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## Tax practice Management

William H. Behrenfeld

Robert J. Ranweiler

American Institute of Certified Public Accountants (AICPA)

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**TAX**  
**PRACTICE**  
**MANAGEMENT**

**AICPA**

American Institute of Certified Public Accountants



**TAX**

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**PRACTICE**

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# TAX

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# PRACTICE

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# MANAGEMENT

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Prepared for the AICPA by

WILLIAM H. BEHRENFELD, JD, LL.M., CPA  
ROBERT J. RANWEILER, CPA

Contributors

Craig E. Behrenfeld, JD, LL.M.  
Richard J. Christiansen, CPA  
Christopher W. Dungan, CPA, PhD, JD  
Millard J. Martin



<i>Editorial Development</i>	Marie Bareille
<i>Production Management</i>	Ingrid Anderson
<i>Design &amp; Typography</i>	AM Lithography (Text) Vantage Art, Inc. (Exhibits)
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# Preface to Supplement 10

This Supplement contains all the changes that you will need in the text, compliance forms, practice aids, and checklists for use in your 1999 return filings. In addition to providing you with up-to-date forms, practice aids, and checklists for individual, corporate, partnership, S corporation, and fiduciary filings, this Supplement presents:

- Updated technology coverage throughout, including new information on electronic filing, electronic research, and on-line training.
- New coverage on leveraging tax preparation into value-added services, including the introduction of the concept of Desktop Review.
- A new tool for justifying changes in fee structure as a result of code complexities.
- Thoroughly updated forms and checklists for managing, administering, and streamlining tax preparation.
- A rundown of the 18 leading software vendors, their programs, and how they are rated.
- More practice tips throughout supplementing related subject matter.

As usual, we are grateful to our colleagues and partners who review the manual annually for changes and additions. We also thank the members of the AICPA Tax Practice Management Committee, past and present whose comments and suggestions have been incorporated into this year's Supplement.

January 2000

W.H.B.  
R.J.R.

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# Preface

In *Tax Practice Management* we have created a handbook dedicated to the unique challenges of managing a professional tax practice. The book does not include discussion of technical issues of tax law and tax planning, such matters being effectively dealt with in other publications. Instead, *Tax Practice Management* presents highly practical discussions of hands-on administrative issues:

- Controlling and organizing client information
- Establishing work flow
- Staff selection and training
- Office procedures
- Billing
- Marketing
- Procedural dealings with the IRS
- Coordination of the tax function with other elements of CPA practice
- Using technology to improve system efficiencies.

The book offers suggestions, illustrations, sample checklists, logs, schedules and data-gathering questionnaires that have worked for us and for other tax practitioners.

In putting our work together, we have relied extensively on previous studies and articles, but primarily on the considerable experience of many practitioners and firms who furnished recommendations and resource materials to us. We also drew upon our own experiences (encompassing both successes and failures) in attempting to come up with concise, effective practice tips. We believe that its organization, its practical approach, and its focus on client-centered issues make *Tax Practice Management* a necessary reference for every tax practitioner.

*Tax Practice Management* can be used as a management tool for all types of tax practices. In fact, most of the guidance applies equally to practices involved with any of the following types of returns:

- Individual tax returns (Form 1040)
- Partnership tax returns (Form 1065)
- Corporate tax returns (Form 1120)
- S Corporation tax returns (Form 1120S)
- Fiduciary tax returns (Form 1041)
- Estate tax returns (Form 706)
- Gift tax returns (Form 709)
- Tax-exempt organization tax returns (Form 990)
- Excise tax returns (Form 720)
- Information returns and required filings

*Tax Practice Management* is composed of three major parts or chapter clusters. **Part I, Management and Administration**, focuses on administrative issues, moving from overall



control and profit matters to marketing, personnel, and tax education. **Part II, Tax Return Preparation**, is a guide to the mechanical steps in the tax return preparation process, including computer processing of tax returns, research of tax matters, accounting and auditing considerations, and dealing with the IRS. **Part III, Legal Liability**, includes three detailed chapters on standards of tax practice, tax preparer penalties, and criminal tax fraud.

You can locate material in *Tax Practice Management* in three ways. The upfront Table of Contents lists all major sections of the book. At the beginning of each chapter, directly following each chapter guide card, is a detailed Table of Contents and Exhibits List. Finally there is a detailed index, which presents a cross-referenced alphabetical listing of all the topics and subtopics covered in the book located by decimally numbered chapter sections (appearing in the left margin and at the bottom of each page throughout the text). *Tax Practice Management* is filled with examples and practice aids, many of which can be used directly or require only minor modification for use in your practice. Topic discussions contain highlighted practice tips—hints you can readily assimilate to improve your practice.

We have avoided long lists of rules and specific instructions on how best to accomplish a task. Instead, we provide alternative suggestions, accompanied by the pros and cons of each, thus allowing you to select and implement the approach most applicable to your own practice. The result is a guide that professionals in diverse tax practice environments can use to strengthen and enhance management and profitability.

We have included a comment sheet to solicit your observations and suggestions. Please give us recommendations, criticisms, sample forms and materials, and even pertinent personal experiences, using the comment sheet, or write to us directly.

William H. Behrenfeld  
1800 Second Street, Suite #790  
Sarasota, FL 34236

Robert J. Ranweiler  
Biebl, Ranweiler & Company, Chtd.  
P.O. Box 696  
New Ulm, MN 56073

We will personally review and consider every comment for inclusion in the annual supplement.

### **Acknowledgments**

*Tax Practice Management* was reviewed and commented on by the members of the AICPA Tax Division's Tax Practice Management Subcommittee. The subcommittee provided us with important guidance and will continue to work with us on annual supplements. We are grateful to Donald H. Skadden, Vice President, AICPA Federal Tax Division, and James A. Woehlke, Technical Manager, Federal Tax Division, and the members of the Management of a Tax Practice Subcommittee who shared with us their knowledge and experience. Their ongoing efforts in tax management provide valuable assistance to all tax practitioners.

### **AICPA Tax Practice Management Subcommittee**

Jacob R. Brandzel, *Chairman*, CPA, Laventhol & Horwath, Philadelphia, PA  
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Lawrence I. Morgan, CPA, Pannell Kerr Forster, New York, NY  
James W. Sansone, Jr., CPA, Berg, DeMarco, Lewis, Sawatski & Co., Northbrook, IL  
David B. Winder, CPA, KPMG Peat Marwick, Washington, D.C.  
Anne M. Yamamoto, CPA, Frank, Rimerman & Co., Menlo Park, CA

We owe a special debt to the following practitioners who reviewed chapter drafts, made specific suggestions for text development, and shared with us checklists and questionnaires used in their firms: Rick G. Betts, CPA, CMA, McFarland & Alton, Spokane, WA; Joseph L. Brotherton, CPA, JD, Brotherton Corporation, Seattle, WA; Steven M. Bullard, CPA, Baird, Kurtz & Dobson, Springfield, MO; David K. Carlson, CPA, A-PlusTax, Sarasota, FL; Jack S. Dennison, Jack S. Dennison & Associates, Bristol, VA; Paul Fleishmann, CPA, Deloitte & Touche, Sarasota, FL; Donald J. Glenn, CPA, Allen, Gibbs & Houlik, Wichita, KS; Kennard Honick, CPA, Natherson & Co., Sarasota, FL; Richard Katcher, JD, Baker & Hostetler, Pepper Pike, OH; Clifford M. King, JD, Williams, Parker, Harrison, Dietz and Getzen, Sarasota, FL; Richard M. Orin, CPA, JD, LLM, Robins & Associates, New York, NY; Stanley Person, CPA, Person & Co., New York, NY; Bernard Pollack, CPA, Ullman, Weisberg/Pollack Einhorn, Great Neck, NY; Howard A. Port, CPA, JD, Irving R. Port & Co., Syracuse, NY; Gerald G. Portney, JD, LLM, KPMG Peat Marwick, Washington D.C.; Walter M. Primoff, CPA, New York State Society of Certified Public Accountants; Lowell V. Ruen, CPA, JD, LLM, McFarland and Alton, Spokane, WA; Paul Sage, CPA, JD, Polansky, Sage, Newman & Kulberg, Carle Place, NY; Richard D. Smith, CPA, Christopher, Smith & Gentile, Bradenton, FL; James G. Sprinkel, CPA, Morris and Sprinkel, Harrisonburg, VA.

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Finally, we thank our families who, although providing us with no management recommendations and performing no typing or editing services, nevertheless, extended the care and understanding required to complete a project such as this.

W.H.B.  
R.J.R.

# Introduction

*Tax Practice Management* is designed primarily to address the needs of sole proprietors and smaller firms. However, most of the concepts discussed should prove equally useful to tax offices of larger firms. You can use the book to reexamine and analyze your own administrative procedures in light of what other firms are doing. If you need to implement administrative changes and improvements, you can use the book as a model from which to draw ideas.

The *Tax Practice Management* text is divided into three parts:

- I. Management and Administration
- II. Tax Return Preparation
- III. Legal Liability

Each part discusses a unique aspect of practice management. Together, these sections provide a global view of what you need to know to effectively and efficiently manage your tax practice.

## **Management and Administration**

Every tax practice requires control of the workload, of information flowing through the tax preparation system, and of due dates and other deadlines associated with a tax practice. Chapter 101 addresses the overall control system required in managing a tax practice. We show you how to establish the necessary control mechanisms to assure that deadlines are properly met, information is properly disseminated to staff and clients, and workloads are properly assigned and managed. Chapter 102 provides numerous pointers on profit management. We describe alternative methods for billing tax returns, including discussion of minimum fees, controlling billing writedowns, collection techniques, and many related topics that allow you to enhance the profitability of your firm. Chapter 103 illustrates marketing opportunities to be considered in managing a tax practice. We give you many practical development tips which you can implement to expand and enhance your practice.

A professional service firm is only as good as the personnel it employs. Refer to Chapter 104 for a discussion of personnel issues, including recruiting and hiring, staff evaluation, and staff motivation suggestions. Once personnel are on board, the responsibility of management is to develop each individual to his or her fullest ability. Chapter 105 recaps professional tax education alternatives and clarifies the education alternatives most beneficial for different staff at different experience levels. Chapter 106 completes the Part I discussion by illustrating the importance of tax planning services to a tax practice. We'll show you how to enhance your practice and better serve clients by making tax planning services virtually a continuing part of your client file organization routine.

## **Tax Return Preparation**

Part II of *Tax Practice Management* focuses on the “mechanical” tasks of actually completing tax returns. We describe the steps required to complete a tax return in Chapter 201, and detail the responsibilities and requirements of each step for you. Most tax practitioners now use automated capabilities to assist in the tax preparation process. In Chapter 202, we provide you



with a recap of the alternative computer processing capabilities available. We describe the advantages and disadvantages of each so that you can make an informed decision about which method or combination of methods best suits your needs. Chapter 203 details tax research sources, citations and alternatives, including electronic database searches, and how to present and retain records of research. Again we present the advantages and disadvantages of a variety of methods to assist your decisions about the most appropriate techniques. We also clarify the accounting and auditing issues to be considered and coordinated with tax practice in Chapter 204, including tax-related checklists to integrate in audit or accounting workpapers. In Chapter 205 we discuss how to most effectively deal with the IRS by detailing IRS examination procedures, the types of examinations, and how to prepare for them, as well as IRS assessment and collection activities.

## **Legal Liability**

Part III of *Tax Practice Management* addresses legal liability issues. A number of pronouncements summarize the professional standards of operating a professional tax practice. We detail these for you in Chapter 301. In Chapter 302, we recap the current penalties that can be imposed on tax preparers. You'll need to keep this information handy to avoid costly and embarrassing penalty situations. Finally, Chapter 303 discusses the issue of criminal tax fraud. We show you how to respond to fraud investigations of clients and what to do if the IRS issues a summons.

*Tax Practice Management* can be used as either a guide or set of blueprints for fully organizing and managing a tax practice, or as a handy reference tool for applications in specific issues or problems. Although busy practitioners will want to keep the book on hand for specific problem-solving suggestions, we urge you to consult it frequently, for the information, guidance and practice aids it contains are otherwise obtainable only through many years of experience and hundreds of hours of discussions and meetings with peers. Consider using sections of *Tax Practice Management* as a training guide for staff on how a tax practice operates and why management considerations are important.

We are confident *Tax Practice Management* will become a handy tool in your practice, frequently referenced, which will assist you in achieving greater personal success and providing timely, quality service to your clients.

Dear Subscriber:

*Tax Practice Management* is supplemented annually to keep its guidance abreast of current developments. We believe the book should be responsive to users' needs as well, with supplements containing materials identified by readers. Thus, we would appreciate your taking a few minutes to tell us what you think of *Tax Practice Management* and how it can better serve you. Please use the reverse of this form if you need extra space.

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Part I

# **Management and Administration**





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# 101 The Overall Control System

Just as rush hour gridlock could develop on city streets if no traffic signals, stop signs, or directional signs were in place, so could a tax practice grind to a halt without proper control of the information and tax files flowing through its office. An efficient and orderly practice requires an analysis of office facilities, personnel needs, client lists, and the overall flow of information and tax files long before the busy season starts. A tax practice calendar like that shown in Exhibit 101-1 can help ensure that your planning process comprises important dates for inception and completion of activities.

You must address a number of critical control issues, including the proper monitoring and management of lead times, control of due dates and promised dates, and control of workload assignments.

The two main components of your tax practice's control system are overall management of client tax information and control over clients. The overall management system includes client information such as carryover schedules and information required for future tax returns. Client control includes the acceptance and elimination of clients and the control of risk through proper use of engagement letters.

## 101.1 Tax Practice Quality Control

For a tax practice to operate effectively, a formal system of quality control must address all key areas of the practice. The AICPA Tax Division's Tax Practice Guidelines Task Force has developed a Voluntary Tax Practice Review program to assist practitioners in developing a quality control system. Based closely on the *AICPA Recommended Framework for Establishing a Required or Voluntary Quality Control System* (May, 1996), the review program recommends that a firm's tax practice policies and procedures address these five areas:

- Advocacy, Integrity, and Objectivity
- Personnel Management
- Acceptance and Continuance of Clients and Engagements
- Engagement Performance
- Monitoring

The Voluntary Tax Practice Review (VTPR) program is consultation-oriented and is not a tool to regulate tax practices. A tax practice review is a wholly voluntary type of review, the sole function of which is to enable tax practitioners to enhance the quality of their practices. No records are kept by the AICPA and no records are kept by the reviewer, except for the engagement letter used for a firm-on-firm review. The firm decides whether to follow the advice resulting from the review, as it would any advice rendered by a consultant. The VTPR should not be confused with the accounting-and-auditing practice-monitoring programs. The tax practice reviews are not designed as either "quality reviews" or "peer reviews" as the terms are used to refer to the accounting and auditing practice reviews required to maintain AICPA



membership. Rather, voluntary tax practice reviews are designed to identify methods to improve the quality of a tax practice. The program is designed for two types of reviews:

- Internal self-assessments
- External firm-on-firm reviews

A system of tax practice quality control should foster an environment for rendering high-quality tax services. The environment should maximize the likelihood that the expectations of the client will be identified accurately and met effectively.

Additional ideas for establishing a tax practice quality control system can be extracted from the following AICPA publications:

- *Statements on Responsibilities in Tax Practice* (1991 edition), Pub. no. 065012
- *Standards for Performing and Reporting on Peer Reviews* (1995), Pub. no. 067021
- *AICPA Peer Review Program Manual*, Pub. no. G01017
- *SEC Practice Section Peer Review Manual*, Pub. no. 017980
- *Guidelines for Voluntary Tax Practice Review* (1998), Pub. no. 061065
- *Tax Practice Guides & Checklists* (1998 edition), Pub. no. 059522

These AICPA publications can be ordered by calling 888-777-7077. Fax orders to 800-362-5066. Publications or CD-ROM versions may also be ordered from the Online Catalog on the AICPA Web site at <http://www.aicpa.org>.

### 101.1.1 Policies and Procedures

Tax practices should strive to adopt formal written policies and procedures covering these five points to the extent warranted by the firm's size, the nature of its practice, and other cost-benefit considerations.

#### **Advocacy, Integrity, and Objectivity**

The firm should require that all employees adhere to the AICPA Code of Professional Conduct and to the rules, regulations, and interpretations of the IRS and other regulatory agencies or be able to document and justify contrary positions. All tax professionals should be familiar with the AICPA's *Statements on Responsibilities in Tax Practice* (see Section 301.3.4) and OMB Circular 230.

#### **Personnel Management**

Tax practices should develop policies and procedures that ensure that work will be performed by employees having sufficient technical training and proficiencies (see Section 101.6.1).

In addition, they need reasonable assurance that employees will seek assistance, as required, from authorities within or outside the firm who are knowledgeable and competent. The policies and procedures developed will depend, in part, on the availability of library and other resources and the expertise among others in the firm (see Chapter 203).

A quality tax practice cannot exist without ensuring that the professionals it hires display integrity, competence, and motivation. The firm's quality control policies and procedures should establish qualifications and guidelines for those involved in the hiring function as well as for evaluating potential hires (see Chapter 104).

Continuing professional education and training activities help provide assurance that employees have sufficient knowledge and skills to handle responsibilities and to advance in the firm. The policies and procedures should establish guidelines for the firm's tax education program and encourage individuals within the firm to strive for professional advancement (see Chapter 105).

Policies and procedures should be established that document the qualifications needed at each level of advancement, provide for periodic progress reviews, and assign responsibility for making promotion decisions (see Section 104.4.1).

#### **Acceptance and Continuance of Clients and Engagements**

The firm should have written policies and procedures for evaluating and approving potential clients in order to minimize the firm's risk exposure and maximize its profitability. Procedures

should be established to document the understanding of services to be provided and the financial arrangements for fees. Procedures should also be established to periodically evaluate existing clients to determine whether a specific engagement should be continued, modified, or terminated (see Section 101.11 and Section 101.12).

### Engagement Performance

A quality tax practice should establish policies and procedures which assure that the tax engagement follows applicable professional standards, regulatory requirements, and the firm's standards of quality. These policies and procedures should encompass all phases of the engagement including planning, performing, supervising, reviewing, documenting and communicating the results of each engagement.

### Monitoring

To ensure that all elements of the firm's quality control system are suitably designed and are being effectively adhered to, the firm should establish policies and procedures to monitor each of the other elements of the quality control system. The results of the monitoring program should be reported to management with recommendations for appropriate follow-up action.

A sample quality control document is presented in Exhibit 101-2. The sample document is designed for a local CPA firm without a structured tax department. Sole practitioners and firms with structured tax departments should refer to the *Guidelines for Voluntary Tax Practice Review* for examples of quality control documents more closely applicable to their practices. All practices should modify such sample documents as necessary.

In addition, the firm's tax practice quality control policies and procedures can address the following items:

- Actual steps to be completed in preparing a tax return
- Rules regarding input preparation for the computer software being used
- Required attachments for all tax returns
- Checklist of review items
- Sample forms and checklists
- Status tracking
- Computer software training
- Fee structure of tax returns
- Confidentiality of client information

A sample set of these tax return policies and procedures is contained in Exhibit 101-3. Policies and procedures such as these should be prepared, approved by management, and distributed and explained to all staff. The policies and procedures in Exhibit 101-3 are an example only and are not intended to be all-encompassing. For example, the policies and procedures may also address the assignment of technical responsibilities for areas of expertise or the assignment of administrative responsibilities. Some firms even expand the policies and procedures to address issues such as workpaper preparation, supplies ordering, microcomputer use, record retention, and security concerns. Naturally, to the extent a separate administrative manual does not address issues such as vacations, holidays, sick leave, and overtime policy, the policies and procedures for the tax department should also address these areas. In developing your own firm's policies and procedures, you may adapt the exhibit to fit your own practice. However, the material discussed in Chapter 201 should be reviewed and incorporated as an integral part of your firm's policies and procedures.

To ensure quality, all staff should be aware of, and understand, Treasury Department Circular 230 on preparer penalties and the AICPA's *Statements on Responsibilities in Tax Practice*. Staff members should also respect the confidentiality of client tax information and the need for independence of mental attitude in tax client relationships.

The five elements of tax practice quality control are discussed in greater depth as follows:

<u>Element</u>	<u>Discussed in Detail</u>
Advocacy, integrity, and objectivity	Chapter 301
Personnel management	Chapter 101, 102, 104, 105, and 203
Acceptance and continuance of clients and engagements	Chapter 101
Engagement performance	Chapter 101 and 201
Monitoring	Chapter 101

**Practice Tip.** A tax practice quality control program yields the dual benefits of 1) superior work quality and 2) improved service delivery.

Superior quality results in less exposure to litigation since a quality control system emphasizes activities that improve documentation, staff training, and review procedures. Quality work limits the occurrence of preparer penalties. Finally, superior quality contributes to staff morale because the steps that insure satisfied employees—a staff development and training system, careful hiring and promotion practices, and appropriate supervision—are part of the nine elements of quality control. A well-designed quality control program emphasizing consistency, structure and systemization, results in improved service delivery.

## 101.1.2 Tax Practice Review

The *Guidelines for Voluntary Tax Practice Review*, prepared by the AICPA Tax Division, is filled with useful checklists, guidelines, and sample documents that can be used to improve the quality of your tax practice.

A tax practice review not only concentrates on policies and procedures and the implementation of the policies and procedures but also focuses on matters such as whether there is compliance with the firm's tax practice quality control system, whether the practitioner is asking questions that best serve the client, and whether the practitioner's compliance work is technically correct. Exhibit 101-4 and Exhibit 101-5 reproduce tax engagement review checklists used in a voluntary tax practice review.

The VTPR program is an ongoing commitment of the AICPA Tax Division. Practitioners who wish to use the program or to make suggestions on improving the program should contact the AICPA Tax Division at 202-434-9268, or write to:

Staff Aide  
Tax Practice Management Committee  
AICPA  
1455 Pennsylvania Avenue NW, Ste 400  
Washington, DC 20004-1007

Firms undergoing VTPR can optionally ask the reviewer to look at special areas of their practice, such as marketing opportunities, proactive client service opportunities and so forth. Because VTPR is in fact a *voluntary* undertaking, it is much less rigid than a required review (such as might occur in the audit and accounting area). Firms that have undertaken a VTPR report improved morale in staff, who recognize the importance of the VTPR and the firm's commitment to quality in its tax practice.

While checklists and other materials are provided as part of the VTPR program for the reviewer, the less rigid approach allows the reviewer to make observations and recommendations in a great number of areas. Many firms request that the reviewer complete an "exit interview" upon completion of the VTPR. A formal report is later prepared by the reviewer and issued to the firm, noting any "matters for further consideration," and in general, making observations and recommendations to improve the quality and efficiency of the tax practice. Firms who have gone through the VTPR process report that in many cases the costs can be recovered through increased efficiencies and improved quality (less re-do of work).

Costs of a VTPR vary, depending on the extent of the review and whether the reviewer is asked to look at special areas of a tax practice. At a minimum, smaller firms should expect VTPR fees in the range of \$2,000 to \$3,000.

The five areas discussed in Section 101.1.1 (and cross referenced at the end of that section) represent the primary areas looked at during a VTPR.

The VTPR materials also provide for a firm's self-evaluation. By acquiring the VTPR materials from the AICPA Tax Division and internally completing a review, significant improvements can result. This approach saves the cost of bringing in an outside reviewer, but requires significant *discipline* on behalf of the firm completing the self-evaluation.

### VTPR Case Study

In describing an actual VTPR, a practitioner reviewed the AICPA VTPR materials and requested the firm being reviewed to gather up materials used in the administration of their tax practice. This included organization charts, policies and procedures, sample worksheets and checklists and so forth. Additionally, the reviewer requested that a certain number of individual tax files, corporate tax files, partnership tax files and fiduciary tax files be pulled.

The reviewer arrived at the site the evening before, and met with tax department management personnel immediately the next morning. At that time, the tax department management personnel requested that some special areas of the tax practice be looked at, such as ways to better offer proactive client service, improvement of quality issues, and better ways to generate work during the summer months.

The reviewer analyzed the tax department policies and procedures, reviewed the various checklists and forms, and then set up a series of meetings with selected tax department personnel. The personnel included individuals at all levels, including partners, tax managers, tax seniors, and seasonal personnel. Inquiries regarding the tax preparation process, use of the policies and procedures, techniques for follow-up work and so forth were all discussed. At the end of the first day, the reviewer had compiled a list of issues to discuss with the firm the following day.

On the second day, the reviewer selectively analyzed some of the client files, looking at client organizer information, source documents, review comments, and any communication with the client at the time of forwarding the tax returns. The reviewer also looked at the technique the reviewed firm was using in terms of generating follow-up work after April 15. The reviewer also analyzed both individual and corporate files which were related, such as the Form 1040 of a sole shareholder and the related corporate return. Again, a list of observations to discuss with the firm was completed.

In the middle of the afternoon on the second day, the reviewer met with the managing partner of the firm, the tax department partner, and other technical people selected by the managing partner (including two tax managers, and other tax department personnel). The reviewer then briefly discussed the observations that had been noted during the review. Some of the observations were quickly cleared by tax department personnel explaining that what appeared to be a deficiency was addressed in other ways, and that the firm did not feel an overall problem existed. In other areas, personnel concurred that the observations were valid and worthwhile, and requested recommendations on how to follow-up on the issues in the future. As an example, although the firm had tax department policies and procedures, they had not been updated in some years, and had not been distributed to all tax department personnel. Besides the recommendation of updating the policies and procedures, the reviewer also recommended that the firm hold training sessions during January of each year to fully go through the tax department policies and procedures with all tax department personnel, including seasonal help.

After the exit interview was complete, the reviewer formalized the observations and recommendations within a few days time and forwarded them to the reviewed firm. The reviewer also made available various checklists and forms which the reviewer felt might assist the firm undertaking the VTPR. Several weeks later, the reviewer then contacted the firm to see if any questions existed or if any additional follow-up work was desired.

The overall feeling of the managing partner and the tax department partner in the firm undergoing the VTPR was that the entire exercise was very worthwhile, and that the firm had met its objectives of efficiency improvements, quality improvements, and profitability improvements from the observations and recommendations obtained from the reviewer. With the preparation work, the actual review and exit interview, and follow-up correspondence and report, total fees of approximately \$3,000 were incurred by the reviewed firm. Again, however,

the feeling of the firm was that many of the recommendations could be turned into profit improvements, allowing the cost of the VTPR to be easily recouped.

## 101.2 Office Layout

The physical layout of the office affects both the efficiency and the control of files and information. Because a well-designed office facilitates the flow of work and allows better supervision and communication, it is part of the control system.

### 101.2.1 Office Appearance

The client's first impression of your firm occurs when he or she walks through the front door. The image conveyed by appearances creates a strong sense of your firm's professionalism, attention to detail, and overall control over work. An unorganized, cluttered office may reflect on your management skills and may at worst shake your client's confidence in your technical abilities.

#### Reception Amenities

The office reception area should be orderly and clean at all times, and client comfort should be considered. Some firms offer coffee and other refreshments. Magazines and other reading material should be available for waiting clients. The types of magazines offered often convey an image of the type of work you do (or would like to do). (See Section 103.3 for a thorough discussion of image setting.)

**Practice Tip.** Make a wide selection of magazines available in sufficient numbers for all clients waiting at any one time. Brochures from the AICPA and state societies and the firm's brochures or client newsletter should be prominently displayed because they confirm your professional involvement and may provoke interest in additional services the firm can provide.

The office manager can keep on hand a supply of activity books to prevent children from becoming too restless in the waiting room and during their parents' interviews.

Background music "piped" into the reception area and used in telephone systems while clients are waiting helps convey an image of the firm. Remember that such music is provided primarily for the comfort of clients, not for staff entertainment. Background music is also helpful in masking distracting conversations throughout the office common areas.

If appointment times with staff for tax services are prescheduled, estimate the time required for each appointment and stagger the schedule to keep an even flow of clients moving through the reception area. Recognize that clients are also busy, so try to keep on schedule. Should the appointment schedule be delayed, have the receptionist call clients sufficiently in advance, inform them of the delay, and communicate the approximate time they will be seen. When appointments are scheduled, always learn where clients can be reached by phone if a cancellation or adjustment is necessary.

**Example.** In an office with four staff taking appointments, try to schedule the appointments to begin at, say, 15-minute intervals, as follows:

Interviewer:	Bob	Sally	Tim	Joan
	7:45	8:00	8:15	8:30
	8:45	9:00	9:15	9:30
	9:45	10:00	10:15	10:30
	10:45	11:00	11:15	11:30



## Cleanliness

Overall cleanliness of the office is a significant issue. Especially during the busy season, frequent file transfers, meals taken at desks, and heavy client traffic in the office result in a rapid accumulation of paper scraps, paper clips, and dirt from shoes. Doors left open to offices may allow clients and other visitors to see files and other information spread out across the floor and desks, all of which conveys an unfavorable image.

A messy office not only transmits an out-of-control image to clients but is also, most likely, a symptom of, or precursor to, bad work habits or a time-management problem. Follow up with staff who habitually keep a messy, disorganized office. Encourage staff to keep doors closed, and be sure cleaning personnel keep the office clean. Discourage staff from storing client work on the floor; cleaning personnel might mistake it for trash.

**Practice Tip.** In this age of smoke-free office environments, clients are sensitive to the effect of passive smoke. If your office has still not adopted a non-smoking policy, clients who insist on smoking should be scheduled late in the day so as not to inconvenience other clients. Offer gum or candy to help some clients through the stress of a tax interview.

## Confidentiality

Confidentiality must not be impaired by keeping client files in open view. You should direct staff to limit discussion of client matters to places where confidentiality is insured, such as in offices with closed doors. Client matters should not be discussed in hallways, elevators, or in open offices. Desks should be kept clear of open client files. Informational forms such as Forms W-2 and 1099 and Schedules K-1 should not be left in open view.

**Practice Tip.** You should see that staff members have enough temporary filing space to keep files in cabinets during their work on a particular set of returns, and that they store information in a neat, orderly manner. Firm partners may be the worst offenders! Information should be filed so it can be easily located, yet assuring confidentiality. The firm's filing system plays an important role, as personnel must have confidence knowing files returned to central filing are properly and quickly filed. Files cannot be allowed to wait for days to be refiled.

## 101.2.2 Evaluation of Work-Space Needs

Physical work-space needs for both full-time and part-time staff must be considered. Many issues go into work-space needs analysis:

- Are separate offices or only workstations required? How does this impact on the privacy of client meetings?
- Can staff members use different offices for completing work and meeting with clients?
- What is the client's impression of the work space? Does it look clean and orderly, or does it give the impression of things being out of control?
- Might confidentiality be impaired by having client files in open view?

## Responsibilities

The responsibilities of each staff member must be considered. For example, staff who primarily deal with clients on an ongoing basis require privacy and ambient noise control to conduct client interviews. Staff who rarely meet with clients may require only a semiprivate workstation or a desk in a common area.

If possible, design the physical work place so that staff have a separate office exclusively for meeting with clients. With this approach, the client meeting office is always uncluttered, while the "work office" allows the person to keep files and projects spread out for ongoing activity. Of course, the luxury of extra offices and computer terminals simply isn't available in many practices, due to physical space and cost limitations.

## Part-Time Work Accommodations

Space limitations can be addressed by using library and conference areas as temporary workstations. Part-time employees, who normally do not have direct client contact, make excellent

candidates to use the library and conference rooms on a temporary basis. A specific work area, even for part-time staff, enables you to organize supplies and information to allow an efficient approach to the work.

**Practice Tip.** Seasonal preparers using interactive data entry can work from completely remote locations, for example, from their homes. By connecting to the firm's network via modem, the seasonal preparer may only need to visit the office once daily to exchange files and discuss problems encountered on specific files. However, if remote access to the firm's network is allowed, password protection is essential to prevent unauthorized access into your tax return files. Again, confidentiality enters the mix when remote work sites are involved. Paper "checkout" of files is a must.

### 101.2.3 Evaluation of Equipment Needs

#### Hardware and Office Furnishings

You should evaluate the availability and adequacy of equipment prior to the busy months. This includes personal computers, calculators, photocopiers, typewriters, filing cabinets, fax machines, and other hardware, furniture, and machines. Remember to take part-time staff into account when evaluating your need for desks, chairs, and other equipment. Be sure to include stationery supplies, and storage.

**Practice Tip.** Short-term leasing of required equipment may be economically advantageous. Consider renting equipment such as computers and printers during the busy season.

#### Communications Software

One dilemma of the busy tax season is that practitioners are usually involved in closed-door client meetings at the same time that other clients are attempting to phone them. To speed response time, handwritten messages taken by receptionists and assistants are rapidly being replaced by electronic mail and voice mail. Voice mail has many advantages, including enabling a caller to give detailed or technical messages with less risk of misinterpretation. However, work thus tends to be upwardly delegated because clients leave messages with partners and senior staff that could otherwise have been presorted and delegated to other staff levels.

**Practice Tip.** E-mail software now exists to help users sort and prioritize incoming messages. A user can preprogram an E-mail system to automatically route messages from certain people directly to an assistant while retaining only important messages from specified senders.

Accountants can take advantage of the ultimate in E-mail communications by becoming a part of the Internet. This worldwide community of computer users allows for immediate communication between terminals regardless of location. The information and communication potential of the Internet for accounting firms is nothing short of phenomenal. E-mail can be sent from other tax preparers or clients directly to one's terminal even though those users are not on the same local area network (LAN). Telephone "tag" is avoided as messages are sent and returned completely at the user's convenience.

The research capabilities of Internet are virtually boundless, ranging from access to the daily status of all current tax legislation, to the ability to discuss accounting and tax issues with other accountants on-line or to order professional publications. Further information on Internet providers and capabilities can be found in many publications, including the *Journal of Accountancy*.

#### Equipment Failure Planning

In addition to evaluating equipment needs, formulate contingency plans for equipment failure. Emergency service agreements can be completed, business-interruption insurance considered, and backup power supplies and surge protectors purchased as deemed necessary. In general, plans should be made for using backup equipment if primary equipment fails.

Maintain a close working relationship with a local computer vendor so that they will immediately jump to action if you have a system failure. Make sure temporary computer equipment can be leased until suitable replacement equipment is purchased. Even though the network file server may be destroyed by an unforeseen casualty, the computer vendor may nonetheless be able to salvage your hard disk file information.

Other firms in your area may allow you temporary use of their tax preparation software (when compatible), but software vendors can normally provide these programs immediately to get a system back up and running. In fact, licensing agreements may prevent one from using other firms' software even in an emergency.

**Practice Tip.** Speak with computer vendors in your area. Compile a written list of those vendors who are able to provide software and rental equipment in an emergency. You should also contact your tax software technical support and determine if they can provide emergency service-bureau operations.

Review and update your backup procedures for the data processing system on an ongoing basis. In general, the backup procedures should include a daily or weekly "father" backup and an offsite "grandfather" backup. Alternatively, consider your firm's need for a fireproof storage safe on the premises. Particularly during the busy time, the destruction of data processing records without adequate backup may be devastating.

Data processing records could be destroyed even with adequate backup if there are inadequate security controls. These controls must keep unauthorized persons from operating the system or making changes that affect the input or output. Do not assume your firm is too small for password protection. If your software allows for individualized passwords, make sure that every system user has a unique password.

Review the adequacy of the insurance coverage on equipment. Consult with your firm's insurance agent regarding whether any equipment requires a rider on your general policy. Business interruption and additional expense coverage should also be purchased. See Exhibit 101-6, Computer Disaster Recovery Checklist.

**Practice Tip.** Some fire extinguishers can seriously damage electronic components. At the next annual check of your office fire extinguishers, make sure that only those that are rated safe for electronic components are placed near computer equipment.

## 101.3 Central Control

An *overall* centralized control system must be established for tracking the flow of all information and the movement of all files within the office. This centralized control system must address due dates and promise dates of individual files and should minimize bottlenecks in the tax preparation process.

### 101.3.1 Use of a Central Control System

In the absence of a central control system, how would your firm handle client inquiries regarding the status of their tax returns? No doubt, the request would require an office-by-office search until the file was located. As your practice size grows, this primitive method of file retrieval becomes increasingly time consuming, costly, and downright embarrassing from a client inquiry perspective.

By using the central control system described in this chapter, a file can always be located. This system dramatically reduces the time required to locate and retrieve files. Because a due date and a promise date are often associated with a file when it is activated, the file locator log or database can be sorted by due date, promise date, or by type of return to monitor the status of files. Under either a manual or automated system, slow-moving work can be identified and reassigned to clear up bottlenecks as they arise.

## 101.3.2 Central Control System Components

A central control system consists of—

- Updating current file status at each stage
- A central routing location for files and client data
- Routing a file to the most appropriate staff person

### Updating File Status

Update the status of the file with either a manual or an automated system. In either case, assign and enter a file identifier (such as a client name or number), along with an identifier of the file location (such as a staff person's initials or employee number) and the current date, in the appropriate area on the log. Exhibit 101-7 contains an example of the file locator log used in a central control system.

Several vendors provide tax return tracking software, and deadline tracking software for tax professionals. Such software not only tracks due dates, but also allows one to view the entire firm's workload on screen, including job status and responsible staff member. While manual control systems can capture the same information, software will greatly reduce the administrative time needed at a modest price.

### Central Routing Location

The basic premise of a central control system is that information and client files do not move without being routed through a central location or entered on a file locator log. As a file is routed, the current status, due date, promise date, and other information are monitored and controlled. Client information is routed through the central location to update the status of the file and to correctly forward the information to the person or group currently processing it.

The key element is one specific area through which information and files can be routed, the status of the file updated, and the information or file forwarded for required action. After a client interview has been completed, for example, the file is forwarded to the central area and its status is updated. The file is then forwarded for tax preparation to an assigned staff person. After tax input is completed, the file is again routed to the central area, where it is updated. It is then sent for further processing to another staff person. The file is continually routed to the central area for all stages of the tax return preparation process (see Section 201.2 for a detailed description of this process).

Smaller firms that are not networked may find it best to assign a single individual to be responsible for monitoring the due date control log. Even a manual log may satisfy a small firm's needs, because it gives the firm the ability to evaluate the effectiveness of a manual tracking system prior to investing in tracking software.

The larger the firm, the greater the opportunity to decentralize the tracking process. A PC-based network can allow each individual to update the tracking system as he or she completes work on the file.

The choice between centralized or decentralized file tracking must take into account staffing availability. In larger firms, centralized tracking can leave one individual dedicated solely to monitoring and routing files. This person will have the best knowledge of relative workloads and can assign files accordingly. On the other hand, decentralized tracking requires that each preparer update the tracking system as files are moved. While no one person is shouldered with the entire responsibility for updating, it does result in additional nonproductive time for the employees preparing returns. There is also the increased risk that the tracking system will be corrupted by the failure of certain preparers to diligently log the movement of files.

A decentralized tracking system where preparers are independently deciding where files are routed increases the likelihood that returns are not assigned to the most efficient preparer. Prior to tax season, staff should discuss which preparers are comfortable and have experience with different types of returns. A listing should be distributed as an aid for later reference, particularly to assist newer staff who may not be familiar with other preparers' expertise.

Many tax software products contain a file management system that can be used in conjunction with tax return preparation.

Exhibit 201-5 in Chapter 201 illustrates a flow chart of the tax return process. Using the flow chart as a guide for all tax returns, the file locator log should be updated as the file moves from one step in return completion to another.

### Routing Files to Staff

When assigning work to staff, route files based on the following criteria:

- Current workload of individual staff members
- Simplicity or complexity of work to be assigned, and technical abilities and experience of staff members

Assigning work to the proper staff is not a simple chore. Through staff meetings and other means of communication, you must monitor the current workload of each staff member. New files should not be assigned to staff that have numerous deadlines or large volumes of work. Of course, staff to whom work is to be assigned should only receive files that are appropriate for their abilities and experience. One method of categorizing files is through a simple coding system. Under such a system, the person conducting the initial tax return interview or reviewing the file for staff assignments uses a letter coding system, whereby returns are judged complex (A), average (B), or simple (C). An entry-level person should not be assigned to work on a “code A” complex return containing, for example, passive losses and alternative minimum tax. Conversely, an experienced person should not be given simple, straightforward “code C” returns except in emergency situations or when absolutely required to even out the flow of work. (See Section 101.6 for further information on workload assignments.)

**Practice Tip.** Problems occur, even with the best-designed system. Document all such instances with the central control system, and properly address weaknesses. For example, if one individual is routing files directly to another without passing the files through the central area, speak with that person immediately. This is not only a violation of the central control system, but may negatively impact quality control and efficiency, since the file may have been routed to the wrong staff level.

### Incoming Client Information

As tax returns are being worked on, additional client information is often needed. Information may be mailed in, dropped off in the reception area, or forwarded directly by banks and other third parties. Your staff must closely control incoming information related to client files. Exhibit 101-8 contains a sample control sheet to be used for incoming client information.

Steps for handling incoming client information are as follows:

1. Use a form similar to Exhibit 101-8 for each piece of client information.
2. Attach the client information to the control form.
3. Check the file locator log to determine the physical location of the file.
4. Request the file (if this is necessary), add the new information, update the central control status, and forward the file to the proper individual.

It is critical that all client discussions be documented. Thorough documentation not only allows proper follow-through and closure on client questions but also provides a permanent record of advice given for billing purposes and could be important from legal perspectives. Exhibit 101-8A is a client telephone discussion memo for logging client questions relative to taxes.

**Practice Tip.** You should consider not accepting client information over the telephone that might have a significant effect on the taxpayer’s return, unless it is also received over a FAX machine or via E-mail. Telephone calls alone do not provide sufficient documentation for the tax preparer’s file, and the likelihood of error is increased. At a minimum, practitioners or clients should follow up with written confirmation whenever significant information, such as year-end inventory valuation, is received in a phone call.

From a practical standpoint, however, many clients call with data to finalize tax information. Be sure to use a form similar to Exhibit 101-8 to control this incoming



information. Again, for information that has a material impact on the tax return results (such as home mortgage interest expense and year-end inventory) be sure to have the client follow up with written confirmation. For immaterial items, such as daycare provider identification number and verification of certain small amounts, properly document the call using a form similar to that shown in Exhibit 101-8.

### 101.3.3 Due Date and Tax Return Control

A tax return due date is important not only because of the filing deadline, but also because of the lead time necessary to physically complete the return. For example, April 13 is too late to identify individual tax returns not yet completed if there is a three-day turnaround period for completion of input, computer calculation, and tax return finalization. Ideally, returns should be ready for clients 10 days before the due date to ensure clients an adequate opportunity for review prior to signing (see Section 201.4.2).

**Practice Tip.** Because due dates and lead times differ for various types of returns, your staff must continuously check the status of returns. Review returns that have not “moved” from one preparation stage to another to be sure they have been properly logged and assigned. For example, if on March 3, the file locator log shows that a return was assigned for review on February 14, contact the assigned individual to be sure all information is in and completion of the return is on target.

As busy season deadlines approach, consider holding regular tax department meetings to monitor the status of files (see Section 104.5 on Team Meetings). Team meetings of the entire tax department are a good way of tracking current status on all open jobs. Although tracking software can show the number of returns assigned to an individual, it cannot tell a supervisor if certain returns are extremely time consuming.

#### Scheduling Lead Time

The typical number of days required to complete a tax return can be determined by working backwards from the completion of several returns to the date all information was first available. As filing deadlines approach, the file locator log should continually be reviewed to be sure there is adequate lead time to complete all work.

**Example.** One firm may determine that all computer input must be entered by April 8 to meet the April 15 completion deadline. Another firm, having enhanced in-house computer capabilities, may find that the required date is April 13. Lead times for each type of return must be determined and used in monitoring the file locator log. Partnership and S corporation returns have earlier deadlines, since the Schedules K-1 flow into other individual returns. Keep in mind that returns to be mailed to clients have a longer lead time than returns that will be picked up at your office (see Section 201.4.2).

Lacking adequate resources, some sole practitioners may contract with other firms to complete the review procedures. However, this may add additional turnaround time due to the logistics of physically moving files to and from another office.

#### Monitoring Delivery of Tax Returns and Other Client Materials

It is important to have control records of when completed tax returns leave your office—whether they are picked up directly by, or mailed to, a client—for two key reasons:

1. To provide a written log “proving” that mailing took place on a certain date in the event a client fails to receive and file the return timely or should the IRS assert an unjustified late filing penalty
2. To monitor due dates on projects or materials to be picked up by clients

A mail log should be used for *all* outgoing mail. Consider using a spiral notebook or automated list to log the date, addressee, and contents. The IRS does not consider such a log proof of timely filing, but a log does lend at least some support to the taxpayer’s position that timely filing did occur. Certified mail, return receipt requested, is recommended for all tax

returns mailed to an IRS Service Center. Because of the risk associated with late-filed returns, make every attempt to get returns to clients for client signature and mailing, while always recommending the use of certified, return receipt requested, mailing by clients.

**Practice Tip.** Should you receive an IRS notice that a return was not filed in a timely manner, remember that a certified-mail return-receipt by itself proves little, except that an envelope was mailed to an IRS Service Center. All returns and elections filed using certified mail should have the return-receipt number entered on the top of the return. In this way, the return can be directly associated with the certified mail receipt to substantiate timely filing.

A secretary or the receptionist should maintain a log of materials to be picked up by clients. Even though a client may have been informed of a critical due date, it is embarrassing to the firm should the project sit in a “pickup drawer” beyond its due date without client reminder phone calls being made.

The information pickup log (see Exhibit 101-9) records the client’s name, due date, contents, date placed in drawer, date client called, date picked up, and the responsible employee’s initials.

These monitoring procedures can be further strengthened by requiring the client to sign an acknowledgment of the materials picked up. See Exhibit 101-10 for a sample Client Materials Return Form.

## 101.4 File Control

In addition to overall centralized control, control of individual files and individual file information is essential.

Essential file information includes the date the file was activated, its due date, and any promise dates associated with it. It also includes special processing and secretarial instructions, and information required for billing purposes, such as special billing instructions and a quoted range of fees.

### 101.4.1 Tax Return Routing Schedules

Exhibit 101-11 illustrates a sample tax return routing schedule. Information on an individual tax return routing schedule may include the following items:

- Client name and number
- Date information received
- Target completion date
- Due date
- Date engagement letter signed
- Grading of the return’s complexity
- Information for next year’s return
- Instructions for processing and secretarial staff
- General data to allow file tracking by the control system
- Billing information

A routing schedule sheet provides a simple reference spot for noting items unique to a return. The schedule also notes important items to be used in next year’s return preparation, such as net operating loss carryovers or changes in dependents. Special instructions may be noted for the processing stage, such as multiple state returns or special forms to attach to the return. Finally, the schedule may provide billing data, such as the prior year’s fee, work-in-process, or a quoted fee range.

The tax return routing schedule generally provides data that can be determined from other sources. However, it assembles all this data in one convenient place for later reference.

Even though the schedule may indicate carryover items from the previous year, it is not a substitute for reviewing last year's return. Carryover information may have changed because of subsequent amended returns, carryback claims, IRS examinations, and other events. (See the discussion at Section 201.2.2 on completing routing schedule data.)

## 101.5 Operating at Full Capacity

The objective in operating the organization at full capacity is to increase the firm's profitability while reducing stress and staff hours. Efficiently moving files through the office and timely completion of quality returns allow the firm to bill clients on a regular basis and accelerate cash receipts.

Your practice must secure necessary personnel to meet demand, yet operate in an efficient manner (so that the maximum resources are used). You must control the busy season, rather than allow the busy season to control you.

Despite the best plans, many firms find that the seasonality of a tax practice results in long hours and significant stress. Alternatives discussed at Section 101.5.2 that result in spreading out the workload and pushing some of the work into the nonbusy months may be advisable.

### 101.5.1 Chargeable Time Budgeting

The tax return routing schedules and data base information for the prior year become the heart of charge-time budgets for the coming tax season. By analyzing the time spent on the prior year's returns, your firm can develop a charge-time budget for the current year's returns. Charge-time budgets are indispensable in—

- Assigning staff workloads equitably.
- Dividing clients according to their returns' level of difficulty.
- Assigning clients to staff members according to the staff member's level of experience.
- Allocating the workload so that each staff member has an equal share in terms of the total budgeted hours.
- Measuring and evaluating employee performance.

See Section 101.6, Workload Assignments, for more information about assigning work to the staff. After developing a time budgeting process within your firm, your own ideas for the use of time budgets will evolve.

As the tax season progresses, some staff members will meet their budget goals more consistently than others. You can use this information for awarding pay raises and bonuses. However, you may find it counterproductive to create excessive competition among your employees who, instead of working with each other, may begin to work against each other. Also, if employees feel too much pressure to meet budget goals, they may develop a tendency to underreport their actual times. Monitor the reported time to determine if it conforms to your perception of the employee's actual time. For example, if the employee's reported time reflects very little overtime and yet the employee is in the office evenings and weekends, it is likely that time is being underreported. By requiring daily time reports (see Section 102.10), the tax manager or tax partner can check more closely reported time and keep aware of daily workloads.

**Practice Tip.** By compiling the total time budgeted for various functions on the tax return routing schedules, you can compare the budget to the total amount of staff time available to determine if the firm is over- or understaffed for the coming tax season. While some overtime is normally expected during tax season, using time budgets allows you to predict it and determine if it is within reasonable bounds.

Total time budgets can be developed for clerical functions, preparer functions, and reviewer functions. Your firm may find itself understaffed in some areas and overstaffed in others. Excess reviewer staff time might be assigned to preparer functions to ease a shortage of preparer staff

time. An extra clerk may be necessary to help with clerical functions. Exhibit 101-12 provides a sample tax season workload projection for budgeting total hours for the entire staff.

The AICPA Tax Division Voluntary Tax Practice Review Program recommends that firms maintain a reasonable estimate of the total number of tax hours for the following activities:

- Tax preparation by type of entity, including corporation, fiduciary, individual, partnership, tax-exempt
- Tax planning
- Tax examination
- Special tax projects
- Other tax projects

Time budgets are a useful device for an end-of-tax-season analysis. If the returns consistently took more time to prepare than had been budgeted, there may be a problem with the preparation system, or there may simply be a flaw in the budgeting process. By examining the total time spent on the various return preparation components—interview, forms input review, and so on—you may be able to pinpoint areas of the process that created bottlenecks. Because budgeted times are developed from the prior year's data, you should consider factors that have changed from one year to the next: a law change, new employee, or change in the computer system. If your budgeting system is automated and updated regularly, you may be able to discover problem areas as the season progresses while there is still time to take corrective action.

**Practice Tip.** A number of time and billing systems are available as computer software packages. In today's environment, it only makes sense to consider a Windows based program, which allows employees to use multi-tasking with other software. Older DOS based programs lack the open architecture platform which allows data to be manipulated in various ways for analytical purposes. The time and billing system can work hand-in-hand with the routing schedules to track and record return preparation times. In fact, some tracking software can export data directly into time and billing programs.

Developing and analyzing overall time budgets can help your firm determine if the overall client base is too large or too small. If your firm is overstaffed for the total work-load, you have the choice of trimming excess staff or finding ways to induce more clients to the firm. If your firm is in the position of having more clients than it can handle, you should seek new staff members to handle the workload.

**Practice Tip.** As soon as possible after the busy season, compile statistics on the number of tax returns, extensions, and reruns processed. Compare these statistics to prior-year statistics to determine staffing needs for the next year and training requirements in certain areas.

## 101.5.2 Managing Workloads

First, plan and prioritize all work. For example, banks and other financial institutions have essentially all of their tax information complete within the first few days after the calendar year ends. This allows for early scheduling of these corporate returns. A significant amount of tax return work for banks with a December year-end can be completed within the first two weeks of January, prior to the time individuals and other corporations have completed and assembled their information.

**Practice Tip.** Consider the following general timetable for scheduling tax return preparation in a manner that effectively manages the office workload:

- |                |  |
|----------------|--|
| Early January: | Financial institutions   |
| Late January:  | Business returns needing assistance with payroll and informational returns |
|                | Qualified farm tax returns eligible for the March 1 tax payment election   |
|                | Preparation of state and/or local tax returns                              |

Early February:	Wage earners expecting refunds Partnership and S corporation returns Smaller returns with investment income only
Late February:	Other business returns Other wage earner returns
March:	Returns with income from pass-through entities

### Extending Tax Returns

Another approach is to consider extensions. Several types of returns are likely candidates for extension:

- Returns with no tax liability
- Returns with only small refunds
- Returns with income from pass-through entities
- Returns awaiting additional client data in the final weeks or days before the due date
- S corporation returns when your firm prepares the shareholders' returns
- Returns for clients who are chronic slow payers of fees
- Returns automatically granted additional time in declared disaster areas

Returns that have no tax due or only a small refund may be candidates for extension. Clients who indicate they had losses for the year or those with significant loss carryovers may be quickly identified as fitting this category. Many individual tax returns contain income from pass-through entities as reported on Schedules K-1 and other information that is often not available until a few days before the filing deadline. These returns also are excellent candidates for extensions, along with returns requiring additional information to be submitted to the preparer in the final two or three weeks before the due date.

Another method for identifying tax returns for potential extensions, and also an opportunity to create additional work for the firm, is to do year-end tax planning and projections for individual clients. This allows a client to know where they will stand on April 15, and many clients expecting to owe some tax are willing to extend their tax returns, since the preparation of the return is simply a finalization of the overall plan that was begun in November or December of the previous year.

**Practice Tip.** Encourage your clients, through your year-end client letter, to bring in data early.

The main objective in encouraging extensions is to push as much work as possible out of the peak season into the normal months. The disadvantage is that, while it may solve your workload problems, it may not be servicing the client's needs. After all, your clients may feel you have unfairly prioritized your own needs over theirs. Estimating tax and preparing extensions take time. Preparing tax returns outside of tax season may be inefficient, as the staff members turn their attention to other matters. Even if lower billing rates are used outside of tax season, these inefficiencies may actually increase the tax preparation time and fees. If this time will be billed to clients, they should have the opportunity to decide whether extending the returns is in their best interests.

There is also a risk of error in quickly estimating the tax liability—errors that could result in late payment penalties imposed on the client for which the preparer may be responsible.

Many sole proprietorships, faced with high income and self-employment tax rates, may benefit from incorporating their businesses. Several valid business reasons could exist for adopting fiscal year-ends on newly incorporated proprietorships that would shift much of the tax preparation work out of the busy season.

### Limiting Interruptions

Frequent interruptions from phone calls and questions from staff reduce efficiency in preparing tax returns. To keep work flowing smoothly to the next preparation stage, consider designating activity times, or quiet times. During these designated times, interruptions from telephone calls



and staff inquiries are not permitted. Rather, staff are directed to work on specific activities and to limit discussion with others in the office to absolute necessities. While efficiencies may result from this strategy, the opposite may occur if it is too rigidly enforced. That is, projects may stall if staff are unable to communicate with others when problems are encountered.

**Practice Tip.** Consider having a quiet time the first hour of every day during which no phone calls or appointments are allowed. The purpose of the quiet time is to make partners and managers available to other staff for inquiries and discussion. The designated time also forces staff to accumulate their questions rather than creating several interruptions throughout the day.

**Practice Tip.** Try to limit the length of phone calls by having your receptionist or secretary take down much of the information or inquiries directly. Returns of client phone calls can largely be held to a certain time each day, such as from 4:00 P.M. to 5:00 P.M., or later, provided they are not time critical.

Strong communication is a key element in operating an organization at full capacity. You should consider holding regularly scheduled team meetings (see Section 104.5), perhaps weekly, with all staff to—

- Communicate technical developments.
- Discuss problems or office procedures.
- Monitor due date lead times.
- Monitor overall workload status.

The larger the firm, the greater the need for a structured meeting agenda. A tremendous amount of firm resources may be tied up in one meeting, so the meeting should have a definite direction. Staff meetings also allow management to monitor due date lead times and overall workload status (see Section 101.3.3). Consider requiring each staff person to submit a schedule of the coming week's activities. As required, distribute internal memorandums or send E-mail on particular problems encountered, computer solutions uncovered, and issues of general interest to the practice as a whole.

**Example.** In reviewing a tax return output from computer preparation, you discover that “Listed Property” is not printing in the proper section of Form 4562. To override this error a special code needs to be entered on the depreciation input.

If your firm holds staff meetings weekly, many returns may reach data entry before you can bring this matter to the entire staff's attention. When items are so critical that they must be communicated immediately, distribute internal memorandums, send E-mail, or hold brief staff meetings at the beginning or end of the day.

### Prescheduling Appointments

Some practitioners are at the mercy of tax season because they allow clients to come in to see them at will. Invariably, many clients delay this often unpleasant task as long as possible, creating an avalanche of last-minute appointments. Clients often procrastinate in tackling the unpleasantness of their income tax returns. Even allowing clients to call your office to schedule appointments in advance can lead to an overload of last-minute appointments.

One method of controlling the busy season is the prescheduling of tax appointments for the expected length of time needed. Appointment letters can be forwarded to clients setting up a date and time for them to bring in their tax information. Since clients generally prefer appointments around the same time of year, you can use a database system to simply update dates and times from the previous year. Although prescheduling appointments may not be workable for all clients, it is an option that should be explored. Sample correspondence for prescheduling appointments is found in Exhibit 101-13. Section 201.2.3 discusses which clients may need appointments and which may simply mail in their data.

Problems are almost certain to arise even though great care may have been taken in prescheduling appointments.

**Example.** A client may have acquired or disposed of a business since last year, greatly expanding the length of time needed for the appointment in the current year. A business client may have retired during the year and expects to file a very simple tax return in the future. This client could be assigned to a less experienced staff member for future years.

Exhibit 101-14 contains a sample worksheet to note appointment changes for next year. You can note appointments that should be scheduled earlier, that require a longer or shorter time frame, or that should be reassigned to another individual in the office.

**Practice Tip.** Be aware of those clients who must schedule their appointments at certain times of the day. Small business owners, such as retailers, restaurant operators, and dairy farmers, cannot be simply scheduled at random. Note these restrictions on your data base for next year's appointment letters.

### Incomplete Client Information

Most tax practices have no trouble operating at full capacity during the busy season. However, keeping the organization operating at full capacity is a challenge when some of the client information is missing. Do you place the entire client file on hold until the missing information is supplied, or should return preparation be initiated and then finalized when the missing information is supplied?

**Practice Tip.** Always encourage clients to use the tax organizers when gathering tax information to assist in a complete gathering of the information. Possibly even consider the implementation of a discount for submitting organizers in a thorough and timely manner.

Section 201.5 discusses missing information from a preparation perspective. However, to answer this question from a control perspective, you need to assess the overall workload within your firm at a given point in time. If some staff have fairly light workloads, files currently on hold could be assigned to them for partial preparation using the data currently available. On the other hand, if all staff people have sufficient work to keep them busy, there is no need to bring additional returns into the system and create a potential bottleneck. It would be more efficient to route the file to the "hold drawer" and continue working on returns that can be moved directly to the next preparation stage.

While there are obvious inefficiencies in picking up a file and setting it down partially completed, it is generally more important to keep the practice operating at full capacity *at all times*. Even the busy months have their own workload peaks and valleys, and leveling this will help prevent bottlenecks later.

The central control system (see Section 101.3) requires that missing information be properly documented on each file. In reviewing the hold drawer at a later time, it should be readily apparent why a file is on hold.

Exhibit 101-15 contains examples of follow-up forms for recording what missing information must be received to complete the return. Clearly indicate on the file control sheet what specific items are missing, such as "Form 1099 from First National Bank" or "property taxes on rental house." Also indicate the date the file was placed on hold and the date by which information is needed, so stalled projects can be reactivated if it appears the client has forgotten to follow up. Consider using a two-part carbonless form, giving the client one copy and retaining the other on top of the file.

**Practice Tip.** You should review all files on hold every 5 to 10 days and more frequently as filing deadlines approach. This can often be done simply from the tracking software. When certain staff are light on work, the hold drawer may provide a number of projects that can be partially completed. It may also reveal clients who need follow-up contact to bring in requested information. Be sure to document any follow-up telephone calls on the follow-up form.

### Computer Reruns

When using automated services, reruns of some returns are unavoidable. Since computer reruns can involve significant lost time and inconvenience, you should monitor and track all reruns.

Exhibit 101-16 contains a form to analyze computer reruns. This form is intended to gather sufficient information so that you can identify and discuss common or frequent problems at staff meetings.

**Example.** The form may reveal that a significant number of reruns occur for Form 2106, Employee Business Expenses. Simply discussing the particular problems encountered with Form 2106 or engaging in further training on it may reduce the number of future reruns. A form to control reruns allows a firm to learn from its mistakes.

**Practice Tip.** Be sure to clearly label “superseded” returns as soon as an error is noted to prevent confusion when the corrected return is processed.

## 101.6 Workload Assignments

For all tax firms except sole practitioners, the most important element in assigning work to staff is assigning it at the appropriate level. That is, assign the more complex work to more knowledgeable and experienced staff, and assign simpler tasks to less experienced staff. Keeping all staff working at their highest skill level is important both to enhance profitability and to maintain staff morale.

**Practice Tip.** Consider having the interviewer indicate on the tax return routing schedule whether the return is simple, moderate, or complex. This will assist the individual assigning returns for preparation to target the return to the proper preparer skill level. The coding for tax return complexity should also be placed on the file folder. (See Section 101.3.2 for further information.)

### 101.6.1 Assigning Staff

Determining the proper level of staff to assign to a particular tax return is often difficult. Reviewing the prior year’s file may reveal that a lower level of staff should have been assigned to a return. Exhibit 101-17 contains sample correspondence to reassign a client file. Addressing this issue immediately after the busy season gives clients and staff sufficient time to prepare for the following year. Some clients are sensitive to being shuffled among staff accountants from year to year and may react negatively to a letter announcing the reassignment of their files. Knowing your clients well, and reassigning those clients by personal introduction rather than by mail, will help ease the transition.

You should clearly communicate to your staff that billing rates are associated with experience and capability levels. In fairness to the client, assign work to the appropriate level. Experienced personnel with higher billing rates who find themselves assigned to simpler tasks should be encouraged to bring this to management’s attention, so that the task can be reassigned. Similarly, less experienced people finding themselves overwhelmed with a complex file should also bring this to management’s attention so the file can be reassigned to a higher, more efficient level.

Staff members should be advised of their assignments and any changes with sufficient advance notice via posted staffing schedules or memos. The person with final responsibility for larger engagements should approve the scheduling and staffing.

### 101.6.2 Using the Team Approach

Because client contact is often limited to one staff member, clients are often under the false impression that only that individual works on all stages of their tax returns. Follow these guidelines to educate your clients about the team approach:

- Explain that several people are involved in preparing the tax return.
- Point out that numerous people provide a better perspective on the file.
- Explain that the work continues to flow if one or more individuals are exceptionally busy.

- Indicate that overall fees are lowered because certain tasks can be assigned to accountants with lower billing rates.
- Note that, in general, the team approach makes the entire firm capable of responding to client inquiries and needs.

Despite these advantages of the team approach, some clients are extremely sensitive (often because of confidentiality concerns) about the involvement of numerous people in their work. Clients who insist on working only with one or two specific individuals should clearly understand that inefficiencies may result (along with higher fees), and that a longer time may be required to complete their work.

**Practice Tip.** Explain the team approach policy to clients through your firm’s newsletter or correspondence accompanying the appointment schedule.

In all cases, be alert to the impact on quality of having only one or two people involved in preparing a tax return. Errors may go undetected if the return is not reviewed by the most qualified staff. For example, one staff person might attempt to limit fees by having inexperienced staff with lower billing rates review the return.

Sole practitioners can overcome this obvious dilemma by contracting with another firm to handle the review process. Sole practitioners who have no other choice but to review their own preparation should allow at least one day before going back over the return. Doing this will allow for a fresh look and may uncover errors or opportunities overlooked during preparation.

### Assign Primary and Secondary Accountants

All clients should be assigned both a primary and secondary accountant. The primary accountant would normally be a partner, responsible for the highest level services to that client.

The primary accountant normally meets with the client for the tax interview and signs the return, but not always. Large returns may actually have the information gathering task delegated to the secondary accountant, while the primary accountant retains purely a global perspective; only consulting on business planning matters and ensuring that the client is being fully serviced.

The secondary accountant is typically the “DO-er,” and often has significant direct client contact. This system guarantees that each client has one accountant ultimately responsible for services, particularly when several accountants provide different services for the same client.

In summary, the responsibilities of the *Primary Accountant* should be as follows:

1. *Management* of overall technical responsibilities for the client, including adequate professional judgment on when to implement the “Consultation” function.
2. At least an annual contact with business clients, either at the client’s place of business or via telephone, preferably by a partner, or at least by a manager (see Section 103.7).
  - Contact is not required for business clients such as trusts, where only the Form 1041 is completed.
  - Justification should exist for any business clients for whom contact by a partner is not made.
3. Current status of billing and accounts receivable.
4. Realization percentage (see Section 102.2.6).
5. Ongoing meetings with secondary accountant to review additional services that could be provided.

The function of the *Secondary Accountant* is as follows:

1. Completion of technical work, such as tax returns and financial statements.
2. Ongoing day-to-day client work and client contact.
3. Exercise of professional judgment as to when to bring the primary accountant in to discuss technical and administrative issues associated with client.
4. Identification of additional services to be provided to the client (see Section 103.11).

## 101.7 Tax Permanent Files

A tax permanent file is an integral part of the control over client information. Consider using permanent files to track critical items for future returns. Permanent files contain information that is a permanent part of the client record and that can be referred to and used year after year for work that is pertinent to the client. Permanent files include information such as carryover items, tax depreciation schedules, research findings, tax elections, certified mail receipts proving timely filing of returns, and IRS correspondence and audit information.

### 101.7.1 Carryover Items

A number of items not deductible by a taxpayer in the current year may carry forward to be used to the taxpayer's benefit in the future. It is essential to keep an ongoing record of these items, so the amounts can be picked up in subsequent years for the client's benefit.

There are a large number of these carryover items. Examples include, but are not limited to, the following:

- General business credit carryover
- Net operating loss carryover
- Capital loss carryover
- Passive loss carryover—regular tax
- Passive loss carryover—alternative minimum tax
- Minimum tax credit carryover
- Four-year spread amounts related to change in accounting method or year-end
- Investment interest expense—regular tax
- Investment interest expense—alternative minimum tax
- State estimated tax paid after January 1 that becomes deductible on the federal Schedule A the following year
- Cost basis in residence
- Basis in nondeductible IRA contributions
- Installment sale gross profit calculations
- Goodwill purchased with a business
- At-risk limitation amounts
- Suspended Section 179 depreciation
- Basis in subchapter S stock, limited partnerships, or mutual funds
- Loan amortization schedules
- U.S. Gift Tax Returns, Form 709, if not maintained in a separate permanent file
- Original election forms with year filed notated, including Form 3115 for change in accounting method, Form 970 election to use LIFO, and so forth

These items are all critically important to a taxpayer. The minimum tax credit, passive loss amounts, and capital loss amounts can significantly reduce the tax burden in future years, so it is vital to maintain carryover schedules. It is also important to inform the client of carryover items, because there may be opportunities throughout the year to create offsetting income or expense against the carryover.

Carrying these amounts forward in a tax permanent file provides a schedule that can be updated and evaluated annually.

### 101.7.2 Depreciation and Amortization Schedules

Because the detailed schedules of depreciation and amortization deductions are not required attachments in a tax return (only Form 4562 needs to be included in certain cases), consider keeping detailed schedules of depreciation and amortization in the permanent records.

Some practitioners prefer to keep detailed depreciation records and fixed asset information on a separate data base, to calculate the depreciation amounts during the nonbusy months.



Others use the computer software used to prepare the tax returns to calculate depreciation amounts also. Either way, if the detail is not included in the tax return, you should keep a copy of it in the tax permanent file.

**Practice Tip.** Most tax return software packages can produce an estimate of the following year's depreciation. Providing a copy to the client along with the return and retaining a copy loose in the file will greatly assist year-end planning whether or not the client formally meets with you.

Similarly, many taxpayers either pay or receive installment contract amounts, or amortize intangibles such as noncompete covenants. The tax permanent file provides a perfect place to keep detailed amortization schedules.

### 101.7.3 Consultation on Special Tax Problems

Because of the complexity of the tax laws, many client matters require specialized research. Upon completing such research, the tax permanent file provides the opportunity to permanently store the research findings. The research could be easily referenced should any future questions arise on the technical issue, such as in an IRS audit.

The tax permanent file should also contain research and support for accounting treatments contrary to IRS positions. Such tax positions may require adequate disclosure within the return.

Consultation with other individuals or technical research sources should be documented. Consultation can occur with technical library resources, the AICPA, a state CPA society, another firm, or another individual. The resolution of any differences of opinion between the engagement personnel and tax specialists should likewise be documented. The firm should designate individuals who have specialized expertise and experience in certain technical tax areas as being available for consultation.

Many on-line tax research systems, as well as those on CD-ROM, can provide an audit trail of the research process used. A copy of this audit trail should also be included in the file to document the methodology used in arriving at the research conclusion.

Exhibit 203-1 contains sample forms to document specialized research problems. The forms ask for background information, a simple one- or two-sentence statement of the problem, the technical citations, and a brief conclusion. The research forms, along with background information from technical services, can be filed in the tax permanent file. Chapter 203 discusses tax research in detail.

**Practice Tip.** Consider setting up separate topical research files where technical research can be filed and referenced should another client require similar research.

### 101.7.4 Engagement Letters

Engagement letters are discussed in Sections 101.13, 201.1.1, and 301.6.3. Regardless of the form your engagement letter takes, you should either file the signed letter in the tax permanent file or in the current year file. As engagement letters are received in future years from the client, they should also be filed accordingly.

**Practice Tip.** Maintaining a record in the permanent or current year file stating that the engagement letter was properly received will prevent tax returns from being released without having a signed engagement letter.

### 101.7.5 Billing Data

Some practitioners prefer to record billing information, particularly as related to tax services, in the tax permanent file. Other practitioners prefer to file billing information in a separate billing file. Either method provides an easily referenced record for tracking billing information from year to year. Chapter 102 discusses the relationship of the current year's fee to the prior year's fee.

## 101.7.6 Client Information

When you accept a new client, certain information should be obtained:

- Name
- Address
- Telephone and FAX numbers
- E-mail address
- Prior accountant
- Prior year's tax returns
- Previous year's fees
- Other services desired
- Previous bankruptcy filing (YES or NO)
- Previous IRS audit (YES or NO)
- Any outstanding Powers of Attorney
- Previous IRS payroll tax and collection problems (YES or NO)

Many firms require this basic information to be completed prior to accepting a new client (see Section 101.12). Once you have entered this client information in the data base, file a copy of the information in the tax permanent file. See Exhibit 101-22 for a data form capturing this information.

## 101.8 Post-Busy-Season Work

During the busy months, many work projects can be identified that are not time critical and that can be deferred until the nonbusy months. In fact, the busy months provide an excellent opportunity to earmark other work. A few of the opportunities for client service during slow months that often surface during tax season client file review are the following:

- Carryback claims
- Amended returns
- Estate or business planning opportunities
- Incorporation work
- Revision of quarterly estimates
- Accounting system design and consultation

See Chapter 103, Marketing and Practice Development, and Chapter 106, Tax Planning Services, for discussions of how tax season creates work year round.

**Practice Tip.** Consider requiring each staff preparer to complete a form for each return prepared, suggesting at least one planning or compliance idea. This procedure compels all staff to be cognizant of tax planning opportunities as an integral part of each engagement.

Exhibit 101-18 contains a sample form for creating a follow-up during the nonbusy months. As work is completed on tax files, the follow-up form should be completed for every post-tax season project or opportunity for work identified during the busy months.

Because the follow-up forms contain a due date as part of the information, have your secretary file them by month and prepare a comprehensive list immediately after the busy season is over. The work can then be assigned by the accountant initiating the follow-up, and prioritized based on due date and significance.

### 101.8.1 Off-Season File Reviews

One of the greatest opportunities for spreading work into the off-season rests with a detailed review of client files. Besides generating additional work (and additional revenue), this significantly enhances your firm's image with the client, because it communicates a "we care" attitude.

The review also can identify files that are not up to firm standards. Exhibit 101-19 contains sample forms for reviewing files during the off season.

Based on these file reviews, many opportunities for additional work that may have been overlooked earlier can be identified and assigned.

**Practice Tip.** You can obtain a fresh and impartial review by assigning an individual not already familiar with a file the responsibility to review all data in it and by having the reviewer complete the form in Exhibit 101-19. Someone unfamiliar with a client cannot rely on his or her own knowledge of the client to explain transactions or events. The workpapers must stand on their own merits. Deficiencies in file documentation or inadequate review are easily observed when the individual has not previously worked with the file.

## 101.9 Coordinating Responsibility for Other Required Returns

One of the areas with greatest potential liability and a need for strong controls is coordinating responsibility for completing other required tax returns. Many projects involve an accountant as well as other professionals, such as attorneys and bankers, who are responsible for coordinating the variety of professional functions. The importance of coordinating responsibilities is significant.

