



# 2023 WICPA NOT-FOR-PROFIT ACCOUNTING CONFERENCE

YOUR SOURCE FOR KEY UPDATES & INSIGHTS ON TIMELY ISSUES

## HIGHLIGHTED TOPICS:



### ACCOUNTING & AUDIT UPDATE

Get an overview of recently issued standards and information on what the future holds



### NAVIGATING ECONOMIC & FINANCIAL MARKET UNCERTAINTY

Find out the best numbers for not-for-profits to watch to know where we stand in the economic market cycle and what to expect in the future



### EFFECTIVE GRANT MANAGEMENT

Learn how to develop a strategy for successfully managing grants from pre-award to post-award close out using real-world experiences to achieve your grant management goals

TUESDAY, SEPT. 12 | WICPA OFFICE & WICPA CPE LIVESTREAM

# 2023 WICPA NOT-FOR-PROFIT ACCOUNTING CONFERENCE

## MATERIALS AT A GLANCE

The following materials are from the afternoon sessions of the 2023 WICPA Not-For-Profit Accounting Conference held on Tuesday, Sept. 12, including:

- Navigating Economic & Financial Market Uncertainty
- Philanthropic Enterprise Act (the Newman Foundation Exception)
- Internal Controls
- Hot Tax Practice, Procedure & Ethics Issues Faced by Not-for-Profits

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YOUR SOURCE FOR KEY UPDATES  
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NETWORK



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## SAVE THE DATE!

### **Business & Industry Fall Conference**

Monday, Sept. 18

Brookfield Conference Center & WICPA CPE Livestream

### **Tax Conference**

Thursday, Nov. 2 - Friday, Nov. 3

Brookfield Conference Center & WICPA CPE Livestream

### **Accounting & Auditing Conference**

Thursday, Nov. 9

WICPA Office & WICPA CPE Livestream

### **Accounting Technology Conference**

Thursday, Dec. 7

WICPA Office & WICPA CPE Livestream



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12:35 – 1:25 p.m.

# Navigating Economic & Financial Market Uncertainty

**Clare Zempel, CFA, CBE, *Principal, Zempel Strategic***



## WICPA Not For Profit Conference

### The Economic and Market Outlook 2023 – 2028

2023 Soft Landing Probable Because Inflation Has Slowed  
Much Faster Than Spending

2024 Recession Possible Unless Fed Eases Soon

Clare Zempel, CFA, CBE  
Economist and Investment Strategist

WICPA Offices  
September 12, 2023

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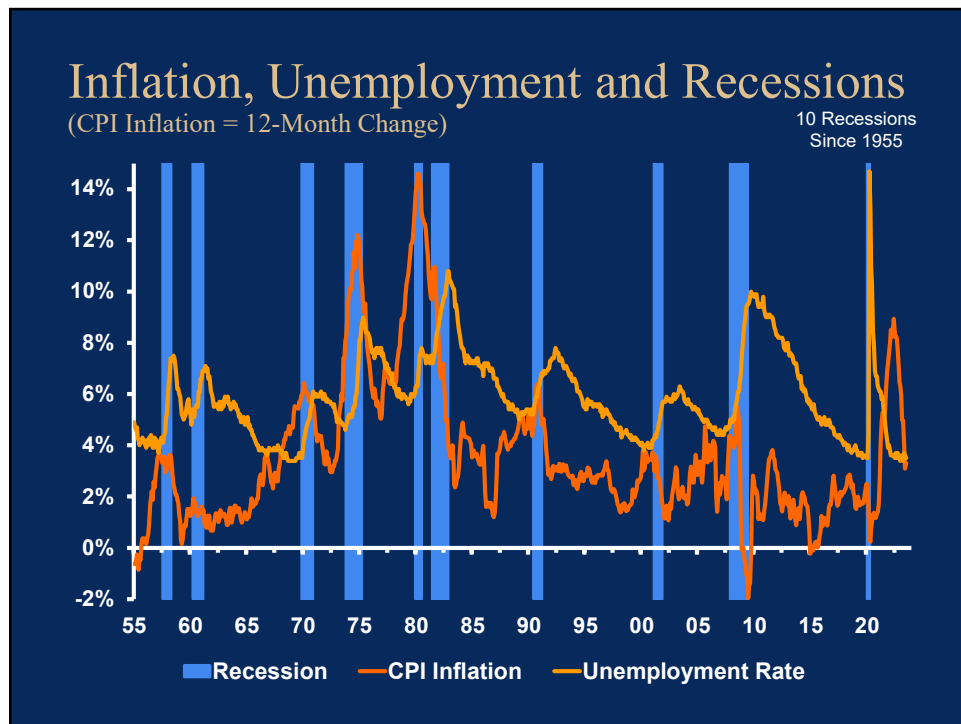
## WICPA Not For Profit Conference


### The Economic and Market Outlook 2023 – 2028

Why Monitor Business Cycles?

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## WICPA Not For Profit Conference

### The Economic and Market Outlook 2023 – 2028

Why High Recession Concerns?

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# Interest Rates and Recessions

(Inversion = 1-Year > 10-Year)

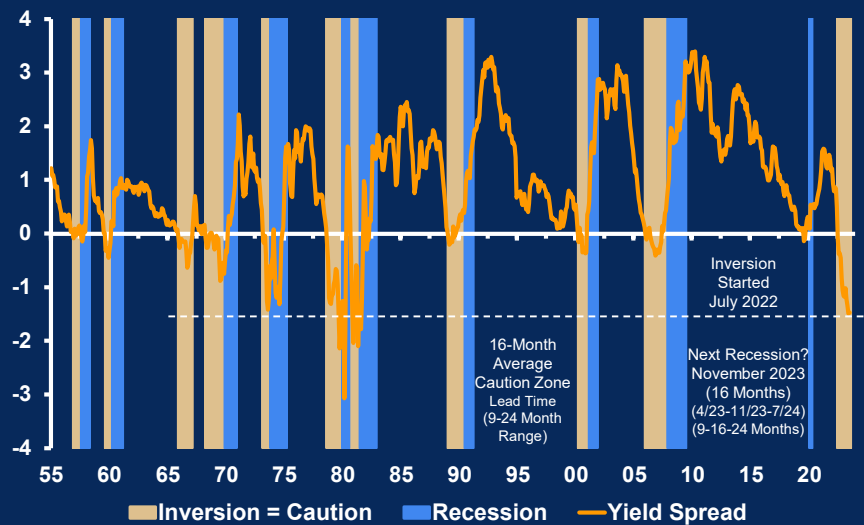
10 Recessions  
Since 1955



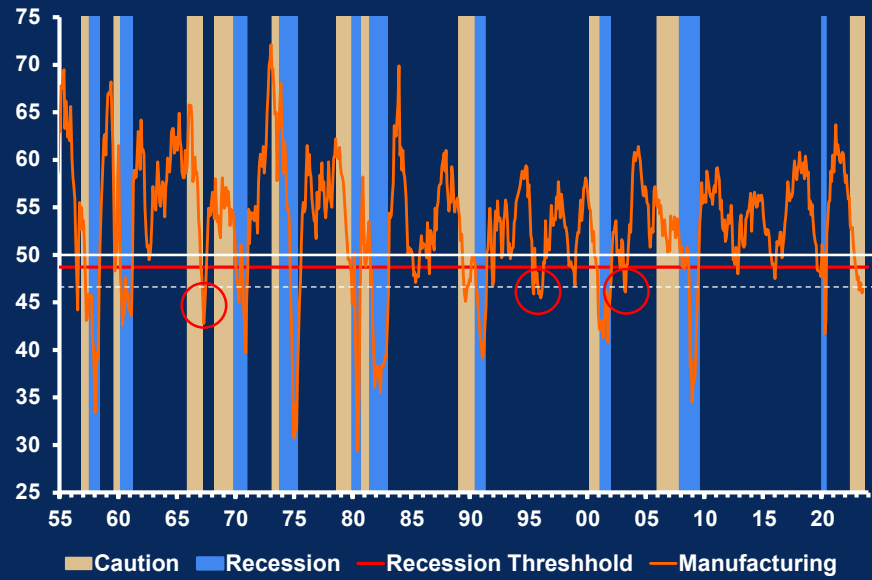
# Yield Spread and Caution Zones ©

(10-Year T-Note Yield Minus 1-Year T-Note Yield) (Percentage Points)

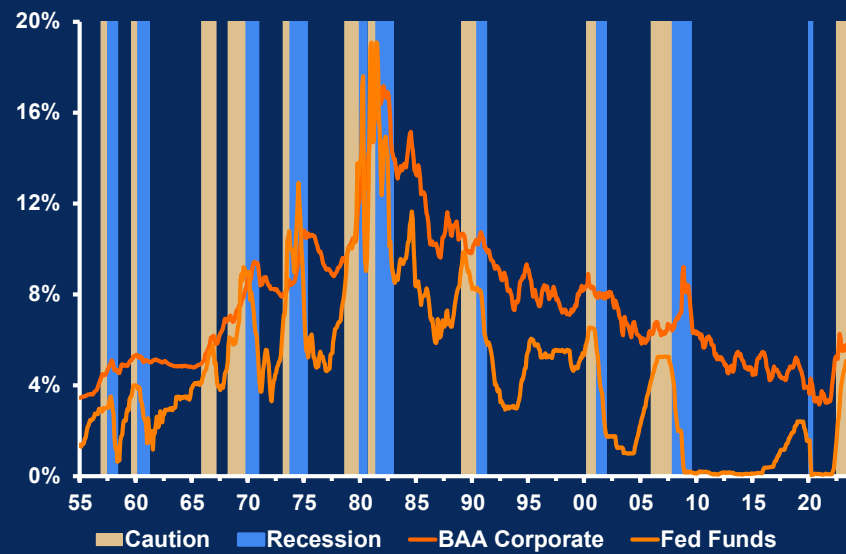
(Inversion = Caution Zone When Fed Funds Rate Is Rising)



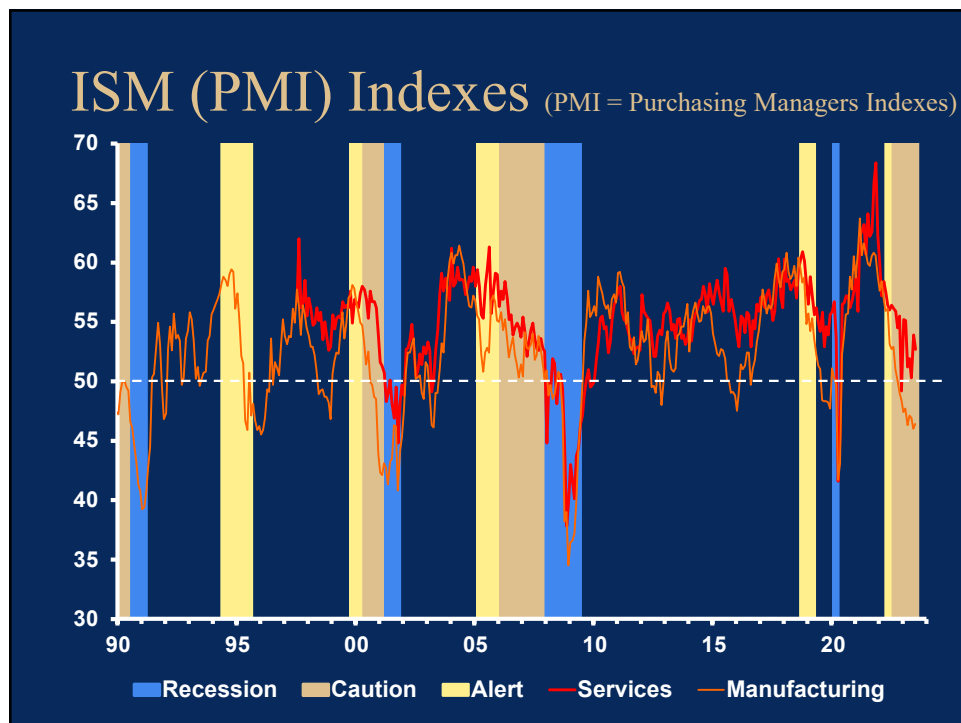
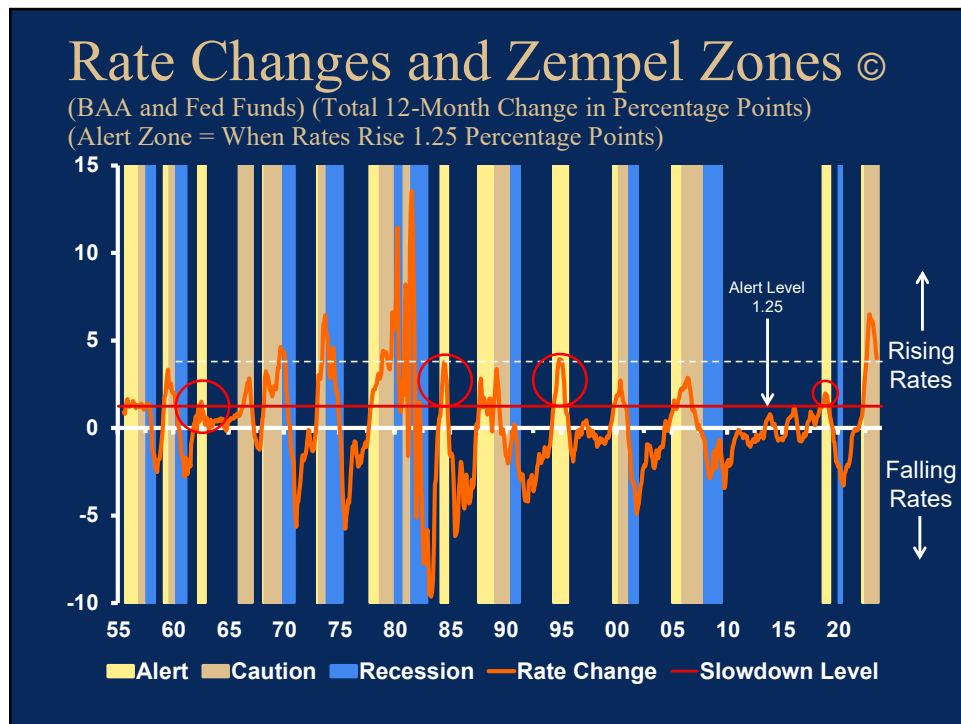
## ISM (PMI) Indexes (PMI = Purchasing Managers Indexes)

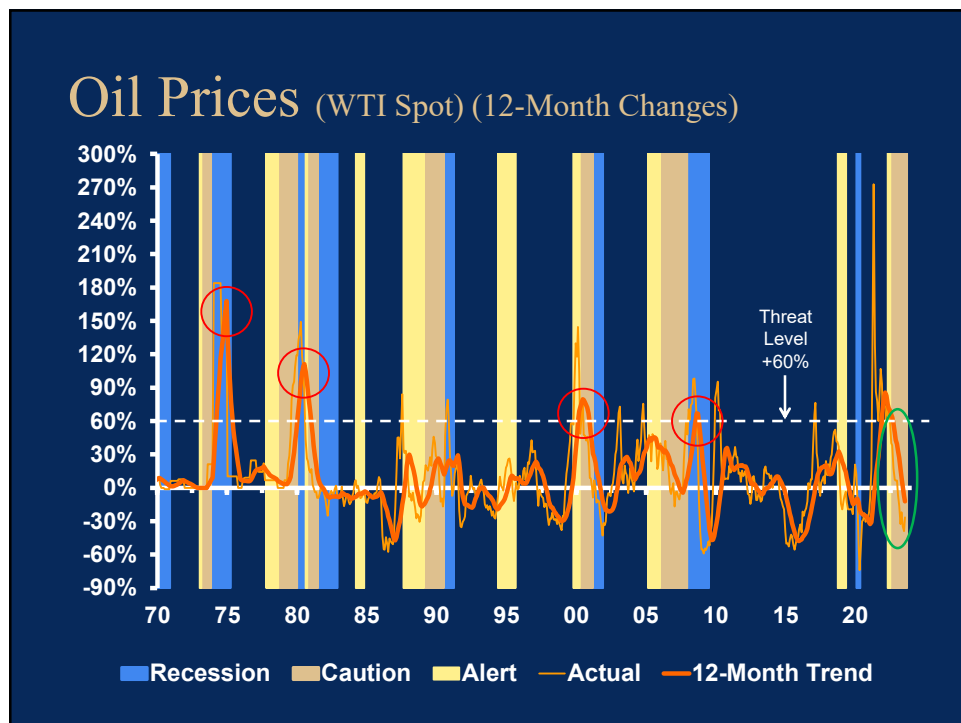
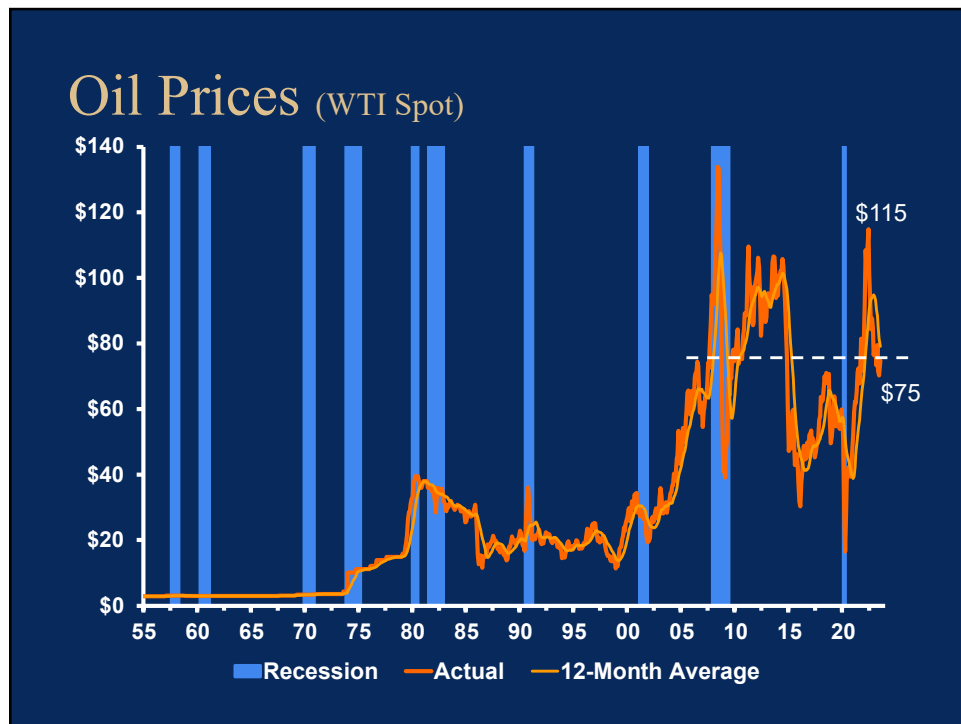


## Interest Rates and Recessions











## WICPA Not For Profit Conference

### The Economic and Market Outlook 2023 – 2028

What Do “Best Indicators” Predict?

