

CHAPTER 1

AN INTRODUCTION TO TAX PRACTICE AND ETHICS

DISCUSSION QUESTIONS

- 1-1. In the United States, the tax system is an outgrowth of the following five disciplines: law, accounting, economics, political science, and sociology. The environment for the tax system is provided by the principles of economics, sociology, and political science, while the legal and accounting fields are responsible for the system's interpretation and application.

Each of these disciplines affects this country's tax system in a unique way. Economists address such issues as how proposed tax legislation will affect the rate of inflation or economic growth. Measurement of the social equity of a tax, and determining whether a tax system discriminates against certain taxpayers, are issues that are examined by sociologists and political scientists. Finally, attorneys are responsible for the interpretation of the taxation statutes, and accountants ensure that these same statutes are applied consistently.

Page 4

- 1-2. The other major categories of tax practice in addition to tax research are:

- tax compliance
- tax planning
- tax litigation

Page 5

- 1-3. Tax compliance consists of gathering pertinent information, evaluating and classifying that information, and filing any necessary tax returns. Compliance also includes other functions necessary to satisfy governmental requirements, such as representing a client during an IRS audit.

Page 5

- 1-4. Most of the tax compliance work is performed by commercial tax preparers, enrolled agents, attorneys, and CPAs. Noncomplex individual, partnership, and corporate tax returns often are completed by commercial tax preparers. The preparation of more complex returns usually is performed by enrolled agents, attorneys, and CPAs. The latter groups also provide tax planning services and represent their clients before the IRS.

An enrolled agent is one who is admitted to practice before the IRS by passing a special IRS-administered examination, or who has worked for the IRS for five years, and is issued a permit to represent clients before the IRS. CPAs and attorneys are not required to take this examination and are automatically admitted to practice before the IRS if they are in good standing with the appropriate professional licensing board.

Page 5 and Circular 230

- 1-5. Tax planning is the process of arranging one's financial affairs to minimize any tax liability. Much of modern tax practice centers around this process, and the resulting outcome is tax avoidance. There is nothing illegal or immoral in the avoidance of taxation, as long as the taxpayer remains

within legal bounds. In contrast, tax evasion constitutes the illegal nonpayment of a tax. Activities of this sort clearly violate existing legal constraints and fall outside of the domain of the professional tax practitioner.

Page 5

- 1-6. In an open tax planning situation, the transaction is not yet complete, therefore, the tax practitioner maintains some degree of control over the attendant tax liability, and the transaction may be modified to achieve a more favorable tax treatment. In a closed transaction however, all of the pertinent transactions have been completed, and tax planning activities are limited to the presentation of the situation to the government in the most legally advantageous manner possible.

Page 6

- 1-7. Tax litigation is the process of settling a dispute with the IRS in a court of law. Typically, a tax attorney handles tax litigation that progresses beyond the final IRS appeal.

Page 6

- 1-8. CPAs serve as a support capacity in tax litigation.

Page 6

- 1-9. Tax research consists of the resolution of unanswered taxation questions. The tax research process includes the following:

1. Identification of pertinent issues;
2. Specification of proper authorities;
3. Evaluation of the propriety of authorities; and,
4. Application of authorities to a specific situation.

Page 7

- 1-10. Circular 230 is issued by the Treasury Department and applies to all who practice before the IRS.

Page 7

- 1-11. In addition to Circular 230, CPAs must follow the AICPA's Code of Professional Conduct and Statements on Standards for Tax Services. CPAs must also abide by the rules of the appropriate state board(s) of accountancy.

Page 7

- 1-12. Beginning in 2011, tax return preparers who prepare all, or substantially all, of a Federal tax return (for compensation) will be subject to new requirements including:

1. Registration
2. Testing
3. Continuing Education (15 hours per year for all paid tax return preparers)
4. Tax compliance checks on all tax return preparers.
5. Extending Circular 230 ethics standards to all preparers.

Pages 11-12

- 1-13. False. Only communication with the IRS concerning a taxpayer's rights, privileges, or liability is included. Practice before the IRS does not include representation before the Tax Court.

Page 7

- 1-14. Section 10.2 of Subpart A of Circular 230 defines practice before the IRS as including:

...matters connected with presentation to the Internal Revenue Service or any of its officers or employees relating to a client's rights, privileges, or liabilities under laws or regulations administered by the Internal Revenue Service. Such presentations include the preparation and filing of necessary documents, correspondence with, and communications to the Internal Revenue Service, and the representation of a client at conferences, hearings, and meetings.

Page 7

- 1-15. To become an Enrolled Agent an individual can (1) pass a test given by the IRS or (2) work for the IRS for five years. Circular 230, Subpart A, Secs. 10.4 to 10.6.