**Example.** The late filing of the annual Form 5500 for a retirement plan could result in costly penalties if you assumed that a bank trust department was responsible, and they assumed that you were responsible, for its preparation.

### 101.9.1 Types of Returns

While preparing an income tax return, you should be alert to other types of returns and services that require completion. Examples include, but are not limited to, these:

- Corporate and partnership returns identified while completing an individual return
- Individual returns identified while completing corporate and partnership returns
- Estate tax and fiduciary returns upon the death of a client
- Federal and state ID number applications for new entities
- Gift tax returns
- Returns for pension and profit-sharing plans
- Intangible tax returns
- Use tax and other similar returns

### 101.9.2 Communicating Responsibility

The most important rule in coordinating and communicating responsibility for other required returns is *communicate, in writing*, your understanding of the responsibilities assigned.

You should identify the other returns and filing responsibilities, and then communicate, in writing, to the client, with copies to all involved parties the responsibilities that have been discussed (or have been assumed). Indicate clearly that, unless you hear otherwise, you assume that the responsibilities will be addressed as summarized in the correspondence.

**Example.** One of the most frequently encountered confusing situations on assigned responsibility is the election of S status by a corporation. Since attorneys are normally involved in establishing the corporation, and the accountant is normally contacted early to establish an accounting system and file for identification numbers, coordination of the responsibility for the S election is vitally important. Once a decision has been made, forward correspondence to those with responsibilities assigned regarding the decisions reached.

## 101.10 File Storage Systems

The larger the practice, the greater the need to select a file storage system to maintain control of client files and information. Seemingly minor issues such as color coding and types of file folders have significant impact on the overall control system.

### 101.10.1 Color Coding

By color coding file folders or labels, different file contents can be identified. For example, corporate tax files may have yellow labels, partnership files brown labels, individual files red labels, and fiduciary files blue labels.

Through the color coding scheme, files can be easily identified and segregated by type. For example, preparers can more easily identify partnership returns associated with individual tax files, and incorrect filing can be minimized.

### 101.10.2 File Folder Alternatives

There are several useful alternatives among file folders. Some practitioners prefer a multi-sided file jacket, while others use a one-sided file folder. Some practitioners prefer hanging files and others prefer loose folders.

A multi-sided file jacket allows you to segregate different information in various sections. For example, copies of prior-year returns could be held in one section, copies of client correspondence in another section, and information used for preparation of the tax return in the third section. A one-section file folder essentially requires all this information to be combined, and adds complexity to locating and retrieving information in the future, since information must be filed in the exact chronological order in which it occurred.

**Practice Tip.** Single-sided folders tend to be less expensive than three-sided folders, but are also less durable and offer less protection to their contents. This type of folder is most appropriate for simple returns of wage-earner clients that are less likely to be retrieved in the future. Segregating file information may also aid in your firm's record retention effort. For example, returns are kept for the life of a client, but some information may be destroyed after a period of time, as required by the firm's record retention policy. Segregated information is easily removed from a file to be discarded, reducing overall firm filing space needs.

Regardless of the type of file folder used, you should keep client information neatly organized to allow for convenient referencing later. Retrieving information will be further simplified by using permanent files (see Section 101.7) for data that is likely to be needed in future engagements.

### 101.10.3 Retrieval Key Alternatives

While often considered to be a minor issue, the policy on the retrieval key for filing client files is of paramount importance. For example, is a file labeled as "Rex Havoc, Inc. d/b/a The Donut Shop" filed under "R" for Rex, "H" for Havoc, "T" for The, or "D" for Donut?

In many firms, each client file is assigned a client number, and a separate index is maintained by this number. This is particularly true when data processing systems are involved. Consider filing by client number, as opposed to client name. While this does not usually allow an alphabetical filing approach, it eliminates misfiling under the wrong name. However, if an alphanumeric coding system is used whereby the numbering closely follows the alphabet (for example, A is 1000–1999, B is 2000–2999, and so on) the files will be in alphabetical and numeric order.

### 101.10.4 Closed Files

The lack of adequate file storage space often presents a problem. As information is filed and stored, the need for additional space quickly grows because of the volume of stored information.

Consider setting up a new file for each client annually. In this manner, files can be stored by year, with the previous year's files moved to another location. After a certain number of years, old client files and records can be destroyed or microfilmed.

Regardless of the approach taken, neat and orderly maintenance of closed files will facilitate file retrieval. Some firms are forced to move old files off site for storage. Off-site storage should be filed under the same retrieval key, with the year of the information clearly labeled on the file.

**Practice Tip.** If long-term storage in house or off site is not feasible, consider forwarding correspondence to present and former clients after a certain period of time, once the tax year is closed, for example, informing them their records for specific years will soon be destroyed, and giving them the option to request the information. Upon request, forward the complete file to the client. Clearly indicate whether there are handling charges in the initial correspondence.

Although this approach may solve the space limitation problem that many firms encounter, there could be disadvantages if this information is required in the future. The contents of files could be permanently lost or jumbled and nearly useless if needed, for example, to research the carryover basis of assets or to detail the year-by-year components of a 15-year net operating loss carryover.

**Practice Tip.** Closed files should not contain unnecessary duplicated data. Significant file space can be saved by removing tax return input sheets. Similarly, tax return processing and diagnostic sheets often contain no data of lasting importance for years that have closed under the statute of limitations.

### 101.10.5 Client Information Retention Guidelines

No strict rules exist regarding the length of time client information must be retained. Obviously, from a legal perspective, information must be retained for the period the statute of limitations remains open. Practically, however, client information should be retained for a longer period of time. Recommended guidelines on the retention of client information are as follows, although this may vary from firm to firm.

- For active clients, retain tax files for the last three years within the office and in off-site storage on a permanent basis.
- For former clients, retain tax files within the office for three years from the time of last work, and for seven years from the time of last work in off-site storage.
- For correspondence files, retain the information within the office for three years and in off-site storage for seven years.

Exhibit 101-23 illustrates a sample label that can be used for file folders, containing not only name and contents information, but retention information as well.

**Practice Tip.** When files are destroyed, make sure an accurate list is prepared of which clients and years are removed. This may save plenty of time later searching for a file which no longer exists.

### 101.11 Evaluation of Present Clients

Chapter 301 deals with standards of practice, and includes a discussion of risk management. Your firm should evaluate clients on an ongoing basis to identify and consider terminating service to undesirable clients and focus the practice on those who represent minimal or controllable risk or potential for additional value-added services.

This annual evaluation becomes particularly important with respect to tax protestors, those aggressively taking positions contrary to the IRS, habitual late filers, or even repentant nonfilers.

Tax clients should be reviewed and evaluated at the end of specific periods or upon the occurrence of specified events to determine whether the relationship should be continued,

modified, or terminated. Such events might include a significant change in the client's business activities, bankruptcy, or change in ownership.

### 101.11.1 Terminating Service to Undesirable Clients

Exhibit 101-20 contains a sample form for rating clients in terms of risks, profitability, collection issues, and other factors. Your firm can identify undesirable clients and take an approach to terminating services to them.

**Example.** Bankruptcy services may be low risk, highly profitable, and easy to collect in your practice. But if your staff finds this work unsatisfying or stressful, you might reconsider the desirability of the work.

**Example.** A staff member may recommend that a client be terminated because they have a “messy bookkeeping system.” A tremendous work opportunity might exist during the nonbusy months to assist the client with changing and enhancing the system. Be careful that clients are not labeled as “undesirable” and terminated without giving the client a fair chance to improve and the firm an opportunity to upgrade or enhance its services.

Before terminating undesirable clients, ask these questions:

- What have we done to assist the client with this problem?
- Is there a mutually beneficial way to convert the client's troublesome aspects into opportunities for the firm?
- Is there a “personality clash” and could this client be better served by another tax preparer in the firm?

After firm management has identified undesirable clients and agreed to terminate them, notify them that the firm no longer desires to work with them and offer assistance in locating an alternative preparer. Exhibit 101-21 contains sample correspondence for terminating service as a result of fee disputes.

### 101.11.2 Risks of Removing Clients

Because of the unpredictable nature of certain clients, such as tax protestors, there is some risk in terminating service. While it is desirable to eliminate or minimize risks in a tax practice by removing certain clients, the client, in fact, may look for opportunities to challenge the firm after he or she has been notified the firm wishes to terminate services. Section 301.6.2 discusses the potential exposure in terminating clients.

This is an extremely sensitive area, so analyze each situation carefully prior to notification. Take great care that no basis exists for the client to allege malpractice, and make every attempt at a friendly parting.

An alternative is to gradually phase out your involvement over a one- or two-year period by turning over certain aspects of your services to a new firm. By disassociating your firm from payroll, audit and accounting, and other management services, the client may reach its own conclusion that another firm is better able to service its needs. The transition period, however, increases the risk of vital services not being completed because the predecessor and successor firms did not communicate (see Section 101.9.2).

## 101.12 Accepting New Clients

One of the best approaches to minimizing risk with clients is to be highly selective when accepting new ones. Be wary of new clients with a past history of IRS problems, whether audit or collection, or with a general reputation for not dealing effectively with professionals.

It may be difficult to ascertain this information prior to initiating work with a client. Greater care must be taken with clients with whom the firm has no familiarity, as opposed to clients referred by attorneys, bankers, and other professionals. Use caution in accepting taxpayers who have had several preparers in recent years. An early review of prior tax returns may raise other concerns about the client's integrity.



**Practice Tip.** Prior to acceptance, carefully analyze clients who wish to work with your firm but who have not been referred. Take great care with those who learned of your firm through yellow page advertising, or who simply walked in, to ensure that the firm is accepting the proper type of client.

### 101.12.1 Using Referrals

Section 103.6 deals with referrals from other professionals. When a new client is referred by an attorney, banker, insurance agent, or other professional, it is helpful to briefly discuss the client with the referral source to see if the client will fit your practice. Be sure to discuss issues such as “business” attitude, payment history, and general attitude toward professionals.

Continually analyze your sources of good referrals. Professionals dealing with specialized areas, such as bankruptcy matters, may provide referrals who need different treatment than other new clients. For example, such referrals may require retainer amounts (see Chapter 102) and, in general, a different billing approach than other clients.

### 101.12.2 Thanking Referral Sources

Whenever clients are referred from other sources, follow up with a “thank you” to the referring source. Personally contact and thank the individual making the referral and make every opportunity to work with the referring source and the client in the future.

Give general feedback to the referral source, assuming the source was another professional, if your ongoing relationship with the client has been positive. However, refrain from discussing any client problems.

### 101.12.3 New-Client Registration Forms

Exhibit 101-22 contains a sample form used to gather information on new clients. The form helps facilitate the decision whether to accept the client. Besides the basic client information, such as name and address, the form also focuses on issues relevant to accepting the client.

If a client is accepted, the registration form provides sufficient information to set up the client on the computer system or other permanent record and to properly record the services and due dates required for the client.

**Example.** The registration form can identify clients with past collection problems, past problems with the IRS, or who appear to offer little opportunity for additional services. For them, another practitioner may be a better alternative.

### 101.12.4 New-Client Data Base Information

When a new client is accepted, various items of data base information should be immediately collected. Additionally, this is an ideal time to put the new client on the mailing list for tax bulletins and newsletters. Exhibit 101-24 contains an example of a new client data base form. Note in the lower, right-hand area the alternatives regarding mailings for the new client. Naturally, the fields contained in Exhibit 101-24 should be customized for your own practice.

## 101.13 Engagement Letters

Engagement letters are also an integral part of the control system, because they define the practitioner’s and client’s responsibility for the preparation of an accurate tax return, and, therefore, are a *must* for a quality tax practice. Many professional liability insurance companies provide discounts for firms that routinely use engagement letters for tax services. Engagement letters are covered in Section 301.6, in the discussion dealing with risk management.

### 101.13.1 Frequency

Firms take different approaches to the frequency of obtaining engagement letters. Some obtain an engagement letter annually from each client, while others require only an initial letter.

Under the latter approach, the client signs an open-ended engagement letter, which the firm files in the tax permanent file. Although the open-ended engagement letter provides a measure of simplicity, it does not periodically reinforce the responsibilities assumed in the way an annual letter does.

### 101.13.2 Explanation of Fee Structure

Some firms prefer to explain their fee structures, including the billing mechanism and even hourly rates, in the engagement letter (see the sample engagement letters in Chapter 301).

The philosophy of including this information in an engagement letter is that the firm desires to eliminate any misunderstanding regarding how they calculate fees. The objective is to avoid any surprises regarding fees that may occur at a later time.

Other firms prefer to remain silent on fee matters in engagement letters, and limit the discussion to the engagement terms. Under this approach, the engagement letter is obtained primarily for liability protection and may, in fact, be required by the firm's liability insurer.

**Practice Tip.** Consult your liability insurance carrier to determine whether any special conditions are imposed on engagement letters signed by the firm's clients.

If value billing (see Section 102.6) is to be used, special consideration may need to be given to the engagement letter to allow value billing to occur. One way to address this is to include wording in the engagement letter to indicate that fees are "generally based on time and direct costs." The engagement letter can then go on to indicate that fees might also be based on certain other factors, "including the complexity of the issues and the particular skills required to complete the services," or on other factors such as "short-time requirements allowed for the matter," or "the accountant's experience, reputation, and ability."

Without such qualifying comments included in the engagement letter, a literal interpretation of an engagement letter stating that fees will be based on "time and direct costs" would normally preclude value billing.

### 101.13.3 Explanation of Payment Terms

Similar to an explanation of fee structure, some firms prefer to explain their payment terms in the engagement letter:

- Does the firm automatically assess interest charges?
- Does the firm reserve the right to charge interest?
- Is payment due at time of return pickup? after 30 days? or when tax refund is received?

Again, other firms simply prefer to remain silent on this issue in engagement letters on the premise that good clients may be offended by a discussion of the firm's collection policy. However, if not disclosed in an engagement letter, the payment terms should be referred to on the eventual invoices.

The exhibits in Chapter 301 contain sample engagement letters, some of which include payment terms.

### 101.13.4 Control of Engagement Letters

As explained in Section 101.7.4, after filing engagement letters in the tax permanent file, monitor them on an ongoing basis. Maintain a master list to ensure that engagement letters for some clients don't fall through the cracks.

**Example.** Clients may have been sent engagement letters but have failed to sign and return them, or new clients may have returns completed for them in conjunction with an existing business client without passing through the normal registration process. Projects should not be finalized until the engagement letters have been returned.

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**Exhibit 101-1: Tax Practice Calendar**

October 1	Finalize financial budget and establish charge hour and total hour budgets. Finalize staffing needs.
October 15	Contact IRS to order Forms & Package X. Install Forms software.
October 31	Assess staff & office layout resources and needs. Update office policy & procedure manual for tax practice. Contract with seasonal tax help.
November 15	Contact clients to arrange year-end tax planning
December 1	Contact various states to request forms
December 31	Preschedule tax season appointments and send out organizers
January 1	Correspondence to clients requesting data to complete Forms 1099
January 10	Complete business returns for those clients with up-to-date trial balances (e.g., financial institutions)
January 15	Farm tax returns can be extended to April 15 if estimated tax paid
January 31	Payroll tax returns and Form 1099 informational returns are due
March 1	Farm tax deadline if over 2/3 gross receipts from farming
March 10	Extend corporate returns as necessary
March 15	Corporate tax deadline for calendar year-ends
March 31	Follow up on all clients that have not gotten data into office
April 10	Extend partnership & individual returns as necessary. Consider first quarter estimated tax due for these clients.
April 15	Individual, Partnership and Fiduciary tax return deadline
April 20	Ask all staff to evaluate problems and successes of the tax season and hold special staff meeting to discuss.
May 15	Form 990 returns due for calendar year ends
May 15	Issue results of post-tax-season critique meeting and assign responsibilities and due dates for action items.
June 15	Extended Partnership returns due. Consider 2nd quarter estimated tax due for extended returns.
July 1	Review staffing requirements for upcoming tax season
July 1	Complete internal self-assessment using selected internal VTPR procedures
July 15	Follow up on all extended returns that still need information
July 31	Form 5500 returns due for calendar year end plans
August 15	Extended individual returns due. May re-extend two months.
September 15	Final deadline for extended corporations
October 15	Final deadline for extended individuals

**Exhibit 101-2: Sample Quality Control Document**

**SAMPLE QUALITY CONTROL DOCUMENT**  
**FOR A LOCAL CPA FIRM WITHOUT**  
**A STRUCTURED TAX DEPARTMENT**

**PREAMBLE**

This sample document was prepared to summarize and communicate quality control policies and procedures for the tax practice of a local CPA firm without a structured tax department. References made to any partner titles will vary depending on the administration of the individual firm. This sample document assumes that the firm has a managing partner and a tax partner. It is intended that the quality control program, as outlined here, will provide the firm with reasonable assurance that it is maintaining and applying quality controls in accordance with the Statements on Responsibilities in Tax Practice recommended by the Tax Division of the AICPA.

In this sample, the tax partner is charged with the overall responsibility for the implementation, communication, and monitoring of quality control policies and procedures. Other technical coordinators and the managing partner assume varying degrees of responsibilities.

In an actual document, this Preamble will be replaced by an introductory section titled "Background of the Firm" that briefly describes the firm's history, goals, and objectives. This introduction may be adapted from the firm's quality control document pertaining to its accounting and auditing services.

**ADVOCACY, INTEGRITY, AND OBJECTIVITY**

The firm has established policies and procedures to provide reasonable assurance that people pursue with professional integrity the firm's role as a client advocate in its tax practice. As advocates, members of the firm seek to advance the client's position as long as that position and firm members' efforts are within standards set by the law and by appropriate regulatory and professional bodies.

1. People are required to adhere to the AICPA Code of Professional Conduct and to the rules, regulations, interpretations, and rulings of the Internal Revenue Service and any other regulatory agencies, to the extent applicable, or must be able to document and justify appropriate departures (for example, a filing position contrary to an IRS revenue ruling).

**Exhibit 101-2: Sample Quality Control Document (cont.)**

In addition, all tax professionals are familiar with the AICPA Statements on Responsibilities in Tax Practice.

- a. The managing partner is responsible for resolving questions relating to the foregoing matters and is available to provide guidance when required.
  - b. The managing partner communicates with legal counsel, the AICPA, the (state) Society of CPAs, or other authorities for assistance in resolving any of the foregoing matters that are not satisfactorily resolved within the firm.
  - c. Memorandums documenting the resolution of these questions are prepared and retained by the managing partner. The other firm personnel involved in the questions review and sign the memorandums.
2. Policies and procedures relating to advocacy, integrity and objectivity are communicated to people within the firm. This includes the need to treat as confidential any and all information regarding client tax matters and to maintain an independent mental attitude in client relationships.
- a. A written statement is used to inform personnel of the firm's policies and procedures and advise them that they are expected to be familiar with these policies and procedures.
  - b. Independence of mental attitude, coupled with advocacy of the client's interest and maintaining objectivity in discharging professional responsibilities is emphasized during training sessions and in the supervision and review of tax engagements.
  - c. The library contains current professional, regulatory, and the firm's own literature relating to tax matters, rulings and interpretations of the IRS, AICPA, the (state) Society of CPAs, the (state) Board of Accountancy, and federal and state law. These rulings and interpretations include Treasury Department Circular 230, preparer penalties, and AICPA Statements on Responsibilities in Tax Practice.
  - d. The firm considers all information relating to a client's tax matters to be confidential client information. The profession's Code of Professional Conduct generally prohibits disclosure of confidential client information without the client's consent. In addition, civil and criminal penalties are imposed by the Internal Revenue Code for disclosure of taxpayer information by return preparers.

**Exhibit 101-2: Sample Quality Control Document (cont.)**

- (1) No disclosure of client tax information to any person outside the firm is permitted without the written approval of the managing partner and either express client consent or an enforceable court order.
- (2) No disclosure of client tax information to any person within the firm is permitted except in the following circumstances:
  - (a) Any communication to the tax partner or the managing partner.
  - (b) A communication to appropriate professional staff of information relevant to the audit, review, or compilation of financial statements for such client.
  - (c) A communication in the normal course of preparation of such client's tax return.
  - (d) The research of issues arising from the preparation of such client's tax return or tax planning rendered to such client.
  - (e) Any other situation expressly permitted by the managing partner pursuant to written policy or confidential memorandum.
3. Compliance with policies and procedures relating to advocacy, integrity and objectivity is monitored.
  - a. The tax partner is charged with the responsibility for monitoring the firm's policies and procedures in its tax practice.
  - b. The managing partner is responsible for the resolution of exceptions to the firm's policies and procedures relating to tax practice.

**PERSONNEL MANAGEMENT**

The firm has established policies and procedures encompasses hiring, assigning personnel to engagements, professional development and advancement to provide reasonable assurance that work will be performed by persons having the degree of technical training and proficiency required in the circumstances. In making assignments, the nature and extent of the supervision to be provided is taken into account. In general, the more able and experienced the personnel assigned to a particular project or engagement, the less the need for direct supervision. The



**Exhibit 101-2: Sample Quality Control Document (cont.)**

quality of the firm's work depends on the integrity, competence, and motivation of the people who perform and supervise the work. Continuing professional education and training activities enable the firm to provide its people with the knowledge and skills to fulfill responsibilities assigned to them and to progress within the firm.

1. The firm's approach to assigning people includes planning the overall needs of the firm, its office and tax work needs, and the measures needed to achieve a balance between engagement requirements, individual qualifications, individual development, and utilization.
  - a. Each year the tax partner projects the total hours and number of people needed to process tax returns within the prescribed time. Staff needs will then be reviewed by the firm's partners.
  - b. On all audits, and on other financial statement engagements, a partner reviews the tax accrual working papers. The purpose of this review is to determine that all material tax matters have been addressed.
  - c. A log is maintained for all tax services, including recurring and nonrecurring matters.
  - d. The tax partner reviews significant client matters prior to fiscal year-end with a view toward identifying potential problem areas and tax planning suggestions for discussion with a client.
  - e. The tax partner considers the following factors in achieving a balance of engagement manpower requirements, personnel skills, individual development, and utilization:
    - (1) Engagement size and complexity.
    - (2) Availability of personnel.
    - (3) Special expertise required.
    - (4) Timing of work to be performed.
    - (5) Continuity of personnel.
    - (6) Opportunities for on-the-job training.

**Exhibit 101-2: Sample Quality Control Document (cont.)**

2. The tax partner is responsible for assigning personnel to engagements after considering the following criteria:
  - a. Staff and time requirements of the engagement.
  - b. Evaluation of the qualifications of personnel as to experience, position, and possession of any special expertise.
  - c. Planned supervision and involvement by managers and partners.
  - d. Projected availability of individuals assigned.
  - e. Need for continuity to provide for efficient conduct of the engagement.
3. The firm maintains a program designed to obtain qualified people by planning for future requirements, establishing hiring objectives, and setting qualifications for those involved in the hiring function.
4. The firm has established qualifications and guidelines for evaluating potential employees at each level.
  - a. The firm seeks to employ individuals who possess high levels of intelligence, integrity, honesty, and motivation and high aptitude for the profession.
  - b. The firm generally requires that a professional staff applicant's academic preparation be sufficient for taking the CPA examination.
  - c. In certain situations (such as hiring relatives of personnel or clients, rehiring former employees, or hiring clients' employees), the approval of the managing partner is required before making an employment offer.
  - d. To have reasonable assurance that persons with acceptable qualifications are hired by the firm, the background of all new employees is appropriately investigated by obtaining completed application forms, college transcripts, and personal references.
5. Applicants and new employees are informed of the firm's policies and procedures relevant to them and their work.

**Exhibit 101-2: Sample Quality Control Document (cont.)**

- a. The firm's personnel policies and procedures relevant to applicants are communicated to them before offers of employment are extended.
  - b. Personnel policies and procedures are in writing and distributed to all personnel.
  - c. The managing partner discusses the firm's personnel policies and procedures with new employees.
6. Guidelines and requirements have been established for the firm's tax education program and are communicated to all people involved in tax work.
- a. The managing partner is responsible for the formulation and implementation of the firm's policy regarding the guidelines and requirements for the firm's professional development programs. The firm's professional development year is from May 1 to April 30. Prior to the start of each year the tax and managing partners are to prepare the professional development program for the coming year with input from the tax partner, including:
    - (1) Professional development objectives.
    - (2) Specific courses to be taken, identified by individual.
    - (3) Tentative dates for professional development by individual.
    - (4) Cost.
  - b. A basic program of tax training will be provided to staff accountants and will consist of on-the-job training, formal group programs, and self-study programs, as appropriate.
  - c. To maximize the training benefits of job assignments, the managing partner develops a plan for each accountant.
  - d. Each partner and professional staff member is required to complete a minimum of 20 hours of continuing professional education each year and a minimum of 120 hours in any three-year period. The managing partner is responsible for having the personnel files of each partner and professional employee updated to include a current record of the hours of professional development completed. Types of programs qualifying for the fulfillment of the requirements include :

**Exhibit 101-2: Sample Quality Control Document (cont.)**

- (1) Continuing professional education programs of the AICPA and state societies. These include both sessions attended and cassette/workbook or workbook programs, as long as there is written evidence of completion.
- (2) College courses related to the profession.
- (3) In-house education programs.

An evaluation of each program is completed and forwarded to the managing partner.

- e. Personnel may be reimbursed for membership dues paid to the AICPA, the AICPA Tax Division, one state society, and the local chapter of the state society.
  - f. Personnel are encouraged to serve on state society or AICPA committees, write articles for professional publications, serve as discussion leaders at professional development seminars, give speeches, etc.
  - g. Resolution of conflicts between professional development course attendance and engagement scheduling requires managing partner approval.
7. Information about current tax developments, changes in professional standards affecting tax practice, and materials containing the firm's policies and procedures affecting its tax practice is made available to all professionals involved with tax work.
- a. Pronouncements (such as those issued by the Internal Revenue Service and other taxing authorities) relating to areas of specific interest are distributed to persons who have responsibilities in such areas.
  - b. The firm conducts formal in-house educational programs. The purpose of the programs is to discuss current literature and elaborate on the distributed materials.
8. The firm encourages people to grow and mature as individuals and as professionals through seminars, workshops, college and university course work, and self-study programs. It also provides, to the extent necessary, programs not otherwise readily available, to fill the firm's needs for people with expertise in specialized areas and industries.

**Exhibit 101-2: Sample Quality Control Document (cont.)**

- a. The firm designates certain individuals to join the appropriate associations and pays for those memberships that are concerned with specialized areas or industries in which the firm is engaged or intends to become engaged.
  - b. The tax partner is responsible for maintaining technical literature on specialized areas and industries.
9. The firm provides for on-the-job training during the performance of tax work.
- a. Personnel with in-charge responsibility on engagements explain to assistants the reasons for any additional work requirements discovered through the review process.
  - b. Personnel are evaluated in part on their effectiveness in properly training and developing subordinates.
  - c. The tax partner monitors tax assignments to determine that personnel are:
    - (1) Gaining experience in various engagements and varied industries.
    - (2) Working under different supervisory personnel.
10. The firm has established qualifications for the various levels of responsibility for people involved with tax work in the firm.
- a. The firm has established the following staff classifications:
    - (1) Staff. The staff accountant is expected to :
      - (a) Prepare individual, corporate, partnership, and various other tax returns for clients, under close supervision of a partner or supervisor.
      - (b) On smaller tax engagements, perhaps perform all aspects of the engagement, including maintaining minimum client contact.
      - (c) Prepare various payroll tax, sales tax, and other local tax returns.
      - (d) Become familiar with the contents of the firm's manuals.

**Exhibit 101-2: Sample Quality Control Document (cont.)**

- (e) Know the rules, regulations, and Code of Professional Conduct of the AICPA, the (state) Society of CPAs, and the (state) Board of Accountancy.
  - (f) Progress professionally by working toward passing the CPA examination as soon as possible.
- (2) Supervisor. The supervisor is expected to :
- (a) Pass the CPA exam, if not already completed.
  - (b) Demonstrate the ability to resolve most tax problems through sources available within and without the firm's library.
  - (c) Supervise a number of engagements at one time.
  - (d) Be able to develop, complete, and review most tax planning situations.
  - (e) Adequately review all working papers and completed returns to ascertain that both meet the firm's standards.
  - (f) Be involved in coordinating the filing of due date extensions.
- (3) Manager. The manager is a CPA and is expected to :
- (a) Assume full responsibility for assignments falling within his or her level of expertise.
  - (b) Supervise the assignment of duties to, and the training of, personnel assigned to the engagement.
  - (c) Supervise a number of engagements at one time.
  - (d) Be involved in the scheduling of personnel, compliance with due dates, and monitoring the time budgets of engagements.
  - (e) Adequately review all working papers and the completed returns for compliance with the firm's standards.

**Exhibit 101-2: Sample Quality Control Document (cont.)**

- (f) Resolve all problems before submitting the returns for final partner review.
  - (g) Communicate the firm's policies and technical information to all personnel through individual or group meetings.
  - (h) Motivate and assist staff in professional development.
  - (i) Represent the firm in professional and service development by conducting seminars, making speeches, writing articles, and similar means.
  - (j) Assist partners with practice development and practice management.
- b. The firm's personnel manual provides information about the firm's advancement policies and procedures. The managing partner issues updates as needed to incorporate changes made by the firm in the policies and procedures.
11. The performance of people is evaluated and their progress periodically reviewed with them. Personnel files are maintained containing documentation relating to the evaluation process.
- a. All professional employees receive an evaluation of their performance at least annually. The individual's progress, strengths, weaknesses, and future objectives and the firm's future objectives are among the items discussed. Documentation of the interview, evaluation forms, and staff assessment are included in personnel files.
  - b. Personnel with the responsibility for the preparation of evaluations are evaluated at least annually by the managing partner.
12. The managing partner is responsible for making promotion decisions.

**ACCEPTANCE AND CONTINUANCE OF CLIENTS AND ENGAGEMENTS**

To minimize its exposure to risk and maximize its long-run profitability, the firm has established policies and procedures for deciding whether to accept or continue a tax client. The firm's image in its practice area is heavily affected by the public perception of who its clients are. Thus, prudence suggests that the firm be selective in determining its professional relationships.



**Exhibit 101-2: Sample Quality Control Document (cont.)**

1. The firm has established procedures for evaluating and approving prospective clients.
  - a. The tax partner should be consulted before the firm accepts a new client if there is any doubt that the firm possesses the tax expertise to complete the job adequately.
  - b. Prior year's tax returns are obtained and reviewed.
  - c. A review is made to ensure that the acceptance of the client would not violate the requirements of the profession and of the firm.
  - d. The managing partner performs an annual review of compliance with the firm's policies and procedures for the acceptance of clients.
2. A partner will ensure that the client understands and accepts the scope of the firm's services, the firm's responsibility for tax advice and returns, and the financial aspects of the client's relationship with the firm.
  - a. Engagement letters are used to document service arrangements for tax clients.
  - b. All clients are informed that they are required to provide adequately substantiated information.
3. Tax clients are reviewed and evaluated at the end of specific periods or upon the occurrence of specified events to determine whether the relationship should be continued, modified, or terminated.
  - a. Reevaluations are made of existing clients on a regular basis or whenever there are new conditions that would have caused the firm to reject the client had such conditions existed at the time of acceptance.
  - b. The following are some reasons for terminating a professional tax relationship:
    - (1) The client is chronically slow to pay.
    - (2) The client clearly fails to provide adequately substantiated information.
    - (3) The client wants to take a position inconsistent with the firm's policies.
    - (4) The engagement involves tax matters the firm is not competent to handle.

**Exhibit 101-2: Sample Quality Control Document (cont.)**

- (5) The timing of the engagement makes unreasonable demands on the firm's personnel.
  - (6) Insurmountable personality conflicts exist.
  - (7) The return on the engagement is too low for the effort expended and the risk taken.
- c. The tax partner should be consulted when significant tax engagements are being considered for termination.

**ENGAGEMENT PERFORMANCE**

The firm has established policies and procedures for the conduct and supervision of work at all organizational levels to provide reasonable assurance that the work performed meets applicable professional standards, regulatory requirements and the firm's standards of quality. The extent of planning, performing, supervision, review, documenting and communicating in a given situation depends on many factors, including the complexity of the subject matter, the risk of penalties being proposed, the qualifications of the persons performing the work, and the extent of the consultation available and used. The firm has also established policies and procedures that personnel are to refer to authoritative literature or other sources and consult, on a timely basis, with individuals within or outside the firm, when appropriate. The nature of arrangements for consultation will depend on a number of factors, including the size of the firm, the availability of library and other resources, and the levels of knowledge, competence and judgment possessed by the people performing the work.

1. All engagements are adequately planned by persons knowledgeable about the client and the type of engagement, including specific evaluation of risk factors.
  - a. Substantial tax engagements are budgeted and planned prior to commencement. The plan contains specific follow-up points for supervisory personnel.
  - b. For engagements in which the firm represents a client in a tax examination by the IRS or other tax authority, the tax partner will develop an approach to the examination, including assignment of appropriate personnel to work with the examining agent.

**Exhibit 101-2: Sample Quality Control Document (cont.)**

- c. An engagement letter or memorandum of understanding is used for all tax returns and substantial tax services to document the nature of the engagement.
2. Procedures are provided for maintaining the firm's standards of quality for the work performed.
  - a. Tax engagements, or those segments of other engagements that include tax matters, are supervised directly by the tax partner or a person designated by the tax partner.
  - b. Working papers document the sources of data used, conclusions reached, and actions taken on behalf of clients.
  - c. To resolve questionable items, a memorandum is prepared stating the interpretation of the facts and citing the authorities relied upon.
  - d. The tax partner is responsible for ensuring that the firm's client filing system meets such needs of the tax practice as accessibility, confidentiality, quality control, and retention.
  - e. A control system is established for the miscellaneous reports and returns prepared or reviewed by the firm.
  - f. The tax partner is responsible for ensuring that file-retention policies comply with the Internal Revenue Code and other regulatory requirements.
  - g. The tax partner reviews any returns, tax working papers, or correspondence files that are scheduled for destruction.
  - h. Conversations with clients in which advice is given or an interpretation of tax impact is made should be documented.
3. The firm maintains systems for tracking the compliance aspects of a tax practice including tax return status and due date maintenance.
4. Procedures are provided for monitoring and reviewing engagement working papers, reports, tax returns, tax opinions, substantive tax correspondence, and oral advice.
  - a. Before delivery to the client, all returns are reviewed by a person other than the preparer and the review is documented in the workpapers.

**Exhibit 101-2: Sample Quality Control Document (cont.)**

- b. Tax research projects are reviewed by the tax partner whether or not the research results in a formal communication to the client. In addition, the managing partner or other responsible person familiar with the client reviews the project documentation to ensure that the facts are properly understood.
  - c. For engagements in which the firm represents a client in a tax examination, the tax partner or the tax partner's designee reviews the examining agent's proposed adjustments and all related working papers before conclusion of the engagement.
5. Areas and specialized situations in which consultation is required are identified, and people are encouraged to consult authorities in other situations that may be complex or unusual to them.
- a. All personnel are advised of the firm's consultation policies and procedures through the quality control document.
  - b. The tax partner has listed areas or specialized situations that require consultation, because of the nature or complexity of the subject matter. This list is periodically updated by the tax partner and distributed to all tax personnel. Areas and situations receiving special consideration in preparing the list include:
    - (1) Application of newly-issued IRS requirements.
    - (2) Situations with unique reporting requirements.
    - (3) Choices among different tax treatments.
  - c. A technical reference library is maintained to assist personnel in resolving tax problems. The tax partner is charged with the responsibility of reviewing the library's contents and making necessary changes.
  - d. All personnel are encouraged to seek advice from the tax partner when confronted with a situation that is not in their area of expertise.
  - e. When expertise on a tax question or problem is not available within the firm, the tax partner will authorize consultation with outside sources, including other firms or educators with expertise on the subject.

**Exhibit 101-2: Sample Quality Control Document (cont.)**

- f. The results of outside consultation are reviewed by the tax partner before a decision is reached on the matter in question.
6. Specific individuals are designated within and without the firm as consultants to serve as authoritative sources, and their authority in consultative situations is defined. Procedures are provided for resolving differences of opinion between the people working on an engagement and the consultants.
  - a. The tax partner maintains a listing, by subject and industry, of those within and without the firm who are particularly knowledgeable in the tax matters related to those subjects and industries.
  - b. The following procedures are used to resolve differences of opinion on tax problems:
    - (1) Differences of opinion between professional staff members are brought to the attention of the tax partner.
    - (2) If the tax partner and staff are able to reach an appropriate resolution, the matter is concluded.
    - (3) If the tax partner is unable to develop an appropriate resolution, the managing partner is consulted. The opinion of the managing partner shall prevail.
    - (4) Any professional personnel, if not in agreement with the decision, may document their disagreement.
7. For those situations in which the firm's policy requires the use of a consultant, a summary of the consultant's conclusions and rationale is to be prepared by the person seeking the consultation. The summary shall be filed in the working papers.

**MONITORING**

The firm has established policies and procedures for monitoring to provide reasonable assurance that the procedures relating to the other elements of quality control are suitably designed and are being effectively applied. Procedures for inspection have been developed and may be performed by individuals from within or without the firm acting on behalf of the firm's management. The type of inspection procedures used will depend on the controls established by the firm and the

**Exhibit 101-2: Sample Quality Control Document (cont.)**

assignment of responsibilities within the firm to implement its quality control policies and procedures.

1. The firm conducts an annual inspection program regarding its quality control policies and procedures.
  - a. Each year the managing partner will perform an inspection to evaluate the firm's quality control policies and procedures for conformity with professional guidelines.
  - b. The managing partner obtains reasonable assurance that quality control policies and procedures are being followed by reviewing:
    - (1) Selected administrative and personnel files.
    - (2) Selected engagement working paper files, tax returns, and reports.
    - (3) Other evidential matter.
2. Provision is made for reporting inspection findings to the partners for monitoring actions taken or planned.
  - a. The results of engagement reviews are discussed with the engagement partner and personnel responsible for the engagement.
  - b. The partner involved in the inspection must correct specific deficiencies noted in the inspection and should address general comments for improvement in writing.
  - c. The managing partner has the responsibility for determining that planned corrective actions were taken and for reporting the extent of compliance to all partners.

**Exhibit 101-3: Sample Tax Return Policies and Procedures**

**SWIFT, MARCH & COMPANY  
TAX RETURN POLICIES AND PROCEDURES**

JANUARY 20XX

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- MODULE 6—Tax Return Status Tracking
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- MODULE 9—Vacation Scheduling

Confidential - Internal Use Only

Approved by: Jane March

Date: April 26, 2000



**Exhibit 101-3: Sample Tax Return Policies and Procedures (cont.)****Module 1  
THE TAX RETURN PREPARATION PROCEDURE**

The normal steps necessary to complete a tax return are as follows:

1. The appointment date and time is set up:
  - a. The firm contacts the client with the date and time set up, or
  - b. The client contacts the firm to set up an appointment.
2. Prior to the appointment, clerical personnel complete the following steps:
  - a. Pull necessary files (tax and general ledger).
  - b. Pull Process Sheet and complete top portion.
  - c. Pull following forms and put in file:
    - Interviewer's Estimate Sheet
    - Review Point Sheet
    - Interview Worksheet
  - d. Route file and attachments to the accountant.
3. Steps normally followed during the actual interview are:
  - a. Review all client-completed worksheets with client and make necessary notations.
  - b. Review Forms W-2, 1099, etc., to make sure all materials are properly completed and present.
  - c. Review last year's tax return and any amended returns to verify tax refunds and payments.
  - d. Make notations from last year's Process Sheet on tax benefits, etc., available for carryforward to current year.
  - e. Go over interview checklist with client.
  - f. Answer any questions client may ask and make any general recommendations to client that are appropriate.
  - g. If time permits, prepare a rough calculation on tax planning software to give client a general projection of balance due/refunds and to assist in decisions on use of Section 179, etc. Indicate in file if expected tax liability figures were given to client.
  - h. Determine if electronic or paper filing will occur.
  - i. When the interview is finished, enter time on Process Sheet and route file for preparation.
4. Steps to be followed in the preparation stage:
  - a. Complete input—refer to Module 2.
  - b. Preparer to review input data.
  - c. Calculate return and review results on screen.
  - d. Send file to review.
5. Steps to be followed in the review stage:
  - a. Refer to Module 4 for checklist of review items.
  - b. Clear diagnostics.

**Exhibit 101-3: Sample Tax Return Policies and Procedures (cont.)**

- c. Compare return with interviewer's calculation and year-end projection.
  - d. Make all necessary follow-ups.
  - e. If return is correct, return goes to processing.
6. Steps to be followed when return is processed:
  - a. Make appropriate number of copies, depending on whether hard copy or electronic filing will occur.
  - b. Compare W-2s and attach to the proper returns.
  - c. Put client's copy in folder with documents enclosed.
  - d. Attach envelopes to the returns.
  - e. Complete filing instruction sheet.
  - f. Copy W-2 forms for file.
  - g. Organize file.
  - h. Send file to billing.
7. Steps to be followed when return is in billing:
  - a. Run work-in-process report.
  - b. Send file to signer.
8. Steps to be followed when return is being signed:
  - a. Check return for accuracy.
  - b. Check return for processing.
  - c. Write note/letter to client regarding the results of the tax return.
  - d. Sign return.
  - e. Bill return from WIP report.
  - f. Send file to administrative secretary for bill approval.
9. Steps to be followed to finish the return:
  - a. Prepare bill.
  - b. Notify client that return is ready for pickup, either by phone or mail.
  - c. Mail return or put in pick-up drawer, and put file away.
  - d. Monitor status and filing of electronic returns, including mailing Form 8453 to the IRS.

**Exhibit 101-3: Sample Tax Return Policies and Procedures (cont.)****Module 2  
RULES REGARDING INDIVIDUAL TAXSOFTWARE INPUT**

For an introduction to the TAXSOFTWARE system and a general overview of operating instructions, pages 1.1 through 1.4 of the 20XX TAXSOFTWARE Practitioner's Manual have been reproduced for reference purposes.

All returns are normally prepared by interactive input by staff accountants. However, in the event that manual input sheets are necessary, the following rules apply:

Particular attention should be given to placing the client's name, office no., and input no. in the required area of each input sheet.

Work should be completed in pencil and photocopied as required, and all entries should be neatly made in order to reduce the likelihood of data entry errors. Do not use a red pencil or marker.

TAXSOFTWARE comments and rules:

General Comments

1. All blank pages must have an "X" marked through the entire page.
2. All pages should have client name, office no., and input no. on them.
3. All pages should be in the proper order.
4. If more than one sheet is needed for two different schedules, each sheet should be numbered.
5. Only whole dollar amounts should be used.
6. Proforma'd sheets must not be removed—clearly "X" out unnecessary data.
7. Preparers are to review the return on-screen and compare results to interviewer's expectations.
8. Network manager should be notified to print "Review" copy of return.

**Exhibit 101-3: Sample Tax Return Policies and Procedures (cont.)**

**Module 3  
REQUIRED ATTACHMENTS WITH ALL TAX RETURNS**

The following information must be included with all computer input review:

1. The complete file should go to the reviewer.
2. Completed client information worksheets related to itemized deductions and other items should be punched into file.
3. Forms 1099, W-2, etc., are to be clipped inside file cover.
4. Organize all information and put in a legal-size file.
5. Any time more than one number is combined with another number for the purposes of computer input, a schedule must either be attached or a code system must be used so that the combination of the numbers can be clearly traced to the return.
6. A Tax Return Process Sheet (enclosed) must accompany all computer input.
7. Attach a Review Point Sheet (enclosed) to each file.
8. Complete an Interview Worksheet (enclosed).
9. Clearly mark and note on separate correspondence any questionable entries on the computer input, so that the reviewer will give special attention to such items.
10. Clearly indicate on the interviewer's tax projection any material differences observed during preparation.
11. Note any special tax preparation options, such as various decisions regarding Keogh/IRA contributions, use of Section 179 expense, etc.

**Exhibit 101-3: Sample Tax Return Policies and Procedures (cont.)****Module 4  
CHECKLIST OF REVIEW ITEMS**

The following checklist shall be used by the reviewer on each individual tax return:

1. Is current-year taxable income consistent with taxable income as shown for previous years? If not, the difference should be explained. Watch for net operating loss carrybacks and amended returns.
2. Check tax benefit carryforward amounts.
3. Check net operating loss carryforward amounts.
4. Check for other carryforward amounts.
5. Check for optional SE/Earned Income Credit.
6. Review general format of tax return vs. previous year's format.
7. If tax projection information is included, review completed return vs. projection and reconcile differences.
8. Review Schedule A information and use of any tax estimates.
9. Compare Form 1099 information and other information in file to numbers in tax return.
10. If return is submitted for signature, review envelopes, instruction sheets, estimates, etc.
11. The reviewer is to make no assumptions regarding input, and is to verify all entries.
12. Make notes to the Preparer for clearing on the Review Point Sheet.
13. **THE REVIEWER IS TO MAKE NO ENTRIES OR CHANGES ON INPUT WITHOUT NOTIFYING THE PREPARER.**
14. Does it appear that the preparer's return decision (i.e., depreciation method, use of Section 179, etc.) is consistent based on the level of taxable income during the current and prior years?

**Exhibit 101-3: Sample Tax Return Policies and Procedures (cont.)**

**Module 5  
SAMPLE FORMS AND CHECKLISTS**

Sample forms related to process sheets, filing instructions, tax return schedules, and miscellaneous forms/schedules are enclosed. Refer to specific forms.

Caution: Use the enclosed forms as required for photocopy purposes. Do not write on the originals.

NOTE: (Include in this module copies of all forms used by your firm in the return preparation process.)

**Module 6  
TAX RETURN STATUS TRACKING**

To facilitate the timely completion of all tax returns, a status tracking mechanism used internally by Swift, March & Company will be adhered to.

By January 1 of each year, Swift, March & Company will update a list of all individual, partnership, and corporation income tax returns that have a due date between January 1 and April 15. Such a list is completed by reviewing returns completed in prior years and also by reviewing the list of tax returns that are expected to be processed. Additions and deletions to the master list can be made as the tax seasons progress. All returns noted on the database without a specific due date should be reviewed for inclusion on the tax season due date list.

As each return is prepared, the return shall be internally tracked in terms of its progress through the tax return completion cycle. Levels of progress include interview, preparation, at computer, post-computer review, processing, signature, etc.

As the file goes from one step to the next, the file should move through the "Logging Basket" so that the tracking mechanism stays current.

**Exhibit 101-3: Sample Tax Return Policies and Procedures (cont.)****Module 7  
TAXSOFTWARE TRAINING**

Much of the basic computer preparation training for new preparers will be done by the computer software organization. If all preparers have previous experience with current computer input forms, only one or two staff persons need to attend refresher courses to pick up current-year changes. That person will then prepare and present a short in-house course for the rest of the staff. All preparers will receive an input manual.

**Module 8  
FEE STRUCTURE OF TAX RETURNS**

Charges for tax returns will be billed to the client based on actual time and expenses involved. Specifics are as follows:

1. Charges will be at the hourly billing rate of the individual working on the return. Normally, this billing rate should be in the range of \$XX to \$YY per hour.
2. The actual computer charge will be billed to the client.
3. A flat processing charge of \$XX per tax return will be imposed. The processing charge will take into account placement of client covers on the client copy of the return, preparation of estimates where required, preparation of instruction sheets and other information, postage and phone charges, proforma charges, etc.

An extension of time at normal billing rates, with additions for processing, computer charges, and proforma, will be completed, and a statement will be submitted with each tax return to the client.

Charges for partnership income tax returns, corporate income tax returns, and other services such as tax audits will also be based on actual time and expenses.

**Exhibit 101-3: Sample Tax Return Policies and Procedures (cont.)**

**Module 9  
VACATION SCHEDULING**

Because vacations have a significant impact on our summer scheduling, we have developed the following guidelines with respect to vacations:

- All vacation requests should be submitted to the Tax Dept. Scheduler on the attached form by March 31 of each year.
- Requests should be for a minimum of one (1) work week.
- Please review your current job responsibilities and try to schedule your vacation around those assignments.
- All vacations should be taken between April 16 and October 31; any post–October 31 vacation requests will not be guaranteed and are discouraged. Any of these requests can and will be cancelled if client service requires it. (Unused vacation will be paid if a post 10/31 vacation is cancelled.)

The management group is committed to honor your vacation requests if the above guidelines are followed. On rare occasions where we would deem it necessary to cancel a vacation, we will work with you to rectify the situation.

If there are any questions or comments about these guidelines, see the Tax Department Scheduler. We feel that this area is extremely important to the continued success of our office and hope that you will be of assistance.



**Exhibit 101-4: Review Questionnaire on Tax Practice Quality Control Policies and Procedures****QUESTIONNAIRE ON TAX PRACTICE QUALITY CONTROL POLICIES AND PROCEDURES**

This questionnaire is intended to provide the reviewer with basic information about the firm's tax practice quality controls. It is not necessarily a checklist of all the policies and procedures that might be applicable to the firm's tax practice. Careful completion of this questionnaire should help firms evaluate the continuing appropriateness of their policies and procedures. Firms should briefly describe the policies in effect and, to the extent possible, make reference to other documents of the firm, such as the firm's tax practice quality control document, personnel manual, tax practice manual, checklists, or forms in which the policies are described in more detail.

In completing the questionnaire, the reviewed firm should use the response column and attach other sheets if necessary. Answers should not be lengthy or elaborate. Wherever practicable, the reviewed firm should provide references to policies and procedures in the firm's quality control document, staff manuals, or other reference materials that adequately convey the response to the particular question. Such references will assist reviewers in finding the indicated policy or procedure in the reviewed firm's materials. In addition to responding to the questions, the reviewed firm should indicate any significant changes in its quality control policies and procedures during the period under review.

**Response, Including Reference to the Firm's Documents****A. ADVOCACY, INTEGRITY, AND OBJECTIVITY**

1. How does the firm inform personnel (for example, through its tax practice quality control document, personnel manual, memorandums, client lists, or training meetings) of the policies and procedures relating to:
  - a. Client advocacy in tax practice?
  - b. The need for objectivity in tax client relationships?

**Exhibit 101-4: Review Questionnaire on Tax Practice Quality Control Policies and Procedures (cont.)**

**Response, Including Reference to the Firm's Documents**

- c. The understanding of and conformance with Treasury Department Circular 230, preparer penalties, AICPA Statements on Responsibilities in Tax Practice, and other applicable rules, regulations, and professional standards?
  - d. The requirements for confidentiality of client tax information?
  - e. The requirements to avoid conflicts of interest?
2. Does the firm's library contain the AICPA Code of Professional Conduct, Treasury Department Circular 230, and AICPA Statements on Responsibilities in Tax Practice?
3. How does the firm monitor compliance with its policies and procedures on advocacy, integrity, and objectivity with regard to :
- a. Contrary filing positions?
  - b. Confidentiality?
  - c. Conflicts of interest?
  - d. Code of Professional Conduct?
  - e. Statements on Responsibilities in Tax Practice?
4. Has the firm or its personnel ever paid a "preparer penalty" or otherwise been penalized or disciplined in connection with its tax practice?

**Exhibit 101-4: Review Questionnaire on Tax Practice Quality Control Policies and Procedures (cont.)****Response, Including Reference to the Firm's Documents**

5. Have legal claims alleging negligence been made against the firm or its personnel regarding its tax practice?
6. Who is responsible for resolving questions on matters of advocacy, integrity and objectivity?
  - a. In what circumstances must the resolution of such questions be documented? Where is the documentation maintained?
  - b. What sources are or would be consulted to resolve these questions?
  - c. Has the firm found it necessary within the last year to consult with sources outside the firm on these matters?

**B. PERSONNEL MANAGEMENT**

1. Are staffing schedules, time budgets, or both used for tax engagements?
  - a. If so, who is responsible for preparing and approving them?
  - b. If not, how are time requirements identified?
2. Who is responsible for assigning personnel to tax engagements?
3. Does the person with the final responsibility for the engagement approve its scheduling and staffing? Is this approval documented and, if so, where?

**Exhibit 101-4: Review Questionnaire on Tax Practice Quality Control Policies and Procedures (cont.)**

**Response, Including Reference to the Firm's Documents**

4. How are staff advised of their assignments and changes in them (for example, copies of staffing schedules, memoranda, or discussion)?
5. Does the firm require the following to have experience appropriate to the engagement :
  - a. Staff?
  - b. Partner-in-charge of the engagement?
  - c. Concurring reviewers?
6. Who is responsible for determining the firm's needs for professional personnel, for deciding on and carrying out a program to meet those needs, and for monitoring the effectiveness of the program?
7. What personal, educational, and experience requirements have been established for :
  - a. Entry-level personnel?
  - b. Experienced personnel?
  - c. Tax specialist personnel?
8. What types of background information regarding the qualifications of potential employees (for example, resumes, transcripts, application forms, interviews, references) are required to be obtained? Is this information?
9. Who is responsible for making the decision to hire?

**Exhibit 101-4: Review Questionnaire on Tax Practice Quality Control Policies and Procedures (cont.)****Response, Including Reference to the Firm's Documents**

10. Does the firm provide an orientation program, relating to the firm and the profession, for newly employed personnel? If so, attach a copy of the program outline.
11. Are all personnel in compliance with continuing professional education requirements needed to meet applicable licensing requirements?
12. Who is responsible for monitoring compliance with applicable (for example, state) continuing professional education requirements?
13. Does the firm have a broad program to facilitate professional development (for example, a mentoring program, regular staff meetings)?
14. Where are the professional development records maintained (including attendance records, course materials, etc.)?
15. How are professional personnel made aware of current tax developments, changes in professional standards affecting tax practice, and the firm's technical policies and procedures related to the tax practice (for example, by distributing technical pronouncements and holding training courses on recent changes and areas identified by the inspection program)?
16. Have guidelines and requirements been established for the firm's tax education program and communicated to all people involved in tax work?

**Exhibit 101-4: Review Questionnaire on Tax Practice Quality Control Policies and Procedures (cont.)**

**Response, Including Reference to the Firm's Documents**

17. Who is responsible for the formulation and implementation of the firm's policy on professional development?
18. Does the firm's professional development policy provide a program to fill its needs for expertise in specialized areas and industries?
19. Is a basic program of tax training and computer training provided to staff accountants using on-the-job training, formal group programs, and self-study programs, as appropriate?
20. Have the appropriate personnel been offered training that, in addition to dealing with their technical tax skills, addresses computers skills, computer-assisted tax return preparation, computer research, and the development of other skills appropriate to tax practice?
21. Are personnel encouraged to serve on state society or AICPA committees, write articles for professional publications, serve as discussion leaders at professional development seminars, give speeches, and so forth?
22. What levels of responsibility exist within the firm (for example, partner, manager, supervisor, and senior)?
23. Have descriptions been prepared of the responsibilities at each level, expected performance at each level, and the qualifications necessary for advancement to a particular level? If so, attach a copy of each description or indicate where (for example, in a personnel manual) this information can be found.

**Exhibit 101-4: Review Questionnaire on Tax Practice Quality Control Policies and Procedures (cont.)****Response, Including Reference to the Firm's Documents**

24. Does the firm periodically evaluate the performance of personnel and advise them of their progress in the firm?
- a. When are these evaluations performed?
  - b. Are these evaluations documented? If so, indicate where this documentation is maintained (for example, in the individual's personnel file).
  - c. Is a standard evaluation form used?
  - d. How are partners evaluated (for example, counseling, peer evaluation, or self-appraisal)?
25. Who is responsible for :
- a. Making advancement and termination decisions?
  - b. Monitoring the system of personnel evaluations and counseling?

**C. ACCEPTANCE AND CONTINUANCE OF CLIENTS AND ENGAGEMENTS**

- 1. Has the firm established procedures for evaluating and accepting prospective clients and engagements?
- 2. Who is responsible for evaluating the information obtained regarding prospective tax clients and engagements and for making acceptance decisions?

**Exhibit 101-4: Review Questionnaire on Tax Practice Quality Control Policies and Procedures (cont.)**

**Response, Including Reference to the Firm's Documents**

3. Are acceptance decisions documented (for example, on a questionnaire or in minutes of partners' meetings)?
4. What procedures are used to document :
  - a. The client's understanding of the scope of services?
  - b. The responsibility taken by the firm?
  - c. That each client has ultimate responsibility for all tax returns?
  - d. That each client is responsible for providing adequately substantiated information?
  - e. The financial aspects of the relationship?
5. Are tax clients and engagements reviewed and evaluated at the end of specific periods or upon the occurrence of specified events to determine whether the service should be continued, modified, or terminated?
6. Who is responsible for evaluating the information obtained, making recommendations for the continuance of clients and engagements, and administering the firm's procedures for continuance?
7. Are continuance decisions documented? If so, in what form? If the firm uses a standardized questionnaire, attach a copy.



**Exhibit 101-4: Review Questionnaire on Tax Practice Quality Control Policies and Procedures (cont.)****Response, Including Reference to the Firm's Documents**

8. Who is responsible for monitoring the firm's compliance with its policies and procedures regarding the acceptance and continuance of tax clients and engagements?

**D. ENGAGEMENT PERFORMANCE**

1. Does the firm have documented procedures for budgeting and planning substantial tax engagements and, if so, where are those procedures found (for example, in the tax manual)? If not, briefly describe the planning procedures followed in practice (including the information considered and the nature, extent, and timing of partner involvement) and indicate any variations in those procedures based on factors such as estimated time requirements, the nature of the engagement, or evaluated risk factors.
2. Does the firm have written guidance material regarding:
  - a. Involvement of tax personnel on engagements that include significant tax matters?
  - b. Tax return tracking system?
  - c. Due date monitor system?
  - d. Documentation of advice to clients?
  - e. Documentation of tax research?
  - f. Form and content of tax working papers?

**Exhibit 101-4: Review Questionnaire on Tax Practice Quality Control Policies and Procedures (cont.)**

**Response, Including Reference to the Firm's Documents**

- g. Other pertinent matters (such as manuals)?
- 3. If the answer to any of the questions under item 2 above is “yes”:
  - a. Indicate where the material is found.
  - b. Describe the documentation required to be included in tax engagement working papers.
- 4. Does the firm use any standardized forms, checklists, and questionnaires for tax return preparation or other tax services? If so, attach a list or indicate where those materials are found and indicate which forms are required and which are discretionary. If not, briefly describe the procedures expected to be followed and indicate how the preparer's self-review process is documented.
- 5. How does the firm provide for review of changes made in tax returns that are the result of additional information received or of error in preparation?
- 6. How are differences of opinion on tax matters between engagement personnel resolved and how are the staff informed of the procedures to be followed?
- 7. Does the firm use other offices or correspondents for tax engagements? If “yes,” does the firm have documented procedures for the supervision and control of that work? (Indicate where those procedures are found.) If “no,” briefly describe:

**Exhibit 101-4: Review Questionnaire on Tax Practice Quality Control Policies and Procedures (cont.)****Response, Including Reference to the Firm's Documents**

- a. How instructions are given to the other office or correspondent.
  - b. The extent to which the work of that office or correspondent is reviewed by the referring office.
8. Does the firm have documented procedures for the review of tax returns, tax research reports, correspondence, and other working papers by the personnel assigned to the engagement? If so, indicate where those procedures are found. If not, briefly describe the procedures expected to be followed and indicate how the review process is documented.
  9. If applicable, how does the firm train and integrate the professional personnel of a merged-in practice in the firm's tax practice quality control policies and procedures?
  10. Are all engagements (tax compliance, research and planning, tax examinations, etc.) adequately planned by persons knowledgeable about the client and the type of engagement, including specific evaluation of risk factors?
  11. How is communication among personnel concerning functional issues (for example, A&A, tax, and consulting) facilitated?
  12. Are tax accountants involved in reviewing working papers related to a financial statement engagement included in engagement planning conferences related to that engagement?

**Exhibit 101-4: Review Questionnaire on Tax Practice Quality Control Policies and Procedures (cont.)**

**Response, Including Reference to the Firm's Documents**

13. If the firm relies on the audit staff to collect information to be used in the tax return, what are the steps taken to assure that all necessary information is gathered by the auditors?
14. When resolving questionable items, is a memorandum prepared stating the interpretation of the facts and citing the authorities relied upon?
15. Who is responsible for assuring that file-retention policies comply with the Internal Revenue Code and any other applicable professional or regulatory requirements?
16. Does the firm have a log to monitor outgoing tax returns?
17. Are any tax returns being prepared manually? If so, which types of returns?
18. Does the firm use computer-assisted tax preparation? If so, what tax return processing package is being used? How is staff selected for preparation of various types of returns (including consideration of degree of difficulty)?
19. Who is responsible for ordering all computer software and tax forms?
20. Who is responsible for the evaluation of the tax processing software and other computer software?
21. Who is responsible for updating the computer software?

**Exhibit 101-4: Review Questionnaire on Tax Practice Quality Control Policies and Procedures (cont.)****Response, Including Reference to the Firm's Documents**

22. Does the firm test the accuracy of the computer system software at least annually? If so, how?
23. What method of computer input is being used (direct entry or input sheets)?
24. Are control totals used in inputting returns?
25. Does a recovery plan exist for disasters, including down time and foul play?
26. Is anti-virus software in place?
27. Are vital files protected by backup and other procedures? If so
  - a. How often is the file backed up (that is, is there a regular system of backup)?
  - b. What other protective (if any) procedures are in place?
28. Is a backup of the computer kept offsite?
29. What controls are in place should it become necessary to override the system?
30. Have certain areas of tax law or specialized situations been identified as requiring consultation? If so, attach a list of such areas and situations or briefly describe them, and indicate where this list will be found (for example, in the tax practice quality control document or tax procedures manual).
31. Explain how all personnel have been advised of the firm's tax practice consultation policies and procedures.

**Exhibit 101-4: Review Questionnaire on Tax Practice Quality Control Policies and Procedures (cont.)**

**Response, Including Reference to the Firm's Documents**

32. Does the firm designate individuals as having specialized experience and expertise in certain technical tax areas and being available for consultation? If so, attach a list of the designated individuals and what their specialties are, and indicate how personnel have been made aware of this information.
33. How are differences of opinion between engagement personnel and tax specialists resolved?
34. What outside sources are consulted on tax matters when it is deemed necessary (for example, AICPA, state CPA society, another firm, or an individual)?
35. Does the firm maintain an adequate technical reference library to assist personnel in resolving tax problems?
36. Does the tax partner monitor the library contents and make necessary changes?
37. Does the firm require that consultations on tax matters be documented? If so:
  - a. To what extent must they be documented?
  - b. Where is this documentation maintained (for example, in the working papers or in a subject file)?
38. If professional personnel are not in agreement with a decision, do they have a right to document their disagreement and disassociate themselves from the resolution of the matter?

**Exhibit 101-4: Review Questionnaire on Tax Practice Quality Control Policies and Procedures (cont.)****Response, Including Reference to the Firm's Documents**

39. Does the firm have a process in place while performing client engagements, to generate planning ideas (tax, personal financial planning, client advisory services, etc.)? If so, is there a procedure in place to follow up on these planning ideas?

**E. MONITORING**

1. How does the firm monitor its tax practice quality control system?
2. Who is responsible for the annual tax practice inspection?
3. Have instructions been prepared concerning the performance of tax practice monitoring activities, including the scope and content of those activities and the necessary qualifications of inspectors? If so, indicate where they can be found.
4. Does the firm use any of the following materials during annual inspections:
  - a. Inspection work programs?
  - b. Questionnaires?
  - c. Tax engagement or other checklists?
  - d. Other [identify]?

**Exhibit 101-4: Review Questionnaire on Tax Practice Quality Control Policies and Procedures (cont.)**

**Response, Including Reference to the Firm's Documents**

5. Does the firm retain evidence of the inspection procedures performed and the conclusions reached regarding the tax practice? If so, describe the materials retained and indicate the periods covered.
  
6. Have inspection findings been acted upon? If so, briefly describe the corrective actions identified and taken.



**Exhibit 101-5: Tax Engagement Review Checklist**

**AICPA TAX DIVISION**  
**TAX ENGAGEMENT REVIEW CHECKLIST**

This section is used as a guide for reviewing each engagement selected for review. It is not practical to review every aspect of each return.<sup>1</sup> The reviewer should perform a brief review of the work product.

The reviewer starts by identifying some of the significant issues related to the work product. A reminder list of potentially significant issues is contained in appendix I. This initial step reduces the review of the work product to a more manageable size and allows the reviewer to concentrate on significant issues.

After the significant issues are identified this checklist is used as a guideline for reviewing the work product. **A separate checklist should be used for each engagement.** All responses on the checklist are understood to be based solely on the information revealed in the course of the review.

At the end of the checklist, the reviewer should provide any appropriate comments relating to this engagement. Comments and notes should be made on the last page of the checklist or attached to the back.

Name or Identification of Engagement: \_\_\_\_\_

Responsible Person(s): \_\_\_\_\_

List the significant issues appearing in the tax return:

- a. \_\_\_\_\_
- b. \_\_\_\_\_
- c. \_\_\_\_\_
- d. \_\_\_\_\_
- e. \_\_\_\_\_

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1. For purposes of this checklist, the term *return* includes the final draft of any document (such as a memorandum or client letter) associated with the engagement.

**Exhibit 101-5: Tax Engagement Review Checklist (cont.)**

	<u>YES</u>	<u>NO</u>	<u>N/A</u>
1. Is there evidence that the return was reviewed in accordance with the firm's policies and procedures?	_____	_____	
2. Have all review notes been adequately cleared?	_____	_____	
3. Was the return signed in accordance with the firm's policies and procedures and pursuant to Treas. Reg. Sec. 1.6695-1(b)(2)?	_____	_____	
4. Was this return entered in the office's:			
a. Due date reminder system?	_____	_____	
b. Tax return control system?	_____	_____	
5. Are the reciprocal items, if applicable, handled correctly on related party returns prepared by the firm?	_____	_____	_____
6. Were the firm's policies and procedures concerning advocacy, integrity, and objectivity complied with?	_____	_____	
7. In relation to the complexity or other requirements of the engagement, does it appear that there was a proper mix between experience and training of engagement personnel and the extent of the supervision provided?	_____	_____	
8. Was there appropriate consultation:			
a. In situations specified by the firm's policy?	_____	_____	_____
b. When the complexity or unusual nature of the issue warranted consultation?	_____	_____	_____
9. If any consultation took place, was it appropriately documented?	_____	_____	_____
10. Was the engagement properly planned?	_____	_____	

**Exhibit 101-5: Tax Engagement Review Checklist (cont.)**

	<u>YES</u>	<u>NO</u>	<u>N/A</u>
11. If an appropriate engagement letter was <u>not</u> obtained, do client files contain sufficient documentation of communications with the client that clearly establish the firm's responsibilities?	_____	_____	
12. To the extent required by the firm's policies and procedures, were forms, checklists, or questionnaires, adequately completed?	_____	_____	
13. Were differences of professional opinion, if any, resolved in accordance with the firm's policies and procedures?	_____	_____	_____
14. Does the file clearly designate carryover items?	_____	_____	_____
15. Does the technical treatment of items in the firm's work product appear to be substantially correct?	_____	_____	
16. Does it appear that the return is adequately supported by workpapers?	_____	_____	
17. Are the tax workpapers generally well organized?	_____	_____	
18. If tax positions are being taken that are likely to be challenged:			
a. Do workpapers support the position taken?	_____	_____	_____
b. Has the risk associated with the position been communicated to the client?	_____	_____	_____
c. Do the workpapers indicate that the responsibilities under SRTP (1991 Rev.) No. 1, IRC section 6694 and, if applicable, IRC section 6662 have been met?	_____	_____	_____
d. If appropriate, has adequate disclosure been included in the return?	_____	_____	_____

**Exhibit 101-5: Tax Engagement Review Checklist (cont.)**

	<u>YES</u>	<u>NO</u>	<u>N/A</u>
19. Does it appear that the return was provided to the client in sufficient time for consideration and proper action?	_____	_____	
20. Is there evidence that relevant tax-saving ideas were considered?	_____	_____	_____
21. Is there evidence that various avenues of potential new service to the client were investigated?	_____	_____	_____
22. Do client files indicate a record of continuing client contact, including the presentation of tax-planning opportunities?	_____	_____	_____



### **Exhibit 101-6: Computer Disaster Recovery Checklist**

Vital information can be lost through equipment theft, malfunction or destruction. Preparing for possible data loss enables a firm to rebuild and reopen in a short time. Here are some important tips:

- 1. *Secure computer equipment.*** This can be accomplished by controlling access to the building during off-hours. A recent study revealed that most office equipment theft occurs between the hours of 6 A.M. and 8 A.M. Thieves find office buildings unlocked for employees who arrive early but unguarded by a receptionist or other employee.
- 2. *Back up data daily.*** Programs needn't be backed up as often, but should be backed up periodically—or when adding upgrades.
- 3. *Monitor the tape backup procedures daily to ensure they are strictly followed.*** The tape should be tested to be sure the backup procedures are working.
- 4. *Maintain a current list of hardware and serial numbers as well as software and version numbers.*** Doing so will help in case of loss or insurance claims.
- 5. *If employees are allowed to take equipment out of the office, set up and follow a system that tracks usage and returns.***
- 6. *Acquire a fire-rated file cabinet in which to store and maintain valuable data processing equipment and software.*** While there should be backups for software, such a cabinet is a good place to store original diskettes and other types of magnetic media.
- 7. *Acquire antivirus software.*** It is extremely important to choose software the manufacturer updates regularly because new and more innovative viruses are being created all the time. Data should be tested periodically for viruses. In addition, all outside media should be tested before they are placed on a network or other company computer.

**Exhibit 101-7: Central Control File Locator Log**

<b>INCOME TAX RETURN FILE LOCATOR LOG</b>							
<i>Client Name/ Number</i>	<u>Interview</u>	<u>Hold</u>	<u>Prep.</u>	<u>EDP</u>	<u>Review</u>	<u>Process/ Collate</u>	<u>Sign/ Corr.</u>
Gary Gaap	ARB 3/10						
Fred Henley	RJC 2/13		CBS 2/15		RJC 2/25		
Ben Johnson	DAT 2/25		KMY 3/4				
Mario Bros.	ARB 2/15		CBS 2/17	3/4	CA 2/20	3/8	
John Smith	RJK 2/1		SKB 2/2	2/26	DAT 2/16	3/3	RJR 3/5
George Thomas		2/28					
Vacation Inc.	RJS 2/4	2/6	KM 2/15	3/6	RJS 3/3		
Frank Zoro	CAM 3/9						

NOTE: Indicate Accountant's initials and date for each step.

**Exhibit 101-8: Control Sheet—Incoming Client Information**

CLIENT NAME: \_\_\_\_\_ PHONE: \_\_\_\_\_

Accountant: \_\_\_\_\_ DATE: \_\_\_\_\_ TIME: \_\_\_\_\_

**INCOME:**

<u>TYPE</u> <i>(Interest etc.)</i>	<u>SOURCE</u>	<u>AMOUNT</u>
_____	_____	\$ _____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

**EXPENSE:**

<u>TYPE</u>	<u>PAYEE</u>	<u>AMOUNT</u>
_____	_____	\$ _____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

**COMMENTS:**

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Call taken by: \_\_\_\_\_



**Exhibit 101-8A**

**Memo—  
Client Telephone Discussion**

Client File No. \_\_\_\_\_

Client \_\_\_\_\_ Date \_\_\_\_\_

Firm staff: \_\_\_\_\_

Discussion  
summary:

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Specific  
recommendations  
made:

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Follow-up action  
required:

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Copy of this memo  
sent to client?

\_\_\_\_\_ yes \_\_\_\_\_ date \_\_\_\_\_ no \_\_\_\_\_



**Exhibit 101-10: Client Materials Return Form**

\_\_\_\_\_  
(Date)

CLIENT: \_\_\_\_\_

Enclosed we are returning to you the following:

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Comments: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Sincerely,

ACKNOWLEDGED:

\_\_\_\_\_  
Signature

\_\_\_\_\_  
Date

**Exhibit 101-11: Tax Return Routing Schedule**

**TAX RETURN ROUTING SCHEDULE**  
 (To be bound with \_\_\_\_\_)

CLIENT NAME/NUMBER \_\_\_\_\_ TAX YEAR \_\_\_\_\_

TYPE OF RETURN \_\_\_\_\_ STATE/LOCAL RETURN(S) REQUESTED \_\_\_\_\_

DUE DATE \_\_\_\_\_ EXTENDED DUE DATE \_\_\_\_\_

DATE DATA RECEIVED FROM CLIENT \_\_\_\_\_ TARGET COMPLETION DATE \_\_\_\_\_

IN-CHARGE \_\_\_\_\_ SIGNER \_\_\_\_\_ ENGAGEMENT LETTER SIGNED \_\_\_\_\_

	<u>Assigned to/ Target Date</u>	<u>Initial/Date</u>	<u>Actual Time/Cost</u>	<u>Budget Time/Cost</u>
Client Interview	_____	_____	_____	_____
Preparation	_____	_____	_____	_____
Update Permanent File	_____	_____	_____	_____
Math Check	_____	_____	_____	_____
Forms Input Review	_____	_____	_____	_____
To Computer Processing	_____	_____	_____	_____
Data Entry/Typing	_____	_____	_____	_____
Returned from Computer Processing	_____	_____	_____	_____
Forms Output Review	_____	_____	_____	_____
Technical Review	_____	_____	_____	_____
Update Carryforward Schedule	_____	_____	_____	_____
Assembly	_____	_____	_____	_____
Signature	_____	_____	_____	_____
Mail/Pick-Up/Delivery (Circle One)	_____	_____	_____	_____
Estimate Reminder Log Updated	_____	_____	_____	_____
Total	_____	_____	_____	_____

<u>BILLING</u>	<u>Time Charges</u>	<u>Computer Charges</u>	<u>Out-of-Pocket</u>	<u>Total</u>	<u>Billing</u>
Prior Year	_____	_____	_____	_____	_____
Current Year	_____	_____	_____	_____	_____

-----

**SPECIAL INSTRUCTIONS/BUDGET EXCEPTIONS:**

\_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

SOURCE: Reprinted from AICPA, 1999 Tax Practice Guides and Checklists (New York, 1999).

