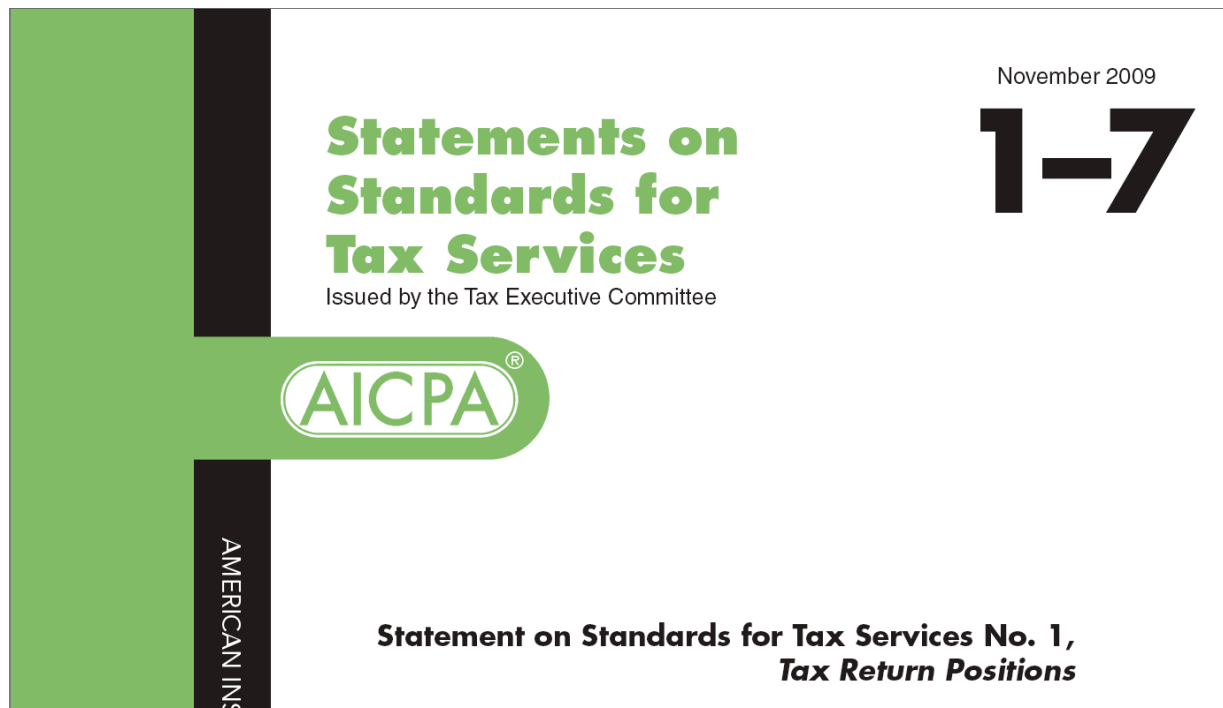


The New Statements on Standards for Tax Services

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Statements on Standards for Tax Services

New Standards Effective January 1, 2010

The American Institute of Certified Public Accountants' Tax Executive Committee adopted revisions to the Statements on Standards for Tax Practice that took effect on January 1, 2010. These revised standards are treated as enforceable standards under the AICPA Code of Professional Conduct and, by extension, the Arizona State Board of Accountancy.

All of the prior standards were impacted by this revision. In fact, after the dust settled and the standards were in place we had one less standard than before (seven instead of eight) and both interpretations were deleted from the guide. In reality that shrinking of the standards is an illusion. Old standards six and seven, which had much duplicative guidance, were combined into new standard six.

The two interpretations as well are only temporarily out of the standards. Revised versions of these interpretations are expected to be released later this year, to reflect the changes made in SSTS No. 1. In today's session we will look at why these new standards were issued and what changed from the old standards to the new.

Regulation of Tax Practice

Federal law at 5 USC 501 contains provisions granting attorneys and CPAs a general right to practice before the IRS. The provision for attorneys broadly grants rights beyond that offered simply for practice before the IRS [5 USC 501(b)]

(b) An individual who is a member in good standing of the bar of the highest court of a State may represent a person before an agency on filing with the agency a written declaration that he is currently qualified as provided by this subsection and is authorized to represent the particular person in whose behalf he acts.

while the CPA provision [5 USC 500(c)] is limited to practice before the Internal Revenue Service

(c) An individual who is duly qualified to practice as a certified public accountant in a State may represent a person before the Internal Revenue Service of the Treasury Department on filing with that agency a written declaration that he is currently qualified as provided by this subsection and is authorized to represent the particular person in whose behalf he acts.

In both cases the United States Code goes on to grant the Treasury Department the right to regulate the conduct of such practice under 31 USC 330. Under the authority granted by that provision, the Department of the Treasury had issued regulations to implement that provisions, regulations that we know as Circular 230. In addition to regulating the conduct of attorneys and CPAs in their practice before the IRS, the regulations provide a method for other individuals to obtain the right to practice before the IRS as enrolled agents (EAs).

The Internal Revenue Code itself also contains provisions regulating CPAs and attorneys with regard to returns and representation before the IRS. Key among these are §6694, which provides for preparer penalties applicable to preparers when a

<p>Treasury Department Circular No. 230 (Rev. 4-2008) Cat. Num. 16586R www.irs.gov</p>	<p>Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, Enrolled Actuaries, Enrolled Retirement Plan Agents, and Appraisers before the Internal Revenue Service</p>
<p>Department of the Treasury</p> <p>Internal Revenue Service</p>	<p>Title 31 Code of Federal Regulations, Subtitle A, Part 10, published September 26, 2007</p>

deficiency arises on a return and certain standards are not met and §7216 which imposed criminal penalties or unauthorized disclosure or use of tax return information.

For CPAs and attorneys, the federal rules are just one set of rules that must be complied with. Since for both classes the right to practice before the IRS is predicated upon the possession of a state granted right of practice, compliance with the professional standards in addition to those imposed by Circular 230 and the IRC is also mandated.