Page 9

- 1-16. The parts of the Enrolled Agents examination are:

1. SEE1 Part 1 –Individuals
2. SEE2 Part 2 - Businesses
3. SEE3 Part 3 - Representation, Practices, and Procedures

Page 9

- 1-17. The Enrolled Agent Special Enrollment Examination (SEE) is an online exam given throughout the year that consists of three parts. The length of each part is 3.5 hours.

Page 9

- 1-18. Enrolled Agents must complete 72 hours of Continuing Education every three years (an average of 24 per year, with a minimum of 16 hours during any year.). Circular 230, Subpart A. Sec. 10.6.

Page 10

- 1-19. True. As a general rule, an individual must be an enrolled agent, attorney, or CPA to represent a client before the IRS. There are limited situations where others may represent a taxpayer; however, this fact pattern is not one of them. Since Leigh did not sign the return, she cannot represent the taxpayer, only Rose can.

Page 8

- 1-20. The names of organizations that can be represented by regular full-time employees are found in Circular 230, §10.7(c). A regular full-time employee can represent the employer (individual employer). A regular full-time employee of a partnership may represent the partnership. Also, a regular full-time employee of a trust, receivership, guardianship, or estate may represent the trust, receivership, guardianship, or estate. Furthermore, a regular full-time 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.

Page 10

- 1-21. Yes. Circular 230, Subpart A, Sec. 10.7.

Page 10

- 1-22. True. A practitioner may be suspended or disbarred from practice before the IRS if he or she knowingly helps a suspended or disbarred person practice indirectly before the IRS.

Page 12

- 1-23. 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. Circular 230 §10.34(b)(1).

Page 15

- 1-24. Under Circular 230, an attorney, certified public accountant (CPA), or enrolled agent may use mass media (e.g., T.V. and the Internet) for advertising purposes. Such media may not contain false, fraudulent, unduly influencing, coercive, or unfair statements or claims. Attorneys, CPAs, and enrolled agents must also observe any applicable standards of ethical conduct adopted by the American Bar Association (ABA), the American Institute of Certified Public Accountants (AICPA), and the National Association of Enrolled Agents (NAEA). Additional standards and listing of items that may be included in mass media advertising are defined under Section 10.30 of Subpart B in Circular 230.

Page 14

- 1-25. Under Section 10.25 of Circular 230, partners of government employees cannot represent anyone for which the government employee-partner has (or has had) official responsibility. For instance, a CPA firm with an IRS agent could not represent any taxpayer that is (or was in the past) assigned to the IRS agent-partner.

Page 12

- 1-26. Under Section 10.21 of Circular 230, each attorney, CPA, enrolled agent, or enrolled actuary who 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 is required by the revenue laws of the United States to execute, shall advise the client promptly of the fact of such noncompliance, error, or omission.

Page 12

- 1-27. According to Circular 230, the best practices rules are inspirational. Thus, a practitioner who fails to comply with best practices will not be subject to discipline by the IRS.

Page 14

- 1-28. Best practices include:

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, 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 importance 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 IRS.

Page 14

- 1-29. A **reliance opinion** is written advice that concludes at a confidence level of greater than 50 percent likelihood that one or more significant Federal tax issues would be resolved in the taxpayer's favor. A **marketed opinion** is written advice that 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 a partnership or other entity, investment plan or arrangement to one or more taxpayer(s).

§10.36 requires a practitioner who has principal authority and responsibility for overseeing a firm's practice of providing advice concerning Federal tax issues must take reasonable steps to ensure that the firm has adequate procedures in effect to ensure compliance with §10.35.

Page 15

- 1-30. A practitioner must not give written advice if the practitioner:
1. bases the written advice on unreasonable factual or legal assumptions (including assumptions as to future events),
 2. unreasonably relies upon representations, statements, findings, or agreements of the taxpayer or any other person,
 3. does not consider all relevant facts that the practitioner knows or should know, or
 4. in evaluating a Federal tax issue, takes into account the possibility that a tax return will not be audited, that an issue will not be raised on audit, or that an issue will be resolved through settlement if raised.

Page 16

- 1-31. The AICPA's Code of Professional Conduct provides a philosophical foundation upon which the Rules of Conduct are based. The Principles of the Code of Professional Conduct suggest that a CPA should strive for behavior that is above the minimal level of acceptable conduct set forth by the rules. The Code was designed to provide the following.
1. A comprehensive code of ethics and professional conduct;
 2. A guide for practitioners in answering complex questions; and,
 3. Assurance to the public concerning the obligations and responsibilities of the accounting profession.

Page 16

- 1-32. The only exceptions to the Rules of Conduct occur when the wording of a Rule indicates otherwise or the member is in a foreign country.

Page 17

- 1-33. Under Rule 503, a CPA may accept a commission if he or she does not do audit, review, or compilation work for the client and a disclosure of the commission is made to the client.

