HOT TAX AND IRS ETHICS PRACTICE AND PROCEDURE ISSUES 2023

Michael G. Goller, J.D.
Reinhart Boerner Van Deuren s.c.
1000 North Water Street, Suite 1700
Milwaukee, WI 53202
414-298-8336
mgoller@reinhartlaw.com

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Boerner Van Deuren s.c. Attorneys at Law

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 I
Hot Practice and Procedure Issues

- The IRS is going to receive a lot of money. They are starting to spend it.
- What are the hot audit issues?

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Hot Issues – Which Will Get Hotter

- Partnership Audits
- High Net Worth Audits
- Private Airplane Cases
- Estate and Gift - Valuation Issues
- Net Operating Loss and Basis Issues
- Passive Losses and the Real Estate Professional
- Cost Segregation Issues
- 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[1] and the Audit Procedures for Electing Large Partnerships.[2] 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

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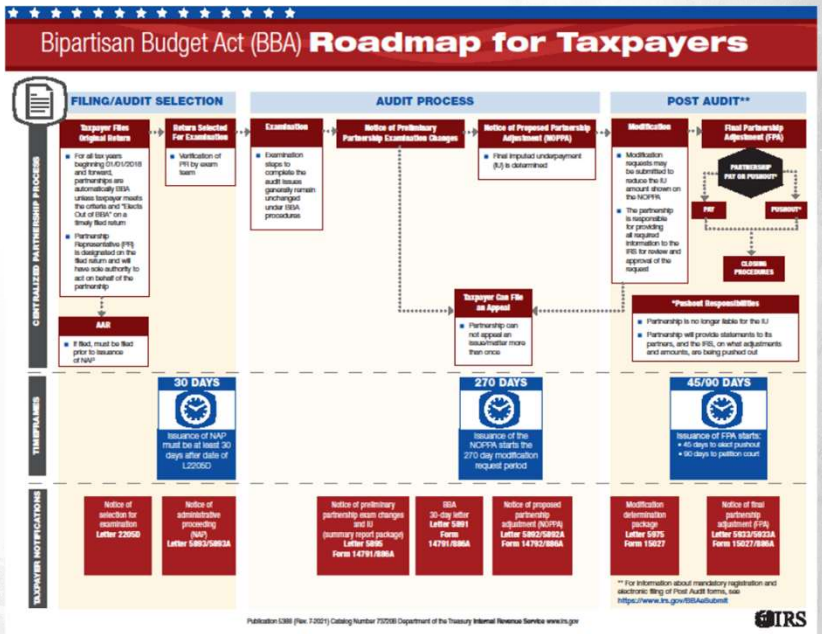

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Current Status

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

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Auditing Net Operating Losses

- What are the rules of the road
- Many traps – the statute of limitations is an issue

Comment: The five year net operating loss carry back has made this very relevant

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Statute of Limitations Issues

- A statute of limitations is a law that specifies the amount of time within which an act must be performed to be legally binding.
- Normally, the IRS must make any assessment of additional tax within three years of the time a return is filed.
- Assessment is nothing more than a bookkeeping entry made on the records of the Internal Revenue Service. Specifically, section 6203 provides that an "assessment shall be made by recording the liability of the taxpayer in the Office of the Secretary [of the Treasury] . . . ."
- A determination as to when the IRS made an assessment can be made by reviewing an IRS transcript of account.

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Statute of Limitations Issues (cont.)

There are a few significant intricacies about the statute of limitations on assessment

A. A return filed prior to the due date is treated as filed on the due date
B. If the return is filed after the due date, then the actual date of filing is used
C. A return required to be filed return is deemed filed when it is postmarked, if the return is timely filed
D. If the return is not filed when due, then the filing date, for limitations purposes, is the date it is actually received by the IRS. When a return is filed with the wrong Service Center, the statute does not begin to run until the redirected return is received by the correct Service Center

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Statute of Limitations Issues (cont.)

E. When calculating the 3-year period, the date that the return is actually filed is excluded

F. When the due date falls on a Saturday, Sunday, or legal holiday, the return is considered timely filed if it is filed on the next business day. In such an instance, the statute of limitations begins to run on the actual date of filing.

G. The statute of limitations on assessing estate tax cannot be extended. See § 6501(c)(4)(A)

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Exception to Three-Year Rule for Items Carried Forward or Back

A. A deficiency attributable to the carry-forward of a net operating loss, capital loss, or unused tax credit may be assessed within 3 years of the date of filing the return for the year the loss or credit is used, even though such date may be well beyond the normal statute of limitations for the year to which the loss or credit originally arose

B. The statute of limitations on a carryback runs from the year of the loss, not the year in which the benefit of the loss is put to use

