2024 NATIONAL INCOME TAX WORKBOOK

CHAPTER 1: ETHICS

Land Grant University
Tax Education Foundation

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LEARNING OBJECTIVES - BOI P. 1

After completing this section, participants will be able to:

- Evaluate whether beneficial ownership interest (BOI) reporting may be the unauthorized practice of law
- Exercise due diligence regarding BOI reporting

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LEARNING OBJECTIVES - DUE DILIGENCE-FBAR P. 1

After completing this section, participants will be able to:

- Exercise due diligence when advising a client about FBAR filing requirements.

3

LEARNING OBJECTIVES–DISCONTINUATION OF A TAX PRACTICE P. 1

After completing this section, participants will be able to:

- Know how to plan for practice continuation or closure in the event of incapacity or death.

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BENEFICIAL OWNERSHIP INFORMATION REPORTING

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BENEFICIAL OWNERSHIP INTEREST (BOI) REPORTING P. 14

In 2022, Financial Crimes Enforcement Network (FinCEN) issued a final rule implementing BOI reporting.

The rule is intended to prevent and combat money laundering, terrorist financing, corruption, tax fraud, and other illicit activity.

The regulations went into effect January 1, 2024.

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BENEFICIAL OWNERSHIP INTEREST (BOI) REPORTING P. 14

Starting in 2024, the Corporate Transparency Act (CTA) requires entities to file reports on:

- Beneficial owners
- Individuals who created or registered the entity

Estimated 32,600,000 businesses will have to comply.

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BENEFICIAL OWNERSHIP INTEREST (BOI) REPORTING P. 14

Tax practitioners may be asked to assist with filing the reports.

Practitioners must consider:

- To not engage in practice of law
- Protect confidential client information
- Duty of competence

Practitioners must consider what services they want to provide.

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UNAUTHORIZED PRACTICE OF LAW PP. 14 -15

Circular 230 and state laws limit the practice of law to attorneys

Is BOI reporting *considered legal advice or administrative assistance?*

Two tests to determine:

- **Difficult Question of Law Test**
- **Commonly Understood Test**

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UNAUTHORIZED PRACTICE OF LAW P.15

Difficult Question of Law Test

The practice of law involves resolving difficult or doubtful questions that demand applying a trained legal mind

Determining a difficult or complex question of law is the practice of law

[*Gardner v. Conway*, 234 Minn. 468 (1951)]

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UNAUTHORIZED PRACTICE OF LAW P.15

Commonly Understood Test

The practice of law includes those activities that are commonly understood to be the practice of law

- [*State Bar v. Arizona Land Title & Trust Co.*, 366 P.2d 1 (1961)]

Court found that those acts that lawyers have customarily carried on throughout the centuries constitute the practice of law

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UNAUTHORIZED PRACTICE OF LAW P.15

Business with more complex ownership, reporting may necessitate legal advice:

1. Is the business a reporting company?
2. Does an exemption from the reporting rules apply?
3. Does a legal relationship constitute beneficial ownership?
4. Who exercises substantial control?
5. Who is the company applicant?

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UNAUTHORIZED PRACTICE OF LAW P. 16

Example 1.1 – Ownership Interest Held by Trust

Circular 230 §10.37 authorizes a tax practitioner to give written advice on federal tax matters.

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PRACTITIONER NOTE: CIRCULAR 230 AUTHORITY P.16

The Report of Foreign Bank and Financial Accounts (FBAR), and CTA are both administered by FinCEN.

However, the IRS has specific authority to enforce FBAR violations, which makes it a law or regulation administered by the IRS. The IRS DOES NOT have authority to enforce BOI violations.

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UNAUTHORIZED PRACTICE OF LAW P.16

If the forms require entry of information that the client has provided, and do not require legal advice, preparing forms is likely not the unauthorized conduct of law.

Some firms have created online questionnaires that can be used to determine whether an entity is a reporting company and who are the beneficial owners and company applicants.