Page 21

- 1-34. Independence is impaired if a CPA:

Had or was committed to acquire any direct or material indirect financial interest in the client.

1. Was a trustee of any trust or executor or administrator of any estate if such trust or estate had or was committed to acquire any direct or material indirect financial interest in the client and
2. Had a joint closely held investment that was material to the covered member.
3. Except as specifically permitted in interpretation 101-5, had any loan to or from the client, any officer or director of the client, or any individual owning 10 percent or more of the client's outstanding equity securities or other ownership interests.
4. During the period of the professional engagement, a partner or professional employee of the firm, his or her immediate family, or any group of such persons acting together owned more than 5 percent of a client's outstanding equity securities or other ownership interests.
5. During the period covered by the financial statements or during the period of the professional engagement, a firm, or partner or professional employee of the firm was simultaneously associated with the client as a(n):
 - Director, officer, or employee, or in any capacity equivalent to that of a member of management;
 - Promoter, underwriter, or voting trustee; or
 - Trustee for any pension or profit-sharing trust of the client.

Page 18

- 1-35. A CPA in tax practice may present an issue resolving doubt in favor of the client in an advocacy engagement. Such presentation by the CPA is permitted and is not considered to impair integrity or objectivity.

Page 19

- 1-36. The four general standards of Rule 201 are as follows:

1. The CPA must be able to complete all professional services with professional competence.
2. The CPA must exercise due professional care in performing all professional services.
3. The CPA shall adequately plan and supervise the performance of all professional services.
4. The CPA must obtain sufficient relevant data to afford a reasonable basis for any conclusion or recommendation in connection with the performance of any professional services.

Page 19

- 1-37.

- a. No violation
- b. 503 - Commissions
- c. No violation
- d. 502 - Advertising and Solicitation
- e. 505 - Form of Practice and Name
- f. 501 - Discreditable Acts

Various pages

1-38. Rule 301 does not apply in the following situations:

1. If there is a conflict with Rules 202 and 203 as set forth by the AICPA Code of Professional Conduct;
2. If the CPA is served with an enforceable subpoena or summons, or must comply with applicable laws and government regulations;
3. The review of a CPA's practice under AICPA or state society authorization; or
4. If the CPA is responding to an inquiry of an investigative or disciplinary body of a recognized society or where the CPA is initiating a complaint with a disciplinary body.

Page 19-20

1-39. The *Statements on Standards for Tax Services* are a series of guidelines, issued by the AICPA, as to what constitutes good standards of tax practice. The Statements also delineate a member's responsibility to clients, the public, and the profession.

The stated objectives of the Statements are as follows:

1. To recommend appropriate standards relative to the member's standards for tax services;
2. To encourage an increased understanding of the member's responsibilities by the Treasury Department and the IRS; and,
3. To foster an increased public understanding of, compliance with, and confidence in the tax system, through awareness of the recommended standards of responsibilities of members.

Page 21

1-40. Under SSTs No. 1, a member should determine and comply with the standards, if any, that are imposed by the applicable taxing authority with respect to recommending a tax return position, or preparing or signing a tax return. If the applicable taxing authority has no written standards with respect to recommending a tax return position or preparing or signing a tax return, or if its standards are lower than the standards set forth in SSTs No. 1, then SSTs No. 1 must be followed.

Page 21

1-41. SSTs No.1 provides that a member should have a good faith belief that a recommended position has a realistic possibility of being sustained if challenged. In addition, a member may recommend a tax return position if the member concludes that there is a reasonable basis for the position and advises the taxpayer to appropriately disclose that position. Thus, a member may prepare or sign a tax return that reflects a position if a member has a reasonable basis for the position and that position is *appropriately disclosed*.

Page 21-22

1-42. Reasonable grounds for omitting an answer on a return include cases in which:

1. The pertinent data are not readily available and are not significant to the determination of taxable income or loss or the resulting tax liability.
2. The taxpayer and the member are genuinely uncertain as to the meaning of the question on the return.
3. An answer is voluminous; however, assurance should be given on the return that the data can be supplied upon request.

Page 22

- 1-43. In preparing a return, the member may ordinarily rely upon information that the taxpayer has provided. Although an examination of supporting documents is not required, the member should encourage the taxpayer to provide supporting documents, whenever appropriate.

Page 22

- 1-44. A member may prepare tax returns that involve the use of the taxpayer's estimates, if, under the circumstances, it is impractical to obtain exact data and the estimated amounts appear reasonable to the member. Estimates may be appropriate where the keeping of precise records with respect to numerous items of small amounts is difficult to achieve, where data is not available as of the time for filing the return, or certain records are missing.