**Exhibit 101-12: Tax Season Workload Projection**

*Tax Season Workload Projection*  
*Budgeted Hours*

Acctnt.	Admin & Other	Interview	Preparation	Review	Signing	Total
ABC	250	250	25	75	75	675
DEF	50	250	175	125	75	675
GHI	150	250	50	175	50	675
JKL	50	175	125	275	50	675
MNO	75	75	300	200	25	675
PQR	150	75	400	50		675
STU	200		450	25		675
VWX			250			250
<i>Projected Availability</i>	925	1075	1775	925	275	4975
<i>Last Year Actual</i>	950	1125	1875	975	275	5200
<i>Expected Changes</i>	-	50	75	25	25	175
<i>Projected Need</i>	950	1175	1950	1000	300	5375
<i>Projected Shortfall</i>	25	100	175	75	25	400

**Exhibit 101-13: Sample Appointment Prescheduling Correspondence**

**SWIFT, MARCH & COMPANY**  
CERTIFIED PUBLIC ACCOUNTANTS  
200 Main Street  
Noplace, Anystate 00000

January 1, 20XX

Mr. & Mrs. John Doe  
100 South Main Street  
Noplace, Anystate 00000

I have scheduled your 19XX income tax return appointment with David Swift on March 1, 20XX at 1:30 P.M.

If for any reason this appointment time is inconvenient for you, please feel free to call and I will be happy to reschedule. No confirmation is required if the date and time are acceptable to you.

You may not be aware that there is an automatic extension of time in which to file your tax return. That date is August 15 of each year. This does not extend the time for payment of tax. In order to avoid interest, payment of the actual tax amount must be paid by April 15. If you are at all interested in having your return extended until August 15, we request that you contact Cathy Olson at our office.

Sincerely,

SWIFT, MARCH & COMPANY

Jane Smith  
Secretary



**Exhibit 101-15: Information Request**

- Check if you want preparer to complete return with information available (suspended processing).
- Check if you want preparer to wait until pending items are received.

CLIENT NAME : \_\_\_\_\_  
 IN-CHARGE : \_\_\_\_\_  
 FORM # : \_\_\_\_\_  
 TAX YEAR : \_\_\_\_\_  
 TELEPHONE # : (\_\_\_\_) \_\_\_\_\_

ITEMS PENDING:

	Mail In	Call In	INFORMATION	RECEIVED
1. _____	<input type="checkbox"/>	<input type="checkbox"/>	_____	_____
2. _____	<input type="checkbox"/>	<input type="checkbox"/>	_____	_____
3. _____	<input type="checkbox"/>	<input type="checkbox"/>	_____	_____
4. _____	<input type="checkbox"/>	<input type="checkbox"/>	_____	_____
5. _____	<input type="checkbox"/>	<input type="checkbox"/>	_____	_____
6. _____	<input type="checkbox"/>	<input type="checkbox"/>	_____	_____
7. _____	<input type="checkbox"/>	<input type="checkbox"/>	_____	_____
8. _____	<input type="checkbox"/>	<input type="checkbox"/>	_____	_____
9. _____	<input type="checkbox"/>	<input type="checkbox"/>	_____	_____
10. _____	<input type="checkbox"/>	<input type="checkbox"/>	_____	_____



**Exhibit 101-16: Internal Rerun Control Sheet**

**SWIFT, MARCH & COMPANY  
TAXSOFTWARE INTERNAL RERUN CONTROL SHEET**

Taxpayer Name: \_\_\_\_\_

Social Security No.: \_\_\_\_\_

Form Initiator \_\_\_\_\_ (use Employee Number)

Rerun Category:

- \_\_\_\_\_ Client Change—rerun charge billed through to client
- \_\_\_\_\_ TAXSOFTWARE Problem—no charge for rerun from TAXSOFTWARE or charge to be discussed with TAXSOFTWARE
- \_\_\_\_\_ Internal Error—attach copy of Rerun Control Sheet

**Exhibit 101-17: Sample Correspondence to Reassign a File**

**SWIFT, MARCH & COMPANY**  
CERTIFIED PUBLIC ACCOUNTANTS  
200 Main Street  
Noplace, Anystate 00000

Dear Client:

The 200X Tax Act is the latest in a long line of recent Tax Acts that significantly changed our tax system. For many individual Form 1040 taxpayers, the system has improved in recent years: rates declined, and larger standard deductions eliminated the need to use the complicated "itemized deduction" schedule. Fortunately, few of the complicated tax law changes have an impact on your return.

Conversely, many of our business clients face the opposite: loss of tax benefits and increased complexity. To compound the problem, the law changes have forced many businesses and trusts that have been reporting on fiscal year ends to convert to calendar year reporting. This is a major problem for us. We now must handle many complex business and trust tax returns during the 1040 filing season, rather than in summer or fall months.

Our office will continue to handle your tax return work, but I will no longer be conducting the initial tax return interview meeting. I will be scheduling your tax return interview with Cindy Goblirsch, CPA, one of our technical tax persons, rather than with me. Cindy will meet with you to gather your tax return data and complete many of the fundamental tasks that I have completed in the past.

Please be assured that your return will go through the same series of preparation and review checks as in the past. While my time will be largely tied up with the new work load of business filing during "tax season," I still will retain responsibility for the final review on your Form 1040. Also, I will continue to sign your return and complete the memo on observations and planning points that accompanies the completed return.

I believe you'll find Cindy a knowledgeable and capable accountant, and I can assure you the same quality tax return product as in the past. If you have any questions now, or special circumstances in the future that require my involvement, please contact me at your convenience.

**Exhibit 101-18: Sample Follow-Up Form**

**FOLLOW-UP/SUMMER WORK**

Date/Initials \_\_\_\_\_

**Client Name:** \_\_\_\_\_

**Client No.:** \_\_\_\_\_

**Primary Accountant:** \_\_\_\_\_

CHECK APPROPRIATE LINES:

Assign to:

<i>Staff</i>	<i>Primary</i>	
_____	_____	Schedule Year-end planning
_____	_____	Order organizer
_____	_____	Request social security earnings history/benefits estimate
_____	_____	Taxpayer pays quarterly tax estimates (to add to database)
_____	_____	Review quarterly estimates _____ 6/15 _____ 9/15 _____ 12/31
_____	_____	Education needed on payroll tax reporting
_____	_____	Education needed on bookkeeping
_____	_____	If proprietorship or partnership, discuss fringe benefit alternatives
_____	_____	Candidate for potential administration of Cafeteria (Sec. 125) Plan
_____	_____	Amended return (detail below)
_____	_____	_____
_____	_____	Carryback claim (detail below)
_____	_____	_____
_____	_____	Other (detail below)
_____	_____	_____
_____	_____	Candidate for gift/estate planning and review of Wills
_____	_____	Business incorporation/entity selection to be discussed
_____	_____	Near retirement, business transition discussion needed
_____	_____	Financial/refinancing/debt restructuring planning

**Exhibit 101-19: Sample Forms for Off-Season File Review**

**FILE REVIEW CHECKLIST—INDIVIDUALS**

Client: \_\_\_\_\_

Init.

Date

Acct. No. \_\_\_\_\_

Initial Review

\_\_\_\_\_

\_\_\_\_\_

Primary Acct. Review

\_\_\_\_\_

\_\_\_\_\_

Work order completed? N/A

\_\_\_\_\_

\_\_\_\_\_

File to Secretary

\_\_\_\_\_

Item

Comments

1. Carryovers (Reg. & AMT):
  - Passive
  - Contributions
  - Investment Interest Exp.
  - ACRS Modification
  - NOL
  - General Business Credits
  - Capital loss
  - Minimum tax credit
  - Nondeductible IRA/State Modif.

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

2. Keogh/SEP/IRA—if Keogh is client on 5500 list?

\_\_\_\_\_

\_\_\_\_\_

3. Remaining basis in rental property—inform client?

\_\_\_\_\_

\_\_\_\_\_

4. Adequacy of withholding

\_\_\_\_\_

\_\_\_\_\_

5. Year-end planning: Set up est. depr., carryovers, etc.

\_\_\_\_\_

\_\_\_\_\_

6. Employment agreements/current? Bring forward in file

\_\_\_\_\_

\_\_\_\_\_

7. Wills and estate planning

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

**Exhibit 101-19: Sample Forms for Off-Season File Review (cont.)**

<u>Item</u>	<u>Comments</u>
8. Bookkeeping/recordkeeping	
9. Soc. Sec. questionnaire	
10. Reassign accountant?	
11. Consumer interest exp. high?	
12. Process sheet c/over items current?	
13. Was interview checklist completed?	
14. Other _____	
_____	
_____	
_____	
_____	
_____	
_____	
_____	
_____	
_____	
_____	

**Exhibit 101-19: Sample Forms for Off-Season File Review (cont.)**

**FILE REVIEW CHECKLIST—CORPORATE**

Client: \_\_\_\_\_

Init.

Date

Acct. No. \_\_\_\_\_

Initial Review

\_\_\_\_\_

\_\_\_\_\_

Primary Acct. Review

\_\_\_\_\_

\_\_\_\_\_

Work order completed? N/A

\_\_\_\_\_

\_\_\_\_\_

File to Secretary

\_\_\_\_\_

\_\_\_\_\_

Item

Comments

1. Corporate minutes

\_\_\_\_\_

2. Debenture payments

\_\_\_\_\_

3. Update depreciation/ACRS  
Modification

\_\_\_\_\_

\_\_\_\_\_

4. Workpapers

\_\_\_\_\_

5. Buy-Sell agreement/Are we  
picking up key person insurance?

\_\_\_\_\_

6. Employment agreement

\_\_\_\_\_

\_\_\_\_\_

7. 2% shareholders (S corp.)  
Fringes

\_\_\_\_\_

\_\_\_\_\_

8. Stock ownership

\_\_\_\_\_

\_\_\_\_\_

9. Shareholder loans—  
Authorization/Interest  
Evidenced by actual note?

\_\_\_\_\_

\_\_\_\_\_

10. Vehicles—personal use

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

**Exhibit 101-19: Sample Forms for Off-Season File Review (cont.)**

<u>Item</u>	<u>Comments</u>
11. Summarize items for next year's year-end projection	<hr/> <hr/>
12. Outstate sales/need for outstate returns	<hr/> <hr/>
13. If have in-house accounting systems—send monthly stmts?	<hr/> <hr/>
14. Annual financial statements—Do working draft for next yr.	<hr/> <hr/>
15. Business development call?	<hr/> <hr/>
16. Bookkeeping/Recordkeeping	<hr/> <hr/>
17. Any carryover limitations?	<hr/> <hr/>
18. Are 1099s being done?	<hr/> <hr/>
19. Current leases in file?	<hr/> <hr/>
20. Expense allowance scheme	<hr/> <hr/>
21. Other _____	<hr/> <hr/>
_____	<hr/> <hr/>
_____	<hr/> <hr/>
_____	<hr/> <hr/>
_____	<hr/> <hr/>

**Exhibit 101-19: Sample Forms for Off-Season File Review (cont.)**

**TAX PERMANENT FILE CONTENTS - INDIVIDUAL**

- \_\_\_ Amended return schedule
- \_\_\_ Basis for mortgage interest computations
- \_\_\_ Buy/sell agreements
- \_\_\_ Client background data
- \_\_\_ Closing documents for purchase/sale of a residence
- \_\_\_ Contracts
- \_\_\_ Copies of gift/estate tax returns
- \_\_\_ Divorce decree(s)/Separation agreement(s)
- \_\_\_ Estate planning documents
- \_\_\_ Forms 2119 (gain on sale of a personal residence)
- \_\_\_ Powers of Attorney
- \_\_\_ Record of taxing authority audits
- \_\_\_ Trust documents
- \_\_\_ Wills
- \_\_\_ Qualified plan documents, if applicable
- \_\_\_ Form 8606 - nondeductible IRA contributions
- \_\_\_ \_\_\_\_\_
- \_\_\_ \_\_\_\_\_
- \_\_\_ \_\_\_\_\_



**Exhibit 101-19: Sample Forms for Off-Season File Review (cont.)****TAX PERMANENT FILE CONTENTS - BUSINESS ENTITIES**

- \_\_\_ Amended return schedule
  - \_\_\_ Annual minutes-continuing matters
  - \_\_\_ Approval of fiscal year election
  - \_\_\_ Approved S election/termination
  - \_\_\_ Articles of incorporation/Partnership agreement
  - \_\_\_ Automobile policies
  - \_\_\_ Buy/sell agreements
  - \_\_\_ By-laws
  - \_\_\_ Client background data
  - \_\_\_ Earnings and profits calculation
  - \_\_\_ Employment/independent contractor agreements
  - \_\_\_ Federal and state taxpayer identification numbers
  - \_\_\_ Form 966 liquidation form
  - \_\_\_ Fringe benefit information (i.e., medical reimbursement, education, deferred compensation, etc.)
  - \_\_\_ Officer life insurance information
  - \_\_\_ Qualified plan IRS determination letter and Summary Plan Description
  - \_\_\_ Record of taxing authority audits
  - \_\_\_ S election acceptance letter
  - \_\_\_ Statement of assets transferred (sections 351/751)
  - \_\_\_ Inventory information (i.e., LIFO layers, constant unit values, § 263A formulas, etc.)
  - \_\_\_ Basis information (i.e., long-term investments, land, etc.)
  - \_\_\_ Accounting methods and elections
  - \_\_\_ Consolidation and elimination history
- 
-

**Exhibit 101-19: Sample Forms for Off-Season File Review (cont.)**

**TAX PERMANENT FILE CONTENTS CARRYFORWARD SCHEDULES**

- \_\_\_ Alternative minimum tax credit carryforwards
- \_\_\_ Basis computation for S corporations/Partnerships
- \_\_\_ Basis investments (including dividend reinvestments/stock dividends)
- \_\_\_ "Built-in gain" valuation workpapers
- \_\_\_ Business credits
- \_\_\_ Capital losses
- \_\_\_ Contributions
- \_\_\_ Data diskettes
- \_\_\_ Depreciation schedules
- \_\_\_ Excess home office expense
- \_\_\_ Excess section 179 deduction
- \_\_\_ Installment sales schedules
- \_\_\_ Loan amortization schedules and related notes
- \_\_\_ Net operating loss and AMT net operating loss carryforwards
- \_\_\_ Non-deductible IRAs
- \_\_\_ Section 1231 gains/losses
- \_\_\_ Suspended passive loss/credits carryforwards
- \_\_\_ Unamortized mortgage points schedule
- \_\_\_ \_\_\_\_\_
- \_\_\_ \_\_\_\_\_
- \_\_\_ \_\_\_\_\_
- \_\_\_ \_\_\_\_\_
- \_\_\_ \_\_\_\_\_
- \_\_\_ \_\_\_\_\_
- \_\_\_ \_\_\_\_\_
- \_\_\_ \_\_\_\_\_

**Exhibit 101-19: Sample Forms for Off-Season File Review (cont.)**

INDIVIDUAL CLIENT REVIEW FOR ADDITIONAL SERVICES

CLIENT NAME/NUMBER \_\_\_\_\_

PERSON IN CHARGE \_\_\_\_\_ PREPARED BY \_\_\_\_\_ DATE \_\_\_\_\_

ROUTE TO: \_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_

The following services should be considered for this client: (check applicable items)

	<u>DISPOSITION/COMMENTS</u>	<u>CLEARED BY</u>
_____ Amend prior year returns - additions, deductions, carrybacks, etc.	_____	_____
_____ Cash/credit management	_____	_____
_____ Compensation and benefit planning	_____	_____
_____ Income and AMT tax planning	_____	_____
_____ Investment and insurance evaluation and planning	_____	_____
_____ Estate planning	_____	_____
_____ Liability and risk management	_____	_____
_____ Tax Attribute Maximization:		
_____ - NOL planning	_____	_____
_____ - Review for available tax credits	_____	_____
_____ Retirement funding adequacy	_____	_____
_____ Children's education funding	_____	_____
_____ Other:		
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

**Exhibit 101-19: Sample Forms for Off-Season File Review (cont.)**

**BUSINESS CLIENT REVIEW FOR ADDITIONAL SERVICES**

CLIENTNAME/NUMBER \_\_\_\_\_

PERSON IN CHARGE \_\_\_\_\_ PREPARED BY \_\_\_\_\_ DATE \_\_\_\_\_

ROUTE TO: \_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_

The following services should be considered for this client: (check applicable items)

	<u>DISPOSITION/COMMENTS</u>	<u>CLEARED BY</u>
_____ Amend prior year returns - additions, deductions, carrybacks, etc.	_____	_____
_____ Business/Strategic Planning	_____	_____
_____ Buy/sell agreements	_____	_____
_____ Cash/credit management	_____	_____
_____ Change in Accounting Method:		
_____ - Alternative methods to defer recognition of income	_____	_____
_____ - Alternative methods to accelerate expense recognition	_____	_____
_____ - Alternative methods to minimize AMT	_____	_____
_____ Enhance or change accounting system	_____	_____
_____ Change tax year	_____	_____
_____ Compensation and benefit planning:		
_____ - Retirement plans (retirement/401(k))	_____	_____
_____ - Deferred compensation plans	_____	_____
_____ - Flexible benefit plans	_____	_____
_____ - Medical reimbursement	_____	_____
_____ Computer Services:		
_____ - has no computer, may need one	_____	_____
_____ - has computer, may need I/C review	_____	_____
_____ - has computer, needs assistance	_____	_____
_____ - needs PC network or enhancements	_____	_____
_____ Disaster recovery planning	_____	_____
_____ Estate or succession planning	_____	_____
_____ Finance and banking relations	_____	_____
_____ Income tax planning	_____	_____
_____ State and Local Tax Planning:		
_____ - Income and franchise tax	_____	_____

**Exhibit 101-19: Sample Forms for Off-Season File Review (cont.)**

**BUSINESS CLIENT REVIEW FOR ADDITIONAL SERVICES**

	<u>DISPOSITION/COMMENTS</u>	<u>CLEARED BY</u>
_____ - Ad valorem/property tax	_____	_____
_____ - sales and use taxes	_____	_____
_____ - Excise taxes and duties compliance review and planning	_____	_____
<b>Tax Attribute Maximization:</b>		
_____ - NOL planning	_____	_____
_____ - Review for available tax credits	_____	_____
_____ - Review for applicable economic development and other business promotion incentives	_____	_____
_____ MAS service - financial, marketing, operations, etc.	_____	_____
_____ Owner and/or executive retirement or financial planning	_____	_____
_____ Risk management	_____	_____
_____ Tax entity changes - incorporation, S election, liquidation, etc.	_____	_____
_____ <b>Other:</b>	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____



**Exhibit 101-20: Client Risk Rating**

**CLIENT EVALUATION FORM**

Rate each characteristic from 1 (lowest) to 5 (highest).

<u><b>Client</b></u>	<u><b>Rating</b></u>				
Integrity	1	2	3	4	5
Payment ability	1	2	3	4	5
Profitability of work	1	2	3	4	5
Condition of records	1	2	3	4	5
Timeliness	1	2	3	4	5
Attitude toward professionals	1	2	3	4	5
Desirability of type of work	1	2	3	4	5
Likelihood of referrals	1	2	3	4	5
Opportunity to expand services	1	2	3	4	5
Appreciation for work done	1	2	3	4	5
Conscientious toward due dates	1	2	3	4	5
 Total Score	 _____	 _____	 _____	 _____	 _____
 Average Score	 _____	 _____	 _____	 _____	 _____

**Exhibit 101-21: Sample Correspondence For Terminating Clients**

August 26, 20XX

Mr. and Mrs. John Doe  
100 South Main Street  
Noplace, Anystate 00000

Dear John and Mary:

We appreciated the opportunity to work with you in the past regarding your tax matters. However, as a result of differences in our firm's approach to providing professional tax services and your expectations, we believe you would be better served in the future by another tax preparer.

The ever-increasing complexity of the tax law requires us to incur extensive costs in training and research materials. To maintain quality control over the sophisticated nature of most of our clients' returns, we also require that each step of the tax return preparation receive an independent review. These measures have forced us to raise our fee structure to a point that seems to exceed the level necessary for your return.

We would be happy to refer you to another firm whose fee structure is better suited to less complicated returns such as yours. Of course, we are always available for consultation should your situation change in the future. Thank you again for the opportunity to serve you.

Sincerely,  
SWIFT, MARCH & COMPANY

David Swift, CPA

DS/lw



**Exhibit 101-22: New-Client Information**

**NEW-CLIENT REGISTRATION FORM**

Name: \_\_\_\_\_  
 Last Name First MI Spouse's Name  
 (if applicable)

Address: \_\_\_\_\_  
 Street  
 \_\_\_\_\_  
 City State Zip

Phone Number: \_\_\_\_\_  
 Home Work

Occupation: Self: \_\_\_\_\_  
 Spouse: \_\_\_\_\_

Prior Accountant: \_\_\_\_\_

Last year's approximate tax preparation fee: \_\_\_\_\_

Have you ever been sued for collection? \_\_\_\_\_ Yes \_\_\_\_\_ No

Why did you choose our firm:

- Referred by \_\_\_\_\_
- Familiar with employee (give employee name) \_\_\_\_\_
- Directory service \_\_\_\_\_
- Other (detail) \_\_\_\_\_

Brief description of tax return

- Sources of income (check all that apply) \_\_\_\_\_ W-2 \_\_\_\_\_ Self-Employed  
 \_\_\_\_\_ Rental Property \_\_\_\_\_ Interest & Dividend \_\_\_\_\_ Farming \_\_\_\_\_ Sale of Property  
 \_\_\_\_\_ Installment Receipts
- Partner/stockholder in another entity? \_\_\_\_\_ (if YES, name of entity: \_\_\_\_\_)
- Out-state returns? \_\_\_\_\_
- Other major items \_\_\_\_\_

Are you interested in other services our firm can offer, such as Estate Planning and Financial Planning? (If YES, state areas of interest: \_\_\_\_\_ )

Please complete form and return to:  
 Swift, March & Company, 200 Main Street, Noplace, Anystate 00000

After our review of the form, we will forward information about our firm and an appointment to you.  
 .....

FOR INTERNAL USE ONLY

\_\_\_\_\_ CLIENT NUMBER \_\_\_\_\_ PROCESSED BY  
 \_\_\_\_\_ INTERVIEW ASSIGNEE \_\_\_\_\_ DATE

**Exhibit 101-23: Sample Workpaper File Label****DRAFT**

## WORKPAPER FILE (Imprint on Redwelds)

(1)	File name		
(2)	Entity's name		
(3)	Date		
(4)	Contents		
(5)	Tax return due date, including extensions allowed (whether or not actually extended)		
(6)	Cleaned out By/Date		/
(7)	Scheduled destruction date		
(8)	Extended destruction date (contact person _____) (indicate reason _____)		

- (1) Enter name under which filed, e.g., if all files for companies in a consolidated or family group are filed together, enter that name here. Enter in the box at the right the letter under which you want the file stored.
- (2) Enter name of entity for which this folder is used. Leave blank if not part of group, (i.e., if prior line is same name). Can also be used to identify the name the company is doing business under (d/b/a), or a/k/a (also known as) name.
- (3) Enter applicable date, e.g., 12/31/9 or 199 for calendar year 199 audit, 199 for individual 1040 tax return for 199 , etc. Also note two digit year end in box at right for use in filing in file room (e.g., "96").
- (4) Describe the file contents, e.g., "1040" for individual income tax return; "Liabilities and Equity" for audit file containing workpapers for those areas.
- (5) Show extended due date allowed, whether or not return was actually extended.
- (6) Enter initials and date of person cleaning out file, i.e., forwarding any items of continuing interest. This is to be done as part of the planning process.
- (7) Scheduled destruction date based on Workpaper Retention Policy.
- (8) Revised destruction date, reason and person controlling retention (i.e., responsible for decision to retain).

**Exhibit 101-24: New-Client Data Base Form****CLIENT FILE MAINTENANCE FORM**

- ( ) Marketing  
 ( ) New Client—All Information On This Page Must Be Provided For *New Clients*  
     Send copy of this page to Marketing Director and PIC  
 ( ) Changes to an Existing Client  
 ( ) Inactive

Originated By \_\_\_\_\_  
 Date \_\_\_\_\_

Client Number \_\_\_\_\_ (5)  
 Summary Number(A) \_\_\_\_\_ (5) Search Name \_\_\_\_\_ (10)  
 Display/Print Name \_\_\_\_\_ (30)  
 Mailing Name \_\_\_\_\_ (40)  
 Address: Line 1 \_\_\_\_\_ (40)  
           Line 2 \_\_\_\_\_ (40)  
           Line 3 \_\_\_\_\_ (40)  
 City \_\_\_\_\_ (17) State \_\_\_\_\_ (2) Zip \_\_\_\_\_ - \_\_\_\_\_  
 Name of contact person \_\_\_\_\_ (30) Salutation \_\_\_\_\_ (15)  
 Telephone number ( ) \_\_\_\_\_ Fax number ( ) \_\_\_\_\_  
 GSO Office \_\_\_\_\_ Biller \_\_\_\_\_  
 Date Opened \_\_\_\_\_ Finance Charge      Yes      No      (circle one)

Additional Job Numbers:

Job Number _____ (2)	_____ (4)	Description _____
Job Number _____ (2)	_____ (4)	Description _____
Job Number _____ (2)	_____ (4)	Description _____
Job Number _____ (2)	_____ (4)	Description _____

Reviewer \_\_\_\_\_ (receives duplicate billing worksheet)  
 Previous Accounting Firm \_\_\_\_\_

Client Type \_\_\_\_\_ (2)\*  
 Group Code (Form of Organization) \_\_\_\_\_ (5)\*  
 Financial Year End \_\_\_\_/\_\_\_\_  
 Tax Year End \_\_\_\_/\_\_\_\_  
 SIC No. \_\_\_\_\_ (3) (see list in supply area)  
 County \_\_\_\_\_  
 Federal I.D. No. \_\_\_\_\_  
 Ownership Type \_\_\_\_\_ (3)\*  
 Basis of Accounting \_\_\_\_\_ (2)\*  
 Client Classification \_\_\_\_\_ (2)\*  
 Number of Employees \_\_\_\_\_ \*  
 Total Assets \_\_\_\_\_ \*  
 Annual Sales \_\_\_\_\_ \*  
 Services: Type of Service \_\_\_\_\_ \*  
           Service Period \_\_\_\_\_ \*  
 Estimated annual fees \$ \_\_\_\_\_

Computer:  
 Computer System \_\_\_\_\_ (2)\*  
 Manufacturer \_\_\_\_\_  
 System Description \_\_\_\_\_  
 Software \_\_\_\_\_

How we got them as a client:  
 Firm member (who) contact (how): \_\_\_\_\_  
 \_\_\_\_\_  
                                     *Be specific*  
 Client referral \_\_\_\_\_  
 Attorney referral \_\_\_\_\_  
 Banker referral \_\_\_\_\_  
 Other \_\_\_\_\_

Entered by \_\_\_\_\_ Date \_\_\_\_\_

Copy sent to PIC \_\_\_\_\_ Date \_\_\_\_\_

Copy sent to Marketing Director, if new client \_\_\_\_\_ Date \_\_\_\_\_

\* see reverse for selections

( ) indicates number of characters available

(A) common number for group of related clients ("Mother number")

Place on mailing list (check one or more):

Footnotes (general)	_____
GSO Tax Letter	_____
Inside Commercial Lending (for bank officers)	_____
On-Site (construction)	_____
Nonprofit Agendas	_____
World Class Manufacturing	_____
Financial Institution Executive Tax Update	_____
Real Estate Advisor	_____
Government Finance Reporter	_____
Dealer Insights (dealerships)	_____
Aware (area computer services)	_____

Add'l Mailing Name: \_\_\_\_\_  
 Add'l Mailing Name: \_\_\_\_\_

Employee Benefit Plans (check if applicable):

Defined Benefit Plan	_____
Defined Contribution Plan:	_____
401(k) Plan	_____
Profit Sharing Plan	_____
Money Purchase Plan	_____
ESOP	_____
Other	_____
Cafeteria Plan	_____
Self Funded Medical Benefit Plan	_____
Insured Medical Benefit Plan	_____

**Exhibit 101-24: New-Client Data Base Form (cont.)**

**CLIENT DATA BASE CODES**

Client Type

Financial Institution .....	01
Nonprofit Organization .....	02
Construction .....	03
Governmental .....	04
Manufacturing .....	05
Wholesale .....	06
Retail .....	07
Service .....	08
Real Estate .....	10
Dealership .....	11
Health Care .....	15
Employee Benefit Plan .....	23
Other industries .....	24
Individual .....	25
Estate or Trust .....	26
Non client charges .....	27

Form of Organization

C Corp .....	CCORP
S Corp .....	SCORP
Nonprofit .....	NONPR
Proprietorship .....	PROPR
Partnership .....	PARTN
Individual .....	INDIV
Governmental .....	GOVTL
Estate .....	ESTAT
Trust .....	TRUST
Employee Benefit Plan .....	EMPBP
Peer Review .....	PRRVW

Computer System

Mainframe .....	MF
Mini .....	MI
PC .....	PC

Number of Employees

1-50 .....	1
51-100 .....	2
101-250 .....	3
251-500 .....	4
501-750 .....	5
711-1,000 .....	6
over 1,000 .....	7

Total Assets (millions)

\$1-50 .....	1
\$51-100 .....	2
\$101-200 .....	3
\$201-300 .....	4
\$301-400 .....	5
\$401-500 .....	6
over \$500 .....	7

Ownership Type

Closely-held (family owned or only a few shareholders) .....	CLD
Publicly-held (large number of shareholders but not SEC) .....	PLD
SEC or equivalent .....	SEC

Basis of Accounting

GAAP .....	GA
Income Tax Basis .....	IT
Cash Basis .....	CB
Current Value .....	CV
Statutory/regulatory .....	SR

Client Classification

Star .....	S
Unrealized Potential .....	UP
Bread and Butter .....	BB
Marginal .....	M
New Client .....	N
Problem/Investment Account .....	PI
Submarginal .....	SM

Type of Service

Audit—unqualified .....	1
Audit—qualified GAAS (scope limitation) .....	2
Audit—qualified (GAAP departures) .....	3
Audit emphasis (uncertainties, going concerns) .....	4
Audit—disclaimer .....	5
Audit—pension/profit sharing plan .....	6
Review .....	7
Compilation with disclosures .....	8
Compilation without disclosures .....	9
Agreed-upon procedures .....	10
Reportable conditions letter (SAS 60) .....	11
Audit committee letter (SAS 61) .....	12
Payroll tax returns .....	13
Accounting services (write-up) .....	14
Management consulting services (MCS) .....	15
Tax return preparation .....	16
Other tax services .....	17

Service Period

Monthly .....	M
Quarterly .....	Q
Yearly .....	Y
As requested .....	R

Annual Sales (millions)

Up to \$1 .....	1
\$1-5 .....	2
\$6-10 .....	3
\$11-15 .....	4
\$16-25 .....	5
\$26-50 .....	6
\$51-75 .....	7
\$76-100 .....	8
over 100 .....	9



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# 102 Profit Management

Tax practitioners operate a business as well as engage in a profession. Unfortunately, firms are too often too busy helping clients toward their financial objectives to work toward their own. Profits lag and client service suffers because of inadequate attention to internal financial considerations. Consultants to the profession suggest that the firms themselves are their most important customers. Accordingly, as you place more emphasis on keeping the financial affairs of your firm in order, you should

- Complete financial budgets and regular financial reports for your firm, similar to those you prepare for other clients.
- Compare budget versus actual, and pay prompt attention to significant variances.
- Impose the same rigid financial controls and establish the same financial budgeting and reporting systems on your firm that you do on your clients.
- Identify and monitor key performance indicators such as number of clients, average annual fee per client, billable hours, and so forth.

## 102.1 Internal Financial Control System

In addition to financial budgeting and reporting and the imposition of a strong financial control system, profit management involves the planning and control of many other areas, including hourly billing rates, value billing, billing writedowns, and collection policies.

You must set goals for profitability, and adequately communicate your profit management approach to all employees. You should educate everyone in the firm on the need for a fair return on investment and labor and on needed capital to fund future growth, and communicate policies and procedures on profit management. It is important to have staff and management evaluation of tax season, so as to improve the next tax season. This will contribute to profit management.

**Practice Tip.** Set up your firm as a “client” on your due date list for monthly financial reports, annual budget completion, and annual tax return. Treat a task not completed on time for your firm as seriously as you would a client’s missed due date.

## 102.2 Fee Setting

Fee sensitivity among clients continues to intensify. Unfortunately, tax practitioners are finding that many clients are so cost-conscious that price has become the controlling force in their professional relationships. In reality, clients, not practitioners, set fees. However, many practitioners have also learned that one of the most effective techniques for responding to fee sensitivity is to provide high-quality and value-added services to clients, in addition to the standard tax-return preparation. Staff must understand the importance of completing efficient yet high-quality services that allow the firm to make a profit while charging the client fairly.



Different firms use various approaches in setting fees for tax services. Some decide on one technique and use only that one. Others use a number of methods, depending on the type of engagement. Some calculate fees under several methods for each engagement and use an average of the techniques, or occasionally choose the highest (or lowest) result.

It is usually best to choose a fee-setting approach and use it consistently. Failure to *consistently* apply a fee-setting method can result in client inquiries for justification of billings and lost profits and will make it impossible to compare different types of tax return services and determine whether they are profitable.

**Example.** A firm billed Mr. and Mrs. Foreman for their tax return based on the different forms contained in their return (this method is described in Section 102.2.3). Their return included Schedules A, B, C, D, SE, and Form 6251. The cost to the Foremans for completion of the tax return was \$495. The same firm billed Mr. and Mrs. Timeman based on the professional time required to complete their return (described in Section 102.2.2). The Timemans' return included almost the same schedules and forms as the Foremans' tax return. The cost to the Timemans was \$325. At a firm-sponsored seminar, the Foremans and Timemans happened to chat about their tax situations, and the discussion moved into the cost for tax return preparation. The firm will have some tough explaining to do to the Foremans.

## 102.2.1 Hourly Rate Formulas

### Cost Plus

There are many formulas for establishing standard hourly billing rates. One is the cost-plus method. To find the rate under this method, first determine the desired net income for the firm in excess of partners' salaries. Then, calculate the firm's total cash needs by assessing the additional cash requirements for salaries and other expenditures. To find the "cost" rate, divide each staff person's annual salary by the estimated number of annual billing hours for that person to estimate his or her *hourly* cost. Then, divide the total of the desired net income in excess of the partners' salaries and all other overhead expenditures by the firm's *total billable hours* to determine the total "plus" rate. Finally, add each person's "cost" rate to his or her "plus" rate to calculate each individual's hourly billing rate. One of the advantages of this method is that it can be used to measure attainment of the firm's profit goals because it includes overhead and profit in the calculation.

**Example.** A small firm has employees with total salaries of \$189,500 (levels are broken out in Figure 102.1, below). The firm also estimates \$75,000 in other expenditures, and desired net income in excess of the owner's salary of \$40,000. Total billable hours for the firm are estimated at 6,700. A total of \$75,000 of other expenditures and desired net income of \$40,000 divided by the 6,700 total billable hours = \$17.16 "plus" rate.

**Figure 102.1: Cost-Plus Fee Table**

	(1)	(2)	(3)	(4)	(5)
	<u>Annual Salary</u>	<u>Billable Hours</u>	<u>Cost Rate 1÷2</u>	<u>"Plus" Rate</u>	<u>Hourly Rate (3+4 rounded)</u>
Owner	\$84,000	1,400	\$60.00	\$17.16	\$77
Senior	42,500	1,700	25.00	17.16	42
Junior	36,000	1,800	20.00	17.16	37
Paraprof.	<u>27,000</u>	<u>1,800</u>	15.00	17.16	32
Total	<u>\$189,500</u>	<u>6,700</u>			

It is important to consider the firm's rate of realization (see Section 102.2.6) and collection of accounts in calculating the cost plus rates. On an average, the firm may find that only 90

percent of chargeable hours are actually billed through to clients. This could be due to any number of factors, such as errors in preparation, time overruns on fixed-fee projects, or even courtesy discounts. One should also consider that not all amounts billed to clients are actually collectible, either due to client complaints or inability to pay.

These factors need to be included in an employee's billable hour calculation. For example, if the firm overall loses 10 percent on billing realization and another 2 percent on accounts receivable charge-offs, only 88 percent of an employee's chargeable hours should be used as the "billable hours" in the cost-plus fee calculation.

### Weighted Value

Another approach to establishing billing rates is the weighted-value method, under which each staff level is assigned a weighted value based on the work of that level relative to the remainder of the firm. (Use a value of one for the least complex level.) First, estimate the total billable hours for each member of the firm. This estimate should already be available if proper firm budgeting has been completed. Multiply each firm member's total number of billable hours by his or her assigned value weight to calculate that member's number of "weighted hours." As in the cost-plus method, next calculate the total of the desired net income in excess of the partners' salaries and the annual salaries and other expenditures. Divide this by the total number of weighted hours calculated for the firm to determine the basic hourly rate. Finally, multiply the basic hourly rate by each person's value weight to determine the hourly billing rate.

**Example.** Assume XYZ Firm Inc. has \$1,125,000 of cash requirements (assume \$725,000 for salaries, \$320,000 for other expenditures, and \$80,000 for desired net income in excess of partners' salaries). Assume a total of 22,500 weighted hours in the firm, for an hourly basic rate of \$50 per hour. (See Figure 102.2.)

**Figure 102.2: Weighted-Value Fee Table**

	(1)	(2)	(3)	(4)	(5)
	<i>Value</i>	<i>Billable</i>	<i>Weighted</i>	<i>Basic</i>	<i>Hourly</i>
	<i>Weight</i>	<i>Hours</i>	<i>Hours</i>	<i>Firm</i>	<i>Rate</i>
				<i>Rate</i>	<i>(1×4)</i>
Partner 1	2.3	1,250	2,875	\$50	\$115.00
2	2.3	1,250	2,875	50	115.00
3	1.8	1,400	2,520	50	90.00
4	1.8	1,400	2,520	50	90.00
Senior 1	1.5	1,600	2,400	50	75.00
2	1.5	1,600	2,400	50	75.00
Junior 1	1.0	1,810	1,810	50	50.00
2	1.0	1,700	1,700	50	50.00
Paraprofessional 1	1.0	1,700	1,700	50	50.00
2	1.0	1,700	1,700	50	50.00
		15,410	22,500		

### Salaries Multiple

Another method of determining hourly rates is based solely on a multiple of salaries or salary costs. Some firms use a multiple of  $3 \times$  salary, while others use  $3\frac{1}{2} \times$  salary or even more. Take care in determining what goes into the calculation of "salary." Some firms include discretionary bonuses, while others use only base salary. Many do not use overtime or other amounts in the base calculation. For part-time employees, the total salary cost is total hours  $\times$  a per-hour wage.

The following formula may be used to arrive at a factor between 3 and  $3\frac{1}{2}$ :

$$\frac{\text{Budgeted chargeable hours} \times \text{Current billing rate}}{\text{Total salary cost}}$$

**Example.** John Smith is paid a base salary of \$2,500 per month, and also receives a discretionary bonus. His bonus on April 15, 19XX is \$2,000. John's budgeted chargeable

hours are 1,800 hours. John's current billing rate is \$50 per hour. Using the formula above, John's factor is 2.81 (1,800 hours  $\times$  \$50/hour divided by \$32,000). If John's billing rate is increased to \$55 per hour, the factor is 3.09 (1,800  $\times$  \$55/hour divided by \$32,000) and would be in a more acceptable range. If the bonus amount is unknown when the billing rates are set, an estimate can be used in making the calculation.

**Practice Tip.** While it does not seem surprising that there is a positive relationship between the multiple employed and the profitability of the firm, most surveys reveal that firms using a multiple of  $3\frac{1}{2}$   $\times$  or more of *total* salary (including bonuses, overtime, and other payments) are generally among the leaders in terms of profitability.

## 102.2.2 Time Based Method

Under the time based method of setting fees, each individual involved in tax services keeps track of the specific time spent on a project. This time spent is multiplied by the individual's hourly billing rate (set by using one of the methods described in Section 102.2.1) to calculate the total amount of fees on a particular project.

Many firms feel this approach is the most equitable. Billing fees normally reflect each individual's experience and capabilities, and clients pay for the specific time required to complete a project. As complexities and other issues arise, resulting in additional time, a higher fee results.

Disadvantages of the time based billing method include the management oversight required to see that time is properly recorded by all personnel, and the fact that the resultant fees may not properly reflect the services performed due to variable efficiencies associated with certain personnel. Also, time based billing may not reflect the true value of the work to the client. An exceptional job in tax planning may be worth more than straight billable hours might suggest. Hopefully, billing rates established for different people take these variables into account, but this is not always the case. Value billing, as discussed in Section 102.6, may be appropriate in a number of cases.

Proper recording of professional time is important in terms of both underrecording and overrecording. Underrecording hurts firm profitability; overrecording is unfair to clients.

**Practice Tip.** Use a chargetime budget at the start of all work to minimize problems of under- and overrecording of time. Similarly, closely monitor actual staff charge hours versus the charge hour budget established for each firm member. Some firms distribute a schedule comparing actual hours to budgeted hours on a regular basis (weekly or monthly).

**Practice Tip.** Managers should help set salary and billing rates. This involvement makes them aware of the firm's profit goals.

## 102.2.3 Form Based Method

Under this approach, charges for the preparation of a tax return are based on the number of forms and schedules included in the return. For example, completing a Schedule D may generate a \$40 fee; a Form 4797, a \$50 fee, and so on. The theory is simple: As forms become more detailed and complex, a higher charge results. One disadvantage is that the same charge results for a Schedule D (for example), whether the form has one transaction or many, unless the charge varies depending on the volume of transactions on a form.

An advantage of the form based method over the time based method is that many forms can be generated and completed with a minimum of effort with computer processing and preparation of tax returns (see Chapter 202, Computerized Tax Return Preparation). The time based method may not accurately reflect certain complexities associated with preparing a tax return. For example, preparing an alternative minimum tax schedule may be fairly "automatic" with computer preparation. The time based method would bill a lower amount, whereas the form based method would impose a fairly substantial charge on the preparation of such a complex form.

**Practice Tip.** Some firms calculate fees using both the time based and the form based methods, and then use the higher of the two amounts. Although the two calculations should produce somewhat similar results, billing consistency problems may arise. This could result in similar client engagements' being charged at differing amounts. Even if billing is actually to occur using only one method, as should be the case, it is a useful management exercise to monitor fees on a sampling of returns using both methods, to assure that profits are being protected and to provide meaningful information for decisions on future fee-setting methods.

A combination of time-based and form-based methods provides a good compromise when the cost per form is kept minimal in relation to the hourly rates. For example, billing through direct computer charges of \$20 for a basic 1040, \$5 for a Schedule A, and \$15 for Form 6251 in addition to the time charges, can recognize both the amount of effort expended on a tax return and also allow the tax practitioner to benefit from the efficiencies of computer-generated tax forms.

## 102.2.4 Using Multiple-Rate Schedules

Some firms use different hourly billing rates depending on the service being performed. The theory behind this approach is that while billing rates should be based on the individual's experience level and the complexity of tasks completed, the same person may complete certain tasks that cannot be justified at the same hourly billing rate. Clients don't require the experience level of partners to have accurate payroll tax reports completed, and would be unwilling to pay the higher hourly rate normally assigned to partners.

The multiple-rate method assigns each individual several rates depending on the task undertaken. This approach minimizes or eliminates billing writedowns and adjustments. For example, an experienced person completing a rather simple task, such as payroll reports, will charge a lower hourly rate for the services. Multiple rates should be used sparingly, since the practice implies an inefficient use of firm resources. Employees are not challenged to work at their highest abilities, and professional development may suffer. Compensation should be *somewhat* based on billing rates, to provide an incentive for an experienced person to use a higher rate on more complex projects, and, consequently, to grow professionally.

There is always an opportunity to charge significantly higher billing rates for such tasks as IRS audit representation and estate planning. The theory behind the multiple-rate approach is simple: Certain projects command a premium billing rate, while other projects merit a lesser rate. One way to address this is by using multiple billing rates.

**Example.** Bob Smith has been assigned a three-tiered billing rate as follows:

Compiled Financial Reports	
Payroll Reports	
Sales Tax Reports	\$60/hr
Individual Tax Returns	
Partnership Tax Returns	
Corporate Tax Returns	\$80/hr
IRS Audit Services	
Strategic Planning	
Business Consultation	\$120/hr

Bob records his time based on the specific task completed. If he is assigned a Form 941, Quarterly Payroll Tax Report, to complete, a \$60-per-hour rate is charged. If Bob works with the CEO of a company on strategic planning, an \$120-per-hour rate is charged. The tiered rate structure recognizes that Bob may occasionally be required to complete less complex tasks at a lower rate, while at the same time recognizing that he should command a premium rate for complex and specialized services.

Multiple-rate schedules allow you to obtain a “premium rate” for certain services, while minimizing billing writedowns that could occur when an experienced individual is assigned (due to workload demands) to less complex tasks. Disadvantages of multiple rates include the inefficient use of firm resources previously mentioned, and the temptation for staff to categorize certain projects as fitting into a lower billing rate, even though the project may in fact be extremely complex.

The use of a chargeable-dollar goal with multiple rates may be appropriate. For example, if an individual has a chargeable-dollar goal of \$120,000 (1,600 hours at \$75.00 per hour), the individual may reach the \$120,000 goal with more or fewer chargeable hours, depending on the billing rate associated with work he or she completes.

**Practice Tip.** Closely monitor the services performed when multiple rates are used. For a variety of reasons, staff may use a lower rate for more complex services (including lack of confidence, sympathy for the client, and so forth). Be sure staff members are completing work (and charging professional time) at the proper levels. Larger firms may find this system to be impractical because of the time necessary to monitor the system.

### 102.2.5 Fixed Fees

Some tax preparers occasionally advertise or charge a fixed fee for certain types of tax returns (for example, the Form 1040 with a Schedule A and Schedule B may be billed at a flat \$200). The fee is adjusted for each additional schedule, for preparing tax estimates, and for additional returns and services. Carefully consider the relationship the fixed fee has to certain types of returns, particularly complex returns and those containing numerous interest and dividend sources. Profit on most fixed-fee work is made through volume.

One risk of the fixed-fee arrangement is that clients may erroneously assume that an unlimited amount of professional services become available by paying a fixed amount. Clients may assume that the fixed-fee arrangement includes the right to call you about tax questions, seek year-end planning advice, or expect the firm’s assistance in the event of an IRS or state tax audit. This risk can be minimized through a clear engagement letter detailing what is covered under the fixed-fee arrangement, so the client can budget for professional fees and plan for these expenditures.

Another risk of the fixed-fee arrangement is that a lower quality job may be done in an effort to stay within the project’s budget if the actual time requirement exceeds the time projected.

If a fixed-fee arrangement is considered, use a range of fees or, at the very least, clearly communicate the services associated with the fixed fee. A misunderstanding could be costly to the firm.

**Example.** Jones, Inc. has asked you for an estimated fee for preparing their corporate income tax return. Rather than quoting a fixed fee of, say, \$750, consider quoting a range of fees, say \$650 to \$1,100. The range provides greater flexibility to deal with unexpected complexities, while allowing Jones to adequately budget for your professional services cost.

**Practice Tip.** Include a range of fees in the annual engagement letter and, in the same document, clearly specify the services to be performed for those fees.

### 102.2.6 Realization Expectations

Billing “realization” is the difference between the amount billed to a client and the amount of work charged to that client at standard billing rates. Billing rates should be set where realistic realization occurs. Your goal should be to bill as much as possible of the amount charged by staff to the client at standard billing rates. Strict control should be placed on billing writedowns (discussed at Section 102.11.4).

**Example.** Ron’s billing rate is \$40/hour, and he charges 3½ hours to the completion of the tax return for Blue, Inc. Sue’s rate is \$55/hour, and she charges 2 hours to the same job. Total charges in the account amount to \$250 (3½ hours at \$40 and 2 hours at \$55).

Depending on the amount of the actual invoice sent to Blue, Inc., realization would be as follows:

<u>Amount of Invoice</u>	<u>Realization</u>
\$300	120%
\$275	110%
\$250	100%
\$225	90%
\$200	80%

Consider the analogy of a retail store with strict credit policies. While it may seem admirable for a retail store to have no bad debts, this may indicate credit policies that are far too restrictive.

Similarly, a realization rate at or near 100 percent may indicate that billing rates are set too low. One consultant suggests to set rates to achieve about a 90 percent overall realization, and then work to raise the realization level to 97 percent or 98 percent. When this is achieved, the consultant suggests that billing rates again be raised to fall back to the 90 percent realization level. This forces you to continually update and monitor your firm's billing rates and billing writedown criteria. Your engagement letter should communicate the current range of billing rates and the fact that these rates are subject to change.

## 102.3 Minimum Fees

There is wide divergence among minimum-fee philosophies. Many firms set minimum fees for tax return preparation and other services, attempting to limit, through fees, the types of clients they deal with.

Whichever fee-setting method (see Section 102.2) is used, strongly consider the implementation of minimum fees. For example, small and simple tax returns, easily completed by a less qualified and less experienced tax preparer, may not be appropriate work for your particular practice. By establishing a minimum fee based on the least complex type of tax return you would handle, you signal to potential clients that such simple tax returns would not be appropriate for your firm; the minimum fee would effectively price your firm "out of the market." The advantage of establishing minimum fees is that they automatically "select" work of an acceptable level for the firm. Minimum fees are disadvantageous in that even simple, straightforward tax returns can provide opportunities to build skill and confidence in less experienced staff, and to evaluate the work habits of new staff. Remember that some "small clients" may be excellent referral sources or may turn into larger, more desirable clients in the future.

### 102.3.1 Establishing Minimum Fees

You should establish minimum fees for each type of tax return completed, because it eliminates any doubt as to fee expectations, and discourages those clients who are most likely to question the amount of a bill. Describe minimum fees in engagement letters, along with billing rates and an explanation of the billing process.

Take special care to assure that your clients understand that the fee quoted is a *minimum fee*, and not an estimate of the actual fee to be charged for the tax return in question.

Some firms establish strict criteria for the types of clients they will deal with. For example, some firms only complete individual tax returns for clients for whom they also complete business services. Other firms discourage simple and straightforward individual tax returns, and refer such work to other qualified tax preparers. The decision relates in part to the image-setting process, discussed in Chapter 103.

### 102.3.2 Examples of Minimum Fees

The minimum fees charged by CPA firms vary widely. Smaller firms in rural communities, which often complete a large volume of individual tax returns, may establish minimum fees in

the range of \$100 to \$150 for individual returns and several hundred dollars for corporate returns. Larger firms in metropolitan areas often establish minimums of several hundred dollars for individual tax returns, electing to concentrate on clients associated with business returns.

**Practice Tip.** When minimum fees are established, be sure to consider current clients who, in the past, have paid amounts under the established minimum. Are these returns to be grandfathered in terms of fee structure? Many firms find it extremely difficult to implement a minimum fee structure for existing clients, when many of these clients were the firm's primary source of revenue in its start-up phase. They elect to grandfather these clients in, even though the fee may be below the established minimum.

## 102.4 Competitors' Fees

Chapter 103 deals with marketing considerations and discusses topics such as image setting (Section 103.3) and competition (Section 103.9). Determine how important is the relationship of your fees to those of your competitors. But be careful in making comparisons. What types of clients do the competitors deal with? What experience do they demand of staff people? What level of quality do they provide? These questions require analysis if a firm is truly interested in comparing its fees to those of its competitors.

### 102.4.1 Higher or Lower Than the Competition?

You must first determine if comparison is justified. Perhaps you have a particular area of expertise or, by design, you employ more experienced people. Many factors go into the fee-setting process: A different fee may be justified based on a particular niche you have developed, or on the people involved.

The fee-setting process must be carefully constructed. While it is not particularly important to justify the difference in fees from those of a competitor, it is important that some rational basis for establishing fees be considered.

You should budget from the bottom up, and establish billing rates using one of the methods described in Section 102.2. Assuming that there are efficiencies in the tax return process, and that billing rates have been properly established, a billing should occur using only this information. Of course, to the extent that there is a large disparity with competitors' fees without any discernible difference in services, the impact of the competitors' fees on the long-term health and existence of the higher priced firm could be substantial.

**Practice Tip.** Just because you receive one or two complaints about "high fees," don't automatically assume that your fees are totally out of line with the competition. In fact, a firm without any fee inquiries or complaints probably has underpriced its services. Investigate all fee inquiries and complaints, but consider the numbers compared to the potential total number of inquiries.

In some circumstances, tax preparation fees might be kept artificially low, to act as a loss-leader for more valuable services. In fact, one of the nation's largest tax preparers specifically targets smaller business or professional clients with the opportunity to provide personal financial planning or to sell financial products.

Even in traditional accounting practices, it is not uncommon to prepare the personal return of a company CEO at a deeply discounted rate in exchange for other profitable audit or consulting services.

## 102.5 Current-Year Versus Prior-Year Fees

Many firms closely monitor the fee for preparation of the current-year income tax return versus the fees charged in prior years. Although much of this appears to be based on client sensitivity to tax fees and, often, on personal and other nonbusiness relationships with clients, the rationale for considering fee increases should be as carefully considered as a retail operation's decision to raise prices.

## 102.5.1 Client Expectations

The first considerations involve a set of questions about client expectations—reasonable or not:

- Does the client expect the fee for a tax return to bear a relationship to the fee paid in prior years?
- Might the client expect the fee to remain the same?
- Will the client agree to a small increase for inflation?

One year's tax return may be extremely complicated compared to the previous year's, whether due to a change in client conditions and/or a change in the statutes. Client education can minimize fee-increase misunderstandings. When tax-law changes make general tax preparation more complex, you should consider a mailing to all clients prior to the busy season explaining the situation. When you are aware that a particular client's situation will be significantly more complex, it is imperative to inform that client and explain the matter as soon as possible.

**Practice Tip.** Operate under the general rule that the fee charged for tax services should be based solely on the work completed. By establishing fair and reasonable billing rates and methods of time recording, prior-year fees should not have an influence. However, you must be prepared to explain to clients how your fee was determined.

## 102.5.2 Fee Increase Justification

If you feel uneasy about the increase in tax-service fees over previous years (and if you feel an absolute need to compare these amounts), a number of reasons may justify the fee increase:

1. Given some of the massive tax-law changes in the last few years, as well as current regulations, rulings, and notices, fee increases are simply the result of more complex tax laws. A sample memo to be provided with the individual tax return and bill is included as Exhibit 102-1.
2. Significant expense increases, such as occurred with professional liability insurance a few years ago, may warrant special explanation.
3. The return may be significantly more complex this year than in previous years. You may want to detail the reason for the increased complexity, such as the imposition of the alternative minimum tax, tax-free exchanges, sales of property, special tax calculations, and so forth.
4. The client's recordkeeping system may be inadequate. To the extent that tax professionals need to do more "bookkeeping" to prepare information for a tax return, additional fees will result. It is advisable to bill this work separately and not combine it with the tax return charge.

**Practice Tip.** Many practitioners complete bookkeeping activities during the busy time, but then write off much of the billing related to these services. They often feel the cost of the tax return would be disproportionately high compared to other similar types of tax returns (which do not require the bookkeeping function). Why not make it a point to contact clients after the busy season to work with them on problem areas of their bookkeeping systems? If such services are not to be billed, it is more tolerable to write off or discount time during your nonbusy season; preparation of the tax return will be easier in the future. The best recommendation, however, is to bill engagements to improve the bookkeeping systems. Both you and your clients will be happier.

5. The client supplies insufficient data. To the extent that the preparer frequently needs to contact the client for additional information or to better understand transactions, additional time and fees result.
6. Part of the increase might be explained as an "inflationary increase," since most general expenses in the firm rise at approximately the rate of inflation.
7. Additional services may have been rendered during the tax return interview, including discussions and advice on estate or investment planning, or other tax-related issues.



**Practice Tip.** Practitioners who use newsletters can use the newsletters as a mechanism to “warn” clients of impending fee increases due to tax law changes, increases in professional liability, insurance, changes in billing policies, etc., long before the client incurs any charges.

**Practice Tip.** Make sure any additional services are clearly detailed on the billing. If possible, try to provide additional services discussed at a return preparation interview *after* tax season rush. This will help to relieve stress and will make billing the work easier. Development of a post-tax-season follow-up system (see Exhibit 101-18) is advisable.

### 102.5.3 How to Bill a Higher Fee

If factors arise that affect *individual* returns, consider adding a paragraph to a transmittal letter or other correspondence to a client explaining the increased services necessary for the preparation of the current return.

A good approach is to look for opportunities to suggest techniques that the client can use to reduce the fee. This might be establishing better recordkeeping systems, or using worksheets and other devices to clearly summarize data.

As mentioned in point 1 of paragraph 102.5.2, a straightforward, yet justified, technique to bill a higher fee is to capitalize on complexities added to the Internal Revenue Code by Congress, or through regulatory interpretations by the Treasury. It is particularly easy to capitalize on these complexities when they are to the benefit of the taxpayer. As an example, the new education credits effective in 1998, as well as the child tax credit added in 1998, can provide significant benefit to taxpayers. This is particularly true when using some of the elective opportunities provided by Treasury via regulations.

**Example.** Charlie and Jane, with AGI of approximately \$250,000, pay qualified tuition of \$8,000 for their son, Brett, to attend college. Brett entered college in September of this year, and because Charlie and Jane provided over half of Brett’s support for the year, Charlie and Jane would normally claim Brett as a dependent on their U.S. Individual Income Tax Return. This would normally make the parents eligible for the education credits, but because of their high AGI, no education credit is allowed.

Under proposed regulations [Prop. Reg. 1.25A-1(g)(1)] issued by the Treasury, Charlie and Jane could elect not to claim Brett as a dependent on their tax return, even though they are eligible to do so by reason of having provided over 50% of Brett’s support for the year. Because Charlie and Jane do not claim Brett, Brett is now eligible to claim the education credits himself on his U.S. Individual Income Tax Return and Charlie and Jane are not allowed to claim any education credits. This result occurs whether the parents or Brett actually pay the qualified tuition.

While Charlie and Jane lose the benefit of claiming the dependency exemption for Brett, this only results in a tax loss of approximately \$500 because the benefit of the personal exemption is phased out at Charlie and Jane’s AGI level (e.g.,  $\$2,750 \times 36\%$  federal rate  $\times 50\%$  phaseout = \$500). Assuming the education credit is of greater value in Brett’s return, the practitioner has successfully capitalized on code complexities for the benefit of the taxpayer, and is entitled to bill a higher fee for this work.

However, as illustrated in Exhibit 102-1, it would probably be advantageous to detail and explain the increased billing and the benefit to the taxpayer in a memorandum attached to the actual tax returns.

In addition to explaining the advantages to the taxpayer in a memorandum attached to the tax return, some practitioners also prefer to provide a detailed billing description in explanation of the additional work performed. Exhibit 102-11 contains a sample billing explanation associated with the above example.

## 102.6 Value Billing

Value billing is a popular concept that creates numerous opportunities. Studies have shown that clients normally rate quality of service as being more important than the cost of the service.

While clients are naturally concerned about the professional fees associated with the completion of professional services, many are willing to pay a higher fee for a *quality* product and *timely* professional services, as opposed to a fee based on a strict mathematical calculation of professional time multiplied by a billing rate.

While every billing system attempts to incorporate some notion of value billing, whether the value is the professional time spent or the number of forms and schedules produced, these systems were developed out of cost accounting techniques. Their premise is that price should be a function of cost, plus a profit. However, pricing can be based on such other concepts as market demand: How valuable is the service to clients, and what are they willing to pay for it? Thus, pricing becomes a marketing decision as well as a function of costs.

**Practice Tip.** Be sure your engagement letter allows for value billing. You need to inform clients up front that unforeseen or extraordinary circumstances may be billed on other than time-and-direct-expense bases only (see Section 101.13.2).

### 102.6.1 Awareness of Opportunities

The opportunity for value billing arises with the successful performance of a service. If extraordinary services are completed for a client, such as the successful completion of a complex IRS audit, or if a particular efficiency is introduced for the client's benefit, such as the successful argument of a business valuation in a court trial by a practitioner who is a recognized authority in the business valuation area, value billing should be considered. In addition, the successful negotiation of the sale of a business, reduction of a proposed IRS deficiency, and other similar services often allow for value billing.

**Example.** Mr. and Mrs. Jones are considering the sale of their closely held manufacturing company. They have already spoken with a potential buyer, who has offered them a price of \$500,000. They are inclined to accept this offer. You ask Mr. and Mrs. Jones for the opportunity to meet with the prospective buyer and attempt to negotiate a higher selling price. Based on this meeting, a total sales price of \$625,000 is secured. Assume that the negotiation with the buyer and subsequent meetings with Mr. and Mrs. Jones took thirty hours of professional time (and further assume your billing rate is \$100 per hour). Because of your outstanding negotiating skills, you managed to secure a significantly higher selling price for Mr. and Mrs. Jones. Many practitioners would consider billing this engagement at, say, \$5,000 to \$7,000, even though only \$3,000 of professional services are involved at standard billing rates. The value-billing amount of \$2,000 to \$4,000 recognizes your unique expertise and the outstanding services you performed for Mr. and Mrs. Jones on the sale of their business. Be sure, however, that you have discussed the value billing alternative with Mr. and Mrs. Jones prior to the negotiations.

### 102.6.2 Research Projects

Significant time efficiencies can occur when research projects are completed using a CD-ROM reference library. Search and retrieval techniques can lead a practitioner to the solution in a fraction of the time needed to go to the firm's library, locate the approximate volume, scan the index, turn to the approximate page, and photocopy the research material. The time savings are even greater if the publication has been misfiled or not updated timely.

Using a straight time billing approach, solely the client benefits from your efficiency. A different billing matrix is needed to recover the costs incurred in CD-ROM hardware and electronic publications.

A completed research project for one client may result in greatly reduced time required for a similar project for another client. Consider value billing to adequately compensate your work for the second client. Value billing allows your particular expertise in this area to be recognized at full value, rather than at a standard hourly billing rate. Additionally, value billing allows research time that could not be fully billed to previous clients to be spread out over a wider client base. Similarly, any complex areas in which you have acquired particular expertise, or in which you have been previously involved, are prime candidates for value billing when the expertise can be used in work on subsequent engagements.

**Practice Tip.** Establish a centralized research file to maintain research and advice letters prepared in response to specific client issues for future reference (see Section 203.1.8).

### 102.6.3 Contingency Arrangements

Preparers cannot charge contingent fees for the preparation of original tax returns under the new Treasury Circular 230 rules. A contingent fee is one based on a percentage of the taxes saved, a percentage of the refund, or on specified other results. However, Circular 230 allows contingent fee arrangements for amended returns or refund claims if one can reasonably anticipate at the time of the fee arrangement that the matter will receive “substantive review” by the IRS. Additionally, consider value billing when tax savings result from tax planning ideas or complex tax calculations, or from favorable results in an IRS audit appeal process or in litigation matters.

You must also consider state-imposed legal restrictions on your ability to engage in value billing. Recognize the difference between a pure contingency arrangement and value billing (where a higher fee recognizes your expertise and accomplishments on a certain piece of work).

One final point about value billing: Value billing is the concept behind a billing system not based strictly on professional time or forms produced. Its aim is to truly capture the value of your services. However, use the concept judiciously. Imagine your reaction if a mechanic charged \$1,000 for a late-night road-service call, claiming that his expert and timely service got you out of a “tough spot.” He also reminds you of your last bill to handle an IRS audit, indicating he likes the concept of value billing. The concept of value billing does not justify gouging clients for higher fees.

## 102.7 Fees for Additional Services

Many practitioners think of themselves and their firms as being tax preparers or tax firms. Despite this, many additional services can be completed for a client. These warrant separate billing.

### 102.7.1 IRS Examinations

A tax preparation fee should *not* cover the cost of representing the client in an IRS examination. The engagement letter should clearly state that any representation of the client by the firm before the IRS is a separate engagement, subject to separate billing.

Several firms have tried the idea of “IRS audit insurance” with clients. Under this concept, the client pays a set amount (for example, \$50 per year) to the firm as “insurance” against the cost of professional fees on an IRS examination. This approach may have some merit, but a major caution against it is that it mitigates the client’s accountability. The client has little incentive (other than a clear conscience and the risk of IRS penalties) to adequately and properly provide all information. If client “shortcuts” in some of the recordkeeping result in an IRS examination, the only cost to the client is the risk of the IRS penalty.

**Practice Tip.** If you elect to offer IRS audit insurance to your clients, carefully consider two possibilities:

1. Offer this service to low-risk clients only. This obviously requires work on your part and the establishment of criteria as to which clients fit in the low-risk category. You must be prepared to explain your selection criteria to your clients.
2. Offer different insurance rates based on the audit risk of each client. This requires that you measure and quantify the audit risk of each client.

### 102.7.2 Technical Research

If technical research is prompted by a problem pertinent to a particular client, the research time should be billed to the client.

For example, if a client sells a residence in a different state and moves into your state, you may need to research the laws of the previous state regarding the tax ramifications on the sale of the residence. The uniqueness of the situation can only be addressed through adequate research on your part. The research time should be billed to the client.

The ever-changing tax laws and regulations create an extremely complex environment. It is unrealistic to expect tax professionals to have first-hand knowledge of all areas. Research is a normal and required aspect of a tax practice, and research time should be billed to the client.

**Practice Tip.** Always obtain a client's clearance up front for research assignments. Adopt a "No Surprises" billing motto.

### 102.7.3 Tax Planning Services

True value to a client comes with tax planning and reduced tax costs, as opposed to pure compliance measures of drafting tax returns. When you spend additional time with clients that is not specifically required for completion of their returns, and make specific recommendations that result in reduced taxes, an additional billing should occur. Some practitioners prefer to simply bill the tax returns at a higher fee; others create a separate billing amount for the tax planning services.

### 102.7.4 Computer-Generated Schedules

Many taxpayers request copies of computer-generated loan amortization schedules and worksheets. When these services are completed, you should bill an additional amount to the client. Remember to build in a charge for the hardware and software. However, when billing, remember that banks offer these services for little or no charge.

There are numerous possibilities for additional services. Be aware of them and fulfill your primary responsibility to the client: Full service and attention to all client needs.

## 102.8 Fee Setting Based on Demand

Should firms use higher billing rates for periods of high demand? The issue is based on the simple economic principle of supply and demand. Periods of high demand may include times when high volumes of work must be completed, as well as rush and other high-priority work.

Billing rates should be established on the basis of a number of factors, including value of service provided, level of expertise of personnel, competitive pressures, and profit objectives. Higher billing rates for periods of high demand can be accomplished either by raising rates during certain periods, or by discounting rates during other periods. The concept applies not only to periods of high demand, but also to projects with short timelines.

### 102.8.1 Higher Rates in Peak Demand

In a perfect world, we would spread out our workload to create an even demand over 12 months. While nothing is perfect, opportunities do exist for leveling out the workload.

For example, if you can offer clients an incentive, such as a discount, to bring in their tax information early or extend tax returns and services out of the busy season, peak workload requirements can be diminished and work opportunities for the slower season can be created. Alternatively, rates can be increased during the busy time. Firms using this approach increase hourly rates for all tax professionals during the busy time, and use the supply-and-demand explanation with clients.

Higher rates may be extended to all types of services, including tax and nontax work. After all, vacation resorts typically raise lodging rates across the board during their peak season even though they offer only one service: lodging. In a tax practice, however, extending higher rates to traditional tax services may depend, in part, on whether the competition adjusts rates. This strategy should be considered in light of the firm's ability to prepare and complete tax returns *most efficiently* during the busy season. Many firms find that during the peak months, professional

personnel, along with the data processing system and support staff, are geared technically and psychologically for the tax preparation process. Often, after April 15, the system is not as efficient. Also consider the time and expense required during peak season to complete an extension request for a return that will not be billed until months later.

Because encouraging extensions may not be feasible for all firms, the issue is raised for consideration, and no conclusions are presented. If any consideration is given to encouraging extensions as a routine matter, care must be taken that you do not lose sight of your primary responsibility: Client service.

## 102.8.2 "Rush" Jobs

If higher rates may be appropriate during periods of peak demand, there is justification, as well, for establishing higher rates for rush and other high-priority jobs.

Client negligence in providing timely data that results in short-fused deadlines justifies a premium rate or a write-up in the billing to account for the high priority placed on the work. All rush activity in commercial enterprises engenders higher rates due to the higher costs incurred. A similar approach in the professional tax area justly recompenses the firm.

**Practice Tip.** As opposed to actually establishing higher rates for rush and high-priority jobs, consider simply marking up the bill (see Section 102.6, Value Billing). Much of the work a tax practice does is of a high-priority status. Consider premium billing, primarily in instances where client negligence in providing timely data results in a close deadline.

## 102.9 Direct Expenses and Data Processing Fees

A number of direct expenses are normally incurred in tax return preparation, including data processing charges, phone tolls, postage and handling charges, photocopy expenses, covers and binders, and so forth. Keep a record of these expenses so they can be fairly and appropriately passed through when billing the client.

Some firms prefer to show direct expenses as a separate itemized charge on the bill, while others include expenses in a summarized total amount. Whichever approach is used, be sure to properly record direct expenses.

It is important, however, to consider materiality when recording and billing direct expenses. To attempt to identify every long-distance phone toll to a specific client may be inappropriate from a cost-benefit standpoint, particularly when a charge is very small. Similarly, to attempt to identify every photocopy and postage charge with a client is inappropriate from a cost-benefit standpoint. It is fairer and more efficient to set thresholds above which charges are identified with a client. For example, keep a record of all long-distance phone tolls.

Your long-distance telephone company may be able to provide logs of the calls made from each telephone station. Some telephone service providers can even require the assignment of a two- or three-digit code after the dialing of the telephone number before the long-distance call will go through. A detailed report of the long-distance calls assigned to each code is then provided along with the monthly billing. A voice-mail system may also provide an automated method of recording long-distance calls. All long-distance phone tolls over a certain dollar amount (e.g., \$5) on a phone company billing may then be associated with a specific client from the log of long-distance calls. Then enter the charge in the work-in-process system.

Similarly, a number of photocopies (e.g., 20 copies) could be set as a threshold, with a dollar amount added to the client's work-in-process if the number of photocopies exceeds the threshold. Postage charges, particularly express and overnight charges, exceeding a certain dollar threshold (e.g., \$5) could be identified with a client and entered into work-in-process. Although the threshold amount is easier to determine if applied on an engagement-by-engagement basis, it could also be applied on an annual basis for certain clients who incur frequent direct charges that are individually immaterial but collectively significant.

**Practice Tip.** Direct expenses below the threshold amount are normally considered part of the normal operating costs of a tax practice, and billing rates should be established to

include these smaller amounts as normal overhead. The objective of recording direct expenses over a certain dollar threshold is to capture *material* expenses that would normally be considered over and above the types of expenses already built into billing rates.

Another method of allocating out-of-pocket costs is to establish a standard cost for each type of return (e.g., Form 1040 with one state: \$50; Form 1040 with two states: \$75; Form 1120 with four states: \$150, etc.). This allocation should be added to all returns to cover software costs, copying costs, telephone tolls and so forth.

Some telephone systems require a client number to be entered before long distance calls can be completed. On a monthly basis a report can be produced showing the client number, the date called, and the phone charge. Phone charges can then be assigned to each client for inclusion in the next billing.

### 102.9.1 Subcontracted Work

Firms sometimes determine that it is more efficient to subcontract certain specialized work. These costs must be passed on to clients as if the subcontractor were one of the firm's own technical employees.