To the extent that filing a BOI report is solely data input, it could be construed as a clerical duty and not unauthorized practice of law.

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DATA COLLECTION AND STORAGE PP.16-17

A practitioner who decides to gather beneficial ownership information must collect personally identifiable information (PII)

The practitioner must exercise diligence in storing and protecting the information.

Practitioners must comply with their WISP, federal, state, & professional organization policies to safeguard data (discussed earlier).

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TIMELY AND CORRECTLY REPORTING P.17

A tax practitioner that assists with BOI reporting must have the knowledge and experience necessary to complete the reports.

They must familiarize themselves with the Corporate Transparency Act and BOI requirements.

This includes staying current with other guidance issued by FinCEN.

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PRACTITIONER NOTE - PENALTIES P.17

Taxpayers who do not timely file the necessary BOI reports could face significant civil and criminal penalties.

Senior officers of an entity that fail to file could be held responsible.

A tax practitioner who knows that a reporting company has not timely or correctly filed a BOI report may have a duty to inform the company/owners about the penalties (Circular 230 § 10.21).

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DUE DILIGENCE – MITIGATING THE RISKS PP. 17-18

Client Notification:

Consider notice to clients of the new reporting requirements, regardless of whether the practitioner plans to assist with the reporting.

Figure 1.3 – Sample Client BOI Reporting Notice

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DUE DILIGENCE – MITIGATING THE RISKS P. 18

Engagement Letters:

Practitioners can use engagement letters and detailed scopes of work to ensure a cooperative understanding with the client and lessen their professional liability regarding BOI. Places the burden on the client to provide accurate information.

Figure 1.4 – Scope of BOI Reporting Services

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DUE DILIGENCE – MITIGATING THE RISKS PP. 18-19

Alternatively, if the tax practitioner will not provide BOI reporting services, the engagement letter should disclaim responsibility for providing those services.

Figure 1.5 – Disclaim Responsibility for BOI

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DUE DILIGENCE – MITIGATING THE RISKS P. 19

Accuracy of Information:

A practitioner who does file reports may have a duty to verify the information provided. Generally, practitioners may rely on information in good faith, but newer or more complex clients may require more substantiation.

Figure 1.6 – Certification of Accuracy

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DUE DILIGENCE – MITIGATING THE RISKS PP.19-20

Ongoing Compliance:

Client information could change, which would necessitate clients notifying the practitioner and making updates to the report.

Report changes within 30 days.

PRACTITIONER NOTE - updates are required regarding changes to owner's names, addresses, or unique identifying numbers.

Figure 1.7 – Notification of Changes

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DUE DILIGENCE – MITIGATING THE RISKS P. 20

Tax practitioners should consult with their insurer to determine professional liability policy coverage for claims arising from BOI reporting services.

A written information security plan (WISP), discussed earlier, should address how the tax practitioner can fulfill his or her duties to keep the BOI information confidential and protected from nondisclosure.

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DUE DILIGENCE FBAR

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DUE DILIGENCE – FBAR P. 21

It's important for practitioners to exercise due diligence regarding foreign account reporting.

The IRS has identified hundreds of possible FBAR nonfilers.

The IRS plans to audit the most egregious cases in fiscal year 2024.

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DUE DILIGENCE – FBAR P. 21

Report of Foreign Bank and Financial Accounts (FBAR) filings of FinCEN 114 is required by the Bank Secrecy Act.

Reporting is required of US persons who have a financial interest in a financial account in a foreign country where the aggregate value of the account exceeds $10,000 at any time during the calendar year.

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DUE DILIGENCE – FBAR PP. 21 - 22

While the FBAR reporting is not a tax return, the information is referenced in tax returns such as Form 1040 Schedule B, Form 1041, Form 1065, and Form 1120.

Circular 230 §10.22 due diligence.

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DUE DILIGENCE – FBAR P. 22

Taxpayers have defended against FBAR penalties by claiming reasonable reliance on the tax return preparer who failed to ask about foreign bank accounts or advise the taxpayer an FBAR was required.