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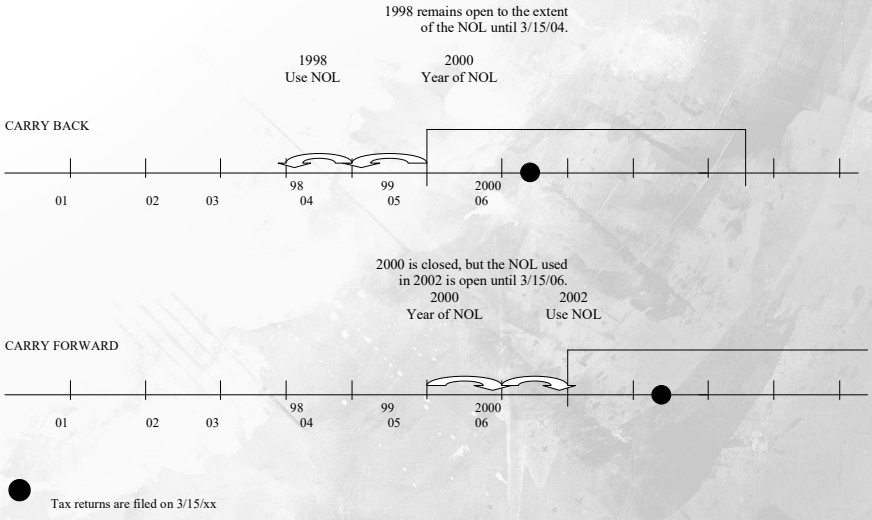
Net Operating Losses and The Statute of Limitations on Assessment § 6501



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IRS Attach on Cost Segregation Studies

- Publication 5653 (Rev. 6-2022) "Cost Segregation and Audit Technique Guide"
- Revisions were not large but whenever the IRS revises an audit manual, there will be audits

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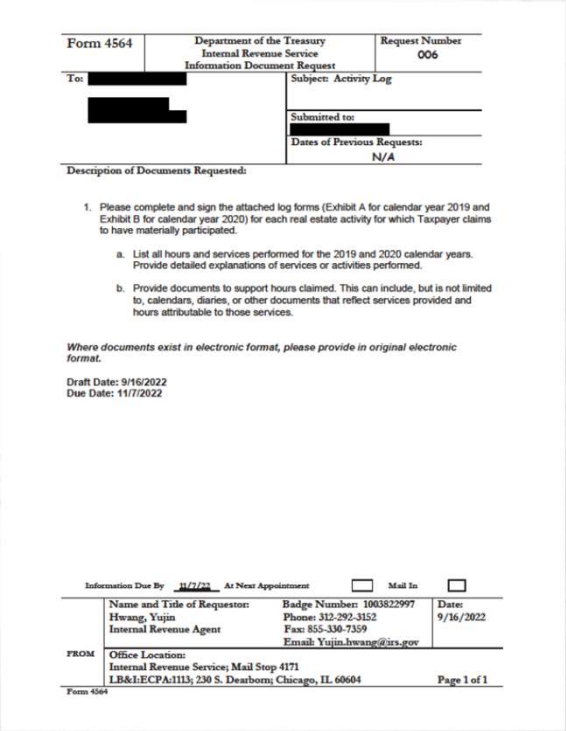
Sample IDR



Form 4564 | Department of the Treasury, Internal Revenue Service, Information Document Request | Request Number 006

To: [redacted]

Subject: Activity Log

Submitted to: [redacted]

Dates of Previous Requests: N/A

Description of Documents Requested:

1. Please complete and sign the attached log forms (Exhibit A for calendar year 2019 and Exhibit B for calendar year 2020) for each real estate activity for which Taxpayer claims to have materially participated.
   a. List all hours and services performed for the 2019 and 2020 calendar years. Provide detailed explanations of services or activities performed.
   b. Provide documents to support hours claimed. This can include, but is not limited to, calendars, diaries, or other documents that reflect services provided and hours attributable to those services.

Where documents exist in electronic format, please provide in original electronic format.

Draft Date: 9/16/2022
Due Date: 11/7/2022

Information Due By 11/7/22 At Next Appointment ☐ Mail In ☐

FROM

Name and Title of Requestor: Hwang, Yujin, Internal Revenue Agent
Badge Number: 1003822997
Phone: 312-292-3152
Fax: 855-330-7359
Email: Yujin.hwang@irs.gov
Date: 9/16/2022

Office Location: Internal Revenue Service; Mail Stop 4171
LB&I:ECPA:1113; 230 S. Dearborn; Chicago, IL 60604

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Form 4564

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Section 183 "Hobby" Loss Cases

- Section 183
- Recent case - Walters v. Comm'r, T.C. Memo 2022-17 "Green Home" was a for profit venture

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WDOR and I.R.C. Section 183

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Basis Issues, Passive Loss and At-Risk Rules – Lessons from the Trenches and Planning to Avoid IRS Attacks

- A taxpayer's ability to deduct a loss may be subject to three sets of limitations:
  - Basis
  - At-Risk
  - Passive
- Partnership allocation rules could also be considered a fourth limitation that impacts the ability of a taxpayer to deduct a loss

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At-Risk Rules

- Applies to:
  - Individuals (including partners, LLC members and S corporation shareholders). I.R.C. § 465(a)(1)(A).
  - C Corporations, if at any time during the last half of the taxable year more than 50% of the value of the corporation's outstanding stock is owned by five or fewer individuals. I.R.C. § 465(a)(1)(B).
- Generally, for purposes of the at-risk rules, each activity conducted by a taxpayer is treated as separate. I.R.C. § 465(c)(2)(A). May aggregate in certain cases.

At-Risk Rules (cont.)