Page 23

- 1-45. The selection of the treatment of an item on a tax return should be based upon the facts and the law that is applicable at the time a return is prepared. Unless the taxpayer is bound by the IRS to the treatment of an item in later years, such as by a closing agreement, the disposition of an item in a prior year's audit does not govern the treatment of a similar item in a later year's return. Therefore, a member may sign a return that contains a departure from a treatment that was required by the IRS in a prior year return, provided the standards under SSTS No. 1 are adhered to.

Page 23

- 1-46. When a member learns of an error in a previously filed tax return, or member becomes aware of an error during an administrative proceeding, he or she must advise the taxpayer promptly. This advice should include a recommendation of the appropriate measures that the taxpayer should take. The member is not obligated to inform the IRS of the error and may not do so without the taxpayer's permission, except as required by law.

Page 24

- 1-47. SSTS No. 7. It states that the member must use judgment that reflects professional competence and serves the taxpayer's needs.

Page 25

- 1-48. No, tax compliance work for an audit client is not prohibited. It must be approved by the audit committee of the issuer.

Page 26

- 1-49. The *ABA Code of Professional Responsibility* is a set of guidelines that define appropriate professional conduct. The ABA Code includes nine Canons, which may be thought of as statements of principles. The ABA Code has been adopted by the policy agencies in all jurisdictions. However, sometimes modifications were made to the Code.

The *Model Rules for Professional Conduct* were adopted in August 1983, but presently are being used by only a few states. It is expected, however, that the Model Rules will eventually replace the ABA Code as the statement of legal ethical principles.

Page 27

- 1-50. Neither the ABA Code nor the Model Rules have the force of law. Each was designed to be adopted by the appropriate agencies that govern the practice of law in the various states. In many jurisdictions, the state Supreme Court is charged with policing the practice of law. In other states, the legislature assumes this responsibility.

Page 28

- 1-51. An Ethical Dilemma is when someone is faced with a situation in which there are no clearly defined answers by regulation or law.

Page 28

- 1-52. The major types of ethical reasoning are:

1. End-based Ethical Reasoning is where the ethical decision is the one that produced the most good for the largest number of people.
2. Rule-based Ethical Reasoning was based on German philosopher Immanuel Kant's idea that individual actions should be such that we would accept similar behavior from everyone else.
3. Care-based Ethical Reasoning says make decisions that would result in the treatment you yourself would like to receive.

Page 29

- 1-53. Professional ethical behavior is the result of the interaction of personal morality, social responsibility, business ethics, and other general ethical standards. When something is judged to be morally right or wrong (or good or bad), the underlying standards on which such judgments are based are called moral standards. The tax practitioner must be aware of social responsibility in areas such as environmental protection, equal opportunity, and occupational safety. Business ethics examines the moral and ethical problems that arise in a business environment. There is disagreement about whether a company has ethical responsibilities. Other ethical standards may include public policy, religious beliefs and cultural values.

Pages 30-33

- 1-54. In the period before the 1960s, the legal profession brought a series of legal challenges to the practice of tax by CPAs and other nonattorneys. The lawyers contended that the practice of tax was part of the field of law and, therefore, nonattorneys could not practice tax. In 1963, the U.S. Supreme Court held (in *Sperry v. Florida*) that a Federal statute that admitted nonattorneys to practice before Federal agencies (in this case, the Patent Office) took precedence over state regulation. Later, in 1965, Congress enacted Public Law 89-332, amending prior law and allowing CPAs to practice before the IRS. Although this law added to the force of the *Sperry v. Florida* decision as it applied to CPAs, *Sperry* still provides for the preemption of Federal regulations and statutes in matters of practice before other Federal agencies.

Page 35-36

- 1-55. To avoid being charged with the unauthorized practice of law, the following activities should be avoided.

- Expressing a legal opinion on a nontax matter
- Drafting wills or trust instruments
- Drafting contracts
- Drafting incorporation papers
- Drafting partnership agreements

Page 36-37

EXERCISES

1-56

- a. Subpart A, 10.4. Discussion of the criteria for enrollment before the IRS
- b. Subpart B, Sec. 10.21. Each attorney, CPA, enrolled agent, or enrolled actuary who 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, shall advise the client promptly of the fact of such noncompliance, error, or omission.
- c. Subpart B, Sec. 10.26. Discussion of the general rules and definitions of the practice by former government employees, their partners and their associates. It also discusses the rules of representation by former government employees.
- d. Subpart B, Sec. 10.29. No tax practitioner can represent conflicting interests before the IRS unless he or she has the express consent of the directly interested parties

Circular 230

1-57.

