

Practice

Practice Tips from the Trenches

By *Charles P. Rettig*

Although often struggling with deadlines and sometimes recalcitrant clients, a tax practice should be an enjoyable, rewarding experience. Tax practitioners provide their clients with an objective, knowledgeable review of financial information that is ultimately presented to the government in the form of a tax or information return. If the client has provided timely, complete responses to the practitioner's requests for information, the process should be fairly smooth and straightforward. Unfortunately, there is a reason many people become clients and it is not because they routinely coordinate all relevant information necessary to the preparation of a return nor do they routinely provide such information in a timely manner.

The 2009–2013 IRS Strategic Plan includes an objective of ensuring that “all tax practitioners, tax preparers, and other third parties in the tax system adhere to professional standards and follow the law.” Possibly more than in any other profession, tax practitioners are required to participate in extensive, ongoing training and education to keep pace with highly complex, ever-changing statutory and case authorities. Cases issued in the morning might impact positions in returns filed later that afternoon. The IRS has recently issued various internal memoranda focusing its filed operations on the possible imposition of practitioner penalties during the course of examining a tax return. Since a purpose in proposing and assessing return preparer penalties is to encourage accountability, affect behavior and increase voluntary compliance, examiners are now generally required to comment on preparer penalties as a material part of the examination process.

In a tax practice, everything is fine—until it isn't!

Problems tend to arise at the most inopportune moments, such as at the height of tax season or during an examination of a tax return. Issues often arise as a result of:



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- **Inappropriate reliance on** (i) information provided by the taxpayer, (ii) unreasonable factual assumptions (Did you act in good faith?) or (iii) positions in returns prepared by others.
- **Inability to control client expectations.** Often the client is overly aggressive and unwilling to consider an objective view of the facts in a manner that could compromise the professional relationship between the client and the accountant. There must be an objective analysis of relevant facts leading to any position set forth in a return or provided to the government during an examination.
- **Failure of the client to understand the nature and scope of your inquiry.** Remote relationships with clients are difficult, at best. A client's interpretation of your question may well differ from yours. Communicating by phone or electronically precludes the knowledge gained by looking someone in the eyes when asking direct, important questions.
- **Failure to expect the unexpected.** Preparation is a key to success. Are you prepared to handle the issues presented? Lack of diligence in representation, before and during the examination of a return, will adversely affect the outcome of any examination. Failure to inquire about additional facts, to discover contrary legal authorities, to review large, unusual or questionable items in the return, to review prior year returns and potentially applicable IRS Audit Technique Guidelines or to identify sensitive issues or "patterns" over multiple years can be the difference between a reasonable resolution and someone going to Club Fed (*i.e.*, prison).
- **Lack of reasonable cooperation or the failure to provide timely responses during an examination.** Practitioners should attempt to cooperate with the examiner in a timely manner. An audit need not be adversarial and the practitioner must maintain appearance of reasonableness throughout the entire process. The examination should not be prolonged simply because the taxpayer is unable to satisfy any resulting deficiency. Practitioners can be subjected to discipline for unreasonably delaying the examination process.
- **Government interviews of an unprepared taxpayer or return preparer.** Is an interview of the taxpayer or return preparer necessary and unavoidable? Government interviews of the taxpayer or return preparer can create awkward moments during an examination, especially if there has been a lack of preparation. If necessary, interviews should be limited in scope and duration.
- **Failure to anticipate conflicts of interest.** There are many potential conflicts of interest that can arise during return preparation or the examination process. The practitioner is often unaware a spouse may be considering a divorce or a business relationship may be falling apart. Conflicts can often be avoided by receipt of a timely, knowing and intelligent waiver. However, if things get tough, someone is likely to contest the "knowing" and "intelligent" waiver. Was counsel involved in the waiver process? Did one party feel economically compelled to sign the waiver?
- **General lack of experience or competency to handle the issues presented.** Were you competent to prepare the return or handle the representation? Being an effective practitioner does not mean you can be all things to all people. Know your limitations and consult your colleagues when you are unsure of any issue. In a profession, professionals help other professionals. Respect those who reach out for assistance and pity those who are embarrassed to do so.
- **Failure to properly disclose questionable positions within a return.** Have potentially questionable issues been properly disclosed in a return? Form 8275 and Rev. Rul. 2010-15¹ represent an opportunity to explain, in single syllable words, why the potentially questionable position is not questionable. Disclosures must be adequate and easily understood by anyone reviewing the return. They should not be subject to being interpreted as misleading or incomplete.
- **Inadvertent waiver of potential privileges.** Privileges are only important when needed the most. Practitioners should have a general awareness of all potentially applicable privileges. When in doubt, ask a colleague for advice.
- **Termination of the client relationship and the failure to return client records.** Terminating your relationship with a difficult or nonresponsive client can be a rewarding experience. When terminating a client relationship, consider returning all client records and remember to notify the government that any outstanding authorizations to receive client information or represent the client have been terminated. Arguing over the return of client records to receive payment for delinquent fees might be rewarded with an unwarranted claim for malpractice. Your other clients deserve your attention and a redirection of your efforts to such clients will be more rewarding over time. Cut your losses and move on or consider referring the difficult client to your business competitors.

