

Federal Tax Research, Ninth Edition
AN INTRODUCTION TO TAX PRACTICE AND ETHICS

TEST BANK, Chapter 1

Multiple Choice

Choose the best answer for each of the following questions:

- ___ 1. Tax compliance is the process of:
- a. filing necessary tax returns
 - b. gathering the financial information necessary to report taxable income
 - c. representing a taxpayer at an IRS audit
 - d. all of the above
- ___ 2. Tax evasion is:
- a. a fraudulent act involving illegal nonpayment of taxes
 - b. one of the objectives of tax planning
 - c. an act of deferring tax payments to future periods
 - d. the same as tax avoidance as both of them result in nonpayment of taxes
- ___ 3. Tax litigation is a process of:
- a. participating in an administrative audit
 - b. settling tax-related disputes in a court of law
 - c. filing amended tax returns as prescribed by tax laws
 - d. arranging a taxpayer's affairs to minimize tax liabilities
- ___ 4. Regarding open transactions, which of the following statements is INCORRECT?
- a. the transaction is not yet completed
 - b. the practitioner can suggest changes to achieve a better tax result
 - c. a tax practitioner has some degree of control over the client's tax liability
 - d. the practitioner can fix the problem by amending the client's tax return

- ___ 5. Which of the following statements *best* describes Circular 230?
- a. Circular 230 has been adopted by the AICPA as its set of rules of practice for CPAs.
 - b. Circular 230 is a set of Treasury Department ethical and legal standards for those engaging in practice before the IRS.
 - c. Circular 230 is a set of internal rules at the IRS designed to protect tax practitioners from unfair discipline by the IRS.
 - d. Circular 230 is a set of ethical rules for taxpayers.
- ___ 6. Who can represent a taxpayer before the IRS Appeals Office under Circular 230?
- a. A CPA
 - b. An officer of a corporation may represent the corporation
 - c. An attorney
 - d. All of the above
 - e. Only a and c
- ___ 7. In a closed transaction, the scope of tax planning is:
- a. more limited as compared to an open transaction
 - b. limited by the IRS rules of practice
 - c. limited to presenting the taxpayer's facts to the government in the most favorable, legal manner
 - d. Only a and c
- ___ 8. Circular 230 includes rules on all of the following topics EXCEPT:
- a. who is authorized to practice before the IRS
 - b. standards for "covered opinions"
 - c. compliance with state ethical requirements
 - d. a set of best practices to guide practitioners

- ___ 9. Standards for Tax Services (SSTS) contain advisory guidelines for:
- a. CPAs
 - b. enrolled agents
 - c. attorneys
 - d. IRS authorities
 - e. All of the above
- ___ 10. An EA must renew his or her enrollment card on a:
- a. 5-year cycle
 - b. 3-year cycle
 - c. 2-year cycle
 - d. Renewal is not required once an EA gets a card
- ___ 11. An unenrolled tax return preparer can make an appearance as the taxpayer's representative only before the:
- a. Examination Division of the IRS
 - b. Appeals and Collection Division of the IRS
 - c. SB/SE Division of the IRS
 - d. Criminal Investigation Division of the IRS
- ___ 12. Due diligence, in essence, means a tax practitioner:
- a. must be efficient in performing his duties
 - b. must give due respect to IRS officials
 - c. should use reasonable effort to comply with the tax laws
 - d. should charge reasonable fees for work performed for a client
- ___ 13. A contingent fee is:
- a. always allowed by Circular 230
 - b. a fee that is out of line with the value of the service provided
 - c. a fee based on a percentage of a taxpayer's refund on a tax return
 - d. all of the above