While billing a client an amount higher than the actual subcontracted fees is not strictly prohibited by the AICPA Code of Professional Conduct, some state boards of accountancy may have more stringent ethics guidelines. Be sure to consult with your state's position on the matter before adopting this policy.

When preparing client invoices, do not mark up direct expenses, such as fees paid on a client's behalf, because of the possible ethical and legal restrictions. For example, if you are passing on a \$300 fee paid to obtain an IRS ruling, it would be nothing short of consumer fraud to identify this fee on your client's invoice at \$500.

**Practice Tip.** A full recovery of *all* direct expenses will never occur. Bad debts and other writedowns will come into play. Many firms use a small index factor to pass through direct expenses. The index considers the uncollectibility of direct expenses from certain clients, and compensates for the time value of money between the time the invoice is paid by your firm and collection occurs from the client.

### 102.9.2 Determining Internal Data Processing Charges

If you handle data processing services internally, you can use several different approaches to establish data processing charges. Some include the following:

- Formula based on outside bureau
- Time based
- Form based

#### Based on Outside Bureau

You can use a data processing charge formula similar to that used by an outside service bureau. This often involves charges for the number of characters or indexes input, and the number and types of forms output. The theory behind this approach is to get as close as possible to the charge that would have been incurred with an outside service bureau. The added benefit is that it emulates that charge and results in a cost familiar to many practitioners.

#### Time Based

Another approach is to base the data processing charge on a time factor. Treat the data processing system as an employee, and assign a charge rate to the system. Determination of this charge rate is a difficult task, but should be based on the cost and overhead of the system, with a profit margin built in.

**Example.** A firm purchased a computer system for a total cost of \$15,000, including hardware and software. The system has an estimated useful life of three years. In addition, the firm calculates that there is approximately \$2,000 of annual overhead costs associated

with the system. These costs include forms and supplies, materials and disks, insurance, training, and so forth. The firm also builds in a profit factor of \$3,000 annually. The total amount to be recovered in the course of a year is \$10,000 (\$5,000 of system costs, \$2,000 of overhead, and \$3,000 of profit). If the firm assumes that 200 hours of processing time will occur over the course of a year, a charge rate of \$50 per hour would be established for the system. Note that you may need to allocate the charge rate by percentage between actual processing (higher percentage), and data entry or printing (lower percentage). It may take a data entry person 30 minutes to input information for a tax return, but only 2 or 3 minutes for the system to complete the necessary computations.

An alternative approach would be to add an amount to the data-entry operator's billing rate to recover the computer system costs. For example, assume the data-entry operator logs 1,000 hours of chargeable time on the computer per year. Using the above facts, a charge rate of \$10 per hour could be added to the computer operator's hourly rate to recover the costs of the computer system. No separate billing for the processing time would be required.

Once the charge rate has been assigned, the amount of time spent processing with the system must be extended by the charge rate. Do this, similarly, for the time spent by data-input personnel. Because more than one individual may use a system for data input purposes at the same time, a lower billing rate is appropriate during the data input phase as opposed to actual processing.

**Practice Tip.** As more firms move to interactive return preparation, where the preparers directly input data, charge rates assigned to the data processing department become inconsequential. Consider providing a higher billing rate for all staff for time incurred using a computer, such as tax return input or trial balance work. This approach spreads the cost recovery of a computer system equally among all users of the system.

### Form Based

As described in Section 102.2.3, some firms use a form based method of calculating charges. Conceivably, the per-form charge could have data processing costs already built in. The critical factor is to recognize that hardware and software costs are significant and that it could be disastrous to ignore or underestimate costs associated with the data processing system.

## 102.10 Timekeeping

The first requirement for billing, collection, and profitability in a firm is proper timekeeping by all individuals. This includes technical staff and partners and, normally, secretarial and clerical personnel. We say "normally" because some firms establish rather high billing rates for their technical and professional personnel and then do not record clerical time in association with client service. This approach, however, appears to be the exception rather than the rule; most surveys indicate that tax practice firms do bill for clerical services.

Whichever approach is used, the requirement for timely and full reporting of all time spent on projects by all personnel is essential. There should be no exceptions! Time reporting must occur according to firm requirements. Written reports should be submitted daily; however, weekly reporting or, at the very least, biweekly reporting may be allowed under limited circumstances. Although your firm's billing cycle may be every two weeks throughout the year, you should strongly consider more frequent time reporting during the busy season. This is especially important if you desire to bill clients as tax returns are picked up or mailed. Biweekly time reporting simply doesn't provide information fast enough for this strategy.

**Practice Tip.** Getting personnel to comply with accurate time reporting is a challenge. Establish charge-time budgets for all personnel, including partners. Work together with staff to establish charge-time goals for the year. Follow up with reporting of actual versus budgeted time, and hold follow-up sessions with employees at intervals during the year. (See Section 101.5.1.)

Some firms review the charge-time statistics for personnel at staff meetings, on the theory that peer pressure provides an incentive for more diligent time recording, although care should be taken to control undue open criticism or competition between staff members.

**Practice Tip.** The best approach is to require daily completion and submission of time reports by *everyone* (including yourself), and to meet with employees regularly (at least quarterly) to review the actual number of charge hours recorded versus the budgeted number previously agreed upon.

Distribute written policies regarding time report requirements. Address violations of policy immediately. No exceptions should be allowed! Assign a staff member to be the policy “enforcer,” one of whose goals it is to see to it that *all employees always turn in time reports on schedule*. Evaluate that staff member in terms of goal achievement.

It is not unreasonable to expect employees to complete time reports before paychecks are disbursed. After all, proper billing and collection of professional time provides the funding for the firm’s payroll. Except as might be prohibited by labor laws, the firm’s policy could be to withhold paychecks until time reports are brought current. Partners might be the worst offenders!

## 102.10.1 Timekeeping System Alternatives

There are alternatives for both manual and automated timekeeping systems. Whichever is used, the fundamental requirement of timely and full recording prevails. Examples of daily and weekly time reports are at Exhibits 102-2 and 102-3.

### Tax Return Routing Schedules

Even with an automated timekeeping system, many firms keep a tax return routing schedule with each tax return or tax project. The routing schedule is used both to track the file and provide a record of the date, the staff person, and the time involved in each particular aspect of a project. The tax return routing schedule can also be used to compare the actual hours incurred to budgeted hours. Section 101.4 provides a full discussion of routing schedules as a part of the central control system.

While it appears redundant to record time both in the timekeeping system and on the routing schedules, the routing schedule allows billing of a project upon completion, even if the work-in-process report has not yet been generated. It permits monitoring variances between the routing schedule and the work-in-process reports to be sure that all time is being properly recorded on the routing schedules. Whenever possible, obtain the most current work-in-process report and bill by adding unposted time from the routing schedule. Care must be taken not to overlook charges. After the initial bill has been sent out, the chances of recovering overlooked charges are minimal.

### Automated Timekeeping

An automated timekeeping system that allows daily input of time reports provides another mechanism for expeditious invoicing of work performed. Up-to-the-minute work-in-process reports can accompany a tax return or other tax project requiring signature, and billing can occur when the project is forwarded to the client.

The only disadvantage of such an approach is the discipline required from everyone in the firm. Time reports *must* be completed on a daily basis, and computer input of the previous day’s work must be completed as soon as possible after the start of the next day’s work. The advantages, however, far outweigh the disadvantages. Tax returns and other tax projects forwarded to clients can be accompanied by a bill.

**Practice Tip.** The importance of attaching a bill to tax returns and other completed projects forwarded to clients cannot be overemphasized. Billing collectibility and cash flow are significantly enhanced. With a well-structured, automated timekeeping system, complete with enforced policies on daily submission of time reports, little excuse exists for not attaching bills to tax returns and other completed projects. If for some reason the billing does not occur at the time the product is forwarded to the client, attempt to total all time



in the work and complete a billing as soon as possible after completion of the work. Each day of delay diminishes collectibility and negatively impacts cash flow.

State-of-the-art time and billing systems allow each preparer to record their daily time report directly, thus eliminating the duplication of manually completing time sheets that are later keyed. Such systems also provide real-time billing information to allow bills to be completed immediately as tax returns are signed.

Preparers who use on-line time recording are not immune from the failure of some employees to report timely. Monitoring must still guard against noncompliance.

## 102.11 Billing Policies

You must develop and enforce billing and collection policies if your firm is to attain long-term financial success. Your policies should assure that the fees are charged and collected in a way that brings about the maximum return on the firm's talent and resources.

The central concept behind your billing and collection policy should be this: Be sure you get what you are worth, and don't sell yourself short. Tax practitioners are highly trained individuals who perform extremely complex services. Do not underestimate the value of these services—be sure that you continually strive to convey full value in everything you do. Always provide the best possible services commensurate with the fees. Remember that you are billing for professional advice, whether in person, over the telephone, or via written communication.

Consider the following guidelines when developing billing policies:

- Discuss fee policy during your first meeting with the client.
- Communicate your billing policies to clients in your engagement letter (see Section 101.13).
- Bill clients immediately upon completion of the services.
- Use progress billings for lengthy or sizable projects.
- Resist efforts on the part of clients to have their bill reduced.
- Use descriptive billing whenever practical.
- Send the bill to the person who either pays it or approves it.
- Consider application of retainers (see Section 102.12.2).

### 102.11.1 Discussing Fees With Clients

Discuss your fee policies during the first meeting (note *meeting*, not phone call or letter) with a client. Be firm about the fees. Use language such as “per our standard fee” or “with returns of this type.” Do not let a client dissuade you by claiming another firm charges less. Had the client wanted to use that other firm, he or she would not be speaking to you. Finally, let the client know that he or she should always feel free to discuss your fees anytime.

### 102.11.2 When to Bill Clients

You should send bills to clients promptly to keep cash flow healthy and to reinforce client awareness of your services. Client appreciation for services rendered diminishes over time. Bill the client while the end product is still fresh in his or her mind. The faster a client receives a bill after completion of work, the better your chances of receiving payment. If your timekeeping system allows (see Section 102.10), prepare and forward the bill at the time the project is completed. This is true whether a tax project is picked up by the client, or it is delivered or mailed.

**Practice Tip.** Add a box on the daily time report to check for any project that is completed and ready for billing. The marked box will indicate to an administrative person that a WIP report should be prepared and delivered to the responsible accountant for billing.

#### Progress Billing

Use progress billing for lengthy or sizable projects. First, clients should be made aware of charges that are accruing. Second, they often prefer a series of small bills to one large one.

Bill each significant project, telephone conversation, and piece of correspondence as soon as possible after completion. Minor items, such as short telephone conversations and brief correspondence, should be held for billing later with larger projects or more complex services. Sometimes, monthly billing is appropriate.

Progress billing not only enhances cash flow, but heads off build-up of excessive amounts in work-in-process, amounts that are eventually difficult to bill. Also, collection problems become apparent before your firm has invested substantial time and resources.

**Example.** Charlie Smith has set aside Friday afternoon for billing. In reviewing the work-in-process report for Colors, Inc., Charlie notes that there is \$1,385 of work-in-process. Charlie also knows that last year the billing for the same project was approximately \$2,000, and that the project this year is only about one-third complete. Progress billing will require Charlie to analyze the situation immediately. If there are particular problems in the current year, Charlie can address them at an early time, rather than waiting until after the completion of the project.

**Practice Tip.** Require your firm's administrative coordinator to provide you with a monthly report on all clients with work-in-process (WIP) over a certain amount (as an example, all clients with work-in-process over \$1,000). Similarly, if the work-in-process system allows, require a monthly report on all clients with work-in-process exceeding a certain age (as an example, with unbilled work-in-process over 90 days). Reports showing the average age of WIP for each accountant can identify those preparers who have difficulty billing timely. Special emphasis should be given to those preparers below the firm average in billing timeliness.

Two questions should be asked about client work showing up on these reports:

1. Because of the large dollar amount, can the account be progress billed?
2. Because of the age of work-in-process, is this account being neglected? The objective should be either to immediately complete the project and bill the work (resulting in enhanced cash flow and client satisfaction), or to prepare a progress billing for work-in-process. A report of this type will head off billing problems early and encourage timely completion of projects.

All firms should have a regularly scheduled time for billing, either weekly or monthly. Some firms have the partners bill together or bill each other's work. Despite the obvious commitment of additional partner time in nonchargeable activities, billings tend to be more aggressive when two partners must concur with a write-down.

In any event, scheduling a pre-determined billing session with an administrative person will help prevent convenient excuses from postponing the billing functions.

### 102.11.3 Billing Writedowns: When and Why

Resist efforts on the part of clients to get their bill reduced. Be aware of your firm's fee policies and their justifications. Recognize that discounting the bill after it has been rendered can lead clients to believe they were overcharged to begin with.

Realizing work-in-process as cash receipts is essential to a firm's profitability. Strict criteria should limit writedowns at the time of billing, and appropriate authorization should be required for writedowns. In addition, complete an analysis of writedowns to achieve better realization in the future.

You should involve all staff in the effort to improve realization. Consider establishing a budget of estimated professional time for all projects, including tax returns. Some firms attempt to associate writedowns with specific individuals. The advantage of this approach is that strict accountability is introduced in terms of why a writedown occurred, and this increases staff awareness regarding the charging and billing of professional time and provides information useful in personnel reviews. The disadvantage of such an approach is the time required to allocate the writedowns to specific individuals. Arguments can arise on who should be "charged" with a writedown amount, and significant effort may be required to reach agreement on the

exact allocation on the writedown. In addition, the approach could have a negative effect on staff morale if it is over-emphasized. Staff should not be asked or directed to complete client work without recording time. Rather, staff should be counseled to improve efficiency of time spent on a particular job if it is in excess of the budgeted time.

Establish criteria for allowing writedowns based on individual requirements. Some situations in which writedowns might be appropriate follow.

### **Training Time**

Training might occur when an employee is involved in a project for the first time. The firm should complete an adequate review of the employee's work on initial projects so that future projects of a similar nature do not result in the same training time. Look for instances of inadequate supervision or lack of communication; inefficiencies that should be avoided can be detected.

### **Accountant Errors**

When an error on a project necessitates the redo of the work (e.g., an amended return where an accountant error is involved), a writedown is appropriate. However, be extremely cautious that writedowns do not occur due to the regular clearing of review points. The number and complexity of tax regulations make it impractical to assume that everyone can complete all projects with no theory or clerical errors. Because many errors ordinarily occur due to the complexity of the tax system, billing rates for accountants are usually based on varying levels of experience.

### **More Than One Practitioner Present in a Meeting**

Under very limited circumstances, discounted billing may be appropriate in situations where more than one practitioner sits in on a meeting. As an example, if one practitioner is intending to be out of the office for some length of time, he or she may request another individual to sit in on a meeting to obtain background information necessary to complete a project. In such limited situations, it may be appropriate to discount the billing for the time of the second individual. Such situations should be closely controlled; minimize times when more than one practitioner must be present and the time for both cannot be billed. The practitioner may want to inform the client up-front that billing for only one professional will occur.

### **Nonprofit Organizations**

Some firms recognize the charitable and not-for-profit aspects of certain organizations by discounting professional fees for them. Because of the discounted fees, many firms do not actively pursue such work, but consider it only when directly approached by a nonprofit organization. Regardless of your firm's policy with respect to charities and not-for-profits, you should handle such work during the nonpeak months and avoid it during the busy months. Discounted billing situations should be closely controlled and monitored.

**Practice Tip.** The amount of the discount should be communicated to the not-for-profit as if it were a "contribution."

### **Quoted or Bid Fees**

A writedown will be necessary for projects where a quoted or bid fee is applicable and the actual work-in-process exceeds that amount. Such projects should be reevaluated before further commitments are made, and billing should occur for any work completed outside of the contracted engagement. This additional work should be examined and documented thoroughly prior to billing for the additional services. In any circumstance, it is preferable to quote a range of fees as opposed to a specific amount.

In the absence of significant internal errors and inefficiencies, there are situations in which a writedown of work-in-process should be avoided. Some examples are the following:

- Research projects that benefit a specific client and may also benefit other clients
- Writedown of work-in-process without client discussion because a higher billing may result in a negative reaction from the client
- Response to an IRS inquiry on client matters

### 102.11.4 Controlling Writedowns

Billing should be the result of realistic pricing based on services rendered, not on issues such as prior years' fees (see Section 102.5) or personal relationships with the client. Establish *accountability* related to billing writedowns, and authorization levels for billing anything other than the total amount in work-in-process.

One practitioner recommends that the best way to control billing writedowns is to request spousal approval on writing down any bill. While the recommendation was made tongue-in-cheek, the primary message holds: always require the approval of another person when writing down any bill.

**Practice Tip.** Use a form for approving and tracking billing adjustments. The form requires the biller to analyze the reasons for the writedown and explain them in writing when preparing the bill. (Sample forms are included as Exhibits 102-4 and 102-5.)

- If the billing variance amount is less than or equal to 10 percent of the work-in-process and the total variance is less than \$100, the individual supervising the project has the authority to authorize the billing writedown, other than for work related to tax returns.
- If the billing variance is more than 10 percent and/or the total dollar variance is over \$100, the authorization must be initialed by a partner prior to billing.
- For any billing variance exceeding \$500, the approval of two partners is required.

**Practice Tip.** Some practitioners, when faced with what they believe may be a large writedown, use the opportunity to telephone the client and discuss the matter up front. Getting the client involved in the process and aware of the problem may sometimes lead to a compromise in which less writedowns occur than if the practitioner had made the decision personally.

**Practice Tip.** If you do choose to write down the bills of family members or professional acquaintances, show the writedown as a discount on the bill. For example, if you write down the bills of family members, show your regular charge and then list "Family Discount." For the writedown of a professional acquaintance show "Professional Discount" on the bill. In cases where the bill was set by a fixed fee, show your regular charges (if they were higher than the fixed fee) along with the final billing amount. Again, let all clients know the true value of the services your firm provides.

On any billings that require writedowns due to staff training or errors, involve those preparers in the billing process. Doing so will give them an appreciation for the agony that often accompanies writedowns. It will also show them the direct consequence of their inefficiency and should teach a lesson for future engagements.

### 102.11.5 Analyzing Writedowns

Once a billing adjustment has been authorized, forward the information forms to an administrative person for review and filing. Have the administrative person analyze the amount of the variance and complete informational reports on billing variances by client, individual staff person, and reason. The disadvantage of introducing the administrative step will be more than offset by the information available from the reports. You may determine that work for specific clients consistently results in billing variances, that a particular staff person consistently has significant variances, or that certain projects consistently result in billing variances. Furthermore, there are computer billing systems that capture and report information, such as historic variances, for each client.

At the very least, if billing variances are authorized, learn from the writedown. This may result in staff reassignment, staff training, or even termination of a client.

**Practice Tip.** Consider sharing some of the information regarding billing variances with staff on a regular basis. While it is probably not a good idea to discuss billing variances by individual staff person, there could be definite advantages to discussing variances related to certain clients and to certain projects. Staff may be able to offer greater insight as to the cause for certain variances, providing the basis for changes in work assignment or client workloads. For example, consistent writedown of payroll tax services may indicate efficiency problems in the entire payroll preparation rather than specific billing problems.

## 102.11.6 Billing Language

Some firms prefer a very detailed bill, giving lengthy descriptions of services provided, and occasionally including the amount of time spent on each aspect of a project and the billing rate of each individual. The advantage of a detailed billing is that the client is clearly reminded of the services performed. The disadvantage is the effort and expense required to complete a bill.

Other firms allow computer-generated billing based on the actual time in the timekeeping system. While the bill may not be as detailed, it provides an impressive document to the client, assuming the client understands the mechanism by which professional time is recorded and extended by the appropriate billing rate.

**Practice Tip.** Regardless of whether bills are prepared manually or directly from the timekeeping software, all employees should be encouraged to provide detailed work descriptions on their daily time reports. The more descriptive the information presented in a billing, the less likely is the client to question the amount.

Another approach is to use standard billing phrases and a coding system. This can be accomplished with either a manual or automated system. Under this approach, standard phrases are set up with an appropriate code. Billing is expedited because simple codes are used and the detail is handled by clerical staff. Some descriptions may need a year or period added, while others may need no additional information. For example, the following sample codes might be used:

<u>Code</u>	<u>Description</u>
1	Services related to preparation of 19XX U.S. and state Individual Income Tax Returns
2	Preparation of 19XX U.S. and state Individual Income Tax Returns, and 19XY Declarations of Estimated Tax
3	Services related to analysis of transactions for the year ended _____ and preparation of U.S. and state Corporation Income Tax Returns
4	Services related to analysis of transactions for the year ended _____ and preparation of 19XY U.S. and state Corporation Income Tax Returns and 19XX Corporate Estimate Declarations
5	Balance due, per prior statement
6	Preparation of Form 5500-C, Annual Report/Return of Employee Benefit Plan for Sole Proprietorship for the year 19XX
7	Services related to calculation of 19XX U.S. and state individual income tax projection, and consultation regarding year-end tax planning and recommendations
8	Services related to preparation of Form 1045, for Refund from Carryback
9	Services related to analysis of transactions for the year ended _____ and preparation of 19XX U.S. and state Subchapter S Corporation Returns of Income
10	Services related to analysis of transactions for the year ended December 31, 19XX, and preparation of 19XX U.S. and state Partnership Returns of Income
11	Services related to preparation of Forms W-3 and W-2
12	Services related to preparation of Forms 1096 and 1099

If justifiable, it is extremely important that detail be given on a bill to allow the client future deductibility of a portion of the fee as legitimate business expenses.

For example, assume there is a \$500 fee associated with summarizing the records for a Schedule C and completing an income tax return. Two alternative billing approaches are as follows:

<i>Approach 1:</i>	Preparation of 19XX U.S. and state Individual Income Tax Returns	\$500
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Under Approach 1, the full amount might need to be deducted as a miscellaneous itemized deduction. The client would probably achieve no benefit under this approach.

<i>Approach 2:</i>	Summary of business records and calculations regarding depreciation	\$300
	Preparation of 19XX U.S. and state Individual Income Tax Returns	<u>200</u>
	Total	<u>\$500</u>

Under this approach, \$300 is deductible as a business expense on the following year's Schedule C, reducing both taxable income and self-employment income. \$200 is deductible as a miscellaneous itemized deduction, subject to the limitation for miscellaneous itemized deductions.

You must be able to justify the type of billing illustrated by Approach 2. A 1992 IRS ruling, Rev. Rul. 92-29 (IRB 1992-16), provides guidance allowing a reasonable allocation of a portion of the professional fees to the business portion of a tax return. The ruling applies to Schedule C and Schedule F proprietors and to Schedule E rental and royalty activities. Some allocation of time may be required, and specific detail of the breakout is advantageous. For example, the following codes might be assigned:

- 1a Services related to compilation of farm taxable income, including update of depreciation computations and adjustments for asset acquisitions/dispositions and general farm consultation
- 1b Services related to compilation of rental taxable income, including update of depreciation computations and adjustments for asset acquisitions/dispositions and general business consultation
- 1c Services related to compilation of business taxable income, including update of depreciation computations and adjustments for asset acquisitions/dispositions and general business consultation

**Practice Tip.** Always summarize important meetings and telephone discussions with file memorandums. Send a copy of the file memorandum to the client "for informational purposes only." Besides clearly documenting the services performed, the tangible product of the file memorandum going to the client often provides a better basis (at least in the mind of the client) for billing the professional services.

### 102.11.7 Practice Management Software

The billing function can be significantly simplified through the use of practice management software. Such software allows the automated preparation of bills based on the timekeeping records. Often, alternate bill formats can be generated. For example, under one alternative, the bill might show professional hours involved in addition to a dollar amount. Under another alternative, only a description of the services and dollar amount is included on the bill.

Practice management software also produces useful management information for controlling and analyzing billing writedowns, and in assessing the overall productivity of various members of the firm. In fact, analysis of billing writedowns can be completed not only on a firm-member basis, but also on a client-by-client basis, or on a "type of services" basis (e.g., individual tax returns, fiduciary tax returns, corporate tax returns, etc.).

Information on available practice management software as well as Client write-up and tax return preparation, and so forth, can be found in a number of technical publications, including the *Journal of Accountancy*. On a regular basis, the *Journal of Accountancy* includes articles comparing available software by capabilities, hardware requirements, price, etc. A number of conferences and technology forums are also made available to the accounting community by the AICPA, state CPA Societies, and software vendors.

**Practice Tip.** Be sure to encourage all staff to enter adequate descriptions in the timekeeping system. By entering thorough descriptions, the use of practice management software to automatically generate bills is significantly enhanced.

## 102.12 Collection Policies

The most important step in collections takes place long before an invoice is completed. Discuss credit policies with clients at the earliest possible time as part of accepting a new engagement, and as an ongoing part of service. Many professionals do not properly communicate credit policies because they anticipate client resistance, or because they believe it to be unprofessional. The engagement letter is one of your best opportunities to communicate credit policies, explain the progress billing approach, and discuss payment expectations with clients.

Many firms place great emphasis on working long hours, recording significant charge time, and controlling billing writedowns. Yet, ironically, many of these firms do not follow through on collection techniques to bring actual cash into the firm. Until the receipt of payment occurs, the cash effect of long hours, time recording, and control of billing writedowns is zero.

Handle collections diplomatically. Fees must be collected in a manner that minimizes any adverse impact on client relationships. Consider the following guidelines when developing billing policies:

- Check the credit of new clients and establish credit limits.
- Request advance payments or retainer fees whenever feasible.
- Implement procedures that set forth the steps in the bill collection process.
- Consider charging interest on overdue accounts.
- Personally contact overdue clients.
- Consider requesting a promissory note when there is a danger of nonpayment.
- Consider dropping clients who constantly dispute their bills.

### 102.12.1 Client Credit Checks and Credit Limits

If a prospective client's fee is expected to exceed a certain amount, your firm might benefit by running a credit check before client acceptance. While such a procedure might not be practical for individual clients with expected billings under \$500, it might be very practical for a prospective small business client with an anticipated fee over \$2,000. Credit bureaus and collection agencies can provide credit checks for varying fees. It is the policy of some firms not to begin performing services (i.e., preparation of tax return) until all prior year fees have been fully collected.

**Practice Tip.** Set credit limits for your clients and compare your work-in-process to the credit limits. Where credit limits have been exceeded, a progress billing may be in order. Accounts in excess of their credit limits should be judged on an individual basis for a possible discontinuance of services until the bill is paid.

### 102.12.2 Retainers

Many firms establish retainers for tax services, which presents both advantages and disadvantages. In any retainer arrangement, the client must clearly understand that a final billing adjustment will occur upon completion of the project, and that the retainer represents only a down payment, or an estimate of what the actual fee may be.

Retainer arrangements are appropriate if there is question about collection (e.g., a nonfiler for several years or a client who previously had a poor payment history), or as a method to level out the client's payments for the year. For example, when monthly or periodic financial reports are prepared, a monthly retainer allows the business to pay the projected fees evenly in all months. Retainers are also appropriate when a client is in bankruptcy or a workout arrangement, and for projects where future collection is questionable, such as a purchase or sale of a business that has a small chance of actually closing.

The advantage of a retainer is the enhancement of cash flow. Retainer fees are steady, incoming cash each month or quarter. From the client's perspective, it is usually easier to pay smaller amounts on a regular basis than to pay one or two large amounts during the year.

The disadvantage is that some clients do not comprehend the need for retainers and may react adversely to the proposal. A careful explanation of the retainer arrangement to the client is essential. In addition, make it clear that the retainer is not a fixed fee, and that additional billings will occur for services that result in fees over and above the retainer amount.

**Practice Tip.** Retainer arrangements shouldn't keep you from analyzing work-in-process regularly to head off budget overruns or special items that should be billed in the current cycle.

One alternative to retainers is to estimate a client's projected fees for a year. These fees may be for services such as tax planning meetings and preparation of actual tax returns. Divide the total amount of estimated fees by four to obtain a quarterly amount, or by 12 for a monthly billable amount. Monitor the actual fees versus the billed amount on an ongoing basis. Adjust the billed amount, if necessary, at regular intervals during the year. Complete a final adjustment annually, usually when the tax return is completed.

If these estimated amounts represent a level billing amount through the year, any excess paid in should be refunded to the client, or applied against future services. This approach is similar to the budget billing process many utility companies offer.

**Practice Tip.** Always require a retainer when completing services for a nonfiler of several years or for a client who previously had a poor payment history.

### 102.12.3 Collection Procedures

Many different approaches are used in forwarding bills and controlling the collection process. These are key points for collections:

1. Complete time sheets and other billing data in a prompt and timely fashion.
2. Standardize and computerize the billing process.

**Practice Tip.** Collections cannot occur until invoices have been completed. Invoices cannot be completed until time sheets and other billing information are made available to the billing system. Be sure all professionals, including partners, submit time records in a prompt and timely fashion. Once all time records and billing information for a client have been gathered, complete and mail the invoice in the most expeditious manner.

Many firms believe special billing formats are required or additional correspondence should be submitted with the invoice. It is not uncommon for those responsible for billing to struggle with the billing information. They often introduce delays by writing and rewriting work descriptions, struggling over fee writedowns, and mentally reworking almost the entire work product when the billing is completed.

Streamline billing procedures and make them *standard*. If computerized bills can be generated, a faster billing process and a lower inclination for billing writedowns result. Many clients respond favorably to computer-generated bills. Part of this favorable response appears to be psychological, as the bills have a favorable appearance, and obviously were automatically generated (and everyone naturally assumes that the computer knows how to calculate amounts).

Occasionally, firms use the billing process in part as a marketing tool, in an attempt to generate additional services. Additional correspondence to the client often accompanies the bill, explaining issues and making recommendations for additional services.



**Practice Tip.** The last step of collecting cash must be properly prioritized. Some firms actually go through all the steps of completing quality services, recording time, and forwarding invoices, but do not follow up on the last step of collecting cash and getting it to the bank!

Some firms accept credit cards, such as VISA and MasterCard, in payment for fees. Many clients want to use credit cards to get frequent flyer miles, so you may find your larger individual clients are using credit cards. Your fees in such cases should allow for bank charges. Discounts are occasionally offered if payment is made when a client picks up completed work. The advantage of these approaches is the early and certain collection of cash. The disadvantage is the percentage fee for credit cards and discount amount lost. Credit card acceptance has become increasingly popular with many firms. Discounts are less popular; most firms require cash payment or extend short-term credit. These firms do not feel the discount is a necessary tool to enhance cash collections.

**Practice Tip.** Consider putting a specific due date rather than “payment due upon receipt” on your invoice so that your client knows when you expect payment. You will be surprised how this simple change will improve cash flow.

## 102.12.4 Handling Overdue Accounts

Be sure to implement follow-up procedures that go beyond the simple reminder bill. Send a “past due” reminder after 30 days, and again at either 45 or 60 days. Samples of applicable correspondence are discussed below.

Remember that when you complete professional services for clients, you record the charge time and create an invoice for the services. When you need to spend time with late payers, you are actually taking time away from your ability to complete and charge professional services for other clients.

Many practitioners actually record the time spent in collection activities. They identify this time by client and then use the resultant management information in deciding which clients remain desirable. One simple approach is to record the time using the client number and a category code or other identifying code of “collections,” in order to capture the time spent on collection matters.

If you elect not to include the time spent on billing, the realization for the particular client will be lower (since the collection time would be written off). In analyzing your clients with low realization, those clients requiring collection activity may surface as being undesirable.

Some firms use interest charges to encourage payment. Interest charges must be within legally allowed amounts. In addition, some states require advance notice and proper disclosure when interest charges are added to overdue balances, so be sure to review the applicable legal requirements in your state before imposing interest charges. Other firms do not apply interest to overdue accounts, arguing that the firm’s policy is payment *when due*; an interest charge indirectly gives the impression that other arrangements are acceptable.

### Contacting Overdue Clients

If reminder notices on overdue accounts do not achieve immediate results, initiate telephone contact with the client. Many clients respond better to a telephone call than to follow-up correspondence. The *personal* nature of a telephone call may either better justify the billings or answer questions the client may have.

**Practice Tip.** Many states and municipalities have restrictions on harassing telephone calls, so be careful of the number of telephone calls and the tone and approach of the calls.

When making a collection call, first identify yourself and your firm, and then make certain of the identity of the customer and the individual to whom you are talking. Talk directly with the person responsible for paying the bill, such as the owner or controller. Immediately state the reason you are calling: to communicate that the account is past due and to request full

payment as soon as possible. Once this has been stated, allow the client to respond and to explain any possible reasons for nonpayment.

Before concluding the collection call with a client, arrive at a satisfactory solution or a plan for the next step. Be sure to properly document the conversation and note any agreements reached. It is best to immediately follow up with brief correspondence to the client summarizing the discussion and the solution agreed upon.

Some firms have established someone other than the client partner, such as the office manager, as responsible for collections. The advantage of this approach is that this third party may generate a quicker response from the client. The disadvantage is that the person may not understand the facts of the situation well enough to respond to client comments, which could irritate a client otherwise disposed to pay promptly.

### Collection Correspondence

Reminder bills and correspondence for collection take many formats. The correspondence should reiterate the firm's policies on overdue accounts.

Exhibit 102-6 illustrates a sample policy on overdue accounts, which can be sent to clients. Exhibits 102-7 and 102-8 illustrate sample correspondence for an account 60 and 90 days past due, respectively. Exhibit 102-9 is sample correspondence regarding a second occurrence of an account being past due.

### Suing for Collection

Many firms are reluctant to sue for collection for professional liability insurance reasons. One of the questions asked on most applications for professional liability insurance is whether the firm sues clients for collection. The concern of the insurance carrier is a countersuit by the client. Even a frivolous countersuit could cost the firm and the professional liability carrier dearly.

Use extreme discretion in suing for collection of accounts. You may want to look at collection matters on a case-by-case basis. Be sure to leave the *impression* that a suit for collection *will* occur, because it is a lawful recourse. Even professional liability insurance carriers do not prohibit lawsuits for collection—they simply warn of the potential pitfalls and discourage lawsuits.

**Practice Tip.** As an alternative to a suit, consider converting the overdue balance to a promissory note. If possible, have the client personally sign and guarantee the note. A promissory note has greater legal enforcement than a simple accounts receivable amount. Assuming the personal guarantee can be obtained, collection can presumably occur from the business entity (e.g., a corporation or partnership), or from the individual. Most lawyers feel that converting an accounts-receivable amount to a promissory note removes any legal question about the type and quality of services rendered. The client essentially agrees to the services that were performed—only the collection remains in doubt. With a normal accounts receivable, the risk is always that the client will argue that payment has not occurred because the services were unsatisfactory.

### Negotiating Trade-Outs

Some delinquent clients may suffer from chronic cash shortages but be long on services or products useful to a tax practice. Don't hesitate to take services or goods in lieu of cash to lower the amount past due. The client may be extremely willing to participate in a trade-out program because the client account is credited for the value of the goods or services but the client's out-of-pocket cost is significantly lower.

Trade-outs can occur with a vast number of clients. Office supplies from a printing company, software from a computer outlet, company vehicle maintenance from a service station, or even the annual company party from a restaurant client. Be aware that bartering income is taxable income; however, this usually would be offset by a legitimate company expense. Any nonbusiness services or goods received by a firm partner need to be treated as personal taxable income.

## 102.13 Annual Fixed Client Costs

One factor in capturing all costs and setting billing rates and tax service fees is the annual fixed cost of dealing with a client. Most firms incur correspondence and mailing costs from newsletters, year-end updates, tax return worksheets, and related materials. File folders and file cabinets need to be purchased, and insurance secured on the file contents. Entries to the data processing system must be made, and backups of this information must be completed on an ongoing basis.

Assess this annual fixed cost and factor it into the fee system. Low-fee clients may turn out to be unprofitable or only marginally profitable once annual fixed costs are considered, unless they are a valuable referral source.

### 102.13.1 Calculation of the Annual Fixed Cost

Many of the elements in the annual fixed cost have been discussed above. Some firms complete file reviews on an annual basis for each client, and require checklists and other documents to be completed.

An example of calculating the annual fixed cost of a client follows.

Newsletters and postage	\$ 1.50
Tax organizers and other client worksheets	4.00
File folder and portion of file cabinet	1.00
Annual insurance costs	1.00
Data processing costs, including file backup and printed material	3.00
Professional liability insurance (estimated)	<u>4.50</u>
Total	<u>\$15.00</u>

This example is given for illustrative purposes only. It highlights the annual costs associated with a client, whether the fees billed for a tax return are \$25 or \$2,500. Admittedly, arguments could be made tying certain costs, such as professional liability insurance, to the size and complexity of the engagement. The key issue is to recognize that an annual fixed cost exists for each tax client, regardless of the size of the tax return.

**Practice Tip.** Consider adding an annual charge to the work-in-process of every client of (as an example) \$25 on January 1 of each year to cover the annual fixed cost of retaining that client. Alternatively, add \$1 or \$2 to the professionals' hourly billing rate to cover these administrative charges. The amount does not necessarily need to be actually billed through to a client, but it does allow for using the work-in-process system as a total cost-capturing tool. If these fixed costs were considered when setting billing rates (as discussed in Section 102.2.1), no additional adjustment is necessary.

### 102.13.2 Cost of Adding a New Client

Similar to the cost of retaining a client on an annual basis, there is a cost associated with adding a new client. Many firms require registration forms and credit checks to be completed prior to formally accepting a new client. New entries into the data processing system and the due-date list must be made, and file folders must be set up.

The cost of adding a new client varies from firm to firm, depending on the amount of effort put into credit checks and background checks (if any) on the client. Some firms immediately add an amount to work-in-process for the cost of adding this new client. This, again, allows the work-in-process system to be used as a total cost-capturing tool.

By adding an amount to work-in-process, the acceptance of clients who will generate only small fees can be discouraged. For example, if a new-client fee of \$50 is added for a new client, it may be difficult to obtain full realization on a tax return fee of a new client whose prior accountant charged a fee of only \$75 to \$100 to prepare the tax return. For larger clients, the

new-client fee is an insignificant amount, having essentially no impact (as a percentage) on overall realization.

If the cost of acquiring a new client is to be absorbed in overhead, established billing rates need to be adjusted higher to recover these additional overhead costs. Exercise caution, however, that a new client is not “penalized” by requesting the services of your firm.

### 102.13.3 Cost of Tax Return Materials

You should also assess the costs of materials associated with the tax preparation process. Tax organizers and other materials enter into the annual cost of retaining a client. In addition to organizers, materials such as estimate vouchers, instruction sheets, client copies of materials, and tax return packaging materials must be considered. Either build these costs into the rate structure of the professionals or add a charge to each tax return to account for them.

Many firms add a standard processing charge (e.g., \$30) to cover the cost of these materials and other miscellaneous charges. This is over and above any computer fees and other direct expenses, and is simply added to other costs associated with completion of the tax return. Many firms vary the processing charge based on the size of the return, under the reasonable assumption that the material cost is higher for larger and more complex returns than it is for small and simple returns.

## 102.14 Developing a Tax Practice Business Plan

Lean times, rising costs, and the tough realities of increasing competition have shown that firms and practitioners must have a clear sense of mission and purpose as well as plans for practice growth, staff development, and client service that can make the firm responsive to changing conditions. Planning, undertaken formally, is the process whereby the firm takes action to become what it wants to become. The firm identifies opportunities and weaknesses, and allocates resources accordingly to exploit or overcome them.

A multi-year tax-department business plan should address administration, staffing, training, and marketing, and should provide general guidance for daily work and decision-making. The plan should support a creative, innovative, and cooperative environment. It should be action- and results-oriented, and it should establish priorities.

Generally, most departmental plans begin with a reiteration of the firm’s statement of philosophy or mission statement. The objectives and goals for each area of departmental concern (i.e., administration, staffing, training) are derived from these statements of purpose and direction. Objectives and goals, accompanied by specific activities that are assignable, measurable, and have due dates, are generally known as strategies. Each area of the firm’s tax practice would normally set forth strategies for getting to where they want to be—for achieving the plan’s purpose. Following are some guidelines for setting objectives.

Planning objectives must—

1. Be in writing—definite, clear, and objective.
2. Specify a result to be accomplished in terms of *what* and *when* (in dollars, time, percentages, quality, etc.).
3. Be expressed in action verbs.
4. Be realistic and attainable, recognizing internal and external restraints.
5. Specify a target date of accomplishment.
6. Assign responsibility for goal attainment.
7. Be coordinated with mission and philosophy statements.

A sample tax group business plan is reproduced as Exhibit 102-10.

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**Exhibit 102-1: Tax Return and Billing Memo—Fee Increase Justification**

**SWIFT, MARCH & COMPANY**  
CERTIFIED PUBLIC ACCOUNTANTS  
200 Main Street  
Noplace, Anystate 00000

**TO:** Mike & Mary Jones  
**FROM:** Robert Swift, CPA  
**DATE:** February 21, 1999  
**SUBJECT:** 1999 Individual Income Tax Returns

The results of your 1999 individual income tax returns are slightly better than we projected at tax interview time, as the few additional expenses you forwarded helped out. The federal balance due is now \$1,547 with a small state refund of \$249.

Your federal taxable income is \$96,369, over \$15,000 more than 1998. The first \$43,050 is taxed at the lowest 15% federal bracket, with the remainder at 28%. The next bracket of 31% starts at \$104,050. Deducting the business vehicle usage saved you over \$3,000 in taxes.

If you have not already done so, you could still make a Roth IRA contribution of \$2,000 for each of you for 1999 by April 15, 2000. Unless your income is likely to be over \$150,000 for 2000, you could also put in a 2000 contribution any time. As your children begin to earn wages, you have an opportunity to make Roth IRA contributions for them as well.

Finally, a few words about our fees. We arrive at our fees by tracking the time involved in preparation. Your returns, as with most we are seeing for the 1999 year, have an increase in time and charges. The reason, of course, is all the changes which have occurred in the federal and state tax system. While this added complexity is unfortunate, the positive aspect is that most of the changes involved increased tax credits, new deductions, capital gain calculations and other developments which reduce taxes. We would be pleased to provide more detail regarding our time and charges, if you should desire any further explanation.

One of the tax changes that affected your return was the HOPE credit. You received a \$1,500 reduction in your taxes as a result of this credit for college tuition.

Thank you for the opportunity to work with you. Please let me know if you have any questions regarding the returns.



**Exhibit 102-3: Weekly Time Report**

**WEEKLY TIME REPORT**

Employee \_\_\_\_\_

Week Ended \_\_\_/\_\_\_/\_\_\_

DAY	Mon.	Tues.	Wed.	Thurs.	Fri.	Sat.	Sun.	TOTAL
Chargeable hours, per daily time reports								
Non-chargeable:								
Vacation								
Holiday								
Sick								
Continuing Education								
Civic/Professional Soc.								
Staff Meetings								
Billing/Collections								
Clerical (clerical use only)								
TOTALS								

Total \$ misc. charges

\$ \_\_\_\_\_



**Exhibit 102-4: Billing Adjustment Sheet**

**BILLING ADJUSTMENT**

Billing Month: \_\_\_\_\_

Work-In-Process: \_\_\_\_\_

Client Number: \_\_\_\_\_

Amount Billed: \_\_\_\_\_

Client Name: \_\_\_\_\_

Variance Amount: \_\_\_\_\_

Brief Billing Description:

Variance Explanation:

\_\_\_\_\_  
Accountant In Charge Date

\_\_\_\_\_  
Partner Approval Date

\_\_\_\_\_  
Partner Approval Date

Authority Needed

1. Variance less than 10% and/or total dollar variance under \$100—Accountant in Charge (optional)
2. Variance more than 10% and/or total dollar variance over \$100—Partner approval
3. Variance over \$500—Two partners approve

**Exhibit 102-5: Tax Return Writedown Control Sheet**

**SWIFT, MARCH & COMPANY  
TAX RETURN WRITEDOWN CONTROL SHEET**

Taxpayer Name \_\_\_\_\_

Form Initiator \_\_\_\_\_ (use Employee Number)

Amount of WIP                    \$ \_\_\_\_\_

Amount of bill                    \$ \_\_\_\_\_

Category (see below)  
—check all that apply

1 \_\_\_\_\_                    2 \_\_\_\_\_                    3 \_\_\_\_\_

Comments (if any):

Categories:

- 1. TAXSOFTWARE rerun charged to Swift, March and Company.
- 2. Writedown exceeds \$10.00.
- 3. Writedown exists and 20YY fee is equal or less than 20XX fee.

.....

For administrative use only:

Dollar Variance \_\_\_\_\_

Percent Variance \_\_\_\_\_

Approved: \_\_\_\_\_

\_\_\_\_\_ (when required)

**Exhibit 102-6: Collection Policy—Overdue Accounts**

**SWIFT, MARCH & COMPANY  
POLICY ON OVERDUE ACCOUNTS**

In order to provide the most timely and highest quality service to those clients most desirous of the professional services performed by Swift, March & Company, it is hereby adopted as a corporate policy that the following should occur for any client for whom a balance due amount exceeds more than 60 days, according to the internal accounts receivable system:

1. All professional services will be immediately terminated until such time as the entire account balance for the client has been paid.
2. At the time the account hits more than 90 days according to the accounts receivable system, the account shall be subject to all collection activities.
3. Where a client has previously hit 90 days past due, and there is a second occurrence of the client hitting more than 60 days past due, the client will be dropped from the active list and correspondence will be forwarded to the client informing them of termination of services by Swift, March & Company. Once the client balance is again current, future work will be performed on a retainer-only basis for the following 24-month period.

There shall be no exceptions to the above policy in the absence of mitigating circumstances. Any such circumstances must be approved by a partner.

Approved: \_\_\_\_\_

Date: \_\_\_\_\_

**Exhibit 102-7: Collection Correspondence—Account 60-Days Past Due**

**SWIFT, MARCH & COMPANY**  
CERTIFIED PUBLIC ACCOUNTANTS  
200 Main Street  
Noplace, Anystate 00000

Upon reviewing our records, we note that your account in the amount of \_\_\_\_\_ is now in excess of 60 days past due.

We hope that this reminder will be sufficient for you to promptly mail us your payment. We look forward to receiving your payment within the next 10 days.

If you have any questions on the computation of our fees, or concern regarding the services that we provided, please contact us.

Sincerely,

Swift, March & Company

Partner in Charge

Enclosure: Policy on Overdue Accounts

**Exhibit 102-8: Collection Correspondence—Account 90-or-More Days Past Due**

**SWIFT, MARCH & COMPANY**  
CERTIFIED PUBLIC ACCOUNTANTS  
200 Main Street  
Noplace, Anystate 00000

Our office sent correspondence to you on \_\_\_\_\_, 20\_\_\_\_  
requesting that you make payment on your account balance of  
\$\_\_\_\_\_ or to contact us regarding any comments or questions you  
may have regarding our billing.

As of this date, we have neither received any payment on your account  
nor have you contacted us to discuss payment terms. If we do not hear  
from you within 10 days, we will be forced to turn this account over  
for collection.

We regret having to take this action, but your inattention to our  
previous request leaves us no choice.

Sincerely,

Swift, March & Company

Partner in Charge

Send Return-Receipt

**Exhibit 102-9: Collection Correspondence—Second Past Due Occurrence**

**SWIFT, MARCH & COMPANY**  
CERTIFIED PUBLIC ACCOUNTANTS  
200 Main Street  
Noplace, Anystate 00000

Upon reviewing our accounts receivable ledger, we note that your account in the amount of \$ \_\_\_\_\_ is now in excess of 60 days past due. We also note that your account was recently more than 90 days past due before collection occurred.

If we do not hear from you within 10 days regarding payment on this account, we will be forced to drop you from the active list of our clients and will be unable to perform professional services for you in the future. If, however, we immediately receive payment, we can continue to perform professional services but only on a retainer basis.

We regret having to take this action, but your account has become a recurring collection problem that leaves us no alternatives.

Sincerely,

Swift, March & Company

Partner in Charge

Send Return-Receipt

**Exhibit 102-10: Tax Group Business Plan**

**TAX GROUP FIVE-YEAR BUSINESS PLAN  
2000–2005**

***Firm Philosophy***

- To promote an environment of creative enthusiasm, loyalty, and team spirit, where challenges are faced in a positive way, where individual potential is encouraged, and where ideas are explored openly.
- To render to our client and community outstanding professional and personalized service, which they perceive as valuable to their continued prosperity.
- To be innovative and progressive, seeking new service areas of high value, while efficiently expanding our existing areas of service.

***Firm Mission***

To be a leading (in terms of quality, professionalism, and profitability) regional accounting and management consulting firm, with intense management involvement in all aspects of the practice and client service.

***Tax Group Philosophy***

To provide existing clients with the best service and product possible, and to foster the growth and development of our tax practice by obtaining new clients and fully servicing existing clients.

***Tax Group Mission***

- To grow and develop our tax practice through effective marketing exposure and satisfied clients.
- To develop a reputation as efficient, creative tax professionals who understand quality client service.
- To develop staff as high-level tax consultants who provide profitable tax products (written research memoranda, issue-oriented return reviews, etc.). Staff must be more than compliance-oriented technicians.
- To find solutions that minimize or eliminate problems caused by diversity of client base, varying degrees of workpaper quality, amount of tax work done outside the group, varying levels of tax knowledge among staff, and increasing statutory complexity.

**Exhibit 102-10: Tax Group Business Plan (cont.)****TAX GROUP BUSINESS PLAN  
ADMINISTRATIVE**

Goal: Provide a system of work flow throughout the office that will both track work and provide for efficient and timely production.

	<u>Staff Assigned</u>	<u>Target Date</u>
1. Identify areas of improvement by visiting other firms		
a. Discuss with _____ appropriate local firms to visit.	_____	7/00
b. Determine who should make visit and make arrangements.	_____	7/00
c. Visit selected firms (above)	_____	7/00
2. Other work flow items		
a. Pursue computer network compatibility	_____	Ongoing 2000–2002
b. Establish Tax Software Resource Group	_____	Done
c. Transfer of _____'s computer responsibilities to other staff.	_____	Done
d. Library—catalog all tax resource materials; locate missing issues and publications; establish library checkout procedures; centralize ordering of tax material; investigate computerized library service.	_____	6/00
e. Forms: Verify that appropriate prior year forms are being kept.	_____	6/00
f. Efficiency and timeliness of tax return preparation: Develop system for monitoring for major clients.	_____	7/00
3. Tracking of tax work		
a. Establish tax project department control log.	_____	7/00
b. Each person responsible for "A" clients should develop own tracking device.	_____	Ongoing
c. Short projects—always get internal due dates and be sure to inform partner-in-charge of problems well in advance of due date.	_____	Ongoing
d. Establish procedures to assure that time budgets for each job are realistic and properly communicated to staff.	_____	7/00



**Exhibit 102-10: Tax Group Business Plan (cont.)**

**TAX GROUP BUSINESS PLAN  
PERSONNEL**

	<u>Staff Assigned</u>	<u>Target Date</u>
<b>A. Goal: Establish future staffing requirements</b>		
1. Update current organizational chart, change format	_____	7/00
2. Create organizational chart representing 5-year staffing needs. Develop 2-year goals	_____	7/00
a. Department size	30	
b. Partners, principals	6	
Managers	5	
Supervisors	6	
Staff	8	
Interns	2	
Administrative Assist.	3	
Total	<u>30</u>	
3. Bring into Tax Department more preparation work to allow for training of staff level personnel.	_____	Ongoing
4. Coordinate personnel and staffing needs with satellite offices.	_____	5/00 & Ongoing
5. Develop current and projected fee base necessary to support respective staff levels. Develop 2-year goals.	_____	8/00
6. Analyze present office space. Make recommendations for change.	_____	Done
7. Analyze projected office space requirements.	_____	8/00
8. Begin planning target dates for tax staff promotions.	_____	Done
<b>B. Goal: Recruit additional staff</b>		
1. Determine the need for an entry level or 12-18 months experienced person.	_____	8/00
	_____	Done
2. Recruit intern to work summer of 2000	_____	Done
3. Recruit intern to work fall 2000 and spring 2001	_____	8/00
<b>C. Goal: Improve scheduling</b>		
1. Develop master schedule from computerized service plan.	_____	7/00
<b>D. Goal: Improve evaluation procedures</b>		
1. Improve timeliness and quality of evaluations.	_____	7/00 & Ongoing
2. Have all written evaluations pre-approved by group managers prior to meeting with staff.	_____	Ongoing

**Exhibit 102-10: Tax Group Business Plan (cont.)****TAX GROUP BUSINESS PLAN  
CLIENT SERVICE**

I. Goals: Provide highest quality service to "A" level clients in an efficient and timely manner.

## A. "A" Clients

<u>Task</u>	<u>Staff Assigned</u>	<u>Target Date</u>
1. Develop and implement service plans/extend service plan to include budget of time and fee involved.	Those assigned coordinated by _____	Continuing—report on status at quarterly intervals
2. Encourage more and earlier projections in order to avoid surprises.	Those assigned coordinated by _____	
3. Perform accrual reviews for all audit clients.	Those assigned coordinated by _____	
4. Develop and implement an organized approach to handling "A" clients.	Those assigned in conjunction with accounting staff	
a. Work must be scoped out in beginning with materiality of all questions evaluated in light of the budget.		
b. Alternatives should be given to the staff/client and an approach agreed upon by everyone including a budget and a mechanism for follow-up. Any potential problems in budget and turnaround dates should be communicated to the partner-in-charge/client as soon as possible.		
c. Those assigned to "A" clients should establish their own internal files which <i>must</i> include a profile of the client, including all related entities, copies of all projections and correspondence and tax memoranda. Additionally, the tax staff assigned to an "A" client should in all cases try to attend meetings with the client as well as attend client service plan meetings.		

## B. Direct interaction with all clients.

1. Copy clients on articles, tapes, memos.	All staff	Report quarterly
2. Go over tax returns with clients personally by delivering vs mailing.	All staff	Report quarterly
3. Go over client service plan with clients.	All staff	Report quarterly
4. Encourage and solicit feedback from clients on service levels.	All staff	Report quarterly
5. Ask client: "What do you want?" "Are you satisfied?"	All staff	Report quarterly
6. Build relationships with controllers:	All staff	Report quarterly
a. Take to lunch.		
b. Coordinate delivery of returns and relevant information material to controller as well as owner.		
c. Ask for referrals.		

**Exhibit 102-10: Tax Group Business Plan (cont.)**

<u>Task</u>	<u>Staff Assigned</u>	<u>Target Date</u>
C. Indirect action relating to all clients.		
1. Turn every seminar/study group attended to client benefit:	All staff	Report quarterly
a. Ask what client coursework is relevant to.		
b. How can I use this information to provide a service to a client?		
2. All calls should be returned within 24 hours.	All staff	Report quarterly
3. Short research projects should be turned around in 48 hours, when possible, or provide alternative.	All staff	Report quarterly
4. Revise client service plans quarterly.	All staff	Report quarterly
5. No tax return should be delivered more than two weeks after interview date.	All staff	Report quarterly
6. Promise things two days later than you plan to deliver.	All staff	Report quarterly
7. Use more graphics in client presentations; visual approach is usually more impressive and easier to understand.	All staff	Report quarterly
II. Establish liaison approach for high-volume "B" and "C" clients.		
A. Establish technical and administrative liaison for all four accounting groups		
1. Responsibility as technical liaison to all groups would be to monitor changes in the law and current developments along with the primary liaison to spot potential areas needing tax alerts or training sessions.	_____	Immediate
2. Responsibility as administrative liaison to the groups would be to assure that the groups are getting proper service and support from the Tax Department and to support the marketing efforts.	_____	Immediate
B. The primary liaisons would be as follows:		
	<u>Group</u>	<u>Liaison</u>
	Pro	_____
	Auto	_____
	RE	_____
	M&D	_____
	PFP	None
1. The responsibilities of the primary liaisons:		
a. Attend group meetings when needed.		
b. Handle questions for "B" & "C" clients (under same approach mentioned above for "A" clients i.e., scoping, giving alternatives, budgets and follow-up).		
c. Train group on changes in tax law and any current developments.		
d. Handle tax administrative task problems for the group.		
III. Render tax examinations services.		
A. Centralize office audits under one person.	_____	7/00
B. Begin tracking all issues involved in corporate and partnership tax examinations.	_____	7/00
C. Become an expert on IRS procedures.	_____	Ongoing
D. Train one other person in handling of office exams as well as IRS procedures.	_____	8/00

**Exhibit 102-10: Tax Group Business Plan (cont.)****TAX GROUP BUSINESS PLAN  
MARKETING**

Goal: Project a true image of outstanding client service and develop a reputation as a number one tax firm. To do this we must involve everyone in the Tax Department at every level. To achieve this each individual should set goals and develop an overall marketing plan for themselves. Goal should be quantified. Each individual should target areas which he/she wishes to develop further within the firm and build goals around those objectives. For purposes of the marketing plan four markets have been identified.

1. Current clients
2. Prospective clients
3. Referral sources
4. The firm groups

	<u>Staff Assigned</u>	<u>Target Date</u>
1. Perform internal marketing to the firm groups	All staff with coordination & follow up by	8/00
a. Brainstorm with other partners and associates within the firm to determine how you can help them and/or where your marketing efforts should be exerted. Through frank discussion, determine what areas you want to market.	All staff with coordination & follow up by	8/00
b. Continue partner/principal training with success stories more frequently.	All staff with coordination & follow up by	8/00
c. Continue and improve on current use of tax alerts while trying to demonstrate the benefits of transforming such information into chargeable work.	All staff with coordination & follow up by	8/00
d. Develop marketing subcommittee within the tax group to meet on a regular basis. Stress tax awareness within the firm.	All staff with coordination & follow up by	8/00
e. Continue to improve on our internal training to other groups by making it more practical and helpful to staff.	All staff with coordination & follow up by	8/00
f. Spend more time with "A" clients by scheduling meetings with them and/or with the accounting staff assigned to them (see service strategy area for better service to "A" clients), keeping in mind that a concentrated effort should be made on developing more "face-to-face" time with clients. A tax planning memo written by the tax specialist on each account may be advisable.	All staff with coordination & follow up by	8/00
g. Make better use of voice mail for sharing information.	All staff with coordination & follow up by	8/00

**Exhibit 102-10: Tax Group Business Plan (cont.)**

	<u>Staff Assigned</u>	<u>Target Date</u>
2. External marketing should be geared toward expanding services to current clients as well as establishing new client relationships.	All staff, coordinated by _____	8/00
a. Make periodic client contact via telephone conversations or, if possible, in person. Direct meetings and consulting time with clients are perceived as the most valuable time spent on an engagement and typically lead to additional tax services. Follow up in writing with the client. For better relations with other groups, always inform other members of the client team of your efforts.	All staff, coordinated by _____	8/00
b. Operate on a proactive basis by taking the initiative with clients. Send relevant information to clients, such as articles, current events, new tax issues, prospective legislation, cases/rulings, etc. This will make clients feel that you really care about them and their business.	All staff, coordinated by _____	8/00
c. Consider seminars on success stories for referral sources.	All staff, coordinated by _____	8/00
d. Set up study groups to help other professionals who can provide client referrals (i.e., attorneys).	_____	9/00
e. Network with other professionals as often as possible especially in noncompeting areas, to talk about XYZ's strengths and position in the marketplace. Develop unique ways to network with professionals such as partnership study groups.	All staff	Ongoing
f. Coordinate community involvement through charitable, civic, and political organizations.	All staff	Ongoing
g. Write articles for local/national publications. Circulate these articles to your network sources and to current and prospective clients in related areas.	All staff, coordinated by _____	Ongoing
h. Look for marketing possibilities of tax law situations such as buy-sell agreements, cafeteria plans, estate and trust plans, and returns.	All staff	Ongoing

NOTE: See Exhibit 103-10 for a list of suggested staff marketing activities.

**Exhibit 102-10: Tax Group Business Plan (cont.)****TAX GROUP BUSINESS PLAN  
TECHNICAL****Statement of Background and Objectives**

The practice of tax accounting in recent years has gone through revolutionary changes. CPAs can no longer survive solely as tax return preparers. We must be equipped with a wide range of knowledge and skills to address the needs of our clients in a climate of increasing change and complexity. All tax professionals must be prepared to function as highly trained legal researchers in tax law, tax planners with sufficient business acumen to understand client needs, trainers in tax law to help younger professionals who need guidance, and risk managers who understand the malpractice and professional responsibility restraints in our everyday interaction with clients.

Our challenge at XYZ is to gain recognition as the leading tax department among local area accounting firms. As the public becomes increasingly aware of the difficulty and risks associated with tax reporting, they will be demanding increased expertise, accuracy, and seasoned judgmental advice to help them through the complicated system we know exists today. Along those same lines, the tax department at XYZ must provide to our professional peers within the firm timely, accurate, understandable, and practical knowledge of tax developments and strategies that are useful to their needs in servicing clients. This guidance must also allow our peers to be outstanding problem identifiers and potential solution providers.

- |      |  |                       |                    |
|------|--|-----------------------|--------------------|
| I.   | <i>Goal:</i> Establish office-wide communications of tax developments, issues and planning opportunities, with Tax Department serving as main source of information on technical developments and planning strategies. | <i>Staff Assigned</i> | <i>Target Date</i> |
|      | A. Coordinate effective communication of current developments and provide guidance on training at all staff levels.  | _____                 | Immediate          |
|      | B. Prepare firm-wide written tax alerts.   | _____                 | Immediate          |
| II.  | <i>Goal:</i> Establish specific Tax Department training and resources.   | <i>Staff Assigned</i> | <i>Target Date</i> |
|      | A. Tax Department will provide high-level technical and planning workshops to its staff.   | _____                 | 7/00               |
|      | B. Establish counseling for each Tax Department member to coordinate specific training programs, as necessary.   | _____                 | 7/00               |
| III. | <i>Goal:</i> Tax Department will take leading responsibility for maintaining appropriate technical library needed for firm's client base. Computerized research tools will be purchased.                               | <i>Staff Assigned</i> | <i>Target Date</i> |
|      | A. Recommend to tax committee print purchases and needs.   | _____                 | 8/00               |
|      | B. Recommend electronic research facility and monitor use.   | _____                 | 8/00               |
| IV.  | <i>Goal:</i> Increase use of "Accrual Review" as necessity to more efficient tax services and more timely planning opportunities.  | <i>Staff Assigned</i> | <i>Target Date</i> |
|      | A. Review financial statement workpaper activity to ferret out planning opportunities.   | _____                 | Ongoing            |
|      | B. Tax Department will become expert on tax accounting under FASB Statement 109 and related pronouncements.  | All staff             | 8/00               |
| V.   | <i>Goal:</i> Market firm's tax expertise.  | <i>Staff Assigned</i> | <i>Target Date</i> |
|      | A. Increase number of seminars related to client-specific tax issues.  | _____                 | Ongoing            |
|      | B. Prepare media articles and monitor them for balance, readability, and proper degree of participation by Tax Department staff.   | _____                 | Ongoing            |

**Exhibit 102-10: Tax Group Business Plan (cont.)**

VI. *Goal:* Improve workpaper documentation skills in tax area.

*Staff Assigned*

*Target Date*

A. Establish easy and accurate communication between Tax and other departments in the firm.

\_\_\_\_\_

8/00

B. Review professional responsibility requirements in light of IRS and AICPA standards.

\_\_\_\_\_

Ongoing

VII. *Goal:* Continual evaluation of staff and return preparation processes to match people and processes with client needs in cost efficient ways.

*Staff Assigned*

*Target Date*

A. Review of computer products.

\_\_\_\_\_

Ongoing

B. Review all Tax Department staff evaluations to direct appropriate skill/levels and abilities to appropriate "client teams."

\_\_\_\_\_

Ongoing

**Exhibit 102-11: Sample Billing Explanation Associated with Tax Complexities****Traditional Billing Explanation**

Preparation of 199X U.S. and State Individual Income Tax Returns, including calculations associated with education credits \$500

**Detailed Billing Explanation to Justify Fee Increase**

Preparation of 199X U.S. and State Individual Income Tax Returns, including test of benefit associated with education credits, comparison of tax cost to parents on foregoing dependency exemption compared to tax benefit to child by being able to claim education credits, also including determination of most favorable approach to generate net tax savings of approximately \$835 \$685

**Note:** Due to elective opportunities in the tax Code, we were able to maximize the tax benefits associated with the education credits, resulting in a reduced tax liability of over \$800. However, included in the fee amount being billed is an additional amount of approximately \$200 associated with our calculations to maximize your tax benefit.





# 103 Marketing and Practice Development

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# 103 Marketing and Practice Development

Competition for new clients and the challenge of retaining existing clients continue to intensify. Old attitudes against marketing a firm's services have changed and limitations on advertising have come down. If you do not yet have a formal marketing strategy for your tax practice, or your old marketing plan is not working, you should begin developing a new one. Marketing a firm's services is necessary to maintain a client base and to create additional profitable business.

Marketing tax services encompasses a wide range of activities, including image setting, advertising and promotion, client communications, and relationships with other professionals. In each of these activities, your primary objectives are to assess client types and differences and to match them with your firm's abilities and service goals.

In this chapter, we discuss ideas for establishing a marketing strategy. We then offer some specific marketing suggestions. The long-term success of your practice depends on continuous updating and refining of your marketing strategy. We also encourage readers to refer to the discussion of a tax department business plan in Chapter 102 for establishment of other strategies for a successful tax practice.

## 103.1 Establishing a Fresh Marketing Program

There is a definite positive correlation between marketing efforts and overall revenues. In addition, a positive attitude about gaining new business helps attract new clients. By targeting marketing goals and allocating firm resources, you initiate the marketing effort. How much of the firm's resources should be applied to the marketing effort? Various surveys indicate that most accounting firms allocate between one percent to three percent of firm revenue on direct out-of-pocket marketing expenses. Without a doubt, at least some minimal marketing structure should be in place. Individual marketing projects can then be analyzed on their own merits. There are seven basic steps to establishing a marketing structure and setting forth a plan for your firm:

- Select someone to be responsible for the marketing plan.
- Perform a situation analysis.
- Target reasonable marketing goals.
- Assign tasks and due dates.
- Budget firm resources for the marketing effort.
- Put the plan in writing.
- Monitor and review the plan's progress.

### 103.1.1 Assign Responsibility for a Plan

The first step in establishing a marketing program is to select someone within the firm to be responsible for it. The person selected should be an individual who believes in the marketing plan and has strong managerial and leadership abilities.

The responsible individual should then identify goals and strategies. Often, this can be done by a team approach that involves and “empowers” others in the firm. The source of the most effective ideas is the firm’s staff because it has an investment in the firm’s success. Periodically holding roundtable marketing discussions (brainstorming) proves useful in developing new ideas, reviewing the progress of current projects, and conducting post mortems on completed projects. The person responsible for the marketing plan must be given the authority to implement strategies and should have access to the firm’s managing partner to be sure the tax department’s marketing plan fits the overall image and direction of the firm.

### 103.1.2 Hiring a Marketing Professional

Contrary to what some might believe, it is a mistake to assume that the size of a firm will determine a firm’s readiness for hiring—and making good use of—a marketing professional. Instead, key variables include management’s preparedness to confront the tough issues that a marketing planning process will inevitably bring to the fore, as well as a clear sense of what it wants to achieve in the way of marketing and business development.

To be sure your firm is ready, ask the following questions:

1. Do our partners believe marketing is a necessary business function, requiring the same level of attention and resources as client service, billings, and employee recruitment?
2. Do we recognize that a skillful marketing professional will try to touch every aspect of the firm, seeking changes that will make it more client- and service-centered?
3. Is our managing partner (or partner in charge of marketing) prepared to guide the marketing professional’s efforts?
4. Do we have a clear sense of what we want to accomplish? In other words, have we completed a marketing plan?
5. Are we prepared to invest the time, money, and firm resources necessary not only to hire a marketing professional, but to fund his or her programs?
6. Do we all recognize that our marketing professional will not contribute to bottom-line profits overnight?

To sum it up, a marketing professional is not a miracle maker, and cannot accomplish significant results without the support and active participation of the firm’s partners and senior staff. Making marketing work takes time, money, and sweat equity—everybody’s sweat.

### 103.1.3 Firm Involvement

The involvement of the entire firm is necessary for any marketing plan to be successful. It should be the responsibility of the managing partner or a firm’s marketing team to identify the different levels of involvement for *each* individual in the firm. See Exhibit 103-10 for a sample memo to staff to implement a marketing program.

Partners must be the role models for staff. Encouraging staff to engage in marketing activities is important, but will be ineffective if partners don’t practice what they preach.

Try to establish realistic expectations and goals for everyone. Budget time for each individual and conduct training sessions regarding the firm’s philosophy on marketing. Finally, monitor individual and firm results.

**Practice Tip.** Use an internal marketing newsletter to keep everyone informed on marketing efforts.

### 103.1.4 Perform a Situation Analysis

Before you can determine where you’re *going*, you’ll have to be sure of where you *are* in terms of the firm’s strengths and weaknesses, its competition, and the opportunities in the client base

and market. The marketing team should prepare an analysis of the firm's tax practice situation. What are the firm's capabilities, personnel strengths, and image and reputation? What about its growth rate? Who are the firm's competitors? How have they grown? What are *their* strengths and weaknesses? What makes the firm stand out from other firms?

Sources for this information are analyses of the firm's current and former clients and analyses of past referrals and client acquisition activities. The marketing team should attempt to get external feedback from the business community, for example, by surveying banks, attorneys, insurance agents, securities brokers, and clients for their perceptions of the firm.

The patterns detected in the situation analysis point to opportunities for exploitation or corrective action from which the goals of the marketing plan can be derived (see Exhibit 103-9).

### 103.1.5 Target Reasonable Goals

When you begin the process of goal setting, remember that it is better to embark on a few projects and succeed than to spread your energies out over a multitude of ventures and fail. In other words, be sure to establish attainable goals that advance the firm's plan and build staff confidence.

Any new system has a learning curve. A marketing effort should be permitted to build slowly to allow staff to gain confidence from its successes. Over time, as the system improves, it will become capable of tackling more and bigger projects. Try to anticipate obstacles in the way of goal achievement, such as insufficient time, gaps in professional capability, staff reluctance, or inexperience in marketing. Freeing up time for practice development, hiring a needed staff person, providing guidance, or training staff in selling professional services are all, in and of themselves, viable goals in a marketing program.

Remember that goals should justify the time, effort, and expense to achieve them. If your firm's goal for the next tax season is to bring in ten new corporate clients, determine what it is worth to the firm to bring in those corporate clients, and try to keep expenses within those bounds. Following are key points to remember when developing a marketing budget:

- A portion of your expenses will have a long-term benefit, especially when initiating the marketing program. Do not cut a project short simply because it cannot pay for itself in the first year.
- The incremental marketing expense necessary to obtain each additional new client is greater than the expense necessary to obtain each prior client. As the expense of gaining each new client rises, it may eventually surpass the value of that client to the firm. However, the value of each new client is not equal. Exercise caution in limiting marketing expense regardless of the importance of the client and the size of the business.
- Like an annuity, a client represents a flow of revenue over time. Do not judge the value of a new client simply by the increased revenue generated in the first year.
- Once a new client is obtained, a marketing effort must be maintained to keep the client. In fact, client retention and service expansion are themselves critical marketing goals.

### 103.1.6 Assign Tasks and Due Dates

As the marketing plan develops, assign the responsibility for completing each phase of a project to the appropriate member of the marketing team. The assignments and responsibility for them should be specific. Do not assign a task to a department or a group of individuals; instead, establish personal responsibility for each job.

**Practice Tip.** Establishment of due dates is crucial to the success of your marketing plan. Set feasible dates for projects, and hold people accountable for meeting them. Plans without deadlines or accountability are doomed to failure.

### 103.1.7 Budget Firm Resources

Budget professional time for marketing just as you would chargeable time spent preparing tax returns. First, this allows you to properly allocate professional time. Second, when you treat

marketing time as being as important as rendering professional service, your staff will consider the hours spent on marketing effort important.

Professional time is your inventory and a valuable asset. By calculating professional time into the marketing budget, you can evaluate alternatives, such as whether it would be better to purchase a packaged client seminar or to develop it in-house.

Establish the level of investment the firm is willing to make to market its tax practice. Budget funds for staff training, acquisition of expertise, and actual implementation of specific projects such as a client seminar or a direct-mail announcement. Promotion and marketing expense should be considered a fixed cost, like rent. In hard times, do *not* cut back, but invest more wisely. A well-balanced marketing plan might devote half the budget for existing clients and the other half toward creating new business.

Budgeting a marketing investment that is directed at creating a recurring income stream should be evaluated over several years, not just the year of expenditure. It is a mistake to conclude that marketing efforts have failed simply because more was expended than was realized in increased revenue. The revenue stream from new business may take several periods to become fully evident.

### 103.1.8 Put the Plan in Writing

The person responsible for the marketing plan needs to formulate written plans. This is a key step, even for sole practitioners. The written plan should blueprint the steps necessary to implement projects. It should briefly set forth—

1. The specific actions the firm will take and the tasks to be performed.
2. The person responsible for each task.
3. The dates by which the tasks will be performed.
4. Anticipated costs and benefits of each task.