Today's presentation looks at a set of standards that CPAs must adhere to, the *Statements on Standards for Tax Services* (SSTS for short). These standards are issued by the AICPA's Tax Executive Committee. The standards are the successor to the older *Statements on Responsibilities in Tax Practice* (SRTP) that had been issued and were effective prior to 2008.

If you read these standards, you'll find that they claim only to apply to members of the American Institute of Certified Public Accountants. Membership in the AICPA is not required for an individual to be licensed as a CPA, so compliance with SSTS appears to only be mandatory for AICPA members. And, previous to 2000, the older SRTPs clearly stated that they were not mandatory for AICPA members. So you may wonder, especially if you are a CPA who is not an AICPA member, why we should worry about these standards.

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The Arizona Board of Accountancy, it turns out, has always considered these standards as applicable to all Arizona CPAs [Arizona Accountancy Reg. R4-1-455.01(G)]. While that regulations continues to refer to the old SRTPs, Arizona Accountancy Regulation R4-1-455.04 also creates a presumption that CPAs are to

comply with the Interpretations of the Code of Professional Conduct of the AICPA--and that Code of Conduct makes compliance with the SSTs mandatory.

Finally, there's an "aspirational" provision in Circular 230 at §10.33 that provides that advisers should adhere to "best practices" in providing services to their clients in tax practice. While officially not a provision subject to sanction under Circular 230 (see §10.52(a)(1)), it is a standard that seems likely to be applied if a civil dispute is raised against the professional's work. At that point, failure to meet the minimum standard of the SSTs would seem to suggest the professional failed to aspire to the standards expected of him/her.

Reasons for the Revision

The revision of the standards did a lot of "clean up" work, but the factor that truly got the revisions moving were developments in the area of federal tax practice regulation and oversight, specifically Congress's revision of §6694 of the Internal Revenue Code. Old SST No. 1 mostly tracked the signing standard found in the older version of §6694 of the IRC.

However, in 2007 Congress made significant changes to §6694, revising the level of comfort the signer of a return must have for a nondisclosed position from determining the position had a realistic possibility of success, defined as a one in three chance of prevailing, to initially a more likely than not standard of success. Since then, the standard has been retroactively revised downward, but only to the level that the adviser must find there exists substantial authority for the position.

At this point, the standard in the IRC was significantly higher than the standard in the SSTs.¹ The AICPA's Tax Executive Committee believed that such a situation was not a tolerable one to allow to continue, so the rewrite of the standards began largely to make sure that the AICPA required CPAs to at least adhere to the signing standards that were contained in the Internal Revenue Code.

The new standards were published in November of 2009 and took effect on January 1, 2010. That was relatively short time from publication to the effective date, but when the standards had been issued as an exposure draft it was made clear they were expected to be effective for 2010 years.

¹ It should be noted that the standard is also higher than the standard that existed in Circular 230. While the OPR has proposed changes to that standard, the proposal was made when the standard was "more likely than not" and has not yet been revised to reflect the new version.

Tax Return Positions (SSTS No. 1)

The first standard deals with standards a CPA must meet in order to recommend a tax return position, or for the positions contained on a return that the CPA is to sign.

At ¶4 we encounter the major change in the standard. While previously the standard simply told a CPA the level of comfort he/she must have with return positions to sign a return, and that standard did not vary from taxing agency to taxing agency, the new standard imposes an overarching agency based standard that is the first of two hurdles to be cleared.

SSTS No. 1 ¶4 requires that a CPA must determine and comply with the standards imposed by the applicable taxing authority with respect to signing a return or recommending a tax position. The CPA first must determine whether standards exists for any taxing agency involved, and then must insure that he/she complies with any applicable standards.

However, there is a second hurdle. Regardless of the taxing authorities standards, a CPA still cannot recommend a position or sign a return unless the CPA:

- Has a good faith belief the position has a *realistic possibility* (1 in 3 chance) of being sustained administratively or judicially on its *merits* if challenged or
- If the position is adequately disclosed on the return or, in the case of recommending a position the CPA advises the client of the need to disclose, the CPA can accept positions so long as they have a *reasonable basis* for the position.

As well, preparers must inform a client of potential penalties that may be applicable, as well as the ability to reduce or avoid penalties via disclosure.

Statement on Standards for Tax Services No. 1, Tax Return Positions

Introduction

1. This statement sets forth the applicable standards for members when recommending tax return positions, or preparing or signing tax returns (including amended returns, claims for refund, and information returns) filed with any taxing authority. For purposes of these standards

a. a *tax return position* is (i) a position reflected on a tax return on which a member has specifically advised a taxpayer or (ii) a position about which a member has knowledge of all material facts and, on the basis of those facts, has concluded whether the position is appropriate.

b. a *taxpayer* is a client, a member's employer, or any other third-party recipient of tax services.

2. This statement also addresses a member's obligation to advise a taxpayer of relevant tax return disclosure responsibilities and potential penalties.

3. In addition to the AICPA, various taxing authorities, at the federal, state, and local levels, may impose specific reporting and disclosure standards with regard to recommending tax return positions or preparing or signing tax returns.¹ These standards can vary between taxing authorities and by type of tax.

¹ A member should refer to the current version of Internal Revenue Code Section 6694, Understatement of taxpayer's liability by tax return preparer, and other relevant federal, state, and jurisdictional authorities to determine the reporting and disclosure standards that are applicable to preparers of tax returns.

Summary of Standards For Return Positions							
Level of Support	Old §6694	Current 6694	Old SSTS 1	New SSTS 1	Current Circular 230	Proposed Circular 230	FIN 48
More Likely Than Not		*				X	X
Substantial Authority		X		**			
Realistic Possibility	X		X	X	X		
Reasonable Basis		With Disclosure		With Disclosure		With Disclosure	
Not Frivolous	With Disclosure		With Disclosure		With Disclosure		
* Required if a tax shelter per §6662(d)(2)(C)(ii)							
** Effective federal rule - must follow standard of taxing authority if higher than default SSTS 1 standard.							

