

2023 NATIONAL INCOME TAX WORKBOOK

CHAPTER 1: ETHICS



CH. 1 - ETHICS

Important tax practitioner ethics obligations – **Cyber security plan**

Information necessary to remain compliant with *Circular 230, Regulations Governing Practice before the IRS*

This hours covers termination of a tax engagement & case studies

TOPICS

P. 1

A discussion of the life cycle of a tax engagement

- Engaging the Client
- Maintaining Ongoing Client Relationships
- Terminating the Engagement

10 Case Studies

TERMINATING THE ENGAGEMENT

TERMINATING THE ENGAGEMENT

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Learning Objectives:

- Know how to terminate the tax practitioner-client engagement
- Know how to ethically collect unpaid invoices
- Understand when records can be withheld for nonpayment

CONSIDER WHO TO ELIMINATE FROM YOUR PRACTICE

True or False

20% of the clients take 80% of your time



CONSIDER WHO TO ELIMINATE FROM YOUR PRACTICE

At times, certain people are not worth the stress or potential litigation

Identify people before they blow up

Are you trying to grow your business or cutting back?

Considerations:

- Age, Income
- Expansion opportunities
- Cooperation of client
- What gives you joy?

TERMINATING THE ENGAGEMENT

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A practitioner may decide to terminate representation of a client –
example - tax position

In writing - It is important to confirm the termination in a letter to the
client

Clearly communicate the end of the engagement to the client

TERMINATION LETTER

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Purpose:

- Letter should indicate the relationship is ending
- Give an effective **termination date**
- May contain a brief and factual reason for the termination
 - If the letter does not indicate a reason, the practitioner can document internally a legitimate nondiscriminatory reason for the termination

Work in progress and how will deadlines be impacted

TERMINATION LETTER –OUTSTANDING DEADLINE

P.23

Practitioner Note: If the client has an imminent tax deadline and/or insufficient time to obtain a successor tax practitioner, the practitioner may have to consider continuing to provide services so that the termination does not occur at a time or under circumstances that would disadvantage the client.

See Circular 230 § 10.23.

TERMINATION LETTER

PP. 23 - 24

Withdraw as Agent:

- If applicable, the letter will explain the practitioner is withdrawing as agent with the appropriate Form 2848
- Write WITHDRAW on top of 1st page of form
- Or send statement with relevant information and sign & date it

- Practitioner Note: CAF 77 request for all client under CAF number, IRS send termination response to TP

TERMINATION LETTER

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Payment of Fees:

- The termination letter should state the amount of fees or that no balance is due with a final billing statement

Records Return:

- The letter should indicate all original client records have been returned.
- Workpapers can be withheld.
- Set a date when a client's access to a client portal will terminate

TERMINATION LETTER

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Figure 1.5 – Sample Termination Letter (pg. 25)

Issues with letter?

Reason for termination

Suggestions for client to use, if any

Review of your attorney & malpractice insurance carrier

No original records have been retained. (Office policy to scan records)

COLLECTING UNPAID FEES

P. 26 & 27

Disputes over fees should be avoided to the extent possible

Referral to a collection agency or fee litigation should be a last resort to collect fees where the practitioner has made every effort to amicably settle any differences concerning either the amount or the timing of the collection of fees

A tax practitioner who is considering using a collection agency to collect unpaid fees must comply with the duties of confidentiality and nondisclosure - Figure 1.6 Confidentially agreement

RETURN OF RECORDS – CIRCULAR 230

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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.

However, if applicable state law allows or permits the retention of a client's records when there is a dispute over fees for services rendered, the practitioner must return only those records that must be attached to the taxpayer's return.

RETURN OF RECORDS – AICPA

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When an initial request for client-provided records is received, the tax practitioner should make those records in the practitioner's custody or control available to the person or entity that provided the records to the practitioner.

The practitioner may charge a reasonable fee for the time and expense incurred to retrieve, copy, and ship such records. However, the client-provided records may not be withheld for nonpayment of such fees.

RETURN OF RECORDS – AICPA

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Follow agreement between the client & practitioner on prepared records & work products

But if no agreement exists, **practitioner-prepared records** and **practitioner's work products** may be withheld if fees are due for that specific work product, work product is incomplete, necessary to comply with professional standards, or threatened or outstanding litigation exists about the engagement or work

RETURN OF RECORDS – STATE LAW

State boards of accountancy may impose additional or different requirements for the return of records.

