ETHICS IN THE EYE OF THE BEHOLDER: WHAT CONDUCT IS MOST LIKELY TO RESULT IN DISCIPLINE UNDER CIRCULAR 230?

APPENDIX A

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HYPOTHETICALS

1. Practitioner (P) advises client (C) about a tax arrangement that makes it possible for client to omit certain income from her tax return as “exempt”. P learned of this opportunity when he attended a seminar given by a “prominent” tax lawyer. P received handouts diagramming the arrangement and took copious notes during the lecture but did no other research or investigation. C accepts P’s advice and enters into the arrangement. A subsequent examination of C’s tax return results in additions to tax, plus interest, and imposition of penalties under sec. 6662 and 6663. P, who represented C during the examination, is notified that a preparer penalty under sec. 6694(b) will be proposed.

Potential Cir 230 violations: 10.22(a)(1) and (2); 10.29; 10.34(a)(1)(i)(C) and (2)(i)(C); 10.34(c); 10.35; 10.51(a)(4) and (7).

2. Practitioner (P) does the books and prepares the tax return for a partnership with two partners. The business has a great year and the partners tell P they want to reduce the amount of tax that will be owed. They ask P if there is some way to increase deductions to offset some of the income being reported. The partners are advised by P to forward all cash remaining in their business on Dec. 30th, to a corporation P set up as owner. The corporation rebated the funds to the partnership in January. P prepared the partnership’s books and business tax return expensing and deducting the entire amount “forwarded” to P’s corporation at the end of the year. Subsequently, the partnership receives a notice of examination and P undertakes the representation.

Potential Cir 230 violations: 10.22(a)(1); 10.29; 10.34(a)(1)(i)(C) and (2)(i)(C); 10.34(c); 10.51(a)(4) and (7).

3. Potential Client (PC) comes to Practitioner with an IRS levy notice attempting to collect unpaid employment taxes from the company’s bank account. PC has been using the tax money to pay net payroll and vendors in order to keep the business afloat. PC says that

1 OPR discipline cases are no longer available to the general public. The examples describe hypothetical situations accumulated by the author over the course of many years in tax practice. While these fact patterns may bear some resemblance to actual disciplinary cases, it is not the author’s intention to disclose information not otherwise publicly available. Any similarities result from the reality that a lot of bad conduct looks the same. Regulations relevant to the potential violations are printed in full at Appendix B.
all he needs is a little more time for some of his contracts to start paying and then he can start paying the IRS. The assessed liability on the levy notice is for $100,000. PC tells Practitioner that the account to which the levy was directed has very little money in it now but that he needs to put funds in it soon to make payroll and cover vendor deliveries that are coming c.o.d. In rapid succession, Practitioner has PC do the following: a) form a corporation; b) open a corporate bank account at a different bank; c) deposit the funds for net payroll and vendors into the new account; d) apply for a new employer id number on behalf of the new corporation; d) advise all clients to make future remittances in the name of the new corporation.

Potential Circular 230 violations: 10.22; 10.51(a)(6) and (7)

4. Practitioner (P) is asked to assist new Client (NC) with an Offer in Compromise (OIC) for assessed personal income taxes. All CDP opportunities have been exhausted. P receives a $10,000 fee advance from NC which he places in the firm’s trust account to be paid as earned, and assigns preparation of the Forms 433A and 656 to new Associate (NA). NC provides all financial information to NA, including disability income distributions paid to NC’s wife resulting from an industrial accident. The disability income is used toward NC and wife’s living expenses. NA prepares the form 433A, omitting the disability income and the $10,000 and has NC and wife sign the Form 656. The Form 433A reflects negative income received on a monthly basis by NC and wife. The Form 656 offers $100 to compromise NC’s tax liability. Without reviewing the forms, P forwards them to the offer specialist (OS). The OS contacts NA to inquire about the canceled $10,000 check to the firm and the periodic deposits of income in excess of the monthly amount reported on the Form 433A she discovered in reviewing NC’s bank records. NA argues that the disability income should not be considered because it is scheduled to end next year and the $10,000 is the firm’s fee for legal services being rendered. OS rejects the OIC and refers NA and P, both of whom are on the PoA to OPR. NA resigns from the firm and takes a teaching position. When contacted by OPR, P states that he was on the PoA as a “pro forma” matter because he is the partner, but NA, now gone and no longer practicing, is responsible for the financial statement submissions and subsequent positions taken with OS. P says he had no idea what NA was doing or saying and therefore cannot have violated any provision of Cir 230.

Potential Cir 230 violations for P: 10.22(a)(1) and (2) because 10,22 (b) will not protect P; 10.34(b)(2)(iii); 10.36; 10.50(c).
5. Practitioner (P) was engaged to represent a taxpayer in a collection matter. The client gave P two money orders totaling $1,500 to forward to the IRS along with an offer in compromise for delinquent taxes. P altered, endorsed and cashed the money orders for her own personal use because “times were tight”.

Potential Cir 230 violations: 10.51(a)(8); 10.22; 10.35.

6. Practitioner (P) is retained by Husband (H) & Wife (W) to represent them in an IRS examination of their 2012, 2013 and 2014 joint income tax returns. Both spouses are gainfully employed. When reviewing the clients’ tax return preparation documents before meeting with the revenue agent for the first time P becomes aware after analyzing H’s business checking account that H failed to report on each year’s tax return approximately $100K in gross receipts in connection with his Schedule C business. W’s gross income was reported to the IRS on Form W-2 that had sufficient FIT withheld consistent with her gross wages of $200K. While interviewing H & W P determines that W is unaware of H’s omission of income. P tenders his PoA to the IRS and proceeds to represent H&W, jointly, during the examination. Result: adjustments to tax in all three years; fraud penalty or in the alternative accuracy-related penalty; interest.

Potential Cir 230 violations: 10.29; 10.21 (with respect to W); 10.35.
7. Firm prepares tax returns for C-Corporation and its two shareholders, who are married. Corporation’s tax information is delivered to Firm in late February so the corporate return can be filed timely on March 15th. Among its deductions are expenses for employee compensation and Director’s fees paid to each shareholder of $100,000, each; various travel and entertainment expenses; and section 179 expense. The corporate return is prepared reflecting these items and amounts. In early September, shareholders deliver their joint tax information to Firm for preparation of their personal return which is on extension until October 15th. Among the items are two W-2’s for compensation in the amount of $50,000 each shareholder received as an employee of the C-Corporation. The joint 1040 is prepared reflecting the W-2 income and is filed timely on Oct 15th. A subsequent examination of the Corporation by the IRS expands to the individual’s joint return for the same year. A member of Firm represents all three taxpayers during the examination. Result: The Corporation’s deductions for T&E and sec 179 are disallowed for lack of proper documentation and/or payment of personal expenses of the shareholders. The disallowed amount is treated as a taxable dividend to shareholders. Adjustments are made to the individual return for the additional Directors’ fee income and the dividend income. Fraud penalty asserted against the individual taxpayers. Preparer penalties under 6694(b) asserted against the members of the Firm who prepared the two returns. Referral of both to OPR.

Potential Cir 230 violations (Preparers): 10.22(a)(1); 10.34(a) and (d); 10.35.

Potential Cir 230 violations (Representative): 10.29

Potential Cir 230 violations (Firm): 10.36, 10.50(c)