The standard still provides that a position may not be advanced to exploit the audit selection process of a taxing entity. Such a position would be one that the CPA knows has inadequate support, but which the IRS is simply unlikely to challenge simply because the return will probably not be pulled for examination. However, once the CPA has determined return positions which are defensible enough for him/her to sign, the CPA at that point can discuss with the client which positions are more or less likely to draw IRS scrutiny. The topic is not totally prohibited, rather the “audit lottery” cannot be sole reason for taking a position.

As well, the CPA cannot advance a position that is placed on the return solely to obtain leverage in negotiating with the taxing authority. That would be the case if the CPA took a position he/she plans to abandon on exam but use as a reason for the examining authority to compromise on other positions on the return.

The standard continues to hold [SSTS 1 ¶12] that a CPA can consider a well-reasoned articles or treatises, regardless of the fact that such would not qualify as a source of authority under Reg. §1.6662-4(d)(3)(iii) which has always been a matter of difference between the AICPA and IRS views of authority. The standard even holds that such is true for purposes of interpreting ¶4’s compliance with IRS standards despite the fact that one of the requirements of complying with the IRS standards is to have acceptable authority under §1.6662-4(d)(3)(iii).

As well, I would suggest that a reliance on such editorial material is dangerous in any event, due to the “well-reasoned” modifier. If, in fact, the article or quick reference

book arrived at an answer that is not upheld upon challenge, the CPA may have a tough time explaining how he/she knew the article was “well reasoned” unless the CPA had actually followed through to check the sources cited as required by Reg. §1.6662-4(d)(3)(iii).

In a civil case, the CPA would be attempting to defend his/her actions by effectively arguing that he/she had turned over their professional judgment to the author of the editorial material relied upon, something that would likely not be a positive influence in helping to decide the question of whether the CPA was negligent.



The item would also not appear relevant to the admonition to explain potential penalties to the client. In many cases the potential penalties applicable will depend on whether adequate support for the position exists using only the sources approved in Reg. §1.6662-4(d)(3)(iii).

Ultimately, all the SSTS says is that the AICPA (and, by extension, the Arizona Board when referencing the SSTSs) could not sanction you for violating SSTS No. 1 if you had such a well reasoned article. However, the IRS could imposed penalties under §6694 on a CPA in such a situation, and the Office of Professional Responsibility would also use the IRS regulations in its assessment of whether a CPA or attorney had proper authority. If a CPA is disciplined by the OPR, that could give the Arizona State Board an independent violation of Arizona rules under which to discipline the CPA.

Answers to Questions on Returns (SSTS No. 2)

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Statement on Standards for Tax Services No. 2, Answers to Questions on Returns

Introduction

1. This statement sets forth the applicable standards for members when signing the preparer's declaration on a tax return if one or more questions on the return have not been answered. The term *questions* includes requests for information on the return, in the instructions, or in the regulations, whether or not stated in the form of a question.

Statement

2. A member should make a reasonable effort to obtain from the taxpayer the information necessary to provide appropriate answers to all questions on a tax return before signing as preparer.

Explanation

3. It is recognized that the questions on tax returns are not of uniform importance, and often they are not applicable to the particular taxpayer. Nevertheless, there are at least three reasons why a member should be satisfied that a reasonable effort has been made to obtain information to provide appropriate answers to the questions on the return that are applicable to a taxpayer:

- a. A question may be of importance in determining taxable income or loss, or the tax liability shown on the return, in which circumstance an omission may detract from the quality of the return.
- b. A request for information may require a disclosure necessary for a complete return or to avoid penalties.
- c. A member often must sign a preparer's declaration stating that the return is true, correct, and complete.

The second standard regards answering questions asked on a tax return. The standard requires that a CPA should make a reasonable effort to obtain from the client information necessary to provide appropriate answers to all questions on a return [SSTS No. 2 ¶2].

The standard's explanation, at ¶3 reminds us that not all questions are of equal importance. But it still advises that a reasonable attempt needs to be made to answer the questions, and gives three specific reasons why this is so:

- The question may impact the computation of taxable income or loss, or the tax liability due, in which case the lack of an answer would create a potentially incorrect return.
- The question may amount to disclosure necessary for the taxpayer to avoid a

penalty

- The jurat the preparer signs states that, to the preparer's knowledge the return is true, correct and complete.

The standard then goes on to give three reasons why it may be reasonable for a preparer to omit an answer, including the answer is not easily available and does not impact the computation of tax, there is genuine uncertainty about the meaning of the question with regard to the return or the answer is voluminous, though in this case the standard holds that a statement should be made on the return that the data will be supplied upon examination.

A CPA is specifically prohibited from omitting an answer merely because it might prove disadvantageous to the taxpayer. While the "merely" clause suggests that if the CPA

can find another reason he/she could still omit an answer that would appear disadvantageous, it will be difficult to convince an impartial third party, let alone an IRS agent, that the real reason the answer was omitted was solely the negative result.

The standard does caution that omitting an answer to a question could, in some cases, result in an incomplete return that could be subject to penalties. In theory such penalties could include a failure to file penalty if the omission was determined to be significant enough. And, clearly, an answer that is omitted whose answer clearly would have been disadvantageous to the taxpayer will put the taxpayer at a real disadvantage in any attempt to mitigate penalties on an assessment that is in any way related to that answer.



The standard concludes with a holding that if, in fact, the CPA has valid grounds under the standard to omit an answer, the CPA is not required to provide a reason for the omission. The standard does not explain how this interacts with the prior holding on attaching a statement regarding omitted voluminous data, but presumably the specific holding that you must attach that statement would override this general provision.

You must complete this part if you (a) had over \$1,500 of taxable interest or ordinary dividends; (b) had a foreign account; or (c) received a distribution from, or were a grantor of, or a transferor to, a foreign trust.		Yes	No
Part III Foreign Accounts and Trusts <small>(See instructions on back.)</small>	7a At any time during 2009, did you have an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account? See instructions on back for exceptions and filing requirements for Form TD F 90-22.1	<input type="checkbox"/>	<input type="checkbox"/>
	b If "Yes," enter the name of the foreign country ► <input type="text"/>	<input type="checkbox"/>	<input type="checkbox"/>
	8 During 2009, did you receive a distribution from, or were you the grantor of, or transferor to, a foreign trust? If "Yes," you may have to file Form 3520. See instructions on back	<input type="checkbox"/>	<input type="checkbox"/>

Example: Form 1040 Schedule B asks if the taxpayer has an interest in a foreign bank account or trust that is to be answered under the three conditions noted, one of which is if such an account exists. The question is a significant item, since the existence of a foreign account can trigger the need to file a Form TD F 90-22.1 with significant penalties for failure to file. The question is generally clear and is an item the client should be able to answer. Finally, there is not voluminous data requested to be attached to answer the question. Thus a CPA will generally need to make inquiries of the client about the existence of such an account.