- a. Subpart C, Sec. 10.51(b). Disreputable conduct is giving false or misleading information or participating in any way in the giving of false or misleading information to the Department of Treasury or any officer, in any matter pending or likely to be pending before them and knowing such information is misleading.
- b. Subpart A, Sec. 10.6(e). In order to qualify for renewal of enrollment, an individual, to practice before the IRS, must certify that he or she has satisfied the continuing professional education requirements.
- c. Subpart A, Sec. 10.2(e). Discussion of definition of practice before the IRS. It comprises all matters concerned/connected with a presentation to the IRS or any of its officers of a client's rights, privileges, or liabilities under laws or regulations administered by the IRS.
- d. Subpart B, Sec. 10.27. Discussion of provision that a practitioner may not charge an unconscionable fee for representing a client in a matter before the IRS. Also, a practitioner may not charge a contingent fee for preparing an original return.

Circular 230

1-58.

- a. Subpart A, Sec. 10.2(e). Defines practice before the IRS
- b. Subpart A, Sec. 10.7(c)(viii). Allows limited representation before the IRS for signers of tax returns.
- c. Subpart B, Sec. 10.24. Prohibits assistance from disbarred or suspended persons.
- d. Subpart B, Sec. 10.34. Defines standards for advising and signing returns.

Circular 230

1-59.

- a. Subpart B, Sec. 10.33. Discussion of adhering to the best practices in providing advice.

- b.** Subpart B, Sec. 10.35. Provides standards on “covered opinions.”
- c.** Subpart B, Sec. 10.36. Requires that a firm take reasonable steps to adhere to the “covered opinions” section.
- d.** Subpart B, Sec. 10.37. Describes situations in which a tax practitioner should not give written advice.

Circular 230

1-60.

- a.** Solicitation is discussed in Subpart B, Sec. 10.30.
- b.** Negotiation of a taxpayer's refund checks is discussed in Subpart B, Sec. 10.31.
- c.** Depositions are discussed in Subpart C, Sec. 10.67.
- d.** Authority to disbar or suspend from practice before the Internal Revenue Service is discussed in Subpart C, Sec. 10.50.

Circular 230

1-61.

- a.** Conflicting interests are discussed in Subpart B, Sec. 10.39.
- b.** Tax shelter opinions are discussed in Subpart B, Sec. 10.33.
- c.** Disreputable conduct is discussed in Subpart C, Sec. 10.51.
- d.** Assistance from disbarred or suspended persons is discussed in Subpart B, Sec. 10.24.

Circular 230

1-62.

- a.** Practice of law is in Subpart B, Sec. 10.32.
- b.** Information to be furnished is in Subpart B, Sec. 10.20.
- c.** Fees are in Subpart B, Sec. 10.27.
- d.** Who may practice before the IRS is in Subpart A, Sec. 10.3.

Circular 230

1-63.

- a.** Best Practices are discussed in Subpart B, Sec. 10.33.
- b.** Covered Opinions are discussed in Subpart B, Sec. 10.35.
- c.** Tax Return Positions are discussed in Subpart B, Sec. 10.34.
- d.** Due Diligence is discussed in Subpart B, Sec. 10.22.

Circular 230

1-64.

- a.** Article VI, ¶01. Services should be consistent with acceptable behavior for certified public accountants. A CPA should perform services with integrity, objectivity, and independence, along with due care. For example, a person who does not use objectivity, independence, or due care in dealing with his clients is inconsistent with acceptable professional behavior as defined by Article VI of the AICPA Code of Professional Conduct.
- b.** Rule 201, ¶02 201-1. This paragraph discusses the competence of a CPA to complete an engagement. It states that competence to perform professional services involves both the technical qualifications of the member and the member's staff and the ability to supervise and evaluate the quality of the work performed. Competence relates both to knowledge of the profession's standards, techniques and the technical subject matter involved, and to the capability to exercise

sound judgment in applying such knowledge in the performance of professional services.

- c. Rule 502, ¶03 502-2. A CPA in public practice cannot seek clients by false, misleading, or deceptive advertising or other forms of solicitation. Activities do not meet this Rule if they:
- Create false or unjustified expectations of favorable results.
 - Imply the ability to influence any court, tribunal, regulatory agency, or similar body or official.
 - Contain a representation that specific professional services in current or future periods will be performed for a stated fee, estimated fee, or fee range when it was likely at the time of the representation that such fees would be substantially increased and the prospective client was not advised of that likelihood.
 - Contain any other representations that would be likely to cause a reasonable person to misunderstand or be deceived.

There are no restrictions as to the type, media, or frequency of a CPA's advertisements.

- d. Rule 504, ¶01. Rule 504 of the AICPA Code of Professional Conduct does not exist.

AICPA Code of Professional Conduct

1-65.

- a. SSTS No. 1. In preparing a tax return, a member should have a *good-faith belief* that a recommended position has a *realistic possibility* of being sustained if challenged; otherwise such a position should not be recommended by the member.
- b. SSTS No. 4. A member may prepare tax returns that involve the use of the taxpayer's estimates if it is impractical to obtain exact data and if the estimated amounts appear reasonable to the member.
- c. SSTS No. 6. The member must advise the taxpayer promptly, whether or not the member prepared or signed the return in question, when he or she learns of an error in a previously filed tax return, an error in a return that is the subject of an administrative proceeding, or a taxpayer's failure to file a required return. However, the member is neither obligated to inform the IRS of the situation, nor may he or she do so without the taxpayer's permission, except as provided by law.