- What is "at-risk"
  - Cash contributed
  - Amounts borrowed with respect to the activity, to the extent the taxpayer:
    - Is personally liable for repayment of such amounts. I.R.C. § 465(b)(2)(A).
      - There are two circumstances in which a partner is considered personally liable for debt:
        - » Partner borrows funds on a recourse basis and contributes those funds to the partnership for use in activity. Prop. Reg. § 1.465-7(a).
        - » Partnership incurs liability for which, under state law, partners may be held personally liable for repayment of the liability. Prop. Reg. § 1.465-24(a)(2)(i).

At-Risk Rules (cont.)

- Has pledged property (other than property used in the activity) as security for the borrowed amount. I.R.C. § 465(b)(2)(B).
  - Taxpayer is considered at risk only to the extent of the net fair market value of the pledged property securing the debt.
  - Property is not considered pledged property for purposes of this rule if the property is financed directly or indirectly by debt secured by the contributed property.
- A taxpayer is not considered at risk with respect to amounts protected against loss through nonrecourse financing, guarantees, stop-loss agreements or other similar arrangements. I.R.C. § 465(b)(4).
- Qualified nonrecourse financing is a big exception.

At-Risk Rules – Key Audit Issues

- A taxpayer is not considered at risk for amounts borrowed from any person who has an interest in the activity or from a person related to a person who has such an interest. I.R.C. § 465(b)(3)(A). Excludes direct borrowing by a partner. Other exceptions apply.
- Guarantees and Contribution Obligations
  - A guarantee does not increase a taxpayer's amount at risk unless the taxpayer has no right of reimbursement from the primary obligor of the liability. Prop. Reg. § 1.465-6(d).
  - An agreement that requires a taxpayer to make future contributions to capital does not increase the taxpayer's amount at risk until the contribution is actually made. Prop. Reg. § 1.465-22(a).
  - It is unclear whether a deficit restoration obligation ("DRO") increases a taxpayer's amount at risk.

Passive Losses and the Real Estate Professional

- Section 469
- Rental Real Estate
- Real Estate Professional
- Proving Material Participation
- Make a Grouping Election – watch limited partnership trap

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Passive Loss Rules

- Limit a taxpayer from deducting losses and excess credits from a passive activity against income from nonpassive activities. I.R.C. § 469(a).
- A passive activity is one that:
  - Involves the conduct of a trade or business in which the taxpayer does not materially participate. I.R.C. § 469(c)(1).
  - Is a rental activity. I.R.C. § 469(c)(2).

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Passive Loss Rules (cont.)

- Establishing Material Participation.
  - A taxpayer materially participates in an activity if, and only if, the taxpayer meets one of the following seven tests:
    - Work done in a taxpayer's capacity as an investor does not count toward the 500 Hour test, unless the taxpayer is directly involved in the day-to-day management or operations of the activity. Treas. Reg. § 1.469-5T(f)(2)(ii).

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Passive Loss Rules (cont.)

- Investor activities include studying and reviewing financial statements or reports on an activity, preparing studies or analyses of the activity's finances or operations for the taxpayer's own use, and monitoring the activity's finances or operations in a nonmanagerial capacity

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Passive Loss Rules (cont.)

- Facts and circumstances. Treas. Reg. § 1.469-5T(a)(7).
  - Taxpayer can establish material participation by regular, continuous and substantial involvement in an activity based on all the facts and circumstances
  - Must participate in activity for more than 100 hours. Treas. Reg. § 1.469-5T(b)(2)(iii).

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Passive Loss Rules (cont.)

  - Caution! Services performed in the management of an activity are disregarded unless:
    - » No other individual is compensated for performing management services in connection with such activity; and
    - » No other individual performs management services that exceed the hours spent by the taxpayer. Treas. Reg. § 1.469-5T(b)(2)(ii).

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Passive Loss Rules (cont.)

- A taxpayer must establish hours of participation under the seven tests.
  - Any reasonable means of proof is sufficient to establish hours of participation. Treas. Reg. § 1.469-5T(f)(4).
  - Courts and the IRS are skeptical when a taxpayer makes extravagant claims on the number of hours of participation.
  - Courts generally do not accept "post-event ballpark guesstimate" of hours unless supported by credible testimony and other objective evidence
  - Taxpayers are recommended to keep careful records of participation
  - Practice Tip
    - Use an affidavit
    - A client interview

Passive Loss Rules (cont.)

- Special Rules for Real Estate Rental Activities.
  - Taxpayers who qualify as "real estate operators" may treat their real estate rental activities as nonpassive upon a showing of material participation. I.R.C. § 469(c)(7).
  - To qualify as a "real estate operator":
    - For CHCs:
      - More than 50% of the corporation's gross receipts for the year must be derived from real property trades or businesses in which the corporation materially participates. I.R.C. § 469(c)(7)(D)(i).

Passive Loss Rules (cont.)

- For individuals:
  - The taxpayer must satisfy the two following requirements:
    - » More than one half of all personal services performed in trades or businesses must be performed in the real property trades or businesses; and
    - » More than 750 hours of services must be performed in real property trades or businesses in which the taxpayer materially participates. I.R.C. § 469(c)(7)(B).