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DUE DILIGENCE – FBAR P. 23

Practitioners have a duty under Circular 230 to ask clients for sufficient detail to prepare correct responses to foreign account questions on client tax returns.

Thus, practitioners must make a reasonable effort to obtain necessary information before signing as the preparer.

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DUE DILIGENCE – FBAR P. 23

There are eight questions a practitioner should ask to ascertain FBAR / tax return obligations.

If the answer is "yes" to any of the eight questions listed, the practitioner must follow up with additional questions.

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RELIANCE ON INFORMATION P. 23

Circular 230 §10.34(d)

A tax practitioner may generally rely in good faith and without verification on information furnished by the taxpayer.

However, they are expected to make reasonable inquiries when FBAR participation seems possible.

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RELIANCE ON INFORMATION P. 23

If the information provided seems incorrect, inconsistent or incomplete, the practitioner must request more information from the taxpayer.

Circular 230 § 10.21 obligation to notify the taxpayer of the FBAR reporting requirement and consequences of failing to file the report.

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DUTY TO ADVISE ABOUT FILING P. 23

Circular 230 §10.34(c)

If the practitioner determines there is foreign bank account information to report, the practitioner is not obligated to prepare the FBAR for the taxpayer but must advise about filing.

The practitioner may decide to complete the filing if they are competent, and the client agrees to the service.

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DISCONTINUATION OF A TAX PRACTICE

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DISCONTINUATION OF A TAX PRACTICE P. 24

Circular 230 §10.33 - A practitioner has a duty to ensure continued provision of services when they retire, become incapacitated, or die and to clearly communicate with clients.

Circular 230 §10.23 – requires prompt disposition of pending matters and practitioners have a responsibility to their clients whose business or individual tax matters could be seriously disrupted if the practitioner is suddenly unavailable.

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PLANNING FOR A TRANSITION P. 24

Engagement letters and practitioner recordkeeping can play an important role in transitions.

The engagement letter informs clients about practice continuation in the event the practitioner is unavailable.

Figure 1.9 shows a sample notice

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PRACTICE CONTINUATION AGREEMENT P. 25

A sole practitioner has a duty to develop a formal succession plan to address termination of the business.

This should be in the engagement letter or otherwise communicated with clients.

This plan should address client notification, file transfers, and record retention.

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OBSERVATION P. 25

Some state CPA societies offer plans (also called emergency assistance plans) to assist the spouse and heirs in situations where the CPA failed to make arrangements ahead of time.

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FILE TRANSFER AND RECORD RETENTION P. 25-26

Documents and records must be available to the successor.

Submit written request to each client requesting consent to transfer files.

Transfer files after client consent or 90 days, whichever is shorter.

Return any client records.

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PRACTICE CONTINUATION AGREEMENT PP. 26 - 29

Figure 1.10 is a sample agreement for continuation of services in temporary incapacity.

The sample agreement is intended solely for *educational purposes.*

The continuation agreement should also address other situations such as permanent incapacity or death.

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PLANNING FOR PRACTICE CLOSURE PP. 29 - 31

A practitioner who is unable to identify a qualified successor may still have obligations in the event of discontinuation.

They should do the following:
- Notify clients of the discontinuation
- Return client records that they are required to provide the client

They can authorize a designated person to close the tax practice. A limited power of attorney can grant authority, **Figure 1.11**

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ETHICS CASE STUDIES

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CASE STUDY 1: BOI REPORTING P. 32

Casey and Jeff start a business

Lilah, the tax preparer, recommends an S corp. to "save money on taxes".

Lilah prepared the articles of incorporation, files with the secretary of state, applies for an EIN, and files the S corp. election.

Lilah tells Casey and Jeff about the BOI reporting requirement.

Casey and Jeff ask, "can't you do it for us?"

