

# 2021 NATIONAL INCOME TAX WORKBOOK

CHAPTER 1: ETHICS



# Ethics - topics

P. 1

Working  
Remotely

Unauthorized  
Practice of  
Law

Volunteering  
for a  
Nonprofit

Abusive Tax  
Evasion  
Schemes

Judicial Tax  
Doctrines

Case Studies

## Working remotely - Confidentiality

### ➤ Duty of Confidentiality

- I.R.C. §7216 nondisclosure rules
  - Return Preparers
  - Casual Preparers
  - Electronic Return Originators
  - Electronic Return Transmitters
  - Intermediate Service Providers
  - Software Developers
  - Reporting Agents

### ➤ Tax Return Information

- Everything from the client
- Workpapers
- Correspondence from the IRS
- Corrected Returns
- Statistical Compilations
- Software Registration Information

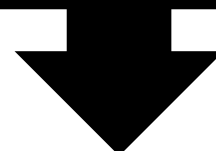
Working  
remotely --  
Confidentiality

P 2-3

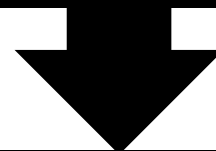
- State Confidentiality Laws
  - Disclosures only in certain situations (court proceedings or by subpoena)
- Professional Organizations Standards
  - AICPA – Code of Professional Conduct
  - Allowable Disclosures
    - Comply with professional obligations
    - Comply with a validly issued and enforceable subpoena or summons
    - Comply with applicable laws and government regulations
    - Review a member's professional practice
    - Initiate a complain with, or respond to, an ethics or disciplinary inquiry or proceedings

# Protecting Files

Reasonable Effort to ensure no access to documents



Electronic Files – encrypted portals



Data Protection – Commissioner Rettig

Security precautions

Two-factor authentication

Planning

# Working remotely – protect client info

PP 3-4

- Telephone calls
  - Text messages
  - Emails
- Video conferencing
    - Prevent video hijacking
    - Require password or control attendees
    - Tips from the FBI

# Polling Question # 1



Do you prefer working  
remotely or in-person?



Remotely or In-person

# Competency and due diligence

PP. 5

## Technological Competence

## Circular 230 § 10.22 Due Diligence –

- Clear communication
- Promptly address pending matters
- Cross-Reference: Client with Diminished Capacity

## Standards for Electronic Communications

- ✓ Adopt security & data protection protocols
  - ✓ Become proficient in a variety of technological platforms
  - ✓ Keep apprised of new technology
  - ✓ Understand each client's available technology and proficiency
  - ✓ Learn each client's preferences of using electronic communication
- ✓ Explain to clients, in writing, how technology will be used to gather and store information
  - ✓ Gather information that reasonably ensures identity of provider
  - ✓ Prioritize phone & video calls
  - ✓ Benefit analysis
  - ✓ Plan for technology failure or interruption of service

## Prompt Disposition -- safeguarding

- ✓ Incoming documents are stored securely and transmitted
- ✓ Use cloud-based practice management software – task & even tracking
- ✓ Programs, files & records are securely accessible
- ✓ Data is backed up
- ✓ Plan to restore data if lost, corrupted or accidentally deleted

# Unauthorized practice of law - tests

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Circular 230 § 10.32, tax practitioners who are not attorneys cannot give legal advice

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WHAT IS LEGAL ADVICE?

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Examples – drafting documents, interpreting laws

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Difficult question of law test - difficult legal questions

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Commonly understood test – commonly the practice of law

# Unauth. Practice of law - Choice of entity

TAX ADVICE vs. LEGAL ADVICE

Figure 1.2 – pg 8

*Columbus Bar v. Verne*

- Drafted Articles of Organization but no operating agreement
- Business partners had a dispute
- Tax and financial on how to structure is valuable
- Liability protection and governance – refer to attorney

## Unauth. Practice of law – business forms

• PP. 9-11

- Articles of Incorporation – Check state law
- May require knowledge of legal issues – Figure 1.3
  - Closing Corporation
  - Professional Corporation
  - Business Purpose
  - Authorized Shares
- Clerical forms – okay if entry of info that client has provided

## Authorized activities

- Representation before the IRS – attorneys, public accountants, and enrolled agents
- AFSP limited representation rights
- Tax Court – attorneys and non-attorneys who pass a test
- Tax Advice/Submissions – tax practitioners

## Polling Question # 2



Have your procedures around protecting client data changed in the past 18 months?