Certain Procedural Aspects of Preparing a Return (SSTS No. 3)

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Statement on Standards for Tax Services No. 3, Certain Procedural Aspects of Preparing Returns

Introduction

1. This statement sets forth the applicable standards for members concerning the obligation to examine or verify certain supporting data or to consider information related to another taxpayer when preparing a taxpayer's tax return.

Statement

2. In preparing or signing a return, a member may in good faith rely, without verification, on information furnished by the taxpayer or by third parties. However, a member should not ignore the implications of information furnished and should make reasonable inquiries if the information furnished appears to be incorrect, incomplete, or inconsistent either on its face or on the basis of other facts known to the member. Further, a member should refer to the taxpayer's returns for one or more prior years whenever feasible.

3. If the tax law or regulations impose a condition with respect to deductibility or other tax treatment of an item, such as taxpayer maintenance of books and records or substantiating documentation to support the reported deduction or tax treatment, a member should make appropriate inquiries to determine to the member's satisfaction whether such condition has been met.

4. When preparing a tax return, a member should consider information actually known to that member from the tax return of another taxpayer if the information is relevant to that tax return and its consideration is necessary to properly prepare that tax return. In using such information, a member should consider any limitations imposed by any law or rule relating to confidentiality.

This standard, whose title is much less than completely enlightening about what it covers, primarily deals with the question of the information a CPA has access to in preparing the return, and deals with three separate issues on that matter. These requirements generally track the similar standards imposed on all tax practitioners under Circular 230.

First, a CPA generally can accept the representations of his/her client without having to independently confirm the information provided [SSTS No. 3 ¶2]. CPAs in tax practice are client advocates generally, and professional independence under Rule 101 of the Code of Professional Conduct is not required for such an engagement.² However the CPA

cannot ignore the implications of information provided by the client to the CPA, including indications that the information is incorrect, incomplete or is inconsistent on its face.

At ¶9 the standard indicates a CPA should make use of a taxpayer's returns for prior years in preparing the current year's return, as well as any prior year tax

² Note that a CPA whose firm also performs attest services for a tax client does have to consider the implications of tax services on the firm's independence, and the specific provisions of Ethics Interpretation 101-3 regarding items that must be in an engagement letter for tax services if independence is to be maintained should be consulted unless the attest engagement is a compilation and a report indicating a lack of independence will be acceptable to users of the financial statement.

determinations. The standard suggests such a procedure is useful to insure items are not omitted from the return or duplicated from prior returns, as well as giving an understanding of the taxpayer's general tax status.

As well, while there is no requirement to obtain additional documentation, the standard at ¶6 indicates the taxpayer should be encourage to submit some types of supporting documentation such as K-1s received from passthrough entities so that the CPA can insure proper treatment for the items.

Example 1: The taxpayer fills in an organizer provided by the CPA. In the section asking about business use of the auto, the client states he drove 12,000 miles for business, 3,000 miles for commuting and 2,000 miles for other personal use, with total miles of 17,000 driven for the year. He also indicates that he has only a single car. In the portion of the organizer dealing with charitable contributions, the client claims he drove 7,000 for charitable work in the same year.

The use of round numbers for an item that should be backed up by written documentation strongly suggests that, in fact, the numbers were not obtained from contemporaneous evidence, and thus no deduction may be allowable under IRC §274(d). As well, the fact that the client has claimed total business and charitable miles in excess of the total miles he claims to have driven is an internal inconsistency in his information. The CPA should additional inquiries regarding this information, and would not be allowed to simply use the numbers given.



Second, if the law or regulations impose a condition with respect to deductibility or the treatment of an item, the CPA must make inquiries to determine if the requirements have been met. The maintenance of a contemporaneous record of the use of listed property in accordance with §274(d) or the existence of the required documentation to

support all charitable contributions as required under §170 are two obvious examples of such requirements imposed by the IRC as a condition for claiming a deduction.

Example 2: The above client did not answer the questions in the organizer regarding the existence of contemporaneous documentation to support the claimed mileage. As well, the taxpayer claimed \$500 of charitable contributions but failed to answer the question in that portion of the organizer regarding whether he had the proper documentation required for various types of donations.

The CPA needs to inquire of the taxpayer about the existence of the necessary records to support the deduction in both cases.

A CPA must consider any information known to the CPA from the return of another taxpayer if that information is relevant to the tax return the CPA is preparing for the current client and consideration of that information is necessary to prepare the return of the taxpayer. The rule cautions that a CPA must consider any limitations imposed by any law or rule relating to confidentiality.

This potential “gotcha” where a CPA can’t prepare a return because he knows it omits a significant item of income, but due to confidentiality also cannot disclose where the information came from is a key reason why preparers must be aware of the requirements to obtain conflict of interest waivers from clients who have such potential conflicts and, as well, consents to make use of information among those entities as part of a conflict waiver.

Example 3: Bob and Mary are both Fred’s clients. Bob and Mary got a divorce in 2010. Bob brings his information in during January with a signed copy of a Form 8332 allowing him to claim the exemption for Chuck, Bob and Mary’s son who now lives with Mary. Mary comes in during March and she lists Chuck as a dependent to be claimed on her return for 2010.

Fred knows that there is an issue with Mary claiming Chuck as a dependent on her 2010 return. However, if he does not have a waiver that allows him to disclose information as needed to service each client from the other’s return, he has a significant problem. Inquiring of Bob about whether he can disclose the fact that Bob claimed the exemption and had a copy of a Form 8332 that appeared to bear Mary’s signature could be seen as disclosing to Bob that Mary

is trying to claim Chuck. Similarly, Fred's detailed questioning of why Mary believes she can claim Chuck could very well tip Mary off that Bob has claimed the dependent.