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CASE STUDY 1 RESPONSE: BOI REPORTING P. 38

1. Did Lilah engage in the unauthorized practice of law when she recommended an S corporation and prepared the articles of incorporation?

Advising about the self-employment tax savings of an S corporation versus a limited liability company is within the scope of authorized tax advice.

Advising about what is necessary to ensure liability protection is likely legal advice.

Filing articles of incorporation and other business formation documents may also constitute the unauthorized practice of law and may be prohibited under state law.

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CASE STUDY 1 RESPONSE: BOI REPORTING P. 38

2. Did Lilah engage in the unauthorized practice of law when she filed the BOI report?

Lilah has given them a questionnaire to complete to assist them with their BOI reporting. The questionnaire may contain legal determinations. For example:

Do the crowdfunding contributors have any equity ownership or voting rights?

Is the loan from Vivian convertible into equity?

What control or influence does Vivian have over important company decisions such as investors, issuance of shares, or financing?

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CASE STUDY 1 RESPONSE: BOI REPORTING P. 38

3. What advice should Lilah have given Casey and Jeff about the business structure?

Lilah may want to consider how additional investors may impact the S corporation eligibility requirements and how the loan from a third party will not increase debt basis for the loss limitation rules. Bylaws, shareholder's agreements, operating agreements, and other entity governance documents can prevent disputes between the owners and protect against personal liability for claims against the corporation or company. Lilah should advise Casey and Jeff to consult with their attorney and insurance agent to discuss how best to protect the limited liability status of the business.

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CASE STUDY 1 RESPONSE: BOI REPORTING P. 38

4. What other due diligence steps could Lilah have taken to reduce her liability for the BOI reporting?

A detailed engagement letter should place the burden on the client to consult with an attorney regarding the determination of beneficial ownership and other information provided. It should include a statement that Lilah can rely on the information provided without additional investigation, and that the clients have a duty to inform Lilah about any changes in ownership or other information that would require an updated report. Lilah should consult with her own attorney and insurer about compliance with her professional and legal obligations.

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CASE STUDY 4: CONTINUATION OF A TAX PRACTICE P. 34

Allison has been a sole practitioner CPA for over 40 years.

She has tried to find associates to take over the practice, but they have left for other opportunities.

She wants to make sure her clients are taken care of and has prepared a notification letter, Figure 1.13.

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CASE STUDY 4: CONTINUATION OF A TAX PRACTICE P. 34

The letter states there is another firm that can continue service and that files have already been delivered to the other firm.

Allison states she has disposed of all records and the new practitioner, Ann, can handle further concerns or questions.

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CASE STUDY 4 RESPONSE: CONTINUATION OF A TAX PRACTICE P. 41

1. Has Allison complied with her ethical duties in referring and transferring her clients' files to a new tax practitioner?

Allison referred her clients to a successor tax practitioner and transferred her clients' files without the clients' consent. The referral and transfer of files violates Allison's duties of confidentiality and nondisclosure.

Under AICPA Rule 1.400.205, Transfer of Files and Return of Client Records, the practitioner must submit a written request to each client subject to the sale or transfer, requesting the client's consent to transfer its files to the successor firm.

Allison should have obtained each client's consent to refer the case and transfer files to Ann.

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CASE STUDY 4 RESPONSE: CONTINUATION OF A TAX PRACTICE P. 41

2. Did Allison have any legal or ethical duty to retain copies of the files?

Tax return preparers must comply with the record retention requirements of Treas. Reg. § 1.6107-1(b). Thus, tax return preparers are required to retain clients' records for a period of at least 3 years.

Circular 230 §10.28 states that, in general, a practitioner must, at the request of a client, promptly return any and all records of the client that are necessary for the client to comply with his or her federal tax obligations. The practitioner may retain copies of the records returned to a client.

Allison should have retained copies of client records in accordance with the regulations and her own record retention policy.

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CASE STUDY 4 RESPONSE: CONTINUATION OF A TAX PRACTICE PP. 41 - 42

3. What could Allison have done differently?

Allison should have given her clients the option to choose a successor tax practitioner. She could have recommended a few practitioners and encouraged each client to conduct his or her own due diligence.