Yield Spread Remains Inverted – Implies Recession Risk  
Rate-Change Still High – Implies Sustained Slowdown  
Energy-Prices Still Support Economic Expansion

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## WICPA Not For Profit Conference

### The Economic and Market Outlook 2023 – 2028

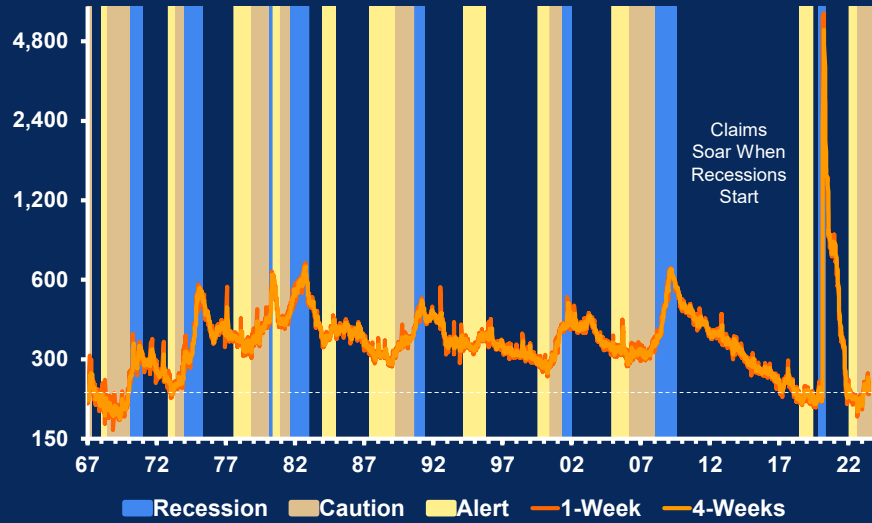
Has Recession Started?  
If Not, Why Not?

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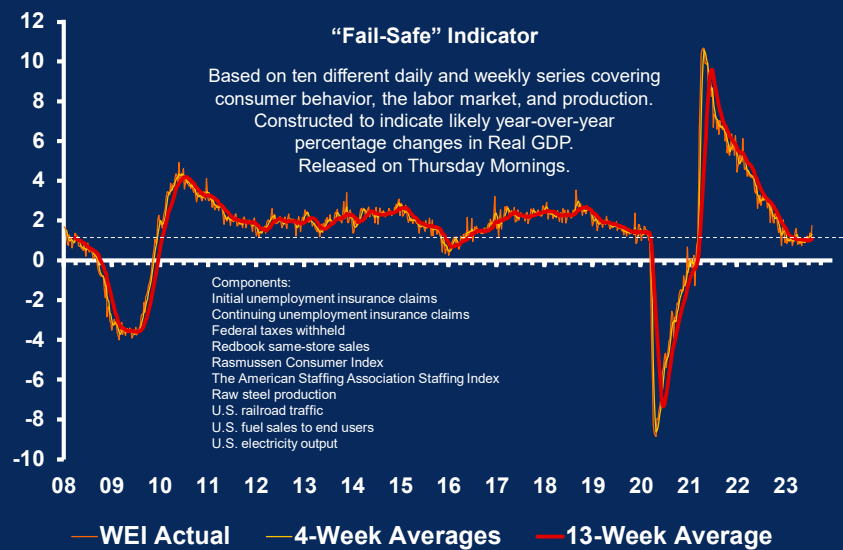
## Jobless Claims and Zempel Zones ©

(Initial Unemployment Insurance Claims) (Log Scale) (Weekly) (Thousands)



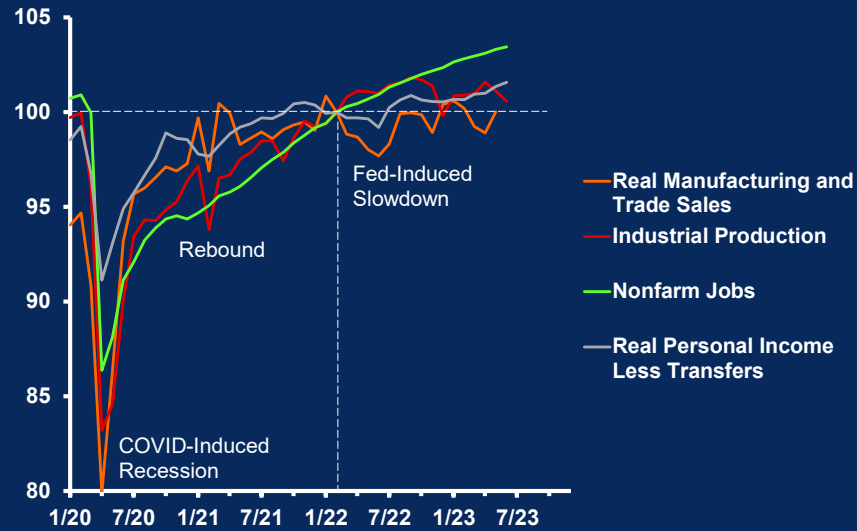
## New York Fed's Weekly Economic Index

<https://www.newyorkfed.org/research/policy/weekly-economic-index#/>



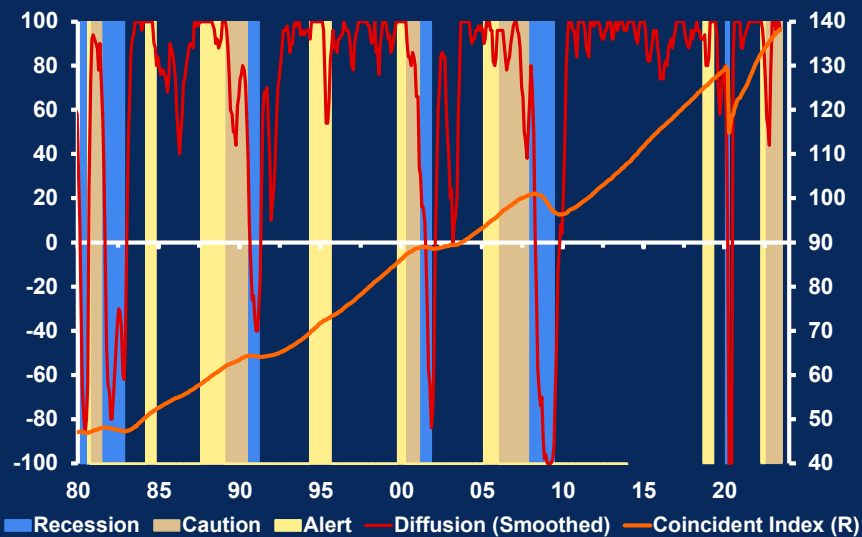
## NBER Recession Watch – Four Key Numbers

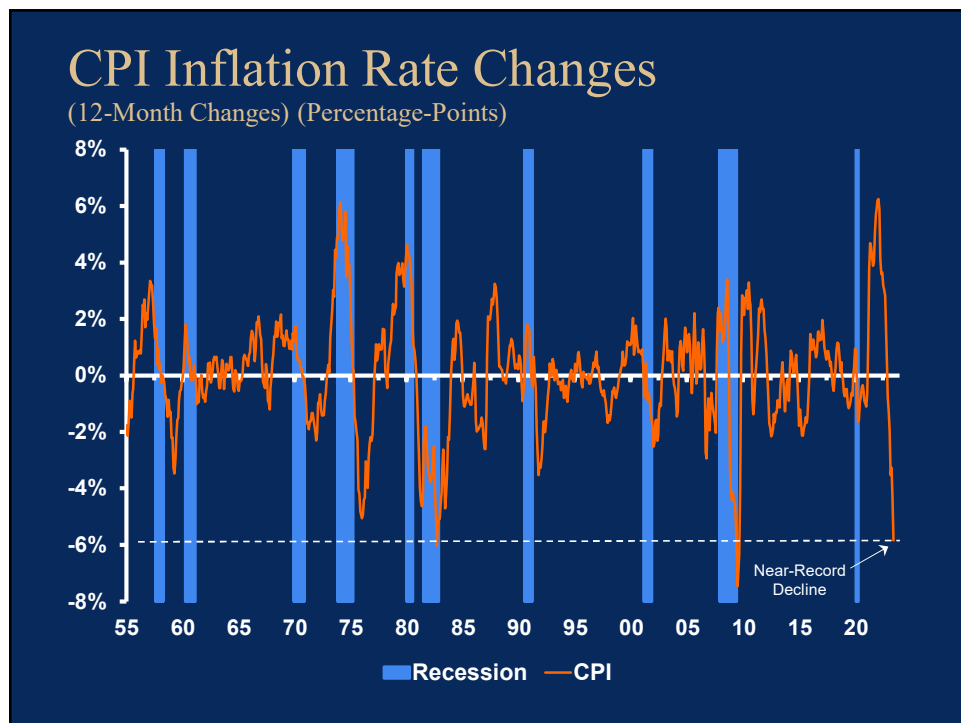
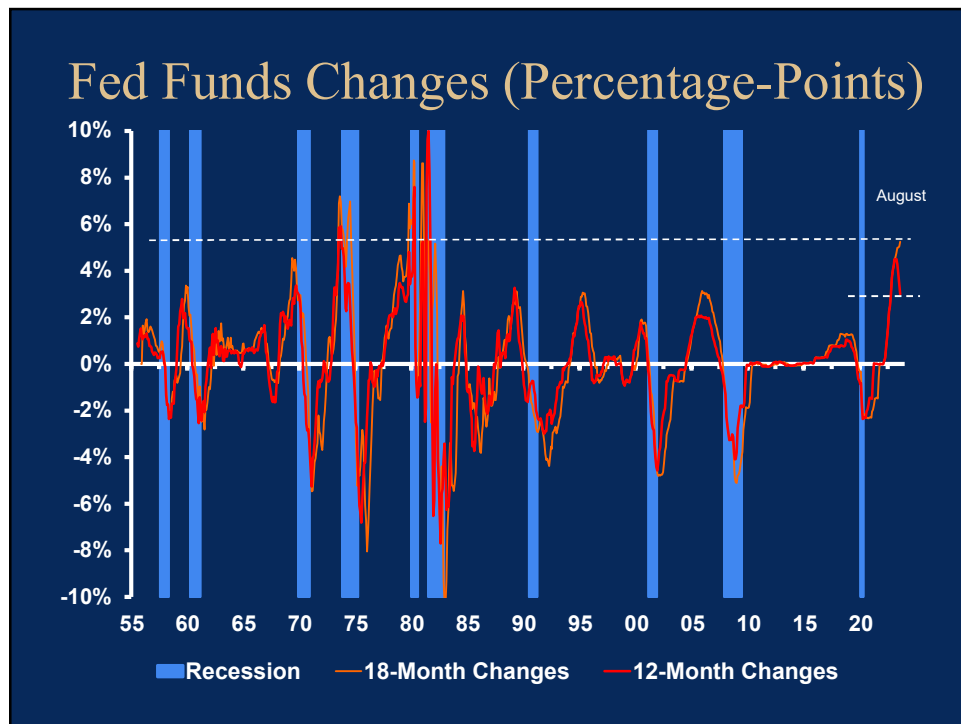
(NBER = National Bureau of Economic Research) (February 2022 = 100)

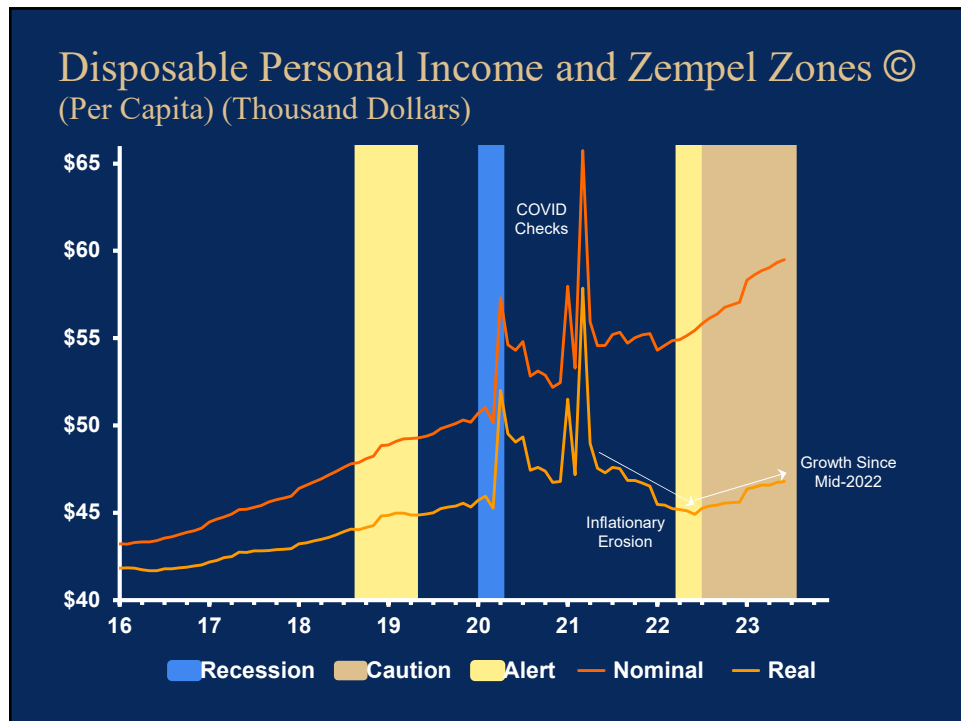
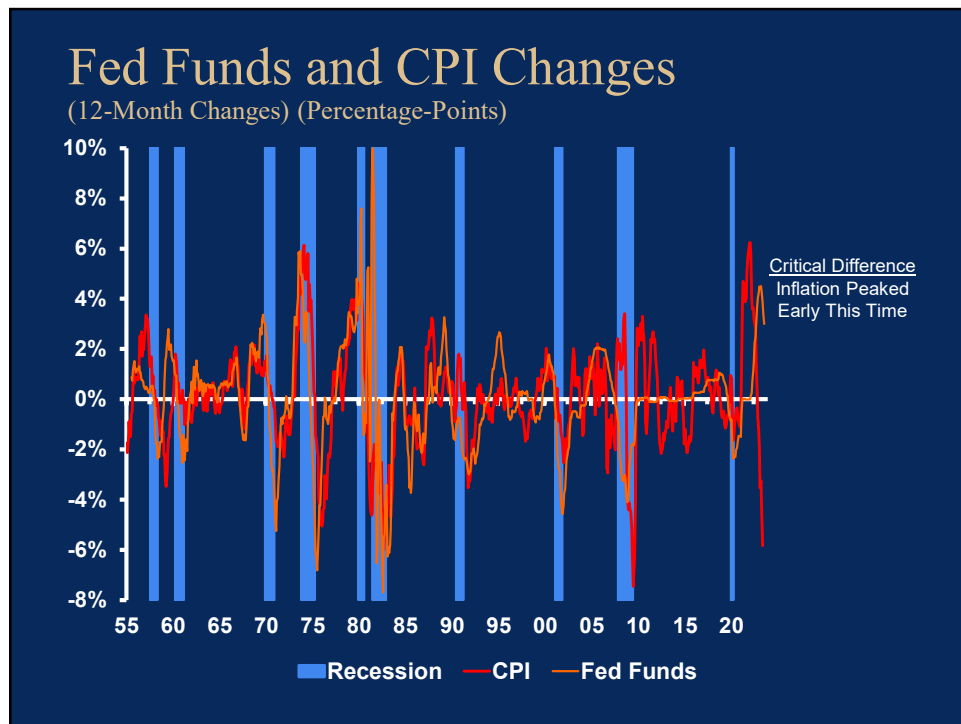


## U.S. Coincident and Diffusion Indexes

(Coincident Economic Activity Index) (Diffusion = States Improving Percentage)









## WICPA Not For Profit Conference

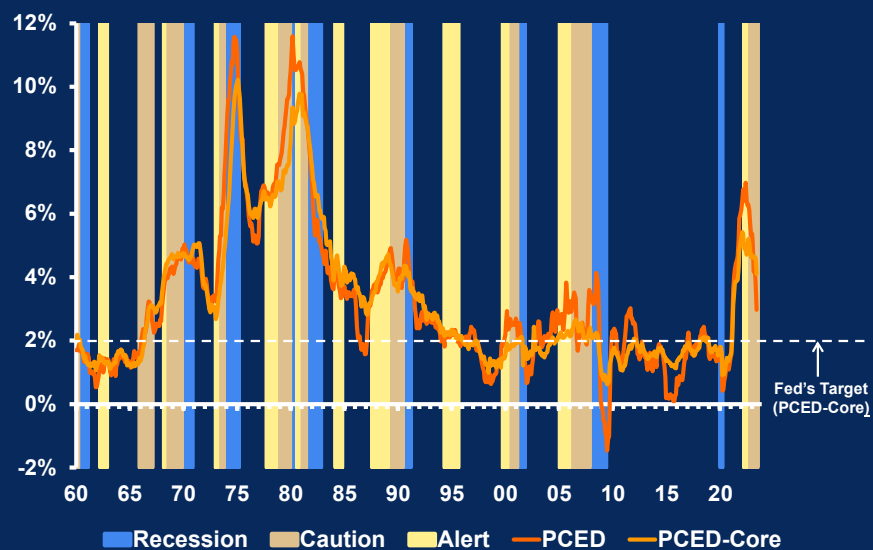
### The Economic and Market Outlook 2023 – 2028

What Causes Inflation?  
Why Did Inflation Peak Early?  
Should Federal Reserve Policy Ease?

