BY KIP DELLINGER, CPA

Watch Your Step

10 Big Mistakes Tax Return Preparers Make

The 10 mistakes discussed here are among those I have observed during my nearly 50 years in tax practice as a CPA, including spending a significant portion in the past 12 years defending CPAs and CPA firms in litigation and regulatory disciplinary matters involving a CPA's appropriate "standard of care" in tax practice

1 Engagement Letters

CPAs and firms are far more likely to secure engagement letters for preparation services than they were just a few years ago. The engagement is a must; any tax malpractice attorney will attest to their importance in setting the understanding with the client and in potentially eliminating misunderstandings, as well as liability if something does go wrong.

However, many CPAs and firms—while adhering to a preparation engagement letter policy—fail to obtain engagement letters for tax authority examinations of a client's return or for tax planning or advice engagements. The preparation engagement agreement does not apply to either of those professional services and the absence of an engagement letter can have serious adverse consequences.

More important, the preparation of an amended return is not the supplemental preparation of the original return and not covered *contractually* by the initial preparation engagement agreement. This, too, can have adverse consequences, such as open-ended liability for the CPA or firm or an assertion that "results" may have been promised.

2 Creeping Conflicts

CPAs and firms often overlook the type of conflicts that can arise years into an otherwise normal engagement. And once caught in the conflicting situation, it becomes difficult to rectify, often results in a necessity to withdraw from serving any of the conflicting parties and is accompanied by possible damages attributable to their need to retain successor CPAs.

Examples of these situations are married clients, partners, family businesses, partnerships, trusts and beneficiaries where perfectly harmonious long-standing relationships gradually deteriorate into acrimonious situations with the CPA "in the middle" and one or more parties contending favoritism. The CPA must be constantly vigilant to identify such situations, and when they begin to arise, either secure conflict waivers or resign from one or more parties—which is not always possible to due obligations to a former client.

While not all acrimonious situations create an actual conflict for the CPA, the CPA should be aware of the possibility of an actual conflict at some point, communicate with the potentially affected parties and secure their acknowledgment.

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3 Due Diligence

While a tax return preparer may use and rely upon information supplied, and representations provided, by the taxpayer and third parties (e.g. a W2 form or mortgage payment statement), they are required to exercise due diligence in preparing returns. CPAs should probe and cannot be too accepting of taxpayer representatives and information. CPAs may not ignore the implications of the information they receive or their independent knowledge. In fact, the IRC preparer penalty provisions apply to tax positions in which the preparer "should" have knowledge. Too often—whether as the result of haste, oversight, fear of client unhappiness or willful blindness—CPAs fall short of their due diligence professional obligations.

4 Tax Positions

CPAs too often rely on "authority" for a tax position on reading a head note that briefly describes the facts and outcome of a tax case. Often, a reading of the entire case would reveal that the actual specific facts and taxpayer motivation in the situation involving the case are not consistent or only partially consistent with the CPA's client's situation; thus, the client would not likely achieve the same outcome.

5 Massaging the Facts

There is an oft-cited adage that everyone is entitled to an opinion, but not to the facts. Too often CPAs—to "help" their clients—will attempt to put words or thoughts into the client's mouth or mind or characterize the client's motivation for an undertaking in manner different than reality to achieve a particular outcome by fitting into the facts of a favorable court case, or statutory or regulatory requirement. This is dangerous ground and can often produce undesired consequences for both the client and the CPA, as the tax authority pursues an investigation. Vivid examples of this issue have long been on display in the extensive litigation pertaining to the abusive tax shelter arrangements of the late 1990s and early 2000s.

6 Failure to Inform Client of Risks with a Tax Position

A CPA may recommend to a taxpayer or treat on a tax return an item if *substantial authority* supports it or there is a lower threshold of *reasonable basis* if disclosure of the item is made in the return in accordance with Treasury or IRS guidance or regulations. Neither of these confidence levels rises to the taxpayer being "more likely than not" entitled to tax treatment of the item, let alone believing that IRS would permit that treatment. Meeting those confidence thresholds insulates the client from penalty attributable to a tax deficiency that will more likely than not arise if the return is examined and the item challenged.