Various possibilities exist for why this situation has arisen: Mary may have revoked the release of exemption, perhaps with court approval. Bob may have forged Mary's signature on the Form 8332 (relatively easy to do today with scanners and available computer software). Mary may just be trying to claim an exemption she is not entitled to. Or Mary may simply have forgotten that she agreed not to claim Chuck. All Fred knows for sure is there is a problem.

While the information Fred has does not indicate conclusively Mary cannot claim Chuck, he currently (without additional inquiry) has no information that supports her claiming the exemption. If the Form 8332 he has seen is valid, Fred could not sign Mary's return since the claimed position would not meet the minimum standard for signing.

Use of Estimates (SSTS No. 4)

The fourth standard deals with the real world problem that CPAs sometimes encounter, where clients don't have all of the records necessary to tie down a figure exactly. A CPA is allowed to use a taxpayer's estimates if the following conditions are met:

- It is not practical to obtain exact data,
- The estimates the taxpayer provides are reasonable based on the facts known to the CPA and
- The use of estimated figures is not prohibited by statute or rule for the tax matter involved.

The first condition makes it clear that the use of estimate is not the first choice of the CPA. If it is practical to obtain the actual numbers those should be used instead. However, it may be impractical simply because the records may not exist or the cost to obtain detailed information may not be worth the additional accuracy to be gained.

The second condition deals with the reasonableness of the taxpayer's estimates. A key first thing to notice is that the estimates in question need to be those of the taxpayer, not items generated by the CPA without taxpayer input. While the CPA may be of service to the taxpayer in determining a methodology that could lead to a reasonable estimate, the taxpayer must be the person ultimately responsible for accepting the estimate methodology.

The CPA then must make a judgement call, based on the information available to the CPA, if the estimate appears reasonable. The fact that a taxpayer may not have perfect information does not excuse a taxpayer from having to file a return based on the best information available, but a taxpayer must prepare a return that, to the *best of his/her knowledge* is complete and truthful.

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Statement on Standards for Tax Services No. 4, Use of Estimates

Introduction

1. This statement sets forth the applicable standards for members when using the taxpayer's estimates in the preparation of a tax return. A member may advise on estimates used in the preparation of a tax return, but the taxpayer has the responsibility to provide the estimated data. Appraisals or valuations are not considered estimates for purposes of this statement.

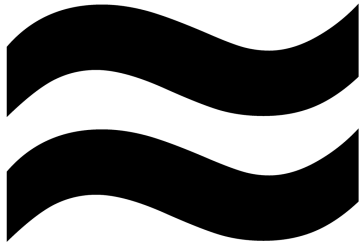
Statement

2. Unless prohibited by statute or by rule, a member may use the taxpayer's estimates in the preparation of a tax return if it is not practical to obtain exact data and if the member determines that the estimates are reasonable based on the facts and circumstances known to the member. The taxpayer's estimates should be presented in a manner that does not imply greater accuracy than exists.

Explanation

3. Accounting requires the exercise of professional judgment and, in many instances, the use of approximations based on judgment. The application of such accounting judgments, as long as not in conflict with methods set forth by a taxing authority, is acceptable. These judgments are not estimates within the purview of this statement. For example, a federal income tax regulation provides that if all other conditions for accrual are met, the exact amount of income or expense need not be known or ascertained at year end if the amount can be determined with reasonable accuracy.

4. When the taxpayer's records do not accurately reflect information related to small expenditures, accuracy in recording some data may be difficult to achieve. Therefore, the use of estimates by a tax-



Although not mentioned in the standard by name, clearly a CPA looking for guidance on how to handle estimates should consider the guidance in the Second Circuit's oft-cited *Cohan* decision (39 F.2d 540, 2 USTC ¶1489, 8 AFTR 10,552) about the proper use of estimated values on a return, keeping in mind the various post-*Cohan* case requirements in specific areas for documentation to

obtain any deduction (such as for travel, meals, entertainment, etc.).

The standard also notes that a CPA should not present amount that “give a misleading impression” about the degree of factual accuracy.

Example 1: Timothy sold 100 shares of XYZ Company in 2010, a sale documented on the Form 1099B that he provided to Roy, his CPA, who is preparing his 2010 return. When Roy asks Timothy for basis information, Timothy replies that the shares were gifted to him by his late Uncle Fred a year before Fred passed away.

Timothy knows that Fred had purchased the shares sometime in the mid-1970s. Timothy finds the high and low fair market values for the period in which he believes his uncle had acquired the shares and uses the average value in that period. He thus tells Roy the cost was \$2,528.33 and picks the mid-point day of March 23, 1974.

The use of the unrounded price and such an apparently random date would appear to violate the prohibition about giving a misleading impression as to the accuracy of the estimate. However, if the basis of the shares was estimated at \$2,500 and acquired on January 1, 1974, there would not appear to be an issue with the estimate under the standard.

Generally a disclosure that an estimate is being used is not required, though the standard suggests that in some “unusual cases” disclosure may be appropriate. Such unusual cases would include a taxpayer who is deceased or ill when the return is filed, a taxpayer has not received a K-1, litigation is pending that bears on the tax return or fire, computer failure or natural disaster has destroyed the relevant records [SSTS No. 4 ¶7].

Departure from a Position Previously Concluded in an Administrative Proceeding or Court Proceeding, (SSTS No. 5)

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Statement on Standards for Tax Services No. 5, Departure From a Position Previously Concluded in an Administrative Proceeding or Court Decision

Introduction

1. This statement sets forth the applicable standards for members in recommending a tax return position that departs from the position determined in an administrative proceeding or in a court decision with respect to the taxpayer's prior return.
2. For purposes of this statement, *administrative proceeding* includes an examination by a taxing authority or an appeals conference relating to a return or a claim for refund.
3. For purposes of this statement, *court decision* means a decision by any court having jurisdiction over tax matters.