Allison should also obtain the client's written consent to transfer the files. Allison should have maintained copies of the files for at least 3 years or contracted with Ann to store a copy of the files and make it available to Allison, if necessary. **Figure 1.18 (p. 42)** shows a sample client notification.

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CASE STUDY 5: PRIOR-YEAR ERRORS P. 35

Same facts as Case Study 4

The new practitioner, Ann, has reviewed the files from Allison and determined three clients claimed the Employee Retention Credit (ERC) that perhaps did not qualify.

Client 1: Claimed ERC for all employees all four quarters in 2020 and first three quarters of 2021.

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CASE STUDY 5: PRIOR-YEAR ERRORS P. 35

Client 2: Claimed ERC in the first and second quarters of 2021 citing supply chain issues, but the client was able to continue operating its retail business.

Client 3: Claimed ERC second and third quarter of 2021 based on client operations being suspended by government order - local health dept. memo stating to wear masks and practice hygienic practices. Due to the IRS moratorium, client 3 has not yet received her refund.

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CASE STUDY 5 RESPONSE: PRIOR-YEAR ERRORS P. 42

1. Can Ann file the 2024 returns for clients 1, 2, and 3?

Client 1 claimed the ERC for all quarters that the credit was available. Qualifying for all quarters is uncommon, and this could be a sign of an incorrect claim.

Client 2 claimed a suspension of operations by supply chain disruption. While a limited number of products were not available, Client 2 was still able to offer a wide variety of products to its customers and Client 2 was not forced to suspend operations.

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CASE STUDY 5 RESPONSE: PRIOR-YEAR ERRORS P.42

Client 3 claimed a suspension of operations due to a health department recommendation. Recommendations, guidelines, and suggestions do not constitute orders for purposes of the ERC and modifications altering customer behavior (for example, mask requirements or making store aisles one way to enforce social distancing) or requiring employees to wear masks and gloves while performing their duties will likely not result in more than a nominal effect on the business operations.

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CASE STUDY 5 RESPONSE: PRIOR-YEAR ERRORS P. 42

If there is an error on the prior-year returns, Ann must promptly advise Clients 1, 2, and 3 that they have not complied with the revenue laws of the United States or have made an error or omission on that return.

She must also advise the clients of the consequences of such noncompliance under the Internal Revenue Code and Treasury Regulations [Circular 230 § 10.21].

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CASE STUDY 5 RESPONSE: PRIOR-YEAR ERRORS P. 42

Ann should, consistent with Circular 230, advise the client of the overstated claim and any additional tax and penalties that could apply and, if requested, competently assist the client in correcting or mitigating the problem.

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CASE STUDY 5 RESPONSE: PRIOR-YEAR ERRORS P. 43

Upon discovering an error or omission involving an understatement of income or an overstatement of deductions, a taxpayer should file an amended tax return and pay any tax due, but the taxpayer is not required to file an amended return.

While the client ultimately decides whether to submit an amended return, Ann should explain that a failure to file an amended return could result in more interest and a larger penalty.

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CASE STUDY 5 RESPONSE: PRIOR-YEAR ERRORS P. 43

AICPA SSTS No. 6, Knowledge of Error: Return Preparation and Administrative Proceedings, states that if the member does prepare such current-year return, the member should take reasonable steps to ensure that the error is not repeated. Unless Ann can convince the clients to disclose the errors, she must consider whether to withdraw from representing them. If the subsequent year's tax return cannot be prepared without perpetuating the error, Ann should decline to prepare the return.