Yes or No



# Chapter 14 – Rulings & Cases

# Understatement Penalty – I.R.C. §6662

P 529

- Negligence or disregard of rules or regulations
  - Substantial understatement of income tax
  - Substantial valuation misstatement under Chapter 1 or I.R.C.
- Substantial overstatement of pension liabilities
  - Substantial estate or gift tax valuation understatement

# Understatement Penalty – I.R.C. §6662

P 529

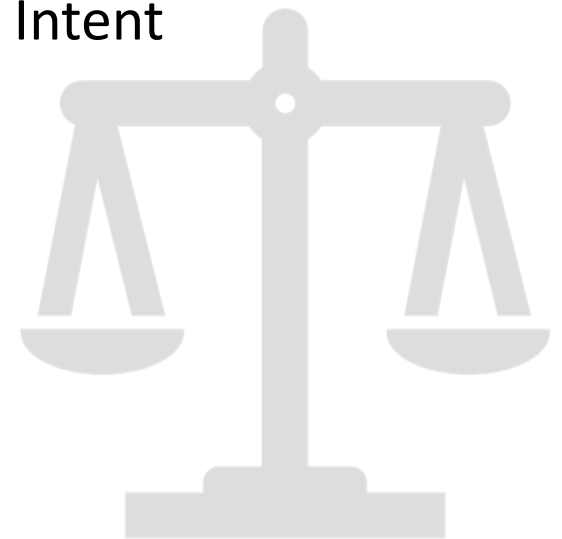
- Disallowance of claimed tax benefits because a transaction lacks economic substance OR failure to meet the requirement of any similar law
- Undisclosed foreign financial asset understatement
- Inconsistent estate basis
- Any overstatement of 2021 above-the-line deduction for charitable cash contributions

Understatement  
Penalty – I.R.C.  
§6662 P 529

- Negligence – any failure to make a reasonable attempt to comply
- Disregard – any careless, reckless or intentional disregard
- Understatement of tax > 10% (5% QBI) of tax required OR \$ 5,000
- Corporations = 10% of tax required OR \$ 10,000,000
- Reasonable Basis – some authority for position
  - NOT “merely arguable or is merely a colorable claim”

# Substantial Authority P 530

- Positions taken on tax return
- “...weight of authorities supporting the position is substantial in relationship to the weight of authorities supporting contrary positions.”
- DOES NOT HAVE TO MEET more-likely-than-not standard (greater than 50%)
- Practitioner Note – Taxpayer Intent



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# Types of Authority

## P 530-534

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Authorities  
P 530

- Statutes
- Regulations
- Revenue Rulings & Procedures
- “relevance and persuasiveness”
- “type of document providing the authority”

Authorities  
– continued  
P 531-532

- IRS FAQs – NOT Authority
- Internal Revenue Code
- Proposed, Temporary, and Final Regulations
- Revenue Rulings & Revenue Procedures
- Tax Treaties
- Federal Court Cases
- Tax Court – watch jurisdiction
- Congressional Committee Reports

Limited or  
NO  
Authority  
P 534

- Private Letter Ruling & Technical Advice Memorandum
- General Counsel Memorandum
- IRS Information Releases, Notices, and Announcements
- Tax Opinions

# Polling Question # 3



Unauthorized Practice of Law is unimportant to non-attorneys



True or False

CASE – Privilege  
& Workpapers  
P 546 - 547

IQL-Riggig v  
Kingsbridge  
Technologies

Federal Rules of  
a Civil Procedure  
§26(b)(4)(D)

Subpoena of  
Accounting  
Records

Work Product  
Immunity -  
§26(b)(4)

CASE – Privilege  
& Workpapers  
P 546 - 547

Privilege between  
Attorney & Client

Privilege between  
Accountant &  
Client

“...documents to  
used to prepare  
tax returns...are  
not privilege.”