Putting the plan in writing avoids confusion about what is to be done and who will do it. The plan and those involved must be periodically reviewed.

### 103.1.9 Monitor and Review Progress

Once an overall marketing program is in place, its progress should be monitored against the written marketing plan that details responsibilities and due dates. The person with overall responsibility should track the progress of various projects.

Hold team conferences periodically to discuss the plan's progress. What went wrong? What went right? Can parts of the project be improved or corrected, or should it be dropped? Be willing to adapt specific marketing projects to changing situations and new information. Be willing to reward successes. Firm members who develop successful marketing projects and ideas should be recognized.

Partners should use a self-assessment form to rate their own involvement in marketing activities. Besides assessing the value of time they devote to learning about existing clients, partners should also rate their efforts to expand the client base.

Few firms have performance reviews for marketing efforts as structured as for general accounting performance. Feedback should come from supervisors throughout the year and at least annually on a formal basis.

**Practice Tip:** Each employee's job description should include specific responsibilities for marketing activities. For example, upon passing the CPA exam, a staff accountant might be required to join a community organization of his or her choice. Senior staff might be expected to author articles for the firm newsletter.

Higher staff levels would be expected to accept speaking engagements and managers to engage in networking activities.

## 103.2 Sustaining a Marketing Program

Marketing creates the "face" a firm shows the public, and marketing considerations enter almost every management decision. The firm markets itself when it chooses its office location, decor,

and even its employees. Marketing decisions determine what type of services will be emphasized, and once a marketing niche is selected, this decision flows down to the firm's recruitment efforts and programs for continuing education.

Marketing plans succeed when practitioners have a marketing orientation. To sustain the marketing effort in your firm over time you can—

- Develop staff training programs.
- Prepare guidelines and procedures in support of the marketing effort.
- Relate marketing concepts and the firm's development plans to all professional activities.
- Reward employee efforts and successes.

### 103.2.1 **Develop Staff Training Programs**

New accountants are trained in accounting and tax law, but they often lack the interpersonal skills necessary for communicating effectively with clients, professionals, and other associates. Establish training programs for your practitioners to develop their ability to conduct client interviews, create a network of business contacts, write effectively, make speeches, identify additional client services, and attract new clients. Send new staff to seminars where selling skills can be developed and trained. Similarly, consider training in effective telephone skills as an area of staff development.

Making speeches is one of the best ways to leverage a practitioner's marketing time, as a message is conveyed to an entire group of individuals already interested in what that person has to say. Develop speaking skills in junior staff by encouraging them to speak to community groups at any opportunity. Train staff in becoming comfortable with group presentations by having them come along and participate in a limited manner when more experienced staff get in front of an audience.

In the service industry, most clients judge a firm by the person sitting across the desk from them. If that person is trained to meet the client's needs and to generate client confidence, the client is more likely to seek additional services from the firm as well as recommend the firm to others.

### 103.2.2 **Develop Guidelines and Procedures**

Review your firm's policies and procedures from a marketing perspective. Do they enhance the marketing effort? Do they promote client satisfaction? For example, does your firm have guidelines for conducting a tax return interview? Guidelines should spell out that client interviews should not be overbooked so that the waiting room becomes crowded and hectic; that clients should be offered a beverage while they wait; and that interviews should be held on time, emphasizing the value of both the practitioner's and the client's time. Policies and procedural guidelines to enhance the marketing effort range from employee dress recommendations to the tax preparation and review process. In other words, think of the tax interview and every other service you provide from a marketing perspective and develop guidelines for your staff to follow throughout.

### 103.2.3 **Keep Marketing Awareness High**

Staff members should make a conscious effort to stop being shopkeepers and start being rainmakers. Bring marketing concepts into non-marketing conversations. Talk about marketing frequently. You need not hold special meetings to discuss practice development. Raise marketing issues with your employees when conducting job evaluations. Review marketing objectives during department meetings. Write about the marketing plan and projects in the office newsletter. Your objective is to remind staff members that the firm is selling a service product, and the better the product sells, the better off every member in the firm will be.

Marketing opportunities identified during the tax preparation process should be exploited. See Section 101.8, "Post-Busy-Season Work" for a further discussion of this topic.



## 103.2.4 Reward Employee Efforts and Successes

Your efforts to market the firm must include ways for the staff to share in practice growth rewards. The staff should not consider the marketing effort simply as more work for them, more money for the partners. Money is not the only means for rewarding staff marketing efforts.

Recognition for staff marketing efforts starts with praise. A personal word in a memo, or even a lunch, can let staff members know that you see and appreciate their efforts. If an employee develops a terrific new marketing idea or generates an exceptional response from a seminar, recognize the achievement at a department conference or in the office newsletter. Finally, compensate staff marketing efforts with additional pay. If you do not tie performance to salary, the marketing efforts of your staff will dwindle. With experienced and upwardly mobile personnel, it's critical to give additional pay or bonuses for successfully attracting new clients. Without such an incentive, manager-type employees may forego a marketing effort or may leave your firm to go out on their own. Consider paying an employee who refers a tax client a bonus based on a portion of the first year fees, or special merit salary increases that reward practice development.

**Practice Tip.** Create a firm scrapbook containing newspaper articles, photographs and advertisements covering the firm's exposure. Include copies of articles in trade magazines authored by the firm. Keep the scrapbook in the reception area for clients to peruse while waiting.

## 103.3 Image Setting

To establish the proper image, you must first decide the market you wish to pursue. For example, some firms cater primarily to corporate clients and do individual tax work only for the owners and top executives of these corporations. Other firms concentrate heavily on individual tax work. Some of these firms pursue a low-cost, high-volume approach, while others concentrate on a higher cost, lower volume approach.

The marketing approach you establish should be consistent with the image you want and the clients you hope to attract. For example, if you want to attract large volumes of individual tax returns, you may find that a marketing program emphasizing accessibility and availability, which includes newspaper and radio advertising to a wide local audience, is appropriate. Alternatively, if you want to attract primarily corporate clients, you may find that client seminars and newsletters, which emphasize selectivity and highly personalized service, are more appropriate.

A number of other issues represent important visual images for your firm. Examples include the following:

- Firm logo
- Office decor, including reception area and publications displays
- Type of stationery, including color, weight, and design
- Business cards
- Newsletter design, including its tone and content

Graphic designers and marketing specialists can help you create the image you want to project. A graphic designer can help create a firm logo, design business cards and the firm newsletter, and even help you select stationery and other materials. Professionals from an interior decorating firm can assist with the establishment of the desired office decor.

**Practice Tip.** New clients are more comfortable if they can recognize a practitioner at their first meeting. Consider placing a sign board in the reception area with photos of each staff member. Even existing clients who often speak with other staff over the phone will appreciate associating a face with the voice.

Working towards a desired image may include establishing a dress code in the office. Some firms require suits and ties for all male employees, and dresses or business suits for all female employees. Conversely, firms wishing to attract large numbers of lower-cost tax return

filers may find that the white-shirt-and-tie image intimidates potential clients, and thus they encourage informal attire for employees.

**Practice Tip.** By creating an appropriate image for your firm and establishing a client service approach consistent with that image, you will attract the types of clients you want. You should be prepared for the decisions required to properly arrive at the desired image, the amount of time you and your firm must commit, professional fees that may be incurred in obtaining assistance, and direct costs for furnishings and materials required to create the image. Remember, too, that image is conveyed by memberships in community, social, civic, and professional organizations.

### 103.3.1 Receptionist's Responsibilities in Setting Image

Do not underestimate the importance of the role the receptionist and other administrative people play in establishing the image of the firm. Phone calls should be answered by the second or third ring; delays in answering a phone call may promote an image of a frenzied or inattentive office, or of slow responsiveness to client needs.

Similarly, the receptionist and others should be trained in telephone skills so that they can handle inquiries in a pleasant, but efficient tone. If the firm is truly committed to client service, the receptionist should be trained to be sure client inquiries and requests are adequately addressed at inception. Placing clients on hold for an extended period of time may prove annoying to clients. Rude responses to client inquiries may provoke the client to seek help elsewhere. In general, the role the receptionist plays in establishing an image for the firm should not be underestimated. Involve these people in the marketing plan, as they often interface with clients or prospective clients.

**Practice Tip.** Receptionists should be informed that clients walking into the office should obtain their immediate attention. Surveys show there is nothing more annoying than a receptionist who ignores a client standing at the reception desk and continues to complete filing or other clerical tasks or continues to carry on a conversation with other firm members.

## 103.4 Advertising and Other Promotion

One of the first things you need to consider is the kinds of promotional techniques that are appropriate. Some firms prefer to operate primarily from a strong referral base, since, in most cases, some of the best promotion comes from providing quality service to clients. Satisfied clients, along with their attorneys, bankers, and other professional associates, refer others to the firm based on the high quality of services they receive. Other firms find that active methods involving advertising and direct promotional techniques are useful for generating the type of work they desire, particularly if they seek to deliver their messages to a large number of prospective clients.

### 103.4.1 What Advertising Can Accomplish

There are a few "general" purposes for undertaking an advertising campaign, regardless of how limited:

- It can provide some contact with potential clients when personal selling efforts cannot be undertaken or must be limited.
- It assists personal-contact efforts.
- It keeps your firm's name before the public, including referral sources.
- It helps establish your image.
- It buttresses and reinforces new clients' decisions to use your firm.

In addition, advertising specifically can inform potential clients of hours of service, locations, identity and qualifications of new staff, extent of tax services offered, and length of time you have been in business.

If advertising is deemed appropriate, you must determine the type of advertising media that will reach the maximum number of potential clients at an acceptable cost. You should analyze the price of the media alternatives—newspapers, radio, and direct mail (newsletters and firm announcements)—on a cost-per-100, or 1,000 readers or listeners, basis. Exhibit 103-13 compares the strengths and weaknesses of various advertising media. One of the best opportunities for efficient advertising on radio or cable TV or in a newspaper would be a talk-show or interview appearance or a regular by-lined column.

Although newspapers are a relatively untargeted medium, newspaper advertisements can be used for messages aimed at specific markets. (For example, if you want to reach senior citizens, you could run an advertisement dealing with social security—“See Us if You are Paying Tax on Your Social Security Benefits.”) Firms that want to specialize in service to specific industries find that advertisements in industry trade magazines are most efficient. (For example, a firm dealing with a number of financial institutions might advertise in publications aimed at the financial institution industry.)

Developing a print advertisement that will get results is not easy. Because most readers tend to flip through a publication only once, the ad must be strong enough to capture attention. To achieve the best response rate, follow a simple formula for print advertisement.

1. Define one action or one idea you want a reader to remember.
2. Because many readers will only read the headline, try to get your message across there before writing the text of the article.
3. Use graphics to make the ad eye-catching. Consider using humor or pictures that startle the reader. A headline that asks a question may provoke one to read the text to elicit the answer.
4. Use as few words as necessary to state your case. Words must be carefully chosen so they do not make unsubstantiated claims or promises that violate ethics rules.
5. Say how you can help a client solve a problem, not just the services you offer.
6. Invite readers to contact the firm by including names of practitioners and phone numbers.

Regardless of the media used, *repetition* or frequency is the key for all advertising. In an advertising approach, you should follow these steps:

1. Establish acquisition goals in terms of the dollar amount of net billings or the number of new clients to be achieved. This will allow you to measure the effectiveness of your advertising or promotional approach at a later time.
2. Determine the type of clients you want to work with and determine which advertising approach best reaches these potential clients.
3. Decide on your overall budget for advertising and spend only what has been allocated.
4. Monitor the results. Chapter 101 includes an exhibit illustrating a sample new-client registration form, by which you can determine how each new client learned about your firm. By properly monitoring results, you can minimize ineffective media expenditures. Bear in mind that marketing results are sometimes difficult to measure, since there may be several factors that together influence a client's selection of a firm.

Some firms advertise by direct mail, that is, through informational flyers and brochures describing tax services. These can be supplied to attorneys, bankers, insurance agents, brokers and other financial product businesspeople, and other professionals in the area, who in turn provide the brochures and flyers to people they deal with. The brochures will have a greater impact if you give them out at your own seminars rather than sending them through the mail.

Some firms take advantage of the business section of the local newspaper to announce special achievements and awards obtained by individuals within the firm. This public relations effort enhances the market awareness of both the staff members' and the firm's expertise and specialty areas. Examples of such achievements include election or appointment to offices of community or professional organizations, obtaining professional designation, such as an enrolled agent, CPA, personal financial planner, ChFC designation, or publication of a professional article or book.

**Practice Tip.** Rule 502 of the AICPA Professional Standards prohibits advertising or other forms of solicitation in a manner that is “false, misleading, or deceptive.”

### 103.4.2 Getting Published

There are substantial promotional benefits to preparing articles, regular tax season columns for the local press, or conducting a radio show. This exposure not only accomplishes many of the same goals as advertising, it also helps create a favorable impression of your firm and its expertise and bolsters your firm’s community involvement and presence. Articles in local newspapers can result in client inquiries or in still more opportunities for public relations and sales efforts, such as invitations to speak or to present community seminars. Your published articles can always be clipped and reproduced to accompany your firm’s brochure or newsletters to clients and referral sources.

### 103.5 Developing a Niche

Many firms achieve significant growth by developing a specialty in a certain area or by finding and servicing a particular population segment. Some firms develop an industry niche, such as manufacturing, agriculture, governmental accounting and nonprofit organizations, financial institutions, health care, and so forth.

Other firms develop a niche in particular service areas, such as business valuation, corporate liquidations and reorganizations, litigation support, pension and profit sharing, and so forth.

Niche development makes a great deal of sense. Many firms find themselves unable or unwilling to fully train and develop staff in all areas of tax planning and compliance. They must look to other sources for expertise they cannot provide in-house, and concentrate on their own areas of expertise. Firms should capitalize on this specialization by broadcasting their niche abilities to other firms in the area in an effort to obtain referrals.

Niche marketing of services is not a metropolitan, large-firm strategy. The opportunity is often greater for smaller firms, or firms operating in rural areas. Firms attempting to develop a niche in large metropolitan areas often find their specialty difficult to highlight among the many firms operating there. Conversely, a firm operating in a suburban or rural setting and providing a specialty can achieve a greater identity and higher recognition level, which result in referrals from other professionals. The networking approach will develop further, with firms referring clients to other firms (potentially even within the same locale), because of growing specialization.

The advantages of niche development and specialization include the opportunity for faster growth, the potential for higher fees, and the ability to select and work with clients you want. Disadvantages include the investment and training required to develop a specialty, the challenge of promoting and highlighting the specialty to others in order to achieve referrals, and the risk associated with limiting your market to a specific area or kind of engagement.

**Practice Tip.** Niche development is enhanced by involvement in the following:

- Professional committee work
- Public speaking
- Professional writing
- Civic, community, and specialty groups
- Continuing professional education course development and instruction

These forums provide excellent opportunities to make others aware of your firm’s specialty and to enhance its image.

### 103.6 Communication With Other Professionals

Referrals from other professionals provide one of the strongest and best sources of new clients for many firms. Examples of these professions include attorneys, bankers, real estate agents,

insurance agents, brokers, and other similar groups. Of course, referrals from other accountants can also be a significant factor. Because of these referral possibilities, many firms attempt to stay in close contact with other professionals, and to indirectly market through them.

Marketing through other professionals is particularly important if your firm operates in niche areas. Because the development of a specialty and emphasis on a particular niche by design provides for a limited marketplace, it is essential that other professionals be made aware of your specialty so they can refer potential clients to you. This might even include other tax practice firms. Besides making these other professionals aware of your specialty, you should attempt to place your firm's name before them as often as possible. The whole objective is to make this potential referral base think *first* about your firm, and to recognize situations in which referrals should be made.

Networking with other firms can be mutually beneficial, especially in light of the new quality review standards imposed on many firms. For example, a tax firm might refer potential certified audits to other firms which, in exchange, may generate opportunities for future tax consultations in their areas of expertise. A firm is not as likely to overstep its bounds in pursuing the other firm's retained services if it is clearly understood that future networking opportunities depend on each firm's respect for the other's relationship with the mutual client.

**Practice Tip.** Several firms in one geographic area can form monthly roundtables at which common problems and issues are openly discussed. Topics for roundtables may include audit issues actively pursued by a local IRS office, liability insurance, time and billing systems, new software tools, or any number of current issues. Roundtables can be very informal or highly structured, with agendas and continuing education credits.

### 103.6.1 Special Mailings on Developments

One of the best communication approaches with other professionals is through special mailings. Send letters containing news items as developments arise affecting their professions or customers.

There are numerous opportunities for communication. Review publications such as the *Wall Street Journal* to learn of early information on developments in your area of expertise. Even developments within a local city or municipality may impact other professionals and warrant contacting them.

For example, suppose Congress proposes a tax law change regarding group medical insurance. By immediately summarizing the news and forwarding information to all insurance professionals in your area, your firm is effectively saying, "We are watching out for developments affecting your profession and our common clients—please keep us in mind when some of these clients need help." Or, photocopy a news article or similar information, add a personal note, and drop it in the mail to those it will impact.

#### Retain Names and Addresses on a Computer Database

With computers and mailing lists in place, a few simple steps provide numerous marketing opportunities. Retain a list of referral sources on a database. The list should be segregated by profession. For example, it might include all attorneys within a 50- to 75-mile radius, as well as bankers, insurance agents, real estate agents, brokers, and so forth. It must be continually expanded, updated, and culled. It is normally advantageous to include all the individuals within each office. However, you might elect to send only one mailing to a location, even though the office may include many attorneys or bankers, for example, in order to reduce postage and mailing costs.

If a mailing is sent only to a location address, you run the risk that your information will not be properly routed within the office. Remember, your objective is to put your firm's name and area of expertise in front of as many professionals as possible and to have them think of your firm *first*. This is best achieved by "going the extra step" and sending the information to all individuals within a given location.

**Practice Tip.** Use the yellow pages of area telephone directories to create the mailing list and keep it up to date.

### Complete a Brief Summary of Developments

Do this on firm letterhead as developments occur affecting a particular profession or the clients of a profession. Communicate that your firm wants to make the recipient aware of a development affecting his or her profession, and that, if necessary, your firm is available to provide services required to assist the professional.

### Send Personal Letters

Do this as soon as possible after a development occurs using the names and addresses on the computer database.

With a current database, and through personalized correspondence, your firm can achieve a strong marketing approach with other professionals. The whole task is primarily clerical, with little technical effort required (other than completing the summary of the development). For the cost of a few envelopes and postage stamps, you can significantly enhance awareness of your firm and the services it offers.

Exhibit 103-1 illustrates correspondence that was sent to attorneys on a change in tax laws. Remember that the objective is not so much to generate a direct response to the correspondence as it is to create *awareness* of your firm and its expertise.

## 103.6.2 Seminars for Professionals

Many firms hold seminars on specific topics for other professionals. This is a well known and highly efficient means of directly encountering qualified purchasers of professional services, as well as professionals who can directly refer their own clients. Seminars can either be directed to a group of professionals at one time, or they can be tailored for specific professions, such as law, banking, real estate, insurance, securities brokerage, and so forth.

The advantage of offering a single seminar for a professional group as a whole is the simplified manner of constructing materials. Designing seminars toward specific professions allows the materials and general approach to be aimed directly at the group. This provides attendees with material and information they will find most beneficial. The professionals themselves will appreciate the advantage to mingle and discuss common issues.

Exhibit 103-2 illustrates an invitation sent to bankers for a seminar on the Small Business Job Protection Act.

The number of attendees should be controlled to allow adequate time for all questions to be answered and comments to be addressed. While the maximum number of participants varies depending on physical facilities and the amount of materials to be covered, it is generally advised that a group of twenty to thirty attendees is optimum, with a maximum normally not much greater. Remember that while training and technical updates are important, one of your primary objectives is to strengthen the professional bond between the attendees and your firm. This includes making them more aware of your firm and the services you can perform to help them and their clients. Seminars are an opportunity to provide education for attendees who get something besides a sales pitch. Done correctly, these seminars should present the firm as a strong, competent, service-oriented group of professionals.

When designing seminars, be sure to consider the value of the attendees' time. Take care not to hold seminars too often, and be sure the material presented is worthwhile. A seminar that runs too long may result in attendance dropping off in the future because of the time commitment required. Section 103.7.3 discusses seminars for clients, and many of the rules and recommendations discussed there also hold for seminars for professionals. It is generally recommended that the maximum length not exceed two hours.

Many firms hold seminars for professionals annually. Others hold them only as special developments occur, such as significant changes in the tax laws (which over the last few years have resulted in *annual* seminars).

Should you charge a fee for seminar attendance? The advantage of charging a small fee is that the cost of materials and other incidentals is at least partially offset. More important, charging a fee obtains a *commitment* from the attendees. By paying even a small fee, professionals tend to feel more of an obligation to attend. If no cost is involved, the opportunity to skip is far too easy. In addition, a small fee, preferably payable in advance, allows a better estimate to be made of the number of attendees. Note the notice of a small fee of \$15 in Exhibit 103-2.

The disadvantage of charging a fee is that an opportunity to build goodwill is missed, as some attendees may feel you are “nickel and dime-ing” them. You should analyze what your goals and objectives are in having a seminar; creating goodwill should be among them.

Because professional attendees normally have continuing professional education requirements, the best approach is to structure seminars and materials that give attendees continuing education credit. To qualify for credit, formal outline materials must normally be constructed, and an application to qualify the session for credit may have to be submitted to the state board responsible for licensing the professional group.

Firms with particular expertise can generate revenue by producing or instructing continuing education courses for other accountants. The market may be as small as a single workshop for another small firm or as large as group study courses sponsored by the AICPA or state CPA societies. Beyond the instructor’s fees, the courses may generate additional services from subsequent consultations with attendees on complex issues.

**Practice Tip.** In developing course materials, treat the course as a client, recording all professional time in work-in-process. Compare the fees generated by the course against the work-in-process to determine the effectiveness of this approach.

A number of other alternatives can be considered for seminars for professionals. Refer to Exhibit 103-7 for a checklist on organizing client seminars.

### 103.6.3 Electronic Means of Communication

With today’s technological advances, communication via electronic means provides new opportunities. Some practitioners use broadcast fax messages, have created Internet home pages, and use other electronic mail capabilities to communicate with professionals and others.

Obviously, different objectives can be addressed with alternative communication capabilities. Broadcast fax and e-mail capabilities provide an effective way to stay in constant communication with other professionals, and to update them on important matters. Alternatively, an Internet home page not only provides a mechanism to communicate with others, but also creates new and exciting marketing opportunities as others can learn more about your firm, its capabilities, and special areas of expertise.

Firms who have created an Internet home page have found a new creative way to market their services and communicate with clients and others. However, firms creating a home page must be sure that the information is kept current. Someone within the organization must be assigned responsibility to manage the contents of the home page, and to make changes and updates as appropriate. Similarly, the individual in charge of the home page content should assume responsibility for updating appropriate “links” and for constantly monitoring the contents of the links. Additionally, someone within the organization must assume responsibility for the technical aspects of the electronic capabilities, including hardware, software, and communication requirements.

Firms with Internet home pages should also look for opportunities in which links to their home page can be added. As an example, a firm specializing in not-for-profit accounting may wish to request that links to its home page be added to the home pages of various not-for-profit associations, state society home pages, and so forth.

### 103.7 Communication With Clients

While communication with other professionals is important to help your business grow, communication with clients is essential to maintain it. You can use an approach similar to the mailings on special developments for professionals (see Section 103.6.1) with specific clients. For example, a major development affecting the retail industry should result in a special mailing to clients associated with that field. Further, assume a particularly important IRS news release or revenue ruling is issued dealing with inventory valuation. By making a copy of the notice and putting a cover letter on it, you not only inform your retail clients of an important development that might affect them, but you also convey the image to your clients that “we care.”

**Practice Tip.** Be mindful not to give away the store. Special mailings to clients should give enough information to generate interest but not so much as to allow them to believe they can solve the problem on their own. A do-it-yourself approach can be disastrous. Don't give out too much gratis advice if it could result in losing a chargeable client engagement.

You can communicate with clients in many ways. A special mailing on a timely topic is only one strategy. For example, you can take advantage of transmittal letters accompanying tax projections and tax returns to point out additional concerns to clients and recommend possible additional services. In fact, every piece of correspondence and every meeting with a client should be considered a marketing opportunity. Don't hesitate to raise additional issues and recommend ways in which your firm could be of additional benefit to the client.

### 103.7.1 Databases

The long-term viability of accounting firms will increasingly depend on the willingness of CPAs to invest in databases that can provide powerful marketing intelligence. With a well-crafted marketing database, a firm can anticipate client and prospective needs which will allow the firm to maximize client service, sales efficiency, and ultimately, firm profits.

For most firms, the first and most important client database is the computer system used to manage time and billings. While not designed to support marketing, it almost always contains the basic client information needed to begin a marketing database.

Once downloaded (or copied) into a separate file, this data forms the beginning of your marketing database. Please note the implicit recommendation that you maintain a separate database for marketing purposes. While a second database means that some basic information will be redundant, marketing databases can quickly expand until they become memory hogs in your computer. They also require significant amounts of management and processing time and this work is usually best handled by someone who is directly involved in the marketing process.

With just the basic fields such as name, address, etc., a number of useful reports can be generated. For example, labels and custom-addressed letters and envelopes can be prepared for mailings. By adding a few new fields—business year-end, and size (by revenues) of client—the process of building a more powerful marketing database has begun.

### 103.7.2 Tax Bulletins and Newsletters

The objective of tax bulletins and newsletters is to put your firm name in front of clients as often as possible while at the same time providing them with tax updates and information on recent developments. Some developments *must* be communicated to clients to prevent potential liability. For example, certain tax law changes may occur during the year that require immediate notification of those clients impacted by the change, especially if timely elections are required.

It is often difficult to recognize situations in which the client *must* be notified, as opposed to issues in which it is desirable, but not mandatory. Exercise professional judgment in determining when communication must occur. For example, a change dealing with methods of contractor accounting would be of critical importance to firms dealing heavily in the construction industry, while the change would probably be of almost no importance to many other firms. One general rule to use is that changes that are made retroactively, or developments that have a significant impact on the current business practices of a wide group of clients, should be communicated at the earliest possible time.

Different schedules are used by firms in the publication frequency of newsletters and tax bulletins. Some firms prefer a monthly approach. This tends to place a huge technical and administrative burden on them and can be extremely costly in terms of printing, mailing, postage, and materials. Other firms use a quarterly approach, and still others, a semiannual approach. Newsletters and tax bulletins on a frequent, regular basis keep the name of the firm and the ideas you promote in front of your clients.

Alternatively, some firms forward bulletins and newsletters on an irregular, as-needed basis. The advantages of this approach are that it is less demanding and far less costly. The



disadvantage of irregular mailings is that it is too easy to forget to prepare them or to forego their completion when no regular mailing schedule exists. Since accountants generally work best with deadlines, establish dates on which newsletters are to go out (for example, quarterly) to impose upon yourself and your staff a discipline to complete and mail the newsletter.

**Practice Tip.** One of the most common reasons given for not preparing newsletters is the perceived inability of firm members to write. To remedy this situation, newsletters can be purchased and the firm name imprinted at the top of the first page. Often, the publishers of such newsletters restrict the geographic area in which competitive firms can buy the same newsletter for mailing. Purchased newsletters can be obtained from the American Institute of CPAs, from many large publishing companies, and from firms specializing in providing marketing materials to practitioners. For more information, review professional publications for newsletter offerings.

### Internal Newsletter Preparation

An effective approach to creating a newsletter in-house is to assign different articles and topics to staff within the firm. The workload is even, and many staff members become involved in completing the newsletter. Staff who write the articles often learn more than the clients reading them. Credit for authorship of each article should be noted in the newsletter. Staff are rewarded thereby with recognition of a “specialty,” and clients know whom to ask for when calling with specific questions.

One person within the firm should be assigned overall responsibility to coordinate the effort and act as editor, normally a partner or supervisory level person. Absolute accuracy in the newsletter must be assured, so a responsible and technically experienced person must be put in charge.

Staff should be directed to make articles short, since the purpose of the newsletter is to inform clients of tax updates and other information, but not to answer all questions related to the topic. In fact, the newsletter, when properly prepared as a marketing tool, should arouse curiosity and result in client calls for more information and assistance on issues.

Be careful not to “give away the store” through the newsletter. If there is a specific action clients should take that could result in consulting engagements with a large number of clients, think twice before simply giving away the advice free of charge through the newsletter. Provide just enough information to provoke clients to want to discuss it further.

**Practice Tip.** When preparing a newsletter internally, accumulate topics on an ongoing basis in a special folder. As the time approaches for the newsletter to be written, select topics from the folder.

Include issues of tax update and technical information. Do not assume that because a topic has been included in the past it cannot be discussed again. People don’t always respond the first time they read something. You might also include articles on firm matters, including staff changes, individuals passing the CPA or IRS enrolled-agent exam, promotions, and other individual and firm accomplishments. Items of a purely personal nature, such as birthday and family matters, should normally be avoided. Other possible topics include continuing education sessions completed and attendance at meetings and conferences, including quotes from speakers highlighting important issues.

Other pertinent issues for a newsletter are a tax calendar, which summarizes important near-term dates such as when payroll deposits and tax estimates are due, other tax-related deadlines for filing, and so on. Articles offering staff members as speakers at client meetings or service groups might be considered.

Some newsletters occasionally spotlight specific client accomplishments. Pick these items carefully to ensure you are not showing favoritism. Be aware of the negative impact this may have on other clients who may feel slighted, and attempt to give all clients an opportunity for some exposure. Be sure to inform those clients selected in advance, as some may decline the honor if they feel privacy is being invaded.

**Practice Tip.** Include a disclaimer in the newsletter to warn recipients against attempting to rely on the newsletter as specific advice. An example of such a disclaimer is: “This newsletter contains general information only. You should consult your tax advisor for answers to specific questions.”

Once the newsletter has been produced, decide how it should be distributed. Many firms send newsletters to the entire client list. Others prefer to limit distribution to business and other specially identified clients. The issue must be decided from a cost-benefit perspective.

The newsletter distribution list should include local businesses that are not clients, particularly bankers, attorneys, real estate brokers, and insurance agents (see Section 103.6.1 for identification of the professional distribution list). The mailing list should also ideally include prospects and referral organizations, and other acquaintances from professional groups, service organizations, and civic and community groups.

Newsletters, like mailings to professionals, should be mailed to individuals, not organizations, and, if possible, they should be sent to the recipient’s home address. Such mail is less likely to get lost in the mass of paper that arrives at the workplace.

Some firms prefer to enclose the newsletter in an envelope and to use all of the space available on the newsletter pages for topical information. Other firms use a self-mailer design, where a portion of the last page is used for the address. With either approach, you should use bulk mail, which significantly reduces the postage costs.

Exhibit 103-3 contains a sample newsletter.

**Practice Tip.** Many newsletters are immediately “deep-sixed” or even culled out by executive secretaries before getting to the intended reader. Consider adding a personal cover letter suggesting that a particular item in the newsletter may be of special significance. This will elevate your newsletter above that of other unsolicited junk mail received every day.

### Electronic Communication

Technological advances now allow new electronic means of communication. These means of communication may be as appropriate for client communication as they are for communication with professionals and others, as discussed in Section 103.6.3. Broadcast fax and electronic mail messaging may be appropriate for clients in certain industries, or for certain functions, such as reminders to pay quarterly tax estimates.

Similarly, Internet capabilities, including a firm home page, may provide an effective means of allowing interaction with clients. It also provides an effective mechanism of informing clients of important developments, similar to what could be communicated in written form via tax bulletins or newsletters.

### 103.7.3 Seminars for Clients

As with seminars for professionals (see Section 103.6.2), client seminars are extremely important. They provide needed information, and put the firm’s name and its staff in front of attendees. They offer opportunities to appeal directly to qualified purchasers of professional services and to train them in bookkeeping and other matters, thereby helping to create a more efficient preparation process at tax time. In fact, besides communicating tax and other developments, client seminars provide an opportunity for a firm to inform clients about procedural matters, such as how to summarize information required for tax return preparation.

The cost of client seminars is often a concern. Either the firm can absorb the full cost or it can charge a small fee to cover part of the cost. This may discourage some clients from attending but, on the other hand, it may limit the audience to a controllable size. A small fee often helps clients make a commitment to attend, thereby allowing a better estimate of the number of attendees. The fee should be small enough that clients are not discouraged from attending.

The length and content of client seminars are critical. Normally, the maximum length should not exceed two hours, to keep client interest throughout. While technical developments in the tax and related areas should be addressed, be careful the client seminar does not turn

into a technical training session. Remember that client understanding of a tax-related matter is at a different level from that required of a trained practitioner. The objective is not to make the client a technical expert in a topic; rather, it is to make the client understand an issue well enough to identify matters that require additional technical assistance from your firm.

**Practice Tip.** Whether the people presenting the seminar are partners or staff members, staff should be present. This increases their visibility to clients. Introduce the staff and, if possible, use them for part of the presentation.

Some firms prefer to bring in outside speakers. To the extent that such speakers bring expertise that does not exist within the firm and provide information pertinent to the clients, the approach is appropriate. Disadvantages include the cost of bringing in the outside speaker, and the possible client confusion created by introducing a “strange face.” Occasionally, firms will contract with someone who is well known (e.g., an athlete or a politician) to increase attendance at the seminar. While this may be appropriate in some cases, the risk is that the seminar will turn into nothing more than a marketing tool for the firm, and no pertinent information will be provided to the attendees. This will result in decreased attendance at future seminars and possible client displeasure.

### Presenting Client Seminars

A wide variety of topics can be addressed at client seminars. Examples of technical topics include, but are not limited to, the following:

- Payroll taxes and payroll reports
- Year-end planning
- Bookkeeping and cash flow training
- Estimated tax payment reminders
- Tax updates
- Pending tax legislation
- Corporate matters
- Social Security tax developments
- Estate planning
- Computer capabilities

Provide outline information, so attendees can follow the speaker during the presentations. Quality visual materials are also appropriate. The client packet should include an evaluation sheet, so that suggested improvements can be addressed at future seminars. It should also include an organizer form for potential leads on new opportunities. A seminar evaluation sheet is shown in Exhibit 103-4, and a seminar follow-up sheet is shown in Exhibit 103-5.

On a selective basis, extend invitations for client seminars to nonclients, including persons identified as prospective clients as well as acquaintances who might find the seminar beneficial. An unsolicited invitation may be frowned upon in many marketplaces; consider calling before issuing formal invitations to nonclients.

You might consider sponsoring seminars jointly with law firms, banks, or other professionals. The advantages of joint sponsorship include sharing development and other direct costs, demonstration of coordinated services, and more informative sessions. In addition, you will be afforded the opportunity to meet clients of the joint sponsor, thus developing new prospects for your firm. The need for careful coordination and organization and potential client confusion about which professionals provide what types of services are potential disadvantages.

Seminars are often held in meeting rooms of local hotels or at a location that is well suited for group presentations. These rooms must allow good visual contact between the audience and the speaker, comfortable temperature and seating arrangements, and adequate acoustics so all attendees can hear the speaker without a problem.

Client seminars are occasionally held in-house at the firm itself. In such a case, the offices must have a good appearance, and the size of the facility must be adequate. At seminars held in your office, the attendees are given an opportunity to learn more about the firm, the physical layout of the office, the image it conveys, and so forth.

There are a wide variety of seminar formats. The two most important variables in deciding which format is best for a seminar are audience size and the desired level of interaction between the speaker (or speakers) and the audience. The overall length of the program may also be a determinant. The program's objectives and the audience's information needs are key factors in determining which format to use.

- *Lecture.* The lecture format is the traditional theater format most people are familiar with (the speaker is at the front of the room, usually at a dais, and the audience is seated in rows, facing the speaker). This is ideal when you plan to have a large audience and when the subject matter is such that interaction between the presenter and the audience is limited to a brief question and answer period at the end of the lecture.
- *Classroom.* The classroom format does not differ markedly from the lecture format, except that there are narrow tables in front of each row of chairs so participants can comfortably follow handouts. This format is ideal if the seminar is to last for two hours or more or when the subject matter is rather technical and it is expected that participants will want to take notes.
- *Round table.* The format of this type of seminar is suggested by the title. The audience and speaker are seated around a large conference table. In this arrangement, the target audience is usually quite small and select: no more than a dozen people. An ideal venue would be the firm's own conference room.

Client seminars normally take place in the slower months, and should be considered one piece of off-season business. They must be scheduled dependent on the ability of clients to attend. For example, firms with a large number of clients in the construction industry should not schedule seminars until colder weather has set in, so clients' schedules allow them to attend the seminar. In most cases, autumn is typically a good time to schedule seminars. By this time, much IRS guidance applicable to the current year has been issued and other developments have occurred, and you and your staff are prepared to discuss them. It is also the natural time to raise issues related to year-end planning and topics associated with tax return preparation.

After the seminar, review the list of attendees and follow up with key individuals. Thank them for attending and determine if any open questions remain. Look for opportunities for additional work as a result of issues raised during the seminar. Exhibit 103-6 contains a sample follow-up letter.

### Checklist for Organizing Seminars

- Assign the task of organizing the seminar and assuring the quality of it to a firm member who has adequate time to devote, marketing talent, and, perhaps, experience in setting up such a meeting. Exhibit 103-7 contains a Seminar/Marketing Checklist to be used in organizing a seminar.
- Plan the seminar in detail to ensure the highest quality. This is your production, and its success will *directly* project an image of a successful accounting firm. Its failure will project an image of an unsuccessful firm.
- The length should not exceed two hours. Ideally, 1 $\frac{1}{4}$  to 1 $\frac{3}{4}$  hours.
- The invitation list should include clients, prospective clients, and community leaders.
- Determine an advance registration procedure. Send confirmations of registration.
- Registration of each guest is important so that a follow-up "thank you for coming" letter can be sent.
- A good mix of speakers includes firm members other than partners. A firm should show off the talents of the entire staff. Show off the "rising stars."
- The speakers should possess a good blend of technical knowledge and excellent speaking ability. Don't select the speakers without seeing them perform first.
- Each speaker must submit an outline, which should be bound into an attractive, preservable manual that the participants can carry home. Enclose ample "soft sell" information about the firm in the manual.

- A refreshment hour following the presentation or between sessions allows the staff to socialize with clients in a relaxed setting. All professional staff should be present and instructed to mingle. Your best “soft selling” could occur here.
- Name badges for each participant and for firm members are needed.
- Vary the topics from technical to light and alter them each year. Seminars do not need to be (and should not be) all accounting and taxes.
- Publish the dates and topics in your newsletter far in advance of the seminar, and send professionally prepared invitations with RSVPs.
- Ban smoking at the seminar site.
- Don't have the seminar in the firm's office during business hours, unless under special circumstances. There are just too many interruptions (which *must* be controlled if the office is used).
- Select a seminar site only after conducting a personal inspection of the facilities, lighting, and so forth.
- Have a formal follow-up with nonclient participants who have shown a lot of interest in the firm.
- If the speakers prepare their own visual aids, make sure you review them for quality. Shabby visual aids give the impression that the firm performs shabby accounting work.

The Seminar/Marketing Checklist at Exhibit 103-7 will assist you in insuring that you are adequately prepared when presenting a firm seminar.

#### 103.7.4 Personal Contacts

While it is never uncommon to think of using unsolicited personal contacts in connection with obtaining *new* clients, it is even more important to call on and stay in touch with your *existing* clients. Let them know you care about and are thinking of them. Remember, your best source of referral is your existing client base.

Make it a point to visit your client's place of business. Also, pick up the phone to see how they are doing. Not only does the development of a close relationship assist in referrals, it also helps to ensure client retention.

Unsolicited contacts should, of course, be without a fee, unless additional services are generated. Your success in this area will be measured by your ability to turn your inquiry or a client's question into a firm project. Exhibit 103-15 contains a sample form to be used for “Client Relationship Building.”

#### 103.7.5 Let Clients Know You Want Business

All too often, accountants in public practice are hesitant to let clients know they are interested in additional business. Do not hesitate to let a client know you would appreciate referrals. A good time is when a client compliments you on a project you have just completed.

Do not convey an impression to clients that you are too busy. Clients are hesitant to ask for additional services from, or refer a friend to, someone who is too busy to be of service.

Whether or not a particular referral received proves productive, always acknowledge the person who made it. Set up a system to ensure that every referral is acknowledged by a telephone call and a follow-up letter. Referrals that result in significant new business may also be acknowledged with an appropriate gift.

Most professionals and business owners are looking for business. Therefore, referrals received should be reciprocated.

#### 103.7.6 Obtain Client Feedback

Find out what is important to your clients. The use of a questionnaire enables you to find out if your firm is meeting the clients' expectations. Ask questions such as:

1. Did you receive prompt service?
2. Were you satisfied with the services you received?
3. Would you refer our firm to a friend?

It is also wise to simply ask clients if your service is meeting their expectations. The feedback you gain may save that client or possibly others who may have had common concerns. See Exhibit 103-14 for a sample questionnaire.

## 103.8 “Thank-You” Marketing

One of the easiest marketing activities is to forward a short thank-you note at every opportunity. Besides properly expressing gratitude to clients and potential clients for special favors and other matters, this approach strengthens the bond between your firm and the recipients.

There are numerous opportunities for the “thank-you” approach. Perhaps the local newspaper favorably mentioned a staff person or the firm; a simple thank-you note to the staff writer is appropriate. Perhaps a client invited a firm member to a theater or sporting event; a thank-you note is again appropriate. Perhaps an attorney or a banker made a referral; a thank-you note is *imperative*. Every day provides numerous opportunities to say “thank you” to others. A short, one-paragraph thank-you note, whether typed or handwritten, not only properly expresses gratitude, but enhances the image of the individual and the firm in the recipient’s eyes.

### 103.8.1 Balancing the Referral Ledger

As a trained accountant, you understand the double-entry method, and the fact that the ledger must always be in balance. The same method applies to referrals. Be sure to keep the referral ledger “in balance.” Think of it as a double-entry set of books: When a referral is received from a specific individual, bank, or law firm, be sure that a balancing of the ledger occurs through a referral back to the individual, bank, or law firm.

**Practice Tip.** When you make a referral to another professional, be sure you let your colleague know that you have referred a potential client to them. The important point is that the referral source be aware that you are thinking of them. It is not critically important whether the prospect actually contacts them or not.

While keeping the referral ledger in balance, be cautious of frequent, specific referrals. Spread referrals around—don’t find yourself accused of favoritism with specific individuals or professionals. Attempt to determine if a client has a particular preference or has worked with certain bankers or attorneys before. Present alternative referral possibilities to clients and let them choose. Be careful of specific referrals; yet, remember to keep the ledger in balance.

## 103.9 Competition: Friend or Foe?

When marketing a tax practice, consider the competition. If a firm is able to establish a specific image (see Section 103.3) and to develop a particular niche (see Section 103.5), other firms may not represent “competition.” Rather, they may be a strong referral base. They can assist your firm with specialties they have developed. In fact, locally competitive firms may help to fulfill the quality control element of consultation. A firm is expected to be able to provide assurance that staff members seek assistance, to the extent required, from persons within or without the firm having appropriate levels of knowledge.

You might become concerned if a new low-fee tax preparation firm opens in the vicinity. Are the clients these firms deal with truly the clients you want? If not, the lower cost preparers may provide an alternative to which your firm can refer smaller clients. Hopefully, they will reciprocate by referring more complex clients to you. This may allow your firm to better develop its niche and to focus on larger clients, providing greater opportunity for other services.

**Practice Tip.** Many firms attract work that doesn’t fit their client-acceptance philosophy, and so look for lower cost tax preparers to refer that work to. Not only does this assist a taxpayer, and possibly please the referral source, but the firm might develop a referral source for itself with the lower cost preparer. Many of these preparers will encounter complex situations that they need to refer to someone else. Hopefully, those complex situations will be sent back to you.

## 103.10 Client Feedback

Continually solicit client feedback to provide the highest level of service. You can obtain feedback using a number of techniques. One approach is to monitor verbal and written comments from clients. Another is to provide a form or postcard for feedback along with the tax return and other materials. Yet another strategy is through a formal client service questionnaire, which is sent to selected clients for completion. Exhibit 103-14 contains a sample Client Feedback Questionnaire.

Besides obtaining client feedback, you must act on it. Investigate and address noted problems and concerns.

### 103.10.1 Client Service Questionnaire

In addition to soliciting comments from clients on opportunities for improvement, the client service questionnaire gives you the opportunity to mention additional services that you offer. Because of the time required to complete the questionnaire, carefully choose a sample of clients to whom it should be sent.

A client service questionnaire should request information in the following areas:

- Professional services used
- Awareness of other services provided by the firm
- Evaluation of specific services
- Problem areas
- Satisfaction with the firm and its staff

Other areas of specific interest and concern can be addressed in designing the client service questionnaire.

**Practice Tip.** Questionnaires are probably best sent shortly after April 15. During the busy months, client services become strained, and the questionnaire provides meaningful information on how your firm performed during this time. Questionnaires should be solicited at regular intervals, such as every year or two years. If you feel your clients may not respond to a formal questionnaire, incorporate questions regarding quality of service and future areas of service into a client permanent file update request.

By using techniques such as a questionnaire, and by acting on information returned to the firm, significant improvements in client service can result.

## 103.11 Other Client Services

One of the surprising comments many practitioners hear is that clients are unaware the firm offers services other than tax preparation. However, more and more practitioners are moving away from emphasis on traditional compliance services and moving toward developing other areas such as business and financial planning, registered investment advisory services, business development services, business valuations, studies of internal controls, recommendations on accounting systems, and so forth.

The tax interview is often the only time a practitioner meets face to face with some clients, and therefore offers a prime opportunity to discuss the needs of clients in relation to other services you can provide. Developing a “menu” of services to provide clients and asking a few probing questions during client conferences will very often lead to new service areas for that client. For example, asking a business owner when the owner wants to retire and how much the owner wants the business to be worth in order to provide needed retirement cash flow can often lead to several engagements including but not limited to, business valuation, personal financial planning, business development services and business succession planning. Upon retirement and the sale of the business, firms offering registered investment advisory services are often the natural candidate to provide investment services for the sale proceeds.

The image you create of your firm is critical. Newsletters, seminars and other mailings can be used to advise clients, attorneys, bankers, and other referral sources of the many services you offer. It is important that everyone within the firm knows all the services you provide and recognizes the need to refer clients to other experts in the firm for some of these specialty areas.

### 103.11.1 **Cross-selling**

Essentially, selling one service while you perform another is cross-selling. It is an effective client-centered technique that keeps your firm involved in the client's affairs. The best way to effect cross-selling is to create a services plan for major clients.

Too often clients get the impression that a firm operates exclusively in the tax area, and that your firm is unable to offer management advice, to assist with accounting systems, and, in general, to provide other professional services to them. Exhibit 103-8 contains a checklist of potential nontax services that should be completed for each client. Complete such a checklist annually and follow up on those areas identified.

**Practice Tip.** Staff often tend to market only in their own areas of knowledge. Be sure that everyone is made aware of the services offered firmwide, so that staff can recognize potential opportunities and market toward those opportunities. Continually address the capabilities of the entire firm through internal memorandums and staff meetings, and encourage cross-selling in all contact with staff.

### 103.11.2 **Organizational Tools**

Most clients appreciate organizational tools (checklists, summaries, etc.) provided by their accountant. These so called "tools" not only organize the client's financial and other important data, but also get the client and accountant thinking about the client's financial affairs. This thought process can lead to additional services, such as review of wills, estate planning, etc.

Exhibits 103-11 and 103-12 are examples of some client organizational worksheets.

### 103.11.3 **Introductory Services**

In an effort to attract new tax clients, practitioners could offer low cost/stepped down services to the public. One such service is a "Desktop Review." This is essentially charging a minimal flat fee for up to a one hour review of a taxpayer prepared tax return. The firm looks for any errors and makes recommendations to the taxpayer. Professional staff with three to five years experience could be assigned this task. This not only gives the taxpayer some peace of mind, but also provides the professional staff exposure to potential clients and experience in communicating with clients and reviewing tax returns. Naturally, this client meeting then also gives the practitioner an opportunity to identify other services of benefit to the taxpayer, such as estate planning, investment advice, successorship planning and so forth.



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**Exhibit 103-1: Sample Correspondence on Change in Tax Laws**

**SWIFT, MARCH & COMPANY**  
 CERTIFIED PUBLIC ACCOUNTANTS  
 200 Main Street  
 Naplace, Anystate 00000

MEMO TO: Attorneys and Other Interested Parties

FROM: SWIFT, MARCH & COMPANY

DATE: August 30, 200X

RE: Small Business Job Protection Act  
 Summary of changes that may have a direct impact on yourself or your clients.

The Small Business Job Protection Act was signed into law on August 20, 200X by the President. The following is a brief summary of some of the changes that may impact you.

**DEVELOPMENTS AFFECTING INDIVIDUALS****SOURCE TAXATION OF PENSIONS BY STATES**

Taxpayers who previously lived and worked in one state, but then retired and moved to another state and began collecting a pension, often were taxed in the state in which they originally lived and worked, even though they were no longer a resident of that state. Effective January 1, 200X, states are prohibited from taxing retirement income of an individual where the taxpayer is no longer a resident of that state.

**SELF-EMPLOYED HEALTH INSURANCE DEDUCTION**

The deduction for the health insurance premiums of self-employed individuals and their families increases from 30% in 200X to 40% in 200Y. Beginning in 200Z, 45% is deductible, 50% in 201A, 60% in 201B, 70% in 201C, and 80% in 201D and after.

**LONG-TERM CARE INSURANCE**

Uncertainty has existed regarding deductibility of long-term care insurance. Effective in 200X, insurance premiums for long-term care insurance will be treated as medical deductions. Accordingly, employers will be permitted to provide long-term care insurance to employees in a tax-free manner (but not within a cafeteria plan or flexible spending arrangement). For individuals, the premiums will be deductible as itemized medical deductions, subject to the 7½%-of-income floor. For self-employed individuals, amounts paid for long-term care insurance are treated as medical insurance, allowing deductibility of 40% of the amount (increased to 45% in 200Y, etc.).

**ADOPTION EXPENSES AND ADOPTION TAX CREDIT**

The new law adds both an exclusion from gross income for an employer-provided adoption assistance program, as well as a nonrefundable tax credit for those who do not receive employer assistance. Both the exclusion and credit are limited to \$5,000 per child. This limit is increased to \$6,000 in the case of a child with special needs, generally defined as a child who cannot be placed with adoptive parents unless assistance is provided. However, all foreign adoptions, including special needs adoptions, are limited to a maximum of \$5,000. These privileges, which begin in 200X, are phased out as taxpayer income exceeds a \$75,000 threshold, with no exclusion or credit available once income reaches \$115,000.

**DEVELOPMENTS AFFECTING BUSINESSES****EXTENSION OF JOBS TAX CREDIT**

The former Targeted Jobs Tax Credit ended in 200X. This is now replaced by a similar Work Opportunity Tax Credit for employees hired after September 30, 200Y through September 30, 200Z. The categories of eligible

**Exhibit 103-1: Sample Correspondence on Change in Tax Laws (cont.)**

employees are much like in the past—AFDC recipients, Veterans, vocational rehab referrals, etc. The tax credit is 35% of the first \$6,000 of first-year wages; effectively, the government will reimburse up to \$2,100 of wages per employee.

**RESEARCH AND DEVELOPMENT TAX CREDIT**

The former Research Tax Credit expired June 30, 200X. The tax credit is restored for an 11-month period from July 1, 200Y through May 31, 200Z. As in the past, the business receives a tax credit equal to 20% of the amount by which current research expenditures exceed the company's historical base. However, there is now an elective alternate method, where a business spending as little as 1% of its gross receipts on research and development may qualify for a tax credit.

**50% DISALLOWED MEALS AND ENTERTAINMENT**

For several years now, 50% of any meal or entertainment expenditure has been disallowed as a tax deduction. However, there are a number of subtle, yet significant, exceptions where 100% deductibility is still permitted. For example, employee-wide meals and entertainment (the summer golf outing or December holiday dinner), as well as open houses available to the general public, remain fully deductible. Now, an important Tax Court case has also suggested that employer-subsidized cafeterias and on-premises business meals may also be fully allowable.

**INDEPENDENT CONTRACTOR RELIEF**

The classification of workers as employees versus independent contractors continues to be a contentious issue with the IRS. Congress has now updated an old 19XX safe harbor rule to better protect businesses from the aggressive reach of the IRS. If your company engages workers as independent contractors, we should review the new safe harbor rules which allow reliance on the "long-standing practice of a significant segment" of your industry to protect independent contractor classification.

**FAILURE TO DEPOSIT PAYROLL TAXES**

The tax law contains an especially harsh provision when a business does not remit withheld employee payroll taxes to the IRS. A penalty mechanism effectively shifts the financial burden to responsible individuals within the company. Congress has now added taxpayer protection, especially where the IRS assesses multiple officers or individuals within the business.

We wanted to immediately bring these changes to your attention and urge you to please let us know if you should have any questions or if we can be of any assistance.

**Exhibit 103-2: Invitation to Banker's Seminar**

**BANKER'S SEMINAR  
HOT TOPICS IN THE SMALL BUSINESS JOB PROTECTION ACT**

*Date:* Tuesday, August 25, 20XX  
*Location:* Holiday Hotel  
Noplace, Anystate 00000  
*Schedule:* 7:00 p.m.–8:30 p.m. Seminar  
8:30 p.m.–9:00 p.m. Social and discussion  
*Fee:* \$15.00 per registrant (includes materials and refreshments)  
*Sponsored by:* Swift, March & Company

*Seminar Objective:*

To bring you and your key staff people up to date on the implications of the Small Business Job Protection Act. Coverage will include provisions affecting bank taxation, as well as the many changes affecting businesses and individuals which you and your staff deal with on a day-to-day basis.

*Topics to be covered:*

- Financial institutions eligible for "S" corporate status
- Key business changes (i.e., depreciation, fringe benefits)
- SIMPLE Retirement plans
- Repeal of Interest Income exclusion on ESOP loans

*To Register:*

Complete the form below and send with payment to Swift, March & Company in the enclosed pre-addressed envelope.

*For Questions:*

Call Jane March at Swift, March & Company at (000) 000-0000

REGISTRATION FORM

August 25, 20XX HOT TOPICS IN THE SMALL BUSINESS JOB PROTECTION ACT Holiday Hotel  
Noplace, Anystate

Bank: \_\_\_\_\_ Bus. Phone: \_\_\_\_\_

Address: \_\_\_\_\_

\_\_\_\_\_ Zip: \_\_\_\_\_

Registrant Names \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Send form and payment to:  
Swift, March & Company, 200 Main Street, Noplace, Anystate 00000

**Exhibit 103-3: Client Newsletter**

**(YOUR FIRM'S LOGO)**

**SEPTEMBER 200X**

## 10 Ways to Cut your 200X Taxes Now!

Although most people do not want to think about taxes at this time of the year, it's never too early to take action to reduce your 200X tax liability. Effective planning should help you achieve your personal and business financial objectives in a tax efficient manner. Strive for sound business decisions which will minimize your taxes. Following is a list of ten actions you can take now to take a bite out of your 200X tax obligation:

1. Make your 200X IRA contribution now to start deferring taxes on the earnings more quickly.
2. If you belong to a 401(k) plan, fund your account to the maximum. Earnings are tax deferred and many employers make matching contributions.
3. If you are self-employed, consider establishing a Simplified Employee Pension (SEP) plan.
4. Utilize an employer provided flex/cafeteria plan which allows you to set aside pre-tax dollars for health care or child care expenses. Both income

and social security taxes can be reduced by using the plan. However, compute your expected costs wisely. Any unused money at the end of the year is forfeited.

5. Be sure to get documentation for any single charitable contribution of \$250 or more; a canceled check is no longer sufficient documentation. You must receive a receipt from the charity.
6. Make a gift of appreciated stock to a charity. No tax is due on the appreciation (the difference between the stock's cost and fair market value), yet you will receive a deduction equal to the fair market value of the stock (provided you held the stock for a full year).
7. If you own a business, consider putting your children to work. The shifted income may be taxed at a lower rate if the child is at least age 14. If you are self-employed, you may also realize payroll tax savings. In all cases, the compensation must be reasonable based on the work performed and the child's age.

8. Pay off your consumer debt (credit cards, etc.). The interest expense is nondeductible. Consider a home equity loan if you lack the funds to pay off the debt. In most cases, the interest on a home equity loan is fully deductible.

9. Consider investing in tax-exempt bonds. Taxpayers in a federal tax bracket of 28% or more may be able to earn a better after-tax return on tax-exempt bonds vs. taxable investments such as certificates of deposit or money market funds.

10. Take full advantage of the \$10,000 annual gift tax exclusion if you may be exposed to estate tax or want to transfer wealth to your children. Although these gifts are non-deductible, they do remove earnings on the gifted property from your tax return in future years.

These are just ten ways of reducing your tax liability. Please call our office for additional tax planning ideas and clarification of these items.

**Exhibit 103-3: Client Newsletter (cont.)**

## Estate Planning

Building wealth during an individual's lifetime is a goal of many. An individual's net worth can grow significantly over a lifetime to include real estate, retirement funds, securities, life insurance, etc. Upon death, this wealth transfers to the heirs and may be subject to federal and state estate tax.

As a general rule, every U.S. citizen can transfer up to \$675,000 (year 2000 amount) of assets, including lifetime gifts, free of estate tax. If the fair market value of an individual's estate at death exceeds \$675,000, the tax on the remaining estate can be as high as 55%.

With proper estate planning, estate tax can be significantly reduced or avoided altogether. Estate planning is a team

approach which normally involves the individual's accountant and attorney. There may also be reason to include a financial planner, trust officer, and life underwriter.

If an individual or married couple's estate is larger than \$675,000, estate planning is essential to minimize estate tax. Although each individual is allocated a \$675,000 exemption from tax, couples need to structure the ownership of their assets and the provisions of their Wills to avoid squandering each spouse's exemption.

**EXAMPLE:** Dad's and Mom's net worth is \$400,000 and \$500,000, respectively. The provisions of both their Wills call for the transfer of assets to

pass to the surviving spouse. If there is no surviving spouse, the assets go to the children. Assume Dad dies first.

There is no estate tax on Dad's estate because spouses are allowed to transfer assets to each other exempt from estate tax. Mom now has an estate worth \$900,000. If Mom dies, the first \$675,000 of the estate is exempt from tax, leaving a taxable estate of \$225,000. Proper estate planning could have avoided taxation of the estate.

Unfortunately, this example is far too common. Our office can assist you and your attorney in the preparation of a good Will. Please give our office a call to set up an appointment to discuss your estate planning.

**Exhibit 103-3: Client Newsletter (cont.)**

## BUSINESS UPDATE

### CLUB/ORGANIZATION DUES

A deduction is no longer allowed for certain club and organization dues. Dues paid to belong to clubs organized for business, pleasure, recreation, or other social purposes are disallowed.

By this definition, it would appear that all club dues are disallowed. However, the IRS has issued guidance which makes it clear that the following types of club dues are deductible:

- Professional organizations
- Trade associations
- Chambers of Commerce
- Boards of trade
- Real estate boards
- Civic and public service groups (Rotary, Lions, etc.)

Dues for civic clubs and professional organizations will generally be deductible if other IRS rules for deductibility are met (such as the requirements that dues be an ordinary and necessary business expense and the expense is properly documented).

If the principal purpose of the club or organization is conducting entertainment activities for members or guests or providing access to entertainment facilities, the dues will be disallowed. "Principal purpose" is not defined, but it is clear that the following types of dues are non-deductible:

- Country clubs
- Golf and athletic clubs
- Airline clubs
- Hotel clubs
- Business lunch clubs

Businesses may continue to pay for these non-deductible dues. However, in order to identify non-deductible dues, we suggest you establish two general ledger accounts within your bookkeeping system: one entitled "Deductible Dues" and the other "Non-Deductible Dues." This will eliminate expensive backtracking at year-end when these amounts must be identified for tax return preparation.

### TRAVEL EXPENSE OF A SPOUSE

Travel expenses of spouses and other companions can't be

deducted unless the companion is an employee of the taxpayer claiming the deduction and is present for a genuine business purpose. This doesn't mean, however, that if you bring your nonworking spouse along on a business trip, you can deduct only half the cost of the hotel room. Instead, you deduct what a single occupancy room would cost; the balance is non-deductible. In addition, you can deduct the full rental of a car in which both spouses travel, since it would cost no less if only one spouse were present.

### BUSINESS MEALS & ENTERTAINMENT

Only 50% of any business meal or entertainment expense is deductible, down from 80% in prior years. As before, an owner or employee must be present when the food or drinks are served. The expense must be directly related to business, or must precede or follow a substantial business discussion.

Please contact us if you have any questions regarding these deductions.

---

## DON'T FORGET!

- If you haven't yet filed your 200X property tax refund claim, there is still time to do so. Although the claim was due August 15, 200Y, you have up to one year after the due date to claim the refund.
- Never assume that a computerized notice from the IRS, assessing additional tax or a penalty, is correct. The IRS has moved to a highly automated system, and their notices these days are often erroneous. Please check with us before taking any action.







**Exhibit 103-6: Follow-Up Letter to Seminar**

**SWIFT, MARCH & COMPANY**  
CERTIFIED PUBLIC ACCOUNTANTS  
200 Main Street  
Noplace, Anystate 00000

December 7, 20XX

Attorney Mark Jones  
Jones Law Firm  
1 South Street  
Noplace, Anystate 00000

Dear Mr. Jones:

This is just a brief note to thank you for attending our presentation on the (enter name of tax act) on August 25. We feel the presentation went well and hope that you found this course to be informative and worthwhile to your daily practice.

If you have any questions regarding the New Revenue Act or should desire our assistance in any matters, please contact us at your convenience.

Sincerely,

John Swift, CPA

**Exhibit 103-7: Seminar/Marketing Checklist**

**SEMINAR/MARKETING CHECKLIST**

Title: \_\_\_\_\_ Coordinator: \_\_\_\_\_  
 Date: \_\_\_\_\_ PIC Approval: \_\_\_\_\_  
 Time: \_\_\_\_\_ Place: \_\_\_\_\_  
 Speaker(s): \_\_\_\_\_  
 Attendance: \_\_\_\_\_ (Est.) Audience Selection: \_\_\_\_\_

<i>Responsible Person</i>	<i>Description</i>	<i>Deadline Date</i>	<i>Cost</i>
_____	_____ Facilities arrangements	_____	\$ _____
_____	_____ Invitations	Print _____	_____
_____		Send _____	_____
_____	_____ Publicity (must be reviewed & approved by Managing Partner)		
_____	_____ Advertisement	_____	_____
_____	_____ News release	_____	_____
_____	_____ Other _____	_____	_____
_____	_____ Audiovisual Equipment:		
_____	_____ Screen	_____	_____
_____	_____ Microphone(s)	_____	_____
_____	_____ Flip Chart & Markers	_____	_____
_____	_____ Slide/Overhead Projectors	_____	_____
_____	_____ Rentals _____	_____	_____
_____	_____ Other _____	_____	_____
_____	_____ Stage Set-Up:		
_____	_____ Table(s)	_____	_____
_____	_____ Chairs	_____	_____
_____	_____ Podium	_____	_____
_____	_____ Other _____	_____	_____
_____	_____ Testing of Equipment		
_____	_____ Greeting Table:		
_____	_____ Name Tags	_____	_____
_____	_____ Table(s)	_____	_____
_____	_____ Registration Book	_____	_____
_____	_____ Printed Agenda	_____	_____
_____	_____ Publication Material	_____	_____
_____	_____ Other _____	_____	_____

**Exhibit 103-7: Seminar/Marketing Checklist (cont.)**

Responsible Person	Description	Deadline Date	Cost
_____	CPE ____ Seminar ____ Title _____		
_____	_____ Breakfast arrangements	_____	\$ _____
_____	_____ Coffee/pop breaks	_____	_____
_____	_____ Lunch arrangements	_____	_____
_____	_____ Dinner arrangements	_____	_____
_____	_____ Refreshment/cocktail hour arrangements	_____	_____
_____	_____ Confirmation of all Speakers		
_____	_____ Travel and lodging arrangements		
_____	_____ Practice Taping Session	_____	_____
_____	_____ Equipment needed:		
_____	_____ Attendance by Firm Employees:		
_____	_____ Partners      _____ Tax Staff		
_____	_____ Managers      _____ All Professionals		
_____	_____ A & A Staff      _____ Other		
_____	_____ Interoffice Communication	_____	
_____	_____ Follow-up Procedures	_____	
_____	_____ Additional Communication	_____	
_____	_____ Evaluation		
_____	_____ Complete Seminar file for future reference. (All documents should be sent to this file.)		
_____	_____ CPE posted, if applicable.		

Comments: \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

Signature: \_\_\_\_\_

**Exhibit 103-8: Client Review for Additional Services**

**CLIENT REVIEW FOR ADDITIONAL SERVICES**

CLIENT NAME/NUMBER \_\_\_\_\_

PARTNER IN CHARGE \_\_\_\_\_ PREPARED BY \_\_\_\_\_ DATE \_\_\_\_\_

ROUTE TO: \_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_

The following services should be considered for this client: (check applicable items)

	<u>Disposition/Comments</u>	<u>Cleared By</u>
<input type="checkbox"/> Amend prior year returns— additions, deductions, carrybacks, etc.		
<input type="checkbox"/> Business development—systemization		
<input type="checkbox"/> Business plans		
<input type="checkbox"/> Business succession planning		
<input type="checkbox"/> Buy/sell agreements		
<input type="checkbox"/> Cash/credit management		
<input type="checkbox"/> Change accounting method/system		
<input type="checkbox"/> Change tax year		
<input type="checkbox"/> Compensation and benefit planning		
<input type="checkbox"/> Computer services		
<input type="checkbox"/> -has no computer, may need one		
<input type="checkbox"/> -has computer, may need internal control review		
<input type="checkbox"/> -has computer, needs assistance		
<input type="checkbox"/> Estate planning		
<input type="checkbox"/> Finance and banking relations		
<input type="checkbox"/> Income tax planning		
<input type="checkbox"/> MAS service—financial, marketing, operations, etc.		
<input type="checkbox"/> Personal financial planning		
<input type="checkbox"/> Qualified retirement plans		
<input type="checkbox"/> Retirement planning		
<input type="checkbox"/> Risk management		
<input type="checkbox"/> Set up accounting systems, records, etc.		
<input type="checkbox"/> Tax entity changes—incorporation, 'S' election, liquidation, etc.		
<input type="checkbox"/> Other _____		

**Exhibit 103-9: Marketing Situation Analysis****MARKETING  
SITUATION ANALYSIS**

1. What is the firm's image or reputation in the following areas?
  - a. Scope of services: \_\_\_\_\_
  - b. Timeliness: \_\_\_\_\_
  - c. Fees: \_\_\_\_\_
  - d. Helpfulness: \_\_\_\_\_
  - e. Other: \_\_\_\_\_
2. For what does the firm want to be known? \_\_\_\_\_  
\_\_\_\_\_
3. What is the firm's market area geographically? \_\_\_\_\_  
\_\_\_\_\_
4. What groupings and/or specialties are there in the client base? \_\_\_\_\_  
\_\_\_\_\_
5. What opportunities exist in the client base and market? \_\_\_\_\_  
\_\_\_\_\_
6. Describe the ideal next client. \_\_\_\_\_  
\_\_\_\_\_
7. What is the firm's desired real growth rate? \_\_\_\_\_  
\_\_\_\_\_
8. At what areas of practice does the firm excel? \_\_\_\_\_  
\_\_\_\_\_
9. Where is the firm weak? \_\_\_\_\_  
\_\_\_\_\_
10. Who are the firm's primary competitors, and what advantages do they have? \_\_\_\_\_  
\_\_\_\_\_
11. How many professional hours are currently devoted to practice development (including civic activities)?  
Partners \_\_\_\_\_ Staff \_\_\_\_\_
12. Realistically, how many professional hours *could* be devoted to practice development next year?  
Partners \_\_\_\_\_ Staff \_\_\_\_\_

**Exhibit 103-10: Staff Memo on Marketing**

**MEMO**

Date: April 21, 20XX

To: Staff

cc: Shareholders

From: Swift, March & Company

Through various sources, I have put together a list of marketing activities that I think each member of the firm should examine. After careful thought, determine your areas of comfort and put together a personal marketing plan. Please note that there are many items on the list that are fairly easy to do, will not require tons of personal time, nor are they heavily involved in "selling." It is the Shareholders' opinion that all personnel should get involved in marketing themselves as quality accountants.

In the next 30–60 days I will be meeting with each of you personally to come up with a personal marketing plan, which will be part of your goals at the firm.

I look forward to meeting with you on this important professional and personal activity.

**Exhibit 103-10: Staff Memo on Marketing (cont.)**

**SWIFT, MARCH & COMPANY  
MARKETING ACTIVITIES**

1. Involvement in community activities (civic).
2. Involvement in trade organizations.
3. Involvement in charitable organizations—United Way, one other example here, etc.
4. Involvement in religious organizations.
5. Speaking in public (small groups).
6. Speaking in public (large groups).
7. Speaking at firm-sponsored seminars.
8. Membership in social clubs.
9. Writing technical articles for a newspaper or publication.
10. Contacting clients when you are not actively working for them.
11. Attending extra-curricular activity with a referral source (or potential referral source).
12. Attending extra-curricular activity with a client.
13. Attending Chamber of Commerce meetings or socials.
14. Taking part in presentations—banks, law firms, etc.
15. Taking clients to lunch.
16. Taking referral sources (or potential referral sources) to lunch.
17. Meeting with prospective clients.
18. Research on prospective clients.
19. Placing 10 friends on our mailing list and contacting them periodically.
20. Other \_\_\_\_\_



**Exhibit 103-11: Personal Document Locator**

By completing the following summary and keeping it up-to-date, surviving family members will be better able to locate important documents and identify the persons who will fill various capacities relating to estate matters.

Document	Location
Tax returns	
Wills	
Letter of instructions	
Trust instruments	
Personal/family budgets	
Unpaid bills	
Sale/purchase contracts	
Insurance policies	
Life	
Disability	
Health	
Automobile	
Homeowners	
Umbrella	
Professional liability	
Other	
Deeds, mortgages and land contracts	
Guardian nomination	
Leases	
Power of attorney/appointment	
Separation/divorce/antenuptial agreements	
Patents, copyrights and royalties	
Employee benefits	
Employee benefits handbook	
Stock option agreements	

**Exhibit 103-12: Key Contact Roster**

By completing the following summary and keeping it up-to-date, surviving family members will be better able to locate important documents and identify the persons who will fill various capacities relating to estate matters.

Contact Person and/or Firm	Relationship	Phone Number
Attorney		
Trust Officers		
Trustees		
Executor		
Personal guardians of children		
Property guardians of children		
Durable power of attorney designee		
Other designees and role		

**Exhibit 103-13: Comparison of Advertising Media**

<b>Advertising Media</b>	<b>Strengths</b>	<b>Weaknesses</b>
<i>Yellow Pages</i>	<ul style="list-style-type: none"> <li>High usage</li> <li>Wide circulation</li> <li>Heavily supported by media ads</li> <li>Catches consumers when they are ready to buy</li> <li>Long shelf life</li> <li>Inexpensive</li> </ul>	<ul style="list-style-type: none"> <li>Ad clutter</li> <li>Infrequent publication</li> <li>Low impact</li> <li>Cannot change ad for one calendar year</li> <li>Long lead time</li> <li>Creative limits</li> <li>Wasted circulation</li> </ul>
<i>Daily Newspapers</i>	<ul style="list-style-type: none"> <li>Broad local reach—all advertising tends to be local</li> <li>Messages can be tailored to specific communities</li> <li>News value—all advertising appears within the atmosphere of the local news on a given day</li> <li>Geographic flexibility—any method of subdividing a mailing list can be used, based on geographic or political subdivisions, such as zip codes, sectional centers, cities, counties, states, regions</li> <li>Timeliness—newspapers are read the day they are delivered or not at all</li> <li>Ad campaigns can be inserted quickly</li> </ul>	<ul style="list-style-type: none"> <li>Short life span—newspapers are read the day they are delivered or not at all</li> <li>Limited repeat exposure—the publication is rarely read more than once, or by more than one reader</li> <li>No color reproductions—black and white only</li> </ul>
<i>Trade Journals</i>	<ul style="list-style-type: none"> <li>Targeted audiences—possible to reach many members of a specific industry</li> <li>Messages can be tailored to specific industries or interest groups</li> <li>Ad campaigns can be inserted fairly quickly—one to three months</li> <li>Multiple exposure—publication tends to be read more than once, and by more than one person</li> </ul>	<ul style="list-style-type: none"> <li>Quality of ad reproduction varies with the publication</li> </ul>
<i>Business and News-magazines</i>	<ul style="list-style-type: none"> <li>Targets business readers</li> <li>News value—all advertising appears within the atmosphere of current news</li> <li>Multiple exposure—the publication tends to be read more than once, or by more than one reader</li> <li>Quality four-color reproductions</li> <li>Good coupon vehicle</li> <li>Must be purchased—shows interest</li> </ul>	<ul style="list-style-type: none"> <li>Slow audience development</li> <li>Expensive</li> <li>Ad clutter—competitors will also advertise</li> <li>Long lead time for insertion—usually three to six months</li> <li>Inflexible—hard to change ad</li> </ul>
<i>Radio</i>	<ul style="list-style-type: none"> <li>Very personal</li> <li>Requires listener to use his or her imagination</li> <li>Timely and topical</li> <li>Flexible—easy to make last-minute changes to the ad</li> <li>High impact</li> <li>Selective audiences</li> <li>Mobile</li> <li>Promotional tie-ins; contests</li> </ul>	<ul style="list-style-type: none"> <li>Waste circulation</li> <li>No illustrations</li> <li>Ad clutter</li> <li>May annoy listeners</li> <li>Much repetition needed</li> <li>Temporary impact</li> </ul>

SOURCE: Nassutti, Colette P., ed. *The Marketing Advantage: How to Get and Keep the Clients You Want* (New York: AICPA, 1993).