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Passive Loss Rules (cont.)

  - Personal services include any work performed by the individual in the connection with a trade or business, except for:
    - » Worked performed by an individual in the individual's capacity as an investor. Treas. Reg. § 1.469-9(d)(4).

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Passive Loss Rules (cont.)

  - » Services performed as an employee, unless the employee is a 5% owner of the employer. I.R.C. § 469(c)(7)(D)(ii).
    - » Practice Tip: When looking to purchase Real Estate (e.g., Apartment Buildings), document that the activity is not investment activity
- – Services of the taxpayer's spouse cannot be combined to satisfy either of the two requirements. Treas. Reg. § 1.469-9(c)(4).

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Passive Loss Rules (cont.)

- Caution! Rental activities held through a passthrough entity constitute a single interest if the entity grouped its real estate as a single activity. Treas. Reg. § 1.469-9(h). However, if a taxpayer owns directly or indirectly a 50% or greater interest in the passthrough entity, each interest in rental real estate is treated as a separate interest unless the taxpayer makes his or her own election to treat all interests in real estate as a single activity.

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Airplane Cases

- Partnership or corporate structure
  - Personal Entertainment v. Non-Personal Entertainment
- SIFL or §274-10(e)
- Schedule C Structure – CCA 202117012 (4/30/21)
- Depreciation and the Section 280F trap
- Entertainment Facility trap

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Examination of Returns—General

- Introduction
  - The possible audit of a taxpayer's return encourages voluntary compliance
  - The chances of examination vary depending on geographical location, type of return, and Adjusted Gross Income

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Examination of Returns—General (cont.)

- IRS Field Audits
  - The field examination is used for most business returns and larger, more complex individual returns
    - Section 7602 of the Internal Revenue Code authorizes the Treasury Department to examine any books, papers, records, or other data that may be relevant or material to ascertaining the correctness of any return

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Examination of Returns—General (cont.)

- Other Types of Audits
  - Correspondence audit
  - Office examinations
  - Employment tax audits
- We have seen an increase in audits of Exempt Organizations. A key issue is control of the organization.

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Handling the Audit

- Examination of Tax Returns—Practical Strategies
  - Control the flow of information
  - Do the agent's job for him or her
  - Where the audit occurs
  - Do not give the IRS free access to the taxpayer's employees
  - How deep will the revenue agent dig?

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Handling the Audit (cont.)

- Responding to Requests for IRS Information
- Tell Your Story
- Burden of Proof Issues
- Privilege Issues

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Handling the Audit (cont.)

- The Concept of Assessment
  - What is assessment
  - Civil statute of limitations on assessment
  - Assessment as a civil concept
  - Generally, before assessment can occur, the normal deficiency procedures must be followed
- Summary of Important Terms
  - Thirty-Day Letter
  - Protest
  - Ninety-Day Letter

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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)

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Acknowledgement IDR

- Use the acknowledgement IDR to support your case

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Getting to Appeals

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

Settling the Case at Appeals

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

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

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

Penalty Issues

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Reasonable Cause and Penalty Avoidance

- How does Section 6662 work
- What is Reasonable Cause
- There is no "one free kick" rule
- Minimizing penalty risks

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Reasonable Cause and Penalty Avoidance

The Section 6662 Penalty

- Negligence or Disregard of Rules or Regulations
- Substantial Understatement of Income Tax
- Substantial Valuation Misstatement under Chapter 1 of the Code
- Substantial Overstatement of Pension Liabilities
- Substantial Estate or Gift Tax Valuation Understatement
- Disallowance of Tax Benefits Because a Transaction Lacks Economic Substance or any Similar Rule or Law
- Any Undisclosed Foreign Financial Asset Understatement

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Section 6662 Penalty (20% or 40%)

- Generally, penalty is 20% and applies to any portion of an underpayment attributable to one or more violations
- In certain instances, penalty can rise as high as 40%

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Interest

Computed from the date of the return

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What is an Understatement?

- Excess of the amount required to be shown on the return over the amount of tax shown on the return. Section 6662(d)(2)(A)

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Tax Return MUST Have Been Filed

Both the Accuracy-Related Penalty and the Fraud Penalty only apply where a return has been filed

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Qualified Amended Return Can Reduce the Amount of an Underpayment

Amount of tax shown on a tax return includes the amount shown as additional tax on a "qualified amended" return

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THE ACCURACY-RELATED PENALTY BASED UPON NEGLIGENCE . . .

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Negligence

- Only applies to that portion attributable to negligence, not the entire underpayment
- Negligence is defined as "any failure to make a reasonable attempt to comply with the provisions of [the Code]"

Comment: One way to settle a case is to apply the penalty to only a small part of a deficiency

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Disregard of Rules or Regulations

- Any "careless, reckless, or intentional disregard"
  - Section 6662(c)

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THE ACCURACY RELATED PENALTY BASED UPON A SUBSTANTIAL UNDERSTATEMENT OF INCOME TAX. . .

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What is a Substantial Understatement of Income Tax?