Engagement Letter  
– “most important  
piece of evidence.”

Engagement Letter  
between Attorney  
& Accountant

Emails are NOT  
privileged

CASE – Privilege  
& Workpapers  
P 546 - 547

Work Produce  
Doctrine

Protects documents  
prepared by an  
Attorney

Protects documents  
prepared by the  
Attorney's agent

Used to analyze and  
prepare a clients case

Rule 26(b)(4)(D)

Experts work product,  
facts or opinions used  
in litigation are  
privileged

Circular 230 –  
§10.28 Return of  
Client's Records

Any & all records  
provided by the  
client

Only those used to  
comply with  
Federal Tax  
Obligations

Only records that  
must be attached  
to the taxpayer's  
tax return

Practitioner must  
retain copies

3<sup>rd</sup> Party  
documents –  
schedules,  
affidavits, appraisal

Fee Dispute –  
“...generally does  
not relieve the  
practitioner...”

# Volunteering for a nonprofit

PP. 13-14

1. Identify
2. Evaluate
3. Disclose and Get Written Consent

Example 1.1 (p. 14) – Ginger is a CPA on the community foundation board. Ginger's client, Trails West, applies for a grant from the foundation. Ginger has a conflict of interest if she participates in the board vote to approve or deny the grant.

# Conflict of interest – disclosure & consent P. 14

- Circular 230 § 10.29
- Disclose conflict
- Obtain Informed written consent
  - What is involved
  - Scope of the risk
- Within 30 days
- Retain for at least 3 years from the end of representation

# Volunteering – duty of confidentiality P. 15

- Confidentiality duty extends to clients and info obtained volunteering
- Example 1.2 – Ginger is still on the foundation board. Homes for Humanity submits a request for a grant. Ginger has confidential information that the executive director of Homes for Humanity is mismanaging funds. Ginger cannot disclose confidential info (and likely has a conflict of interest).

# Volunteering – integrity and objectivity<sup>PP. 15-16</sup>

- Acting as both board member and service provider must maintain integrity and objectivity
- Differences of Opinion – AICPA steps to reduce threat of material misrepresentation or violation of laws
- Gifts and Entertainment – OK if reasonable (7 factors)
- Example 1.3 – Nonprofit gives Jacob a crystal bowl to recognize 5 years of service on the board. Occasion and one-time frequency indicate the gift is reasonable.

# Volunteering – due diligence

PP. 15-20

- Before volunteering on a board consider:
- Bylaws – indemnification of directors (Figure 1.4)
- Insurance – general liability and D&O
- Conflict of interest policy (Figure 1.5)

# Abusive tax evasion schemes

P. 21

- **Goal is to Reduce Taxes – But Not by Abusive Schemes**
- How to recognize abusive schemes
  - Common recommendations
  - Promoter claims (Figure 1.6)

Example 1.3 – Ashley went to a tax seminar. Promoter advised forming tiers of entities to funnel income to a foreign trust that has only foreign income and no US tax liability. Appearance of giving up control but does not. Tax practitioner should recognize abusive scheme and advise to not participate.

# Ethical duties

P. 22

- Circular 230 § 10.34 - **do not** willfully, recklessly, or through gross incompetence advise or take a position that
  - Lacks reasonable basis
  - Is an unreasonable position
  - Willfully understates tax liability/ recklessly disregards rules

# Abusive tax schemes - reporting

PP. 22-24

- Form 14242 (Figure 1.7)
- IRS Hotline (Figure 1.8)

# Abusive tax schemes - penalties

PP. 24-25

- Understatement of Liability
- Promoting Abusive Tax Shelters
- Aiding and Abetting an Understatement
- Fraud and False Statements
- Fraudulent Returns, Statements, or other Documents

# Judicial Doctrines

P. 26

Circular 230 § 10.33 evaluate the reasonableness of any assumptions or representations, relate the applicable law (**including potentially applicable judicial doctrines**) to the relevant facts, and arrive at a conclusion supported by the law and the facts.