Statement

4. The tax return position with respect to an item as determined in an administrative proceeding or court decision does not restrict a member from recommending a different tax position in a later year's return, unless the taxpayer is bound to a specified treatment in the later year, such as by a formal closing agreement. Therefore, the member may recommend a tax return position or prepare or sign a tax return that departs from the treatment of an item as concluded in an administrative proceeding or court decision with respect to a prior return of the taxpayer provided the requirements of Statement on Standards for Tax Services (SSTS) No. 1, *Tax Return Positions*, are satisfied.

Most disputes with the IRS do not result in the matter being resolved with a final decision from the United States Supreme Court or, frankly, even a trip to a court of any sort. Rather the parties eventually settle the matter or, if it does go to court, decide to accept a decision rendered by the court at a particular level rather than proceed to appeal the decision.

Quite often the decision is driven not so much by whether or not the taxpayer agrees with the result, but simply the fact that the cost of pursuing a more favorable outcome is found to be higher than the expected benefit from continuing the dispute. Or the position may have been abandoned in order to settle the case where the government conceded certain other position.

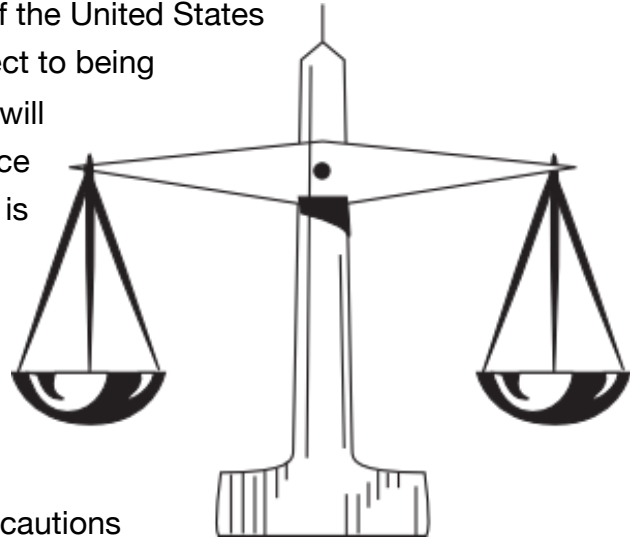
In such an instance, a question arises about whether agreeing to a treatment on the returns under exam affects the taxpayer's ability to claim a contrary position on later returns. This standard addresses that matter.

Generally, under SSTS No. 5 ¶4, a return position determined in an administrative proceeding or court proceeding does not restrict the CPA from recommending a different position in a later year's return unless the taxpayer is bound to a specified treatment in a later year, such as by a formal closing agreement. The standard notes

that while the government tends to act consistently with regard to a position that was decided in an earlier proceeding, it is not bound to do so. The taxpayer has the same right. Similarly, later court decisions and changes in the law may also render the prior agreement irrelevant to the treatment in future years.

Similarly, rulings of courts below the level of the United States Supreme Court are always potentially subject to being reversed, though in most cases the parties will not appeal the result even if there is a chance of the decision being reversed, as doing so is an expensive proposition.

Rather, the CPA applies the standards outlined in SSTS No. 1 for tax return positions to the position being advanced to test whether the position meets the applicable signing standard. The standard cautions that the results of the administrative or court proceeding is, nevertheless, information the CPA must consider in applying the SSTS No. 1 standards [SSTS 5, ¶6].



Example: During the examination of the taxpayer's 2007 return, the IRS proposes to require the taxpayer to capitalize certain amounts that the taxpayer had expensed as a repair expense. The CPA believes the amounts are clearly deductible as repair expenses, using the criteria outlined in the *Federal Express* case. However, the change in tax due for the year would be minor for the item in question and the client would likely end up expending more in professional fees in continuing to challenge the item than the amount of tax assessed.

Agreeing to the treatment in 2007 of these items would not impact the CPA's ability to recommend the continued expensing of these items on the 2010 return.

Knowledge of Error: Return Preparation and Administrative Proceedings (SSTS No. 6)

The Tax Executive Committee, in the revision to SSTS, reduced the number of standards from eight to seven, doing so by creating new SSTS No. 6 to replace the old SSTS Nos. 6 and 7. Previously SSTS No. 6 dealt with a CPA's knowledge of an error

on a previously filed return when preparing a tax return, while SSTS No. 7 dealt with the same situation if it arose during an examination of the taxpayer's return.

The guidance in both cases was essentially the same, so the decision was made to combine the two standards in this revision. The guidance is much the same as the guidance provided in Circular 230 for the same situation, though the standards goes into a bit more detail than does Circular 230.

The standard applies regardless of whether or not the CPA actually prepared the return in which an error has been discovered.

An error for purposes of the standard includes the discovery of any position on a return that did not meet the standards under SSTS No. 1 at the time the return was filed, or where it no longer meets the standard due to legislative, judicial or administrative pronouncements having retroactive effect. It does not include items that have an insignificant effect on the taxpayer's tax liability [SSTS No. 6 ¶1].

The standard sets out three situations in which its guidance is applicable [SSTS No. 6 ¶1]:

1. An error has been found in a previously filed return of the taxpayer

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Statement on Standards for Tax Services No. 6, Knowledge of Error: Return Preparation and Administrative Proceedings

Introduction

1. This statement sets forth the applicable standards for a member who becomes aware of (a) an error in a taxpayer's previously filed tax return; (b) an error in a return that is the subject of an administrative proceeding, such as an examination by a taxing authority or an appeals conference; or (c) a taxpayer's failure to file a required tax return. As used herein, 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 Statement on Standards for Tax Services (SSTS) No. 1, *Tax Return Positions*. The term *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. The term *administrative proceeding* does not include a criminal proceeding.

2. This statement applies whether or not the member prepared or signed the return that contains the error.

3. Special considerations may apply when a member has been engaged by legal counsel to provide assistance in a matter relating to the counsel's client.