- Noncorporate taxpayer
  - Exceeds the greater of 10% of the tax required to be shown on the return or $5,000
- Corporation other than S Corporation or Personal Holding Company
  - Exceeds the lesser of one of the following:
    - 10% of the tax required to be shown on the return (or if greater, $10,000); or
    - $10 million

Section 6662(d)(1)

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Reasonable Basis

- Under Treasury Reg. § 1.6662-3(b)(3), negligence is negated if there is a reasonable basis for the return position
  - Determining what is Reasonable Basis
    - "A relatively high standard of tax reporting, that is significantly higher than not frivolous or not patently improper. The reasonable basis standard is not satisfied by a return position that is merely arguable or that is merely a colorable claim."
  - What authorities can be cited to prove Reasonable Basis?

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Reasonable Cause

- Defined as Ordinary Business Care and Prudence
- Section 6662 Penalty can be avoided by showing reasonable cause (in most-cases)
- Proof of Reasonable Cause, when arguing reliance on a professional – 3 part test
  - Advisor was competent and had significant expertise to justify reliance
  - Taxpayer gave advisor adequate and necessary information
  - Taxpayer relied in good faith upon the advisor

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Disclosure

- Penalty may often be avoided by a complete and adequate disclosure of the item or position at issue and there is:
  - Reasonable basis for position
  - Taxpayer keeps adequate books and records

Comment: Disclosure will not avoid the accuracy related penalty based on negligence.

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Substantial Authority

- See Treas. Regs. § 1.6662-4(d).
  - A Confidence Level of perhaps 40%?

Understatement Related to a Tax Shelter

- If related to a tax shelter, adequate disclosure of the item will not relieve the taxpayer from the penalty
  - Must meet elevated substantial authority test
  - Must show Substantial Authority and a reasonable belief that the treatment was MLTN correct tax
    - A tax shelter exists if a significant purpose of an entity, plan or arrangement is the avoidance of income tax

Raising Reasonable Cause Can Waive a Privilege

CAUTION:

Raising the assertion of reliance on professional advice constitutes reasonable cause probably waives the attorney/client privilege and the Section 7525 privilege.

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Raising Reasonable Cause Can Waive a Privilege (cont.)

- IRM 20.1.5.6.4 (January 24, 2013)
  (If the taxpayer claims a tax memorandum or advice is privileged, the IRS will not abate the penalty)

Comment: Would the IRS assert a penalty to force a privilege waiver?

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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[1]	Yes[2]
Disregard of the Rules or Regulations	Yes[4]	Yes	Yes[3]	Yes[5]
Substantial Understatement of Income Tax	No	Yes	Yes[6]	Yes
Substantial Valuation Misstatement (Income)	No	Yes[7]	No	No
Substantial Valuation Misstatement (E&G)	No	Yes	No	No
Gross Valuation Misstatement (Income)	No	No[7]	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)(ii).
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).

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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)

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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

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

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

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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

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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).

How Aggressive Can (Should) The Practitioner Be?

- Standards With Respect to Tax Returns and Other Documents §10.34
  - The practitioner must inform a client to of any penalties that are reasonably likely to apply with respect to:
    - A return position the practitioner provided advice on;
    - A return the practitioner prepared or signed; and
    - Documents submitted to the IRS.
  - A practitioner may not advise a client to take a frivolous position in a document, affidavit or other paper submitted to the IRS
  - Further, a practitioner cannot advise a client to make a submission to the IRS if the submission is frivolous, intended to cause delay, or intentionally disregards IRS rules or regulations

Caution: An offer in compromise or a Collection Due Process appeal cannot be filed solely to delay collection activity

How Aggressive Can (Should) The Practitioner Be?

- The practitioner must also inform the client of the opportunity to avoid such penalties by disclosure and the requirements of adequate disclosure
- It is critical that the practitioner understand how Section 6662 works
- Do a memorandum to the file

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AICPA Rule

AICPA Statement on Standards for Tax Services No. 1, Tax Return Positions, Section 6.

When recommending a tax return position or when preparing or signing a tax return on which a position is taken . . . [a CPA] should, when

> relevant, advise the taxpayer regarding potential penalty consequences of such tax return position and the opportunity, if any, to avoid such penalties through disclosure.

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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

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Other Authority

- ACTEC Commentary to Model Rule 1.7

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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.

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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.

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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

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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.

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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

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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?

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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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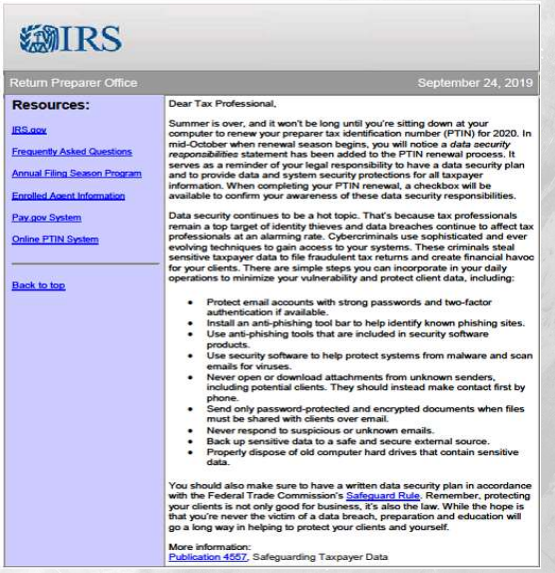
Need both a PTIN and a Data Security Plan



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

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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

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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;

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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

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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.