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## PCED Inflation and Zempel Zones ©

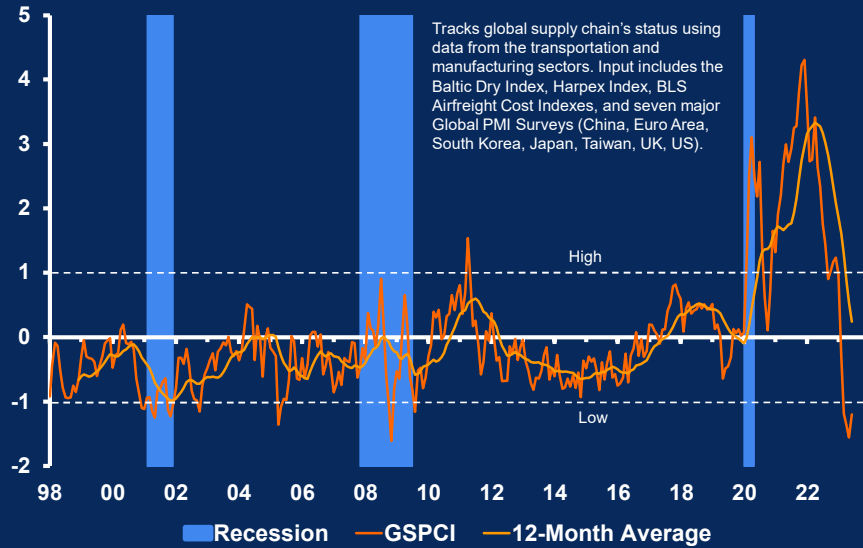
(PCED = Personal Consumption Expenditure Deflator) (12-Month Changes)





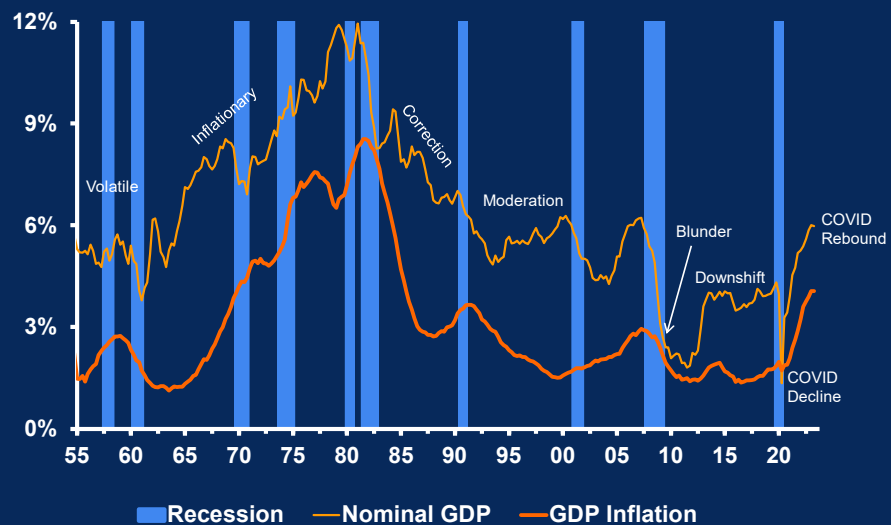
## Global Supply Chain Pressure Index

(Monthly) (New York Fed)



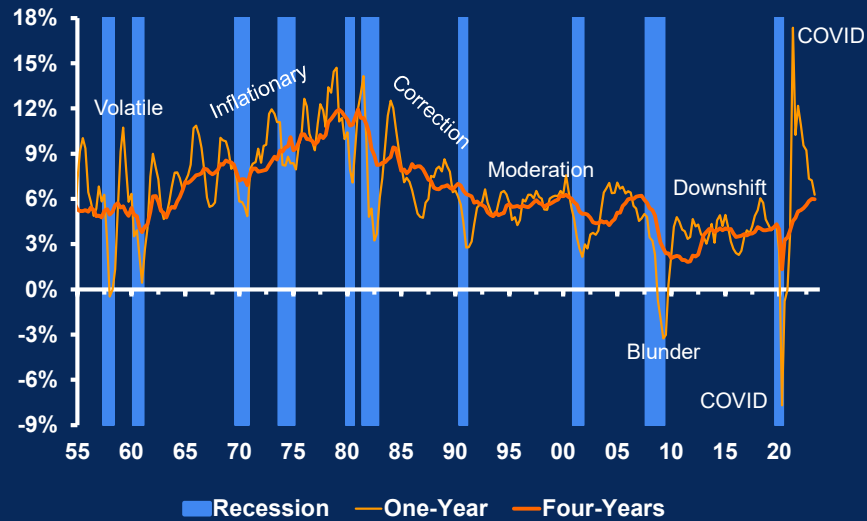
## GDP Growth and Inflation

(Four-Year Growth Rates)

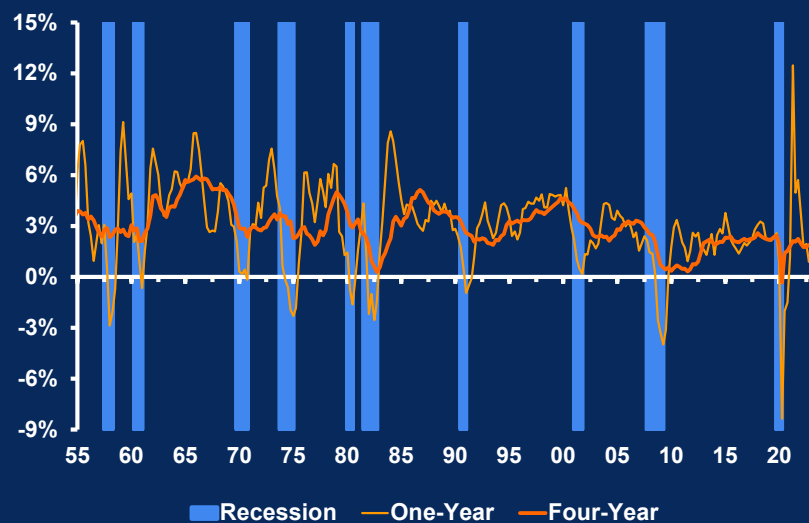


## Nominal GDP Growth Rates

$$M * V = \underline{P} * T$$



## Real GDP Growth Rates



## GDP Inflation Rates



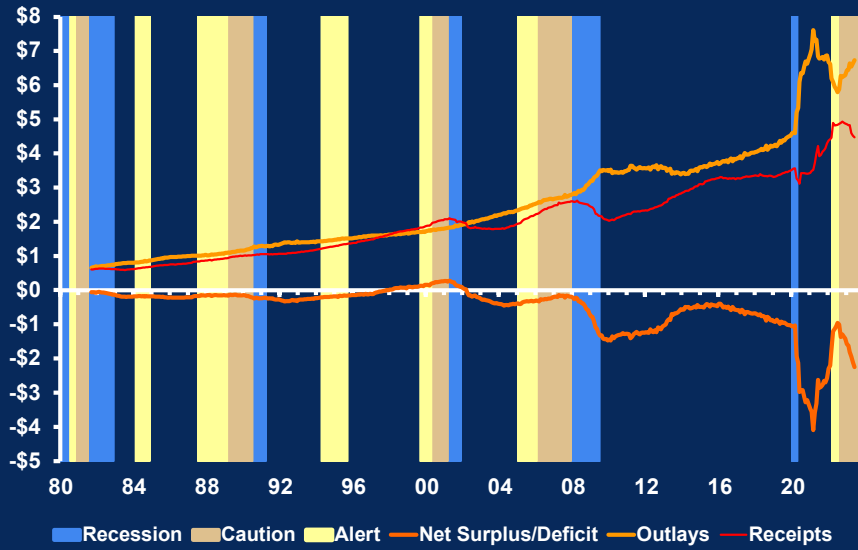
## M2 Growth and Zempel Zones ©

(M2 Money Stock) (Monthly)



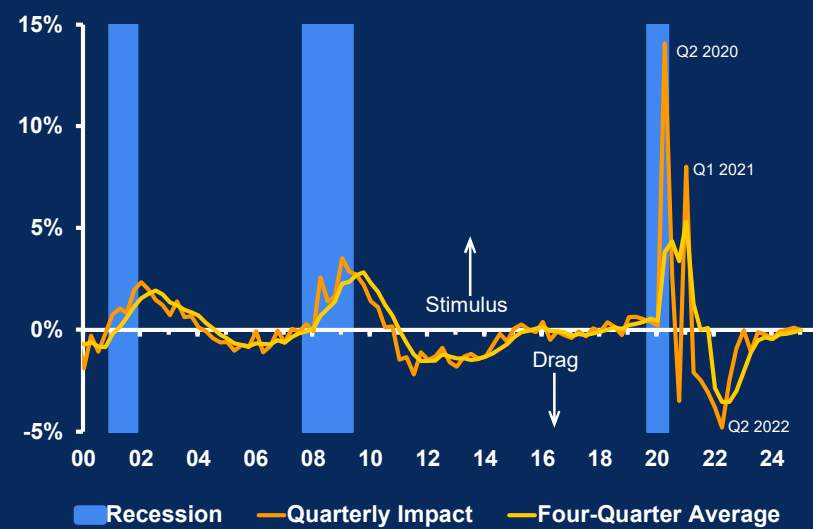
## Federal Budget and Zempel Zones ©

(Trillions) (Monthly) (12-Month Totals)



## Hutchins Center Fiscal Impact Measure

(GDP Growth Contributions)



Odds update every minute | Last updated: 7:22PM EDT on Aug 11, 2023

## Election Betting Odds

By [Maxim Lott](#) and [John Stossel](#)

[Why This Beats Polls](#) | [Odds from Betfair, Smarkets, PredictIt, Polymarket](#) | [How People Bet](#)

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Primaries: [Democrats](#) | [Republicans](#)

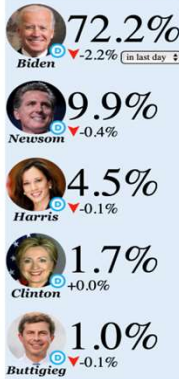
Final winner: [By Party](#) | [By Candidate](#)

Electability: [Democrats](#) | [Republicans](#) | [Biden Out?](#)

Hover over candidate pics to see market breakdown. Hover over underlined titles for amount bet.

### Chance of...

#### DEM Nomination 2024



#### GOP Nomination 2024



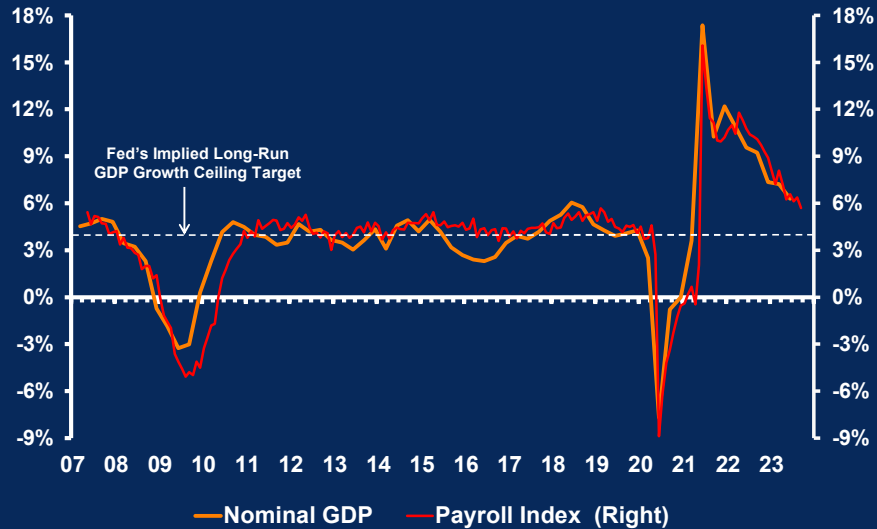
#### US Presidency 2024



## Nominal GDP and Payroll Index Growth

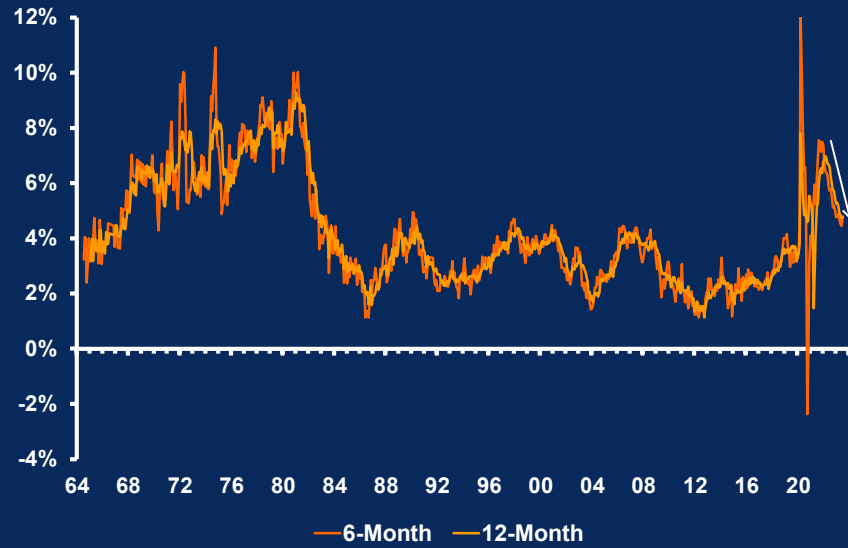
(Nominal GDP Growth = 4-Quarter Change)

(Payroll Index = Hours x Wages) (Payroll Index Growth = 12-Month Change)

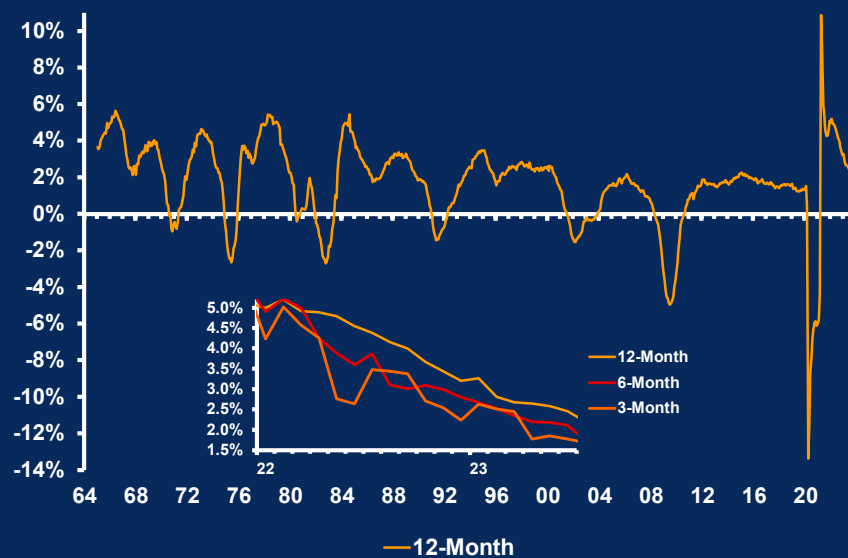


## Average Hourly Earnings Growth

(Private Production and Nonsupervisory Employees)



## Nonfarm Employment Growth

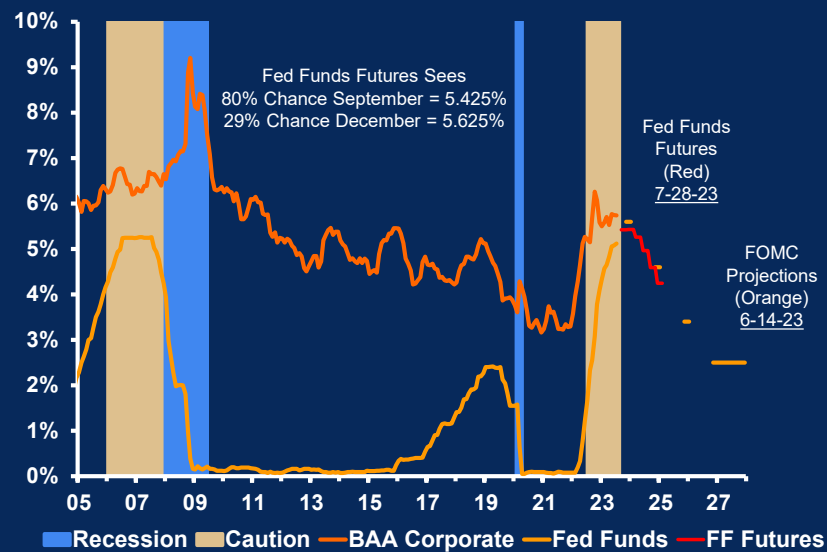




## Payroll Index Growth (Payroll Index = Hours x Wages)



## Interest Rate Prospects





## WICPA Not For Profit Conference

### The Economic and Market Outlook 2023 – 2028

Inflation Has Peaked – Fed's Target Achievable Soon  
Monetary Policy Remains Restrictive  
Fiscal Policy Remains Restrictive  
Political Prospects Look Unpromising  
But No Recession If Inflation Falls Further + Fed Eases  
Fed's Rate Plans Do Risk Recession Next Year

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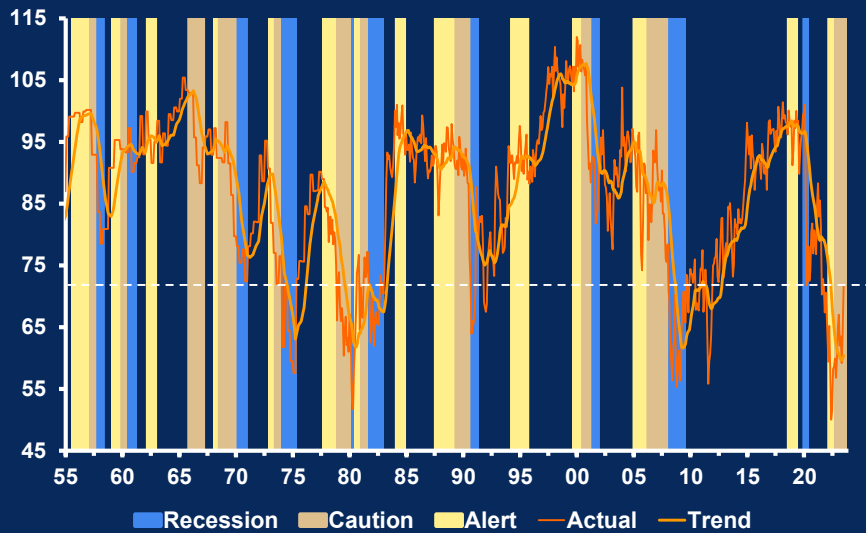
### The Economic and Market Outlook 2023 – 2028