Under the AICPA Records Requests rule, tax practitioners must comply with applicable rules and regulations of authoritative regulatory bodies, such as the state board(s) of accountancy

Thus, if state law prohibits withholding records, the practitioner may not withhold the records

Example 1.3 Restrictive Michigan or state law?

CH. 1 ETHICS – CASE STUDIES

10 Case Studies

The following case studies are intended to promote a discussion of how ethical guidelines are applied in a tax practice

The case studies are based on fictitious persons and hypothetical situations. They are solely for educational purposes

CASE STUDY 6: TERMINATING REPRESENTATION P. 33

**Niles operates
2 restaurants &
a bar**



CASE STUDY 6: TERMINATING REPRESENTATION

Niles Larson has been a client of Rocky Mountain CPAs for 3 years. Client requires annual planning & returns, & and have been a steady source of income for Rocky Mountain CPAs, Niles has problems with retaining staff

Niles often ignores planning advice from Rocky Mountain CPAs
This year Niles was late providing information to the office

He refused to provide more information or extend the return and told them to “get it done.” He paid late even though Rocky Mountain got the return completed in time

Because of staff shortages Rocky Mountain is not sure how to keep up

CASE STUDY 6: TERMINATING REPRESENTATION

P. 33

1. Should Rocky Mountain terminate representation of Niles?
2. What if, due to staffing issues, Rocky Mountain knows that no other local accountants are taking on new clients?
3. If Rocky Mountain decides to terminate representation, how should they do it?

CASE STUDY 6: RESPONSE

PP. 42 - 43

1. Should Rocky Mountain terminate representation of Niles?

Rocky Mountain should have a policy to review client engagements and terminate those engagements if the risks outweigh the benefits.

Rocky Mountain could work with Niles to improve his treatment of the staff, as well as the timeliness and thoroughness of the information that he provides. They could require a retainer as a deposit toward fees incurred. However, given the risks that Niles is not providing sufficient information to prepare complete and accurate returns, it may be better to terminate representation.

CASE STUDY 6: RESPONSE

P. 42 - 43

2. What if, due to staffing issues, Rocky Mountain knows that no other local accountants are taking on new clients?

Under Circular 230 § 10.23, a tax practitioner has a duty to not unreasonably delay the prompt disposition of any matter before the IRS. If Niles has an imminent tax deadline and no other local accountants are accepting new clients, Rocky Mountain may have to consider continuing to provide services until the urgent items have been completed.

CASE STUDY 6: RESPONSE

PP. 42 - 43

3. If Rocky Mountain decides to terminate representation, how should they do it?

If termination of representation of Niles is the choice, they should send him a termination letter by certified mail. The letter could give him a concise and factual reason for the termination, such as the inability to replace a retiring employee. The letter should discuss any deadlines pending, work to be done, and records to be returned or transferred. They should revoke any Forms 2848 that they have on file for Niles and his businesses. The letter could include an invoice for any remaining unpaid fees.

CASE STUDY 7: FEE COLLECTION / RECORDS RETURN P.34



Records Gone in Flood,
Reconstructing With
unanswered Questions
No Payment Received

CASE STUDY 7: FEE COLLECTION / RECORDS RETURN

Cole has a glamping business in Montana. In 2022, heavy floods damaged the area, including Cole's business and records. Cole did not file 2022 tax returns

In November 2023 Cole hired Grizzly Tax and Bookkeeping to reconstruct 2022 & 2023 records and to file the returns

Grizzly has stated in the engagement letter they will withhold work products for nonpayment

The engagement terminates because of Cole's lack of information and payment

CASE STUDY 7: FEE COLLECTION / RECORDS RETURN P. 34

1. Can Grizzly withhold any of these records pending Cole's payment of the outstanding invoices?
2. Can Grizzly send the past-due invoices to a collection agency?

CASE STUDY 7: RESPONSE

P. 43

1. Can Grizzly withhold any of these records pending Cole's payment of the outstanding invoices?

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. Fee dispute generally do not relieve the practitioner of his or her responsibility to return records.

If applicable state law allows or permits the retention of a client's records when there is a dispute over fees for services rendered, the practitioner must return only those records that must be attached to the taxpayer's return.

If not otherwise agreed, work products may be withheld if fees are due for the specific work product or if the work product is incomplete. Here, Grizzly and Cole have agreed in the engagement letter that work products may be withheld for nonpayment of fees. If not prohibited under state law, Grizzly can decline to give Cole its work products (the partially completed return and unfinished electronic file).

