Advising Financial Institutions in Times of Uncertainty

ABA Tax Section Midyear Meeting
New Orleans
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Moderator & Panelists

**Moderator:**
- Shay Menuchin, KPMG Law, Toronto, ON

**Panelists:**
- Christopher Ferguson, Kostelanetz & Fink, New York, NY
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Our Agenda

- Welcome & Introductions
- Session Objectives
- Quick Review of Sources
- Discussion of Hypotheticals
- Questions
Our Objectives

• Establish a baseline about applicable standards of practice
• Explore situations implicating those rules with emphasis on situations in which
  • The law is unclear,
  • The statutory language and legislative history are contradictory, and/or
  • Interpretive guidance is not forthcoming.
• Address your Questions
• Wrap-up
Establishing a Baseline – Sources of Professional Regulation: What Rules Apply To Me?

- Circular 230 – Regulations Governing Practice Before the IRS (applicable to all practitioners)
- State Courts/Bar Associations – Rules of Professional Conduct (applicable to attorneys)
- AICPA Code of Professional Conduct & Statements on Standards for Tax Services (applicable to CPAs)
- IRC provisions – (including civil and criminal penalties) E.g. § 6694
- Your employer’s own rules
- Practical considerations/prior industry practice
Establishing a Baseline – Circular 230

• “Practice before the IRS” is defined in Circular 230 § 10.2(a)(4) as “all matters connected with a presentation to [IRS] relating to a taxpayer’s rights, privileges, or liabilities under laws or regulations administered by” the IRS
• Such presentations include, but are not limited to:
  • preparing documents
  • filing documents
  • corresponding and communicating with the IRS
  • representing a client at conferences, hearings, and meetings
  • rendering written advice with respect to any entity, transaction, plan or arrangement, or other plan or arrangement having a potential for tax avoidance or evasion
Establishing a Baseline – Circular 230

- The scope of “practice before the IRS” was substantially narrowed by Loving v. IRS, 742 F.3d 1013 (DC Cir 2014):
  - Statutory authority for Circular 230 does not cover preparation of tax returns
  - Thus, portions of Circular 230 covering return preparers are invalid
- And subsequently the ability of Treasury to regulate activities that do not involve active representation of a taxpayer before the IRS was further limited by Ridgely v. Lew, 55 F. Supp. 3d 89 (DDC 2014):
  - IRS may not regulate the contingent fee arrangement between a CPA and client with respect to preparation of a refund claim
- See also Sexton v. Hawkins (DNev 3/17/2017)
Establishing a Baseline – Circular 230: Regulations Governing Practice Before the IRS (cont’d)

• What About In-House Tax Professionals?
  • Generally no differentiation between in-house professionals and outside preparers/advisors
  • OPR applies Circular 230 to corporate tax professionals
  • AICPA Code of Professional Conduct applies to all members, including those in industry. AICPA Code of Prof’l Conduct ¶0.100.010.01.
  • AICPA Statements on Standards for Tax Services address the obligations to “taxpayers,” which include the member’s employer. SSTS 1, ¶1(b).
Establishing a Baseline – Attorneys

- Each state establishes its own rules of professional conduct, generally modeled on ABA Model Rules
  - Refer to rules where admitted and where employed

- Sources of Guidance
  - ABA Ethics Opinions (ABA possesses no disciplinary authority)
    - ABA Opinion 85-352
  - State and local bar ethics opinions
  - Comments to state and Model Rules
Establishing a Baseline – CPAs

- AICPA Code of Professional Conduct
  - Applies to all members, including those in industry
  - AICPA possesses disciplinary authority
- AICPA Statements on Standards for Tax Services (SSTGs)
  - Some states have adopted SSTGs as enforceable standards
- State Board of Accountancy rules (where licensed and where employed)
Establishing a Baseline – IRC & Regs.

E.g.:  
• IRC § 6694 (preparer penalties)  
  • Signing vs. nonsigning preparer  
• IRC § 6701 (aiding and abetting understatement of liability)  
• Criminal penalties  
• IRC § 7407(a) (IRS may seek to enjoin a tax preparer from engaging in specific practices)  
• Advice must take taxpayer accuracy and penalty standards into account! (IRC § 6662)
Establishing a Baseline – Tax Court

• Tax Court Rule 201(a) adopts ABA Model Rules

• Tax Court Rule 24(g) – conflicts of interest
Sources of Conflict

• Virtually all difficult ethical problems arise from conflicts between and among a practitioner’s responsibilities
  • to clients
  • to the tax system, and
  • to the practitioner’s own interest in remaining an ethical person while earning a satisfactory living
Issue # 1: Limiting the Scope of Advice

• The law is unclear. Your research and reasoning skills only get you so far.