# Step-transaction doctrine

PP. 26-27

- Collapse a series of transactions into one end result
- End Result Test
  - Are separate steps prearranged to achieve the ultimate result?
- Interdependence Test
  - Would the taxpayer have completed one transaction without the others?
- Binding Commitment Test
  - Was there a binding commitment to take the later steps?

## Substance over form/business purpose P. 27

- Economic substance controls if different from legal form.
- Example 1.5 – Jenny, age 76, wants to do estate tax planning. She transfers \$15,000 stock to each of her 4 kids and to 20 friends who then gift the stock to Jenny’s children. The form of the gifts qualifies for the annual exclusion, but the substance is that all the gifts were intended for Jenny’s children.

## Case study 1: negative online review

- Ronald prepared a return for Naomi.
- He told her she couldn't claim the home office deduction because she used her home office for a gym (spin bike, kettle bells, yoga mat).
- The deduction would have saved her \$3,000. Naomi posted bad reviews.
- Naomi posted negative reviews about Ronald because he told her she couldn't claim a home office deduction for her home gym.
- The sites won't take down the negative reviews.
- Can Ronald post rebuttals
- What information can he post?
- What information can't he post?

# Case study 1 response

P. 34

- Ask her to remove or edit her posts.
- If she won't, he can make a curative post. But be careful of confidentiality. See the Oregon Bar case – no self defense objection.
- Note, Naomi didn't disclose her full name in the review.
- Keep it general and factual.

## Case study 2: working remotely

P. 29

- Eddie is a CPA, working remotely has its perks – with no long commute from NJ to NY he has time to clean the house, make dinner, and bake banana bread.
- He has a home office but shares the printer and internet with his family.
- He got a 30-day notice for his client, Elisha, who is also the children's orthodontist.
- He left the notice in the scanner tray where his daughter could see it.
- He emailed the notice to Elisha but didn't calendar it.
- Elisha called 45 days later upset that the IRS had levied her bank account.
- Eddie's wife overheard.

## Case study 2: working remotely

P. 29

- What are Eddie's duties to safeguard info?
- Has he violated those duties?
- Has he violated any other duties?
- What could he have done differently?

# Case study 2 response

PP. 34-35

- Eddie is trying to work from home, but he disclosed a document, missed a deadline, and allowed a confidential conversation to be overheard.
- Eddie has a duty to safeguard Elisha's info under I.R.C. § 7216, state law, and any professional societies that he belongs to (e.g., the AICPA).
- Eddie violated those duties by leaving the notice in the scanner, emailing unencrypted sensitive information, and failing to keep his conversation with his client confidential.
- Eddie also violated his duties to competently and diligently represent Elisha. He didn't calendar the notice, emailed it, and didn't follow up.
- Eddie needs some policies and procedures about safeguarding info, emailing, and calendaring.

## Case study 3: unauthorized practice of law P. 29

- John and Jeff are starting a business to rent ATVs in the summer and snowmobiles in the winter.
- Their tax return preparer Luke suggested that an S corporation could save them money.
- Luke prepared the Articles of Incorporation and filed them with the state.
- 2020-2021 was a low snow season and 2 customers from Florida were injured trying to ride a snowmobile up a steep slope.
- They are suing the S corp., and John and Jeff personally.

## Case study 3: unauthorized practice of law P. 29

- Did Luke engage in the unauthorized practice of law by recommending an S corp. and preparing the Articles?
- What advice should Luke have given John and Jeff?
  - Luke gave good advice when he advised about taxation of an S corp.
  - Advice about liability protection is likely legal advice.
  - Filing Articles may be the practice of law under state law, or if the forms require legal knowledge.
- Luke could have advised John and Jeff to talk to their attorney about bylaws, shareholder's agreements, and other docs that can help protect against disputes and personal liability.