CASE STUDY 7: RESPONSE

P. 43

2. Can Grizzly send the past-due invoices to a collection agency?

Before Grizzly sends Cole's debt to a collection agency, it should exhaust other efforts to collect that debt.

If those efforts fail, Grizzly can use a collection agency to recover unpaid fees for services rendered only to the extent that debt collection efforts comply with Grizzly's ethical obligations. Grizzly has duties of confidentiality and nondisclosure under state and federal law.

In using the services of a collection agency, details should be limited to the minimal information necessary to collect the debt. Grizzly must also ensure that the collection agency treats that information confidentially.

CASE STUDY 8: SUCCESSOR TAX PRACTITIONER P. 35



TP hires new professional accountant with questions



CASE STUDY 8: SUCCESSOR TAX PRACTITIONER P. 35

Cole from previous Case Study 7, finally pays his bill, Grizzly returned all records to Cole

Cole meets with a new accountant, Laura Hill

He gives Laura the incomplete file from the previous engagement

He states he "does not want to pay for the same thing twice"

Laura and the previous accountant are friends, and Laura asks what led to the termination of Cole's prior engagement

CASE STUDY 8: SUCCESSOR TAX PRACTITIONER

P. 35

1. What information, if any, can Dona give Laura?
2. What should Laura do if Cole will not grant consent to disclosure?
3. If Laura accepts Cole as a client, can she rely on information in the partially completed tax return and finish the work that Grizzly started?

CASE STUDY 8: RESPONSE

P. 44

1. What information, if any, can Dona give Laura?

A professional accountant in public practice who is asked to replace another professional accountant should determine whether there are any reasons, professional or other, for not accepting the engagement. Direct communication with prior accountant is needed to establish the facts and circumstances behind the proposed change. Get *permission* to talk to new accountant.

AICPA Code of Professional Conduct § 1.700.020, “Disclosing Information From Previous Engagements,” states that when a member withdraws from an engagement due to, for example, discovery of irregularities in a client’s tax return, if contacted by the successor, the member should suggest that the successor ask the client to permit the member to discuss all matters freely with the successor. The successor is then on notice of some conflict.

CASE STUDY 8: RESPONSE

P. 44

2. What should Laura do if Cole will not grant consent to disclosure?

If the new accountant is unable to communicate with prior accountant, the new accountant should try to obtain information about any possible threats by other means such as through inquiries of third parties or background investigations on senior management or those charged with governance of the client. (Look at prior communications with the client.)

Where the threats cannot be eliminated or reduced to an acceptable level through the application of safeguards, the new accountant should, unless there is satisfaction as to necessary facts by other means, decline the engagement.

CASE STUDY 8: RESPONSE

P. 44

3. If Laura accepts Cole as a client, can she rely on information in the partially completed tax return and finish the work that Grizzly started?

If Laura does an independent investigation of Cole's business and decides to accept the client, she must consider whether she can rely on the portion of the return prepared by Grizzly.

Based on Cole's unwillingness to grant authorization to obtain information from Grizzly, Laura must consider information entered on the return may not be complete and accurate. Laura has a duty of diligence as to the accuracy of the return [Circular 230 § 10.22]. She did not engage or oversee Grizzly's work, and it may not be reasonable for her to rely on Grizzly's work product.

CASE STUDY 9: EMAIL ADVICE

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Grow business
with edibles &
marijuana
license



CASE STUDY 9: EMAIL ADVICE

Jasmine lives in Montana, a state that has legalized recreational marijuana. A dispensary has approached Jasmine to expand her business. Only Montana residents can get a license.

They sent Jasmine a \$50,000 advance payment which she spent on employee bonuses

She is anticipating \$500,000 in total cash to expand her business

She asks her accountant a “quick question” - does she have to pay tax on the \$500,000 & if she purchases equipment can she take it all as a deduction

CASE STUDY 9: EMAIL ADVICE

P. 35

1. Should Ted respond to Jasmine's email?
2. If he chooses to respond, how much information should Ted include?
3. What other due diligence obligations does Ted have?

CASE STUDY 9: RESPONSE

P. 45 - 46

1. Should Ted respond to Jasmine's email?

Providing substantive tax advice can create problems. Ted must consider whether he can provide an adequate response. Jasmine has asked a complicated question, and a simple “yes” or “no” answer is not sufficient to fulfill Ted's ethical obligations.