Economic Sector Performances  
Prospects Remain Positive But Not Robust

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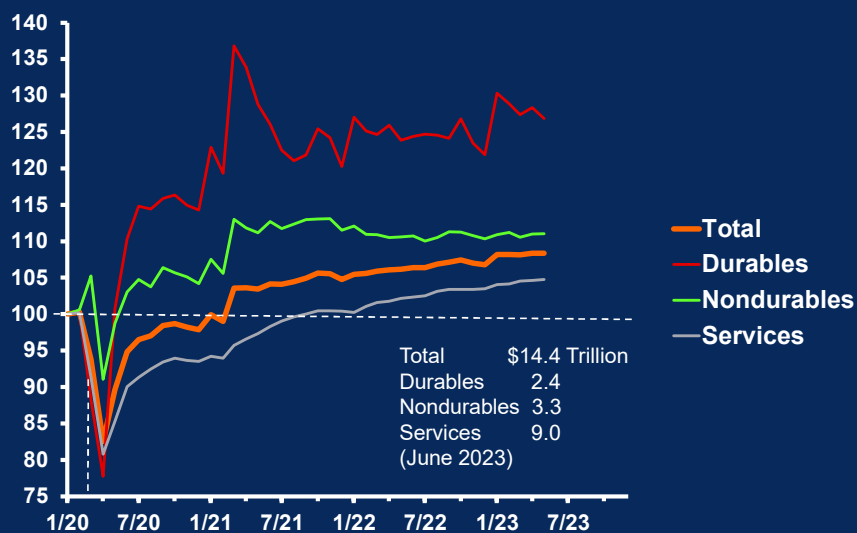
## Consumer Sentiment and Zempel Zones ©

(Consumer Sentiment Index) (University of Michigan) (Monthly)



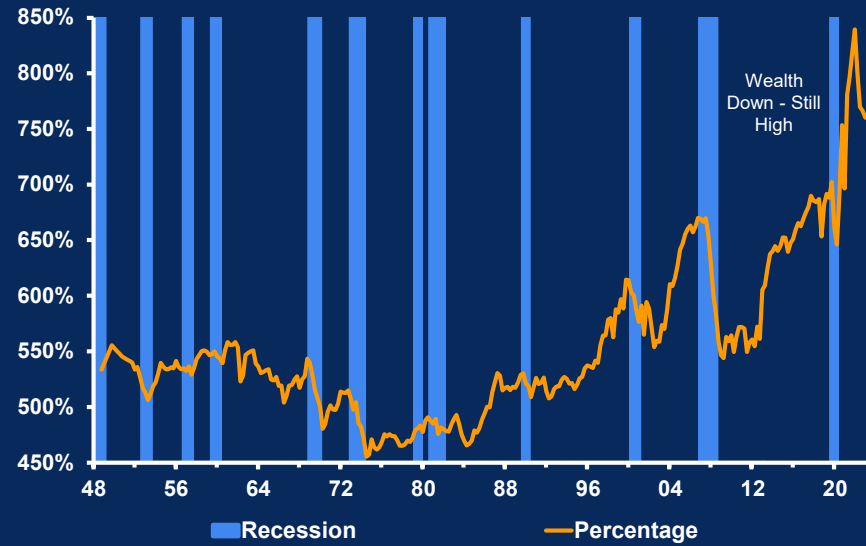
## Real Personal Consumption Indexes

(January 2020 = 100)



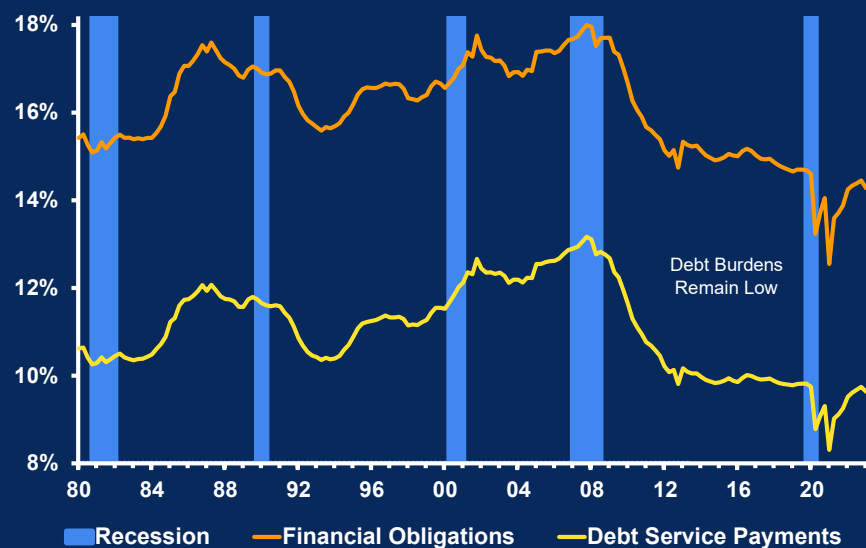
## Net Worth (Percentage of DPI)

(Households and Nonprofit Organizations)

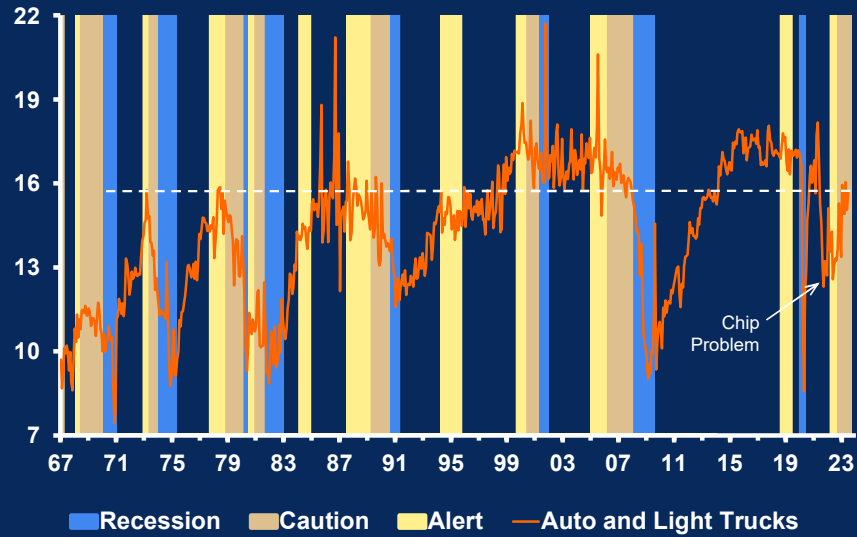


## Household Debt Burdens

(Percent of Disposable Personal Income)

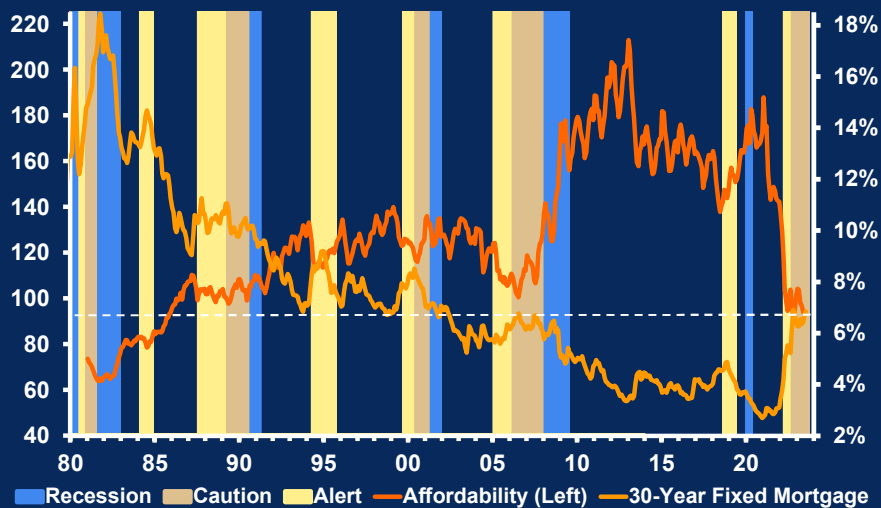


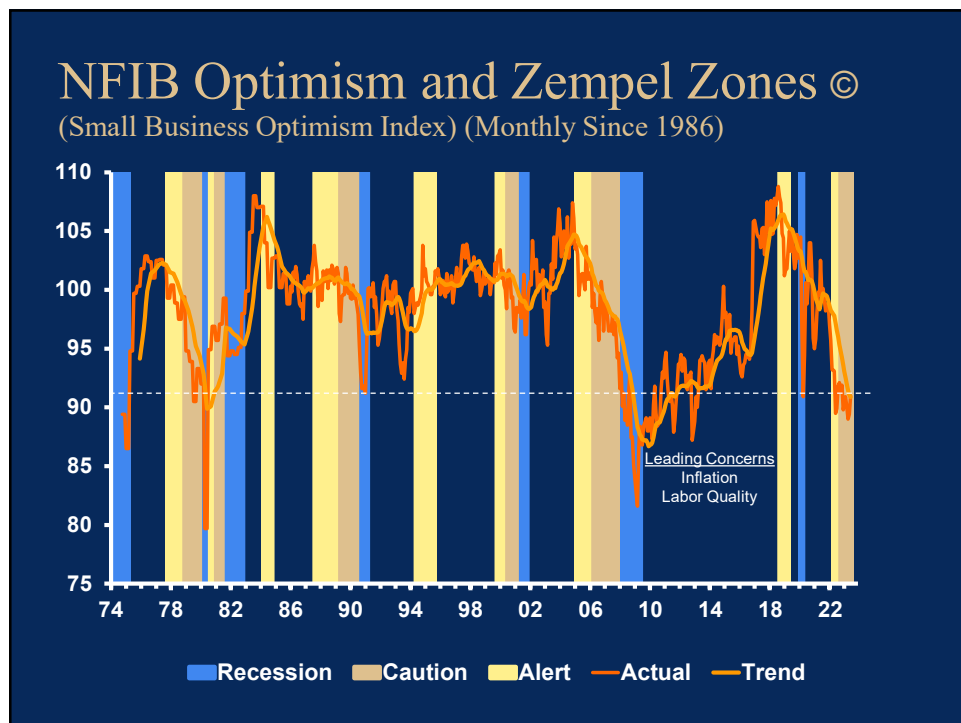
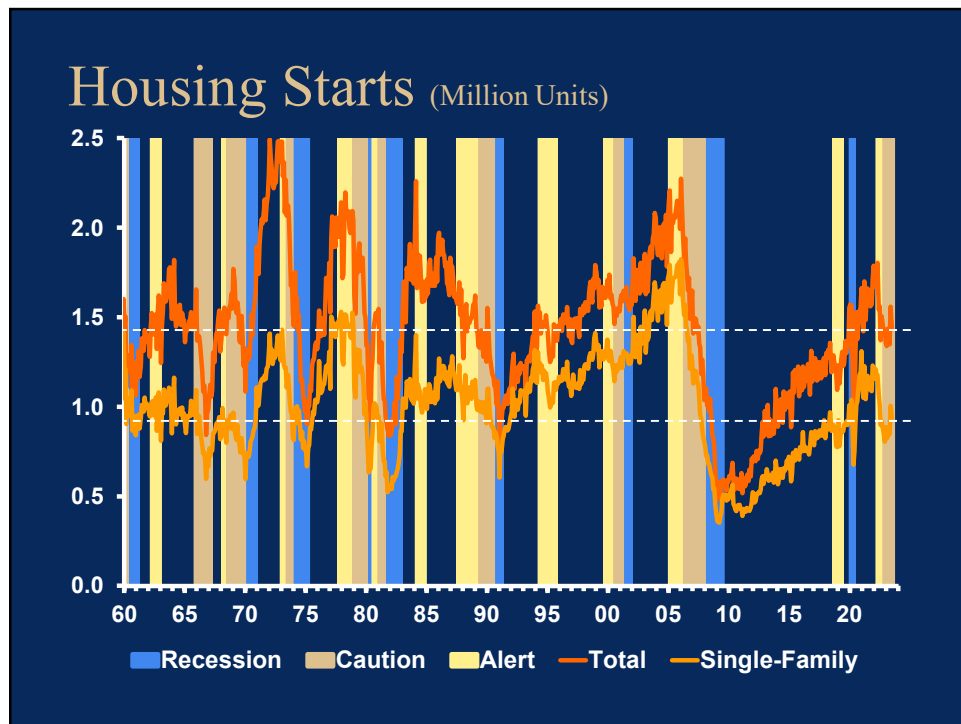
## Auto and Light Truck Sales (Million Units)



## Mortgage Rate and Affordability

(National Fixed-Rate Average) (Fixed-Rate Affordability Index)

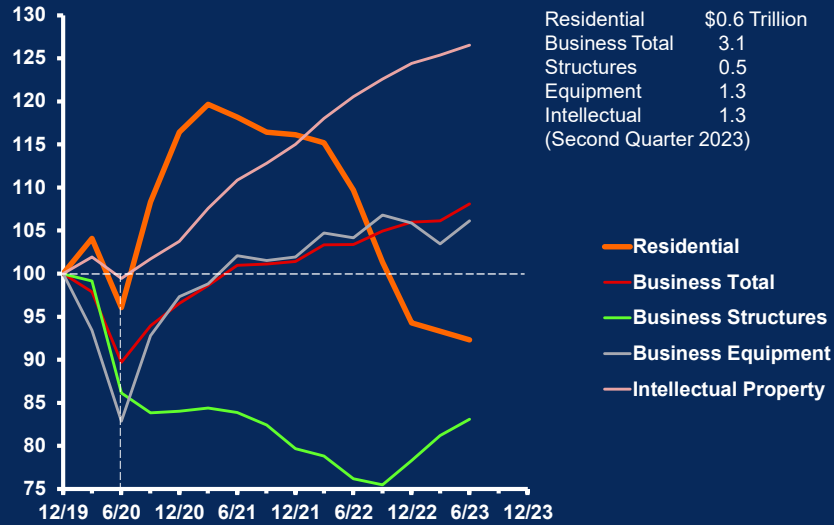






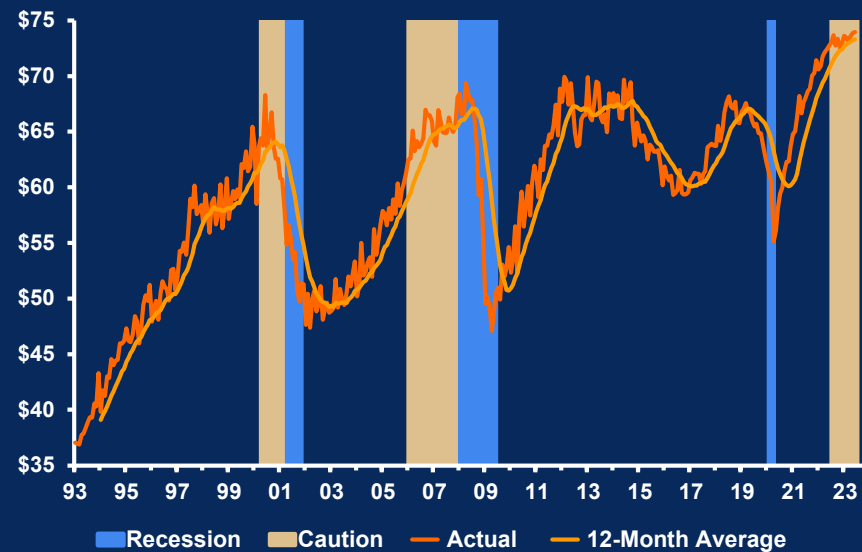
## Real Investment Indexes

(Quarterly) (December 2019 = 100)



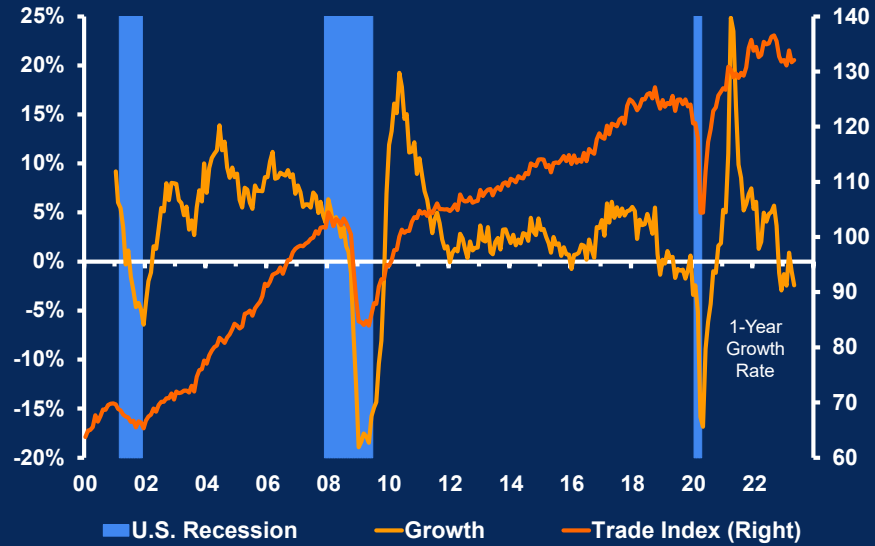
## New Non-Defense Capital Goods Orders

Excluding Aircraft (Monthly) (Current Dollars) (Billions)



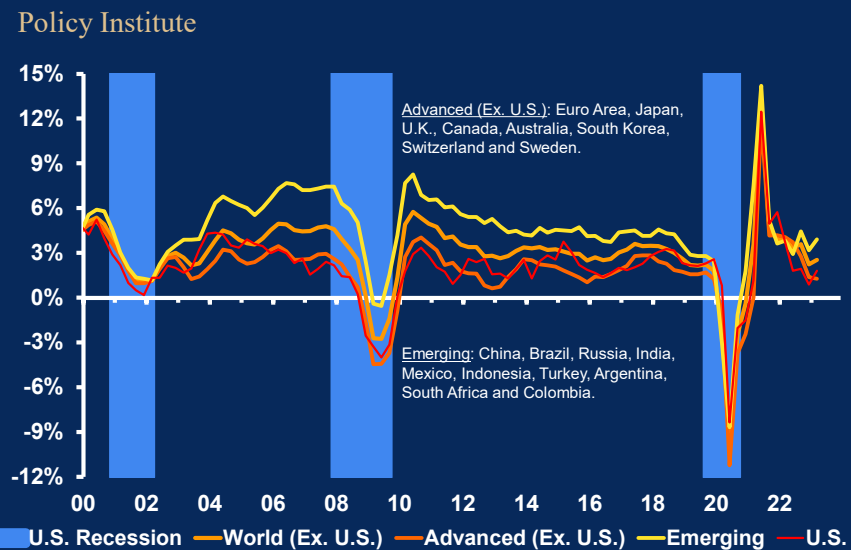
# World Trade Volume Index

(CPB Netherlands Bureau for Economic Policy Analysis) (2010 = 100)