Pages 21-24

1-66.

- a. *Lowell Bar Association v. Loeb*. The preparation of "simple" tax returns did not constitute the unauthorized practice of Massachusetts law because tax return preparation could not be identified as strictly within the legal discipline.
- b. *Bercu*. The court held that Bercu could have provided tax advice if it had been incidental to the tax return work he regularly performed for his clients.
- c. *Sperry v. Florida*. The U.S. Supreme Court held that a Federal statute that admitted nonattorneys to practice before Federal agencies (in this case, the Patent Office) took precedence over state regulation, thus CPAs and Enrolled Agents were not engaged in the unauthorized practice of law when they were giving tax advice.

Page 35-36

1-67.

False. See Circular 230, §10.29.

1-68.

True. See Circular 230, §10.7.

- 1-69. False. See Circular 230, §§10.2 and 10.3.
- 1-70. True. See Circular 230, §10.22.
- 1-71. **c.** See Circular 230, §10.30
- 1-72. **d.** See Circular 230, §10.75
- 1-73. **d.** Under Rule 502 of the AICPA Code of Conduct, CPAs cannot make self-laudatory statements not based on verifiable facts.
- 1-74. **c.** Under Rule 505 of the AICPA Code of Conduct, CPAs cannot practice public accounting under a firm name that is misleading. A sole practitioner is not a company. The only exception is when a sole practitioner survives the death or withdrawal of all other partners or shareholders, he or she can continue to practice under a firm name for up to two years after becoming a sole practitioner.
- 1-75. **b.** SSTS No. 4 allows a member to use reasonable estimates in the preparation of a tax return.
- 1-76. **d.** Under Rule 302 of the AICPA Code of Conduct, CPAs are allowed to take contingent fees in tax matters if they are based on judicial proceedings or the findings of governmental agencies.
- 1-77. **c.** Under Rule 301 of the AICPA Code of Conduct, CPAs cannot reveal confidential client information without the consent of the client unless it is to an investigative body, trial board, quality review body, or court of law.
- 1-78. **a.** SSTS No. 4 requires members to disclose to the IRS the use of estimates when fire or computer failure has destroyed the relevant records.
- 1-79. **d.** Under Subpart A, §10.7(c)(2)(i) of Circular 230, persons who are disbarred or suspended are not allowed to practice before the IRS.
- 1-80. **b.** Under Subpart B, §10.21 of Circular 230, practitioners must notify clients of any noncompliance with the tax law. A similar rule is found in SSTS No. 6.
- 1-81.
- a.** Circular 230, Subpart A, §10.7(a) states that a taxpayer can appear on their own behalf before the IRS.
 - b.** The tax shelter opinions are found in Circular 230, Subpart B, §10.33.
 - c.** Under Rule 301 a CPA in the practice of public accounting must not disclose confidential client data without the specific consent of the client.
 - d.** SSTS No. 4 addresses the use of estimates.
 - e.** Under Statement on Standards for Tax Service (SSTS) No. 1, a member must have a good-faith belief that a recommended position has a realistic possibility of being sustained if challenged.
- Various pages in the text.
- 1-82.
- a.** Circular 230, Subpart C, §10.51 states that a practitioner can be disbarred or suspended from practice before the IRS for disreputable conduct.
 - b.** The knowledge of client omissions rule is found in Circular 230, Subpart B, §10.21.
 - c.** Under Rule 503 A CPA in public practice cannot charge or receive a commission or referral fee from a client for whom the CPA or the CPA's firm performs audit, review, or compilation work.

- d. SSTS No. 3 states that in preparing or signing a return, the member ordinarily may rely without verification on information that the taxpayer or a third party has provided, unless such information appears to be incorrect, incomplete, or inconsistent.
- e. Under Statement on Standards for Tax Services (SSTS) No. 7, a member must use judgment that reflects *professional competence* and serves the taxpayer's needs.

Various pages in the text.

- 1-83. The parts of the enrolled agent exam are:
Part 1 - Individual Income Taxes
Part 2 - Businesses
Part 3 - Representation, Practices, Procedures

See www.irs.gov for more information on the enrolled agent exam.

- 1-84. This is an online activity based exercise. The current president of the NAEA is Diana Thompson. The headquarters is in Washington, D.C.
- 1-85. This is an online activity based exercise.
- 1-86. This is an online activity based exercise.
- 1-87. This is an online activity based exercise.
- 1-88. Answers will vary by state.