# Polling Question # 4



Substantial authority is vital  
when taking a position on a tax  
return



True or False

## Case study 4: judicial tax doctrines

P. 30

- In 2019, Richard's attorney advised him to gift the family farm to his son George, to protect it in case Richard needed assisted living. Richard gifted the farm and died in 2021. George wants to sell the farm to a developer. His accountant Tiffany estimates \$230,000 federal income on the sale. George calls Richard's attorney who tells him that he can judicially "undo" the 2019 gift so George instead inherits the farm. George asks Tiffany if the judicial action would reduce his tax obligation.
- 1. How should Tiffany respond?
- 2. Does she have an ethical duty to consider any tax doctrines?

## Case study 4 response

P. 36

- George asked Tiffany about setting aside a gift so he could instead inherit the family farm.
- 1. In form, Tiffany may conclude that the proposed transactions would result in a step-up in basis.
- 2. However, Tiffany has a duty to consider the step-transaction doctrine and the economic substance of the proposed transactions. Tiffany may conclude that George would not set aside the gift if it did not lead to him inheriting the farm, and that the sole purpose of a judicial action is to avoid federal income tax. Thus, the transactions lack economic substance.

## Case study 5: volunteering for a nonprofit P. 30

- Alex is a new accounting grad who opened his own office in Polson. He agreed to serve on the board of the Polson food pantry, hoping it could enhance his reputation and generate business. The CEO of the food pantry had Alex review the payroll and deposit schedule, prepare quarterly financials, and prepare the annual return based on info from the CEO. The IRS later assessed unpaid payroll taxes and found that the tax return overreported contributions and underreported expenses.
- 1. Do Alex's dual roles as CPA and director violate any ethical duties?
- 2. What is his liability for the unpaid taxes and errors on the return?
- 3. What could he have done differently?

# Case study 5 response

PP. 36-37

- Alex is a volunteer director at the Food Pantry. The IRS assessed unpaid payroll taxes and an audit showed errors on the tax return.
- 1. Alex is a director of the nonprofit and also provided tax and accounting services. He may have a conflict of interest. If the CEO does not tell the board about the IRS notice and audit findings, he may have a hard time maintaining confidentiality. He may also violate his duties of objectivity and integrity if the CEO doesn't pay the taxes and amend the return.
- 2. Alex is likely not a responsible person for purposes of the payroll taxes. However, he prepared the erroneous return, and as a director, likely had access to the correct information.
- 3. Alex should have evaluated the possibilities for conflicts and ethical issues at the beginning. Maybe it would have been better to volunteer to provide free tax and accounting services, and not serve on the board.

## Case study 6: abusive tax schemes

P. 31

- Sunny's client Sasha owns profitable yoga studios. Sasha shows Sunny a brochure for an investment in a conservation easement that promises to give Sasha a \$3 deduction for every dollar that she invests.
  1. How can Sunny investigate if the scheme is legitimate?
  2. How should she advise Sasha?
  3. Does Sunny have a duty to report the scheme?

# Case study 6 response

PP. 37-38

- Sunny's client Sasha is thinking about investing in a tax scheme.
- 1. If it sounds too good to be true it probably is – Sunny should investigate whether the scheme is legitimate. She starts by reviewing the IRS list of abusive transactions and finds a notice detailing the scheme and concluding that the IRS will challenge the scheme.
- 2. Under Circular 230 § 10.34 Sunny has a duty to not advise Sasha to take a position that lacks reasonable basis, to take an unreasonable position, or to enter into an abusive tax shelter. Sunny must tell Sasha to not invest in the scheme and advise her about potential penalties.
- 3. Sunny does not have an obligation to report the scheme, but the IRS encourages tax practitioners to report abusive tax schemes.

## Case study 7: client w/ diminished capacity P. 31

- Lilah is a CPA working mostly from home. She has prepared returns for Brian for over 20 years. Brian's wife died recently, and Lilah has noticed a decline in his health. Lilah emailed Brian a tax organizer to gather information for his 2020 return. She did not get it back, so she left him a voice mail. Lilah got an email from Brian's address stating that he doesn't own the house anymore, his only income was \$21,000 social security, and he paid his caregiver Linda \$100,000. The email directs Lilah to have any refund deposited in Linda's account.
- 1. Can Lilah prepare a return based on the info Brian provided?
- 2. Does Lilah have a duty to confirm the info or the identity of the sender?