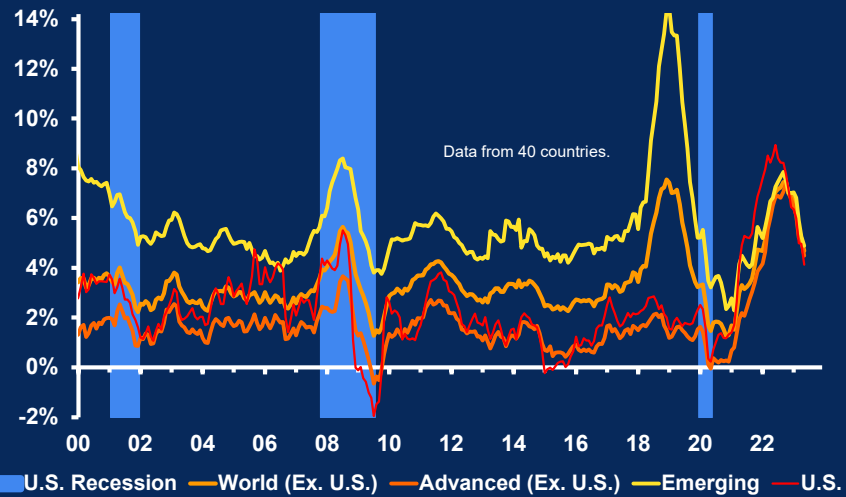
# World Real GDP

Dallas Fed's Globalization & Monetary Policy Institute



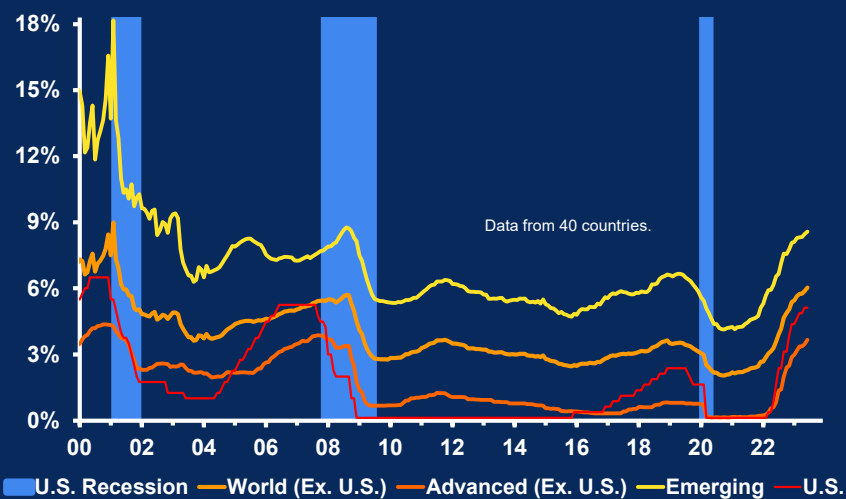
## World Headline CPI Inflation Rates

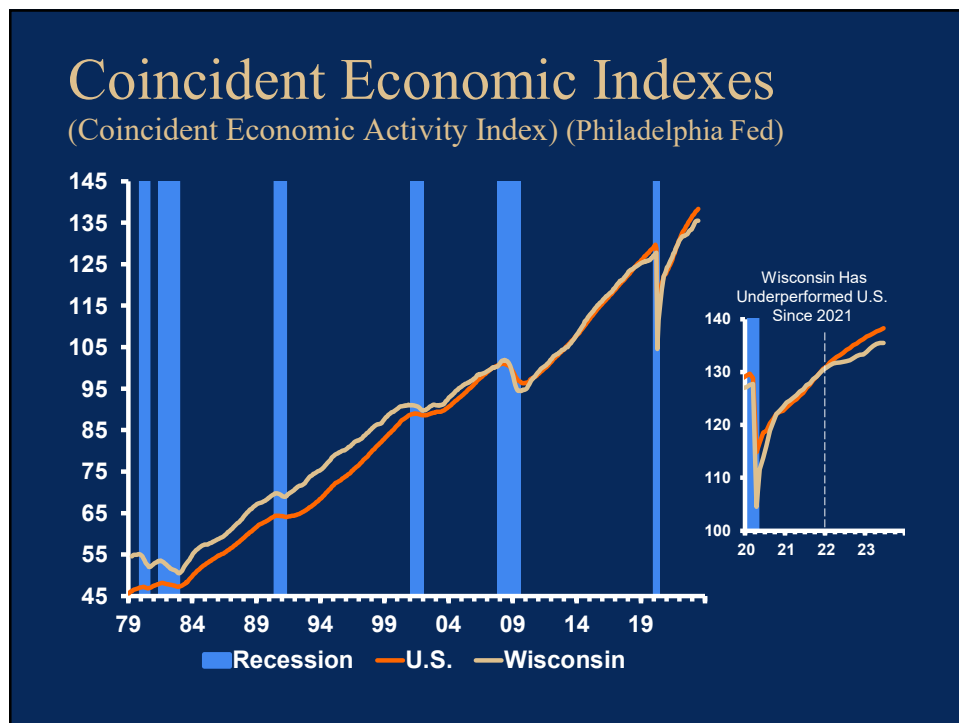
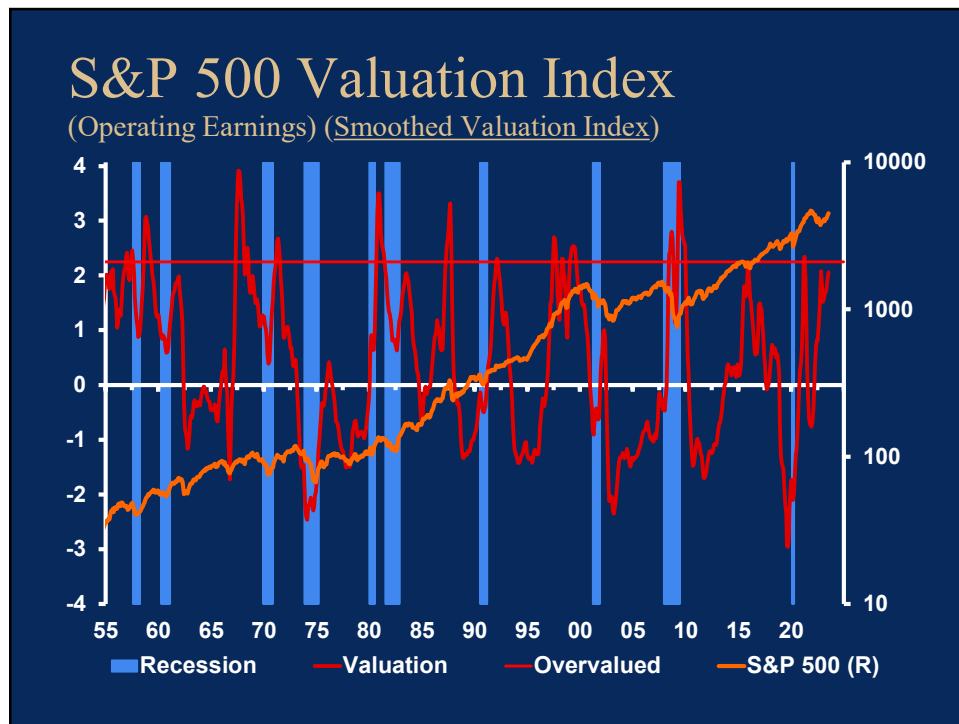
Dallas Fed's Globalization & Monetary Policy Institute



## World Policy Short-Term Interest Rates

Dallas Fed's Globalization & Monetary Policy Institute







## WICPA Not For Profit Conference

### The Economic and Market Outlook 2023 – 2028

Has Recession Started? No

What Do “Best Indicators” Predict? Slowdown + Recession

Can Recession Be Averted? Or Downside Limited? Yes

Best Case? Inflation Slows Further + Fed Tempers Hawkishness

How Would Sectors Perform Then? Moderate Expansion

Worst Case? Fed’s Hawkishness Triggers 2024 Downturn

What to do now depends on sensitivity to economic slowdowns.

“Alert Zone” means temper optimism.

“Caution Zone” now means plan for recession.

Delay implementation until jobless claims soar or own orders drop.

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## Questions...

Clare W. Zempel, CFA, CBE

Zempel Strategic

Applied Economics and Financial Market Analysis

[www.zempelstrategic.com](http://www.zempelstrategic.com)

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1:35 – 2:25 p.m.

# Philanthropic Enterprise Act (the Newman Foundation Exception)

**Sherry Martin, J.D.**, *Associate, von Briesen & Roper, s.c.*

**Thomas Moniz, J.D.**, *Shareholder, von Briesen & Roper, s.c.*



# ***WICPA Not For Profit Conference***

## **Private Foundations – Excess Business Holdings & the Philanthropic Enterprise Act**

September 12, 2023

Thomas W. Moniz and Sherry B. Martin



Tom is Chair of von Briesen's Nonprofit and Tax Exemption Section where he focuses on tax exemption, nonprofit formation and governance, and Benefit Corporations. He also has a significant trust and estate planning and administration practice. Tom's clients view him as a legacy advisor – using a personal, connected approach to work with clients and their families related to their unique business needs, personal needs and assets in conjunction with their estate plans. Tom especially enjoys working collaboratively and strategically with clients' other trusted advisors – an approach that he believes adds value now and for successive generations. Tom is active with several nonprofits including Envision Greater Fond du Lac (Advocacy Committee), Oshkosh Area Community Foundation (Audit Committee) and Boys & Girls Club (Building & Capital Campaign).

**Tom Moniz** | [thomas.moniz@vonbriesen.com](mailto:thomas.moniz@vonbriesen.com)





Sherry focuses her practice on estate planning; tax planning including revocable trusts, irrevocable grantor trusts, life insurance trusts, supplemental needs trusts, spousal access trusts, beneficiary grantor trusts, and qualified personal residence trusts; administration of probate and non-probate estates; and premarital agreements. Sherry has significant experience creating and funding family business entities and foundations. Prior to joining von Briesen, Sherry practiced with a large Wisconsin law firm in its Estate Planning Section. During law school, Sherry was a member of the Elder Law and Estate Planning Society and graduated with Honors in the Estate Planning Concentration. Sherry is a volunteer for the Wills for Heroes Foundation.



**Sherry Martin** | [sherry.martin@vonbriesen.com](mailto:sherry.martin@vonbriesen.com)

3

## Agenda

- Excess Business Holdings
- Philanthropic Enterprise Act
  - History
  - Test – 3 factors
- Planning Considerations
- Case Studies



4

## **History**

- The excess business holdings rules were designed in part to 1) prevent foundations from running businesses to benefit family members, rather than charity, 2) keep foundation managers focused on charitable goals, rather than business operation, and 3) avoid foundation-owned enterprises from holding profit and making minimal distributions to the benefiting foundation.
- While the excess business holding rules addressed these concerns, the rules also effectively prohibited private foundations from owning substantial interests in business entities.



5

## **Excess Business Holdings**

### **IRC 4943 – Excess Business Holdings Rules**

- Limits a private foundation's ownership of business holdings.
- Private foundation with excess business holdings is subject to excise tax on its excess business holdings.

### **Purpose of Excess Business Holdings Rules**

- Prevent private foundations from being distracted from charitable work.
- Prevent unfair competition for for-profit businesses.
- Prevent profits from escaping tax.



6

## **Excess Business Holdings**

Test: The combined holdings of a private foundation and its disqualified persons are limited to 20% of the voting stock of a corporation or 20% of the beneficial interest of a partnership, joint venture, or other unincorporated enterprise.

A private foundation is generally not counted against the 20% limitation if disqualified persons do not own more than 20% of the voting stock.

Disqualified persons – substantial contributors, foundation managers, 20% owners, family members/spouses of the above, 35% owners, related private foundation, and certain government officials.



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## **Excess Business Holdings**

### **Penalty:**

- Initial Tax: 10% of the value of the excess holdings
- Additional Tax: 200% of the value of the excess holdings



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## **Excess Business Holdings**

### **Exceptions:**

- De Minimis Exception – not more than 2%
- Third-Party Control Exception – increase to 35%
- Newman's Own Exception (the Philanthropic Enterprise Act)



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## **Philanthropic Enterprise Act**

**Adopted:** February 9, 2018 by President Trump as part of the Bipartisan Budget Act of 2018

**Purpose:** to save the Newman's Own Foundation



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## **Philanthropic Enterprise Act**

### **Test:**

- Exclusive Ownership Requirement
- All Profits to Charity Distribution Requirement
- Independent Operation Requirement



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## **Philanthropic Enterprise Act**

### **Exclusive Ownership Requirement:**

(2) Ownership.—The requirements of this paragraph are met if—

- (A) 100 percent of the voting stock in the business enterprise is held by the private foundation at all times during the taxable year, and
- (B) all the private foundation's ownership interests in the business enterprise were acquired by means other than by purchase.



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## **Philanthropic Enterprise Act**

### **All Profits to Charity Distribution Requirement:**

#### **(3) All profits to charity.—**

(A) In general.—The requirements of this paragraph are met if the business enterprise, not later than 120 days after the close of the taxable year, distributes an amount equal to its net operating income for such taxable year to the private foundation.



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## **Philanthropic Enterprise Act**

(B) Net operating income.—For purposes of this paragraph, the net operating income of any business enterprise for any taxable year is an amount equal to the gross income of the business enterprise for the taxable year, reduced by the sum of—

- i. the deductions allowed by chapter 1 for the taxable year which are directly connected with the production of such income,
- ii. the tax imposed by chapter 1 on the business enterprise for the taxable year, and
- iii. an amount for a reasonable reserve for working capital and other business needs of the business enterprise.



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## **Philanthropic Enterprise Act**

### **Independent Operation Requirement:**

(4) Independent operation.—The requirements of this paragraph are met if, at all times during the taxable year—

(A) no substantial contributor (as defined in section 4958(c)(3)(C)) to the private foundation or family member (as determined under section 4958(f)(4)) of such a contributor is a director, officer, trustee, manager, employee, or contractor of the business enterprise (or an individual having powers or responsibilities similar to any of the foregoing),



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## **Philanthropic Enterprise Act**

### **Independent Operation Requirement (continued):**

(B) at least a majority of the board of directors of the private foundation are persons who are not—

(i) directors or officers of the business enterprise, or

(ii) family members (as so determined) of a substantial contributor (as so defined) to the private foundation, and

(C) there is no loan outstanding from the business enterprise to a substantial contributor (as so defined) to the private foundation or to any family member of such a contributor (as so determined).



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## **Philanthropic Enterprise Act**

### **Application:**

(5) Certain deemed private foundations excluded. This subsection shall not apply to:

(A) any fund or organization treated as a private foundation for purposes of this section by reason of subsection (e) or (f),

(B) any trust described in section 4947(a)(1) (relating to charitable trusts), and

(C) any trust described in section 4947(a)(2) (relating to split-interest trusts)."



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## **Planning Opportunities for Business Owners**

- Ongoing charitable gift with business profits
- Considerations
  - Do you own the entire voting interest of the business?
  - Are you ready to give up control/employment?
  - Are you ready to give up profits?
  - Do you have individuals who could serve as directors of the foundation and the business?



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## **Planning Opportunities for Business Owners**

- Considerations (continued)
  - Are there arrangements between the business and you, your family and other disqualified persons that violate the independent operation requirement (such as loans)?
  - Will you need a change in tax status or business structure (such as S corp classification)?



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## **Considerations for Private Foundations**

- Structure of foundation board
- Beware violating the Philanthropic Enterprise Act and falling back under the excess business holdings rules
- Need sufficient liquidity to make 5% annual distribution
- Can certain passive-income producing activities be carried on more efficiently by the foundation itself (rather than retaining such activities in the business)?



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## **Case Studies**

- Newman's Own Foundation
- Other Examples



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## **Other Alternatives**

- Gift business to public charity
  - Option of using a single member limited liability company
- Retain voting stock and gift non-voting stock to private foundation
- ESOPs



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# Questions?



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**Thank you!**



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2:35 – 3:25 p.m.