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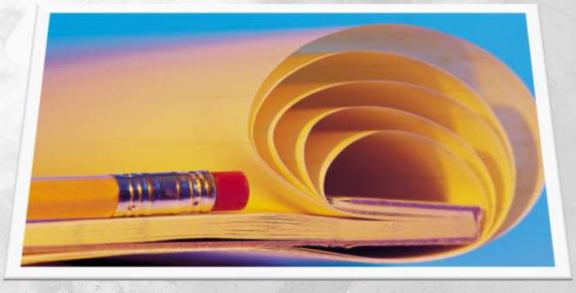
Written Tax Advice Form Section 10.35 and Section 10.37(a) Revised June 9, 2012

- 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



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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

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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

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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

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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

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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

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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

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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**).

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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

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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

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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**

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Diligence as to Accuracy §10.22

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

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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

Preparing a Tax Return

- The provisions of Circular 230 "piggy back" on I.R.C. Section 6694
  - Under Circular 230, practitioners may not willfully, recklessly or through gross incompetence sign (or advise a client to take a position on) a return or claim for refund if the practitioner knows or should know the return reports a position that lacks a reasonable basis, is an unreasonable position under I.R.C. Section 6694(a)(2), is a willful attempt to understate the tax liability, or is a reckless or intentional disregard of IRS rules or regulations

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

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

[1] The percentage of comfort is perhaps 5% or less
[2] Reasonable basis is defined in Section 1.6662-3(b)(3); the percentage of comfort is perhaps 20%
[3] Use Form 8275 or 8275R, or disclose pursuant to annual revenue procedure (e.g., Rev. Proc. 2015-16)
[4] "Substantial authority" is defined in Section 1.6662-4(d). It is a comfort level of perhaps 40% or more
[5] 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 ..."

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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.

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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

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Professional Responsibility and the Employee Retention Credit

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ERC - 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.

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ERC - Circular 230 Issues

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.)

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ERC - Circular 230 Issues

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.**

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ERC - Circular 230 Issues

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.

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ERC - Circular 230 Issues

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.

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ERC - 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.

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IRS

Professional Responsibility and the Employee Retention Credit

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

IRS

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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PART III
High Net Worth And Family Office Issues

- FY 2022 Audit Campaign Issue
- High-income taxpayers will continue to receive audit attention (the audit rate is approximately 9% for those reporting income of $1 Million to $5 Million)
  - These taxpayers often have income and losses from flow-through entities
  - Thus, the audit of an individual will often lead to the examination of various related entities

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High Net Worth Issues (cont.)

- The audit process involves a review of not only the taxpayer's personal income tax return, but also related partnership tax returns, fiduciary income tax returns, and estate and gift tax returns
- The audit is a complete review of the taxpayer(s) (*i.e.*, the IRS uses LB&I Audit Methods and Techniques)

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LAW360 Tax Authority

Portfolio Media, Inc. | 230 Park Avenue, 7th Floor | New York, NY 10169 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

IRS Announces New Pass-Through Unit to Scrutinize Wealthy

By David van den Berg

Law360 (September 20, 2023, 6:33 PM EDT) – The Internal Revenue Service will launch a new group focused on scrutinizing pass-through organizations as part of its broader plan for beefing up enforcement work against the wealthy, according to an agency statement. . . [A] new unit scrutinizing pass-through organizations is part of a previously announced plan. . . to ramp up enforcement work against high-income earners, corporations and partnerships.

The agency said the initiative will drill down on large or complex pass-throughs. . . to ramp up enforcement work against high-income earners, corporations and partnerships. . .

The pass-through group will be housed in the IRS' Large Business & International Division, according to the agency. The pass-through entity's workforce will eventually also include current employees in both Large Business & International and the Small-Business & Self-Employed divisions, the agency said. The IRS' statement also said the pass-through group will include the more than 3,700 revenue agents it **plans to hire** for expanded enforcement work geared toward large corporations and complex partnerships. . .

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IRS Announces New Pass-Through Unit to Scrutinize Wealthy (cont.)

The IRS' **strategic plan** for the funding increase provided by the Inflation Reduction Act called for expanded enforcement work against large partnerships and said the agency would hire specialized compliance workers and train others to help ensure pass-through entities comply with the law. . .

Greater resources are needed to evaluate the compliance of pass-through entities, especially large and complex ones, and pass-through audit rates dropped because of funding cuts, the agency said. . . [its] the strategic plan. The agency audited 4.4% of pass-throughs in 2010, and the rate dropped to 0.1% in 2017, the most recent year with nearly all audits closed, according to the plan, which was released in April.

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High Net Worth Issues (cont.)

- Responding to Information Document Requests can be very burdensome, with a number of practical and ethical concerns
- IRS Counsel is often involved through the audit
- Often if information is not produced by the IDR deadline the IRS will issue a pre-summons letter and then an IRS summons

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High Net Worth Issues (cont.)