- ___ 14. According to Circular 230, the “best practices” rules are:
- a. mandatory for all tax practitioners
 - b. restricted only to attorneys and CPAs
 - c. aspirational, to act as goals for tax practitioners
 - d. enforced by disbarment from practice before the IRS
- ___ 15. According to Rule 101 of the AICPA Rules of Professional Conduct, a CPA in public practice must:
- a. comply with Circular 230
 - b. disclose any conflict of interest with another client
 - c. keep client information confidential
 - d. be independent of his or her clients
- ___ 16. Under AICPA Rule 502, which of the following actions would constitute deceptive advertising?
- a. advertising too frequently
 - b. implying that the CPA had the ability to influence an IRS official
 - c. promising a favorable result without justification
 - d. Only b and c
- ___ 17. Under Statements on Standards for Tax Services No. 3, (SSTS No. 3) a CPA preparing a tax return should perform all of the actions EXCEPT:
- a. independently confirm the accuracy of the taxpayer’s information
 - b. obtain additional information if the taxpayer’s information appears to be incorrect or incomplete
 - c. review the prior year’s return when feasible
 - d. determine when conditions for a deduction have been met

- ___ 18. Which of the following is CORRECT about a CPA's responsibility with regard to tax return positions under Statements on Standards for Tax Services No. 1 (SSTS No. 1):
- a. A CPA may not base his or her position on authority that is not approved by the IRS under Section 6662 (accuracy-related penalty).
 - b. A CPA may sign a return which has a tax position that has a *realistic possibility* of being sustained on the merits.
 - c. A CPA may not sign a return which has any tax position that is not fully disclosed.
 - d. All of the above statements are correct.
- ___ 19. The Statements on Standards for Tax Services (SSTS) are issued by:
- a. the Internal Revenue Service
 - b. the FASB
 - c. the AICPA
 - d. the American Bar Association
 - e. the AICPA and the American Bar Association jointly
- ___ 20. The Statements on Standards for Tax Services are:
- a. part of the ABA Code of Professional Responsibility
 - b. intended to replace Circular 230
 - c. intended to supplement the AICPA Code of Professional Conduct and Circular 230
 - d. none of the above
- ___ 21. Which of the following statements *best* explains the need for tax practitioners to understand nonregulatory ethical models of behavior?
- a. Competing ethical solutions must be resolved by the courts.
 - b. There is more to ethical behavior than just following the rules of professional organizations.
 - c. Practitioners must always choose the action with the greatest benefit for their client.
 - d. Ethical choices are clearly spelled out by IRS regulations.

- ___ 22. The primary change made by the Sarbanes-Oxley Act which affects the practice of public accounting is:
- a. Public accounting firms may no longer provide any actuarial services.
 - b. Accounting firms may no longer offer tax shelters.
 - c. Auditors may never do tax compliance work for their clients.
 - d. Public accounting firms may provide some nonaudit services to their audit clients if the services are approved in advance by an audit committee.
- ___ 23. The *Lowell Bar Association v. Loeb* case addressed the issue of:
- a. unauthorized practice of law by nonattorneys engaged in tax practice
 - b. legal research by taxpayers
 - c. attorneys and CPAs working together in a practice
 - d. all of the above
- ___ 24. In which of the following situations would a CPA be engaged in the unauthorized practice of law?
- a. The CPA drafts a contract for his small business client.
 - b. The CPA files a client's state tax return.
 - c. The CPA answers estate tax questions for his client.
 - d. The CPA represents his client before the IRS.
- ___ 25. Which of the following statements is CORRECT regarding unauthorized practice of law?
- a. Taxpayers may draft not their own contracts.
 - b. Taxpayers may not represent themselves in Tax Court.
 - a. A CPA cannot express a legal opinion on a non-tax matter.
 - b. A CPA cannot express a legal opinion on a tax matter.

True or False

Indicate which of the following statements are *true* or *false* by circling the correct answer.