**Exhibit 103-13: Comparison of Advertising Media (cont.)**

<b>Advertising Media</b>	<b>Strengths</b>	<b>Weaknesses</b>
<i>Television</i>	Demonstration of product Color illustration Timely and topical Extremely creative High impact Captive audience Televisions are in every home	Temporary impact Expensive Ad clutter May annoy viewer Much repetition needed Zapping factor Wasted circulation Difficult to produce Difficult to change ad on short notice

**Exhibit 103-14: Client Feedback Questionnaire**

Name of Your Organization \_\_\_\_\_

**New Contacts Service**

1. Who are your two key \_\_\_\_\_ (firm) \_\_\_\_\_ contacts in order of importance to you?

(A) \_\_\_\_\_  
Most important

(B) \_\_\_\_\_  
Next most important

Directions: Next to each applicable term please respond using the following descriptions:  
1=Poor 2=Fair 3=Acceptable 4=Very Good 5=Excellent

2. Please rate each person's performance in the following areas:

	<i>Person</i>	
	A	B
a. Meeting your deadline and getting your work done on time	_____	_____
b. Informing you of delays	_____	_____
c. Answering your questions	_____	_____
d. Being accessible	_____	_____
e. Presenting a positive attitude	_____	_____
f. Listening to your concerns	_____	_____
g. Acting in a professional manner	_____	_____
h. Presenting a professional appearance	_____	_____
i. Taking an active interest in your business	_____	_____
j. Understanding your business goals	_____	_____
k. Understanding your personal goals	_____	_____
l. Contributing as part of your management resource team	_____	_____
m. Understanding the problems within your organization	_____	_____
n. Offering recommendations and solutions to improve business performance	_____	_____
o. Proactively suggesting tax planning strategies	_____	_____
p. Returning telephone calls promptly	_____	_____

**Firm Performance**

- 3. How well do we maintain continuity of \_\_\_\_\_ (firm) \_\_\_\_\_ personnel doing work for you? \_\_\_\_\_
- 4. Tax services
  - a. Overall satisfaction with tax planning advice \_\_\_\_\_
  - b. Overall satisfaction with tax return preparation \_\_\_\_\_
- 5. Accounting and audit services
  - a. Overall satisfaction with audit, review and compilation or other agreed upon report service \_\_\_\_\_
- 6. Management consulting services
  - a. Overall satisfaction with business advisory/consulting services \_\_\_\_\_
  - b. Overall satisfaction with computer consulting services \_\_\_\_\_
- 7. Keeping disruption of your business routine(s) at a minimum? \_\_\_\_\_
- 8. Providing adequate lead time for your personnel to respond to our requests? \_\_\_\_\_
- 9. How clearly do our invoices describe the work we have performed? \_\_\_\_\_

**Perceptions About Our Firm**

- 10. How does the value of the services compare with the fees you are charged? \_\_\_\_\_
- 11. How well known is \_\_\_\_\_ (firm) \_\_\_\_\_ in your business community? \_\_\_\_\_
- 12. What is the general reputation of \_\_\_\_\_ (firm) \_\_\_\_\_? \_\_\_\_\_
- 13. What is \_\_\_\_\_ (firm's) \_\_\_\_\_ reputation as business advisors? \_\_\_\_\_
- 14. Has anyone from \_\_\_\_\_ (firm) \_\_\_\_\_ ever asked you to recommend us to others? (Y N) \_\_\_\_\_
- 15. Have you recommended \_\_\_\_\_ (firm) \_\_\_\_\_ to any of your associates, colleagues or friends in the past year? (Y N) \_\_\_\_\_
- 16. Would you consider recommending \_\_\_\_\_ (firm) \_\_\_\_\_ to others? (Y N) \_\_\_\_\_  
If no, please tell us why: \_\_\_\_\_
- 17. Do you read our newsletters? (A)lways (U)sually (O)ccasionally (N)ever \_\_\_\_\_
- 18. Are the articles helpful and informative? (Y N) \_\_\_\_\_
- 19. How many years have you been a client? \_\_\_\_\_
- 20. During the past 12 months have you seriously considered changing accounting firms (Y N) \_\_\_\_\_  
If yes, please tell us why: \_\_\_\_\_

**Exhibit 103-14: Client Feedback Questionnaire (cont.)**

**Key Relationships**

- 21. Which \_\_\_\_ (firm) \_\_\_\_ person do you call when you have questions or concerns? \_\_\_\_\_
- 22. When do you contact this person (circle all that apply)
  - a. To solve problems
  - b. For business or accounting advice
  - c. For personal/friendly/social reasons
  - d. Other (please list): \_\_\_\_\_
- 23. When does this \_\_\_\_ (firm) \_\_\_\_ person contact you? (Circle all that apply)
  - a. With info concerning compliance issues, traditional tax and audit updates, or work in progress
  - b. To offer suggestions or timely information
  - c. For personal/friendly/social reasons
  - d. Other (please list): \_\_\_\_\_

**General**

- 24. Please rate our performance in the following areas:
    - a. Communicating and working in understandable language \_\_\_\_\_
    - b. Involving you in decision—the schedules, tasks performed, timing, scope, etc. \_\_\_\_\_
    - c. Using good judgment about recommending \_\_\_\_ (firm) \_\_\_\_ services to meet your needs. \_\_\_\_\_
  - 25. What are your most important business concerns? \_\_\_\_\_
  - 26. What are other important services or support \_\_\_\_ (firm) \_\_\_\_ should provide to help address these business concerns? \_\_\_\_\_
- Please share any additional comments or suggestions for \_\_\_\_ (firm) \_\_\_\_ :  
 \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

**Exhibit 103-15: Client Relationship Building**

**PLANNING SCHEDULE  
CLIENT RELATIONSHIP BUILDING**

Initials \_\_\_\_\_

Date \_\_\_\_\_

Client	Week/Month to Contact
1.	
2.	
3.	
4.	
5.	
6.	
7.	
8.	
9.	
10.	

*Suggestions:*

- Identify major clients or major referral sources where we do not have ongoing contact, and schedule a luncheon or visit at an appropriate time.
- Primary accountant has responsibility to schedule and call client; consider including another accountant as appropriate (e.g., former primary accountant on a recent transition client, staff accountant who is regularly involved).
- Suggestions for phrasing the contact phone call to client to arrange meeting: "It's been awhile since we've had a chance to visit . . . (We like to keep in touch with clients/Things are hectic when we meet in office). Let's get together for lunch—This one is on us—no meter running."





# 104 Personnel Issues

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# 104 Personnel Issues

Almost all practitioners agree that the most important resource in a tax practice is personnel. Virtually all other assets are secondary. Highly motivated, well trained personnel provide opportunities for growth and profitability and yield the highest level of client service and satisfaction.

An entire section of the *Management of an Accounting Practice (MAP) Handbook*, available through the AICPA, is devoted to the subject of “Personnel.” Readers are encouraged to refer to the *MAP Handbook* for a thorough discussion of personnel issues germane to the entire firm.

This chapter addresses personnel issues unique to a tax practice. Although some overlap with the *MAP Handbook* occurs, the discussion emphasizes unique issues faced in a tax practice and unique characteristics of many tax staffs.

## 104.1 Organizational Alternatives

The organizational alternatives in a tax practice normally include the following:

- *Departmental structure.* Are individual staff members dedicated to a technical function and organized accordingly, or do staff members operate as generalists within the practice?
- *Multioffice structure.* Does the firm operate with only one office dedicated to the tax function, or are tax staff members located in more than one office?

The organizational question is normally addressed from a firmwide standpoint, as opposed to an office standpoint. Even in multioffice firms, a staff of dedicated specialists or a staff of generalists in *each office* normally addresses the tax function, as opposed to one office being staffed specifically for tax purposes and another for audit or other purposes.

Even firms with formal departmental structures often require temporary reassignment of staff during the busy months, when audit staff may be assigned to the tax department. In many smaller firms, there is no clear delineation of departmental structure, and almost all personnel become involved in tax services on an as-needed basis.

The question of a formal departmental structure or even a multioffice structure is sometimes independent of the size of the staff, the number and kind of clients, and the total billings of the firm. As a general rule, however, firms with formal departmental structures are usually larger in terms of staff size and total billings, as are firms with several offices.

### 104.1.1 Departmental Structure

Firms that are structured in a departmental format often include a tax department, an audit department, and a management services department. Occasionally, other areas of responsibility are organized as separate departments, such as personal financial planning, technical training, and so forth. Typically, each department is headed by a partner or supervisor, with other individuals within the department assigned lesser levels of responsibility and authority. Many

smaller firms do not use a formal departmental approach. The same staff may be involved in audit assignments, tax assignments, and, potentially, consulting assignments.

The advantage of a clearly defined departmental structure relates to organizational accountability. For example, one partner or supervisor can be responsible for development and quality control in audit, another in tax, and so forth. Staff training within each department can be primarily in topics specifically pertinent to the department. Workloads can be scheduled considering only the functional area itself. For example, the audit department can schedule staff based on the deadlines of audit engagements, normally without considering the workloads in other departments.

The recent trend in accounting firms is to structure the organization around industry lines. With such an arrangement, individuals within the tax department focus on and are trained in key issues relative to specific industries. This allows these individuals to quickly become technically very proficient. For example, a tax practice with a strong automobile dealership concentration might focus its people on LIFO for automobile dealerships, as opposed to LIFO in general. Or tax personnel could focus on issues such as uniform capitalization as it is specifically relative to certain clients.

For smaller firms, the primary disadvantage of a rigid departmental structure is that flexibility is reduced in assigning personnel. When individuals devote all their time to either tax or audit, or to a specific industry, their overall practice development suffers. While in-depth knowledge is valuable, it precludes the ability to deal with a broad range of issues. Because of this, many firms with a rigid departmental structure still cross train staff. Cross training should be a significant benefit to staff; some people might leave if they feel their professional development is stunted by their work environment. Individuals within the audit department must complete some training in the tax area, and vice versa.

**Practice Tip.** Just as staff in the audit or management services department should be trained in the tax area, tax department staff should be trained in accounting and auditing. Tax staff without such training tend to get lost in a client's general ledger or not understand the accounting aspects of a particular situation. Be sure to adequately cross train, to allow at least some flexibility in assigning personnel.

Smaller firms without formal departments find an advantage primarily in the flexibility of staff assignments. Because staff members become experienced in many areas, they can be assigned where the need is greatest. The disadvantage of using the less formal approach relates to the organization of the firm. Less experienced staff often find it confusing to be assigned to an audit engagement for several days, and then to the tax area. Often, there is no clear understanding of the organizational chain of command within a firm without formal departments. Staff may not be sure who they report to or, worse yet, may actually need to report to more than one person.

Regardless of which approach is used, the heavy demands of tax season often require additional resources. A firm structured by department normally requires its tax department staff to work additional hours during the busy season. These firms occasionally assign others within the audit and management services departments who have the expertise to assist the tax department during the busy months. When such temporary assignments occur, be sure the reassigned staff are properly trained, and be sure to review and supervise their work.

Of course, even in a departmental structure with rigid boundaries, staff in the audit department and occasionally in the management services department contribute to the tax process in various ways, such as in the preparation of working papers for tax return purposes, the gathering of information on strictly tax issues (such as 50 percent disallowed meals expense), and so forth.

Smaller firms without a formal departmental structure usually have most of the staff concentrate their time on tax services during the busy months. Unfortunately, this means that much nontax work is delayed until after April 15. The advantage of achieving greater staff flexibility is often outweighed by the disadvantage of not paying proper attention to the nontax work. While it might be argued that nonessential, nontax work can legitimately be given a lower priority, you should be sure to manage the entire workload of your firm, not just the tax area, during the busy months.

**Practice Tip.** Be sure to specify in each job description that, although an individual has specific assignments, he or she has a larger responsibility to the firm as a whole. Exhibit 104-1 shows a sample job description containing such a statement. This should also be communicated during interviews with prospective staff.

## 104.1.2 Multioffice Structure

Firms with more than one office add a special dimension to managing a tax practice. As mentioned, on rare occasions, separate offices are organized by function, with one office primarily servicing tax clients, another primarily servicing audit clients, and so forth. However, all client services are more commonly offered by each office location.

### Staff Assignment

There are a couple of organizational alternatives involved in assigning individuals in a multioffice structure:

- Individuals are assigned to only one office and work exclusively out of that office.
- Individuals are moved around during busier periods to offices where they are most needed.

The advantages of assigning individuals to only one office are that the scheduling is simplified and, from an individual perspective, time out of the office and out of town is minimized. The primary disadvantage is that flexibility to address special workloads is reduced. For example, because of the demographics of an area, one office location may have a higher proportion of corporate tax returns with a March 15 due date. By being able to assign individuals from another office to this one, the March 15 deadline can be better addressed. The advantage of moving individuals around during the busy time is the ability to address the special needs that arise within the firm as a whole.

Staff of a multioffice firm may be concerned by the amount of time they are required to be out of town, particularly if this includes overnight travel. In circumstances where offices are relatively near, overnight travel may not present a problem, but the firm does need to consider lost productivity in terms of driving time, the cost of mileage reimbursement, lodging, and other expenses arising from temporarily assigning staff to a different office.

### Facilities and Management

If you operate a multioffice practice, you might find that assignment of individuals to a specific office works best. However, in critical times, individuals may be temporarily transferred to another location to meet needs. You should make every attempt to employ similar computer systems, to use a consistent set of policies and procedures, and a consistent approach to management in each office. This consistency permits work to be more easily reviewed and contributes to office-to-office quality within the firm. It also allows personnel who are temporarily transferred among offices to operate in a familiar environment, thus expediting the learning process, and reducing errors in filing, processing, and work procedures that can result from “transfer trauma.”

## 104.2 Professional Staff

Before we describe the important qualities of a tax staff, a critical point must be made: You must avoid not only unlawful discrimination in recruiting and promotion, but even the appearance of it. This is necessary for both legal reasons and employee morale. Similarly, firms must comply with other legal requirements, including the Federal Fair Labor Standards Act, the Family Leave Act, and the Americans with Disabilities Act. Even without legal requirements, firms should act in a socially responsible manner, allowing flexibility for staff in terms of work and personal matters. With proper training of employees, proper documentation of procedures, and through the rotation of job assignments, firms should be able to adequately compensate for the absence of individual employees for short periods of time.

The Voluntary Tax Practice Review guidelines from the AICPA Tax Division include the following policies and procedures related to personnel management:

- The firm should have reasonable assurance that work will be performed by people having the degree of technical training and proficiency required in the circumstances.
- The firm should have reasonable assurance that employees possess the appropriate characteristics to perform competently.
- The firm should have reasonable assurance that people completing tax work possess the knowledge required to enable them to fulfill the responsibilities assigned.
- The firm should have reasonable assurance that personnel selected for promotion have the necessary qualifications for fulfillment of the responsibilities they will be called on to assume.

Although requirements of tax staff differ depending on the position being filled, the following qualities are normally considered critical for tax personnel:

- **Technical Qualities**

- *Tax skills*: The individual must possess the technical abilities and analytical skills to work in the tax area, including good knowledge of state and federal tax codes and regulations, and return preparation and research skills.
- *Consulting skills*: The individual must be able to aggressively seek out planning opportunities and render advice and education to clients as a routine part of every engagement.
- *Management*: The individual must have the ability to handle client projects by *proper delegation* and *timely* and *efficient* completion of a task in a *thorough* manner.
- *Communication skills*: The individual must be able to speak and write well.

- **Professional Qualities**

- *Conscientious approach*: The individual must be dedicated to a high *quality* of professional services.
- *Leadership*: The individual must convey an impression of skill and strength that inspires client, staff, and community confidence in the ability of the individual and the firm.
- *Entrepreneurship*: The individual must bring enthusiasm and drive, and be a positive influence on the direction of the firm, with the ability to create work in new areas.
- *Dedication to clients and profession*: The individual must be willing to make personal sacrifices on occasion when client needs arise.
- *Dedication to firm*: The individual must be a team player who takes a strong interest in improving the firm as a whole, and its profitability.

- **Personal Qualities**

- *Integrity*: The individual must possess integrity of the highest level.
- *Motivation*: The individual must work effectively without supervision.
- *Congeniality*: The individual must work well with other staff and with clients.
- *Social presence*: The individual must have the self-confidence and social skills to deal effectively with others.

While many firms consider other qualities to be important in individuals working in the tax area, most practitioners would agree that the above list captures the most critical of them. Of course, the specific job responsibility for which an individual is hired prioritizes the different qualities. For example, if you are hiring at a supervisory level, then experience, management abilities, leadership, and entrepreneurship are probably of prime importance. For an entry level position, more importance is placed on the technical skills (and primarily on the ability to *learn*), and on a conscientious approach and integrity.

Of course, the specific qualities required for a job, along with the specific responsibilities of the job, should be clearly spelled out in a *job description*. Job descriptions are vital since they set forth the boundaries of responsibility within which goals are established.

**Practice Tip.** Job descriptions should be updated on at least an annual basis, and staff should have input in the updating. Exhibit 104-2 contains a sample job description for a technical staff person, and Exhibit 104-3 further exemplifies technical job descriptions.

Beginning July 1, 1992, firms with twenty-five or more employees needed to comply with ADA requirements. As of July 1, 1994, employers with fifteen or more employees also need to comply. The ADA is designed to remove unreasonable bias against any disabled individual who is otherwise qualified to perform the essential functions of a job.

The employer's determination of what are a job's essential functions should be disclosed in a written job description. Although usually obvious in tax practice, the working conditions should also be disclosed. How much travel is required? Does the job involve carrying of heavy files? Will the job involve sitting at a desk or standing at a counter assembling tax returns?

## 104.2.1 Required Qualities

A brief description of the individual qualities and the importance of each at different experience levels follows.

### • *Technical Qualities*

- *Tax skills:* For entry level people, it is important that individuals have *at least* some training in the tax area, and that they have exhibited, through their performance in school or with a previous employer, the ability to learn and to grasp new concepts. This is especially significant for tax work because of the high degree of technical and administrative change that occurs virtually daily. For positions requiring higher technical skills, you should be sure an individual possesses the technical experience necessary to address the level of responsibility and to lead and train others. Most firms require degreed staff with a major in accounting. More restrictive firms might require a Masters in taxation.
- *Consulting skills:* Even entry level personnel should be directed to seek out planning opportunities as a routine part of every engagement. For more-experienced personnel, this trait is imperative to develop work for other staff and to fully address the needs of clients.
- *Management:* This trait includes organizational skills, due date compliance, the ability to understand time budgets, apply standard rates, and so forth. It is less important for entry level staff, but becomes extremely important at a more experienced level.
- *Communication skills:* The analogy of an excellent physician with a poor bedside manner holds in a tax practice also. You should always seek out individuals (at every skill level) who possess good interpersonal skills and can effectively communicate with clients. Written communications ability is invaluable.

### • *Professional Qualities*

- *Conscientious approach:* A dedication to detail and to high-quality service is important for all individuals. To many clients, a misspelled name or an incomplete or incorrectly assembled tax return may raise serious doubts about the overall quality of the firm's work. With all staff, emphasize the importance of *quality*, timeliness, and thoroughness of service.
- *Leadership:* While the leadership quality and the ability to inspire client, staff, and community confidence is often associated with an experienced person, it is a trait of critical importance in all personnel. Even entry level staff who miss due dates or do not properly follow directions, convey an impression of weakness or disorganization that results in clients and other staff questioning the ability of the individual and the firm.
- *Entrepreneurship:* Similar to the requirement that staff be able to recognize planning services, this quality becomes more important with more experienced personnel. This might not be a trait you normally look for in entry level personnel, but is definitely of primary importance at the supervisory level.
- *Dedication to clients and profession:* This quality is important at all skill levels. Because of the special demands of a tax practice, you should be sure that individuals are willing to make personal sacrifices on occasion as client needs arise.
- *Dedication to firm:* This quality is also important at all skill levels. Individuals interested in advancing the firm as a whole will also be interested in improving its profitability. This shows up in factors such as the proper recording of charge time, proper billing of clients, and so forth. It is an important trait at all skill levels.

## 104.2.2 Recruiting and Hiring

Your firm should have recruiting guidelines and practices designed to assure that qualified individuals are hired into the firm. To incorporate quality control elements in your firm's hiring program, consider these steps:

- Investigate the background of all potential employees. Obtain completed application forms, college transcripts, resumés, and personal references from applicants to provide assurance that they have the necessary qualifications.
- Test to evaluate an individual's strengths and weaknesses. These tests might include bookkeeping tests for individuals in paraprofessional or clerical positions, or aptitude and perception tests for technical personnel. A "predictive index" test can be used to measure the candidate's work-style preference. Whatever type of test is used, be sure you hire the right kind of person for the right kind of job. Testing can be used not only in the hiring phase, but also in the counseling phase.
- Inform applicants and new employees in writing of firm policies relative to personal and professional performance.
- Provide orientation programs for applicants and new employees that provide them with a good understanding of the firm.

Seven areas should be considered before beginning the employment process:

- Identify the purpose of the position and justify its cost.
- Draft a job description detailing areas of accountability, responsibility, and specific duties.
- Evaluate the pros and cons relative to the utilization of part-time, full-time, seasonal, and potential "shared jobs."
- Consider internal promotions and transfers.
- Evaluate the labor market with an eye to future employment needs.
- Understand specifically what the company is looking for in background, skill level, qualifications, salary range, etc.
- Research opportunities and obligations that take advantage of federal and local programs, grants, and other legal obligations the company may have.

Whenever recruiting and hiring, you should first determine the skill level and experience level required for the position being filled. Some positions require more client contact than others, which means that traits such as communication skills and poise are more important. Other positions may require greater technical and analytical skills, such as used primarily in the tax return review process. When recruiting and hiring, use the stated list of technical, professional, and personal traits and prioritize each one for the specific position to be filled. Then seek out individuals with characteristics and skills in the required areas and complete the interviewing process targeted toward acquiring these skills in the people you hire.

**Practice Tip.** One method to analyze your staffing needs is to perform an analysis of how each individual spent his or her professional time in the previous year. This information should be available from your practice management reports. Then prepare a projection of growth and changes in the mix of your work. By comparing the projection to the current staff's capacity, a determination can be made of where shortages exist and the type of individual(s) to be hired.

### Internal and External Recruitment

Firms have two alternatives for recruitment: internal and external. Internally, by means of career development planning, individuals may be selected for given positions as promotions or transfers. Employers can only benefit when they allow employees to grow within their careers and capabilities. The more knowledge and skills employees possess, the greater their potential contribution. Training, combined with transfers or promotions to different responsibilities, enables employees to accumulate more knowledge so that their talents can be developed to



meet the employer's needs. For this reason, many employers identify employees with potential for promotion early on and actively encourage them to pursue advanced training.

External recruitment can take many avenues:

- Walk-ins
- Unsolicited resumes received in the mail
- Advertising in newspapers, industry publications, or Web sites
- Resumes received through college placement offices
- On-campus interviews
- Personal referrals
- Employment agencies and professional recruiters

**Practice Tip.** Before initiating a search for a suitable applicant, all unsolicited applications and resumes that have been received, as well as those of people who have been rejected for previous positions, should be reviewed.

### Finding External Recruits

When hiring entry level people, the placement offices of colleges and universities, along with many fraternity and sorority organizations, provide recruiting opportunities and sources. Maintain contacts with accounting faculty at local schools. Professional meetings and local CPE offerings, along with civic groups, may also yield leads on potential employees. Many firms keep in touch with attorneys, bankers, and other professionals in their locales and ask them to be on the lookout for bright men and women seeking employment in the tax area. Also, keeping in touch with other tax firms results in employment referrals as individuals move from community to community, often because of the job transfer of a spouse or for other personal reasons.

**Practice Tip.** Prepare a brief description of the firm, its facilities, and locale, plus notice of positions open and applicant qualifications. Send this to placement offices of local universities or schools you want to recruit from.

When hiring entry level people, you need to consider whether individuals should be hired directly into the tax department, or whether other staff within the firm (such as those in the accounting and auditing department) should be considered first. You should also instruct partners and supervisory personnel in the audit and other departments to be on the lookout for people expressing interest in transferring to the tax department. In particular, this might surface in counseling sessions between partners and staff.

**Practice Tip.** Many firms conduct career planning sessions in which staff are able to describe personal career objectives and the firm is able to comment on the respective strengths and weaknesses of a staff member. Such career planning sessions may help to identify people interested in transferring to the tax department.

### Emphasizing the Firm

Some firms provide an orientation program for applicants as an introduction to the firm. This program serves the dual purpose of acquainting individuals with the firm while screening out those who decide your firm is not suited to them. Exhibit 104-9 contains an Orientation Checklist that can be used as a script for setting forth firm policies and benefits to applicants and as a formal checklist for new hires. Even if you do not present formal recruiting or orientation programs, you should have your firm's development brochure available for applicants. Interviews with candidates should include time to explain the firm's philosophy, opportunities for and policies on advancement, benefits, the amount of travel and overtime to expect, and a general description of the client base and the nature of engagements. Effort should be made at this stage of the hiring process to present an impressive, albeit honest, view of the firm that can serve to create good will as well as establish a realistic set of expectations.

**Practice Tip.** Use opportunities such as presentations to local high school students and Career Day speeches to encourage young men and women to seek employment as tax professionals in their hometown after completing their education.

## Psychological Testing

Unfortunately, most tax practitioners are not good at adequately assessing an applicant's strengths and weaknesses from a job interview. While college grade point average and high school standing can give a good indication of intelligence and ability to learn, it is often hard to look inside an applicant's psyche and reveal the "true" candidate.

Contracting with an industrial psychologist can help identify warning signs not otherwise noted in the hiring process, such as poor stress management, poor organizational skills, inability to work well with others or inability to accept constructive criticism. Considering the high cost of developing new staff, the small additional cost of psychological testing is probably worth the effort if it can keep you from making even one wrong hiring decision.

### 104.2.3 Interviewing

The greater the number of applicants interviewed, the better the chance of finding the ideal employee; remember, however, one person with the right qualifications is all it takes. During the interview process, be sure to review the following areas:

- **Basic qualifications:** The resumes or job applications received should indicate which individuals are sufficiently qualified to be given further consideration; be sure to check for the *minimum* requirements that have been established for the job.
- **Work experience:** The best way to evaluate work experience is to design a checklist of job specifications and duties and compare the experience of the applicant against the established job criteria.
- **Education:** An applicant's academic, vocational, or professional education should be examined in terms of how it relates to a job's requirements.
- **Personal characteristics:** When screening applicants who are still good prospects, look for factors that are potentially significant indicators of success in the job, such as personality, motivation, and interests.

**Practice Tip.** The appearance of the resume or application says something about the applicant:

- Is the resume or application neat and legible?
- Is the information presented well?
- Are there inconsistencies or contradictions?

Observe whether there are any omissions in the applications, or questions that have been left unanswered.

### Preparing for the Interview

There are five major steps in preparing for interviews, and each plays a critical role in the selection process:

- **Know the job:** The interviewer should carefully review the job description to understand the job to be filled and the qualifications it requires.
- **Determine the objective of the interview:** Screening interviews are intended to select potential candidates for further consideration, and once several good candidates have been selected, the next interview determines the best-qualified candidate or candidates.
- **Plan the format:** Determine the number of interviews to be conducted by whom, the approximate time allotment for each interview, and the specific issues to be covered.
- **Learn about the applicant in advance:** Carefully review each candidate's job application or resume in advance.
- **Provide for privacy:** Make sure there are no interruptions during the interview.

Forms to be used for recording the results of an interview and for documenting the evaluation of the interviewer are included in Exhibit 104-10.

## 104.3 Employee Morale

Positive morale among employees is imperative to the successful operation of a tax practice. Positive morale leads to effective teamwork and cooperation among employees, creating an efficient and effective workplace that mitigates many of the negative aspects of long and stressful hours.

Although employee morale can be affected (both positively and negatively) by many factors, management is responsible for maintaining it at a high level, and at least for avoiding practices that depress or destroy it. Following are a few basic pointers that maintain a spirit of cooperation and achievement among staff:

- *Consistently* apply policies and procedures throughout the firm and effectively communicate them to employees.
- Provide for effective two-way communication by informally checking with employees on how things are going, such as individual workloads, personal problems, and so forth, and provide an open door for employees to contact you with concerns and recommendations. Remember that listening is a prerequisite to communication.
- Establish individual goals and opportunities and fair, clear staff evaluation standards and policies (see Section 104.8, Staff Evaluation) that provide meaningful feedback on employee achievement.
- Provide opportunities for staff to work as independently as possible at a level that is achievable but that presents substantial productive challenge, and provide opportunities for continuous learning and development.
- Provide staff with formal and informal training opportunities.
- Conduct a formal, upward evaluation session at least annually (see Section 104.8).

Declining morale is sometimes hard to detect. You should watch for these signs of weak morale:

- Excessive absenteeism or failure to observe standard work hours
- A reduction in quality from an employee or a group that is normally very conscientious
- A decline in congeniality or a moody or snappish attitude
- A decline in motivation or the need for continuous direction when little has been required in the past

These are just a few of the individual signs of weak morale. When morale declines in an individual, it affects the entire firm because clients and staff perceive the problem and choose either to avoid the person or, worse yet, subscribe to the same philosophy.

You should make every attempt to monitor employee morale daily. Depending on the size of your firm, you might want to check in with every employee, or with as many employees as possible, for a minute or two every day in order to take a reading on stress factors, personal problems, and so forth. If you detect morale problems, make every attempt to address them *immediately*. A decline in morale quickly spreads from one employee to another, and within a short period of time, the entire firm can be affected.

Motivate staff by recognizing good work and achievements. A simple “thank you” or a pat on the back can go a long way toward improving morale. Constantly be on the lookout for instances of employees doing something *right*, and give them positive reinforcement for these accomplishments. Most important, however, is for partners and supervisory staff to set a good leadership example. Morale is boosted when employees respect the people they work for.

**Practice Tip.** Set a goal of communicating positive reinforcement on a daily basis. Keep track of the incidence of significant accomplishment by staff, and highlight some of these activities in staff memorandums and at staff meetings. Go out of your way to convey the message that good accomplishments are recognized and rewarded (even if the reward is only in terms of verbal reinforcement).

### 104.3.1 April 15 Appreciation Alternatives

Many firms enhance employee morale through dinners and other means of appreciation on, or immediately after, April 15. It may be a planned, formal dinner for all employees and spouses, or an informal gathering with sandwiches and refreshments, with the firm picking up the tab. Other firms simply determine what the per-person cost of a dinner or party would be, and pay that amount to the employees, encouraging them to do what they want after April 15 with the additional dollars, thereby allowing them to spend time with their families.

In all informal staff gatherings, two major issues must be considered:

1. Be aware of legal liability issues with firm-sponsored or firm-endorsed activities at which liquor is served. Because of the potential liabilities, many firms hold company picnics and other gatherings *without* alcohol.
2. As with any gathering outside of the office and with nonemployees present, explicitly warn staff not to discuss client matters. Make it very clear that client matters are to be discussed *for business reasons only* in the confidential setting of the office. This should be made an inflexible policy of the firm regarding client confidentiality. Because of the extreme temptation to discuss such matters around April 15, specific warnings might be appropriate, even though you might not consider them to be necessary.

Some firms sponsor events such as staff trips, where an established amount for every person (for example, \$300 per person) is used towards transportation and hotel costs at a location selected by the staff. Such events are sincerely appreciated by staff, particularly after the busy months. However, because many of these expenditures need to be treated as taxable income to the recipient, carefully weigh the benefits of such alternatives against a simple bonus payment, where the recipient can individually decide how the dollars should be spent.

**Practice Tip.** Some firms allow April 16 as a holiday, or offer a “Tax Day Off” to be used shortly after April 15, either on a Monday or a Friday. Others offer extended personal time to employees, sponsor other types of activities such as golf outings or other sporting events, and, in general, look for whatever alternatives might exist to express appreciation to staff after April 15. These approaches go a long way toward improving employee morale and expressing a sincere thank you to employees. Whatever approach is used, allow staff to offer input on the decision and arrangements, since they are a work-community.

### 104.3.2 Busy Season Weekends Away

Some firms *require* each staff member to be out of the office for at least one weekend during the busy season. The dates must be scheduled in advance, to assure that adequate staff remain in the office. Some firms complement the weekend away by paying all or a portion of the expenses for a hotel room and/or meals for the employee and family.

**Practice Tip.** A weekend away during the busy season not only *improves employee morale*, but provides much needed relief from the stress and strenuous activity of the busy season. Most practitioners agree that the rest and relaxation provided by the weekend out of the office significantly enhances overall productivity by preventing errors that occur because of exhaustion and severe tension. Occasionally, firms extend the required period away, allowing time frames such as noon on Friday until Monday morning for the individual to be out of the office, or even allowing a three-day weekend.

The primary disadvantage of busy-season weekends away is the negative impact on productivity that might occur in the short run. Some firms have found that staff spend a day or two anticipating the weekend before leaving and another day or two “catching up” upon return to the office, resulting in a significant decrease in productivity during this time. This catch-up time can be reduced if the remaining staff are encouraged to “pitch in” and pick up the slack. This is not an unreasonable request since all staff will receive the benefit of having a weekend away.

An alternative approach is to schedule several informal events during the busy season. One week it might be a pizza party for staff, another week a visit to a special restaurant, another

week an evening boat ride, and so forth. The advantage to this approach is that it provides an opportunity for the staff to relax and maintain a team spirit, without being out of the office for an extended period of time. The key is to keep such events as informal as possible to avoid further conflict with staff's at-home and family obligations. The disadvantage is that it may not provide the physical and mental relief from stress and strenuous activity that two or three days out of the office might.

### 104.3.3 Soliciting Staff Comments and Recommendations

As soon as possible after April 15, meet personally with each staff member to solicit comments and recommendations on the busy season. Also, consider the use of a "Staff Tax Season Evaluation" form, as illustrated in Exhibit 104-4. Discuss all aspects of your tax practice, including controls, the data processing system, stress, and other factors. In general, provide an opportunity and forum for employees to recommend better ways to approach tax season in the future.

While some firms ask for written comments (either identified or anonymous), most find that an informal discussion works best. Take thorough notes and consider staff comments carefully, but also exercise caution in considering the environment against which the comments and recommendations were made.

Complete these meetings as soon as possible after April 15 to provide a forum for staff while thoughts and recommendations are fresh in their minds. Follow up on the meetings with individual staff members with a discussion summarizing the comments at the next staff meeting. Attempt to reach some consensus among staff as to the priority of issues, and arrive at a decision on how various factors should be addressed.

**Practice Tip.** Staff meetings for feedback are truly valuable, but only if management acts. Be sure you are responsive to the feedback obtained from your staff. If an idea is not going to be implemented, communicate to staff the reasons why not.

## 104.4 Developing Staff

Management should continually discuss career path alternatives with staff. Inquiries should be posed to staff regarding their likes and dislikes, with a focus on the individual career objectives. Similarly, management should be directing feedback to staff regarding the respective strengths and weaknesses of individual staff members, in an attempt to help guide the staff down the correct career paths. Management must always recognize its responsibility for staff development and training.

However, there is a clear distinction between staff development and staff training. Staff training occurs through continuing professional education and other formal educational programs. Staff development takes on a much broader role, including general business skills, marketing skills, and the development of supervisory skills. Many of these attributes are learned through experience—you should assign higher levels of responsibility to staff and then provide feedback on their handling of the responsibility. Proper delegation allows not only for development of staff, but also for an efficient and profitable practice. However, in delegating work to staff, be sure that proper direction is given and adequate follow-up occurs. Two dangers normally exist with the delegation function:

- Improper or inadequate delegation
- "Upward delegation" (i.e., where staff do not thoroughly complete a job, but rather "delegate" the work back to a superior for completion, even though staff is capable of completing the work)

Staff development is affected by the procedures a firm uses to complete tax returns. A tax return preparation technique using computer input forms completed by less-experienced staff might result in slower staff development than could be achieved with desktop preparation, where an individual enters the input and actually completes the return. When a less-experienced person only completes the computer input forms, he or she may never see a "finished return,"

and accordingly will not properly associate many source documents with a completed return. In interactive return preparation, the individual not only enters information from the source documents and organizers, but also can see a “finished return.” This technique promotes greater accountability and accelerated staff development. Staff obtain a better and wider comprehension of complex issues such as passive loss limitations and alternative minimum tax.

General business, marketing, and supervisory skills are learned in the office and community environment. One of the best methods to develop staff is to encourage individuals to participate in professional activities and civic and community work. For example, staff should participate in activities of the local Chamber of Commerce, the United Way, perhaps the local theater or symphony organization, and other nonprofit organizations. These activities not only provide a tremendous training ground, but offer numerous marketing opportunities associated with present and potential clients.

**Practice Tip.** Be sure to provide adequate feedback to allow staff improvement and growth. Not only should this occur in evaluation sessions, but also on a day-to-day basis. Too often managers and supervisors are unwilling to take the extra time required to provide positive reinforcement and to communicate problems or concerns to their staff, in order to work on improving individual achievement. This is particularly true with less-experienced staff and particularly during the busy season.

Experienced staff have a *responsibility* to assist in the training and development of newer staff members. Have experienced staff act as mentors on a formal or informal basis with new or developing staff. Be sure experienced staff communicate review points and adequate explanations to newer staff, and take time to answer questions and explain complex issues. Because management capability is one of the traits required of supervisory personnel in the technical area, evaluations of upper-level staff should always take into account their ability to properly supervise and develop those who report to them.

#### 104.4.1 Advancement

Every firm should have guidelines for personnel advancement. The AICPA Tax Division’s Tax Practice Review Program includes advancement systems as one of the personnel management areas a firm should review. A *system* for advancement is an important component of a firm’s quality control because it provides reasonable assurance that employees selected for advancement have the abilities and credentials to fulfill new responsibilities. Additionally, the system for advancement clearly allows staff to understand what is expected of them and what the criteria are for advancement within the firm. These criteria should detail the requirements for advancement at all levels within the firm, including the partner level.

Refer to Exhibit 104-3 for sample professional job profiles, which clearly delineate the responsibilities of all professional levels, including the partner level. Staff often comment that one of their biggest complaints is not having written criteria for advancement available or a clear understanding of what is expected and how performance will be evaluated.

When developing a program for employee advancement in your firm, you should—

- Determine and set forth in writing the required qualifications for each level of experience in the firm (see Section 104.2.1).
- Regularly review employee performance (see Section 104.8).
- Establish responsibility for overseeing the personnel evaluation and counseling systems.
- Delegate the responsibility (if possible) for making advancement decisions.

With the availability of improved management information systems, staff should be able to complete self-assessment on issues such as budgeted vs. actual charge hours, realization percentages, and so forth. Be sure to regularly share activity reports and other management information with staff to allow their continuous monitoring of firm prospects.

Involve employees in their own advancement. Have the employees review the qualifications for their current position and the position they strive to be promoted to. Then have the employees evaluate themselves as to whether they feel they have mastered the skills for their current

position and whether they have begun to master the skills required for the next level to which they aspire.

Whenever possible, the responsibility for promotion decisions should rest with specific individuals or a standing committee. Whoever conducts the evaluation interviews should be responsible for documenting the interview results. Advancement and termination recommendations are based on the interviews and personnel files. Good documentation of interviews cannot be stressed enough, from both internal operations and legal standpoints. A senior partner or executive committee should review the recommendation and make the final decisions. A two-step process helps reduce the effect of individual bias when making evaluation and advancement decisions.

**Practice Tip.** Providing a mechanism for the advancement of qualified personnel in the firm benefits the firm by assuring that the firm is staffed with competent personnel. Also, the staff morale is improved and the turnover rate reduced when staff members know opportunities for advancement exist.

## 104.5 Staff Meetings

*Communication* among all members of the firm is imperative. The importance of constant and thorough communication cannot be overstated. While certain issues must be kept confidential, a great number of issues can be communicated to staff without a problem. Examples might include potential hiring decisions, remodeling plans, computer enhancements and software changes, and so forth. In fact, staff often can give feedback which proves highly beneficial in firm matters.

Staff meetings, at which all staff members are required to be present, are an integral part of any successful tax practice. Schedule staff meetings weekly or bimonthly and make attendance mandatory. Allow no phone calls or other interruptions during the staff meeting. Follow procedures for conducting effective meetings: select a leader; establish an agenda (no matter how brief); take minutes; and follow up on conclusions or developments.

Written minutes of staff meetings should be prepared and distributed. Those unable to attend the meeting can then keep abreast of important developments in the firm. Written minutes also provide a “to do” list and add accountability for specific follow-up actions.

The staff meeting provides an open forum to discuss issues impacting individuals within the firm. Topics that warrant discussion at staff meetings include, but are not limited to, the following:

- Marketing ideas
- Technical developments (For the tax department, this should be an important topic. Provide opportunities for everyone to be involved.)
- Developments on use of data processing system
- Status of overall work
- Individual problems or concerns
- Individual workload levels
- Firm measurement statistics, including billings, realization, number of returns filed, and so forth

**Practice Tip.** Be sure staff meetings are scheduled on the calendars of all participants in advance, and allow adequate time for discussion of all topics. Staff meetings not only present an opportunity for communication of important items, but for participants to pose questions and seek advice on complex or troubling issues. Technical development of staff can be supported at these meetings. Some firms assign a different person to be the “Chair” at each meeting, including entry level personnel who are given an opportunity to assume a leadership role.

Occasionally, it may be appropriate to hold staff gatherings without partners. This approach puts less stress on staff, allows a more open discussion, and helps staff to better relate to their

direct supervisors. Supervisory personnel present should be sure to keep the discussion at a positive level, and not allow the meetings to become events that adversely affect employee morale. Some firms conduct such meetings by bringing staff together for a working lunch, with the firm picking up the tab.

**Practice Tip.** During the slower months assign each employee a tax topic to be presented and discussed at weekly staff meetings. A fifteen minute presentation with examples and case studies will not only provide needed information but will also help develop effective speaking and presentation skills. This exercise doesn't need to require significant preparation and research time, as the topics could be simply reproduced from well-known publications.

## 104.6 Using Paraprofessionals, Part-Timers, and Seasonal Staff

Because of the work demands during the busy months, many firms use paraprofessionals, part-timers, and seasonal staff to help them meet the heavy demand. Individuals with proper skills and training are sought out and used. A particular advantage results if the same people come back year after year, since little training is required and productivity tends to be enhanced.

There are excellent opportunities for hiring such employees. Interns can fill staffing requirements during peak seasons and are a recruiting opportunity for the firm. Year-round "flex" people also provide excellent opportunities. These individuals may work two or three days per week during the off season and five or six days per week during tax season. For example, in agricultural areas, farmers and ranchers with technical training (or college degrees) often look for employment during months when their workload is otherwise light. Spouses not employed outside the home are excellent candidates for training and employment as part-time personnel. Retired businesspeople within the community may be interested in assisting on a part-time or seasonal basis. College students can be hired to assist, which also provides a basis for analyzing those individuals as prospective full-time employees. Finally, alumni of the firm who have taken jobs in industry or left the firm to work at home are excellent candidates for part-time and seasonal staff positions.

You should continually watch for seasonal and part-time candidates from clients you meet with. Some clients take pride in good recordkeeping skills. Many of these people have prior experience or training, and are ideal candidates for seasonal work. Additionally, you should let other professionals (e.g., bankers and attorneys) and clients know that you are always seeking good seasonal help. If the same people are encouraged to come back year after year, productivity will be enhanced.

Men and women who are starting families often choose to devote several years to the full-time care of children. Sometimes these individuals are willing to work part-time during the busy tax season, from which both the firm and the individual benefit. The parent remains in contact with the firm and stays abreast of changing tax laws and practice issues, and the firm maintains its contact with a valuable employee who may eventually return to the firm on a full-time basis.

Paraprofessionals and others within the firm who perform less technical or even nontechnical services during other months can be trained to assist with tax return preparation during the busy months. These resources can have a significant impact on offsetting the increased professional time demand during the busy season.

Finding workspace for seasonal staff can be a problem, but these personnel do not necessarily need to be supplied with a full office. They can be provided with a semi-private work station or a desk in a common area. However, it is important that they be provided with a fixed work area to allow organization of supplies and information. With today's technology, it is possible for seasonal staff to do some work outside of the office, although you need to develop controls and policies associated with files and client information that is carried outside the office.

Seasonal and part-time staff should be provided with training similar to other personnel, including the following:

- Basic training and review of fundamental tax preparation points (usually in January)
- Refresher on computer system usage



- Annual Tax Update course
- New legislation course, if any
- Optional seminars, workshops, college courses, self-study programs
- On-the-job training through good feedback

**Practice Tip.** In some firms, technology enables the use of less experienced people to document files and do basic input. The review of files and wrap-up is performed by experienced staff. Such arrangements have experienced people at the top offering high-level planning and advice, intermediate-level people performing compliance duties, and experienced staff carrying out review and quality checks.

Productivity and profitability of the firm can be maximized by using the concept of “just-in-time” staffing. Rather than allowing hiring decisions to be solely a knee-jerk reaction to work overload, attempt to build a model showing total required and available billable hours over the coming twelve months (refer to Exhibit 101-12 for a model dealing with a tax season workload projection).

Even during the non-busy months, keeping full-time staffing slightly below expected need and using part-time staff to supplement will insure that employee labor is always fully utilized.

Firms which attempt to staff at the “average” needed over the course of a year will find that excess capacity exists in the slower season (resulting in under-utilized employees) while a work overload is forced on these employees during tax season. Such an arrangement might be negatively viewed by staff as a “sweatshop” since it does not convey a sense of forward planning by management.

Other firms calculate their full-time staff needs in terms of busy season requirements and then shift to shorter office hours, or a flex-time arrangement, during the summer months. For example, some firms close at noon on Friday or shorten workdays during the summer months. Under a flex-time arrangement, employees are able to take time off in lieu of being paid for longer hours worked during the busy season. The arrangement might apply to all employees, or only to professional or clerical groups of employees. Consider the implications of the Federal Fair Labor Standards Act in shortening employee hours. Many firms allow employees who are exempt under law from the Act to take time off in summer months in lieu of receiving overtime wages during the busy season. Such arrangements are not legally permitted for employees covered under the Federal Fair Labor Standards Act.

### 104.6.1 Managing Workload Compression

While many firms use part-timers and seasonal staff to minimize the problems associated with workload compression, overall planning to address the workload compression problem must be addressed. Firms and individuals must be willing to *change* their processes and general approach towards tax preparation.

One of the biggest keys to managing workload compression is the ability to properly delegate. Many practitioners are reluctant to delegate and shift work to its proper level, yet complain of long hours and high stress when they do the work themselves.

Even firms that are able to hire part-timers and seasonal staff must complete additional planning in order to address the workload compression problem. The capabilities of all technical personnel within the firm must be assessed, and a shifting of responsibilities must occur. That is, the most experienced people should only be working on highly technical projects. Tasks able to be completed by others should be delegated to lower levels. Similarly, middle-level technical personnel should shift lower-level technical work to the part-time and seasonal staff. Of course, if some part-time or seasonal personnel are able to handle technical projects, this work should be assigned to them.

**Practice Tip.** Delegation is the overall key. Work must be assigned to the proper level to facilitate an even flow of work, prevent bottlenecks, and develop expertise in less experienced staff.

Another technique is to encourage flexibility and department cross-training. During the peak of compliance work, audit staff can be assigned to the tax department (and during summer,

tax staff can be loaned to the audit side). This enhances skills and client familiarity of all staff members and helps the firm stay nimble throughout the year.

## 104.6.2 Flexible Work Arrangements

Flexible work arrangements allow enhancement of work/life balance. The majority of tax firms offer part-time and flex-time opportunities, with many also offering summer/holiday hours, work-at-home options, and job sharing. Flexible work arrangements are important to allow adaptation to changing demographics and lifestyles and to reduce expensive turnover costs. Other benefits include improved client service, improved productivity, and improved employee performance and morale.

### Flexible Full-time Work Options

Flexible full-time work options allow personnel to choose starting and quitting times within limits established by management. This is a very widely used option, with benefits including improved workforce quality, reduced employee stress, reduction in absenteeism and tardiness, improved scheduling (by allowing extended coverage or service hours), and improved productivity. In establishing a flex-time program, management must define the total length of a workday, the normal operating hours in a standard work week, core hours that all personnel must be present, and so forth.

### Reduced Work-time Options

Compressed work weeks can also be offered, such as four ten-hour days, three twelve-hour days, etc. Benefits of a compressed work-time arrangement include extended hours of service, extended use of capital equipment (leveraging the cost of the equipment over a greater period), improved scheduling for peak workloads, and improved employee morale. However, the Federal Fair Labor Standards Act may require payment of overtime for some employees, and specific state legislation should also be reviewed.

### Telecommuting

Telecommuting allows personnel to work off-site for a portion of the time. In addition to reducing office space requirements and certain overhead expenses, advantages of using telecommuting include improved productivity, recruitment and retention of quality personnel. Telecommuting promotes more efficient use of equipment and management effectiveness.

Any program for flexible workplace needs to make provision for certain policy issues such as reversibility of the flex arrangement, confidentiality of client information, insurance coverage during regular working hours and provision of equipment and expenses such as phone lines, messengers, paper goods, and so forth.

### Work-sharing and Job-sharing

As opposed to adjusting operating costs by cutting back on the number of personnel, management might reduce paid hours and salary. Options in this area include a voluntary reduction of work time by personnel, ad hoc work-sharing, and work-sharing with short-time compensation. Advantages of work-sharing arrangements include better coverage and continuity, broader range of skills and experience, and creation of possibilities for upward mobility.

For an excellent discussion of the implementation of flexible work arrangements in a tax practice, including details on a “how to” approach, see the AICPA publication *Flexible Work Arrangements in CPA Firms*. This publication, product no. 090425, is available through the AICPA Order Department by calling 1-888-777-7077. The price is \$19.95 for AICPA members or \$24.95 for non-members, plus shipping and handling.

## 104.6.3 Compensation and Benefit Issues

When dealing with part-time and seasonal staff, billable hours is the factor used by many firms as the basis for calculating salary. Employees on a reduced work schedule often receive a pro-rata share of the compensation they would have earned as full-time employees. Although

employees may work less than full time for some months of the year, some firms still treat them as full-time personnel with full benefits, but simply have the salary paid pro-rata over the entire year.

Benefits are normally provided to personnel working less than full time by having the firm pay a pro-rata portion of the benefits, meaning that part-time employees may need to pick up a percentage of benefit cost, such as health insurance and disability insurance.

Policies and procedures that are barriers within a firm to increased flexibility must be identified and revised. Based on surveys of the profession, flexibility represents the number one work/life issue in organizations. Perhaps more than anything, the support of supervisors is a key in effectively implementing flexible work arrangements. Additionally, everyone within the organization, from the receptionist who watches personnel come and go to the partners in the firm must support policies and procedures associated with flexible work arrangements. While formal policies may exist providing flexible work arrangements, negative comments from personnel may destroy the efforts of the firm to effectively implement a flexible work arrangement environment.

## 104.7 Personnel Policies and Procedures

Your firm should have established personnel policies and procedures. These provide a consistent set of guidelines for personnel, and allow you to take a consistent approach to employee issues. You should discuss deviations from established policies and procedures with the particular staff person involved. Consistent disregard of policies and procedures should result in probation and potential termination of employment.

To effectively implement your personnel policies and procedures, complete the following steps:

1. Once the personnel policies and procedures have been established, communicate them to all employees.
2. Analyze the policies and procedures on an ongoing basis, and even consider soliciting staff assistance in analyzing them. Update them as necessary.
3. *Enforce* the policies and procedures on a consistent basis.

Exhibit 104-8 is a sample table of contents for a personnel policies and procedures manual.

## 104.8 Staff Evaluation

It is extremely important to work with staff in establishing goals for the year. Goals should be attainable, but challenging. Goal setting should occur at least on an annual basis in a meeting with each employee, often at the employee's annual review.

On a more frequent basis, you should review the accomplishments of staff versus the goals established. Job performance should be evaluated on a periodic basis with all staff, either when a tax project over a certain number of hours (as an example, 30 or 40 hours) is completed, and/or with evaluations at established time intervals (as an example, quarterly or semiannually). Evaluations of partners should also occur. This can be by cross-evaluations among partners, or by a special partner evaluation group.

You should also consider flash evaluations. These are periodic one-paragraph evaluations that aim at obtaining a quick impression of interrelationships and effectiveness. They can also be used for staff to evaluate all others within the firm, including partners and themselves. They are normally conducted informally, using forms collected and analyzed on a confidential basis. The advantage is that certain problems that would otherwise not be detected are nipped in the bud if immediately addressed. The disadvantage of this type of evaluation is that it focuses on special situations rather than overall performance, and may have a tendency toward negativity.

Exhibit 104-5 contains a sample form for conducting a formal staff evaluation. The form follows the traits described as desirable in tax staff. An evaluation is completed, and there is space on the form to list mutually updated goals for the next period. Alternatively, the evaluation

form might list attributes that are better than expected on one page and provide a separate section for written comments on attributes that need improvement. It is important to remember that evaluations are not report cards. Check-off blocks and rating systems are subjective depending on the person completing them. Written comments evaluating performance specific to a job rather than generic numbers and check-offs are much more effective in helping people grow.

Many firms combine a performance review with a salary review. Ideally, you should *conduct a salary review separately* from the performance review. When salary reviews are combined with performance reviews, staff tend to focus their attention on the financial aspects of what is said, attempting to place a plus-or-minus dollar value on all observations. They tend not to be as attentive to a discussion of their performance and goal setting.

Reviews for tax staff normally should occur shortly after April 15. Similarly, salary adjustments also work quite well if timed after April 15. In the event of required changes in staff, this allows adequate time to interview and hire new employees. Similarly, scheduling salary reviews shortly after April 15 allows yet another method of linking performance, evaluation and compensation.

The individual who works closest with the staff member should normally complete the evaluation. Ordinarily, this would be the employee's immediate supervisor. However, people completing the evaluations should occasionally be alternated so the staff person does not always deal with the same person. Suggestions for improvement should be given whenever aspects of performance appear weak. Always cite improvements and accomplishments and always set goals for the next period. Often, two supervisors can provide a more objective and complete evaluation than solely relying on one person's perspective.

**Practice Tip.** One approach used by many firms is to use the same form (see Exhibit 104-5) for both a self-evaluation by the staff member and an evaluation by the supervisor. As a part of the staff evaluation process, the forms are compared and used as discussion vehicles. Regardless, a mutual approach to goal setting and problem recognition/attention must occur.

Exhibit 104-6 illustrates another sample questionnaire that can be used to evaluate the skills of employees. These skills interface with the job profiles contained in Exhibit 104-3. A close relationship should exist between requirements contained within a job description for a specific person and the evaluation questionnaire used to determine the skill level of the employee.

Exhibit 104-7 is a sample of a quarterly performance evaluation form.

In evaluating staff, remember that not everyone possesses strong skills in all areas. Attempt to find the best in all your people, and exploit the strengths of personnel, while minimizing weaknesses. Consider the specialization that has occurred in the sporting world, emphasizing that the strengths of people are not universal, and that the best result often can be achieved by combining the unique strengths of many.

**Practice Tip.** Performance evaluations need only be as long as required to outline an employee's responsiveness to the requirements of the job. All performance evaluations should be documented, dated, and signed by the employee and respective supervisor.

## 104.9 Retention of Staff

One of the greatest challenges facing professional firms is retaining good people after they have been recruited, hired, and trained (see Section 104.3 for a discussion of employee morale issues). Individuals change jobs for many reasons: better salary, improved working conditions, more opportunity, and personal reasons, just to name a few.

In a tax practice, a number of key issues impact staff retention:

- *Fair pay for work performed.* Salary and fringe benefit amounts must be in line with those being paid by competitors, or staff will be inclined to look elsewhere. If one or more individuals are truly exceptional, be sure you are paying them a fair amount for

their abilities—in essence, what they are worth to you and to the firm—even though this may be significantly higher than what competitive salaries would be.

- *Good working environment.* A well-maintained office area, and work space for the individual commensurate with professional responsibilities, is important.
- *Opportunity for advancement.* Most professionals look for new challenges and increasing responsibilities. Well-designed firm growth plans and crisp firm objectives allow career counseling with staff members, and provide a clear vision of available opportunities (see Section 104.4).
- *Incentive programs.* Well-designed incentive programs contribute to staff retention. Examples are cash bonus amounts paid on charge hour, firm growth, firm profitability targets, and so forth (see Section 104.10), and tuition or registration reimbursements for advanced degree programs or other education.
- *Professional treatment.* All individuals within a tax practice bring a sense of professionalism to their work. Treat them as professionals! Allow a working environment that provides for individual creativity, but that allows overall control and the production of a quality product.

**Practice Tip.** Continually assess the salary and fringe benefit program of existing staff against what you are offering new recruits. One of the most serious morale busters in many firms is discovery by a staff member with three or four years' experience that his or her salary is only a few dollars above what a recruit receives.

## 104.10 Compensation

The fundamental objective of a salary administration plan is to ensure that employees are paid in relation to the value of the work they perform. The company should receive a fair return on its salary investments, and in turn, individual employees should receive a fair compensation for their abilities and efforts.

### 104.10.1 Compensation Objectives

The specific objectives of any compensation plan should be:

- To pay competitive salaries as an attraction to superior people and motivation for them to do their best.
- To establish and maintain a logical, consistent scheme on value relationships among positions that represent an objective analysis of the division of responsibility.
- To pay individuals fairly according to their relative contribution to the effectiveness of operations, the objective measurement of which is considered to be the relative value of the work each individual performs and the results achieved.
- To establish and maintain a competitive, sound salary structure—one that provides strong inducement to individuals to advance and to assume greater responsibilities.
- To establish and maintain salary ranges for the respective salary grades that afford ample latitude for recognizing and rewarding performance improvement and superior performance.
- To establish and maintain logical earnings relationships between supervisors and their subordinates.
- To maintain a competitive compensation structure that is applied subject to various economic pressures such as inflation, salaries at other companies, and the profitability of the organization.
- To establish meaningful differentials in compensation between individuals performing at significantly different levels and administer adjustments so as to recognize these differentials.

- To comply fully with provisions of all government regulations regarding compensation.
- To plan and implement all compensation expenditures through the budget system.
- To communicate with all employees the compensation policy and the methods of administering this policy.

### 104.10.2 Salary Ranges

A salary range is established to allow an individual room for growth within a job classification based on job performance over the years. Each individual range moves on an annual basis. Employee performance should be evaluated to be consistent with the company's ability to pay an appropriate salary that is commensurate with performance and that moves the individual up the salary range of the position.

Those employees who consistently far exceed performance expectations progress to the upper portions of their salary range, while employees who make steady performance improvement generally retain their position within their salary range.

**Practice Tip.** Accordingly, it is necessary for the supervisor to determine each employee's performance relative to the performance of peers in addition to the employee's performance results against the established job standard and agreed-upon objectives.

### 104.10.3 Bonuses and Incentives

Many firms find that incentive systems pay dividends in terms of staff productivity and overall firm profitability. Incentives might be based on targets such as achievement of charge hour or firm profitability goals.

In addition to cash incentive systems, you must also consider the benefits package provided to employees—health insurance, disability insurance, life insurance, Sec. 401(k) plans, and so forth. You should be sure to communicate to employees that the full compensation system of the firm includes not only the normal payroll, but also benefit programs and other amounts paid through incentive programs.

By establishing an incentive program based on charge hours, the individual is compensated for his or her individual accomplishments. For example, assume an employee is paid a base salary plus \$25 per hour bonus on all charge hours over a target level of, say, 1,700 hours. If the employee achieves 1,740 charge hours, a \$1,000 bonus would be paid (40 hours at \$25 per hour). The disadvantage of this approach, however, is that not all charge hours can necessarily be billed to clients. Additionally, the employee would naturally expect to have adequate work assigned to him or her at all times. A better approach is to base an incentive program on "net realized dollars." That is, the number of charge hours for an individual multiplied by the billing rate, taking into account the amount *actually billed through* to clients (after any writeoffs or amounts that cannot be billed and so forth). The problem with this approach is that it's hard to calculate and administer. Another approach might be to pay a bonus based on a percentage of writeups or value billings.

Alternatively, incentives could be paid based on firm profitability. This institutes a form of profit sharing, where employees all share in a portion of the firm's profits, often based on a predetermined formula using agreed-upon amounts of owner compensation and disregarding certain expenses such as owner travel and entertainment and so forth. While this is much easier to administer, the disadvantage is that the incentives would be paid if the profit target is achieved, regardless of the contribution a particular individual might have made toward the overall firm profitability. As mentioned, you need to consider controllable factors affecting profitability, such as salaries to owners.

Some firms pay a discretionary bonus. However, most practitioners agree that a discretionary bonus cannot be paid without its becoming part of the actual salary program. In fact, many practitioners think that a bonus or incentive system, once implemented, is considered a normal part of the salary structure by most recipients. Once implemented, these systems are very difficult to terminate.

If you feel a bonus and incentive system should be implemented, use the following steps:

1. Budget a specific dollar amount for your bonus and incentive program.
2. Determine the firm expectations at which the bonus amounts will be paid. Discuss these expectations and goals with staff members, and *clearly document* the thresholds at which amounts will be paid.
3. On an ongoing basis, monitor with staff the actual results versus the target, and be sure that there is no misunderstanding on the current status or on when the bonus amount will be paid.
4. Compare actual to target, and make whatever payments are required by the agreed-upon date. Do not delay in making payments once a date has been promised to an employee.

**Practice Tip.** As with any bonus and incentive system, be sure the established targets for the incentive payments are appropriate. Allow the target amounts to provide sufficient incentive for the individual to work to achieve the incentive. Targets established should be achievable, yet not too difficult or too easy.

Again, exercise caution in implementing any bonus or incentive system; there is a risk of having it become part of the normal salary structure. Carefully consider your decision—once implemented, you will have an extremely difficult time backing off such incentives in the future.

A more cautious approach is to adopt bonus programs on a person-by-person basis, tied to specific projects. When the project has been completed, the person associated with the bonus program should clearly understand that the program terminates. As an example, assume that your firm puts a person in charge of profitability for a tax practice you have recently acquired. By establishing a one-year bonus program tied to profitability goals, there should be no doubt that the program terminates after the specific project (and project goals) have been achieved.

## 104.11 Termination

### 104.11.1 Performance Evaluation and Documentation

Measurement of performance is one of the most crucial tasks performed by managers and supervisors. Although performance evaluation may seem to be directly related only to discussions that occur at salary evaluations, it is a topic relevant to many other day-to-day activities in the workplace. Performance evaluation is actually an ongoing communication effort, beginning with the initial job interview, and continuing throughout the employment cycle.<sup>1</sup>

An employee's history of not meeting performance requirements is often the cause for termination. Failure to communicate performance requirements fully is often the underlying problem if a company is faced with employment-related litigation. Inability to meet performance standards must be fully documented in order to support a termination decision. In order to reduce the potential for any future problems, it is essential that performance requirements, and the employee's record of meeting or not meeting those requirements, be communicated at the time an employee is hired, regularly during employment, and again at employment termination.

### 104.11.2 Guidelines for Termination

Prior to terminating an employee, the company should consider several questions:

- Does the organization have options other than termination?
- Should management seek a voluntary resignation instead of a termination accompanied by the employee's signed release of all claims?
- How should the grounds for dismissal be worded in order to avoid any potential discrimination lawsuit?

<sup>1</sup>Section 104.11 is reprinted from the *Accountant's Business Manual*, (New York, AICPA, 1996).

- Should a peer review board or committee be instituted to resolve disputes over potential terminations?
- What individual within the organization should notify the employee of the impending termination?
- When should a terminated employee be physically released from the organization?
- How are inquiries from the outside handled and by whom?
- What impact will a termination have on the company image, operations, and remaining employee morale?
- What sorts of severance benefits, if any, should be offered the terminnee, and under what circumstances?
- What formula should be developed and used to compute the severance and compensation package?
- What company benefits are to continue after the termination and for how long?
- Should job outplacement be considered for the terminated employee?

### 104.11.3 Prior to Finalizing a Termination Decision

If termination is being considered due to a violation of company policy, it is imperative that the company adhere to the procedures listed below. Following these procedures will help to protect the company's position if the employee were to sue for wrongful discharge.

- Document all pertinent facts. Documentation of policy infractions is the basis for a "good cause" defense. This documentation should begin at the time infractions, and related disciplinary actions, present the possibility of dismissal. Every violation of policy, regardless of how trivial, should be recorded in the employee's personnel file. All records of violations should fully indicate the resulting disciplinary action, whether formal or informal.
- Use progressive discipline. Establish formal, written guidelines for discipline and follow them rigorously. Under a typical progressive discipline system, an employee will be given an oral warning for the first offense, a written warning for the second, and suspension or termination for the third. If a suspension procedure is implemented, termination would not normally occur until the fourth offense. The system should also provide for immediate dismissal under certain conditions, such as gross unprofessional conduct, or other activities that management deems highly inappropriate or damaging.

If termination is considered due to repeated poor performance, the performance evaluation process must be scrutinized. In order to defend its position, management should be able to answer the following questions based upon the company's performance evaluation process as it relates to the terminated employee:

- Is it obvious what activity/job/position is being evaluated?
- Are the performance objectives explicit, fair, and realistic?
- Is the evaluation objective, fair, and unbiased as to sex, race, religion, handicap, and national origin?
- Was the employee told of the performance evaluation and notified of the functional areas where performance needed improvement?
- What performance standards are used to evaluate the employee's performance?
- Are the performance criteria and/or performance standards ever changed? If so, the following questions must also be addressed:
  - Are the changes explicitly and formally communicated to the affected employee?
  - Are copies of these communications permanently maintained?
- Are performance standards based on the job analysis?
- Are the same job performance standards applied to all employees holding similar jobs?
- Were the evaluations consistent with sound personnel practices?
- Were the evaluations done by a person thoroughly familiar with the terminated employee's performance?



- Has the employee been given appropriate assistance and guidance toward reaching objectives?
- Were the necessary resources made available to reach the established objectives and standards?
- Does the company provide necessary training to enable the employee to keep relevant knowledge up-to-date?
- Were unsatisfactory performance issues discussed with the employee at reasonable intervals?
- Was the employee advised of the consequences of continued unsatisfactory performance?
- Were deadlines provided for remedial actions?
- Is the company's performance evaluation program formal and has it been formally communicated to employees?
- Have employees ever been evaluated as satisfactory even though the performance was poor, unsatisfactory, or marginally satisfactory?
- Is a complete and accurate file of each employee's performance evaluations maintained? If so, also address the following:
- Does this file support the termination?

Answers to these questions should enable management to assess its position in potential termination based on poor or unsatisfactory performance. Questions that cannot be answered positively and explicitly must alert management to reevaluate its stand on a discharge on grounds of unsatisfactory performance.

#### 104.11.4 **After the Decision to Terminate Has Been Finalized**

After the termination decision has been made, several steps should be taken to prepare for the termination interview:

- Check whether there is any employment contract for a definite term.
- Carefully review each provision in the employee handbook.
- Make sure that an impartial third party has reviewed all facts.
- Determine the reason that is to be given for the termination.
- Draft the termination letter.
- Keep a record of the termination notice and all termination-related documents.
- Notify those who are likely to be affected by the termination.
- Employees who could potentially be harmful to the company must be asked, and should be asked, to leave the premises soon after termination notice is given. Compensation in lieu of advanced notice should be arranged.
- Exercise extreme confidentiality in handling terminations.
- Be prepared to ensure a replacement for the terminated employee if the position is not being abolished.
- Scrutinize the details of the severance package.
- Be sensitive to the time in which the employee is notified.

#### 104.11.5 **During the Termination Interview**

During the termination interview, several important steps should be followed:

- Come to the point within the first two to three minutes.
- Outline and put into a logical order all the relevant reasons for the termination.
- Keep the termination interview brief and businesslike.
- Determine the terms to be used for the employee's departure.
- Preferably, conduct the exit in a neutral territory.
- Inform the employee of the "bad news" in a way that will alleviate trauma.

- Do not try to compensate the terminated employee for the “psychological shock” of losing the job.
- Offer assistance in helping this person find another job.

### 104.11.6 After the Termination Interview

Once the termination interview is complete, be sure the following additional steps are completed:

- Notify all the departments within your organization that are apt to be affected by the employee’s departure.
- Have the employee return all company property and make sure that the employee’s financial obligations to the firm are cleared.
- Find out whether the employee has any vested rights to the pension, profit sharing, or other related plans.
- Inform the departing employee the kind of contact the company will allow from them after he or she leaves.
- Inform the employee what to expect in terms of future references.
- If you are to assist with outplacement, stay in contact and follow through accordingly.
- Perform an exit interview, if possible.

Employee terminations are an extremely serious and sensitive subject and should be treated as such by all managers, executives, and owners. Whether a termination results in a potential lawsuit for wrongful discharge will often depend on how the termination process is handled. Lawsuits are not only expensive, but are embarrassing to both the terminating organization and the terminated employee. Every effort should be made to ensure that terminations, when inevitable, have been properly handled by management.

## 104.12 Employee Risks

Normally, little consideration is given to the risks associated with being an employee of a tax practice. Due to the ever-increasing cost of professional liability insurance, many firms have elected to drop their coverage. An employee working in such a firm faces considerable risk!

**Practice Tip.** In the event of an employee error, a subsequent lawsuit normally includes the firm as a whole, as well as all individuals who worked on the project. An employee working in a tax practice that does not carry professional liability insurance may find himself or herself in an extremely precarious position.

Consider the implications to your employees of dropping professional liability insurance. Have you clearly informed them of the risks associated with this? If not, might you be subject to lawsuits for not properly communicating these risks? And what will be the impact on hiring and retaining good employees?

While a firm can never establish a total defense or completely shield itself from liability issues, the implementation of a control system such as that defined in Chapter 101 should diminish the exposure to liability issues. You should also review Part III, which deals with liability matters. However, regardless of the actions you have taken to limit liability within your firm, you must strongly consider the risks to both you and your employees of dropping professional liability insurance.

A number of health risks also exist with employees, particularly with data processing systems. Back injuries, eye strain, and so forth can often occur in a tax practice, particularly when using data processing equipment. These risks can be minimized through the purchase and implementation of proper ergonomic equipment, with special seating for computer systems, wrist pads, non-glare screens, and proper lighting. Be sure to monitor these issues on an ongoing basis so as to minimize the health risk for staff.

# Exhibits

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**Exhibit 104-1: Job Description—Clerical****JOB DESCRIPTION—SECRETARY TO TECHNICAL STAFF**

General Secretarial	Type correspondence, memos, etc., as assigned by technical staff, schedule appointments for technical staff, file files in appropriate places and file loose materials.
Processing	Process financial statements, payroll reports, 1099s, W-2s, and tax returns.
Back-up Receptionist	Answer phone, assist clients when receptionist is away from desk, and fill in for receptionist when out.
Supervision	Interview, test, train, and supervise part-time/temporary clerical employees, including delegation of workload.
General Clerical	Transmit and check in tax returns from computer service, order tax forms, order office supplies, responsible for supply room and forms drawer.
Housekeeping	Order (and purchase) kitchen and cleaning supplies, responsible for appearance of secretarial area, mailroom, and storage room; share responsibility with receptionist for other misc. items such as making coffee, washing dishes, emptying garbage as necessary, and vacuuming as necessary.
Hand out tax returns	Assist clients with signing of tax returns, writing of checks, mailing of returns, etc. Should advise Administrative Secretary if critical projects arise where assistance is required.
Supervisor:	Administrative Secretary

NOTE: Every employee works for Swift, March & Company, not just for a particular supervisor or department. Accordingly, employees are expected to act in the best interests of the firm, even if doing so requires actions or responsibilities not listed in the above job description. See policy manual for description of job working conditions.