Some examples of the broad scope of high net worth audits include

- Estate and Gift tax issues
- **Valuation issues**
- Executive Compensation
- C corporation and S corporation issues
- Noncash charitable contributions
- **Partnership and LLC issues**
- Passive activity losses
- Foreign Trusts
- Foreign Bank Account reporting
- Basis and At-Risk issues
- Transfer Pricing Issues
- **Private airplane issues**

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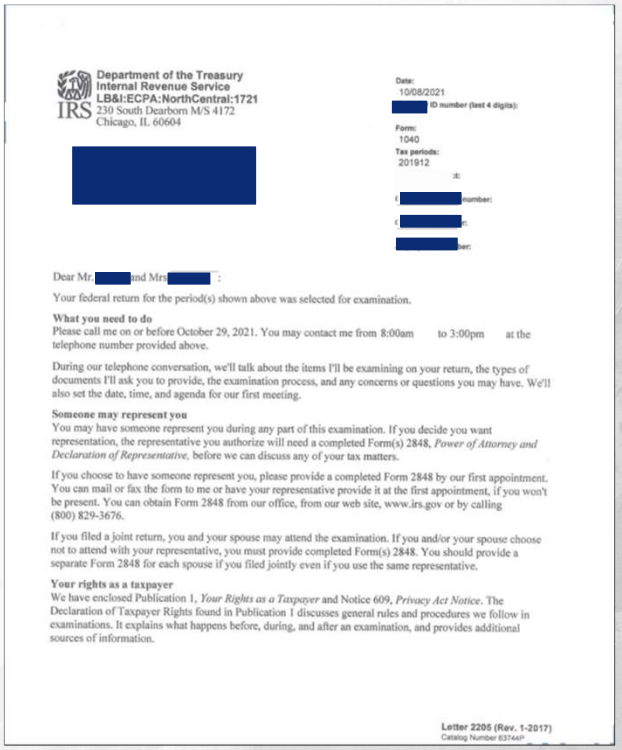

Department of the Treasury
Internal Revenue Service
LB&I:ECPA:NorthCentral:1721
230 South Dearborn M/S 4172
Chicago, IL 60604

[redacted]

Date:
10/08/2021
[redacted] ID number (last 4 digits):
Form:
1040
Tax periods:
201912
[redacted]

Dear Mr. [redacted] and Mrs. [redacted]:

Your federal return for the period(s) shown above was selected for examination.

What you need to do
Please call me on or before October 29, 2021. You may contact me from 8:00am to 3:00pm at the telephone number provided above.

During our telephone conversation, we'll talk about the items I'll be examining on your return, the types of documents I'll ask you to provide, the examination process, and any concerns or questions you may have. We'll also set the date, time, and agenda for our first meeting.

Someone may represent you
You may have someone represent you during any part of this examination. If you decide you want representation, the representative you authorize will need a completed Form(s) 2848, *Power of Attorney and Declaration of Representative*, before we can discuss any of your tax matters.

If you choose to have someone represent you, please provide a completed Form 2848 by our first appointment. You can mail or fax the form to me or have your representative provide it at the first appointment, if you won't be present. You can obtain Form 2848 from our office, from our web site, www.irs.gov or by calling (800) 829-3676.

If you filed a joint return, you and your spouse may attend the examination. If you and/or your spouse choose not to attend with your representative, you must provide completed Form(s) 2848. You should provide a separate Form 2848 for each spouse if you filed jointly even if you use the same representative.

Your rights as a taxpayer
We have enclosed Publication 1, *Your Rights as a Taxpayer* and Notice 609, *Privacy Act Notice*. The Declaration of Taxpayer Rights found in Publication 1 discusses general rules and procedures we follow in examinations. It explains what happens before, during, and after an examination, and provides additional sources of information.

Letter 2205 (Rev. 1-2017)
Catalog Number 63744P

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A video presentation, "Your Guide to an IRS Audit," is available at http://www.irsvideos.gov/audit. The video explains the examination process and will assist you in preparing for your audit.

Thank you for your cooperation and I look forward to hearing from you by [date] .

Sincerely,

[redacted]
Internal Revenue Agent

Enclosures:
Publication 1
Notice 609

Letter 2205 (Rev. 1-2017)
Catalog Number 63744P

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Form 4564	Department of the Treasury Internal Revenue Service Information Document Request	Request Number 001
To: and	Subject: Initial IDR - Form 1040 – 201912	
	Submitted to:	
	Dates of Previous Requests: N/A	

Description of Documents Requested:

The purpose of this Information Document Request (IDR) is to obtain information relevant to your Form 1040 filed for the tax year ending December 31, 2019.

Please provide the following documentation:

1. Copies of any amended Forms 1040 (including all schedules/attachments) filed for the tax year ending December 31, 2018, December 31, 2019, and December 31, 2020.
2. Copies of any correspondence from the Internal Revenue Service concerning Form 1040 for the tax year ending December 31, 2019 excluding the Letter 2205 (initial contact letter) sent by .
3. Copies of all audit reports issued by any federal or state agency for tax year ending December 31, 2019.
4. Personal net wealth and/or financial statement(s) as of December 31, 2019, if available. This should include the method of accounting used to compile them, net worth computations or other financial data regarding your assets, liabilities, net worth, income and losses, and cash flows from all sources within and without the United States, including all underlying documents and any applicable exhibits and/or footnotes associated therewith, and if not apparent, please identify the preparer of such documents. If not available, provide a negative written response.
5. A brief summary of your business and investment activities, including items reported on the Form 1040, Schedule E. For activities identified as non-passive, elaborate on your involvement and day-to-day role with each entity.
6. Provide a copy of the worldwide legal organization chart as of January 1, 2019 and December 31, 2019 including all domestic and foreign affiliates, places and dates of incorporation and their relationship to the reporting partnership/LLC for the entities you have greater than 50% control of through the rules of attribution. This chart should include all entities to which the Taxpayer is related within the meaning of Section 267.