- T F 1. Tax avoidance and tax evasion are both illegal.
- T F 2. Tax research is only required for tax planning, not preparing returns.
- T F 3. Tax planning has a more likelihood of success when a tax practitioner is dealing with an open transaction instead of a closed transaction.
- T F 4. Paid tax return preparers must register with the IRS and obtain a PTIN.
- T F 5. Enrolled actuaries are allowed to practice before the IRS.
- T F 6. Under Circular 230, “covered opinions” include *oral* advice on tax avoidance transactions.
- T F 7. Circular 230 bans tax practitioners from giving written advice on a Federal tax issue based on the likelihood of an audit.
- T F 8. CPAs may never disclose confidential taxpayer information under the AICPA rules.
- T F 9. A member of the AICPA is not allowed to prepare tax returns that involve the use of the taxpayer’s estimates.
- T F 10. State Boards of Accountancy are the organizations with responsibility to license public accountants in each state.
- T F 11. The Sarbanes-Oxley Act addresses issues of corporate governance as well as the independence of auditors.
- T F 12. The ABA Model Code of Professional Responsibility has the force of law and covers all attorneys practicing in the United States.
- T F 13. An attorney, CPA, or enrolled agent may use advertising to obtain clients under Circular 230.
- T F 14. If a CPA becomes aware of an error in a tax return, he or she must immediately notify the IRS.
- T F 15. A CPA can rely without verification on information given to the CPA by a taxpayer unless the information appears to be incorrect.

- T F 16. An ethical dilemma occurs when someone is faced with a situation for which there are no clearly defined answers.
- T F 17. The three categories of modern tax practice include tax planning, tax compliance, and tax research.
- T F 18. To become an enrolled agent, a person must either pass a special IRS examination or must work for the IRS for at least five years.
- T F 19. Drafting wills is a part of a CPA's professional duties.
- T F 20. Tax practice can be defined as the application of the tax laws to specific accounting situations.

Short Answer

1. Who may represent a taxpayer before the IRS in cases which go *beyond* the examination of the return?
2. Taxation and tax practice are comprised of the interaction of several disciplines. What are those disciplines? Briefly discuss their impact on the tax system.
3. What standard must tax practitioners meet under Section 6694 (preparer penalties) of the Internal Revenue Code with respect to *undisclosed* positions taken on tax returns?
4. Does the IRS regulate unenrolled tax preparers? Explain your answer.

Essay Questions

1. Explain the AICPA guidelines under SSTS No. 3 for relying without verification on taxpayer or third party information when preparing a tax return.
2. What should an AICPA member do upon learning about an error in a prior year's tax return?
3. Explain which types of services a CPA can and cannot provide to avoid engaging in the unauthorized practice of law.
4. Explain the concept of "limited practice without enrollment" under Circular 230 and list several of the special situations in which the IRS allows this type of representation.
5. Explain the standards for professional services that involve tax return positions under SSTS No.1. What is the level of authority for disclosed or undisclosed positions and what types of authority can be relied upon?

SOLUTIONS, CHAPTER 1 TEST BANK

Multiple Choice

- | | | | | | | | |
|----|---|-----|---|-----|---|-----|---|
| 1. | d | 8. | c | 15. | d | 22. | d |
| 2. | a | 9. | a | 16. | d | 23. | a |
| 3. | b | 10. | b | 17. | a | 24. | a |
| 4. | d | 11. | a | 18. | b | 25. | c |
| 5. | b | 12. | c | 19. | c | | |
| 6. | d | 13. | c | 20. | c | | |
| 7. | d | 14. | c | 21. | b | | |

True or False

1. F Tax avoidance is the **legitimate** object of modern tax practice.
2. F Tax research is undertaken by all three types of tax practice--planning, compliance and litigation.
3. T
4. T
5. T
6. F The term 'covered opinions' includes **written** advice concerning one or more Federal tax avoidance transactions.
7. T
8. F CPAs may disclose confidential taxpayer information with the taxpayer's consent or in response to a subpoena or summons or if there is a review or investigation by the AICPA or a state CPA society.
9. F A member **may** prepare tax returns that involve the use of the taxpayer's estimates if it is impractical to obtain exact data and if the estimated amounts appear reasonable to the member.
10. T
11. T
12. F The ABA Model Code of Professional Responsibility does not in itself have the force of law and must be adopted by the state licensing authority before becoming mandatory for a state's attorneys.
13. T
14. F A CPA member is neither obligated to inform the IRS of the situation, nor may he or she do so without the taxpayer's permission, except as provided by law.
15. T
16. T
17. F The three types of tax practice include tax planning, tax compliance and **tax litigation**.
18. T
19. F Drafting wills by a CPA would give rise to the issue of unauthorized practice of law.
20. T

