larry notes that the earned income disclosed is below the threshold at which the client would be ineligible for the earned income tax credit. Furthermore, Larry believes the client's expenses are disproportionately high relative

to his income. In doing his due diligence, Larry reviewed the client's tax return for the previous year and found that, although the client reported receiving only \$3,000 in investment income this year, his investment income in the previous year had been \$25,000. Based on the client's records, apparent living standard, strong interest in the earned income tax credit and previous tax return, Larry believes the information and records he received from the client are incorrect and that the client may be attempting to deceive him. Despite that concern, Larry simply asked the client if all the information and records supplied were complete and accurate. The client answered that they were, and Larry completed and signed the tax return. The client claimed a substantial earned income tax credit.