Statement

4. A member should inform the taxpayer promptly upon becoming aware of an error in a previously filed return, an error in a return that is the subject of an administrative proceeding, or a taxpayer's failure to file a required return. A member also should advise the taxpayer of the potential consequences of the error and recommend the correc-

2. An error is found in a return that is the subject of an administrative proceeding, such as examination or an appeals conference (criminal proceedings are not covered by this standard)
3. The CPA discovers the taxpayer had failed to file a required return

The CPA is required in each of these cases to notify the client of the matter and recommend corrective actions to be taken. Unless required by law, the CPA is not to notify the taxing authority without the taxpayer's permission. Note that the CPA is not required to prepare an amended return-the decision on that matter is one for the client [SSTS No. 6 ¶4].

If a client has not correct an error on a prior return and the CPA is requested to prepare the current year's return, the CPA is first instructed to consider whether or not to withdraw from the engagement, as well as whether the CPA should continue a professional or employment relationship with the taxpayer.

The standard recognizes that the taxpayer may not be required to file an amendment or disclose the error, but such action may be predictive of future actions that might require a CPA to withdraw from representation. If the CPA waits until that future event, he/she may face risk of liability to the client since a withdrawal at that point could effectively amount to a disclosure of a problem. If the CPA does prepare the current year's return anyway, he/she needs to assure that the error does not carryover or is not duplicated on the current year's return.

Example: Eunice is a new client that Joan picked up this year. In reviewing Eunice's returns for 2009, Joan notes that Eunice had claimed interest on the same loan as home mortgage interest on Schedule A and as interest expense on Schedule E for a rental property. The error appears to have been an accidental oversight by Eunice's prior accountant. Joan informs Eunice of the error and advises her that she believes the 2009 return should be amended.

If the CPA believes the error on the return is one that could lead to allegations of fraud or other criminal misconduct on the part of the taxpayer, the standard indicates that the CPA should advise the client to seek legal counsel before any action is taken [SSTS No. 6 ¶11].

As a practical matter, the CPA should also advise the client at that point that such a conversation with legal counsel needs to take place before he/she says anything more

to the CPA. Information the CPA is given related to the matter is discoverable in a criminal matter, so the last thing the CPA should be doing once he/she suspects there may be criminal exposure is to obtain additional information from the client.

Form 1040X Department of the Treasury—Internal Revenue Service
Amended U.S. Individual Income Tax Return OMB No. 1545-0074
 (Rev. January 2010) See separate instructions.

Your first name and middle initial: _____ Your last name: _____ Your social security number: _____
 If a joint return, your spouse's first name and middle initial: _____ Your spouse's last name: _____ Your spouse's social security number: _____
 Your current home address (number and street). If you have a P.O. box, see page 5 of the instructions. Apt. no. Your phone number: _____
 Your city, town or post office, state, and ZIP code. If you have a foreign address, see page 5 of instructions.

All filers must complete lines A, B, and C.

A Amended return filing status. You must check one box, even if you are not changing your filing status. *Caution: You cannot change your filing status from joint to separate returns after the due date.*
 Single Married filing jointly Married filing separately
 Qualifying widow(er) Head of household (If the qualifying person is a child but not your dependent, see page 5 of instructions.)

B This return is for calendar year 2009 2008 2007 2006
 Other year. Enter one: calendar year _____ or fiscal year (month and year ended): _____

C Explanation of changes. In the space provided below, tell us why you are filing Form 1040X.

Income and Deductions	Correct Amount
1 Adjusted gross income (see page 8 of instructions). If net operating loss (NOL) carryback is included, check here <input type="checkbox"/>	1
2 Itemized deductions or standard deduction (see page 8 of instructions)	2
3 Subtract line 2 from line 1	3
4 Exemptions. If changing, complete the Exemptions section on the back and enter the amount from line 30 (see page 6 of instructions)	4
5 Taxable income. Subtract line 4 from line 3	5

Tax Liability	
6 Tax (see page 7 of instructions). Enter method used to figure tax:	6
7 Credits (see page 8 of instructions). If general business credit carryback is included, check here <input type="checkbox"/>	7
8 Subtract line 7 from line 6. If the result is zero or less, enter -0-	8
9 Other taxes (see page 8 of instructions)	9
10 Total tax. Add lines 8 and 9	10

Payments	
11 Federal income tax withheld and excess social security and tier 1 RRTA tax withheld (if changing, see page 8 of instructions)	11
12 Estimated tax payments, including amount applied from prior year's return (see page 8 of instructions)	12
13 Earned income credit (EIC) (see page 8 of instructions)	13
14 Refundable credits from <input type="checkbox"/> Schedule M or Form(e) <input type="checkbox"/> 2439 <input type="checkbox"/> 4136 <input type="checkbox"/> 5405 <input type="checkbox"/> 6801 <input type="checkbox"/> 8812 <input type="checkbox"/> 8863 <input type="checkbox"/> 8885 or <input type="checkbox"/> other (specify): _____	14
15 Total amount paid with request for extension of time to file, tax paid with original return, and additional tax paid after return was filed (see page 9 of instructions)	15
16 Total payments. Add lines 11 through 15	16

Refund or Amount You Owe (Note. Allow 8–12 weeks to process Form 1040X.)	
17 Overpayment, if any, as shown on original return or as previously adjusted by the IRS (see page 9 of instructions)	17
18 Subtract line 17 from line 16 (if less than zero, see page 9 of instructions)	18
19 Amount you owe. If line 18 is more than zero, enter the difference (see page 9 of instructions)	19
20 If line 18 is less than line 19, enter the difference. This is the amount overpaid on this return	20
21 Amount of line 20 you want refunded to you	21
22 Amount of line 20 you want applied to your (enter year): _____ estimated tax <input type="checkbox"/> 22	22

For Paperwork Reduction Act Notice, see page 11 of instructions. Cat. No. 11300L Form 1040X (Rev. 01-2010)

Clients whose actions do appear to carry a criminal charge risk but that want to “play the audit lottery” pose a number of risks a CPA should consider. A client that believes it’s “OK” to have an erroneous return on file may believe it’s similarly “OK” to file a return that is erroneous to begin with, or to have selective memory if problems arise later, denying that the CPA had ever warned them about the error in a malpractice claim.

As well, such a client may want the CPA to be of assistance in covering up the error should an IRS exam arise for the year in question. In that case the CPA cannot be of such assistance, but the CPA’s abrupt resignation

from representation may arguably be considered an indirect disclosure to the IRS of the existence of a problem.