Short Answer

1. Under Circular 230, the following individuals may represent taxpayers before the IRS beyond the examination stage:
 - Attorneys
 - CPAs
 - Enrolled agents
 - Enrolled actuaries

The above individuals must be in good standing and have a current license. Also, certain authorized individuals may represent taxpayers in special situations under the “limited practice without enrollment rules” of Section 10.7.

2. Tax practice involves a blend of accounting and law. The tax law itself is a product of economics, political science, and sociology. Each of these disciplines influences taxation in a different way. Economics provides input about how the tax law will affect the economy. Political science is the process by which laws are made, and sociology provides the framework to determine the equity and societal goals of the tax law.
3. Tax return positions which are not disclosed on the tax return must meet the standard of “substantial authority” to avoid the penalties under Code Section 6694, relating to understatement of taxpayer's liability by tax return preparer.
4. Yes, unenrolled preparers are now regulated by the IRS under proposed amendments to Circular 230 and recent IRS regulations. Tax return preparers who prepare returns for compensation and sign the return are authorized to conduct “limited practice” before the IRS. The tax return preparer may only make an appearance before the Examination Division of the IRS. All paid preparers must register for a Preparer Tax Identification Number (PTIN) and include that number on all returns submitted to the IRS. In addition, tax return preparers are subject to competency testing and are required to take continuing professional education courses. They also are subject to the Circular 230 ethical standards.

Essay Questions

1. In preparing or signing a return, an AICPA member ordinarily may rely without verification on information that the taxpayer or a third party has provided, unless such information appears to be incorrect, incomplete, or inconsistent. A more formal, audit-like review of documents or supporting evidence is generally not required for a member to sign the tax return. Where material provided by the taxpayer appears to be incorrect or incomplete, however, the member should obtain additional information from the taxpayer. In situations where the tax law requires that specific conditions be met, the member should determine, by inquiry,

whether the conditions have been met. For example, the Code and Regulations impose substantiation requirements for the deduction of certain expenditures. In such a case, the member has an obligation to make appropriate inquiries regarding the client's recordkeeping.

Although members are not required to examine supporting documents, they should encourage the taxpayer to provide such documents when deemed appropriate; for example, in the case of deductions or income from a pass-through entity, such as a partnership, the entity's documents might be useful in preparing the owner's tax returns.

The member should make proper use of the prior year's tax return when feasible to gather information about the taxpayer and to help avoid omissions and errors with respect to income, deductions, and credit computations.

2. A member must advise the taxpayer promptly, regardless of whether the member prepared or signed the return in question, when he or she learns of an error in a previously filed tax return, an error in a return that is the subject of an administrative proceeding, or a taxpayer's failure to file a required return. Such advice should include a recommendation for appropriate measures the taxpayer should take. However, the member is neither obligated to inform the IRS of the situation, nor may he or she do so without the taxpayer's permission, except as provided by law.

The term "error" includes any position, omission, or method of accounting that, at the time the return is filed, fails to meet the standards set out in SSTS No. 1. An error also includes a position taken on a prior year's return that no longer meets these standards due to legislation, judicial decisions, or administrative pronouncements having retroactive effect. However, an error does not include an item that has an insignificant effect on the taxpayer's tax liability.

If the member is requested to prepare the current year's return, and the taxpayer has not taken action to correct an error in a prior year's return, the member should consider whether to proceed with the preparation of the current year's return. If the current year's return is prepared, the member should take reasonable steps to ensure that the error is not repeated. A member should advise a taxpayer, either orally or in writing, as to the correction of errors in the prior year's return. In a case where there is a possibility that the taxpayer may be charged with fraud, the taxpayer should be referred to an attorney.