# Internal Controls

**Rachel Swanson**, *Senior, CLA*

**Lauren Wanta**, **CPA**, *Senior Accountant, CLA*



*We'll get you there.*

CPAs | CONSULTANTS | WEALTH ADVISORS

# Internal Controls

Rachel Swanson and Lauren Wanta

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## Objectives of Today's Session

- Gain an understanding of the internal control framework
- Identify areas where you can strengthen internal controls to better business procedures and help prevent fraud risks
- Discover best practices for remote work and use of technology



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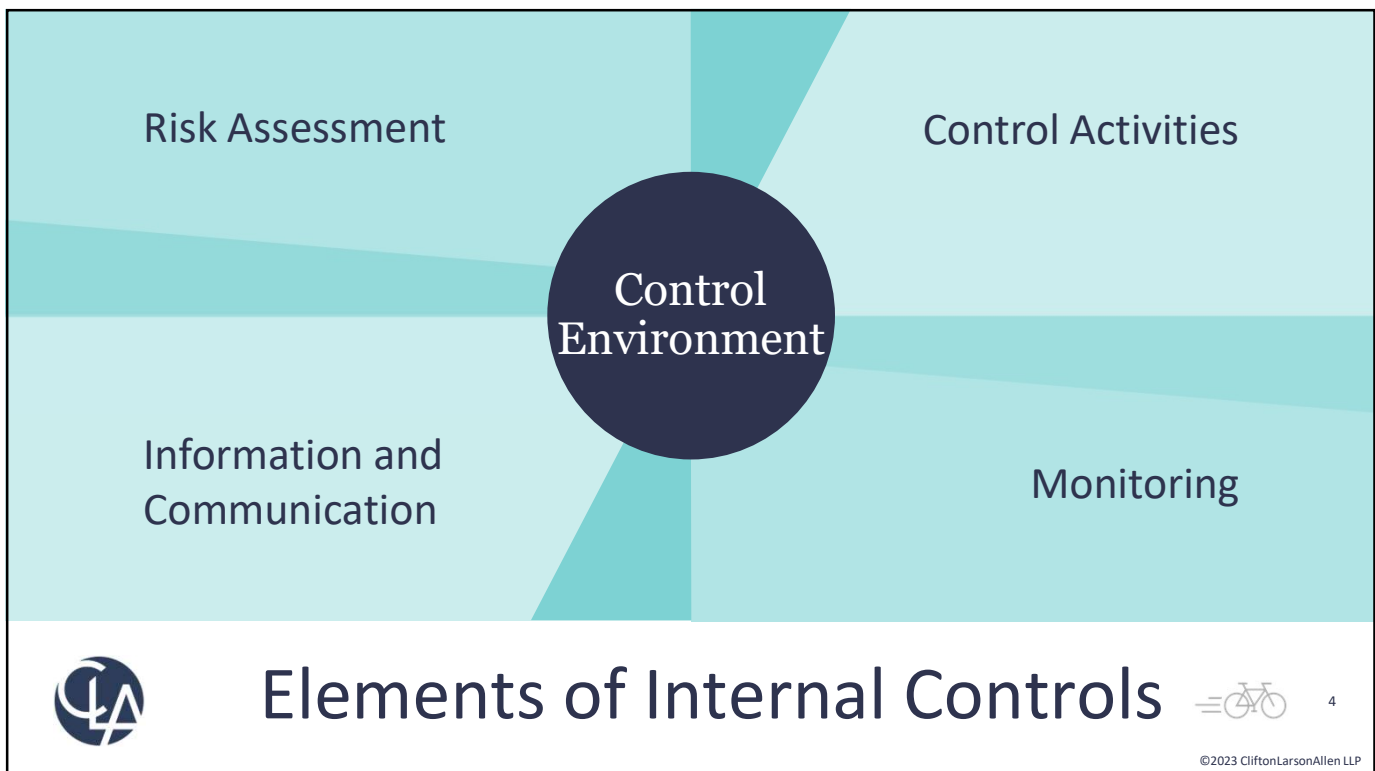


# The Purpose of Internal Controls

- To safeguard assets
- To produce accurate accounting data
- To contribute to efficient operations
- To promote compliance with board policy and donor restrictions
- Internal controls help to limit the **opportunity** to commit fraud.



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Elements of Internal Controls



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# Control Environment

The foundation of internal controls is the tone of your business at the management level.

- Having policies and procedures in place to guide the organization
- Emphasizing the importance of internal controls
- Leading by example with integrity and ethical values
- Formal budget process and regular review of variances
- Goal to attract and retain competent staff
- Effective board committees

Control Environment

Risk Assessment

Control Activities

Information & Communication

Monitoring



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# Risk Assessment

Analyzing risks of the company from internal and external factors.

- Having clear objectives about operating, financial reporting, and legal compliance functions
- Assessing and evaluating risks related to the objectives to prevent an adverse event from occurring

Control Environment

Risk Assessment

Control Activities

Information & Communication

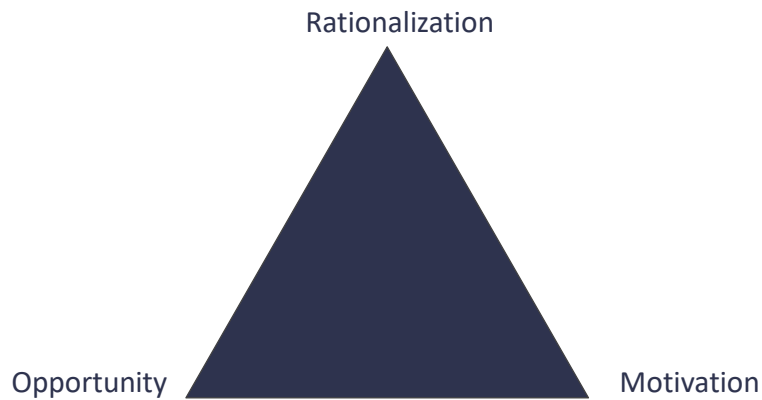
Monitoring



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# Fraud Triangle



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## Control Activities

Actions established through policies and procedures to help ensure risk responses are effectively carried out.

- Segregation of duties, approvals, authorizations, reconciliations, and security over assets
- Preventative or detective
- Manual or automated

Control Environment

Risk Assessment

Control Activities

Information & Communication

Monitoring



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# Information and Communication

Exchange of information within the company.

- Developing and maintaining effective financial management information systems
- Enables management to share clear communications to employees
- Internal and external communication
- Publicized channels for employees to report suspected fraud
- Procedures in place for handling reports of suspected fraud

Control Environment

Risk Assessment

Control Activities

Information & Communication

Monitoring



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# Monitoring

Assessing the internal control procedures in place to ensure they are operating effectively.

- Identifying and correcting weak controls
- Comparing supporting schedules to accounting records
- Following up on budgeted results vs actual results

Control Environment

Risk Assessment

Control Activities

Information & Communication

Monitoring



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## Summary Question – True or False

Internal controls that are well-documented and firmly implemented will always run effectively and efficiently.

True or False



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## Best Practices

Consistency  
and  
Effectiveness

Safeguarding  
Assets

Segregation of  
Duties

Review and  
Approval

Authorizing  
and Training



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## Consistency and *Effectiveness*

- Documenting policies and procedures in place
- Uniform training to ensure procedures performed are consistent

Having consistent and effective procedures helps to reduce errors and eliminate duplicate efforts.



Best Practices



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## Safeguarding Assets

- Safes and locked cash drawers should be used
- Tracking equipment held to reduce the risk of assets being misplaced
- Limiting access to authorized individuals



Best Practices



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## Segregation of *Duties*

- Segregating duties so one individual does not authorize, execute, and record a transaction
- Performing reconciliations of accounts

Helps to reduce the risk of inaccurate financial reporting and improper use of funds.



Best Practices



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## Review and *Approval*

- Adding a level of review and approval performed by a knowledgeable individual independent of the process
- Documenting approval
- Timely review

Helps to reduce errors and to detect irregularities and incomplete information.



Best Practices



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## Authorizing and *Training*

- Consistent training
- Limiting access to authorized personnel
- Documenting what employees can initiate purchases, approve purchases, and sign checks.



Best Practices



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## Summary Question – True or False

An appropriate way for ABC Company to limit inefficiencies within their information system is to give all employees administrative rights.

True or False



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# Specific Controls



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## Specific Controls

### Bank Accounts

- Limited number of accounts
- Use of an entity name, not an individual
- Limited number of check signers
- Monthly reconciliations
  - Timely review of reconciliation by an independent party
- Regular review of cancelled checks and statements



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# Specific Controls

## Cash Receipts

- Immediate endorsement of all receipts
- Cash on hand is held in a secure location
- Cash is deposited in a bank account on a timely basis
- Deposit detail is retained (deposit slips from bank or listing prepared internally)

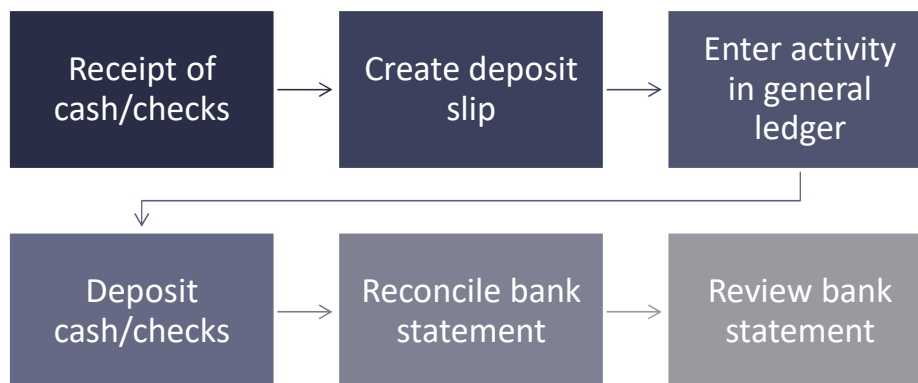


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## Cash Receipts

Cash receiving, processing, and recording functions are segregated between individuals



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# Specific Controls

## Disbursements

- Using pre-numbered checks
- No pre-signed checks
- Blank checks are securely stored
- Two signatures required on each check
- Alteration and retaining of voided checks
- Require adequate support (original invoices with proper authorization) before writing checks
- Capitalization Policy

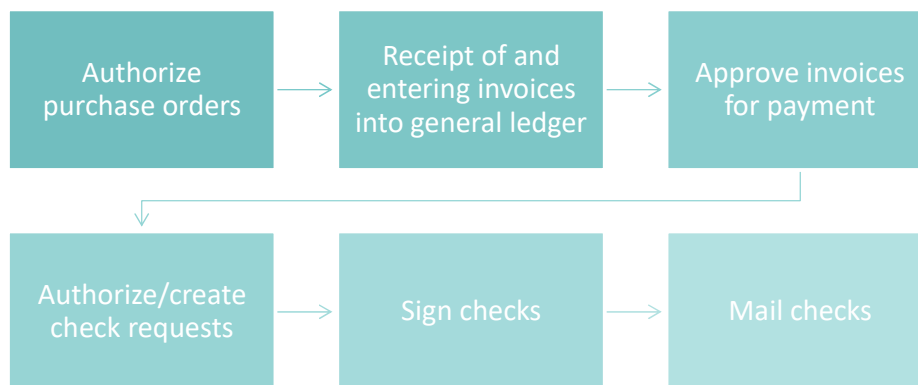


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## Cash Disbursements

Authorizing, processing, check signing, and recording functions are segregated between individuals



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## Summary Question – True or False

Segregating duties will make an organization more efficient.

True or False



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## Specific Controls

### Investments

- Custody of investments should be segregated from accounting personnel
- Use of independent custodians and investment managers
- Reconciliation of activity using investment statements
  - Timely review of reconciliation by an independent party
- Board approved Investment Policy



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# Specific Controls

## Receivables

- Specific approval required for all write-offs
- Allowance for doubtful accounts has special approval
- Regular review of delinquent accounts
- Reconciling accounts receivable aging to trial balance account(s)
  - Timely review of reconciliation by an independent party



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# Specific Controls

## Payroll

- Timesheets are maintained and approved by managers/supervisors
- New hires, terminations, wage changes, and payroll deductions are authorized
- Timely recording of payroll transactions

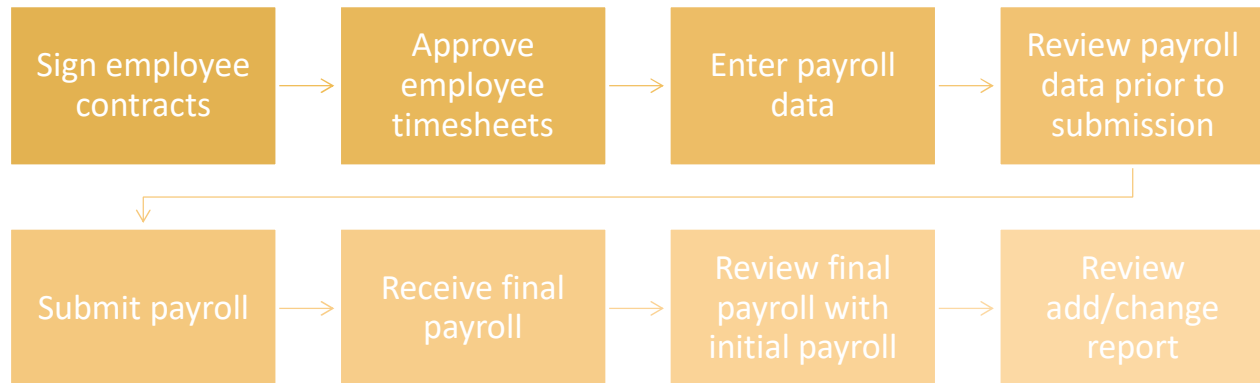


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# Payroll

Authorizing new employees, payroll approval, and recording functions are segregated between individuals



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## Specific Controls

### Payables

- All approved invoices and payments are promptly recorded in accounts payable register
- Unpaid invoices are tracked
- Invoices from unfamiliar or unusual vendors are reviewed and approved for payment
- Reconciling accounts payable aging to trial balance account(s)
  - Timely review of reconciliation by an independent party



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# Specific Controls

## Fundraising

- Thank-you letters to donors
- Internal tracking of donor restrictions
- Control access to safe
- Cash on hand is held in a secure location
- Regular reconciliation of donor databases to trial balance account(s)
  - Timely review of reconciliation by an independent party



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# Specific Controls

## Financial Reporting

- Budgets are prepared
- Financial statements are prepared on a timely, regular basis and presented to board members or management for review and discussion
- Data-retention policy
- Policy and procedures manuals



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## 2 Person Office

### Bookkeeper

Record all general ledger activity

Reconcile bank statements

Receive cash

Authorize invoices

Write & mail checks

Approve payroll

### President / Treasurer

Read only general ledger access

Review bank reconciliations

Complete deposit slips

Sign checks

Perform bank transfers

Approve timesheets

Distribute payroll

Sign employee contracts



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## 3 Person Office

### Bookkeeper

Record general ledger activity

Write checks

Reconcile bank statements

### Office Manager

Process and approve invoices

Mailing checks

Receive cash

Approve & distribute payroll

Authorize timesheets

### President / Treasurer

Completes deposit slips

Signs checks and performs bank transfers

Review bank reconciliations

Sign employee contracts



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## 4 Person Office



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## Summary Question – True or False

Timely reconciliations and financial statements review are key parts of a strong internal control system.

True or False



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# High Risks Areas for Fraud or Error

## Unsupported Journal Entries

*Recommended Control: Review of entry and supporting documentation by independent individual*

## Revenue

*Recommended Control: Reconciling fundraising software to trial balance account(s)*

## Cash

*Recommended Control: Timely bank reconciliations and safeguards for physical cash*

## Payroll

*Recommended Control: Reviewing payroll registers for fictitious employees and having supervisors approve timecards*



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# How to Segregate Duties With Limited Staff

## Board of Directors Involvement

- Sending Board of Directors monthly financial packets for review
  - Bank and investment account reconciliations
  - Manual journal entry reports
  - Payroll registers
  - Accounts payable and accounts receivable aging
- Member of the Board of Directors signs checks



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## Information Technology - Controls

- Unique logins and passwords
- Required vacation time
- Ensuring audit trail is capturing system activity
- External threats
- Banking controls (positive pay, FOB passwords, maximum thresholds for activities, etc.)
- Data recovery and back-ups of system activity



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## Remote Work Environment - Controls

- Re-evaluate and update policies and procedures documentation to account for virtual work environment
- Document approvals in electronic form
  - Invoice approval in PDF (DocuSign or Adobe functions)
  - Email approval
- Maintaining timely reconciliations
- Electronic receipt of invoices when available
- Ensure accounting system has appropriate (limited) user access
  - Limited administrative access



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## Remote Work Environment - Controls

- Review of user access listings to all systems
  - Removing terminated employees
- Use of Electronic Payments
  - ACHs and Wire Transfer
- Lockbox
  - Payments sent directly to a predetermined financial institution. Checks are posted based on reports received from bank.



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## Summary Question – True or False

Board of Directors should always take a hands-off approach to the internal control systems of their organization.

True or False



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## Key Takeaways



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## Questions?



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3:35 – 4:35 p.m.

# Hot Tax Practice, Procedure & Ethics Issues Faced by Not-for-Profits

**Michael Goller, J.D.**, *Shareholder & Tax Department Chair,*  
*Reinhart Boerner Van Deuren s.c.*

# HOT TAX AND IRS PRACTICE AND PROCEDURE ISSUES THAT IMPACT THE NOT-FOR-PROFIT

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**Michael G. Goller** is a shareholder in Reinhart's Tax, Litigation and Business practices. He focuses on tax controversy and tax litigation, as well as tax and estate planning. His clients range from large public corporations to midsized, privately held businesses and their owners. Michael works on behalf of his clients in disputes with the IRS, the Department of Justice and various other taxing authorities.



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- Part II - **Hot** Ethics Issues
- Part III - **Hot** Employment Tax Issues

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## PART I Hot Practice and Procedure Issues

- The IRS is going to receive a lot of money. How will it be spent?
- What are the hot audit issues?

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# Hot Issues - Which Will Get Hotter

- Partnership Audits
- High Net Worth Audits
- Estate and Gift - Valuation Issues
- Net Operating Loss and Basis Issues
- Passive Losses and the Real Estate Professional
- Section 183 - “Hobby” Loss Cases
- Refund Claim Traps
- Employment Tax Audits
- Penalty Issues

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## PARTNERSHIP AUDITS

New Partnership Audit Program and related high net worth audit program are **HOT** in FY 2022, and beyond.

Source: Tax Notes (9/20/21)

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## Overview

The BBA, among other things, eliminates the so-called TEFRA Unified Partnership Audit Procedures<sup>1</sup> and the Audit Procedures for Electing Large Partnerships.<sup>2</sup> It also creates a more streamlined partnership audit approach, thus making it easier for the IRS to audit a partnership.

1 These were first created in the Tax Equity and Responsibility Act of 1982.

2 Created as part of the Taxpayer Relief Act of 1997.

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## Neutral Revenue Raiser

- The BBA was promoted as a “neutral” revenue raiser (*i.e.*, a revenue raiser in disguise); in that an increase in partnership audits will raise revenue without increasing taxes.
- It is expected that the new audit procedures and increased audits will yield \$9.3 billion of additional revenue over ten years. As such, the law gained quick approval in Congress.