That deficiency assessment sometimes becomes an unpleasant surprise to a client that asserts that the CPA "didn't tell me" or the CPA "didn't inform me of the substantial costs associated with attempting to defend the tax treatment on the return."

When material uncertain positions are recommended to a client or taken on the client's income tax return by the CPA, the client should be informed of potential significant cost that might be incurred in defending the position in administrative proceedings with the tax authority and in potential litigation.

7 Listening Too Long

It's important to understand that "privilege" regarding communications between a taxpayer and CPA belongs not to the CPA, but to the taxpayer. Generally, when questioned by a tax authority, the CPA may refuse to answer until the court determines the outcome of a client's assertion of privilege. And until that act occurs, the CPA would be in violation of the duty of care owed to a client and, as well, specific confidentiality duties owed to a taxpayer-client under state laws and board of accountancy rules.

However, oral and written communications, and information received from a taxpayer regarding a tax return,

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is not subject to privilege and therefore the courts will generally rule that they are subject to discovery by tax authorities. Also, planning or tax position advice given by the CPA to a client also is unlikely to be protected by privilege where the results are subsequently included on a tax return. In addition, information that a taxpayer reveals about omissions or errors on previously filed tax returns also are not likely subject to the taxpayer's privilege assertion.

In tax practice, because the CPA has an obligation to protect the interests of a client, the CPA should cease communication about a tax matter at the earliest indication that the client might have engaged in illegal acts. The CPA should not inquire further about the matter in any respect because the client's response may reveal willful behavior and criminal intent.

Should the CPA acquire knowledge of that intent or the client's motivation for an error or omission on a tax return, the CPA could be compelled to serve as a witness against the taxpayer.

Moreover, it's entirely possible that a client confronted by a tax authority may implicate the CPA in the formulation of the error of omission and expose the CPA to criminal or civil penalties.

8 Unauthorized Practice of Law

Generally, the preparer may interpret and provide advice on, or take return positions based on, tax law. However, to perform those tasks, it's often necessary to interpret non-tax laws prior to applying the law. For example: state fiduciary, marital, partnership or property law may first have to be referred to and interpreted before it can be applied. When the CPA interprets non-tax state law, the CPA is engaged in the practice of law without a license. While it may be unlikely that a state bar association, board of accountancy or similar regulator will engage independently in disciplinary action against the CPA, the conduct is fair game in a malpractice suit and it's possible that the plaintiff counsel, on behalf of the client, will file a formal complaint with a regulatory body.

9 Anecdotal Experience

Too often, a CPA unfamiliar with the tax treatment of an item on a return or with a procedural issue will ask other tax professionals how best to report or handle the issue. This often happens in discussion groups. Sometimes responses include authority that the CPA can confirm. In other cases, though, the matter really involves the exercise of *professional judgment*. Often the advice is similar to, "Well, I did this and it worked," or "The IRS examiner told me … ," and is not accompanied by reference to any authority. It should be remembered that in tax practice the experiences of CPAs, including what they heard from someone else, is anecdotal, lacks authority and can lead to undesired outcomes. This remains true even if five, 10 or 20 CPAs have had similar experiences.

10 Past as Prologue

Too often CPAs believe they will achieve a desired outcome in tax return, penalty abatement or examination issue "because that's what happened last time." The past is a poor indicator of the future—and this has become increasingly so and is likely to escalate in the future as tax authorities are developing more sophisticated tools and becoming more aggressive in enforcement. The past is not likely to be a prologue.

Kip Dellinger, CPA, is a senior tax partner at Cooper Moss Resnick Klein & Co. LLP and frequent CalCPA Education Foundation instructor. You can reach him at kip@CMRKCPA.com.