RESEARCH CASES

Note: For the following cases, students may present other positions which could be considered ethically correct. The answers presented below are the views of the authors and are presented as a basis to judge a student's ethical conclusion.

- 1-89. **Note:** There is no right or wrong answer to this question, it is designed to elicit discussion about ethical issues. Ethical issues involved in this case could include morality and business ethics. The moral issue involves the consideration of the "right thing to do" with respect to the plane ticket. The business ethics issues involve maintaining the integrity of the firm.
- 1-90. **Note:** There is no right or wrong answer to this question, it is designed to elicit discussion about ethical issues. Ethical issues involved in this case could include morality. The moral aspects of the case may include the materiality of the supplies stolen and a consideration of what is the right thing to do given the circumstances.
- 1-91. **Note:** There is no right or wrong answer to this question, it is designed to elicit discussion about ethical issues. Nonregulatory ethical issues involved in this situation could include morality and business ethics. Examples of the moral aspects of this case are:

- 1) the materiality of the violation of the Internal Revenue Code, and
- 2) a consideration of the "right thing to do."

The business ethics issues involve:

- 3) the obligation of the business for fair and honest dealings with its clients,

- 4) the obligation of the business for fair and honest dealings with the Internal Revenue Service, and
- 5) maintaining the firm's integrity within the business community

1-92. Note: There is no right or wrong answer to this question, it is designed to elicit discussion about ethical issues. The nonregulatory ethical issues in this situation involve morality and business ethics. The moral aspects of this case involve the obligation of both parties to disclose assets to determine an equitable allocation to each party. The business ethics issues involve the obligation of the business to the community at large not to participate in unfair or dishonest dealings of its clients and the obligation of the business not to participate in dishonest dealings with the Internal Revenue Service.

1-93. AICPA Code of Professional Conduct
 Rule 101: Independence
 Rule 102: Objectivity and Integrity
 Rule 301: Confidential Client Information
 Rule 501: Acts Discreditable

SSTS No. 1: Tax Return Positions

It is not advisable for the Ahi Corporation to complete the transaction. Under Rule 102, all professional services by a CPA should be rendered with objectivity and integrity, avoiding any potential or existing conflicts of interest. The CPA must exercise due professional care in the performance of all professional services and comply with all standards promulgated by the bodies designated by the AICPA Council. Under Rule 501, a CPA must not commit an act that is discreditable to the profession. Under the Statements of Standards for Tax Services (SSTS), a CPA should have a good-faith belief that a recommended position has a realistic possibility of being sustained if challenged.

The CPA must use judgment that reflects professional competence and serves the client's needs. Written communication should be given to the client in important, unusual, or complicated transactions. The CPA should advise the client of such risk as in the instant case. Where the taxpayer insists on the specific position, the CPA should not continue with the engagement as the tax return position is exploitative and frivolous.

1-94. AICPA Code of Professional Conduct
 Rule 102: Objectivity and Integrity

SSTS No. 1: Tax Return Positions
 No. 6: Knowledge of Error: Return Preparation and Administrative Proceedings

A CPA must comply with all standards promulgated by bodies designated by the AICPA Council and conform to generally accepted accounting principles. Under Rule 102, all professional services by a CPA should be rendered with objectivity and integrity, avoiding any potential or existing conflicts of interest. In addition, a CPA should neither knowingly misrepresent facts nor subordinate his or her judgment to that of others in rendering any professional services.

Under the Statements of Standards for Tax Services (SSTS), a CPA should have a good-faith belief that a recommended position has a realistic possibility of being sustained if challenged. In the instant case, the CPA must notify and advise the client promptly upon his or her knowledge of a prior or current tax return error(s) that has a significant effect upon the taxpayer's liability. The client must be notified and advised either orally or in writing. Once rental prices of the current area have been verified and compared against the amount paid by Haddock Corp., the CPA should

take the appropriate actions. The CPA should consider whether to proceed with the preparation of the current year's return or resign from the engagement completely. He or she should not sign the tax return until the appropriate measures have been taken to correct the errors made in the current and prior returns.

- 1-95. AICPA Code of Professional Conduct
Rule 102: Objectivity and Integrity
Rule 301: Confidential Client Information

Under Rule 301 of the AICPA Code of Professional Conduct, a CPA in the practice of public accounting must not disclose confidential client data without specific consent of the client. There are exceptions that exist for Rule 301. Under Rule 102, all professional services by a CPA should be rendered with objectivity and integrity, avoiding any potential or existing conflicts of interest. In addition, a CPA should neither knowingly misrepresent facts nor subordinate his or her judgment to that of others in rendering any professional services.

In the instant case, the CPA should notify the client, Shark Corporation, of the misrepresentation of facts. If the client is not willing to notify the buyer of the building's current structural condition, the CPA should resign from the engagement. If the CPA has already told the other side that the building was OK when he or she learns of its status, the CPA should resign from the engagement with the Shark Corporation.

