

Annual Ethics Issue

Preparing Accurate Returns in a Global Economy • Benford's Law & Enrolled Agents

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AVOIDING THE PERILS *OF FEE PREDICAMENTS*

Is Your Firm Ready? • Determining Civil Fraud Penalty • Call for Awards
Call for BOD Nominations • Presidential Call to Annual Meeting
National Conference Info & Registration

6 Avoiding the Perils of Fee Predicaments

By Jennifer MacMillan, EA

10 Benford's Law & Enrolled Agents

By Raven Deerwater, EA

16 Preparing Accurate Returns in a Global Economy Means Knowing When to Put on Your Detective Hat

By Alison Flores, JD



Inside This Issue

- | | | |
|---|--|--|
| <p>3 President's Message:
YOU + NAEA = SUCCESS
By Betsey Buckingham, EA</p> <p>4 Capitol Corner:
Do the Right Thing.
Do the Thing Right.
By Robert Kerr</p> | <p>20 Practice Builder:
IRS Requires Firms
to Establish Circ. 230
Compliance Procedures
By Karen Brosi, EA</p> <p>23 Tax Court Corner:
Determining Civil
Fraud Penalty
By Steven R. Diamond, CPA</p> | <p>27 Ethics CE Test</p> <p>31 Call for BOD Nominations</p> <p>33 Call for Awards</p> <p>37 Presidential Call to
Annual Meeting</p> <p>39 2013 NAEA
National Conference
Info & Registration</p> |
|---|--|--|

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Preparing Accurate Returns in a Global Economy Means
**KNOWING WHEN TO PUT ON
YOUR DETECTIVE HAT**

By Alison Flores, JD



Disclaimer: The primary purpose of this article is not to provide information about foreign account or asset-reporting requirements, penalties for non-compliance, or Offshore Voluntary Disclosure Initiatives. Rather, the intention is to introduce the challenges of complying with Circular 230's ethical guidelines when assisting taxpayers with international connections.

In the best detective novels, the hero solves the puzzle through a mysterious process involving observation, logic, intuition, and inference. This solution process could also help practitioners prepare more accurate tax returns, especially tax returns for clients with foreign financial accounts or foreign assets.

The foreign bank account questions on Schedule B have been around awhile but are frequently misunderstood by taxpayers, notwithstanding the fact that the recent IRS focus on compliance with the Form TD F 90-22.1 (Report of Foreign Bank and Financial Accounts (FBAR)) has increased awareness of foreign financial account reporting requirements among taxpayers. At the same time, it seems like few taxpayers have even heard of the new Form 8938 (Statement of Specified Foreign Assets). Combine that problem with the fact that taxpayers do not receive information documents from foreign institutions about their financial accounts and assets in envelopes stamped "Important Tax Information" to provide them a vital clue that the information might be reportable, and the result might be an inaccurate return.

KNOWING WHEN TO PUT ON YOUR DETECTIVE HAT

The requirement that tax practitioners prepare an accurate return is clearly laid out in Circular 230, Sec. 10.22(a), Diligence as to Accuracy.

A practitioner must exercise due diligence— (1) In preparing or assisting in the preparation of, approving, and filing tax returns, documents, affidavits, and other papers relating to Internal Revenue Service matters; (2) In determining the correctness of oral or written representations made by the practitioner to the Department of the Treasury; and (3) In determining the correctness of oral or written representations made by the practitioner to clients with reference to any matter administered by the Internal Revenue Service.

Most of the time the only information a practitioner has about the taxpayer is provided by the taxpayer orally during an interview, written on an intake/interview form, and through physical documents.

It is also clear that tax practitioners can rely on this information under the authority of Circular 230, Sec. 10.34(d), Relying on information furnished by clients.

A practitioner advising a client to take a position on a tax return, document, affidavit or other paper submitted to the IRS, or preparing or signing a tax return as a preparer, generally may rely in good faith without verification upon information furnished by the client. The practitioner may not, however, ignore the implications of information furnished to, or actually known by, the practitioner, and must make reasonable inquiries if the information as furnished appears to be

To satisfy Sec. 10.34(d), practitioners may have to conduct a thinking process involving observation, logic, intuition, and inference similar to the process a detective might use to solve a mystery.

incorrect, inconsistent with an important fact or another factual assumption, or incomplete.

But by affirmatively requiring a tax practitioner to do further investigation if information furnished by a taxpayer appears to be incorrect, inconsistent, or incomplete, Sec. 10.34(d) is essentially requiring the practitioner to put on a detective hat. To satisfy Sec. 10.34(d), practitioners may have to conduct a thinking process involving observation, logic, intuition, and inference similar to the process a detective might use to solve a mystery. Many practitioners are also fortunate to have extensive experience that helps them identify possible issues. While the best fictional detectives might keep their thinking process a secret or only share it after the mystery is solved, a simple three-step process will work for tax practitioners.

Step 1

Identify whether any information furnished appears to be incorrect, inconsistent, or incomplete. This step involves listening to the taxpayer, intentionally looking through

the information the taxpayer provided, and determining whether the information makes sense. Focusing on global issues, here are three examples where it is possible the information provided may be incorrect, inconsistent, or incomplete.