The standard notes at ¶10 that a conflict may arise between the CPA’s responsibilities to the client under Rule 301 of the Code of Professional Conduct (relating to confidential client information) and federal or state tax law and regulations requiring a representative to be truthful in dealings with the taxing agency, and specifically notes that a resignation once the taxing agency is involved may itself be effectively a prohibited disclosure of the existence of an issue in violation of Rule 301.

If the error involves an erroneous method of accounting and it's past the due date for the taxpayer to request a change to a proper method for the year in question, the CPA may sign the return for the current year so long as the return contains an appropriate disclosure of the use of a prohibited method of accounting.

If the issue arises in an administrative proceeding and the client gives consent to disclose the matter to the agency, the CPA should assure the disclosure is made in a timely manner. If the disclosure is delayed, it may give the impression that the taxpayer and CPA failed to act in good faith, or attempted to mislead the taxing agency.

A CPA who is not performing tax services for the client but who uncovers an error covered by this rule must advise the client of the existence of the error and advise the taxpayer to discuss the matter with the taxpayer's tax return preparer [SSTS No. 6, ¶14]. Note that this provision imposes responsibilities on all CPAs, including those working who view themselves as auditors only or CPAs in industry (such as the controller of a business).

A CPA who is engaged by legal counsel to provide assistance to the legal counsel's client is advised that special considerations apply in that case. Or, put more simply, the CPA needs to consult with the legal counsel in such a case regarding the matters at hand. Such engagements are most often entered into when it is believed that such an arrangement may allow the CPA's work for the attorney to be protected as part of the attorney's privileged work for the client.

Form and Content of Advise to Taxpayers (SSTS No. 7)

The final standard involves standards for providing tax related advice to a client alone. The standard specifically excludes any advice that is likely to be relied upon by parties other than the taxpayer.

The standard provides:

- The CPA should assure that the advice provided reflects competence and appropriately serves the client's need. If the advice is in writing, the CPA must comply with the standards, if any, imposed on such advice by the taxing authority and the CPA must use professional judgment regarding the need to document any oral advice.
- Because the CPA must assume the advice will affect the manner in which the transaction will be reported on a return, the advice must always consider return

reporting and disclosure standards applicable to the return position and potential penalty consequences of the position proposed.

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Statement on Standards for Tax Services No. 7, Form and Content of Advice to Taxpayers

Introduction

1. This statement sets forth the applicable standards for members concerning certain aspects of providing advice to a taxpayer and considers the circumstances in which a member has a responsibility to communicate with a taxpayer when subsequent developments affect advice previously provided. The statement does not, however, cover a member's responsibilities when the expectation is that the advice rendered is likely to be relied on by parties other than the taxpayer.

Statement

2. A member should use professional judgment to ensure that tax advice provided to a taxpayer reflects competence and appropriately serves the taxpayer's needs. When communicating tax advice to a taxpayer in writing, a member should comply with relevant taxing authorities' standards, if any, applicable to written tax advice. A member should use professional judgment about any need to document oral advice. A member is not required to follow a standard format when communicating or documenting oral advice.

3. A member should assume that tax advice provided to a taxpayer will affect the manner in which the matters or transactions considered would be reported or disclosed on the taxpayer's tax returns. Therefore, for tax advice given to a taxpayer, a member should consider, when relevant (a) return reporting and disclosure standards applicable to the related tax return position and (b) the potential penalty consequences of the return position. In ascertaining applicable return reporting and disclosure standards, a member should follow the standards in Statement on Standards for Tax Services No. 1, *Tax Return Positions*.

4. A member has no obligation to communicate with a taxpayer when subsequent developments affect advice previously provided

•No obligation is imposed on the CPA to communicate the impact of any subsequent developments after the advice is provided unless the CPA is assisting in implementing the plans or procedures or when the CPA undertakes the obligation by a specific agreement.

Circular 230 has two standards that directly impact the provision of written advice. The standards on covered opinions under §10.35 has received lots of coverage since the 2005 revisions, but of more practical importance are the standards covering all other written advice at §10.37. Note that a CPA (nor an attorney or EA for that matter) can avoid meeting the minimum standards of §10.37

by attaching the “standard disclaimer” to written advice. CPAs should be sure they have read and understand the rules contained in §10.37, as the reference in SSTS No. 7 to written advice is specifically meant to highlight the need to consult this provision.

SSTS No. 7 goes on in §5 and following to discuss the nature of advice. SSTS No. 7 does not impose a specific form of advice, allowing either oral or written advice [SSTS No. 7 ¶5]. But at ¶6 the standard makes a strong suggestion that advice should be given orally only for routine matters or in well-defined areas. In other cases the advice

should be in writing, and the CPA should consider the need to document any oral advice given.

At ¶7 a number of factors are listed that the CPA should consider in determining the form of advice to provide a client.

If the CPA is engaged to assist in implementing procedures or plans associated with the advice. In such a case, the CPA is reminded that there is a continuing obligation during the implementation for the CPA to communicate to the client the impact of any subsequent events on the advice given, and consider revising the advice if necessary [SSTS No. 7 ¶8]. However, if the CPA is not involved in the implementation, then the CPA has no obligation to update that advice unless specifically engaged to do so [SSTS No. 7 ¶9].

The CPA is specifically admonished that the advice should make certain limitations clear to the client on the nature of the advice given. Such advice should communicate:

- The advice reflects the CPA's professional judgement based on the CPA's understanding of the facts and law existing as of the date the advice is provided;
- Subsequent developments could affect the advice that has been given and
- The advice is based specifically upon the stated facts and authorities and is subject to change [SSTS No. 7 §10].

Finally the standard notes that CPAs should be aware of the potential for applicable confidentiality privileges. That would include the §7525 federally authorized tax practitioner privilege, any state law privilege issues and, for a CPA hired by legal counsel to assist the counsel with work with a client, any standard legal privilege that might attach to the work being done. Obviously the key issue here is to insure that the CPA doesn't manage to destroy the ability of the client to assert a privilege if one could have existed.