- 1-96. AICPA Code of Professional Conduct
Rule 102: Objectivity and Integrity
Rule 201: General Standards
Rule 301: Confidential Client Information

Under Rule 301 of the AICPA Code of Professional Conduct, a CPA in the practice of public accounting must not disclose confidential client data without specific consent of the client. There are exceptions that exist for Rule 301. In the instant case, if and only if Anchovy gives permission to Tom can Anchovy's financial condition be disclosed to the Sardine Corporation, Alice's client.

- 1-97. AICPA Code of Professional Conduct
Rule 101: Independence
Rule 102: Objectivity and Integrity

As the tax manager, it is not advisable for you to go on the fishing trip with the audit manager, all expenses paid by Snapper. Under Rule 101 of the AICPA Code of Professional Conduct, a CPA in public practice must be independent of the enterprise for which professional services are being rendered. As in the instant case, independence is impaired if a CPA (or CPA firm) has any direct or material indirect financial interest in the client's enterprise, since Snapper could be a major client for the CPA firm. Under Rule 102, all professional services by a CPA should be rendered with both the utmost objectivity and integrity, avoiding any conflict of interest. Rule 102 prohibits a CPA firm from being requested to follow blindly the demands of an audit client or to subordinate his or her judgment to that of others in rendering any professional services.

It would be in good faith to notify the CPA firm of the audit manager's failure to comply with the Rules under the AICPA Code of Professional Conduct. Notifying the CPA firm could require a moral decision to inform on a fellow staff member. It is in the best interest of the CPA firm to abide by all Rules and Regulations or risk severe consequences.

Circular 230
AICPA Code of Professional Conduct

1-98.

- a. Under §10.27 of Circular 230, a tax practitioner cannot charge an unconscionable fee. Since the attorney appears to be charging such a fee, the CPA should inform the attorney of that fact. If the attorney does nothing about the fee, then the CPA is faced with an ethical dilemma.
- b. Ethical problems: (1) since the CPA works for the attorney, is it proper to go directly to the attorney's client, or (2) should (or can) the CPA inform the IRS of the unconscionable fee? There is general guidance under Article II (Public Interest) and Article III (Integrity) in the AICPA Code of Professional Conduct on what a CPA should do in unusual situations. However, this situation is more a nonregulatory ethics question since it is not covered directly by official pronouncements (e.g., Circular 230). Since there is no clear answer to this situation, expect students to come up with a variety of opinions on what to do and why it should be done.

1-99.

- a. There should be a variety of student recommendations on what Darlene should do in this situation. The recommendations could range from eat the time to quit the firm.
- b. The ethical questions raised in this situation should be of the nonregulatory type. Questions of what is right? Is the situation fair? etc. Since there is no clear answer to this situation, expect students to come up with a variety of opinions on what to do and why it should be done.

1-100.

- a. There should be a variety of student recommendations on what Freya should do in this situation. The recommendations could range from do nothing to be a whistle blower and call the U.S. Navy to report the problem.
- b. The questions raised in this situation could be of the legal or ethical type. For example, could Freya get into legal trouble for not reporting the double billing? Of course, the ethical questions of what is right, what is moral, and what is proper come into play in this situation. Expect students to come up with a variety of opinions on what to do and why it should be done.

1-101.

- a. There should be a variety of student recommendations on what Jenny should do in this situation. The recommendations could range from do nothing to be a whistle blower and call the Securities and Exchange Commission to report the problem.
- b. The questions raised in this situation could be of the legal or ethical type. For example, could Jenny get into legal trouble for not reporting the accounting reporting problem? Of course, the ethical questions of what is right, what is moral, and what is proper, come into play in this situation. Expect students to come up with a variety of opinions on what to do and why it should be done.

1-102.

- a. This situation runs afoul of the Sarbanes-Oxley Act requirement that the audit committee approve any non-audit services provided by a CPA firm for a client. Eric should probably inform both the partner on the engagement and the client of the problem so that it can be addressed.
- b. The questions raised in this situation could be of the legal or ethical type. For example, could Eric get into legal trouble for not reporting the accounting reporting problem? Of course, the ethical questions of what is right, what is moral, and what is proper, come into play in this

situation. Expect students to come up with a variety of opinions on what to do and why it should be done.

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1-103.

- a.** The answer to this question will vary by student. Some will say go ahead since it is "legal," while others might say even though it is legal, it would be improper to go ahead with the inversion on moral grounds.
- b.** The ethical questions are such items as; what is right, what is moral, and what is proper. Expect students to come up with a variety of opinions on what to do and why it should be done.

1-104.

Section 10.22 of Circular 230 requires tax practitioners to use due diligence in preparing tax returns and in their practice before the IRS. This would be a clear case where there was a lack of due diligence.