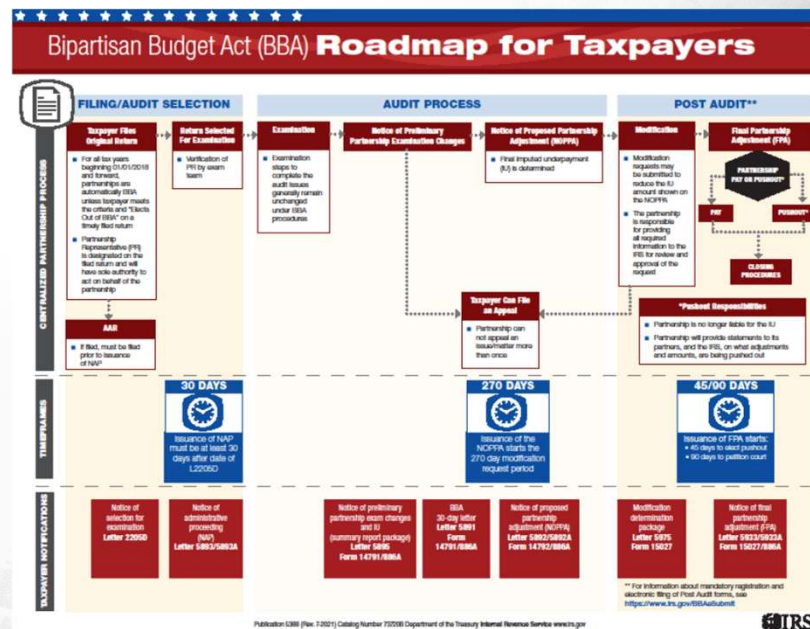
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# Partnership Audit Road Map





## Current Status

- These audits seem to be off to a slow start
- IRS is asking for lengthy statute extensions

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## IRS Acknowledgement IDR-- Happens at the end of the audit

- IRS issues to most larger taxpayers an IDR that attempts to box the taxpayer into certain facts
- How to respond to the IDR?
- Why noncompliance is not an option:
  - Burden of proof issues
  - Rule of evidence issues (must make info available to opponent)
  - Penalty issues--arguing reasonable cause
  - IRS appeals uses a nonresponse as a basis for not appealing
  - Qualified Offer issues

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## Cooperation Issues

- Consider if you are eligible to switch the burden of proof to the IRS
  - Cooperation is important
  - Adequate records are important
- Noncooperation leads to admissions (e.g., statements or inferences that are later used against you)

## Acknowledgement IDR

- Use the acknowledgement IDR to support your case

## Getting to Appeals

- 30 day letter
- Protest - Skinny or fat - pros and cons
- Do an FOIA request
- Exam's "T-letter"

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## Settling the Case at Appeals

- Hazards of litigation
- Does the IRS have uniform settlement guidelines?
- What to do if you hit a "brick wall"?

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## Which Court to go to

- U.S. Tax Court
- Federal District Court (refund)
- U.S. Court of Federal Claims (refund)
- Issues to consider
  - Precedent
  - Discovery issues and cost
- IRS v. DOJ

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## IRS Attorneys Requests for Information

- IRS attorneys have a set of standard questions
- Need to be able to address these questions in a cost-effective manner
- Trap - the failure to respond can lead to formal discovery or deemed admissions

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# Penalty Avoidance Matrix

	Reasonable Basis §1.6662-3(b)(3)	Reasonable Cause §6664 §1.6664-4(b)	Disclosure §6662(d)(2)(B) §1.6662-3(a)	Substantial Authority §1.6662-4(d)
Negligence	Yes	Yes	No <sup>1</sup>	Yes <sup>2</sup>
Disregard of the Rules or Regulations	Yes <sup>4</sup>	Yes	Yes <sup>3</sup>	Yes <sup>5</sup>
Substantial Understatement of Income Tax	No	Yes	Yes <sup>6</sup>	Yes
Substantial Valuation Misstatement (Income)	No	Yes <sup>7</sup>	No	No
Substantial Valuation Misstatement (E&G)	No	Yes	No	No
Gross Valuation Misstatement (Income)	No	No <sup>7</sup>	No	No
Gross Valuation Misstatement (E&G)	No	Yes	No	No

1. § 1.6662-7(b).  
2. There must also be a reasonable basis for the position, adequate records must be kept and the position must be properly substantiated. § 1.6662-3(c). In a case where there is substantial authority for a position, since this standard is higher than the reasonable basis standard (which negates negligence), there is no negligence. § 1.6662-3(b)(3).  
3. There must be reasonable basis and the taxpayer must keep adequate books, records and substantiation. § 1.6662-3(c)(1).  
4. The disregard can be careless, reckless or intentional. § 1.6662-3(b)(2). The first two (careless and reckless) are for all practical purposes, the same as negligence, meaning reasonable basis would negate these two triggers. Further, however, if a position is intentionally contrary to a rule or regulation, reasonable basis would not be enough. However, see the disclosure election.  
5. A position that is contrary to a Revenue Ruling or Notice is not treated as disregarding the ruling or notice if the contrary position has a realistic possibility of being sustained (a standard that is lower than substantial authority § 1.6662-3(b)(2)). It is technically possible to have substantial authority that is contrary to a Treasury Regulation, which means the penalty could apply. In this case the taxpayer should be sure to make a disclosure.  
6. There must also be a reasonable basis for the tax treatment of the disclosed item. § 6662(d)(2)(B)(i).  
7. There is no reasonable cause exception for a gross valuation misstatement with respect to charitable deduction property and the exception only applies to a substantial valuation statement when there is a qualified appraisal and the taxpayer made a good faith investigation of the value of the property. § 6664(c)(3).

# Income Tax Overstatement of Value e.g., a Charitable Contribution

- Substantial Valuation Misstatement
  - There is a 20% penalty applicable to any underpayment attributable to a Substantial Valuation Misstatement
    - Section 6662(b)(3)
  - A substantial valuation misstatement occurs if the value (or adjusted basis) of any property claimed on a return claimed income is 150% or more of the correct amount
    - Section 6662(e)
  - The penalty is not imposed unless the misstatement results in an underpayment of greater than \$5,000 (\$10,000 for a C-corporation)
    - Section 6662(b)(2)



## Gross Valuation Misstatement

- There is a 40% penalty in the case of a Gross Valuation Misstatement.
- A Gross Valuation Misstatement occurs if the value of the property is 200% or more of the correct value section.
- The standard is automatically met if the correct value is zero.
  - Treas. Reg. Section 1.6662-5(g).
- Example
  - Donor claims a deduction under Section 170 for the donation of property to a qualified charity

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## Reasonable Cause and the Income Tax Valuation Penalties

- A reasonable cause exception under Section 6664 can apply when the underpayment is attributable to a substantial (but not a Gross) understatement with regard to a charitable contribution if the following occurs:
  - The claimed value of the property is based upon a qualified appraisal by a qualified appraiser;
  - The taxpayer also made a good faith investigation of the value of the contributed property; and
  - The taxpayer acted with reasonable cause and in good faith
    - Section 6664(c)(3)

Comment: Review the definitions of a qualified appraiser and appraisal in Treas. Reg. Section 1.170A-13(c)(3) and (5)

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# Penalty for Erroneous Refund Claims – Section 6676

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## Penalty for Erroneous Refund Claims (Section 6676)

- Penalty equal to 20% of the excessive amount claimed unless:
  - It is shown that there is reasonable cause for the claim for the excessive amount.
  - Assume reasonable cause is the same as under Section 6664.

Comment: Reasonable cause is a defense.

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## PART II

### Ethics

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## Ethical Obligation to Talk About Penalty Avoidance

- Under IRS Circular 230, practitioners must advise the client of any penalties that are reasonably likely to apply and the practitioner must discuss the possibility of penalty avoidance via disclosure.  
§10.34(c)

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## The Office of Professional Responsibility

- There is often a tendency to assume that the Department of the Treasury's Circular No. 230 (Circular 230) pertains solely to preparing tax returns, tax opinions or dealings with the IRS
- The conventional wisdom is that a violation Of Circular 230 must mean a practitioner has engaged in some sort of outrageous behavior
- The reach of this ethical code is far greater than one might think
- A violation can (and does) occur in many more situations than practitioners might otherwise expect

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## A Violation of Circular 230 Is a Serious Matter

- Public discipline for violating Circular 230 usually involves obvious misconduct such as one's own failure to file or pay tax, or the conviction of a criminal offense
- We have been seeing more cases that pertain to alleged "bad tax practice," such as a lack of due diligence, failure to give sound tax advice, conflicts of interest or other issues that indicate a tax practitioner's lack of fitness to practice before the IRS

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## Who Is Subject to Circular 230?

### Section 10.3 (Revised June 9, 2014)

- Circular 230 applies to those who “practice before the IRS”
- “Practice before the IRS” comprehends all matters connected with a practitioner’s presentation to the IRS with respect to a taxpayer’s rights, privileges or liabilities under the tax law, including
  - Preparing or filing documents, correspondence and communicating with the IRS
  - Rendering written advice with respect to an entity plan or arrangement that has a potential for tax avoidance or evasion
  - Representing a client at IRS conferences and hearings

## Who Is Subject to Circular 230?

### Section 10.3 (Revised June 9, 2014)

- Attorneys and CPAs (including in-house practitioners) who are not under suspension or disbarment from practice before the IRS may file a Power of Attorney (POA) (Form 2848)
  - This permits them to and practice before the IRS and makes them subject to Circular 230
- One need not file a POA to provide written tax advice, however, providing written tax advice constitutes practice before the IRS
  - *i.e.*, makes the individual subject to Circular 230

## When Is Conduct Sanctionable?

- Generally, a practitioner may be sanctioned if the practitioner:
  - Is incompetent or disreputable;
  - Intentionally misleads a client so as to defraud that client; or
  - Is acting with a specific mental state or competency standard (*i.e.*, willful, reckless or gross incompetence), fails to comply with key provisions of Circular 230

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## AICPA Rules

- Statements on Standards for Tax Services

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

- Interpretation No. 1-1, Reporting and Disclosures
- Interpretation No. 1-2, Tax Planning

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

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## AICPA Rules

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

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

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

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## AICPA Rules

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

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

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## ABA Model Rules of Professional Conduct

- Some Version of the MRPC has been adopted in almost all states.
- Rules are mandatory.
- Comments to the rules are aspirational (not mandatory).

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## Circular 230 Conflicts of Interest Section 10.29

- A major cause of malpractice claims, especially for Estate Planners



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## A Conflict of Interest Exists If

- The representation of one client will be directly adverse to another client; or,
- There is a significant risk that the representation of one or more clients will be materially limited by the practitioner's responsibilities to another client, a former client or third person, or by the personal interest of the practitioner.

Comment: Rule is very similar to Model Rule 1.7

## Other Authority

- ACTEC Commentary to Model Rule 1.7

## Conflict Waivers - Circular 230 10.29



- The client must provide a written consent waiving the conflict within 30 days of giving verbal consent.
- The written waiver must be retained for at least three years after the conclusion of the representation of any affected client.

## Obtain a Waiver

- Where a conflict exists, a practitioner may still handle the matter if the practitioner reasonably believes that he/she will be able to provide competent and diligent representation to each affected client, the representation will not otherwise violate the law and each affected client waives the conflict in an informed consent at the time the conflict is discovered by the practitioner.

## Traps for the Unwary

- Representing spouses
- Personal interest of the lawyers
  - penalty issues
  - lawyer as a fiduciary
- Lawyer paid by a third party
- Innocent spouse relief issues

## Tax Court Rule 24(g)

- The Rule goes beyond the normal conflict definition and states that if Counsel of Record was involved in planning or promoting a transaction at issue before the Court, that attorney must either obtain a consent or withdraw from the case.
  - This is a trap for the unwary.

Comment: More cases are becoming docketed in Tax Court due to the IRS insistence that a year or more remain on the assessment statute. The estate tax statute on assessment cannot be extended. Thus, the application of Rule 24(g) will come up more often in estate tax cases.



## Why are more and more estate planners finding it necessary to docket a case in Tax Court?

- Two reasons
  - IRS budget cuts
  - Section 6501(c)(4)(A) provides that the statute of limitations on assessment can be extended with regard to "any tax imposed by this title, except *the estate tax . . .*" (emphasis added)
  - Practical Comments

## Additional Trap for the Unwary

- Tax Court Petition is due before an executor is appointed (presumably an income tax issue that pertains to a pre-death year).
- Petition is filed in the name of Joe Smith, Deceased.
- Under Rule 60, must ratify Petition or the case may be dismissed.
- Dismissal of your Tax Court Petition means the IRS assessment stands.

Comment: If the estate has multiple beneficiaries, does the estate and a surviving spouse have a conflict?

# More Conflict Traps for the Unwary

## The Practitioner's Own Interest

- A common conflict, which is often overlooked, is the situation where a practitioner prepares a tax return, either as a signing or nonsigning preparer, and then handles the subsequent tax audit or appeal.
- In this situation, there may be a conflict if the practitioner has a personal interest that conflicts with the client's interest.
- For example, if the IRS asserts an accuracy-related penalty, will the practitioner be hesitant to argue that the penalty should not apply because of the taxpayer's good-faith reliance on the practitioner's tax advice?
- What if the practitioner has a conflict because of an unreasonable fee?

Comment: The estate and gift tax valuation penalties are mathematical triggers. Thus, if value is too low the trigger (and thus a possible conflict) could arise without much warning.

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# More Conflict Traps for the Unwary (cont.)

## Representing Both Spouses

- Another common conflict exists when the practitioner represents both a husband and wife, and the two spouses' interests become adverse.
- In such a situation, the practitioner may be unable to represent either spouse.
- Example — clients divorce and there is a pending Tax Court case. Does one spouse have a claim for relief under Section 6015 (i.e., innocent spouse and similar relief)?

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# Need both a PTIN and a Data Security Plan



**IRS**

Return Preparer Office September 24, 2019

**Resources:**

- [IRS.gov](#)
- [Frequently Asked Questions](#)
- [Annual Filing Season Program](#)
- [Enrolled Agent Information](#)
- [Pay.gov System](#)
- [Online PTIN System](#)
- [Back to top](#)

Dear Tax Professional,

Summer is over, and it won't be long until you're sitting down at your computer to renew your preparer tax identification number (PTIN) for 2020. In mid-October when renewal season begins, you will notice a data security responsibilities statement has been added to the PTIN renewal process. It serves as a reminder of your legal responsibility to have a data security plan and to provide data and system security protections for all taxpayer information. When completing your PTIN renewal, a checkbox will be available to confirm your awareness of these data security responsibilities.

Data security continues to be a hot topic. That's because tax professionals remain a top target of identity thieves and data breaches continue to affect tax professionals at an alarming rate. Cybercriminals use sophisticated and ever evolving techniques to gain access to your systems. These criminals steal sensitive taxpayer data to file fraudulent tax returns and create financial havoc for your clients. There are simple steps you can incorporate in your daily operations to minimize your vulnerability and protect client data, including:

- Protect email accounts with strong passwords and two-factor authentication if available.
- Install an anti-phishing tool bar to help identify known phishing sites.
- Use anti-phishing tools that are included in security software products.
- Use security software to help protect systems from malware and scan emails for viruses.
- Never open or download attachments from unknown senders, including potential clients. They should instead make contact first by phone.
- Send only password-protected and encrypted documents when files must be shared with clients over email.
- Never respond to suspicious or unknown emails.
- Back up sensitive data to a safe and secure external source.
- Properly dispose of old computer hard drives that contain sensitive data.

You should also make sure to have a written data security plan in accordance with the Federal Trade Commission's [Safeguard Rule](#). Remember, protecting your clients is not only good for business, it's also the law. While the hope is that you're never the victim of a data breach, preparation and education will go a long way in helping to protect your clients and yourself.

More information:  
[Publication 4557, Safeguarding Taxpayer Data](#)



**Publication 5293, Data Security Resource Guide for Tax Professionals**  
**Identity Theft Information for Tax Professionals**

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## Firm Management Procedures to Ensure Circular 230 Compliance Section 10.36 (Revised June 10, 2014)

- The IRS appears to be attempting to create a “culture of compliance”
- Practitioners in a position of authority must do more than ensure their own compliance with Circular 230
- Supervising practitioners must ensure that all individuals they supervise comply with Circular 230 as it pertains to the preparation of returns, claims for refund or other documents submitted to the IRS

## Section 10.36

- A practitioner responsible for implementation of Circular 230 compliance procedures will be subject to disciplinary action if:
  - 1(a) The responsible practitioner, through willfulness, recklessness or gross incompetence, does not take reasonable steps to ensure that the firm has adequate procedures to comply with Circular 230; and
  - 1(b) One or more individuals who are members of, associated with, or employed by the firm are, or have engaged in a practice in connection with their practice with the firm of failing to comply with Circular 230;

## Section 10.36

- 2(a) The responsible practitioner, through willfulness, recklessness or gross incompetence, does not take reasonable steps to ensure that firm procedures in effect are properly followed; and
- 2(b) One or more individuals who are members of, associate with, or are employed by the firm or have engaged in a pattern or practice, in connection with their practice with the firm of failing to comply with Circular 230; or

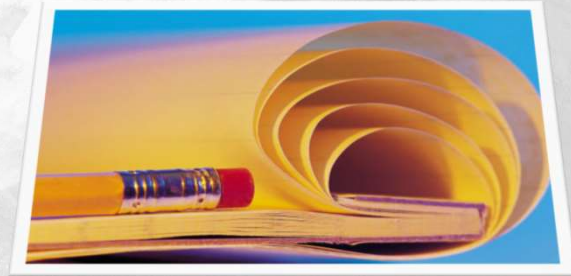
## Section 10.36

- 3(a) The responsible practitioner knows or should know that one or more individuals who are a member of, associated with, or employed by the firm are, or have engaged in a pattern or practice in connection with their practice with the firm that does not comply with Circular 230, as applicable; and
- 3(b) The responsible practitioner, through willfulness, recklessness or gross incompetence, fails to take prompt action to correct the noncompliance.