Information Due By: 11/05/21 At Next Appointment ☐ Mail In ☐

	Name and Title of Requestor: Internal Revenue Agent	Badge Number: Phone: Fax: Email:	Date: 10/8/2021
FROM	Office Location: Internal Revenue Service; Mail Stop 4171 LB&I:ECPA:1113; 230 S. Dearborn; Chicago, IL 60604		Page 1 of 3

Form 4564

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Form 4564	Department of the Treasury Internal Revenue Service Information Document Request	Request Number 001
To: [redacted] and [redacted] [redacted]	Subject: Initial IDR - Form 1040 – 201912 Submitted to: Dates of Previous Requests: N/A	

Description of Documents Requested:

The following should be included in the chart:
a. Name of each entity,
b. Employer Identification Number,
c. Ownership percentage in each entity,
d. U.S. tax treatment of entity,
e. Country in which the entity was created or organized,
f. Country in which the entity operates, and
g. Business activity of the entity.

If there is a difference in entities reported at January 1, 2019 and December 31, 2019, please provide an explanation.

7. Tax return workpapers and reconciliation schedules used to prepare the Form 1040 (original and amended, if applicable) for the tax year ending December 31, 2019.

8. For all disregarded entities with activities reported on the Taxpayer's (each spouse) individual tax returns for the tax year ending December 31, 2019, please provide:
   a. Detail General Ledger Transaction file (Lowest level transaction detail that can be reconciled to the Year-end Trial Balance amounts),
   b. Year-end Trial Balance file showing beginning of the tax period balances and end of the tax period balances,
   c. Chart of Accounts (GL Account Number, GL Account Name, Account Type),
   d. LLC Operating Agreements,
   e. Check-the-box elections (Form 8832), and
   f. Reconciliation of the Profit and Loss records to the Form 1040 tax return.

9. Provide all Schedule K-1s issued to [redacted], and its disregarded entity/entities (flowing into Form 1040) for tax year ending December 31, 2019. Provide any Schedule K-1 workpapers and reconciliation to the 2019 tax return.

Information Due By 11/05/21 At Next Appointment ☐ [illegible] ☐

	[illegible] of Requestor: Internal Revenue Agent	Badge [illegible] Phone: [redacted] Fax: [redacted] Email: [redacted]	Date: 10/8/2021
FROM	Office Location: Internal Revenue Service; Mail Stop 4171 LB&I:ECPA:1113; 230 S. Dearborn; Chicago, IL 60604		Page 2 of 3

Form 4564

Reinhart
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Form 4564	Department of the Treasury Internal Revenue Service Information Document Request	Request Number 001
To: [redacted] and [redacted]	Subject: Initial IDR - Form 1040 – 201912 Submitted to: Dates of Previous Requests: N/A	

Description of Documents Requested:

10. Any other tax returns filed for the tax years ending December 31, 2019, including Excise Tax, 1099, 1096, W-2, 940, 941, Schedule H, and Gift or Estate Tax returns.

11. Copies of any gift or estate tax returns filed for the tax year ending December 31, 2019.

12. Did you make gifts in excess of $15,000 during the tax year ending December 31, 2019? If yes, specify the amount of the gift, when it was made, and the name(s) of the recipient(s).

When responding to this IDR, please identify each response to each item requested in this IDR by labeling each response with the corresponding number or letter listed in the IDR. This will help facilitate an efficient review of the information provided and decrease the likelihood of additional follow up questions. Where documents exist in electronic format, please provide in original electronic format.

Due Date: 11/05/2021

Information Due By 11/05/21 At Next Appointment ☐ [illegible] ☐

	[illegible] of Requestor: Internal Revenue Agent	Badge [illegible] Phone: [redacted] Fax: [redacted] Email: [redacted]	Date: 10/8/2021
FROM	Office Location: Internal Revenue Service; Mail Stop 4171 LB&I:ECPA:1113; 230 S. Dearborn; Chicago, IL 60604		Page 3 of 3

Form 4564

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

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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

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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

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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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High Net Worth Issues

- Responding to Information Document Requests can be very burdensome, with a number of practical and ethical concerns
- IRS Counsel is often involved through the audit
- Often if information is not produced by the IDR deadline the IRS will issue a pre-summons letter and then an IRS summons

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Qualified Appraisals

- See Goller Checklist

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Lender Mgmt LLC V. Comm'r, T.C. Memo 2017-25

- Family office takes a profits interests in investments and is treated as a trade or business.

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PART IV
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.

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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.

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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.

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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"

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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.

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.

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.

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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.

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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)

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CONCLUSION

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