**Exhibit 104-2: Job Description—Technical**

**JOB DESCRIPTION—ENTRY LEVEL ACCOUNTANT  
JOB GRADE 11**

Technical Duties:

Tax	Prepare simple income tax returns and data entry forms from information obtained in client interviews, assist in handing out tax returns to clients, prepare correspondence to accompany returns, prepare carryback claims and amended returns, respond to routine IRS inquiries and notices.
Payroll	Calculate client payroll and payroll deposits, prepare payroll tax reports, prepare sales tax and information returns.
Audit & Accounting	Assist in audit fieldwork, including inventory observation, write-up work involving periodic financial statements, prepare and adjust workpapers from clients' trial balance, reconcile bank accounts, draft annual financial statements, including footnote disclosures.
Management Services	Calculate depreciation and amortization schedules, assist in preparing projections, forecasts, and budgets, client assistance and contact through phone conversations, meetings, fieldwork, and correspondence.

Administrative Duties:

Work-Load Management	Expected to manage own workload by monitoring project due dates, frequent daily contact with immediate supervisor in assessing project status and problems encountered.
Continuing Education	A minimum of 40 hours annually primarily in basic tax and accounting workshops, expected to monitor payroll tax updates and disseminate technical changes to other staff.
Internal Projects	Assist management in internal projects, including firm accounting, and client newsletters.

Immediate Supervisor: Senior Accountant

NOTE: See policy manual for description of job working conditions.

**Exhibit 104-3: Sample Professional Job Profiles****PROFESSIONAL JOB PROFILES**

- I. **Client Service Bookkeeper.** A client service bookkeeper is expected to do the following under supervision:
- Develop computer literacy.
  - Work on assigned segments of compilation reports.
  - Assist with audit and review fieldwork and report preparation.
  - Learn how to read financial statements.
  - Prepare payroll and sales tax reports.
  - Calculate depreciation, run amortization schedules and run other computer programs.
  - Become knowledgeable with respect to professional publications and pronouncements.
  - Become knowledgeable of firm policies, procedures and the AICPA and state CPA Society's rules, regulations and code of ethics.
  - Strive for good workpaper techniques.
  - Study and sit for CPA examination (if eligible).
- Education and experience: Minimum of post secondary accounting degree. No experience necessary.
- Immediate supervisor: Senior Tax Accountant.
- II. **Staff Accountant.** A staff accountant is given more difficult assignments and greater responsibilities. A staff accountant is expected to:
- Assume full responsibility (under supervision) for preparation of compiled and reviewed financial statements.
  - Assist with more complicated segments of audit and accounting engagements.
  - Identify potential management letter comments.
  - Perform most assignments with minimum supervision and train bookkeepers, instructing them in work to be performed, review of work completed and directing of necessary revisions.
  - Prepare and review payroll and sales tax reports.
  - Prepare individual, business and fiduciary tax returns and projections.
  - Perform limited number of tax return interviews.
  - Become knowledgeable with respect to payroll and sales tax issues.
  - Research tax and accounting issues.
  - Recognize potential problem areas in specific engagements and discuss them with person responsible for the engagement.
  - Prepare for and pass CPA examination, if eligible and not already done.
  - Possess creativity in evaluating payroll and write-up procedures and recommend improvements in these systems.
  - Develop oral and written communication skills.
  - Interact directly with clients and clients' accounting personnel.
- Education and experience: Minimum 6 months experience.
- Immediate supervisor: Senior Tax Accountant.
- III.a. **Senior Tax Accountant**
- Interview, review and sign individual, business and fiduciary tax returns.
  - Prepare tax projections and other tax planning strategies.
  - Handle tax audits.
  - Become knowledgeable with respect to estate planning, financial planning, financing alternatives, etc.
  - Assign work to staff members on the basis of their knowledge and capabilities.
  - Support training of bookkeepers and staff accountants and assist managers in development of staff to provide a high level of capability and competence.

**Exhibit 104-3: Sample Professional Job Profiles (cont.)**

- Research increasingly complex tax issues.
- Look for opportunities to provide additional services to clients.
- Possess good communication skills (both oral and written).
- Develop network of referral sources through active involvement in professional and civic organizations.
- Possess creativity in evaluating tax service procedures and recommend improvements in those systems.

Education and experience: Minimum 3<sup>1</sup>/<sub>2</sub> years experience and CPA certificate.

Immediate supervisor: Tax Manager.

**III.b. Senior Auditor**

- Plan and organize audits, including communication with client management regarding timing of fieldwork and client assistance levels.
- Responsible for all aspects of audit fieldwork.
- Supervise staff during audits.
- Assure that the audit workpapers contain collaborating evidence to support the objectives.
- Study and evaluate client internal controls.
- Assign work to staff members on the basis of their knowledge and capabilities.
- Prepare audit reports, including all relevant disclosures.
- Support training of bookkeepers and staff accountants and assist managers in development of staff to provide a high level of capability and competence.
- Research increasingly complex accounting issues.
- Look for opportunities to provide additional services to clients.
- Possess good communication skills (both oral and written).
- Develop network of referral sources through active involvement in professional and civic organizations.
- Possess creativity in evaluating audit and accounting service procedures and recommend improvements in those systems.

Education and experience: Minimum 3<sup>1</sup>/<sub>2</sub> years experience and CPA certificate.

Immediate supervisor: Audit & Accounting Manager.

**IV.a. Tax Manager**

- Interview, review and sign tax returns that are the manager's primary responsibility.
- Assume large tax assignments in the manager's area of expertise.
- Organize, plan, supervise and review the work of staff.
- Training and development of staff. Keep staff advised of tax developments.
- Assist in some of the firm's administrative matters.
- Overall responsibility to monitor progress of engagements in relation to budgets and due dates.
- Evaluate and develop efficient and improved procedural systems for delivering tax services.
- Become a "rainmaker": a constant source of work projects for subordinate staff.
- Actively market and promote the firm to potential client sources.
- Possess suitable character traits and work ethics necessary for consideration of future partnership.
- Cultivate network of referral sources through leadership role in professional and civic organizations.

Education and experience: Minimum 7 years experience and CPA certificate.

Immediate supervisor: Director of Tax Services.

**IV.b. Accounting and Auditing Manager**

- Review and approve audit workpapers and reports before submission to partner.
- Organize, plan, supervise and review the work of staff.
- Training and development of staff. Keep staff advised of current developments.
- Assist in some of the firm's administrative matters.

**Exhibit 104-3: Sample Professional Job Profiles (cont.)**

- Overall responsibility to monitor progress of engagements in relation to budgets and due dates.
- Evaluate and develop efficient and improved procedural systems for delivering audit and accounting services.
- Become a “rainmaker”: a constant source of work projects for subordinate staff.
- Actively market and promote the firm to potential client sources.
- Possess suitable character traits and work ethics necessary for consideration of future partnership.
- Cultivate network of referral sources through leadership role in professional and civic organizations.

Education and experience: Minimum 7 years experience and CPA certificate.

Immediate supervisor: Director of Accounting Services.

**V. Director of Tax Services/Director of Accounting Services**

- A director’s responsibilities include all of the duties of a manager.
- Communicate firm policies and technical information to accounting personnel.
- Motivate and assist staff in professional development.
- Participate in partner meetings in non-voting capacity.
- Take charge of overseeing significant administrative matters.
- Assumes role of a “partner-in-training”.

Education and experience: Minimum 9 years experience and CPA certificate.

Immediate supervisor: Partner.

**VI. Technical Consultant**

- Assume high level of technical competence for a specific area of client service.
- Ability to research, problem solve and communicate results to clients and/or staff.
- Responsible for developing special area of practice.
- Does not necessarily require managerial or supervisory responsibilities.
- Responsible for keeping staff informed of pertinent developments.
- Technical consultants are not considered for promotion to partner level.

Education and experience: Minimum 3½ years experience. No CPA certificate required.

Immediate supervisor: Partner.

**VII. Partner**

- Exhibit leadership in motivating and developing staff.
- Possess expertise and technical competence in a field of specialization and an ability to apply sound business recommendations to clients.
- Contribute to firm growth through significant and sustained marketing to existing and new clients.
- Use sound business judgment on an ongoing basis and be profit oriented.
- Display innovative administrative abilities and earn respect of subordinates.
- Dedication to the profession and the firm; adhere to professional ethics and recognize civic responsibility.
- Responsible for overseeing significant administrative matters.

Education and experience: Minimum 10 years experience and CPA certificate.

**Partnership Organizational Positions****I. Managing Partner**

Overall responsibility for:

- Coordinating the activities of the partner group.
- Setting long-range policy for the future direction of the firm.
- Coordinating all marketing activities of the firm to ensure they are consistent with the goals of the partner group.



**Exhibit 104-3: Sample Professional Job Profiles (cont.)**

- Ensuring that the firm maintains the highest level of quality service.
- Setting agenda and chairing meetings of the partner group.
- Establishing criteria for evaluating partner performance and contribution to the firm.
- Oversee activities of the Quality Control Committee.

**II. Administrative Partner**

Overall responsibility for:

- Approving operating budgets and measuring results.
- Billing and collection activities.
- Internal accounting control of the firm.
- Occupancy matters, including leases and asset acquisitions.
- Supervising the activities of the firm administrator.
- Financial reporting to the partner group.
- Oversee activities of the Billing Committee.

**III. Personnel Partner**

Overall responsibility for:

- Staff evaluations and promotions
- Salary increases and bonuses.
- Screening, interviewing and hiring recommendations.
- Grievance resolution.
- Establishing fringe benefit programs.
- Oversee activities of the Personnel & Benefits Committee.

**IV. Technical Services Partner**

Overall responsibility for:

- Controlling workload to ensure an efficient use of staff resources.
- Establishing and monitoring charge hour budgets for staff.
- Ensuring the proper tools exist for staff, including resource materials and software.
- Monitoring continuing education opportunities and needs.
- Establishing efficient productivity systems for all aspects of client service.
- Oversee activities of the Professional Development Committee.
- Disseminating information to ensure the competency of staff.

**NOTES:**

- 1) With the exception of Technical Consultants, all accounting staff are responsible for supervising duties and responsibilities of all job grades at or below their own.
- 2) Due to the firm's size, personnel may not exist at all levels. This will necessarily require personnel to assume some duties outside their stated position. In addition, other special assignments may be required of all staff. These special duties will be discussed on an individual basis.
- 3) All professional staff are strongly encouraged to pursue a CPA certificate as this is a prerequisite for continuing advancement.
- 4) Advancement is at the recommendation of the personnel partner, with approval of the partner group.
- 5) Working conditions for all job classifications require the following:
  - a) Occasional out-of-town travel with overnight stay for work at clients, meetings or seminars using a personal vehicle.
  - b) Occasional overtime work required throughout the year. Heavy overtime work required from January to April; may be in excess of 55 hours per week.
  - c) Frequent light lifting and carrying of files, briefcases, audit bags, etc.

**Exhibit 104-4: Staff Tax Season Evaluation**

**STAFF TAX SEASON EVALUATION**

DATE:

MEMO TO: All Professional Staff

FROM:

SUBJECT:

Please take a few minutes to give your constructive comments on this past tax season. To make a full evaluation, we need input for those areas that need improvement as well as those areas that functioned well. Your suggestions for changes/improvements to the system are appreciated. Thank you in advance for your cooperation.

Positive:

Negative:

Suggestions for improvement:

Overall evaluation:

**Exhibit 104-5: Personnel Review Form**

**PERSONNEL REVIEW FORM**

Name: \_\_\_\_\_

Period: \_\_\_\_\_

**I. Technical Traits**

A. *Technical Skills*: Possesses technical abilities and analytical skills commensurate with current work product and billing rate.

Comments: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

B. *Consulting Skills*: Aggressively seeks out planning opportunities and renders advice and education to client as a routine part of every engagement.

Comments: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

C. *Management*: Ability to handle a client project with proper *delegation* and *timely* and *efficient* completion in a *thorough* manner (includes organizational skills, due date compliance, billing realization, etc.).

Comments: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

D. *Communication Skills*: Ability to speak and write well.

Comments: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

**Exhibit 104-5: Personnel Review Form (cont.)**

Name: \_\_\_\_\_

Period: \_\_\_\_\_

**II. Professional Traits**

A. *Conscientious Approach*: Dedication to high *quality* of professional service.

Comments: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

B. *Leadership*: Conveys an impression of skill and strength that inspires client, staff, and community confidence in personal ability.

Comments: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

C. *Entrepreneurship*: Brings input and drive to the direction of the firm, with the ability to create work in new areas.

Comments: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

D. *Dedication to Clients and Profession*: Willing to make personal sacrifices on occasion when client needs arise.

Comments: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

E. *Dedication to Firm*: A team player who takes a strong interest in furthering the firm as a whole and its *profitability*.

Comments: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

**Exhibit 104-5: Personnel Review Form (cont.)**

Name: \_\_\_\_\_

Period: \_\_\_\_\_

**III. Personality Traits**

*A. Integrity of the Highest Level*

Comments: \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

*B. Motivation: Works effectively without supervision.*

Comments: \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

*C. Congeniality: Works well with staff and clients.*

Comments: \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

*D. Social Presence: Has the self-confidence and social skills to deal effectively with others.*

Comments: \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

**Exhibit 104-5: Personnel Review Form (cont.)**

Name: \_\_\_\_\_

Period: \_\_\_\_\_

*Overall Comments:* \_\_\_\_\_

\_\_\_\_\_  
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\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

*Goals and Plan of Action:* \_\_\_\_\_

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\_\_\_\_\_  
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\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

*Total charge hours to be attained from 10/1 through 9/30:* \_\_\_\_\_

I hereby indicate that this Personnel Review Form has been discussed with me, that all ratings and comments are understood, and that the goals and plan of action has been thoroughly discussed with me and that I have received a copy of this Personnel Review Form for my records.

*Employer:* \_\_\_\_\_  
*Date*

*Employee:* \_\_\_\_\_  
*Date*

*Employee Comments (optional):* \_\_\_\_\_

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

**Exhibit 104-6: Performance Review Form**

**PERFORMANCE EVALUATION QUESTIONNAIRE  
TAX DEPARTMENT**

Job performance evaluations should be performed by individuals who have achieved the level of tax supervisor and above.

Staff Member \_\_\_\_\_ Staff Level \_\_\_\_\_

Client Projects \_\_\_\_\_

Period of Evaluation: From \_\_\_\_/\_\_\_\_ 20\_\_\_\_ to \_\_\_\_/\_\_\_\_ 20\_\_\_\_

Terminology Defined

- (O) "Outstanding professionals" should expect greater advancement and accelerated responsibility.
- (HS) "High satisfactory professionals" demonstrate high quality performance measured by firm standards, which allows for continued success and advancement within the firm. "High satisfactory" designation indicates qualities approaching the goal of outstanding performance.
- (S) "Satisfactory professionals" perform competently but do not distinguish themselves from others who produce outstanding or high satisfactory (see above) work for clients and the firm, given their level of experience.
- (LS) "Low satisfactory professionals" should be on alert that they have deficiencies that should be corrected within a reasonable timeframe.
- (US) "Unsatisfactory professionals" have deficiencies that have not been corrected from the "low satisfactory" stage or are fundamentally irreversible. When individuals consistently fall in the "unsatisfactory" category, determination should be made with partners as to whether career counseling out of the firm is required.

Written commentary should be thought of with the following questions in mind.

What could the staff person do to make him/her more effective?

What are the areas where staff member needs improvement or additional training?

Should this staff member be assigned more advanced assignments?

What could the staff person do that could make the in-charge more effective in his/her job?

What is it that you regard or respect most highly in this staff person?

**Exhibit 104-6: Performance Review Form (cont.)**

Factors

Comments

*Professional and  
General Skills*

Understands assignments and follows instructions

---

Working paper and financial statement prep./review techniques

---

Accuracy of work including neatness, clarity, and compliance with firm standards of documentation

---

Understands client's industry

---

Ability to work independently

---

Ability to analyze complex matters

---

Ability to develop conclusions

---

Ability to make decisions

---

Communication with client, client personnel, and client advisors

---

Communication capabilities  
in (a) writing

---

(b) speech

---

Creativity, initiative, and enthusiasm demonstrated

---

Professionalism in appearance and behavior among clients and colleagues

---

Takes advantage of self-development and training

---

Ability to apply sense of professional ethics to client engagements

---



---

Overall Rating in Area (O, HS, S, LS, US) \_\_\_\_\_

Staff member comments encouraged on reverse of page.



**Exhibit 104-6: Performance Review Form (cont.)**

<u>Factors</u>	<u>Comments</u>
<u>Professional and Administrative Skills</u>	
Ability to organize and plan work	
Ability to meet scheduled deadlines	
Communicates progress to in-charge	
Ability to adhere to time budget	
Ability to delegate, supervise, and review work of others	
Ability to train others	
Dependability in following up and getting job done	

Overall Rating in Area (O, HS, S, LS, US) \_\_\_\_\_  
Staff member comments encouraged on reverse of page.

**Exhibit 104-6: Performance Review Form (cont.)**

Factors

Comments

*Identification and Implementation  
of Client Services Beyond  
Traditional Accounting Product Skills (Value Added Services)*

Ability to recognize improvement areas  
of value to clients

---

Ability to effectively discuss with clients  
and firm personnel suggested client  
improvements and solutions

---



---

Ability to help clients implement solutions  
to problems on an effective and  
profitable basis

---



---

Staff member's sale of additional value  
services to clients

---



---

Ability to detect accounting system  
deficiencies in engagement and  
suggest creative solutions for correction

---



---

Ability to recognize and communicate  
internal control issues and suggest  
improvements that reduce cost and  
enhance client control of business

---



---

Ability to recognize techniques to  
strengthen cash flow management for  
enhanced use of business assets

---



---

Ability to recognize areas of  
improvement in client sources of  
capital (debt, equity, etc.)

---



---

Ability to formulate potential tax planning  
issues

---



---

Developed skills in working with bankers,  
lawyers, and other professionals on  
client projects

---



---



---



---



---

Overall Rating in Area (O, HS, S, LS, US) \_\_\_\_\_

Staff member comments encouraged on reverse of page.

**Exhibit 104-6: Performance Review Form (cont.)**

Factors

Comments

*Tax Department:*  
Technical Skills

Ability to analyze client prepared financial information

---

Ability to understand materiality and risk

---

Ability to recognize issues in relation to the engagement taken as a whole

---

Ability to understand automated systems

---

General knowledge and application of in-house computer programs

---

Recognition and research of federal, state, and local tax issues relative to the assignment

---

Ability to apply tax knowledge toward the review of compliance engagements

---

Knowledge of research resources and proper application

---

Ability to logically resolve and document tax research and compliance positions

---

Ability to apply professional judgment to level of authority for research and compliance positions

---

Knowledge of current developments in practice of tax

---

Knowledge of tax concepts associated with taxpayers, in general

---

Knowledge of tax concepts associated with corporations

---

Knowledge of tax concepts associated with partnerships

---

Knowledge of tax concepts associated with "S" corporations

---

Knowledge of tax concepts associated with individuals and compensation/retirement plan areas

---

---

---

**Exhibit 104-6: Performance Review Form (cont.)**

Factors

Comments

*Tax Department:*  
Technical Skills

Knowledge of potential planning techniques and concepts in estate/gift tax area

---

---

Knowledge of multistate income tax concepts

---

---

---

---

---

---

---

---

---

---

---

---

Overall Rating in Area (O, HS, S, LS, US) \_\_\_\_\_

Staff member comments encouraged on reverse of page.

Overall Evaluation (O, HS, S, LS, US): \_\_\_\_\_

Evaluated by \_\_\_\_\_ Staff Level \_\_\_\_\_ Date \_\_\_\_\_

Reviewed by PIC \_\_\_\_\_ Date \_\_\_\_\_

Reviewed by Group Manager \_\_\_\_\_ Date \_\_\_\_\_

Reviewed by Counselor \_\_\_\_\_ Date \_\_\_\_\_

Filed in Personnel File \_\_\_\_\_ Date \_\_\_\_\_

Person Evaluated \_\_\_\_\_ Date \_\_\_\_\_

**Exhibit 104-7: Quarterly Performance Evaluation**

**PERFORMANCE EVALUATION — TAX**

*(To be completed at the end of each calendar quarter.)*

Name \_\_\_\_\_ Classification \_\_\_\_\_

Quarter ended:  September 30,  December 31,  March 31,  June 30, Year \_\_\_\_\_

Describe work assigned: \_\_\_\_\_

This individual is able  not able  to assume increased responsibility. Explain \_\_\_\_\_

**Rating:** Enter comments which describe the tax specialist's performance during this period. Rate the tax specialist on each of the items below as Outstanding (O), Very High (VH), Good (G), Below Normal (BN), or Not Applicable (NA).

*(Support each caption with specific incidents or remarks.)*

**Technical Knowledge:** Did the tax specialist possess adequate technical knowledge to function effectively at the level assigned? Did the tax specialist know the applicable IRC regulations, rulings, etc., and were they applied properly? Has the tax specialist kept abreast of current developments by reading newsletters, tax magazines, and other technical publications?  
Rating:  VH  G  BN  NA  
Rating:

**Analytical Ability and Judgment:** Did the tax specialist display the ability to recognize and solve problems readily, including the recognition of any side effects and their materiality? Did the tax specialist assume a positive approach to solving client problems? Was the tax specialist alert to tax planning opportunities?  
Rating:  VH  G  BN  NA  
Rating:

**Written and Oral Expression:** How effective were the tax specialist's letters, memoranda, and other forms of written communication? In conversation, did the tax specialist communicate intentions effectively? Were instructions understood the first time? Did the tax specialist sell ideas and obtain acceptance and action?  
Rating:  VH  G  BN  NA  
Rating:

**Performance:** Could you depend on the tax specialist for consistently high-quality work? Was work reliable and accurate? Did the tax specialist readily assume responsibility? Did the tax specialist meet time estimates and present orderly work papers?  
Rating:  VH  G  BN  NA  
Rating:

**Development of Personnel:** When assigning work, did the tax specialist make the most effective use of available talent in terms of getting the work done and in terms of developing those performing the work? Did the tax specialist make assignments which were either too easy or too hard? Was the tax specialist readily accepted as a leader? Was the tax specialist effective in on-the-job coaching?  
Rating:  VH  G  BN  NA  
Rating:

**Exhibit 104-7: Quarterly Performance Evaluation (cont.)**

**Client Relations:** How well did the tax specialist relate to clients and gain their acceptance? How well did the tax specialist recognize and take advantage of practice development opportunities? Was it through extension of services to existing clients or to new clients?  
 VH  G  BN  NA  
Rating:

---

---

**Attitude:** Did the tax specialist demonstrate a positive and professional approach to assignments? Was this demonstrated by sustained effort in completing work? Were assignments undertaken with enthusiasm and zest? Did the tax specialist respond in a positive way to suggestions and guidance from superiors? To what degree did the tax specialist make personal sacrifices to meet client requirements? Was the tax specialist a helpful member of the team? Did the tax specialist make an effort to help an associate?  
 VH  G  BN  NA  
Rating:

---

---

**Personal Characteristics:** Did the tax specialist possess self-confidence and was this confidence projected in an acceptable way? Were positive impressions created with clients and associates? Did the tax specialist demonstrate a keen sense of what to do or say (tact)? Were clothes and grooming professional?  
 VH  G  BN  NA  
Rating:

---

---

Strong points which were evident: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Recommendations for improvement: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

**Comments of Tax Specialist Being Evaluated:** \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

**Signatures:**  
Evaluated tax specialist \_\_\_\_\_ Date \_\_\_\_\_  
Manager \_\_\_\_\_ Date \_\_\_\_\_  
Partner \_\_\_\_\_ Date \_\_\_\_\_

**Exhibit 104-8: Personnel Policy Manual Topics**

**PERSONNEL POLICY MANUAL**

Table of Contents

Section I	<b>INTRODUCTION</b> Introduction Functions of this Manual Classification of Employees Professional Job Classifications Support Staff Job Descriptions Affirmative Action Employer AIDS Policy Productive Work Environment	Section IV	<b>BENEFITS AND SERVICES</b> Leaves of Absence Request for Personal Leave of Absence Request for Temporary Disability Leave Holidays Vacations Request for Vacation Medical Insurance Long-Term Disability Insurance Term Life Insurance Retirement Savings Plan—401(k) Employee Computer Purchase Plan Expense Reimbursement Reimbursement of Education Expenses Masters of Business—Taxation Program Dependency Counseling
Section II	<b>EMPLOYEE RESPONSIBILITIES</b> Office Hours Attendance Conflict of Interest Safety Telephone Use Copier Firm owned computer software Confidentiality Employment at Will Solicitation Consumption of Alcoholic Beverages Smoking Policy Attire Ethical Obligations Independence Office Closing Due to Unavoidable Conditions Staff Meetings	Section V	<b>COMMUNICATIONS</b> Open Communications
Section III	<b>EMPLOYEE PERFORMANCE</b> Exempt and Non-Exempt Employees Performance Reviews Payroll Periods Payroll Deductions Savings Plan Salary Adjustments Time Reports Overtime Tax Season Bonus Payments Production Bonus Payments		

**Exhibit 104-9: Orientation Checklist**

Name \_\_\_\_\_ Position \_\_\_\_\_

Address \_\_\_\_\_

Person to contact in case of emergency \_\_\_\_\_

Phone \_\_\_\_\_

Date of Birth \_\_\_\_\_

Date \_\_\_\_\_ Orientation done by \_\_\_\_\_

\_\_\_\_ Full-time \_\_\_\_ Part-time \_\_\_\_ Temporary Date employed \_\_\_\_\_

SS# \_\_\_\_\_

**A. Supply employment forms and materials**

- \_\_\_\_ Tax forms (federal, state, etc.)
- \_\_\_\_ Independence questionnaire (refer to Sec. 8, pages 810:1–810:18 of Personnel Manual)
- \_\_\_\_ Assign Employee Number ( )
- \_\_\_\_ Verify that the following is in new associate personnel file: application form, transcripts (if any), resume, reference letter/reference check(s), office interview forms (if any) and correspondence (if any).

**B. Employee benefits (explain and issue brochures and applications)**

- \_\_\_\_ Group disability
- \_\_\_\_ Group life insurance
- \_\_\_\_ Group medical insurance
- \_\_\_\_ Cafeteria plan
- \_\_\_\_ 401 (k)

**C. Issue personnel manual and explain**

- \_\_\_\_ Office hours
- \_\_\_\_ Payroll procedures
- \_\_\_\_ Vacation, personal time, disability and sick policy
- \_\_\_\_ Travel reimbursement policy
- \_\_\_\_ Meal reimbursement policy
- \_\_\_\_ Staff evaluation policy
- \_\_\_\_ Time and expense reporting policy
- \_\_\_\_ Scheduling procedures
- \_\_\_\_ Telephone procedures (long distance calls)
- \_\_\_\_ Mailing procedures
- \_\_\_\_ File room procedures
- \_\_\_\_ Library and periodicals
- \_\_\_\_ Supplies

**D. Firm membership policies**

- \_\_\_\_ AICPA and state society memberships
- \_\_\_\_ Other civic organizations

**E. Education policy**

- \_\_\_\_ CPA exam policies
- \_\_\_\_ Responsibility of a professional to keep knowledge current (state law and firm policy)
- \_\_\_\_ Review CPE timekeeping responsibilities (firm and individual)



**Exhibit 104-9: Orientation Checklist (cont.)**

F. Miscellaneous items

- Confidential nature of client affairs
- Policy on outside work
- Firm social activities
- Organizational structure (organization chart)

G. Introduction to office

- Tour of office
- Lunchroom
- Introduction to partners/associates
- Show where to obtain supplies
- Show libraries and briefly explain usage and available publications

H. Notify the following departments of employment

- Administrative manager
- Data processing manager

I. New employee package

- Accounting and auditing manual (if applicable)
- Audit staff reference manual (if applicable)
- Personnel manual to read
- Quality control procedures manual (if applicable)
- Master tax guide (if applicable)
- Accounting standards—current text
- Office floor plan
- Insurance form
- Database information
- Employment agreement
- Personnel manual signature page

**Exhibit 104-10: Interview Rating Reports**

<b>INTERVIEW REPORT FORM</b>							
<b>Applicant</b> _____				<b>Interviewer</b> _____			
<b>Date</b> _____				<b>For Position</b> _____			
<b>Initial Impression</b>	<u>Favorable</u>	1	2	3	4	5	<u>Unfavorable</u>
Appearance							
Manner							
Self-expression							
Responsiveness							
<b>Work Experience</b>	<u>Favorable</u>	1	2	3	4	5	<u>Unfavorable</u>
Relevance of work							
Sufficiency of work							
Skill and competence							
Adaptability							
Productivity							
Motivation							
Interpersonal relations							
Leadership							
Growth and development							
<b>Education</b>	<u>Favorable</u>	1	2	3	4	5	<u>Unfavorable</u>
Relevance of schooling							
Sufficiency of schooling							
Intellectual abilities							
Versatility							
Breadth and depth of knowledge							
Level of accomplishment							
Motivation, interests							
Reaction to authority							
Leadership							
Teamwork							

**Exhibit 104-10: Interview Rating Reports (cont.)**

<p><b>Early Years (Optional)</b></p> <p>Socio-economic status                  Parental examples                  Attitudes toward achievement,                  work and people                  Emotional and social adjustment                  Basic values and goals                  Self-image</p>			<p><u>Favorable</u>    1    2    3    4    5    <u>Unfavorable</u></p>					
<p><b>Present Activities and Interests</b></p> <p>Vitality                  Management of time, energy                  and money                  Maturity and judgment                  Intellectual growth                  Cultural breadth                  Diversity of interests                  Social interests                  Social skills                  Leadership                  Basic values and goals</p>			<p><u>Favorable</u>    1    2    3    4    5    <u>Unfavorable</u></p>					
<p><b>Summary                  Plus (+) and Minus (-)</b></p> <p>Talents, skills                  Knowledge                  Energy                  Motivation                  Interests                  Personal qualities                  Social effectiveness                  Character                  Situational factors</p>	<p><b>STRENGTHS</b></p>			<p><b>WEAKNESSES</b></p>				
<p><b>Overall Summary and                  Recommendations</b></p>			<p><u>Favorable</u>    1    2    3    4    5    <u>Unfavorable</u></p>					

**Exhibit 104-10: Interview Rating Reports (cont.)****INTERVIEWER'S EVALUATION**

Candidate name: \_\_\_\_\_ Position applied for: \_\_\_\_\_

1. Job Knowledge: How knowledgeable is the candidate about basic components of the job?

 Very knowledgeable  
 Requires special training Has basic job knowledge  
 Insufficient knowledge to succeed

Comments: \_\_\_\_\_

2. Education: Has the candidate completed necessary educational requirements for the position?

 Yes  No  Is currently attending school

Comments: \_\_\_\_\_

3. Prior Work History: Has there been evidence of successful work assignments?

 Yes  No

Comments: \_\_\_\_\_

4. Goal Orientation:

a. Evaluate the candidate's basic drive to succeed. Consider whether this position will satisfy his/her need for job satisfaction, or will the candidate become dissatisfied quickly?

 Excellent  Very Good

Comments: \_\_\_\_\_

b. Consider what the candidate has done to prepare himself/herself for a career in this area.

 Excellent preparation (education & experience)  
 Good preparation (education & experience)  
 No preparation for this position

Comments: \_\_\_\_\_

5. Considering the minimum qualifications necessary to do this job, is the candidate qualified for this position?

 Yes  No

To what extent?

 Minimally  Moderately  Extremely  Not at all

Comments: \_\_\_\_\_

6. Recommendation:

 Hire  Reject  Hold

Why? \_\_\_\_\_

Signature: \_\_\_\_\_ Date: \_\_\_\_\_



# 105 Professional Tax Education

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# 105 Professional Tax Education

One of your most important responsibilities in managing a tax practice is your own professional development and that of your staff. It requires working with each professional to maximize his or her potential. One key element is continuing professional education (CPE). CPE not only helps to improve individual performance and your practice as a whole, but also is required in most states to retain a CPA license, and by the American Institute of CPAs (AICPA) as a condition of membership.

## 105.1 Planning for Professional Tax Education

The AICPA requires members who are in public practice to complete 120 hours of CPE for each three-year reporting period beginning with the 1990 calendar year. A minimum of 20 hours must be earned each year. Members in industry, government, and education must complete 90 hours, with a 15-hour minimum per year, during three-year reporting periods.

For those individuals joining the AICPA on or after January 1, 1990, the three-year reporting period and the CPE requirements begin in the calendar year following the year membership begins.

Fulfilling the AICPA's standards will not necessarily satisfy state requirements, which also must be fulfilled.

The AICPA will accept a wide variety of programs. An acceptable program must enhance the CPA's professional competence and be a formal program of learning as described in the AICPA's *Statement on Standards for Formal Continuing Professional Education (CPE) Programs*, available from the Institute. These types of programs would ordinarily qualify, if other conditions are met:

- Conferences held by a college or university
- Seminars offered by a state CPA society
- Self-study programs, including CD-ROM- and on-line-based training
- In-house courses
- Video courses, both individual and in-house study
- College courses that add to the CPA's expertise
- Serving as the instructor of a formal CPE program

### Scheduling

You can count on these benefits by properly *planning* and *scheduling* continuing professional education:

- An individual's career development is enhanced by assuring that the CPE attended is appropriate for the individual's level of expertise and experience.
- The coordination of scheduling requirements is enhanced, since CPE can be targeted during periods of lower workloads.

- Overall CPE cost is minimized, which is important because CPE represents a substantial cost for all firms.
- A program is provided to meet firm needs for expertise in specialized areas and industries.

### **Monitoring Need**

Because CPE should be targeted to enhance the career development of each staff person, it is important to consider the types of staff with whom you are dealing. Individuals with technical responsibilities in a tax practice come from a variety of backgrounds:

- Undergraduates with degrees in accounting or business, often with a concentration of tax courses
- Graduate degree holders, primarily those with an MBA or a Masters in Business Taxation, who have completed in-depth tax training
- Individuals who previously worked for the IRS or a related agency
- Individuals who worked in the accounting and auditing area, and who now work in the tax area
- Attorneys with tax law experience (including those with the LLM degree), some of whom have previously worked for the IRS or a related agency
- Individuals who attended training programs or who are self-taught in the tax area through years of experience (often employed as paraprofessionals or seasonal workers in the tax area)

Because of the varying skill and experience levels of these tax practitioners, different CPE alternatives are appropriate. This is true not only in terms of the depth covered by a CPE offering, but also in the delivery format. For example, some practitioners require the dynamics of an instructor-led group study course, while others find a self-study video or audio course more effective.

Practitioners must continually keep abreast of the ever-changing laws and enhance their skills in technical areas for the following reasons:

- A practitioner must be able to recognize problems and opportunities related to specific clients. By staying informed of client activities, and by combining this knowledge with current developments in the tax area, the practitioner stays alert to tax opportunities and pitfalls affecting clients.
- A practitioner must work with a client's attorney on matters such as employment agreements, buy/sell agreements, updating corporate minutes, and authorizing certain activities.
- Due to the many legal interpretations of the tax laws through rulings and court cases, a practitioner must stay abreast of developments through an understanding of legal concepts and a review of rulings and court cases.

**Practice Tip.** Establish a CPE committee (of three or four people) or appoint a CPE coordinator with responsibility to budget CPE dollars and select and recommend courses for staff. This can help to assure that the most cost-effective and appropriate training sessions are chosen. It also helps to create staff "ownership" of the responsibility to themselves and to the firm to develop enhanced skills.

## **105.2 Continuing Professional Education Alternatives**

There are many CPE alternatives for a practitioner seeking to enhance skills in the tax area. Due to the proliferation of tax law changes and related accounting principles, and because of the predominance of tax service offered by practitioners, training offerings are widely available.

### **105.2.1 Group Study Courses**

The AICPA and other course developers and publishers provide instructor-led group study seminar courses in the tax area (discussion leader seminars). AICPA group study courses are



distributed and made available to AICPA members and others through the state CPA societies. Group study courses include live instruction and normally encourage participant interaction. The exchange of ideas and experiences between participants and the instructor and among participants brings a perspective not normally available from other continuing education alternatives. It allows the discussion to focus on solutions to practice problems common to many of the participants.

For many courses, instructors and discussion leaders who meet prescribed experience and technical standards are provided by the AICPA and other course suppliers. Other courses use discussion leaders selected by the sponsoring state society. Most course materials are copyrighted; thus, no duplication without permission is permitted.

A current list of courses can be found at the AICPA Web site ([www.aicpa.org](http://www.aicpa.org)). Schedules of course offerings are available through your state CPA society. Information may also be obtained by calling AICPA Group Study Administration at 1-888-247-3277.

State CPA societies and private developers provide group study courses. Course listings can be obtained by contacting individual state CPA societies (see Exhibit 105-1) or your state board of accountancy (Exhibit 105-3).

The primary advantage of group study courses is normally the participant interaction that occurs with a knowledgeable discussion leader and other participants. Participants talk with their peers during the lunch and break periods, and propose questions to the discussion leader; this enhances individual focus and enables them to come away with specific insights about troublesome practice areas and new ideas for implementation.

Another advantage of group study courses is that developers continually assess the market and the needs of practitioners to put together courses in areas of particular importance, timely topics, or critical need. You need only glance through a catalog to learn what the hot topics and troublesome areas of practice are for most practitioners.

Disadvantages of group study courses include the cost of the courses and the time spent away from the office. Another possible disadvantage is the dependence on the discussion leader and the pace at which the course is conducted. A knowledgeable leader with good presentation skills significantly enhances the learning attained in a group study course, but leaders less adept at motivation and public speaking leave participants to rely heavily on printed course materials.

**Practice Tip.** Attempt to select courses conducted by well-known discussion leaders and that are consistent with the knowledge and experience level of the staff attending the course.

Because group study courses are targeted for different experience levels, they are appropriate for almost all tax personnel. Annual workshops on individual taxes, corporate taxes, and so forth are appropriate for less experienced personnel, who need many of the basics of tax concepts and forms completion. Annual tax update sessions are appropriate for almost everyone in the firm. They summarize the changes in legislation and regulations over the past year, and bring everyone up to date on opportunities and pitfalls associated with the current tax environment.

Even experienced tax practitioners will find many group study courses of particular interest. Many courses on issues such as “advanced issues in partnership taxation,” “advanced fiduciary tax return preparation,” and so forth are particularly applicable to experienced practitioners and are, of course, updated to provide sophisticated information on the latest tax developments.

Under the AICPA *Statement on Standards for Formal Continuing Professional Education (CPE) Programs* (CPE Standards) currently in effect, one hour of CPE credit is provided for every 50 minutes of group study course participation.

## 105.2.2 In-House Courses

Some firms opt to offer in-house group study courses. A significant advantage of all in-house courses is that specific client issues can be emphasized and can be discussed in depth without breaching confidentiality. In-house presentations normally take place in a number of formats:

- purchased materials, with a firm member as discussion leader
- purchased materials, with an independent instructor as discussion leader

- self-developed materials, with a firm member as discussion leader
- self-developed materials, with an independent instructor as discussion leader

Another popular format is video accompanied by an in-house discussion leader.

### **Purchased Materials, Firm Member as Discussion Leader**

In this approach, materials are purchased from an outside vendor, and a firm member handles the presentation using the materials. Many firms find that purchasing materials is less expensive in materials and staff time than attempting to develop them internally. AICPA courses are available through state societies for purchase and use in-house. For larger firms, the cost of purchasing materials for an in-house seminar is often significantly less than sending individual staff members to outside seminars. Firms interested in this strategy should contact their state CPA society for further information.

The disadvantages of in-house courses are the amount of preparation time required by the discussion leader and the risk that the staff person will not bring the required teaching and discussion skills to the presentation for the most effective learning.

### **Purchased Materials, Independent Instructor as Discussion Leader**

An independent instructor, knowledgeable in the subject matter and usually experienced in delivering it, can often create a better learning environment than can an internal staff member. In addition, the instructor can often tailor purchased materials for firm-specific issues. The disadvantage, of course, is the professional fee and other related expenses. College professors in nearby schools are often available as instructors for in-house courses. Some firms have been able to work out an ongoing relationship with one or more professors (or with the school's Department of Accounting) to provide a variety of CPE courses tailored to the firm's needs.

### **Self-Developed Materials, Firm Member as Discussion Leader**

The advantage of this approach is that the materials can be specifically tailored, using only topics of major importance to the firm or even to individual members of a firm. Also, the costs can be lower if the materials are assembled when staff have available time. That is, programs can be presented during slack periods, when overall work demands are not particularly high. Self-developed materials may encourage specialty within a firm. Staff members who become experienced and who keep highly up-to-date in particular areas can offer periodic training within the firm and become in-house experts for consultation.

The disadvantages are the uncertainties associated with the quality of the program and the costs of producing the materials. What often appears to be a simple and straightforward task develops into a lengthy, complex program. The quality of materials must be assured through review at professional levels because the course developers often have little training in instructional design. Additionally, there may be inconsistencies in quality and delivery depending on which firm member leads the discussion.

### **Self-Developed Materials, Independent Instructor as Discussion Leader**

The advantages and disadvantages previously noted for self-developed materials apply for this approach also. In addition, it is often difficult to locate a knowledgeable discussion leader to teach from unfamiliar materials. Experienced discussion leaders normally prefer to use materials they have developed or with which they are familiar.

## **105.2.3 Conferences**

The AICPA and other organizations stage conferences that provide continuing professional education. Conferences use different formats, but generally include concurrent sessions (which allow attendees to choose from among different presentations occurring at the same time), and general sessions (which are directed to all participants).

Conferences vary from one to several days, and are designed to address a wide range of tax topics. They produce high-quality presentations, often providing more than one speaker or a "team of experts" from throughout the country on the same topic. Generally, the speakers

are recognized authorities in the topic area. Some conferences target specific tax topics (for example, estate planning or divorce), while others are directed at general tax topics, such as:

- Industry-specific tax issues
- High-income or older taxpayers

CPE credit for conferences follows the policy for group study courses, and is based on session offering and conference length.

Conferences are offered at different locations across the country and, occasionally, the same conference is repeated at more than one location. Because of related travel and lodging costs, conferences often represent a higher total cost per hour of continuing education than group study courses. Conferences are usually an opportunity for attendees to combine personal travel and leisure with continuing professional education. Some also offer spouses' and children's programs to permit family activities. The AICPA prepares brochures for its members on conferences that it sponsors and publishes conference schedules in the *Journal of Accountancy*.

Advantages of conferences include:

- Clustering topics in a particular tax area
- Bringing together well-known experts in a particular area
- Ability to pick up a significant number of CPE credit hours in a relatively short period of time
- Ability to meet with numerous peers and discuss common issues and problems
- Opportunity to combine some personal business and leisure objectives with CPE requirements

Disadvantages of conferences include:

- Probable travel and lodging costs in addition to registration fees
- Requirement to be out of the office for an extended period of time

Because of the higher cost of conferences and the wide topic coverage normally designed for people who manage many activities, attendees at conferences are often more experienced staff members, and managers and partners of a firm.

Conference brochures can be obtained by writing or calling:

AICPA Member Services  
 Harborside Financial Center  
 201 Plaza III  
 Jersey City, NJ 07311-3881  
 1-888-777-7077

This information is also available on the AICPA Web site: [www.aicpa.org](http://www.aicpa.org).

## 105.2.4 Video Courses

The AICPA and other vendors offer video-assisted CPE courses, which can be viewed either by individuals or by small groups. These courses generally consist of a video tape and a participant's manual designed for use in conjunction with the tape. They may also include an exam to be used if the program is administered as self-study. Two types of videos are updates and training. An example of the former is "The AICPA Experts' IRS Restructuring and Reform Act of 1998." "The AICPA Experts' Taxpayer Confidentiality Privilege Videocourse" is an example of the latter.

Video courses offer practitioners the opportunity to obtain CPE without traveling. They offer skillful course leadership and presentation in the practitioner's own environment and are relatively inexpensive. Another advantage of video courses is that they can easily be used as a brush-up on a topic (appropriate for all staff levels) or as a brief introduction to a new topic (best for less-experienced staff).

Video courses are appropriate for group study. In this case, a staff person is selected as the discussion leader, and participants view the video, stopping at predetermined or viewer-selected points to discuss the topics involved. In essence, the video is an “outside lecturer,” and the firm is the sponsor that would determine the CPE credit, based on the actual time spent by the group.

Video courses may also be used in a self-study format, whereby the participant can study at his or her own pace. If used as a self-study program, a video course lacks live interaction with an instructor; however, a good design and a thorough workbook can compensate for interaction. Because the video self-study format is completed at a self-directed pace, checkpoints should be established in the course to assure that individuals complete the work in an effective and timely fashion.

CPE credit for self-study video is recommended by the course developer. (The developer pre-tests the course and recommends one CPE hour of credit for each 100 minutes of video course completed.) The participant must complete an examination, which is returned to the sponsor, as evidence of completion.

For more information about AICPA video courses, call 1-888-777-7077.

### 105.2.5 Audio and Text-Only Courses

Audio cassettes can be used in several settings. Many practitioners and CPAs in industry play cassettes in automobiles while driving to and from the office or at home. Some listen on cassette recorders while exercising or traveling. Others use audio cassettes in a group setting, playing the cassette and discussing issues related to their companies or to specific clients. As with video courses, a workbook is provided, and the participant must complete an examination to obtain CPE credit if the audio course has been used in a self-study format.

The advantages of audio courses are that they are relatively inexpensive and permit great time and place flexibility. Individuals can work at their own pace, even repeating lessons as necessary, and audio courses offer an excellent opportunity for expanding knowledge in very specific areas. Cassettes can be passed among firm members, increasing the knowledge of many, although CPE credit can be obtained only by completing a written examination in a workbook (which must be bought separately for each person claiming CPE credit).

Because audio courses also contain a workbook, the participants must allow not only for the playing of one or more cassettes but also for review and completion of the workbook.

In addition to the cassettes and workbooks, many audio courses include supplementary materials including pronouncements of the AICPA, FASB, GASB, and OMB, IRS publications, and tax forms. The pronouncements and publications are generally required reading.

Because of the flexibility and wide range of topics available, audio courses are appropriate for all personnel in the firm. Less experienced staff can select introductory courses, while more experienced staff can choose advanced topics. The use of audio courses in a group setting is particularly useful for updating staff on a particular subject. The cassettes can be played and one person can act as facilitator in leading staff discussions on issues affecting the firm's clients.

CPE credit for audio courses is allowed in the same manner as for video courses.

Text-only courses are much the same as audio courses, without the cassettes. The texts are much like the workbooks of audio courses in format. A typical text contains editorial explanations, an exercise at the end of each chapter to test the individual's mastery of that chapter's concepts, and multiple choice and/or true, false examination at the end of the text to be submitted for recommended CPE credit. Some programs may require a completed case study. Text-only courses often include the same sort of supplementary materials (e.g., pronouncements of AICPA, FASB, and GASB) as audio courses.

The text-only approach may sometimes be more appropriate than the audio approach for subjects that involve tax forms, mathematical formulas, arithmetic examples, and tables of figures. The rate of individual progress through the course can be more directly controlled with text-only than with any other delivery made. An additional advantage of text-only courses is their shelf-life as reference works after CPE credit is earned.

For more information about AICPA audio and text-only courses, call 1-888-777-7077 (Select Options 1, 3, 1).

## 105.2.6 National Training Schools

The AICPA national training schools enhance the skills of tax practitioners while providing CPE credit. These schools last one week for each level and provide a forum for participants to obtain intensive training in specific areas of taxation, such as individual, partnership, and corporate tax. There are five different weeks of training available. Information on the locations, dates, and subject matter of national training schools can be obtained from the AICPA at 1-888-777-7077 or on the AICPA Web site.

Participants travel to the school and may reside in college dormitories or in alternative lodging facilities for the course's duration.

The advantage of a national training school is intensive training over a short time. CPE credit varies with the course length and normally follows the guidelines for group study CPE.

Individuals may not enroll for more than two weeks each year. Most enroll for one week only each year and come back the following year to complete the program.

This intensive training is particularly suited to less-experienced staff members. It provides attendees with the opportunity to obtain extensive instruction in a particular topic, such as individual taxation, partnership taxation, corporate taxation, and so forth over a period of just five days.

## 105.2.7 Satellite Teleconferences and Cable Television

Continuing education through satellite teleconferences and cable television is expanding. The AICPA, state societies and other organizations have offered a variety of satellite teleconferences. For example, the AICPA and the American Bar Association cosponsored a teleconference on the new Taxpayer-Accountant Confidentiality Privilege. It was broadcast via satellite to a variety of locations throughout the country. Participants use interactive keypads with built-in microphones to communicate with the instructors and to respond to questions.

Programs offered through cable television are also expanding. Participants watch a television course on a particular topic, such as individual or corporate tax, and then must successfully complete an examination to obtain CPE credit. The design and format is much like a video course.

The advantages of cable television are similar to video, including the relative ease with which CPE credit is available, often in the comfort of the participant's home. The disadvantage up to this point has been the cost, since a license fee must be paid for the service. It is also time-specific in delivery, unlike a video, which can be scheduled at the participants' convenience.

As this concept becomes more popular, its offerings will be appropriate for people at all experience levels.

## 105.2.8 Publications

Practitioners can enhance their technical tax skills by reading publications and other technical reference material. Some publications, if properly designed to comply with the CPE standards, offer readers the opportunity to obtain CPE credit. The reader completes an examination at the end of the article or workbook, which must be mailed in for grading. As an example, the AICPA offers *CPE Direct*, a new self-study program incorporating the *Journal of Accountancy* with extensive workbooks.

All personnel should continually enhance their professional skills through technical reading, including the *Journal of Accountancy*, *The Tax Adviser*, and other AICPA and non-AICPA publications. Publishers offer technical materials on specialized topics specifically targeted for the professional tax practitioner. Since tax is one of the most widely practiced CPA specialties, most general professional journals and magazines run a regular department, or one or more features, addressing thorny or persistent tax issues.

**Practice Tip.** Clip and file articles for reference or closer study. Or, maintain an index file (manual or computerized) of article subject, journal title, month, and page numbers to quickly locate recent advice in your tax publications library.

While CPE credit may not be available, tax knowledge can be greatly enhanced by reviewing publications, which are dedicated to presenting the most recent information in readily absorbable formats.

### 105.2.9 Computer-Based Training

Practitioners are able to enhance their tax skills through computer-based instructional techniques using PCs. Computer-based training allows practitioners to interact with the computer, effectively providing a question-and-answer forum. Many computer-based programs covering tax and tax-related subjects are available. The AICPA offers interactive CD-ROM courses in S Corporations, family limited partnerships, estate planning, and IRS practice and procedure. The disks have text, graphics, audio clips, video clips, quizzes, and a final exam. There are also hypertext links to primary source material, including regulations.

Computer-based techniques can also be taught in a discussion leader format using a hands-on microcomputer approach for the participants, with a discussion leader teaching them. This is common for teaching software tools, such as automated spreadsheets and tax planning and tax preparation packages.

Computer-based techniques are appropriate for everyone in a firm. It will probably prove most attractive to personnel who appreciate the opportunity to interact with the computer while completing a course. Experienced practitioners may find this approach particularly appropriate on specific topics that meet a particular need or address a specific weakness.

For more information about AICPA computer-based training courses, call 1-888-777-7077.

### 105.2.10 Certificate of Educational Achievement (CEA)

The Certificate of Educational Achievement (CEA) is a program of courses in a specific subject area. Upon completion of the entire cluster of courses, the participant is awarded a CEA certificate in the subject area, including tax.

CEA programs differ from national training schools (see Section 105.2.6) in that they can be completed over an extended period, while national training schools are concentrated in a short period. CEA courses program are established to form a curriculum, and are completed by the attendees based on the offering dates and locations of the courses. Normally, the same location or general area offers all courses in a CEA program over a prescheduled period to facilitate completion of the program by the participants. In a sense, a CEA program parallels college-level course offerings, with a common location offering a series of courses that build upon each other to achieve a “degree” (in the case of CEA, a *Certificate* of Educational Achievement). There are typically 5 to 8 courses in a program, which may take from several months to up to three years to complete.

CEA programs are offered by the AICPA, through many state CPA societies, in Advanced Business Valuation (BVA). A brochure specifically on the CEA programs can be obtained by calling 1-888-777-7077.

The advantage of a CEA program is that an attendee who successfully completes it can represent to clients that he or she has completed targeted training in a specialized area, such as Business Valuation. Programs also provide well-designed and well-structured approaches for individuals to achieve expertise in certain subject matters.

CEA programs require participants to complete a number of courses in a particular area. Some individuals may find that they already have expertise beyond the initial courses. This disadvantage may require practitioners to complete one or two courses that are below their current experience level.

The CEA programs are designed for both less-experienced and more-experienced personnel within the firm. Attendance should be considered for all staff members who need to develop expertise in the subject matter, as well as for more-experienced staff who wish to achieve a recognized special certificate in the subject matter.

**NOTE:** The AICPA CEA Programs provide an educational experience that awards a Certificate. They are *not* voluntary programs that result in a specialty designation (such as the AICPA’s specialization in PFP, which results in the designation PFS). Accordingly, a CPA is

not permitted to hold out to the public as an accredited specialist in advanced business valuation as a result of earning that Program's Certificate of Educational Achievement.

### 105.2.11 On-the-Job Training

The AICPA Tax Section Voluntary Tax Practice Review Program Guidelines recommend that firms provide on-the-job training during the performance of tax work. Observation and counseling regularly provided during the course of an engagement provide one of the best possible learning experiences, heightened by relevance. A training plan should be developed for each staff person to maximize the training benefits of job assignments. Experienced personnel should be evaluated on their effectiveness in training and developing subordinates so that the subordinates gain appropriate experience in various tax matters and varied industries.

One of the most effective mechanisms of providing on-the-job training is through *feedback* on work completed. Reviewer comments and personal evaluation sessions allow less experienced staff to learn from experienced staff as they take on more complex tasks. While the tendency of many experienced technicians is often to “fix it myself” (of course, to save time), on-the-job training and successful staff development occur only through adequate feedback.

One-on-one review of work and constructive evaluation also help develop good personal communication skills. The ability to express and accept differing points of view is essential to working with clients and building solid business relationships.

While on-the-job training is very important in attaining and maintaining professional competence, the AICPA's *Statement on Standards for Formal Continuing Professional Education (CPE) Programs* defines this type of training as informal learning which would not qualify for CPE credit.

### 105.2.12 On-line Training

Practitioners are also able to enhance their tax skills through on-line information and training courses. On-line training allows practitioners to access a wide array of tax information, whether to simply enhance current skills or to earn CPE credit.

One example of on-line training opportunities exists at the AICPA Web site: **www.aicpa.org**. By then clicking on the “CPE/Products & Services,” users can access CPE central. This Web site not only provides information on where to order on-line products and to request catalogs, courses and conferences, but it also provides information on downloading demonstrations of an interactive learning series and of opportunities to earn CPE credit via on-line training. Other providers also offer Web sites for tax practitioners to enhance their skills and earn CPE credit.

## 105.3 CPE Providers

Continuing professional education courses are offered by numerous private providers, by all state CPA societies and the AICPA. Most private providers announce courses through direct marketing techniques such as brochures and direct mail, as well as in professional tax journals and at professional meetings, conferences, and conventions. Your state CPA society can provide information on these CPE course providers, as can your state board of accountancy.

Exhibit 105-1 contains an address list of state CPA societies, all of which offer CPE courses.

## 105.4 Evaluating CPE Sessions

Continuing professional education requires a significant time and financial investment. Because of this, it is important to adequately plan and evaluate CPE sessions.

Exhibit 105-2 illustrates a sample form for staff evaluation of CPE courses. Although designed primarily for group study courses, the same form can be used for video and audio courses and other CPE alternatives. The participant gives the course an overall rating, and

rates the subject matter and instructor (if applicable). The participant also details new concepts learned, and recommends whether others should attend. Course evaluations should be as thorough as possible and they should be retained for a period of time. Your own files on courses can be the best guide to which programs and instructors or developers seem best for your staff and your environment.

**Practice Tip.** Have attendees spend five to ten minutes at a staff meeting summarizing a CPE session for other firm members after completing a course. Ask whether they recommend that others attend the CPE course the following year. Although this is particularly true for group study, it also applies to audio and video courses and other CPE alternatives.

Be sure to have attendees complete a CPE course evaluation for every course they complete. Then file the evaluations by course name, and use them in planning sessions for the next year. Evaluations of particularly worthwhile CPE alternatives should be circulated to staff. It is particularly important that a CPE course evaluation be completed for firm sponsored CPE (reference Section 105.2.2), so that the firm can track the effectiveness of firm sponsored sessions and enhance planning of internal CPE sessions in the future.

**Practice Tip.** Report sessions with particularly good or bad ratings to the course sponsor, normally the state CPA society. These comments allow the sponsor to communicate with the course developer, resulting in future enhancement of the course (and ultimately the profession).

## 105.5 Tracking CPE Sessions

Because of mandatory CPE requirements in most states, and the need for a firm to control CPE sessions attended by staff, every firm should specifically track and keep records of these sessions.

Tracking should occur by individual, to assure that everyone receives adequate training in required areas, and to provide information for CPE reporting requirements. In addition, tracking and evaluating CPE sessions eliminates redundancy in attendance, and allows better selection and planning for CPE courses in the following year.

Exhibit 105-3 lists the names and addresses of the State Boards of Accountancy. Please contact your state board for its particular CPE reporting requirements.

## 105.6 AICPA National CPE Curriculum

The National CPE Curriculum Subcommittee of the AICPA established curriculums in six fields of study, including taxation. The curriculums have been codified in a manual, which can be obtained from the AICPA or from state CPA societies.

Besides offering a basic platform from which to develop training programs, the National CPE Curriculum can be used to evaluate whether formal CPE conferences, seminars, and other programs actually contain what you hope to achieve at a given experience level. The learning unit descriptions contain objectives, summaries of materials, requisite prior knowledge and experience, topic summaries, and companion learning units. The learning units detailed in the National CPE Curriculum describe what should be the subject matter content at basic, intermediate, advanced, and update levels of instruction and achievement, and specify the field of employment—Public Practice, Industry, or Government—for which the units are appropriate.

You should refer to the National CPE Curriculum for guidance if you wish to develop a typical tax curriculum for staff who deal with taxes. Use of the National CPE Curriculum also facilitates the logical and orderly development of in-house programs by reference to the learning units it details.

Well-designed training programs for staff should follow the National CPE Curriculum. You should determine how every CPE program fits in with the guidance contained in it. By combining information in the National CPE Curriculum with the advantages and disadvantages



of the alternate approaches and delivery methods described in this chapter, you should be able to design an effective professional tax education program for yourself and your staff.

An excerpt from the National CPE Curriculum is included as Exhibit 105-4, which summarizes the suggested curriculum in the “Taxation” field of study.

The AICPA offers a wide variety of courses for tax professionals. Most courses are offered in both group and self-study formats, including

- AICPA Experts’ “No-Holds-Barred” Tax Planning for Corporations (1999 Edition) (TPOC)*
- AICPA Experts’ “No-Holds-Barred” Tax Planning for Individuals (1999 Edition) (TPOI)*
- AICPA Federal Tax Update (FTU)*
- AICPA Form 990 Nonprofits Workshop (F990)*
- Compensation Issues in Not-for-Profit Organizations (CINP)*
- Estate Planning Techniques for the Closely-Held Business (CLOZ)*
- Family Limited Partnerships and Beyond—Saving Taxes and Protecting Clients (FLPAT)*
- Getting the IRS Off Your Client’s Back: Installment Agreements, Offers in Compromise, Bankruptcy and Other Strategies (GIRS)*
- Income Taxation of Estates and Trusts (ITET)*
- The Limited Liability Company—Tax and Business Considerations (LLC)*
- Meeting Your Older Clients’ Needs: Tax, Health Care and Asset Protection Planning (TMAP)*
- Offshore Asset Protection: Tax Planning Strategies (OFFT)*
- Proven Estate Planning Strategies to Protect Client Wealth (LEPS)*
- Real Estate—Tax and Financial Planning (TSRE)*
- Sophisticated Estate Planning Techniques—How and When to Use Them (EPHW)*
- Tackling Tough Tax Topics in Nonprofit Organizations (TTTT)*
- Tax Consequences of the Purchase and Sale of a Business (PSB)*
- Tax Election for Small and Closely-Held Businesses (APSB)*
- Tax Planning for Entrepreneurship: Tips for the Self Employed (ATOE)*
- Tax Planning with Life Insurance (LIFE)*
- Taxation of Stocks, Bonds, and Other Financial Products (STOK)*
- Today’s Best Ideas in Forming and Advising Small Businesses (TBI)*
- Today’s Hottest Device in Estate Planning: The Family Limited Partnership (THDE)*
- U.S. Taxation of International Inbound Transactions and Operations of Foreign Businesses (INTI)*
- U.S. Taxation of International Outbound Transactions and Operations of U.S. Businesses (INTO)*
- VEBAs, Cafeteria Plans, and Other Fringe Benefit Plans (VEBA)*

Note that the *Corporate and Individual Tax Workshops* by the renowned Sydney Kess are offered in group study. Additional group-study, self-study, video, and computer-assisted courses, as well as a number of national conferences and training schools, are available through the AICPA. Call 1-888-777-7077 to receive more information on these programs. Exhibit 105-5 lists 2000 AICPA conferences and training schools offering tax-related course concentrations.

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**Exhibit 105-1: State Society Addresses****STATE CPA SOCIETY ADDRESSES**

Alabama Society of CPAs  
1103 South Perry Street  
Montgomery, AL 36104  
Telephone: (334) 834-7650  
Facsimile: (334) 834-7310  
<http://www.ascpa.org>

Alaska Society of CPAs  
341 W. Tudor, Suite 105  
Anchorage, AK 99503  
Telephone: (907) 562-4334  
Facsimile: (907) 562-4025  
<http://www.akcpa.org>

Arizona Society of CPAs  
2120 N. Central Ave., Suite 100  
Phoenix, AZ 85004  
Telephone: (602) 252-4144  
Facsimile: (602) 252-1511  
<http://www.ascpa.com>

Arkansas Society of CPAs  
415 North McKinley, Suite 970  
Little Rock, AR 72205  
Telephone: (501) 664-8739  
Facsimile: (501) 664-8320  
<http://www.arcpa.org>

California Society of CPAs  
275 Shoreline Drive  
Redwood City, CA 94065  
Telephone: (650) 802-2600  
Facsimile: (650) 802-2661  
<http://www.calcpa.org>

Colorado Society of CPAs  
7979 E. Tufts Avenue, Suite 500  
Denver, CO 80237-2853  
Telephone: (303) 773-2877  
Facsimile: (303) 773-6344  
<http://www.cocpa.org>

Connecticut Society of CPAs  
179 Allyn Street, Suite 201  
Hartford, CT 06103  
Telephone: (860) 525-1153  
Facsimile: (860) 549-3596  
<http://www.cs-cpa.org>

Delaware Society of CPAs  
28 The Commons  
3520 Silverside Road  
Wilmington, DE 19810  
Telephone: (302) 478-7442  
Facsimile: (302) 478-7412  
<http://www.dscpa.org>

Greater Washington Educational Foundation  
1023 15th Street, NW, 8th Floor  
Washington, D.C. 20005-2602  
Telephone: (202) 789-1844  
Facsimile: (202) 789-1847  
<http://www.gwscpa.org>

Florida Institute of CPAs  
P.O. Box 5437 (32314)  
325 W. College Ave.  
Tallahassee, FL 32301  
Telephone: (850) 224-2727  
Facsimile: (850) 222-8190  
<http://www.flcpa.org>

Georgia Society of CPAs  
3340 Peachtree Road NE  
Tower Place, Suite 2750  
Atlanta, GA 30326  
Telephone: (404) 231-8676  
Facsimile: (404) 237-1291  
<http://www.gscpa.org>

Guam Society of CPAs  
361 South Marine Drive  
Tamuning, Guam 96911  
Telephone: (671) 646-3884  
Facsimile: (671) 649-4265

Hawaii Society of CPAs  
900 Fort Street, Suite 850  
P.O. Box 1754 (96806)  
Honolulu, HI 96813  
Telephone: (808) 537-9475  
Facsimile: (808) 537-3520  
<http://www.hscpa.org>

Idaho Society of CPAs  
250 Bobwhite Court, Suite 240  
Boise, ID 83706  
Telephone: (208) 344-6261  
Facsimile: (208) 344-8984  
<http://www.idcpa.org>

Illinois CPA Foundation  
222 S. Riverside Plaza, 16th Floor  
Chicago, IL 60606-5808  
Telephone: (312) 993-0393  
Facsimile: (312) 993-9954  
<http://www.icpas.org>

Indiana CPA Society  
8250 Woodfield Crossing Blvd., Suite 305  
Indianapolis, IN 46240-0069  
Telephone: (317) 726-5000  
Facsimile: (317) 726-5005  
<http://www.incpas.org>

**Exhibit 105-1: State Society Addresses (cont.)**

Iowa Society of CPAs  
950 Office Park Road, Suite 300  
West Des Moines, IA 50265  
Telephone: (515) 223-8161  
Facsimile: (515) 223-7347  
<http://www.iacpa.org>

Kansas Society of CPAs  
P.O. Box 5654  
400 Croix St.  
Topeka, KS 66605  
Telephone: (785) 267-6460  
Facsimile: (785) 267-9278  
<http://www.kscpa.org>

Kentucky Society of CPAs  
1735 Alliant Avenue  
P.O. Box 436869  
Louisville, KY 40299-6326  
Telephone: (502) 266-5272  
Facsimile: (502) 261-9512  
<http://www.kycpa.org>

Society of Louisiana CPAs  
2400 Veterans Blvd., Suite 500  
Kenner, LA 70062  
Telephone: (504) 464-1040  
Facsimile: (504) 469-7930  
<http://www.lcpa.org>

Maine Society of CPAs  
153 U.S. Route 1, #8  
Scarborough, ME 04074-9053  
Telephone: (207) 883-6090  
Facsimile: (207) 883-6211  
<http://www.mecpa.org>

Maryland Association of CPAs  
1300 York Road, Suite 10, Bldg. C  
P.O. Box 4417 (21094-4417)  
Lutherville, MD 21093  
Telephone: (410) 296-6250  
Facsimile: (410) 296-8713  
<http://www.macpa.org>

Massachusetts Society of CPAs  
105 Chauncy Street, 10th Floor  
Boston, MA 02111  
Telephone: (617) 556-4000  
Facsimile: (617) 556-4126  
<http://www.mscaonline.org>

Michigan Association of CPAs  
28116 Orchard Lake Road  
P.O. Box 9054 (48333-9054)  
Farmington Hills, MI 48334  
Telephone: (248) 855-2288  
Facsimile: (248) 855-9122  
<http://www.michcpa.org>

Minnesota Society of CPAs  
N.W. Financial Center, Suite 1230  
7900 Xerxes Avenue South  
Minneapolis, MN 55431  
Telephone: (612) 831-2707  
Facsimile: (612) 831-7875  
<http://www.mncpa.org>

Mississippi Society of CPAs  
P.O. Box 16630 (39236)  
246 Highland Village  
Jackson, MS 39211  
Telephone: (601) 366-3473  
Facsimile: (601) 981-6079  
<http://www.ms-cpa.org>

Missouri Society of CPAs  
P.O. Box 419042 (63141)  
275 N. Lindbergh Blvd., Suite 10  
St. Louis, MO 63141  
Telephone: (314) 997-7966  
Facsimile: (314) 997-2592  
<http://www.mocpa.org>

Montana Society of CPAs  
P.O. Box 138 (59624-0138)  
44 West Sixth Avenue  
Helena, MT 59601  
Telephone: (406) 442-7301  
Facsimile: (406) 443-7278  
<http://www.msca.org>

Nebraska Society of CPAs  
Roman L. Hruska Law Center  
635 South 14th Street, Suite 330  
Lincoln, NE 68508  
Telephone: (402) 476-8482  
Facsimile: (402) 476-8731  
<http://www.nescpa.org>

Nevada CPA Foundation  
5250 Neil Road, Suite 205  
Reno, NV 89509  
Telephone: (702) 826-6800 x104  
Facsimile: (702) 826-7942  
<http://www.nevadacpa.org>

New Hampshire Society of CPAs  
3 Executive Park Drive  
Bedford, NH 03110-6923  
Telephone: (603) 622-1999  
Facsimile: (603) 626-0204  
<http://www.nhsca.org>

New Jersey Society of CPAs  
425 Eagle Rock Avenue  
Roseland, NJ 07068  
Telephone: (973) 226-4494  
Facsimile: (973) 226-7425  
<http://www.njscpa.org>

**Exhibit 105-1: State Society Addresses (cont.)**

New Mexico CPA Foundation  
1650 University NE, Suite 450  
Albuquerque, NM 87102  
Telephone: (505) 246-1699  
Facsimile: (505) 246-1686  
<http://www.nmcpa.org>

New York State Society of CPAs  
Foundation for Accounting Education  
530 Fifth Avenue, 5th Floor  
New York, NY 10036-5101  
Telephone: (212) 719-8300  
Facsimile: (212) 719-3364  
<http://www.nysscpa.org>

North Carolina Association of CPAs  
3100 Gateway Center Road  
Morrisville, NC 27560-9241  
Telephone: (919) 469-1040  
Facsimile: (919) 469-3959  
<http://www.ncacpa.org>

North Dakota Society of CPAs  
2701 South Columbia Road  
Grand Forks, ND 58201  
Telephone: (701) 775-7100  
Facsimile: (701) 775-7430  
<http://www.ndscpa.org>

Ohio Society of CPAs  
P.O. Box 1810  
535 Metro Place South  
Dublin, OH 43017  
Telephone: (614) 764-2727  
Facsimile: (614) 764-5880  
<http://www.ohioscpa.com>

Oklahoma Society of CPAs  
50 Penn Place  
1900 N.W. Expressway, #910  
Oklahoma City, OK 73118-9998  
Telephone: (405) 841-3800  
Facsimile: (405) 841-3801  
<http://www.oscpa.com>

Oregon Society of CPAs  
10206 S.W. Laurel Street  
Beaverton, OR 97005  
Telephone: (503) 641-7200  
Facsimile: (503) 626-2942  
<http://www.orcpa.org>

Pennsylvania Institute of CPAs  
1608 Walnut Street  
Philadelphia, PA 19103  
Telephone: (215) 735-2635  
Facsimile: (215) 735-3694  
<http://www.picpa.org>

Puerto Rico Society of CPAs  
Colegio De Contadores Publicos Autorizados De  
Puerto Rico  
Edif. Capital Center  
Torre Sur 239  
Avenue Arterial Hostos, #1401  
San Juan, Puerto Rico 00919-1478  
Telephone: (787) 754-1950  
Facsimile: (787) 753-0212  
<http://www.prccpa.org>

Rhode Island Society of CPAs  
One Franklin Square  
Providence, RI 02903  
Telephone: (401) 331-5720  
Facsimile: (401) 454-5780  
<http://www.riscpa.org>

South Carolina Association of CPAs  
570 Chris Drive  
West Columbia, SC 29169  
Telephone: (803) 791-4181  
Facsimile: (803) 791-4196  
<http://www.scacpa.org>

South Dakota Society of CPAs  
P.O. Box 1789 (57101-1789)  
1000 West Avenue North, #100  
Sioux Falls, SD 57104  
Telephone: (605) 334-3848  
Facsimile: (605) 334-8595  
<http://www.sdcpa.org>

Tennessee Society of CPAs  
Box 596 (37024)  
201 Powell Place, Suite 120  
Brentwood, TN 37027  
Telephone: (615) 377-3825  
Facsimile: (615) 377-3904  
<http://www.tncpa.org>

Texas Society of CPAs  
14860 Montford Drive, Suite 150  
Dallas, TX 75247  
Telephone: (972) 687-8500  
Facsimile: (972) 687-8618  
<http://www.tscpa.org>

Utah Association of CPAs  
220 E. Morris Ave., Suite 320  
Salt Lake City, UT 84115  
Telephone: (801) 466-8022  
Facsimile: (801) 485-6206  
<http://www.uacpa.org>

Vermont Society of CPAs  
100 State Street, Suite 500  
Montpelier, VT 05602  
Telephone: (802) 229-4939  
Facsimile: (802) 223-0360  
<http://www.vtcpa.org>

**Exhibit 105-1: State Society Addresses (cont.)**

Virginia Society of CPAs  
4309 Cox Road  
Innsbrook Corp. Center  
Glen Allen, VA 23058-4620  
Telephone: (804) 270-5344  
Facsimile: (804) 273-1741  
<http://www.vscpa.com>

Virgin Islands Society of CPAs  
c/o Mittie E. Benham, CPA  
P.O. Box 5108, VDS  
St. Thomas, VI 00803  
Telephone: (809) 776-1852  
Facsimile: (809) 776-1845

Washington Society of CPAs  
902 140th Avenue NE  
Bellevue, WA 98005  
Telephone: (425) 644-4800  
Facsimile: (425) 562-8853  
<http://www.wscpa.org>

West Virginia Society of CPAs  
1201 Huntington Square  
P.O. Box 1673  
Charleston, WV 25326  
Telephone: (304) 342-5461  
Facsimile: (304) 344-4636  
<http://www.wvscpa.org>

Wisconsin Institute of CPAs  
P.O. Box 1010 (53008-1010)  
235 N. Executive Drive, Suite 200  
Brookfield, WI 53005  
Telephone: (414) 785-0445  
Facsimile: (414) 785-0838  
<http://www.wicpa.org>

Wyoming Society of CPAs  
1603 Capital Avenue  
Suite 413  
Cheyenne, WY 82001  
Telephone: (307) 634-7039  
Facsimile: (307) 634-5110  
<http://www.wyocpa.org>

**Exhibit 105-2: CPE Course Evaluation Form**

**CPE COURSE EVALUATION**

Course Name: \_\_\_\_\_

Course Location: \_\_\_\_\_

Course Date(s): \_\_\_\_\_

Overall Rating:	5	4	3	2	1
	.....				
	<i>Excellent</i>				<i>Poor</i>

Subject Matter Rating:	.....				
	<i>Excellent</i>				<i>Poor</i>

Instructor Rating:	.....				
	<i>Excellent</i>				<i>Poor</i>

New Concepts Learned (3 most important points):

1.