- **Inadequate internal office supervision.** Enough said.
- **Unauthorized use of return information.** Return preparers who “knowingly or recklessly” make “unauthorized disclosures or use” of “information furnished in connection with the preparation of an income tax return” are subject to criminal sanctions (*i.e.*, imprisonment!). “Preparers” include those engaged in preparing or assisting in preparing tax returns, including those who provide auxiliary services such as developing software to prepare or e-file a return. “Tax Return Information” includes everything received to prepare the return plus computations, worksheets and printouts created by the preparer. If uncertain, review Rev. Proc. 2008-35² and Reg. § 301.7216-1, *et. seq.* for further information and pro forma taxpayer consent forms. Code Sec. 7216 was implemented for a purpose. Don’t let that purpose be you.

Tips from the Tax Trenches

Many experienced, sophisticated practitioners continue to be involved with community and professional organizations and feel free to inquire of their colleagues when facing difficult or unusual issues in their practice. If asked, those within the tax profession will almost always provide extremely valuable insight and advice on issues that could be extremely important for you, your client and your reputation. If you do not have the experience or know the answer, find a competent colleague who should be willing to assist you.

If an examination problem seems overwhelming, consider contacting the Taxpayer Advocate Service (TAS). TAS is an independent organization within the IRS whose employees assist taxpayers who are experiencing economic harm, who are seeking help in resolving tax problems that have not been resolved through normal channels, or who believe that an IRS system or procedure is not working as it should. You can contact TAS by calling the TAS toll-free case intake line at 1-877-777-4778 or TTY/TDD 1-800-829-4059 to determine whether you are eligible for assistance. You can also call or write to your local taxpayer advocate, whose phone number and address are listed in your local telephone directory and in Publication 1546, *Taxpayer Advocate Service—Your Voice at the IRS*. You can file Form 911, *Request for Taxpayer Advocate Service Assistance (and Application for Taxpayer Assistance Order)*, or ask an IRS employee to complete it on your behalf. For more information, go to www.irs.gov/advocate.

Engagement letters should specify the scope and terms of the engagement. Services rendered should be within the scope of the engagement as clearly set forth in the engagement letter. If additional services are to be provided, additional engagement letters should be obtained. If a client relationship is terminated for any reason, written confirmation of the termination should be promptly provided to the client and the opposition. If the government has been involved, the government should also be clearly advised of the termination of the client relationship.

When having returns prepared for a Schedule C taxpayer or a taxpayer involved in a cash intensive business (restaurant, bar, etc.), require the preparation of a simple bank deposit analysis. The analysis should add the deposits for the 12-month period under consideration and for the month immediately preceding and following the period involved. That figure should then be divided by 14 and multiplied by 12 to determine an approximation of an amount deposited during the year. If the total deposits bear no relation to reported gross receipts, further inquiry may be warranted which might include a more in-depth bank deposits analysis, a cash expenditures analysis, a net-worth analysis and/or a mark-up analysis.

When involved in the preparation of returns for a taxpayer having other return filing requirements (sales tax returns, etc.), request copies of all other relevant returns for the tax period(s) at issue. Often, businesses prepare certain returns internally and seek to have others prepared by their outside tax advisors. “Gross receipts” on sales tax returns for the same tax period as an income tax return should be somewhat comparable. If you haven’t received copies of all related returns, ask for them.

Be familiar with IRS Audit Technique Guides (ATG) when providing tax advice, preparing tax returns, preparing for an audit or examination and when preparing a client for an interview by the government. There are many publicly available ATGs that have been prepared by the IRS. The ATGs coupled with the government’s specialization of examiners is designed to improve compliance by focusing on taxpayers as members of particular groups. Each ATG instructs the agent on typical methods of auditing a particular group of taxpayer, including typical sources of income, questions to be asked of the taxpayer and their representative during the audit, etc. These groups have been defined by type of business (*i.e.*, gas stations, grocery stores, etc.), technical issues (passive activity losses), types of taxpayer (*i.e.*, returns lacking economic reality) or method of operation (*i.e.*, cash businesses). A practitioner should not proceed with an audit without being generally familiar with any

potentially relevant IRS ATGs. Often, it may be beneficial to review relevant ATGs earlier in the process, perhaps while preparing the return.

The administrative process should not be abused merely because of the taxpayer's desire to delay the determination and collection of any potential liability. It is generally advisable to attempt to resolve any civil tax dispute at the earliest opportunity. A lengthy audit may be costly from the perspective of the expenditure of time and effort involved, as well as the taxpayer's degree of frustration with the normal administrative process. Further, a prolonged audit is more likely to uncover potentially sensitive issues that could generate increased tax deficiencies, penalties or the possibility of criminal sanctions. Collection-related issues should be sorted out through an installment payment arrangement that would be negotiated through the normal collection process following conclusion of the audit process.