1. Taxpayer works abroad, but does not give practitioner any information about foreign financial accounts or assets. Here, it seems possible that a taxpayer employed abroad might have a foreign checking or savings account, a foreign investment account, a foreign retirement account, foreign life insurance policy, or other type of financial asset.
2. A taxpayer living in the United States is from a foreign country, advises the tax practitioner he will return or retire in the home country soon, and does not give practitioner any information about foreign financial accounts or assets. Here, it seems possible that this taxpayer would be maintaining financial ties to his home country through foreign accounts or assets.
3. A taxpayer living in the United States owns property in a foreign country but provides no information about foreign financial accounts or assets. In this case it seems possible that the taxpayer would have some liquid financial accounts or assets in the foreign country to facilitate property ownership.

Information provided by a taxpayer may appear to be incorrect, inconsistent, or incomplete in a wide variety of fact patterns

KNOWLEDGE OF CLIENT'S OMISSION

10.21 A practitioner who, having been retained by a client with respect to a matter administered by the Internal Revenue Service, 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 submitted or executed under the revenue laws of the United States, must advise the client promptly of the fact of such noncompliance, error, or omission. The practitioner must advise the client of the consequences as provided under the Code and regulations of such noncompliance, error, or omission.

and cases. Every taxpayer is different, and what might seem incomplete for one client may seem complete for another.

Step 2

Make reasonable inquiries to determine whether additional information is necessary or if the information can be reconciled.

The extent and nature of additional inquiries will vary depending on the situation. The information might be easily reconciled after one or two questions. On the other hand, some situations might require probing questions and additional time to resolve. While documenting the inquiries and taxpayer responses is not explicitly required under Circular 230 as it is under the EITC due diligence regulation, it might be a wise idea to document the information.

Step 3

Take action to resolve any outstanding issues. This could include, but is not limited to, the following:

- Completing the return as originally planned.
- Completing the return with additional forms (such as Schedule B or Form 8938) and/or helping the taxpayer complete and file an FBAR.
- Completing the return with the additional forms listed above and including any other additional income or deductions brought to light during the discussion.
- Determining whether any prior year returns need to be amended or whether prior year FBARs should have been filed.
- Helping the taxpayer understand what information should be brought in next year in order to facilitate tax return preparation.
- Referring the taxpayer to another practitioner or attorney for additional assistance if necessary.
- Advising the taxpayer of any penalties likely

to apply as required under Circular 230, Sections 10.21 and 10.34(c).

Taxpayers can be liable for substantial penalties in the international context. Therefore, it is very important to help taxpayers identify when income needs to be reported and when information reporting requirements must be complied with when filing tax returns. However, while taxpayers need to understand the potential penalties for noncompliance, that is not the entire story. Practitioners need to understand that they are also responsible for advising the taxpayer of penalties that are likely to apply as required under Circular 230, Sections 10.21 and 10.34(c). (See sidebars.)

Sec. 10.21 requires a practitioner who knows that a taxpayer is not in compliance to advise the taxpayer of the consequences. One example where this duty arises is a situation where a taxpayer who is not in compliance consults a practitioner about participating in the Offshore Voluntary Disclosure Program—and then decides not to participate. In this case, the practitioner must advise the taxpayer of the noncompliance and of the consequences of the noncompliance.

Sec. 10.34(c) requires practitioners to inform taxpayers of penalties that are likely to apply due to positions taken on a return or other document submitted to the IRS that the practitioner is preparing or advising on, and of any opportunities for the client to avoid penalties through disclosure. One example where this duty arises is a situation where a taxpayer decides not to ask the practitioner to complete an FBAR. Because an FBAR is not a tax return (but rather an information report required under the Bank Secrecy Act), a practitioner can complete and file an accurate income tax return (with an accurately completed Schedule B) without preparing an FBAR for the taxpayer. However, the practitioner would have an affirmative obligation to advise the taxpayer of the requirement to file an FBAR and the consequences for failure to file an FBAR when required.

ADVISING CLIENTS ON POTENTIAL PENALTIES

10.34 (c)(1) A practitioner must inform a client of any penalties that are reasonably likely to apply to the client with respect to—

- (i) A position taken on a tax return if—
 - (A) The practitioner advised the client with respect to the position; or
 - (B) The practitioner prepared or signed the tax return; and
- (ii) Any document, affidavit, or other paper submitted to the Internal Revenue Service.

(2) The practitioner also must inform the client of any opportunity to avoid any such penalties by disclosure, if relevant, and of the requirements for adequate disclosure.

(3) This paragraph (c) applies even if the practitioner is not subject to a penalty under the Internal Revenue Code with respect to the position or with respect to the document, affidavit, or other paper submitted.

Conclusion

As international trade, investment, and migration are increasing, this means practitioners are more likely to see international issues now more than ever before. Knowing when to ask a taxpayer with international connections additional questions will be key to preparing accurate returns in the future. So be prepared to put on your detective hat. **EA**

About the Author:

Alison Flores, JD, is a lead tax research analyst with the Tax Institute at H&R Block, where she analyzes proposed and enacted laws, as well as administrative guidance and court cases for the Tax Institute. She holds a JD from the University of Kansas and a BA from Bethel College, Kansas.

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