• How/Can you limit the scope of your advice?
• To what extent can you disclaim (in advance) your advice?
• How should a client take your caveats into account in its planning?
  • Should the taxpayer go forward?
  • Sometimes, a taxpayer just has to act.
Issue # 1: Limiting the Scope of Advice (cont’d)

Cites:

• ABA Formal Opinion 85-352
• IRC § 6694; IRC § 6662
• AICPA SSTS 1
• Circular 230 § 10.34
• Model Rule 1.2(c) and Comments 6 & 7
• Model Rule 1.1
Issue #2: Oops! The advice you gave was wrong

• Is the client a current client? Former client?
• Can you continue to represent the client?
• What steps might the client need to consider?
  • Separate counsel?
  • Revise or modify any submissions?
• Does it matter who discovers the error?
• Who is the law firm’s lawyer? If you are general counsel to the firm/ethics counsel to the firm, who is your client?
Issue #2: Oops! The advice you gave was wrong (cont’d)

Cites:

• Model Rule 1.4 (communications)
• Model 1.7 (conflict of interest: current clients)
• Model Rule 1.9 (duties to former clients)
• Treasury Dept. Circular 230 § 10.21 (knowledge of client omission), § 10.29 (conflicting interests); § 10.33 (best practices for tax advisors)
• Model Rule 1.13 (organization as client)
• Model Rule 1.6 (client confidences); IRC § 7216 (use of taxpayer return information)
• ABA Formal Op. 481 (April 17, 2018) (duty to inform client of mistake)
Issue #3: The advice you gave was correct under prior law, but the law has changed

- Is the client a current client? Former client?

- What steps might the client need to consider?
  - Revise or modify any submissions?

- What steps must you advise the client to take?
Issue #3: The advice you gave was correct under prior law, but the law has changed (cont’d)

Cites:

- Treasury Dept. Circular 230 § 10.21 (knowledge of client omission), § 10.22 (diligence as to accuracy), § 10.33 (best practices for tax advisors), § 10.34 (standards re tax returns and documents), §10.37 (requirements for written advice)

- Model Rules 3.3 (candor toward the tribunal), 3.4 (fairness to opposing party and counsel), 3.9 (advocate in non-adjudicative proceeding), 4.1 (truthfulness in statements to others), 1.9 (duties to former clients)

- AICPA Statements on Standards for Tax Services
  - No. 1 (Tax Return Positions – advice regarding disclosure responsibilities, potential penalties)
  - No. 7 (Form and Content of Advice to Taxpayers)
Issue #4: How do you get to substantial authority?

“There is substantial authority for the tax treatment of an item only if the weight of the authorities supporting the treatment is substantial in relation to the weight of authorities supporting contrary treatment. All authorities relevant to the tax treatment of an item, including the authorities contrary to the treatment, are taken into account in determining whether substantial authority exists.” Reg. § 1.6662-4(d)(i).

• How does one get to substantial authority in the absence of authorities?
• To what extent can you trust your instincts?
• What if you have no instinct with respect to a particular issue?
Issue #4: How do you get to substantial authority? (cont’d)

Cites:

• Reg. § 1.6662-4(d): Only the authorities listed in Treas. Reg. 1.6662-4(d)(3)(iii) may be considered
• Includes things such as the Internal Revenue Code, temporary and final regulations, revenue rulings and procedures, treaties, cases, congressional intent as reflected in congressional history, private letter rulings, technical advice memos, action on decisions and general counsel memos, IRS notices, announcement and press releases
• Conclusions reached in treatises, legal periodicals and legal opinions rendered by tax professionals are not authority, but the authorities underlying such expressions of opinion may give rise to substantial authority

• Circular 230 § 10.34
• Model Rule 1.1, 1.3
Issue #5: You can’t get to substantial authority

The law is new and there are no useful authorities. You conclude that you can’t get to substantial authority.

- What advice can you give? What should your client do?
Issue #5: You can’t get to substantial authority (cont’d)

Cites:

• ABA Opinion 85-352
• Model rule 1.2(d)
• Reasonable Basis is defined in Treas. Reg. 1.6662-3(b)(3)
  • Reasonable basis is a relatively high standard of tax reporting that is significantly higher than not frivolous or not patently improper. The reasonable basis standard is not satisfied by a return position that is merely arguable or that is merely a colorable claim.
  • If a return position is reasonably based on one or more of the authorities used for the substantial authority standard, then the position has a reasonable basis.
Issue #5: You can’t get to substantial authority (cont’d)

Cites:

What is adequate disclosure?

• Adequate Disclosure is defined in Treas. Reg. 1.6662-4(f) and Cir. 230, sec. 10.34(c).
  • Form 8275 or 8275-R
  • Special rules via Rev. Proc.
  • Adequate disclosure can be a speech to the taxpayer, documented in writing, about penalty standards and ability to avoid penalties through disclosure
Issue #6: Client asks about risk of audit

Your client asks you about the likelihood that he/she/it will get audited.