It is often a good practice to provide an extension of the applicable statute of limitations during the course of any audit or examination. However, it is also good practice to have extensions signed by the client, rather than the client's authorized representative (even though authorized by the power of attorney). Years later, the client may not recall having authorized you to extend the statute of limitations. If their signature is on the extension (Form 872), the situation will not likely escalate. Further, it is almost always preferred to sign a limited extension with a specified expiration date (Form 872) rather than an indefinite extension for an unspecified term (Form 872-A).

It is often advisable to submit a request under the Freedom of Information Act (FOIA) following the unagreed resolution of a federal tax examination. It should also help tailor your discussions at the next administrative level while providing insight into what the next government representative assigned to the case will be reviewing. The process is relatively simple and inexpensive. Relevant information regarding the submission of a FOIA request is readily available at www.irs.gov by searching "FOIA."

A question often presented is whether the taxpayer and others should consent to interviews by the government, force the issuance of Summonses or invoke various Constitutional protections. Certainly, if there are extremely sensitive (*i.e.*, potentially criminal) issues, the taxpayer should not consent to an interview and should invoke their Fifth Amendment privilege against self-incrimination. It is always preferable for a taxpayer to avoid providing incriminating information when compared with the possibility of propelling a civil tax examination into a criminal tax investigation/prosecution.

The government typically seeks to interview taxpayers near the commencement of an examination. Unfortunately, at that time, the practitioner typically does not have sufficient information to determine whether there are potentially sensitive issues that might arise during an interview of the taxpayer. If possible, it is often preferable to postpone a taxpayer interview if the practitioner is otherwise able to provide prompt responses to relevant inquiries. If it occurs, the interview should occur toward the end of the examination, possibly with an understanding that if the taxpayer submits to an interview and answers the questions, the government will proceed to close the examination. However, the practitioner must take extreme caution, since such an understanding is not likely a basis for challenging the use of statements from the interview in a subsequent proceeding.

If a taxpayer interview is necessary and otherwise unavoidable (it is always avoidable in a potentially criminal sensitive issue case), the interview should occur far into the audit process such that the representative can appropriately assist the taxpayer in preparing for the interview. The representative should attempt to obtain as much information about the issues, the information within the agent's possession and the government's position with regard to the issues, before agreeing to submit the taxpayer to an interview. Under any situation, the representative must prevent presentation of false or misleading information or the presentation of false statements by the taxpayer or the taxpayer's representative. Presentation of false statements or documents significantly enhances the potential for penalties and a possible criminal investigation/prosecution (that may include an investigation of the representative!).

Although there are various "badges of fraud," civil revenue agents are more inclined to consider a criminal referral if there is a substantial unexplainable understatement of taxable income, fictitious or improper deductions, accounting irregularities (occurring in more than one year), acts or conduct of the taxpayer relating to false statements, attempts to hinder the examination, destruction of books and records, transfers of assets for purposes of concealment, or patterns of consistent failure to report or under-reporting of income. Certain behavior patterns on the part of the examiner may indicate that they are considering a criminal referral—excessive time devoted to the audit; extensive copying of basic financial records, bank records, accountant work papers, etc.; or attempts to determine the taxpayer's net worth over a period of several years.

Do not inadvertently exceed the scope of your license or experience. At a minimum, a nonlawyer representative should strongly recommend that a client consult counsel with admonition that discussions held between a client and a nonlawyer may have to be disclosed in the event of a criminal investigation or prosecution. Code Sec. 7525 does not protect information provided to the nonlawyer representative from disclosure in a criminal investigation or prosecution.

Throughout, treat all government representatives with respect and act like the professional that you want others to know and respect. Do not mislead, affirmatively or otherwise, anyone at anytime. Always maintain the appearance of reasonableness, even in times where the government may appear to be anything but reasonable. If you have problems with an agent during the course of an examination, ask to speak to their manager. If you have problems, it is likely that other representatives have previously had similar discussions with the agent's manager. While the manager may appear to be supporting the agent when meeting with you, it is also likely that the manager will have a direct conversation with the agent outside your presence and that your future interactions with the agent will be significantly improved.

Be All You Can Be

A busy tax practice can be surrounded by minefields. Use your best efforts and remember that a tax return is not an offer to negotiate with the government. Document your advice in writing, limit the nature and scope of services to be provided in your engagement letter, establish a system of checklists (and follow the system) and use your best judgment. If the client is unwilling to accept and follow your advice, strongly consider terminating the engagement. Life is short and the headaches of trying to convince someone to do the right thing may simply not be worth your effort. If you encounter an undeserving or possibly disrespectful client, let them go and move on with your practice. Ninety-eight percent of the problems come from two percent of the clients.

You cannot be all things to all people, regardless of the effort and personal sacrifice. Lastly and perhaps most importantly, your client is not your friend. If you feel the need for friends, get a dog!

ENDNOTES

¹ Rev. Rul. 2010-15, IRB 2010-23, 730.

² Rev. Proc. 2008-35, IRB 2008-29, 132.

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