# Case study 7 response

P. 38

- Lilah suspects that the client Brian has diminished capacity.
- 1. The email that Lilah got from Brian is concerning. What happened to the house? And \$100,000 is a lot to give to his caretaker Linda. If Lilah thinks the information is inconsistent or incomplete, she can't rely on it, and must request additional substantiation.
- 2. Lilah called Brian, but she did not get a return call. She suspects that the email may have come from the caregiver who is influencing Brian. Lilah should try to video conference with Brian or meet with him in person to confirm what is going on. If there is a risk of harm to Brian, she may have to take further action.

# Case study 8: tax advice

P. 32

- Samantha works as a chairlift engineer at the local ski resort. A cable snapped and hurt her wrist. She went to the hospital and later filed an injury report. Earlier that week Samantha had posted a picture of herself snowboarding and holding a beer. Samantha's employer saw the post, claimed she faked the on-the-job injury, and fired her. Samantha sued for wrongful termination. They settled out of court for \$250,000 and the employer withheld \$15,000 in federal income tax. On April 14, 2021, Samantha texted her tax advisor, Jake with a "quick question" about including the settlement proceeds in her income.
  - 1. Should Jake respond to a text message?
  - 2. If so, how much info should he include?
  - 3. Does he have any other due diligence obligations?

# Case study 8 response

P. 39

- Samantha has texted Jake a “quick question” about the taxation of settlement proceeds.
- 1. Giving substantive tax advice in a short and informal text message isn’t recommended because it’s hard to fully explain the basis for the advice, and difficult to document.
- 2. Even a text must comply with Circular 230 § 10.37 requirements for written advice (ascertain relevant facts and relate the applicable law). Jake must consider that this is an important transaction and a complex issue.
- 3. Jake can rely on furnished info, without verification. But here, he needs more info about the underlying claim in the lawsuit and the basis for the settlement to determine if the proceeds were paid on account of physical injury. Lucky for Samantha, the 2020 filing deadline was extended. Jake can briefly respond by text and follow up with an email and conference later.

## Case study 9: Conflict of interest

P. 32

- Jeff prepares individual returns for Donna and Henry and also a partnership return for their dog grooming/vet business. They are divorcing but will continue to own and operate the business together. Donna runs the vet business, Jeff runs the grooming business, and they share a side business selling CBD pet supplements. They asked Jeff about how to structure compensation for their services.
- 1. Can Jeff continue to provide services for Donna, Henry, and the business?
- 2. If so, what should he do before he provides those services?

# Case study 9 response

P. 40

- Jeff provides tax services for Donna and Henry (who are getting divorced) and their business.
- 1. Jeff may have a conflict of interest if he continues to represent Donna, Henry, and the business. The vet business is an SSTB and the grooming and supplement businesses are not. They have asked for advice about compensation, which will impact the QBI deduction and each owner's income and deductions.
- 2. If Jeff reasonably believes that he can provide competent and diligent representation, he must get a signed written conflict disclosure/waiver.

# Case study 10: data protection

P. 33

- During tax season, Raymond is working 16 hours a day. Several of his firm associates are still working from home. At 1:00 a.m. Raymond is at his home computer responding to upset clients who were still waiting for refunds. He got an email that appeared to come from the IRS and asked for sensitive information. Raymond suspects that it is a phishing email that was sent to everyone in the firm. He calls the IT person.
- 1. What should Raymond do to ensure that his employees don't fall for the scam and give out sensitive information?
- 2. What best practices should Raymond have in place for his employees working from home?

# Case study 10 response

P. 41

- Raymond's firm got a phishing email seeking information that would allow the cyberthieves to file fraudulent returns.
- 1. Raymond should report the email to the IRS and TIGTA and immediately warn his employees about the scam. The IT person should update the security software and check for viruses. If any employees fell for the scam, Raymond must take additional action.
- 2. Raymond has a duty to ensure that he and his staff safeguard client info. Raymond must have an information security plan and train his employees. Employees working from home need security software that automatically updates and need to know how to recognize phishing scams.

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QUESTIONS?

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