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CASE STUDY 5 RESPONSE: PRIOR-YEAR ERRORS P. 43

2. Does Ann have a duty to advise client 3 to withdraw her claim?

The ERC voluntary disclosure program ended November 22, 2024, but the IRS continues to accept and process requests to withdraw an employer's full ERC claim under the special withdrawal process. Employers that submitted an ERC claim that has not yet been paid can withdraw their claim and avoid the possibility of getting a refund for which they are ineligible. Ann should inform client 3 about the error in determining eligibility for the ERC and encourage client 3 to take advantage of the withdrawal process to avoid interest and penalties.

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CASE STUDY 5 RESPONSE: PRIOR-YEAR ERRORS P. 43

3. Can or should Ann report Allison to the IRS?

If Ann thinks that an unscrupulous return preparer helped clients 1, 2, and 3 improperly claim an ERC, she can submit Form 3949-A, Information Referral. She can also report instances of fraud and IRS-related phishing attempts to the Treasury Inspector General for Tax Administration by calling 800.366.4484. In reporting, Ann must comply with her duties of confidentiality and nondisclosure, and the information that she reports should be only information about the unscrupulous preparer, and not information about her client.

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CASE STUDY 8: DUE DILIGENCE PP. 36-37

Darcy started a nonprofit to introduce disc golf in the community.

Darcy receives a $175,000 annual salary from the organization.

A board member helped incorporate the entity.

John is a CPA with experience in nonprofits.

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CASE STUDY 8: DUE DILIGENCE PP. 36-37

Darcy wanted to discuss the application for tax-exempt status.

She gave John a completed 1023-EZ, the streamlined application for exemption under 501(c)(3).

She asked John to review and help file the form.

She also asked John if he would serve on the board.

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CASE STUDY 8 RESPONSE: DUE DILIGENCE P. 45

1. Can John help file the form?

The nonprofit organization pays Darcy a $175,000 salary and is planning to raise $1,500,000 to build a new disc golf course. John could likely conclude that the organization is not eligible to file Form 1023-EZ because its average annual gross receipts exceed $50,000.

John should advise Darcy about the eligibility requirements for Form 1023-EZ and the requirement to verify, under penalty of perjury, that the information in the application is true, correct, and complete.

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CASE STUDY 8 RESPONSE: DUE DILIGENCE P. 45

John should advise Darcy about the I.R.C. § 7206 penalties for a willful false declaration under perjury and how those penalties could be assessed against Darcy and also against John for assisting Darcy to file a false declaration.

John should also advise Darcy that the IRS could retroactively revoke the organization's tax-exempt status if there is a misstatement of material information, including an incorrect attestation regarding the organization's eligibility to file Form 1023-EZ.

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CASE STUDY 8 RESPONSE: DUE DILIGENCE PP. 45 - 46

2. If John determines that the organization is not eligible for the EZ form, can he review the form and have Darcy file it?

Under Circular 230 § 10.34, a tax practitioner cannot advise a client to submit a document to the IRS that contains or omits information in a manner that demonstrates an intentional disregard of a rule or regulation. John cannot advise Darcy to file Form 1023-EZ if the organization is ineligible to do so.

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CASE STUDY 8 RESPONSE: DUE DILIGENCE P. 46

3. What should John consider before he agrees to serve as a director?

John may suspect that Darcy formed a nonprofit organization to supplement her income and engage in a recreational activity.

Before agreeing to serve on the board, he should conduct his own due diligence. At a minimum, he should verify that the nonprofit organization maintains both a general liability insurance policy and a directors' and officers' policy.

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CASE STUDY 8 RESPONSE: DUE DILIGENCE P. 46

John should review the organization's conflict-of-interest policy and consider whether his responsibilities as a provider of tax and accounting services, and his fiduciary responsibilities as a director of the nonprofit organization, could create a conflict of interest under the policy or Circular 230 § 10.29(a).

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CASE STUDY 8 RESPONSE: DUE DILIGENCE P. 46

Finally, as a tax practitioner, John has a duty to act with objectivity and integrity. The duty extends to volunteer services.

If Darcy's compensation is not reasonable as compared to similar service providers, or if the organization is not truly organized and operated for nonprofit purposes, John should decline to serve on the board.

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