• Can you discuss risk of audit?
• Can you consider adopting riskier positions based on likelihood of audit?
• What if your explanation of audit practices and risks leads the client to plan to report a riskier position?
• What is a legitimate use of audit risk information?
• Can you discuss the likelihood or possibility of settlement of an issue on audit?
Issue #6: Client asks about risk of audit (cont’d)

Cites:

• Treas. Reg. § 1.6994-2(b)(1) (in assessing the merits of a return position, “the possibility that the position will not be challenged by the . . . IRS (for example, because the taxpayer’s return may not be audited or because the issue may not be raised on audit) is not to be taken into account.”)

• Treas. Reg. § 1.6692-4(d)(2) (“possibility that a return will not be audited or, if audited that an item will not be raised on audit, is not relevant in determining whether the substantial authority standard (or the reasonable basis standard) is satisfied.”)

• Treasury Dept. Circular 230 § 10.37 (“in evaluating a Federal tax matter [the practitioner should not] take into account the possibility that a tax return will not be audited or that a matter will not be raised on audit.”)

• Statement on Standards for Tax Services No. 1, Tax Return Positions 10 (2009) (“A member should not recommend a tax return position or prepare or sign a return reflecting a position that the members knows . . . exploits the audit selection process of the tax authority.”)
Issue #7: Sharing your thoughts on social media

Everyone is looking around for help in understanding the new law and how to use it in tax planning. This presents a good opportunity to share your thoughts to a wide audience.

• What risks arise in blogging about your experience? Your expertise?
• Reaching out to specific parties via social media?
• Responding to critiques of you and your work on social media?
• Endorsements?
• Searching the social media profiles of others?
• Using social media information of a former client found on public site
Issue #7: Sharing your thoughts on social media (cont’d)

- Pennsylvania Bar Association Formal Opinion 2014-300: Ethical Obligations for Attorneys Using Social Media
- Pennsylvania Bar Association Formal Opinion 2014-200: Lawyer Response to Client’s Negative Online Review
- ABA Social Media webpage (note ABA Social Media Policy coming soon): https://www.americanbar.org/groups/committees/scocle/social-media.html
- Model Rule 8.4 (misconduct)
Issue #8: Technology

• Can you be a dinosaur?
• What do you need to worry about on the tech side of your legal life?
  • Data Breaches
  • Confidentiality
Issue #8: Technology

• ABA Formal Op. 483 (Oct. 17, 2018) (Lawyers Obligation After an Electronic Data Breach or Cyberattack)

• ABA Formal Op. 482 (Sept. 19, 2018) (Ethical Obligations Related to Disasters)

• ABA Formal Op. 477 (May 11, 2017) (Securing Communication of Protected Client Information)

• ABA Social Media webpage (note ABA Social Media Policy coming soon):
  https://www.americanbar.org/groups/committees/scocle/social-media.html
Appendix

AICPA Statements on Standards for Tax Services

- SSTS No. 1 – Tax Return Positions
- SSTS No. 2 – Answers to Questions on Returns
- SSTS No. 3 – Certain Procedural Aspects
- SSTS No. 4 – Use of Estimates
- SSTS No. 5 – Departure from a Position Previously Concluded
- SSTS No. 6 – Knowledge of Error
- SSTS No. 7 – Form and Content of Advice to Taxpayers
Appendix

Circular 230

- 10.2 Definitions
- 10.20 Information to be furnished
- 10.21 Knowledge of a client’s omission
- 10.22 Diligence as to accuracy
- 10.29 Conflicting interests
- 10.33 Best practice for tax advisors
- 10.34 Standards with respect to tax returns and other documents
- 10.35 Competence
- 10.37 Requirements for written advice
- 10.51 Incompetence and disreputable conduct
Appendix

Civil Penalties Applicable to Practitioners

- IRC 6694 – Understatement of taxpayer’s liability by tax return preparer
- IRC 6695 – Other penalties for return preparers
- IRC 6695A – Penalties for incorrect appraisals
- IRC 6700 – Promoting abusive tax shelters, etc.
- IRC 6701 – Penalty for aiding and abetting understatement of tax liability
- IRC 6707/6708 - Failure to report or maintain list of reportable transactions
- IRC 6713 – Disclosure or use of information by preparers of returns
Appendix

Criminal Penalties Applicable to Practitioners

• IRC 7201 – Tax Evasion
• IRC 7206(1) – Filing a False Return
• IRC 7206(2) – Aiding or Assisting the Filing of a False return
• IRC 7212 – Any Attempt to Interfere with the Administration of the Internal Revenue laws
• IRC 7216 – Disclosure or use of information by preparers of returns
• 18 USC 371 – Conspiracy
• 18 USC 1001 – False statement to a federal official
More Useful Information

• Office of Professional Responsibility
  1111 Constitution Ave. N.W.
  SE:OPR  Rm. 7238
  Washington, D.C. 20224

• Information on OPR, Circular 230 and Discipline visit:

• Circular 230 (Rev 6-2014)

• OPR Listserv