3. Frequently, legal and accounting questions are so intertwined in tax practice that they are difficult to distinguish. Over the years, a number of court cases have addressed the issue of unauthorized practice of law by accountants and other tax preparers. Though state and federal court cases have some inconsistent results, the current belief is that CPAs and other nonattorneys who practice law before the IRS do not engage in the unauthorized practice of law if they are careful not to

provide any general legal services. Thus, the following types of general law activities should be avoided by nonattorneys:

- Expressing a legal opinion on any non-tax matter.
- Drafting wills or trust instruments.
- Drafting contracts.
- Drafting incorporation papers.
- Drafting partnership agreements.

As long as CPAs and other nonattorneys stay within the practice of tax and do not cross over into the practice of general law, they can avoid the problem of unauthorized practice of law.

4. Under Section 10.7 of Circular 230, certain individuals are authorized to represent a taxpayer before the IRS without being an attorney, CPA, or enrolled agent. These special situations include the following types of representation:

- An individual may represent a member of his or her immediate family.
- A regular, full-time employee of an individual employer may represent the employer.
- A general partner or a regular, full-time employee of a partnership may represent the partnership.
- A bona fide officer or a regular full-time employee of a corporation (including a parent, subsidiary, or other affiliated corporation), association, or organized group may represent the corporation, association, or organized group.
- A regular, full-time employee of a trust, receivership, guardianship, or estate may represent the trust, receivership, guardianship, or estate.
- An officer or a regular employee of a governmental unit, agency, or authority may represent the governmental unit, agency, or authority in the course of his or her official duties.
- An individual may represent any individual or entity, who is outside the United States, before personnel of the Internal Revenue Service when such representation takes place outside the United States.
- An individual who prepares and signs a taxpayer's tax return as the preparer, or who prepares a tax return but is not required (by the instructions to the tax return or regulations) to sign the tax return, may represent the taxpayer during an examination of the taxable year or period covered by that tax return, but this right does not permit such individual to

represent the taxpayer before Appeals Officers, Revenue Officers, Counsel or similar officers or employees of the Internal Revenue Service or the Department of Treasury.

5. Under SSTS No. 1, a member should determine and comply with the standards, if any, that are imposed by the applicable taxing authority with respect to recommending a tax return position, or preparing or signing a tax return. If the applicable taxing authority has no written standards with respect to recommending a tax return position or preparing or signing a tax return, or if its standards are lower than the standards set forth in the SSTSs, then the standard in SSTS No. 1 applies. This standard provides that, in providing professional services that involve tax return positions, a member should have a good-faith belief that the position has at least a realistic possibility of being sustained administratively or judicially on its merits if challenged. In addition, a member may recommend a tax return position if the member concludes that there is a reasonable basis for the position and advises the taxpayer to appropriately disclose that position. Thus, a member may prepare or sign a tax return that reflects a position if a member has a reasonable basis for the position and that position is appropriately disclosed.

A member may reach a conclusion that a position is warranted based on a well-reasoned construction of the applicable statute, well-reasoned articles or treatises, or pronouncements issued by the applicable taxing authority, regardless of whether such sources would be treated as authority under Internal Revenue Code Section 6662 (the accuracy-related penalty on underpayments). A position would not fail to meet these standards merely because it is later abandoned for practical or procedural considerations during an administrative hearing or in the litigation process.

In cases where the member believes that the taxpayer may have some exposure to a penalty, the statement suggests that the member advise the taxpayer of such risk. Where disclosure of a position on the tax return may mitigate the possibility of a taxpayer penalty under the Internal Revenue Code, the member should consider recommending that the taxpayer disclose the position on the return. Additionally, a member should not recommend a tax return position or prepare or sign a tax return reflecting a position that the member knows could exploit the audit selection process of a taxing authority, or serves as a mere arguing position advanced solely to obtain leverage in a negotiation with a taxing authority.