# Written Tax Advice Form Section 10.35 and Section 10.37(a) Revised June 9, 2012

- The Covered Opinion Rules (Former §10.35)
  - These have gone away — Proposed regulations were issued on September 14, 2012
  - Final regulations were issued June 9, 2014 and became effective on June 12, 2014



## Old Rules

- Certain burdensome requirements existed if one issued one of the following:
  - A listed transaction opinion;
  - Principal purpose opinion is tax avoidance; or
  - Significant purpose to avoid tax opinion PLUS the opinion is one of the following opinions
    - Reliance Opinion
    - Marketed Opinion
    - Opinion subject to conditions of confidentiality
    - Opinion subject to contractual protection

## Ramifications of the Withdrawal of the Covered Opinion Rules

- No more legends on our e-mails
- Issuing a tax opinion may be more complex than before
- It is clear under the new rules that government submissions on matters of general policy and continuing education presentations are not considered written tax advice

## Requirements for Written Tax Advice Section 10.37(a) (Revised June 9, 2014)

- The Practitioner must
  - Base written advice on reasonable factual and legal assumption
    - Including assumptions as to future events
  - Reasonably consider all relevant facts and circumstances the practitioner knows or reasonably should know
  - Use reasonable efforts to identify and ascertain the facts relevant to written advice on each federal tax matter

## Requirements for Written Tax Advice Section 10.37(a) (Revised June 9, 2014)

- Not rely upon representations, statements, findings or agreements (including projections, financial forecasts, or appraisals) of the taxpayer or any other person if reliance upon them would be unreasonable
- Relate applicable law and authorities to the facts; and not, in evaluating a federal tax matter, take into account the possibility that a tax return will not be audited or that a matter will not be raised on audit

Further, reliance upon a representation, statement, finding or agreement is specifically unreasonable if the practitioner knows or reasonably should know that one or more representations or assumptions on which any representation is based is incorrect, incomplete or inconsistent

## Reliance on Others Section 10.37(b) Revised June 9, 2014

- The practitioner may only rely on the advice of another person if the advice was reasonable and the reliance is in good faith considering all the facts and circumstances
- Reliance is specifically not reasonable when
  - The practitioner knows or reasonably should know that the opinion of the other person should not be relied upon;
  - The practitioner knows or reasonably should know that the other person is not competent or lacks the necessary qualifications to provide the advice; or
  - The practitioner knows or reasonably should know that the other person has a conflict of interest in violation with Circular 230
    - e.g., the conflict has not been properly waived



## Standard of Review

### Have I Complied with the Rule?

- In evaluating whether a practitioner's written tax advice complies with Section 10.37, the IRS will apply a "reasonable practitioner" standard, considering all facts and circumstances, including, but not limited to the scope of the engagement and the type and specificity of the advice sought by the client

## Standard of Review

### Have I Complied with the Rule?

- In the case of an opinion the practitioner knows or has reason to know will be used or referred to by a person other than the practitioner in promoting, marketing or recommending a transaction, a significant purpose of which is the avoidance or evasion of tax, the IRS will apply an elevated "reasonable practitioner" standard. Emphasis will be given to the additional risk, caused by the practitioner's lack of knowledge of the specific taxpayer's particular circumstances (*i.e.*, when tax advice is going to be used to promote a transaction to a third party, the IRS will apply an elevated standard of care).

## Due Diligence

### Section 10.22 (Revised June 9, 2014)

- Practitioner Must Exercise Due Diligence
  - Every practitioner must exercise due diligence when practicing before the IRS
    - This includes exercising diligence in preparing documents relating to IRS matters and verifying the correctness of oral and written presentations made to both the IRS and one's client with regard to any matter administered by the IRS
    - A practitioner's duty to be diligent is a very broad concept
    - A lack of diligence would seem to exist in most instances of deficient practice-related conduct

## Due Diligence

### Section 10.22 (Revised June 9, 2014)

- The concept of diligence seems to require more than the mere belief that a presentation is correct the moment it is submitted to the IRS or a client
  - The implied approval of past incorrect statements would seem to be a violation of Section 10.22
  - If a practitioner fails to correct an incorrect statement made to the IRS or a client, knowing full well that the recipient continues to rely on that statement
  - A failure to correct the error is inconsistent with the practitioner's obligation to be diligent

## Reliance on Others



A practitioner will be presumed to have exercised due care if the practitioner relies on the work product of another person so long as the practitioner used reasonable care in engaging, supervising, training, and evaluating the person, **taking into account the nature of the relationship between the practitioner and the other person**

## Diligence as to Accuracy §10.22

- Trap for the unwary – FBAR (FinCin 114) and foreign bank accounts





## IRS Circular 230 Issues

### Purpose and Operation of the ERC

The ERC is a refundable tax credit. The ERC was enacted for employers who continued paying employees during a shutdown due to the COVID-19 pandemic or who experienced significant declines in gross receipts, from March 13, 2020, to December 31, 2021.

Eligible employers may claim the ERC on an original or amended Form 941.

## IRS Circular 230 Issues (cont.)

To claim the ERC, employers must have:

- Sustained a full or partial suspension of their business operations due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings due to COVID-19 during 2020 or the first three quarters of 2021,
- Experienced a significant decline in gross receipts during 2020 or the first three quarters of 2021 because of COVID-19, or
- Qualified as a recovery startup business for the third or fourth quarters of 2021. (Only recovery startup businesses are eligible for the ERC in the fourth quarter of 2021.)

## IRS Circular 230 Issues (cont.)

The amount of the ERC depends on various factors, including:

- the number of employees
- the amount of the employer's payroll and gross receipts
- and whether the employer paid any sick or family leave wages.

The amount of the ERC reduces the employer's allowable wage deduction on its income tax return. **Employers cannot claim the ERC for any quarter for which wages were reported as payroll costs in obtaining Payroll Protection Plan (PPP) loan forgiveness or were used to claim certain other tax credits.**

## IRS Circular 230 Issues (cont.)

In its news releases, the IRS has noted that some advisers were urging employers to claim the ERC without appropriately informing them of the limitations on eligibility and the correct computation of the credit.



## IRS Circular 230 Issues (cont.)

### Tax Professionals' Role in ERC Compliance

The IRS's outreach efforts to employers about possible excessive ERC claims have prompted requests from tax practitioners for the IRS—and, in particular, the Office of Professional Responsibility (OPR)—to provide guidance on their obligations in connection with clients' ERC claims.

## IRS Circular 230 Issues (cont.)

### Diligence as to Accuracy - Section 10.22(a)

Practitioners who prepare income, employment, and other tax returns for clients have a duty of due diligence to inquire of their clients with sufficient detail to ascertain the information necessary to determine clients' eligibility for the ERC and to claim the proper amount of the ERC on the clients' returns.

## IRS Circular 230 Issues (cont.)

### Reliance - Section 10.34(d)

- Must be good faith

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## IRS Circular 230 Issues (cont.)

### Duty to Inform Client of a Prior Mistake - Section 10.21

- Promptly inform the client of the mistake and consequences of the mistake.

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## IRS Circular 230 Issues (cont.)

### Standards with Respect to Tax Returns - Section 10.34(b)

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## IRS Circular 230 Issues (cont.)

### Written Advice and a Conflict of Interest

A prior adviser, who may have advised the client to claim the ERC, has a conflict because of the amount of the fee the adviser charged for the advice, then the practitioner's reliance on that advice may not be reasonable?

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## Use of Estimates

- AICPA Statement on Standards for Tax Services No. 4, Use of Estimates
  - Unless prohibited by statute or by some other rule, a CPA 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 CPA determines that the estimates are reasonable based on the facts and circumstances known to the CPA
    - The taxpayer's estimate should be presented in a manner that does not imply greater accuracy than exists

## Preparer Penalty Standards Under I.R.C. Section 6694(a) and Circular 230 Section 10.34

Standard	Preparer Duty
Frivolous <sup>1</sup>	Cannot prepare tax return
Reasonable basis <sup>2</sup>	Can prepare tax return with disclosure <sup>3</sup>
Substantial authority <sup>4</sup>	Need not disclose unless a tax shelter or a Section 6662A Reportable Transaction <sup>5</sup>
Reasonably believe more likely than not ( <u>i.e.</u> , more than 50%)	Need not disclose

<sup>1</sup> The percentage of comfort is perhaps 5% or less

<sup>2</sup> Reasonable basis is defined in Section 1.6662-3(b)(3); the percentage of comfort is perhaps 20%

<sup>3</sup> Use Form 8275 or 8275R, or disclose pursuant to annual revenue procedure (e.g., Rev. Proc. 2015-16)

<sup>4</sup> "Substantial authority" is defined in Section 1.6662-4(d). It is a comfort level of perhaps 40% or more

<sup>5</sup> A tax shelter is an arrangement that has a significant purpose of avoidance or evasion of income tax. Section 6662(d)(2)(C)(iii). See Notice 2009-5 for how, in limited situations, to lower the standard to substantial authority for a tax shelter (basically educate the taxpayer about penalty exposure and document this fact)

## Competence – Section 10.35 (Revised June 9, 2014)

- A practitioner must possess the necessary competence to engage in practice before the IRS
- Competent practice requires knowledge, skill, thoroughness and the preparation necessary for the matter at issue
- A practitioner may become competent through various methods such as consulting with experts or studying the relevant law

Comment: Sections 10.35 and 10.36 together mean that managers have a duty to ensure that their subordinates have the requisite knowledge and skill and that they appropriately use that knowledge and skill

## AICPA Rules

- AICPA Code of Professional Conduct, Section 50, Article V, Due Care
- “... Members should be diligent in discharging responsibilities to clients, employers and the public. Diligence imposes the responsibility to render services promptly and carefully, to be thorough, and to observe applicable technical and ethical standards ...”

## MRPC -1.3

- A lawyer shall act with reasonable diligence and promptness in representing a client

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## Prompt Disposition of Matters and Responses to Requests for Information §10.20 and §10.23

- If the IRS makes a proper request for records or information, a practitioner must promptly respond to the request unless the practitioner reasonably has the good-faith belief that the information is privileged
- A practitioner may not unreasonably delay the prompt disposition of any matter before the IRS



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## Prompt Disposition of Matters and Responses to Requests for Information §10.20 and §10.23

- The practitioner must make a reasonable inquiry of the practitioner's client as to who has possession or control of the requested information
  - However, a practitioner need not make inquiry of any other persons or verify information provided by the client

Comment: Consider these rules when responding to a "wealth squad" IDR, a detailed LB&I IDR or a very broad discovery request.

## Prompt Disposition of Matters and Responses to Requests for Information §§10.20 and 10.23

- Where the documents or information requested by the IRS are not in the possession of the practitioner or client, the practitioner must promptly provide the IRS employee seeking the information with any information the practitioner has about who has possession or control of the requested information

Comment: This rule certainly seems to raise Section 7525 and attorney-client concerns

# Professional Responsibility and the Employee Retention Credit

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## Professional Responsibility and the Employee Retention Credit

Internal Revenue Service (IRS) sent this bulletin at 03/07/2023 04:16 PM EST



Alerts from Office of Professional Responsibility (OPR)

03/07/2023

### OPR Resources

[Circular 230 Tax Professionals](#)

[Circular No. 230 \(Rev. 6-2014\)](#)

[Frequently Asked Questions](#)

[Latest News and Guidance from OPR](#)

[Disciplinary Sanctions - IRB](#)

[OPR Webinars](#)

Issue Number: 2023-02

### Inside This Issue

#### Professional Responsibility and the Employee Retention Credit

Since the Fall of 2022, the IRS has issued several warnings to employers to beware of third parties promoting improper Employee Retention Credit (ERC) claims. See IRS IR-2023-40 (Mar. 7, 2023); IRS IR-2022-183 (Oct. 19, 2022); COVID Tax Tip 2022-170 (Nov. 7, 2022). With tax filing season in full swing, tax professionals are requesting guidance to ensure they are meeting their Circular 230 professional responsibilities and the standards required to prepare and sign original tax returns, amended returns, or claims for refund relating to these credits.

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# Privileges In a Tax Setting

- Federal Rules of Evidence - Rule 501- Privileges in General
  - Rule 501 provides that common law governs a claim of privilege unless provided otherwise by the Constitution, a federal statute, or rules prescribed by the Supreme Court. In a civil case, state law governs.
- There are a Number of Relevant Privileges
  - Attorney-Client
  - Accountant-client or practitioner privilege
  - Work Product Doctrine
    - Each can be waived
    - There are exceptions to each Recent case law
  - Spousal Privilege

## Attorney-Client Privilege (cont.)

### The Kovel Letter

- The Privilege Can Extend Communications with the Attorney's Agents
- So long as a client's communication is made to an agent of an attorney (*i.e.*, a CPA that has been retained by the attorney) in confidence, for the purpose of obtaining Legal Advice from the lawyer, it is privileged. *United States v. Schwimmer*, 892 F.2d 237, 243 (2d Cir. 1989).
- What is a *Kovel* Letter?
- This rule, generally known as the *Kovel* rule. The application of the *Kovel* rule can be difficult in situations where non-legal services, such as preparing a tax return, are provided with legal services because it is difficult to distinguish between communications made for the preparation of a tax return and those made for the provision of legal services. Because the *Kovel* rule rests on the attorney-client privilege, the protection of the *Kovel* rule is lost anytime the attorney-client privilege is lost.
- When to use a *Kovel* Letter.

Comment: The key is the facilitation of communication between the lawyer and client

# OBTAINING A "GOOD" VALUATION REPORT - The Do's and Don'ts Obtaining a "Good" Report

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- How to retain an expert
  - Kovel letter
- Does my expert understand the tax law?
  - Section 2703
  - Tax affecting earnings
  - Use of a weighted average when there are multiple valuation methods
- Reliance
- Privilege waiver
- Tax Court Requirements - T.C. Rule 143(g)
- Ethically - What can I tell my experts?

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## Switching the Burden of Proof to the IRS

- Burden of proof can be important in valuation cases.
- This is especially so if the IRS does not obtain a good valuation report.
- Thus, failure to shift the burden can be a significant malpractice issue.

Comment: Given IRS budget issues, it is more difficult for the IRS to obtain a solid valuation report.

## Make Sure During the Audit That the Burden of Proof Will Switch at Trial

- Burden to IRS
  - In most civil controversies, a rebuttable presumption existed that the IRS's determination of tax liability is correct
    - *i.e.*, the taxpayer has the burden of proving the IRS is wrong
  - Section 7491 switched the burden to the government in any non-criminal court proceedings, regarding a factual issue, if the taxpayer introduces credible evidence, which is relevant to determination of its liability.



## Make Sure During the Audit That the Burden of Proof Will Switch at Trial (cont.)

- Qualification
  - Code Section 7491, which switches the burden of proof to the IRS, applies only to litigation in the courts between the taxpayer and the IRS;
  - In order to obtain a shift in the burden of proof, the taxpayer must first comply with all requirements of the code section;
  - Comply with substantiation requirements contained in the Code and Regulations;
  - Cooperate fully with the IRS;
  - Exhaust all administrative remedies available to the taxpayer, such as going to the IRS Appeals office; and
  - Produce credible evidence at trial.

## Make Sure During the Audit That the Burden of Proof Will Switch at Trial (cont.)

- The requirement to prove credible evidence means that the burden technically starts out on the taxpayer, but shifts to the government unless the taxpayer produces evidence that would enable the court to find in favor of the taxpayer, absent any contrary evidence being produced by the IRS and ignoring the judicial presumption of IRS correctness.

## Make Sure During the Audit That the Burden of Proof Will Switch at Trial (cont.)

- Finally, the shift in the burden of proof applies to all income, gift, estate, generation-skipping, taxes and all penalties in addition to tax
  - However, it does not apply to corporations, partnerships or trusts with the net worth exceeding \$7 million (book value)

## Failure to Obtain PTIN Section 10.8(a)

- Any individual who, for compensation, prepares or assists in the preparation of all or substantially all of a tax return or claim for refund must have a PTIN
- Generally, one must be a licensed attorney, certified public accountant, enrolled agent or registered return preparer to obtain a PTIN

## PART IV

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## Employment Tax Issues

- New Audit Program
- Three Main Issues -
  - Employee/Independent Contractor
  - Fringe benefit issues
  - Deduction issues

October 1, 2021 - A very interesting day

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## Fringe Benefit Issues

- Executive compensation issues in general
- Vehicle and tool *per diem* issues
- IRS is looking at the issue of whether employees are attempting to turn “wages” into taxable *per diem* allowances
  - Carefully scrutinize what expenses can be included in a *per diem*
- Comment: Contractors who have a large amount of unreimbursed business expenses are asking for increased per diems due to the nondeductability of these expenses.

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## Section 530 of the Revenue Act of 1978



- Generally allows taxpayer to treat worker as not being an employee for employment tax, but not income tax or other purposes
- Must have reasonable basis and meet certain requirements

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## Section 530 of the Revenue Act of 1978 (cont.)

- *Reasonable basis* for treating a worker as an independent contractor exists if the taxpayer reasonably relied on
  1. Past IRS audit practice with respect to the taxpayer, or
  2. Published rulings or judicial precedent, or
  3. Long-standing recognized practice in the industry of which the taxpayer is a member, or
  4. If the taxpayer has any "other reasonable basis" for treating a worker as an independent contractor.

## Section 530 of the Revenue Act of 1978 (cont.)

Comment: When section 530 relief is at issue, the IRS is supposed to consider the application of this relief before determining if an employment relationship existed.

## Section 530 of the Revenue Act of 1978 (cont.)

- Additional requirements
  1. The taxpayer must not have treated the worker as an employee for any period
  2. All federal tax returns, including information returns, must have been filed on a basis consistent with treating such worker as an independent contractor
  3. The taxpayer (or a predecessor) must treat all workers holding substantially similar positions consistently for purposes of employment taxes
    - The "similar worker consistency requirement"

## Statute of Limitations in Employment Tax Cases

Section 6513 governs when a return is deemed to be filed for purposes of Section 6511 (i.e., for purposes of whether a claim for refund is timely filed). Subsection (c) pertains to Social Security Taxes and Income Tax Withholding (i.e., the taxes reported on a Form 941). Section 6513(c) provides that:

If a **return** for any period ending with or within a calendar year is **filed before April 15** of the succeeding calendar year, such return shall be considered filed on April 15 of such succeeding calendar year.

§ 6513(c)(1). (Emphasis added.)

**Thus, when a Form 941 for a period is filed before April 15 of the following period, the tax return is considered filed on April 15 of that following year.**



## Interest-Free Adjustments

- Generally, for employment tax (i.e., Form 941 obligations), if the adjustment to the Form 941 (i.e., the tax deficiency) is
  - paid on or before the due date of the 941 for the period in which the error is "ascertained,"
  - the amount of the underpayment shall be paid without interest being charged.
- An error is ascertained when resolved at examination or with appeals.

## Interest-Free Adjustments (cont.)

- If, however, the case is not resolved at Appeals and the taxpayer receives a notice and demand for payment from the IRS, the adjustment will not be interest free.
- In addition, the taxpayer will not be allowed an interest free adjustment where a prior audit found that additional tax was due with respect to the same issue.

# CONCLUSION

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