Under Circular 230 § 10.35, Ted must ensure that he is competent to answer Jasmine's questions. He must have the appropriate level of knowledge, skill, thoroughness, and preparation necessary for the matter for which he is engaged.

If he is not already familiar with taxation of marijuana businesses, Ted can become competent by consulting with experts in the relevant area or studying the relevant law.

CASE STUDY 9: RESPONSE

P. 45 - 46

2. If he chooses to respond, how much information should Ted include?

When providing advice, Ted must comply with the Circular 230 standards for written advice, which apply to electronically communicated advice such as emails & text messages.

Ted must use his professional judgment & should consider, among other factors, the importance of the transaction and amounts involved, the short time to give advice, and will this change the ownership of the business and related issues.

CASE STUDY 9: RESPONSE

PP. 45 - 46

3. What other due diligence obligations does Ted have?

No verification is required. However, he cannot ignore the implications of information furnished and must make reasonable inquiries if the information furnished appears to be incorrect, inconsistent, or incomplete.

Here, Jasmine has given him no information about the “investment.” Is it a loan, a contribution to equity, or a purchase of Jasmine’s interest in the business? Ted has a duty to request additional information. Given the complexity and importance of the transaction and the time frame involved, he can call Jasmine or schedule a meeting.

CASE STUDY 10: LEGAL ADVICE

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Form 1120-S		U.S. Income Tax Return for an S Corporation		OMB No. 1545-0123
Department of the Treasury Internal Revenue Service		Do not file this form unless the corporation has filed or is attaching Form 2553 to elect to be an S corporation. Go to www.irs.gov/Form1120S for instructions and the latest information.		2022
For calendar year 2022 or tax year beginning _____, 2022, ending _____, 20				
A S election effective date	TYPE OR PRINT	Name	D Employer identification number	
B Business activity code number (see instructions)		Number, street, and room or suite no. If a P.O. box, see instructions.	E Date incorporated	
		City or town, state or province, country, and ZIP or foreign postal code	F Total assets (see instructions)	
C Check if Sch. M-3 attached <input type="checkbox"/>			\$	
G Is the corporation electing to be an S corporation beginning with this tax year? See instructions. <input type="checkbox"/> Yes <input type="checkbox"/> No				
H Check if: (1) <input type="checkbox"/> Final return (2) <input type="checkbox"/> Name change (3) <input type="checkbox"/> Address change (4) <input type="checkbox"/> Amended return (5) <input type="checkbox"/> S election termination				
I Enter the number of shareholders who were shareholders during any part of the tax year				

Can you file Form 2553, Articles of Incorporation, or operating agreements?

CASE STUDY 10: LEGAL ADVICE

Jewels Curtis wants to start a martial arts & boxing gym. Jewels has a student, Melissa, who was a marketing executive. Melissa agrees to help Jewels start the business

They meet with a new accountant, John. John recommends an S-Corporation to “save some money on taxes”.

Melissa asked John if they could use her existing LLC which was formed several years ago for real estate investment

CASE STUDY 10: LEGAL ADVICE

P. 36

1. Can John advise Jewels and Melissa about whether to use the existing LLC or form a new S corporation?
2. If Jewels and Melissa want to form a new corporation, can John prepare and file the articles of incorporation?

CASE STUDY 10: RESPONSE

P. 47

1. Can John advise Jewels and Melissa about whether to use the existing LLC or form a new S corporation?

John may offer advice about the tax treatment of different entities, but he cannot advise Jewels and Melissa about legal matters

Self-employment tax savings of an S corporation versus a limited liability company is authorized tax advice; as is advice about S corporation eligibility requirements, & how existing LLC operating agreement may not meet those requirements.

However, offering advice about ongoing liability of the LLC and its members for prior acts related to the real estate venture is likely legal advice.

CASE STUDY 10: RESPONSE

P. 47

2. If Jewels and Melissa want to form a new corporation, can John prepare and file the articles of incorporation?

Jewels and Melissa may ask John to assist them with filing business formation documents. Such assistance may constitute the unauthorized practice of law if the information on the forms requires legal knowledge. Such assistance has been a problem under Michigan law.

John should advise Jewels and Melissa to consult with their attorney and insurance agent to discuss how best to structure their business arrangement and protect the limited liability status of the business. Consider meeting with the attorney and client for John's input on the taxes.