2.

3.

Items of major importance to other staff (indicate specific individuals, if applicable):

Do you recommend course to other staff members:

YES       NO

If YES, to whom? \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

**Exhibit 105-3: State Boards of Accountancy Addresses**

**Alabama State Board of Public Accountancy**

P.O. Box 300375  
Montgomery, Alabama 36130-0375  
Att: J. Lamar Harris, CPA  
*Executive Director*  
Telephone: (334) 242-5700  
Facsimile: (334) 242-2711

**Alaska State Board of Public Accountancy**

Department of Commerce and Economic Development  
Division of Occupational Licensing  
P.O. Box 110806  
Juneau, Alaska 99811-0806  
Att: Steven B. Snyder  
*Licensing Examiner*  
Telephone: (907) 465-2580  
Facsimile: (907) 465-2974  
<http://www.commerce.state.ak.us/occ/pcpa.htm>

**Arizona State Board of Accountancy**

3877 N. Seventh St., #106  
Phoenix, Arizona 85014  
Att: Ruth R. Lee  
*Executive Director*  
Telephone: (602) 255-3648  
Facsimile: (602) 255-1283  
<http://www.accountancy.state.az.us/>

**Arkansas State Board of Accountancy**

101 East Capitol, Suite 430  
Little Rock, Arkansas 72201  
Att: James E. George  
*Executive Director*  
Telephone: (501) 682-1520  
Facsimile: (501) 682-5538  
<http://www.state.ar.us/asbpa>

**California State Board of Accountancy**

2000 Evergreen Street, Suite 250  
Sacramento, California 95815-3832  
Att: Carol B. Sigmann  
*Executive Officer*  
Telephone: (916) 263-3680  
Facsimile: (916) 263-3674  
<http://www.dca.ca.gov/cba>

**Colorado State Board of Accountancy**

1560 Broadway, Suite 1340  
Denver, Colorado 80202  
Att: Robert Longway  
*Administrator*  
Telephone: (303) 894-7800  
Facsimile: (303) 894-7790  
<http://www.dora.state.co.us/accountants>

**Connecticut State Board of Accountancy**

Secretary of the State  
30 Trinity Street, P.O. Box 150470  
Hartford, Connecticut 06115  
Att: David L. Guay  
*Executive Director*  
Telephone: (860) 509-6179  
Facsimile: (860) 509-6247  
<http://www.state.ct.us/sots/SBOA/bdacc.htm>

**Delaware State Board of Accountancy**

Cannon Building, Suite 203  
861 Silver Lake Blvd.  
Dover, Delaware 19904  
Att: Mary E. Paskey  
*Administrative Assistant*  
Telephone: (302) 739-4522  
Facsimile: (302) 739-2711

**District of Columbia Board of Accountancy**

941 North Capitol St. N.E.  
Room 7W45  
Washington, D.C. 20002  
Att: Harriette Andrews  
*Administrator*  
Telephone: (202) 442-4461  
Facsimile: (202) 442-8390  
<http://www.gwscpa.org/dcba>

**Florida Board of Accountancy**

2610 N.W. 43rd Street  
Suite 1A  
Gainesville, Florida 32606-4599  
Att: Martha P. Willis  
*Division Director*  
Telephone: (352) 955-2165  
Facsimile: (352) 955-2164  
<http://www.state.fl.us/dbpr/html/>

**Georgia State Board of Accountancy**

166 Pryor Street, S.W.  
Atlanta, Georgia 30303  
Att: Barbara W. Kitchens  
*Executive Director*  
Telephone: (404) 656-2281  
Facsimile: (404) 651-9532  
<http://www.sos.state.ga.us/ebd.accountancy/>

**Guam Territorial Board of Public Accountancy**

P.O. Box 5753  
Agana, Guam 96932  
Att: Lisa A. Leon Guerrero  
*Administrative Director*  
Telephone: (671) 735-2559  
Facsimile: (671) 734-3461

**Hawaii Board of Public Accountancy**

Department of Commerce and Consumer Affairs  
P.O. Box 3469  
Honolulu, Hawaii 96801-3469  
Att: Laureen Kai  
*Executive Officer*  
Telephone: (808) 586-2696  
Facsimile: (808) 586-2689

**Idaho State Board of Accountancy**

P.O. Box 83720  
Boise, Idaho 83720-0002  
Att: Barbara A. Porter  
*Executive Director*  
Telephone: (208) 334-2490  
Facsimile: (208) 334-2615  
<http://www.state.id.us/boa>



**Exhibit 105-3: State Boards of Accountancy Addresses (cont.)****Illinois Board of Examiners**

505 E. Green, Room 216  
 Champaign, Illinois 61820-5723  
 Att: Joanne Vician  
*Executive Director*  
 Telephone: (217) 333-1565  
 Facsimile: (217) 333-3126  
<http://www.illinois-cpa-examcom/cphtml>

**Illinois Public Accountants Registration Committee**

Public Accountancy Section  
 320 West Washington Street, 3rd Floor  
 Springfield, Illinois 62786  
 Att: Daniel Harden  
*Board Liaison*  
 Telephone: (217) 785-0800  
 Facsimile: (217) 782-7645  
<http://www.state.il.us/dpr>

**Indiana Board of Accountancy**

Indiana Prof. Lic. Agc.  
 Indiana Government Center South  
 302 West Washington Street, Room E034  
 Indianapolis, Indiana 46204-2246  
 Att: Nancy Smith  
*Exam Coordinator*  
 Telephone: (317) 232-5987  
 Facsimile: (317) 232-2312  
<http://www.ai.org/pla/accountancy/index.html>

**Iowa Accountancy Examining Board**

1918 S.E. Hulsizer Avenue  
 Ankeny, Iowa 50021-3941  
 Att: William M. Schroeder  
*Executive Secretary*  
 Telephone: (515) 281-4126  
 Facsimile: (515) 281-7411  
<http://www.state.ia.us/iacc>

**Kansas Board of Accountancy**

Landon State Office Building  
 900 S.W. Jackson, Suite 556  
 Topeka, Kansas 66612-1239  
 Att: Susan L. Somers  
*Executive Director*  
 Telephone: (785) 296-2162  
 Facsimile: (785) 291-3501  
<http://www.ink.org/public/ksboa>

**Kentucky State Board of Accountancy**

332 West Broadway, Suite 310  
 Louisville, Kentucky 40202-2115  
 Att: Susan G. Stopher  
*Executive Director*  
 Telephone: (502) 595-3037  
 Facsimile: (502) 595-4281  
<http://www.state.ky.us/agencies/boa>

**State Board of CPAs of Louisiana**

601 Poydras Street, Suite 1770  
 New Orleans, Louisiana 70139  
 Att: Michael A. Henderson, CPA  
*Executive Director*  
 Telephone: (504) 566-1244  
 Facsimile: (504) 566-1252

**Maine State Board of Accountancy**

Department of Professional and Financial Regulation  
 Division of Licensing and Regulation  
 35 State House Station  
 Augusta, Maine 04333  
 Att: Cheryl Hersom  
*Board Administrator*  
 Telephone: (207) 624-8603  
 Facsimile: (207) 624-8637  
<http://www.state.me.us/pfr/led/account/index.htm>

**Maryland State Board of Public Accountancy**

500 N. Calvert Street, Room 308  
 Baltimore, Maryland 21202-3651  
 Att: Sue Mays  
*Executive Director*  
 Telephone: (410) 333-6322  
 Facsimile: (410) 333-6314  
<http://www.dllr.state.md.us/occprof/account.html>

**Massachusetts Board of Public Accountancy**

239 Causeway Street  
 Suite 400  
 Boston, Massachusetts 02114  
 Att: Leo H. Bonarrigo, CPA  
*Executive Secretary*  
 Telephone: (617) 727-1806  
 Facsimile: (617) 727-0139  
<http://www.state.ma.us/reg/boards/pa/default.ht>

**Michigan Board of Accountancy**

Department of Consumer & Industry Services  
 P.O. Box 30018  
 Lansing, Michigan 48909-7518  
 Att: Suzanne U. Jolicoeur  
*Licensing Administrator*  
 Telephone: (517) 241-9249  
 Facsimile: (517) 241-9280  
<http://www.cis.state.mi.us/ocs/acct/home.htm>

**Minnesota State Board of Accountancy**

85 East 7th Place, Suite 125  
 St. Paul, Minnesota 55101  
 Att: Dennis J. Poppenhagen  
*Executive Secretary*  
 Telephone: (651) 296-7937  
 Facsimile: (651) 282-2644  
<http://www.state.mn.us/dir/sainde.html>

**Mississippi State Board of Public Accountancy**

653 North State Street  
 Jackson, Mississippi 39202-3304  
 Att: Susan M. Harris, CPA  
*Executive Director*  
 Telephone: (601) 354-7320  
 Facsimile: (601) 354-7290  
<http://www.msba.state.ms.us>

**Missouri State Board of Accountancy**

P.O. Box 613  
 Jefferson City, Missouri 65102  
 Att: Ken L. Bishop  
*Executive Director*  
 Telephone: (573) 751-0012  
 Facsimile: (573) 751-0890  
<http://www.ecodev.state.mo.us/pr/account/>

**Exhibit 105-3: State Boards of Accountancy Addresses (cont.)**

**Montana State Board of Public Accountants**

Arcade Building, Lower Level  
111 North Jackson  
P.O. Box 200513  
Helena, Montana 59620  
Att: Suzanne M. Criswell  
*Administrator*  
Telephone: (406) 444-3739  
Facsimile: (406) 444-1667  
[http://www.com.state.mt.us/license/pol/pboards/pac\\_board/board\\_page.htm](http://www.com.state.mt.us/license/pol/pboards/pac_board/board_page.htm)

**Nebraska State Board of Public Accountancy**

P.O. Box 94725  
Lincoln, Nebraska 68509-4725  
Att: Annette L. Harmon  
*Executive Director*  
Telephone: (402) 471-3595  
Facsimile: (402) 471-4484  
<http://www.nol.org/home/BPA>

**Nevada State Board of Accountancy**

200 S. Virginia Street, Suite 670  
Reno, Nevada 89501-2408  
Att: N. Johanna Bravo  
*Executive Director*  
Telephone: (702) 786-0231  
Facsimile: (702) 786-0234  
<http://www.state.nv.us/account>

**New Hampshire Board of Accountancy**

57 Regional Drive  
Concord, New Hampshire 03301  
Att: Louise O. MacMillan  
*Assistant to the Board*  
Telephone: (603) 271-3286  
Facsimile: (603) 271-2856  
<http://www.state.nh.us/accountancy>

**New Jersey State Board of Accountancy**

P.O. Box 45000  
Newark, New Jersey 07101  
Att: Kevin Earle  
*Executive Director*  
Telephone: (973) 504-6380  
Facsimile: (973) 648-2855  
<http://www.state.nj.us/lps/ca/nonmed.htm>

**New Mexico State Board of Public Accountancy**

1650 University N.E., Suite 400-A  
Albuquerque, New Mexico 87102  
Att: William J. Heath, Jr., CPA  
*Executive Director*  
Telephone: (505) 841-9108  
Facsimile: (505) 841-9113

**New York State Board for Public Accountancy**

State Education Department  
Cultural Education Center, Room 3013  
Albany, New York 12230  
Att: Dan Dustin, CPA  
*Acting Executive Secretary*  
Telephone: (518) 474-3836  
Facsimile: (518) 473-6282  
<http://www.nysed.gov/prof/cpa.htm>

**North Carolina State Board of CPA Examiners**

1101 Oberlin Road, Suite 104  
P.O. Box 12827  
Raleigh, North Carolina 27605-2827  
Att: Robert N. Brooks  
*Executive Director*  
Telephone: (919) 733-4222  
Facsimile: (919) 733-4209  
<http://www.state.nc.us/cpabd>

**North Dakota State Board of Accountancy**

2701 South Columbia Road  
Grand Forks, North Dakota 58201-6029  
Att: Jim Abbott  
*Executive Director*  
Telephone: (701) 775-7100  
Facsimile: (701) 775-7430  
<http://www.state.nd.us/ndsba>

**Accountancy Board of Ohio**

77 South High Street, 18th Floor  
Columbus, Ohio 43266  
Att: Robert D. Joseph  
*Executive Director*  
Telephone: (614) 466-4135  
Facsimile: (614) 466-2628  
<http://www.state.oh.us/acc>

**Oklahoma Accountancy Board**

4545 Lincoln Boulevard, Suite 165  
Oklahoma City, Oklahoma 73105-3413  
Att: Diana Collinworth  
*Executive Director*  
Telephone: (405) 521-2397  
Facsimile: (405) 521-3118

**Oregon State Board of Accountancy**

3218 Pringle Road, S.E. #110  
Salem, Oregon 97302-6307  
Att: Carol Rives  
*Administrator*  
Telephone: (503) 378-4181  
Facsimile: (503) 378-3575  
<http://www.boa.state.or.us/boa.html>

**Pennsylvania State Board of Accountancy**

124 Pine St., 1st Floor  
Harrisburg, Pennsylvania 17101-2649  
Att: Dorna J. Thorpe  
*Board Administrator*  
Telephone: (717) 783-1404  
Facsimile: (717) 705-5540  
<http://www.dos.state.pa.us/bpoa/accbd.htm>

**Puerto Rico Board of Accountancy**

Box 3271, Old San Juan Station  
San Juan, Puerto Rico 00904-3271  
Att: Carmen Carreras-Perez  
*Director*  
Telephone: (787) 722-4816  
Facsimile: (787) 722-4818

**Rhode Island Board of Accountancy**

233 Richmond Street, Suite 236  
Providence, Rhode Island 02903-4236  
Att: Rosemary B. Snyder  
*Executive Secretary*  
Telephone: (401) 222-3185  
Facsimile: (401) 222-6654

**Exhibit 105-3: State Boards of Accountancy Addresses (cont.)****South Carolina Board of Accountancy**

110 Centerview Drive—Kingstree Building  
 P.O. Box 11329  
 Columbia, South Carolina 29211  
 Att: Robert W. Wilkes, Jr., CPA  
*Administrator*  
 Telephone: (803) 896-4492  
 Facsimile: (803) 896-4554  
<http://www.llr.state.sc.us/bac.htm>

**South Dakota Board of Accountancy**

301 East 14th Street, Suite 200  
 Sioux Falls, South Dakota 57104  
 Att: Lynn J. Bethke  
*Executive Director*  
 Telephone: (605) 367-5770  
 Facsimile: (605) 367-5773  
<http://www.state.sd.us/dcr/accountant>

**Tennessee State Board of Accountancy**

500 James Robertson Parkway, 2nd Floor  
 Nashville, Tennessee 37243-1141  
 Att: Darrel E. Tongate, CPA  
*Executive Director*  
 Telephone: (615) 741-2550  
 Facsimile: (615) 532-8800  
<http://www.state.tn.us/commerce/tnsba>

**Texas State Board of Public Accountancy**

333 Guadalupe Tower III, Suite 900  
 Austin, Texas 78701-3900  
 Att: William Treacy  
*Executive Director*  
 Telephone: (512) 305-7800  
 Facsimile: (512) 305-7854  
<http://www.tsbpa.state.tx.us>

**Utah Board of Accountancy**

P.O. Box 146741  
 Salt Lake City, Utah 84114-6741  
 Att: Dan S. Jones, Esq.  
*Administrator*  
 Telephone: (801) 530-6720  
 Facsimile: (801) 530-6511  
<http://www.commerce.state.ut.us/web/commerce/dopl/dopll.htm>

**Vermont Board of Public Accountancy**

Office of Professional Regulation  
 26 Terrace Street, Drawer 09  
 Montpelier, Vermont 05609-1106  
 Att: Nancy Morin  
*Administrator*  
 Telephone: (802) 828-2191  
 Facsimile: (802) 828-2465  
<http://vtprofessionals.org/accountants>

**Virginia Board for Accountancy**

3600 West Broad Street  
 Richmond, Virginia 23230-4917  
 Att: David E. Dick  
*Assistant Director*  
 Telephone: (804) 367-8507  
 Facsimile: (804) 367-2475  
<http://www.state.va.us/dpor>

**Virgin Islands Board of Public Accountancy**

P.O. Box 3016, No. 1A Gallows Bay Market Place  
 Christiansted  
 St. Croix, Virgin Islands 00822  
 Att: Pablo O'Neil, CPA  
*Secretary*  
 Telephone: (340) 773-4305  
 Facsimile: (340) 773-9850

**Washington State Board of Accountancy**

210 East Union, Suite A (98501)  
 P.O. Box 9131  
 Olympia, Washington 98507-9131  
 Att: Dana M. McInturff, CPA  
*Executive Director*  
 Telephone: (206) 753-2585  
 Facsimile: (206) 664-9190  
<http://www.cpaboard.wa.gov>

**West Virginia Board of Accountancy**

200 L&S Building  
 812 Quarrier Street  
 Charleston, West Virginia 25301-2695  
 Att: JoAnn Walker  
*Executive Director*  
 Telephone: (304) 558-3557  
 Facsimile: (304) 558-1325  
<http://www.state.wv.us/wvboa>

**Wisconsin Accounting Examining Board**

1400 East Washington Avenue  
 P.O. Box 8935  
 Madison, Wisconsin 53708-8935  
 Att: Alfred Hall  
*Director*  
 Telephone: (608) 266-3423  
 Facsimile: (608) 267-3816

**Wyoming Board of Certified Public Accountants**

First Bank Building  
 2020 Carey Avenue  
 Cheyenne, Wyoming 82002  
 Att: Peggy Morgando  
*Executive Director*  
 Telephone: (307) 777-7551  
 Facsimile: (307) 777-3796  
<http://commerce.state.wy.us/btc/cpa/>

**Exhibit 105-4: National CPE Curriculum Suggested "Taxation" Summary****TAXATION**

This field of study includes subjects dealing with tax compliance and tax planning. Compliance covers tax return preparation and review and IRS examinations, ruling requests, and protests. Tax planning focuses on applying tax rules to prospective transactions and understanding the tax implications of unusual or complex transactions. Recognizing alternative tax treatments and advising the client on tax saving opportunities are also part of tax planning. While this curriculum is aimed primarily at the public practitioner, tax professionals in industry will be interested in many subjects covered here.

	<i>Field of Employment</i>
<b>TAX RESEARCH</b>	
Basic Tax Research	PI
Intermediate Tax Research	PI
The Art of Tax Research	PI
Using Electronic Tax Data Bases	PI
<b>TAX ACCOUNTING</b>	
Accounting Methods and Periods	PI
Income Tax Aspects of Inventories	PI
Uniform Capitalization Rules	PI
Tax Applications of the Time Value of Money	PI
Interest Allocation	PI
Employee Fringe Benefit Programs	PI
<b>INDIVIDUAL INCOME TAXATION</b>	
Preparation of Individual Income Tax Returns and Introduction to Individual Income Tax Concepts	PP
Concepts of Individual Income Taxation	PP
Tax Aspects of Divorce and Separation	PP
Sales and Exchanges of Property	PP
Problems in Individual Income Taxation	PP
Tax-Advantaged Investments for Individuals	PP
Individual Income Tax Developments—Update	
<b>PARTNERSHIP TAXATION</b>	
Preparation of Partnership Tax Returns and Introduction to Partnership Tax Concepts	PP
Concepts of Partnership Taxation	PP
Problems in Partnership Taxation	PP
Partnership Tax—Update	PP
<b>CORPORATE INCOME TAXATION</b>	
Preparation of Corporate Income Tax Returns and Introduction to Basic Corporate Income Tax Concepts	PI
Corporate Formations	PI
Corporate Nonliquidating Distributions	PI
Stock Redemptions	PI
Corporate Liquidations	PI
Accumulated Earnings Tax and Personal Holding Companies	PI

NOTE: Fields of Employment are—Practice and Industry (PI), Public Practice (PP), and Industry (II).

**Exhibit 105-4: National CPE Curriculum Suggested "Taxation" Summary (cont.)**

	<i>Field of Employment</i>
Concepts of S Corporations	PI
Problems of S Corporations	PI
Reorganizations	PI
Consolidated Tax Returns	PI
Tax Aspects of Business Planning	PI
Closely Held Corporations	PI
Corporate Tax Developments—Update	PI
<b>CORPORATE TAX CONSIDERATIONS IN INDUSTRY</b>	
Corporate Tax Compliance—Federal, State, and Local	PI
Corporate Tax Planning	PI
<b>TAX-EXEMPT ORGANIZATIONS</b>	
Introduction to Tax-Exempt Organizations	PP
Concepts of Tax-Exempt Organizations	PP
Unrelated Business and Debt-Financed Income	PP
Private Foundations	PP
Problems of Tax-Exempt Organizations	PP
<b>ESTATE AND TRUST TAXATION</b>	
Fiduciary Accounting	PI
CPA's Role in Estate Administration	PI
Introduction to Income Taxation of Estates and Trusts	PI
Introduction to Estate Taxation	PI
Introduction to Gift Taxation	PI
Problems in Income Taxation of Estates and Trusts	PI
Problems of Estate and Gift Taxation	PI
Generation-Skipping Transfers	PI
Valuations for Estate and Gift Tax Purposes	PI
Estate Planning	PI
Post-Mortem Estate Tax Planning	PI
Estate Planning for Closely Held Business Interests	PI
Using Trusts in Income and Estate Planning	PI
Estate Planning—Update	PI
<b>COMPENSATION CONSIDERATIONS FOR TAXATION</b>	
Introduction to Qualified Retirement Plans	PI
Problems in Qualified Retirement Plans	PI
Cash or Deferred Arrangements (CODAs)	PI
Loans and Distributions for Qualified Plans	PI
Employee Stock Ownership Plans (ESOPs)	PI
Executive Compensation	PI
Compensation Planning—Update	PI
<b>REAL ESTATE TAXATION</b>	
Introduction to Real Estate Taxation	PP
Concepts in Real Estate Taxation	PP
Problems in Real Estate Taxation	PP
Real Estate Syndications	PP
Real Estate Taxation—Update	PP

**Exhibit 105-4: National CPE Curriculum Suggested "Taxation" Summary (cont.)**

	<i>Field of Employment</i>
<b>INTERNATIONAL TAXATION</b>	
Survey of Tax Aspects of International Operations	PI
Tax Treatment of Americans Abroad and Nonresident Aliens	PI
Advanced Taxation of International Operations	PI
Taxation of International Operations—Update	PI
U.S. Operations of Foreign Investors	PI
<b>STATE AND LOCAL TAXES</b>	
State and Local Taxation	PI
Corporate Interstate Taxation	PI
State and Local Taxes—Update	PI
<b>TAX PRACTICE MANAGEMENT AND PROCEDURES</b>	
Procedures and Practice Before the Internal Revenue Service	PP
Tax Fraud: What the CPA Should Know	PP
Protecting the Tax Practitioner	PP
Taxpayer Representation Strategies	PP
Administering the Estate Planning Practice	PP
<b>COMPUTERS IN THE TAX PRACTICE</b>	
Introduction to Computers in Tax Practice	PP
Managing Computers in a Tax Practice	PP
<b>SPECIAL TAX MATTERS</b>	
Tax Aspects of Debtor and Creditor Relationships	PI
Payroll Taxes (Federal)	PI
Excise Taxes	PI
Tax Implications of Community Property	PI
Tax Aspects of Research and Development Expenditures	PI
Equipment Leasing	PI
Record Keeping	PI
Information Reporting for Tax Purposes	PI
Electronic Filings	PI
Tax Penalties	PI
Natural Resources	PI
Business Credits	PI
<b>LOSS AND PREFERENCE RESTRICTIONS</b>	
Carrybacks and Carryovers—Individuals	PI
Limitations on Hobby Losses, Home Offices and Vacation Homes	PI
At Risk Considerations	PI
Limitation on Losses and Credits from Passive Activities	PI
Limitation on Investment Income	PI
Introduction to the Alternative Minimum Tax	PI
Problems with the Alternative Minimum Tax	PI

**Exhibit 105-5: AICPA Tax Conferences and Training Schools****2000 AICPA TAX CONFERENCES & TRAINING SCHOOLS****Tax Strategies for the High Income Individual**

May 17–19 Las Vegas, NV

**AICPA-University of Illinois National Tax Education Program**

June 12–16—Week 1 Champaign-Urbana, IL

June 19–23—Week 2 Champaign-Urbana, IL

July 10–14—Week 3 Champaign-Urbana, IL

July 17–21—Week 4 Champaign-Urbana, IL

July 24–28—Week 5 Champaign-Urbana, IL

**AICPA Spring Tax Division Meeting**

June 7–9 Seattle, WA

**AICPA Advanced Estate Planning Conference**

July 19–21 Boston, MA

**National Conference on Federal Taxes**

October 23–25 Washington, DC

For further information or to register for tax-related conferences, or to be placed on a brochure mailing list, please call the AICPA-CPE Division at 1-888-777-7077. Register by phone with Visa or Master Card. On-line information and registration is available on the AICPA's website: [www.aicpa.org](http://www.aicpa.org).





# 106 Tax Planning Services

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# 106 Tax Planning Services

In providing quality service, you should offer clients meaningful tax planning ideas and suggestions. Most tax practitioners have close associations with their clients due to the pervasiveness and highly personal nature of tax services. This puts them in an ideal position as a financial advisor to recognize opportunities that extend beyond simple tax planning, such as—

- Income tax planning.
- Estate tax planning.
- Personal financial planning.
- Business planning.
- Retirement planning.

A number of objectives can be achieved through offering professional planning services. You can—

- Provide the fullest and highest quality services to clients.
- Assure that clients are taking advantage of every opportunity to achieve the lowest tax cost and the highest accumulation of wealth.
- Increase quality of a client relationship by providing additional opportunities to work with a client and strengthen the advisor/client relationship.
- Assure that clients' records and information are up to date and maintained in an orderly fashion.
- Balance office workload throughout the year with assignments outside the busy months.
- Long-term benefit of referrals or development of a speciality.

Clients are best served through planning services, because a proactive, as opposed to a reactive, approach can be taken on many matters. A proper review of a client's tax and general financial position in light of the opportunities and pitfalls of the tax and overall economic environment helps clients avoid problems and maximize economic potential.

By continually monitoring the client's position and counseling on required actions, you can help minimize overall tax liability, and the client can take advantage of opportunities to increase wealth.

Unforeseen events and opportunities often require quick decisions; it is imperative that client records be maintained in an up-to-date and orderly fashion. This provides information that can be used to respond to opportunities and pitfalls that require quick analysis and decision.

Other benefits accrue to you, as well, as a result of planning services:

- Planning results in additional work opportunities and tends to balance the workload during the year.
- Proper planning eliminates nasty surprises that can cost you time, money, and client loyalty.
- Economies of scale developed by application to several clients and reuse of computer templates.

A firm policy to keep client records up to date can spread much of the client workload over the year. For example, instead of having to summarize 11 months of information in December, or 12 months of information during February or March of the following year, planning provides for records to be summarized on a more frequent basis, monthly or quarterly, for example. A fixed-asset schedule might be updated at quarterly or semiannual intervals during the year. These approaches not only balance your workload during the year and reduce the work requirements during the busy months, but often allow you to point out opportunities and pitfalls to your clients, generating consulting and business assistance engagements on an ongoing basis throughout the year. There should be a coordinated effort to contact clients on a continuing basis to gather material for planning activities.

Consider these examples of additional services to be derived from planning activities:

- You determine that a company has a lack of clear business direction and recommend that your firm work with the company on strategic planning.
- You determine that little strength exists in the management of a company other than the owner, and recommend that your firm work with the company on succession planning.
- You detect financial control weaknesses and recommend that your firm work with the company on budget, internal control, and cash flow matters.
- You determine that debt service requirements could be improved, and recommend that your firm work with the company on debt restructuring or a change in lending institutions.

These are just a few of the *many* additional services that arise through planning activities. Not only should your clients be grateful for sound planning, but the workload and financial results of your firm will improve.

Proper planning eliminates surprises. Planning services and marketing considerations (see Chapter 103) fit closely together, because both serve the dual purpose of properly servicing the client and creating additional work opportunities for your firm.

Many practitioners educate clients on the need for planning services through newsletters and seminars (these topics are discussed in depth in Chapter 103). Far too often, practitioners ignore planning services because of their focus on tax compliance, even though client appreciation of planning services is often far greater than for compliance services.

**Practice Tip.** Keep a notepad handy or design a simple form labeled as a Planning Idea Sheet to use while completing tax returns. Simply note the client name and a planning idea or two. After April 15, consolidate and control the lists through one person or a department. Then, be sure proper follow-up and attention to the planning ideas occur. Often, follow-up to planning ideas identified while completing tax returns results in identification of additional planning opportunities.

## 106.1 Year-Round Planning Opportunities

Many practitioners consider planning to be only a year-end responsibility. This is a narrow and somewhat inaccurate viewpoint. Planning is a year-round task. In fact, it is a daily, ongoing responsibility. You should assess clients' tax and economic affairs on an ongoing basis, and encourage planning in client communications, including newsletters and seminars.

It is important to document any ideas developed and work completed throughout the year. Emphasis should be placed on the proper documentation of conferences, including both office conferences and phone conferences. Not only does this provide much needed file documentation regarding the issues discussed and any recommendations given, it also provides the client with a tangible product (a copy of the file memorandum should be forwarded to the client) that can later be described on an invoice and used by the client for future reference. The written file memorandum sent to the client also protects you, if your client misinterprets the telephone conversation.

**Practice Tip.** Contact attorneys and bankers in your area and educate them on the importance of having clients contact a professional for assistance with accounting and tax advice

on transactions such as the sale of real estate, business formation, sale of a business, and so forth. This should be done on one to one lunches, seminars or speaking as forums to educate other professionals.

**Staff training and resources.** In order to establish planning as an important client service, you should take the following steps:

- Train staff in areas such as income and estate tax planning, and in related areas, such as business finance and overall management techniques. (Refer to Chapter 105, Professional Tax Education.)
- Acquire the necessary tools to enhance planning processes, including software products and research materials.
- Emphasize that even the most inexperienced staff should recognize and promote planning ideas, and that experienced staff are expected to develop potential planning engagements as part of their responsibilities.
- Require that each client be reviewed on a systematic, routine basis to uncover planning opportunities and provide the highest level of client service.
- Use checklists and form letters to standardize the planning process. These tools, along with automated capabilities, increase efficiency in planning opportunities.

With proper training, even the most inexperienced staff should be in a position to recognize and promote planning ideas. For example, an inexperienced practitioner dealing with alternative minimum tax (AMT) should note that recommendations should be made to the client about reducing future tax preferences and avoiding certain items, such as tax-exempt bonds, and so forth that are taxable for AMT purposes.

**Establish routines.** A systematic and routine review may include only examination of a client's permanent tax file information (as discussed in Section 101.7), or it may involve a face-to-face meeting with the client. Implementing a system of ongoing conferences for many clients can produce significant results. For example, you could select the top 10 or 20 percent of clients in terms of volume, complexity, or some other measurement criteria. Then establish semiannual or more frequent (monthly or quarterly) conferences with these clients to discuss planning opportunities.

Checklists and form letters add efficiency to the review process. Requests can be forwarded to clients specifying the information required. Exhibit 106-1 contains sample correspondence that can be sent to clients for tax planning information. It is often useful to show last year's information and to have the client update those figures with his or her best projection of what the current year will be.

**Bill appropriately.** Planning services normally command a higher fee than pure compliance services. You should be sure to bill separately for planning when services are rendered. Clients should react positively if you can demonstrate that planning recommendations saved them tax dollars or had a positive impact on their wealth.

**Practice Tip.** Consider establishing a checklist of client actions and issues to be looked for or queried about for planning opportunities. See Section 101.8.1 for a discussion of off-season file review and Exhibit 101-19 for sample forms to be used for this purpose. See Exhibit 106-2 for Corporation Year-End Planning Checklists. (This is different from what you would use to review a tax return.)

## 106.2 Special Planning Opportunities

Although planning is a year-round task, special time-critical needs often exist. For example, many clients require a projection of their taxable income and their tax liability, and a determination of alternatives prior to year-end. This is particularly important for cash-basis taxpayers, including personal service corporations subject to the highest corporate tax rate on all income. Another example is accrual-basis corporations with no ability to accrue bonuses to shareholders. They

require year-end planning to pay bonuses and take other required action prior to the end of the taxable year. S Corporations also require special planning attention, because of the complexity associated with their organization.

You should establish a system to review entities such as personal service corporations and S Corporations on a frequent basis. For example, personal service corporations with a fiscal year-end not only require fiscal year-end planning, but also calendar year-end planning associated with the minimum distribution payments to shareholders. The opportunities you can derive from special planning issues and the objectives you can achieve are no different than with all planning issues: Service the client to the fullest, generate additional work, and even out the workload during the year.

**Practice Tip.** As the year-end approaches, review your entire client list to assure that planning opportunities have been properly addressed with everyone. Even taxpayers who have limited options prior to year-end may require planning to psychologically and financially prepare for the forthcoming tax situation.

**Practice Tip.** Even where a client feels little or no control over his or her taxes for the year, the planning process can be important for several reasons:

- The client may not fully understand all the planning opportunities available.
- Professionals cannot advise on planning alternatives until the planning process has been completed.
- Even if no planning steps are implemented, the client has advance knowledge of any tax liability due the following April 15.

The opportunities for special planning described above, are a direct result of a close advisor/client relationship. In order to strengthen the relationship with the client, you should maintain regular phone conversations or meetings throughout the year. You should avoid being regarded as a once-a-year tax season appointment.

## 106.3 Written Reports

Planning recommendations and the discussion of alternatives should always be issued to clients in writing. This prevents confusion and misunderstanding and provides a documented outline for both you and the client. Tax preparation software, coordinated with word processing software, can make the preparation of written reports quite easy. Some tax preparation software even includes word processing modules that facilitate the preparation of written reports. Normally, the types of reports and recommendations are quite similar from client to client, other than, of course, names and specific amounts.

Written summaries of planning recommendations also remind the client of the benefits of the planning process. As a result, the fees charged for planning are better understood and appreciated (and hopefully paid) by the client.

Planning reports might accompany a computer-generated tax projection created by tax planning software (see Section 106.6). Exhibit 106-3 shows the contents of a standard planning report template prepared with a word processing program. Exhibit 106-4 is a finished planning report; note that much of the text of 106-4 is nearly identical with that in 106-3. Exhibit 106-5 lists a data file containing values that will be assigned to the various areas of Exhibit 106-3. All you need to do is place the required values in the type of file in Exhibit 106-5, and the word processing software will produce a document as shown in Exhibit 106-4. Tax planning software makes the task simple since it generates the values contained in the summary of data provided as output.

The planning report constructed in Exhibits 106-3, 106-4, and 106-5 represents only one example of how planning software can be combined with other software to provide greater efficiencies. The purpose of the exhibits is to illustrate how to structure reports using planning and word processing software products.

For further information on client communications, refer to Section 301.3.4 herein, for discussion of the AICPA SRTP No. 8: Form and content of advice to clients.

## 106.4 Taxpayer Responsibilities in Planning

Be sure to inform clients that they have a major responsibility in planning. As opportunities arise and facts change impacting results, encourage clients to contact you for advice and recommendations.

At the same time, remember that you and the client have a *shared* responsibility in planning. You must keep clients informed of changes and opportunities, and clients must keep you informed of new and changing facts. Clients should be encouraged to contact you when any of the following arise:

- Significant events (marriage, divorce, births or deaths)
- Start-up of a new business
- Purchase, sale, or merger of a business
- Successorship of business within family
- Sale of personal or business property
- Sale or purchase of real estate
- Exchanges of property
- Retirement planning
- Education funding
- Estate and gift issues
- Lease versus buy transactions
- Financing alternatives
- Receipt of a significant bonus or other compensation

This is just a partial list of the transactions that clients should be encouraged to discuss with you before making a final decision. The better job you do of informing clients of their shared responsibility in planning, the better the service you can provide and the more distressing surprises you can eliminate. While the client should be aware that informing the advisor of changing facts is important to planning, the practitioner must insure that the relationship allows this free flow of information.

As discussed in Chapter 103, firm newsletters should provide clients with information on services available from your firm. Clients should be encouraged to review newsletters carefully, and to contact your firm with any questions or on any issues on which further assistance or information is required.

**Practice Tip.** Construct a list of issues and transactions that you would like clients to contact you about prior to finalization. Then communicate this list to your clients either through your newsletter or a special mailing.

## 106.5 Tax Projections and Actual Results

In many situations, particularly as year-end approaches, projections of estimated tax liability are completed for many taxpayers, as discussed in Section 106.2. When actual tax returns are completed, you should always review the actual versus the projected amount. Any discrepancies should be reconciled and discussed with clients, and any misunderstandings should be quickly resolved.

**Practice Tip.** If the projection you completed is extremely close to the actual results (which, hopefully, it is), use the opportunity to remind the client of the importance of proper planning, the results achieved with the planning, and the need to continue planning in the future.

## 106.6 Tax Planning Software

The complexity of tax laws normally necessitates computer assistance in the tax planning process. Automated capabilities allow you to perform what-if analysis, whereby a number of complex

alternatives can be set forth and quickly assessed. The calculations and results obtained from the assumptions of one alternative does not affect the results of any other alternatives being simultaneously compared. Many in-house tax preparation packages now integrate with a tax planning package. This allows actual information for the preceding year to be automatically transferred to the current year's projection. The tax planner saves time because only the information that changed for the current year needs to be entered.

For many clients, information can be entered and stored for later retrieval. As facts and circumstances change, amounts are retrieved and updated and a new projection is completed. Automated capabilities allow the assessment of actions on a client's tax situation over the next several years, in addition to the immediate year in question.

To demonstrate the importance of storing information for later retrieval, consider this case of the fictitious Dr. X.

### Case Study

Dr. X runs in the "economic" fast lane. She receives wages from a professional corporation, receives self-employment income in the form of consulting fees, owns numerous pieces of rental property, and is involved in a number of limited partnerships.

Assume you are completing a manual tax projection for Dr. X. She calls you in late September regarding the possible sale of a piece of rental property for cash. The doctor has supplied you with other information related to the current year's tax situation, including an estimate of interest and dividend income, Schedule A itemized deductions, capital gains and losses, partnership gains and losses, and the like. You have taken out a 13-column pad, a sharp pencil, and a brand new eraser. You have spent hours combing through Dr. X's information putting together the tax projection, calculating the tax liability under the regular tax system and also under the alternative minimum tax system. You've included computations related to carryover passive losses and certain other complexities. You have passed the projection on for review, cleared up the review comments, and are confident that you are ready to advise the doctor on the tax ramifications of selling the rental property.

Quickly consider how much time it has taken you to complete this manual projection and what you are going to bill Dr. X for it.

With the finished projection in hand, assume you now reach for the telephone to convey the initial results to the doctor (*naturally*, you will also follow up with your written findings and recommendations). However, before you can pick up the telephone, an incoming call comes through; Dr. X is on the line. The doctor's comment is, "Am I glad I caught you before you finished that projection. The deal has changed! Instead of selling the property for cash, I'm only taking 40 percent down. Please redo the projection and get back to me at your earliest convenience."

What are your options, considering the change the doctor reported? Do you take out a new 13-column sheet and rip up the previous projection? Do you use that brand new eraser to start over and recompute all aspects of the first projection? Quickly consider how much time the redo will take and what you might charge for the redo.

Now, what if the same projection had been completed using tax planning software? Upon completion of the initial projection, assume that you stored the information for later retrieval. The amount of time required and billed for this initial computer-generated projection is probably similar to the manual projection.

Consider your actions when the doctor calls with a change. How long will it take to redo the projection using the software? Thirty seconds? Two minutes? Maybe a little longer? What will you bill the doctor to redo the projection? \$2 (we hope not)? \$50? \$100?

The ability to store information for later retrieval and to perform what-if calculations with tax planning software results in numerous opportunities and efficiencies for you.

### Summary

Always remember that tax planning software can only be used as an aid to an already well established planning process. Be sure you place the proper reviews and controls on software output to assure the validity of output information.

**Practice Tip.** Even if tax planning software is not used for every computation, and not all information is saved, consider using it as a review tool to catch incidents of alternative minimum tax, phase-out of IRA amounts and rental losses, and similar complexities that might be missed in manual computations and reviews.



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**Exhibit 106-1: Correspondence Requesting Tax Planning Information**

**SWIFT, MARCH & COMPANY**  
CERTIFIED PUBLIC ACCOUNTANTS  
200 Main Street  
Noplace, Anystate 00000

Mr. and Mrs. John Doe  
100 South Main Street  
Noplace, Anystate 00000

RE: 20XX Personal Tax Planning

Dear John and Jane:

So that we might get an early start on your 20XX personal tax planning, I am requesting that you round up the information listed on the enclosed sheet and forward it to our office as soon as possible.

We will then complete a preliminary projection of your 20XX tax situation, and provide you with information as to where you currently stand. We can then decide whether we need to get together to discuss planning actions, or whether things appear to be in reasonably good shape as we head towards the year-end.

Please forward the information to me in the envelope provided as soon as possible.

Sincerely,

Jane March, CPA

Enclosure

**Exhibit 106-1: Correspondence Requesting Tax Planning Information (cont.)**

Client Name (s) \_\_\_\_\_

Address: \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

*We will assume  
the same as 20XX  
unless you  
indicate otherwise*

Items Pertaining to Your Taxes

\_\_\_\_\_ Copy of latest pay stub for taxpayer \_\_\_\_\_

\_\_\_\_\_ Copy of latest pay stub for spouse \_\_\_\_\_

\_\_\_\_\_ Interest income \_\_\_\_\_

\_\_\_\_\_ Dividend income \_\_\_\_\_

\_\_\_\_\_ Gain from sale of stocks, investments, property \_\_\_\_\_

\_\_\_\_\_ Home mortgage interest expense \_\_\_\_\_

\_\_\_\_\_ Business income (Schedule C) \_\_\_\_\_

\_\_\_\_\_ Farm income (Schedule F) \_\_\_\_\_

\_\_\_\_\_ Asset purchases or sales \_\_\_\_\_

\_\_\_\_\_ Partnership or S Corporation income \_\_\_\_\_

\_\_\_\_\_ Rental property income \_\_\_\_\_

\_\_\_\_\_ Other (please list) \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

**Exhibit 106-2: Corporation Year-End Planning Checklist**

**SWIFT, MARCH & COMPANY  
Corporation Year-End Planning Checklist**

Client Name: \_\_\_\_\_  
 Prepared By: \_\_\_\_\_  
 Reviewed By: \_\_\_\_\_  
 Tax Department: \_\_\_\_\_  
 Client No: \_\_\_\_\_

Period Covered: \_\_\_\_\_  
 Date: \_\_\_\_\_  
 Date: \_\_\_\_\_  
 Date: \_\_\_\_\_  
 Return Due Date: \_\_\_\_\_  
 Extension Due Date: \_\_\_\_\_

Yes	No	Comments
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**Corporation Loans To and From Shareholders**

- Does the corporation loan funds to shareholder?
- Do shareholders borrow funds from the corporation?
- Are loans between corporation and shareholders documented with specific interest rates, loan term and payment amounts?
- Is the interest being paid?
- Is there any potential exposure to IRS treatment of loans to shareholders as either dividends or compensation?


**Corporation Vehicles**

- Does corporation provide the use of corporation vehicle to shareholder?
- Does corporation report compensation to shareholder for personal use of corporation vehicle?
- Does operator of corporation vehicle sign a statement regarding usage of vehicle?
- Is the corporation considering trading a vehicle?
- If so, what is the book value versus the trade value?
- Might the corporation be better off tax wise to sell the vehicle and purchase another?


**Depreciation**

- Have repairs and maintenance been analyzed to determine if the costs should be expensed or capitalized?

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**Exhibit 106-2: Corporation Year-End Planning Checklist (cont.)**

	Yes	No	Comments
• Have capitalized costs been examined to see if they can be expensed?			
• Have leasehold improvements been componentized to break out property eligible for seven year life?			
• Keeping in mind the increased Section 179 election, would the corporation benefit by moving any equipment purchases into the current year?			

**Employee Benefits**

• Does the corporation have a retirement plan? (Are they satisfied with the administration of the plan?)			
• Does corporation have a cafeteria plan?			
• Does the corporation provide disability insurance? (How is the premium handled?)			

**Charitable Contributions**

• Does the corporation make charitable contributions?			
• If corporation makes charitable contributions, will the corporation be able to deduct the contributions? (This is of particular concern for personal service corporations.)			

**Deduction Limitations**

• Does the corporation maintain records that separate meals and entertainment subject to the deduction limitation from travel and entertainment costs not subject to the limitation?			
• Does the corporation have compensation (including stock options) exceeding \$1,000,000 per executive?			
• Is the compensation tied to performance?			
• Is the compensation shareholder and director approved?			

**Exhibit 106-2: Corporation Year-End Planning Checklist (cont.)**

- Does the corporation pay temporary living expenses for its employees?
- Do any of the temporary assignments exceed 1 year?

Yes	No	Comments

**Officer's Life Insurance**

- Does the corporation have officer's life insurance policy?
- Can any planning be done to lessen the potential impact of AMT on the proceeds of officer's life insurance?
- How long has it been since the corporation's life insurance policies were reviewed?
- Would there be any benefit to replace life insurance contracts in existence pre-1990 with new contracts?


**Tax Credits**

- Has the corporation made any improvements that were designed to make the property more accessible for individuals with disabilities?
- Does the corporation expect to make improvements to make the property more accessible?
- If so, could those improvements be made before year end?
- Is the corporation eligible for the targeted jobs credit?
- Is the corporation eligible for the research and development credit?
- Is the corporation eligible for the restaurant FICA tax credit?


**Nexus**

- Does the corporation have nexus in states other than X STATE?
- If the corporation does business in other states, does it comply with the sales and use tax laws?


**Exhibit 106-2: Corporation Year-End Planning Checklist (cont.)**

Yes	No	Comments

- Does the corporation keep track of sales by state?

**In General**

- Does the corporation update the corporate minute book on an annual basis?
- What methods might be available for compensation to shareholder/employees that would be deductible if Congress passes law limiting deductible compensation?
- Can the corporation justify the employment of shareholder children?
- Does the corporation have potential exposure to the accumulated earnings tax?


**Succession Planning**

- What plans has the corporation made for succession planning?
- Does a buy/sell agreement exist?
- If a buy/sell agreement exists, how long has it been since it was reviewed?


**S Corporations**

- Do S corporation shareholders have sufficient basis to deduct loss on their individual return or to receive distributions tax free?
- Should S corporation shareholders consider creating basis by loaning funds to the corporation?
- Have distributions to shareholder during year been in proportion to shareholder interests?
- Are amounts treated as salary better left as income to lessen the FICA impact?


**Exhibit 106-2: Corporation Year-End Planning Checklist (cont.)**

Yes	No	Comments
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**Estimates**

- Is the corporation a “large corporation” for tax purposes? (Taxable income greater than \$1,000,000 in 1 of the 3 prior years.)
- Can the corporation lower its tax payment by using the new 2 and 4 month annualization method?


**Acquisitions**

- Has the corporation acquired the assets of a business in the last year?
- Can the corporation benefit by applying the 15 year amortization rules to previous acquisitions?
- Are there new products, lines of business or geographic areas that could be put into a separate corporation whose stock would be eligible for the 50% capital gain exclusion?
- Could the stock in the new corporation be owned by the current shareholder’s children?


**Estate and Financial Planning**

- Have the owners reviewed their wills and estate plans recently?
- When was the last time?
- Should they have a check-up?




**Exhibit 106-3: Planning Report Template**

&date&

Mr. &first& &middle& &last&  
&address&  
&city&, &state& &zip&

Dear &salutation&:

Please find enclosed the year-end tax projection that we have previously discussed. The assumptions used in preparing the projection are as follows:

- 1) You will be making an IRA contribution of \$&IRA&.
- 2) You should incur an additional \$&expense& in expenses in your cash-basis business.
- 3) You should prepay your state income tax balance due in the amount of \$&tax& to get an additional federal deduction. The payment voucher is enclosed, which should be paid on or before December 31, 20XX.

Please review this projection and feel free to contact our office if you have any questions.

Sincerely,

John Swift, CPA

**Exhibit 106-4: Complete Planning Report**

**SWIFT, MARCH & COMPANY**  
CERTIFIED PUBLIC ACCOUNTANTS  
200 Main Street  
Noplace, Anystate 00000

May 24, 20XX

Mr. John A. Doe  
100 South Main Street  
Noplace, Anystate 00000

Dear John:

Please find enclosed the year-end tax projection that we have previously discussed. The assumptions used in preparing the projection are as follows:

- 1) You will be making an IRA contribution of \$2,000.
- 2) You should incur an additional \$10,000 in expenses in your cash-basis business.
- 3) You should prepay your state income tax balance due in the amount of \$2,500 to get an additional federal deduction. The payment voucher is enclosed, which should be paid on or before December 31, 20XX.

Please review this projection and feel free to contact our office if you have any questions.

Sincerely,

John Swift, CPA

**Exhibit 106-5: Planning Report Data File**

<u>Information Entered in Data File</u>	<u>Variable Name</u>	<u>Value of Variable</u>
May 24, 20XX	Date	Date of Report
John	First	The Client's First Name
A.	Middle	The Client's Middle Initial
Doe	Last	The Client's Last Name
100 South Main Street	Address	The Client's Address
Noplace	City	The Client's City
Anystate	State	The Client's State
00000	Zip	The Client's Zip Code
John	Salutation	The Greeting to Be Used in the Report
2,000	IRA	Amount of IRA Contribution
10,000	Expense	Expenses to Incur
2,500	Tax	State Income Tax Estimate



Part II

# Tax Return Preparation





# 201 Tax Return Preparation

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# 201 Tax Return Preparation

As a tax practitioner, you must strike a balance between the quality control measures necessary to produce complete and accurate tax returns and the need to prepare a volume of returns as efficiently as possible. With too little quality control (reviews, cross checks, etc.), returns will contain an unacceptable error rate, requiring expensive rework, agitating clients, and creating a potential for costly client disputes, not to mention potential preparer penalties. If the preparation process is inefficient (too many reviews, cross checks, etc.), each engagement will use far more professional and clerical time than can be billed, resulting in costly writedowns or even outright losses on the service. Although all accounting services must strike this balance between quality control and efficiency, it is especially critical in the compliance practice area. Because each engagement is relatively small, a firm has little room left to recover from an inefficient process.

This chapter contains a structured and systematic approach to the tax return preparation process. While the material emphasizes the preparation of individual income tax returns, the same principles apply to the preparation of tax returns for any entity: fiduciary, corporate, tax-exempt organization or partnership. Practice tips are offered as suggestions for improving a firm's service to its clients, refining office procedures, or protecting the firm from a client dispute. Because Chapter 101 analyzes control procedures for a firm's overall tax preparation system, you may want to read it together with this chapter.

Perhaps the most critical step in the tax return preparation process is the first—gathering client information. This chapter devotes a major section to discussion of what client information to obtain and techniques for gathering the information. Another section discusses methods of organizing client information, preparing the return, and making the review process more comprehensive. It discusses specific reviewer guidelines for dealing with return preparation errors and corrections. Finally, the chapter looks at the final steps in the return preparation process—signing, packaging, and delivering the return.

## 201.1 Sources of Client Information

The first step in preparing a tax return is gathering the tax information from the client. The primary methods of obtaining data necessary to complete a client's tax returns include the engagement letter, client organizer, source documents, third parties, oral representations, and prior-year returns or IRS audit reports.

### 201.1.1 Engagement Letters

The engagement letter becomes a legal contract between your firm and the client, and securing one from a client should be standard practice for your firm. Engagement letters explain to clients the services provided and, sometimes, how the fees will be charged. Engagement letters help prevent client misunderstandings and defend you in a conflict.

Before adopting a standard engagement letter, review the letter for any necessary revisions further clarifying the agreement or indicating changes in the services provided the client. You



may also want to run any proposed changes by your attorney. It is not enough simply to modify an engagement letter; make certain the client comprehends the modifications.

It is not uncommon for engagement letters pertinent to new or expanded client services to be overlooked. Rather than simply noting that the engagement letter should be obtained next year, immediately follow up after the current return has been completed. Either have the client sign an engagement letter when the return is picked up, or mail an engagement letter along with a return address envelope. Even if the client fails to return the engagement letter, you have still notified the client of your respective responsibilities for the return.

**Practice Tip.** Because clients often don't read engagement letters after several years of receiving them, they might miss changes. Attach to the engagement letter an explanation of the changes and their ramifications. Clients need to be reminded in the engagement letter or transmittal letter that they are responsible for the information on the tax return. (See Sections 101.7.4, 101.13, and 301.6.3 for more information concerning engagement letters.)

A termination letter is necessary when you end a relationship with a client. Without something in writing to show you have severed the relationship, you may receive a phone call after April 15th from an ex-client who claims you are responsible for late filing his or her return. For further information concerning client terminations and termination letters, see Section 101.11.1, Terminating Service to Undesirable Clients, and Section 301.6.2, Avoiding or Eliminating Undesirable Clients.

## 201.1.2 Client Organizers

For accuracy and efficiency, clients need an organized system of putting together their tax information. The easier you can make a client's data-gathering task, the more efficient will be the tax preparation process. Organizers are worksheets that clients can use to gather and arrange their tax information, and they come in all shapes and sizes. Preprinted corporate, S corporation, partnership, and tax-exempt entity organizers from the AICPA Tax Division are reproduced in Exhibits 201-1 through 201-4.

*Client questionnaire*, *client tax information worksheet*, and many other terms are often used synonymously for *organizer*. This chapter uses *organizer* throughout. Exhibit 201-9 is an example of an organizer (titled "New-Client Tax Information Worksheet").

Some practitioners dispute the value of an organizer, sensing a certain redundancy in asking clients to provide both a filled-out organizer and the source documents supporting the organizer's figures. In fact, asking clients to complete organizers that closely resemble the actual tax return forms may prompt a number of clients to think that they are capable of preparing their own returns. Yet, when properly filled out, organizers significantly reduce preparation time because they help the client—

- Assemble the tax material, and
- Discover overlooked deductions.

Organizers also help the preparer by—

- Systemitizing the tax preparation process.
- Verifying that a client's tax information is complete.
- Securing permanent information in the file for later reference.
- Providing some protection against a subsequent claim by a client that an error or omission of an income or deduction item originated in your office.
- Presenting data in sequence to be keyed directly from the organizer for simpler tax returns. Very little additional input may be necessary.

Perhaps the biggest boost organizers give the return preparation process is the assistance they provide clients in gathering their complete tax information. Missing information can delay the process by days or weeks while preparers list missing information, contact the client by telephone or mail, and wait for the client to locate and respond with the missing information.

With their prior year's information printed in an organizer, clients are less likely to omit items or give incorrect information in a current-year interview.

**Practice Tip.** Many computer tax preparation programs generate personalized client organizers showing the prior year's information. See Exhibit 202-3 in Chapter 202 for an example of a portion of an organizer preprinted with the client's prior-year tax information.

Even with a filled-out organizer, it is still critical that clients provide copies of their source documents, such as Form 1099, Schedule K-1, etc. Problems could crop up when a client omits backup documentation from the organizer. For example, a client with noncash contributions might fail to supply the IRS-required receipts and list of items donated with their estimated fair market value. It is better to head off such situations by making it a practice to require backup documentation.

Some clients prefer to submit their own schedules of income and deductions. In lieu of an organizer, "homemade" schedules are the next best thing; however, these clients lose the benefit of an organizer that contains a comprehensive list of income items and deductions, updated each year to reflect law changes. These clients should also be providing source documentation to substantiate their worksheets.

Many clients routinely assemble their household income and expenses using PC-based software programs. For example, commercially available programs like Quicken and Works can provide a ready-made recap of an individual's annual tax information.

Although preparers are not required to audit returns, they are expected to make reasonable inquiries if a client's information appears to fall short of the Internal Revenue Code's recordkeeping requirements. Otherwise, they could be subject to negligence penalties. Furthermore, the AICPA Statement on Responsibilities in Tax Practice No. 2 states that it is a preparer's responsibility to make a reasonable effort to obtain from a client appropriate answers to questions on the tax return, before signing as a preparer.

Consider including in the organizer information sheets that detail IRS regulations and requirements governing the deductibility of automobile, travel, and entertainment expenses, dues, and noncash contributions. These put the client on notice about the documentation requirements. They protect you from clients' claiming that you did not inform them of the requirements. Include a place for the client's signature, signifying that the client has read the requirements, has the documentation, and has provided accurate and complete data.

Send the organizers to clients before the start of the tax season, accompanied by cover letters emphasizing the importance of providing thorough information. Educate your clients that the better organized the information they submit, the less time you will need to prepare the tax return, and their result will be a higher quality return at a lower fee.

**Practice Tip.** Early in November, send your clients year-end tax planning guides that inform clients of year-end maneuvers they can complete to reduce taxes, and help them begin to organize their tax information.

In late December, with the current year's organizer for the upcoming return, send your clients envelopes marked "dividends and interest," "business expenses," "medical," and so on, so they can organize the next year's tax data throughout the coming year. To avoid the possibility of the organizers' being lost in holiday mail, send them in late December, or wait until early January.

**Practice Tip.** Set a deadline for client information to be received in order to have adequate time to complete the return in a timely manner. Communicate the date to clients when mailing the organizer.

### 201.1.3 Source Documents

Because many clients may not understand the tax results of their transactions or misinterpret the information they receive, source documents are essential for completing an accurate return. Even if your clients fill out their organizers, encourage them to provide as much source documentation as possible. Source documents include—

- Forms W-2.
- Forms 1099 for dividends, interest, rents, royalties, or nonemployee compensation.
- Schedules K-1 from partnerships, S Corporations, or trusts.
- Mutual fund annual statements.
- Forms 1098 mortgage statements from banks.
- Any other third-party document that adds support to the information in the client's return.

Clients often make mistakes interpreting source documentation. For example, they sometimes misread a 1099-DIV and total the gross dividend with the capital gain portion, thus reporting the capital gain income twice. Source documentation reduces the possibility of misunderstandings, errors, and potential administrative problems if the IRS ever examines the return.

Even with the most conscientious client, honest mistakes in classifying expenses often occur. A common error is overstating the mortgage interest expense on a business schedule by including interest paid to individuals. Because Form 1098 is only required by commercial lenders, any other type of interest expense cannot be included on the mortgage interest line without inviting an IRS-proposed adjustment notice. Despite the fact that such interest is paid on loans secured by real estate, it is not reported to the IRS on Form 1098.

Should you keep copies of source documentation in your client files or return them to the client after completing the return? There is no obvious "correct" answer to this question. If you keep source material in the client files, you can run into serious storage problems. However, keeping source documents enhances your service to the client. It allows you to easily research past information and tax situations whenever necessary. If it is your practice to return source documentation to the client, you must request that the client retain the information for an appropriate period. If your practice normally keeps source material, and the client requests its return, retain copies or schedules of any information that were pertinent to the return.

**Practice Tip.** A compromise between immediately returning or indefinitely retaining source documents is to maintain clients' files for all open tax years (normally three), plus a permanent file for information that carries over beyond the standard three-year limitation, such as the cost basis of a personal residence or suspended passive losses. Once a tax year closes, the file can be returned to the client (see Section 101.10.4, Closed Files). This system prevents the steady buildup of client files until the problem of storage space takes on gigantic proportions (see Sections 101.7 and 101.10 for more information about tax permanent files and file storage systems).

Regardless of your decision, the source documentation must always be available for future reference. If you do not keep the source documentation, you must make clients aware that they are responsible for it. With malpractice suits against accountants on the rise, and the increased information matching done through the IRS's CP-2000 program, the trend is toward keeping as much source documentation as possible in your client files.

Another option for retention of source documents focuses on significant individual items. With this approach, copies of only certain source documents, for example, copies of Forms W-2, Schedules K-1, and Forms 1098 (mortgage statement from banks), are kept, while Forms 1099-INT and 1099-DIV are returned to the client (with instructions to retain them for some period of years). However, even with the Forms 1099-INT and 1099-DIV, a materiality issue may arise, so copies of *significant* Forms 1099 might be made, or copies might be retained for higher-income taxpayers only. This approach allows the practitioner to keep file copies of most important documents, without scores of small-amount Forms 1099-INT and 1099-DIV.

**Practice Tip.** Use bright pressure-sensitive labels to designate source matter as: COPY AND ATTACH TO RETURN, RETAIN IN FILE, RETURN TO CLIENT, COPY AND RETURN TO CLIENT, or store the source documents in folders so labeled to segregate them. Examples of these folders are illustrated in Exhibit 201-13.

## 201.1.4 Third-Party Information Sources

Clients cannot always provide all the information necessary to complete their returns. Many simply do not know what information is required. In this situation, you may need to contact third parties such as attorneys, brokers, bankers, and other tax preparers.

**Practice Tip.** Obtain the names and addresses of your client's attorney, broker, life insurance agent, and so on, as part of the tax permanent file or database file (see Section 101.7).

During conversations with third-party sources, be careful not to disclose any private client tax information. Internal Revenue Code Section 7216 provides preparer penalties for disclosure of client tax information. See Section 302.2.1 for a further discussion of disclosure penalties.

## Attorneys

Attorneys can be a source of additional client information. If the client purchased or sold real estate and does not have a copy of the closing statements, they should be available from the attorney who represented the client. In addition, documents such as separation agreements, business agreements, wills, and trusts are available from attorneys and should ideally be included in the client's tax permanent file.

Preparation of a first-year corporate return for a client who has incorporated should not be done without contact with the attorney. The incorporation documents usually contain valuable information such as

### Articles of Incorporation

- Date of formation
- Registered agent and address
- Legal name of corporation

### Stock ledger book

- Ownership of shares

### By-Laws

- Fiscal year-end

### Minutes of stockholders and Directors meetings

- Subchapter S election
- Corporate officers
- Fringe benefit plans
- Salary and bonus authorization
- Retirement plan contribution accrual
- Assets and liabilities transferred to corporation under tax-free incorporation

Because the communication between an attorney and client is privileged, expect attorneys to insist that the client contact them before they provide any information. You can ask the client to contact the attorney directly, or you can draft a letter requesting the needed information and provide a space for the client to sign.

## Stockbrokers

Stockbrokers are required by the Securities and Exchange Commission to keep records of their clients' transactions, so they are a source of information about a security's cost basis and purchase date. If a client no longer has information about the original purchase date and cost, the broker will often have the missing information in his or her records.

If you are unable to get brokerage statements from the client, they may be obtainable from the client's stockbroker. Most brokerage firms are willing to send duplicate statements to you upon a client's request. If you can convince the client to have duplicate statements sent to you, the client is relieved of digging through his or her files to provide you with brokerage information. Typical documents available from stockbrokers are—

- Monthly brokerage statements.
- Annual Forms 1099 for dividend distributions, interest income, or original issue discount interest.
- Form 1099-B reporting proceeds and transaction dates of broker transactions.

Another alternative is to ask the client to send the original (or a copy) of the statement to you, or to actually have the brokerage statement mailed directly to your office. Alternatively,

clients might authorize the brokerage firm to send a duplicate statement to your office as a routine practice. Such an approach would allow you to always have the required purchase and sale information associated with the client's transactions in your files.

Many transactions will be reported directly to the IRS, and you will want to make certain that the client's returns reflect them.

**Practice Tip.** There are always clients who, for one reason or another, do not provide the cost basis and purchase dates for their security and mutual fund sales. In the summer or fall, your staff can review these clients' brokerage statements to begin the process of finding original cost and purchase dates for securities that were sold.

**Practice Tip.** Many clients use "managed accounts" where the broker provides an annual summary of all capital gain and loss transactions. If the client has a large number of transactions, the practitioner may want to attach a notation of "See Schedule Attached" as a simple line item entry, while matching to the Form 1099-B amount.

### Bankers

Information regarding home mortgage or bank account interest can be obtained directly from a client's banker. Banks, like attorneys, may insist that your clients contact them directly. They also may want written authorization to convey the information.

**Practice Tip.** Make it a standard procedure to request third-party information by letter, and have the client sign the letter. The third parties will feel more comfortable providing the information, and the client will not be surprised by discovering that you have gained access to the information.

### Other Tax Preparers

Returns prepared by other accountants often contain information affecting related taxpayer's returns. For example, a client selling stock in an S corporation may need to turn to the accountant preparing the corporate return for some of the information needed to compute stock basis. Similarly, basis of assets acquired through inheritance or gifts can normally be found in the donor or decedent's tax file.

## 201.1.5 Telephone Information

You and your staff should follow a standard procedure for documenting tax matters discussed during telephone conversations with clients. A formal record should be maintained with the client's name, the time and date of the call, and the subject matter discussed. This record should become part of the client's tax file.

**Practice Tip.** If a client calls in details needed to complete the tax return, request that he or she mail or FAX you a copy of the document confirming or containing the information so the client's file is complete. This ensures the accuracy of the return and can prevent a later dispute. Also, reference Section 101.3.2 and Exhibit 101-3.

If the client does not transmit the documentation as requested, send a letter confirming the information received over the telephone. In the unlikely event of a later dispute, the letter will support your contention that the return was based on information supplied by the client.

Always ask clients to send you copies of any information that could have a material effect on a return, such as a Schedule K-1. Tell the client that you cannot complete his or her return until you review the information.

## 201.1.6 Verifying Information With a Client

According to IRS Regulation 1.6694-1(b)(2)(ii), you may, in good faith and without verification, rely on information furnished by a client or third party. After all, your primary function as a tax practitioner is to prepare a return, not to audit it. Still, you cannot ignore the implications

of the information furnished. If there are obvious errors or missing information in a client's tax material, you must make reasonable inquiries of the client to resolve any inconsistencies. You should use prior years' returns to detect errors or omissions, and you should satisfy yourself that the necessary records to support the return information exist.

**Example.** A client owning a small trucking company provides to you his year-end income and expense data. Although he appeared to have had an unusually profitable year, you recognize that depreciation expense can vary greatly from year-to-year in this industry. Without accepting this possible explanation blindly, you scan the prior-year Schedule C and determine that the client failed to give you his fuel expenses for the current year.

You must evaluate your client—age, sources and amounts of income, financial sophistication, marital status, and so forth—and ask reasonable questions to seek information that the client may have accidentally omitted.

**Example.** A client has turned age 62 and has begun to receive Social Security benefits. You need to ask the client if benefits have begun or will be delayed until age 65. Without realizing that Social Security could be taxable, the client might omit this information from the tax organizer.

The case *Brockhouse v. United States* concerned a practitioner who prepared an individual return for a doctor and a corporate return for the doctor's professional corporation (749 F.2d 1248 (7th Cir. 1984)). The preparer was held to be negligent when he did not carry amounts deducted as interest expense on a corporate return over to the individual return as interest income. Tax information supplied by the corporation did not identify the interest payee. In addition, the prior year's corporate interest payment had not been made to the doctor. However, the corporate balance sheet did show amounts payable to the shareholders. The court asserted that the corporate balance sheet flagged the possibility to the preparer of interest payments to the doctor, and the court concluded that the preparer was negligent not to inquire further.

You should be wary of clients who ask you to prepare their business returns but not their personal returns, or vice versa. Their motive may be to prevent anyone, even their tax preparer, from knowing all the details of their financial endeavors. This arrangement often results in poor communication between the tax preparers that increases the likelihood that important tax data will be omitted.

**Practice Tip.** If you prepare a corporate, partnership, or fiduciary return as well as an individual return for a client, items that carry through from one return to the other must be reflected in both. If you are uncertain about the tax result of an item, ask the client appropriate questions to clarify the situation. Copies of information documents, such as Schedule K-1 or Form 1099, should be immediately routed to the individual file. For other items that carry from one return to the other, complete a file memorandum or other documentation and immediately route this information to the other file affected.

### 201.1.7 Prior Years' Returns

Ask new clients for their three previous federal and state income tax returns since they cover the tax periods not closed by the statute of limitations. By reviewing these returns, you can contrast the current year's information with that of the prior years to determine the nature of the income and deductions and to avoid duplicating items. Prior-year returns are also a source of information on the tax basis of depreciable assets, amortized items, carryovers of capital losses, suspended passive losses, alternative minimum tax carryovers, investment credit carryovers, and other information that is required to be maintained from year to year. The AICPA's Statement on Responsibilities in Tax Practice No. 3 indicates that obtaining and reviewing the prior years' returns is one of the preparer's responsibilities. For a further discussion of AICPA standards, see Section 301.3.4.

### 201.1.8 Prior Years' IRS Revenue Agent Reports

You may encounter clients whose deductions for automobile or travel and entertainment have been audited and adjusted repeatedly by IRS agents. Many self-employed individuals have

weak documentation of their travel and entertainment expenses, and the IRS auditors know it. They hit these areas hard when auditing a self-employed person's return. If you have a client in this situation, carefully review with him or her the IRS requirements for substantiating these deductions. Additionally, IRS audit reports should be reviewed to determine if adjustments are required to certain carryover items, such as the tax basis of depreciable assets, capital loss carryovers, passive loss carryovers, and business credit carryovers.

## 201.2 The Tax Return Process

### 201.2.1 Basic Steps

Many phases of the tax return preparation process take place before the first client interview or before client information begins arriving in the mail. Organizers and engagement letters have been mailed out. The clerical staff has scheduled appointments for client interviews. Client files for the current year should already contain estimated payment schedules, telephone memos, and any other tax information generated over the previous year. At the beginning of the tax season, the staff will have updated client files with new routing schedules, checklists, and the current year's pro forma input sheets.

Exhibit 201-5 shows a flowchart featuring the various steps in preparing a tax return. This flowchart shows all steps in the tax return process and assumes that direct input is being completed for the computer processing system. If input forms are being used (client information is keyed manually, entered on input sheets and later into the computer system), certain steps in the flowchart may be modified. Some of these steps can be done by the same person, while other steps, such as preparation and review, should be performed by two or more individuals (see Section 201.3). Each step is necessary to assemble accurate and complete tax returns.

### 201.2.2 Routing Schedules

Because tax return routing schedules are updated with each phase of the return preparation process, they are discussed here. Each tax return file should have its own routing schedule, with places to enter preparer and reviewer initials, hours spent, the dates when the return is worked on, and so forth. Even sole practitioners will want to maintain routing schedules to track the time spent on the various steps in the return preparation process. The routing schedules set up a job-costing analysis for each return, and the total time spent on the return becomes the basis for the client billing. Routing schedules are also the foundation for control time budgets (see Section 101.4.1). For an example of a tax return routing schedule, see Exhibit 101-11. The routing schedule in the exhibit is designed to be as comprehensive as possible. Individual practices can mold their own versions of schedules to their firms' particular needs.

As each phase of the return preparation process is completed, the person working on the return updates the routing schedule. This data is entered directly into the computer database or provided to the administrative personnel keeping the tax return file locator log. The locator log lists all the returns a firm is preparing and shows where each is in the preparation process. Routing schedules and the tax return file locator log are also discussed in Section 101.3, Central Control.

**Practice Tip.** Any special instructions for the tax preparer, reviewer, and administrative staff should be placed on the routing schedule. For example, if a client has both winter and summer residences, the schedule should show where the return should be mailed.

**Practice Tip.** Different colors of routing schedules could be used for different types of returns (e.g., 1040, 1120, etc.), enabling returns to be identified and enhancing the preparation and assembly processes.

## 201.2.3 Gathering Tax Information

### Interviews

You should always conduct some form of interview with your clients. New clients will naturally want to meet you face-to-face to evaluate you and the firm. Sometimes the interview can take place on the phone. The client can mail in the information with which you begin the initial preparation; you can interview the client over the phone to clear up any fine points. Be sure to obtain written confirmation of significant issues discussed. See the practice tip in Section 101.3.2. Rather than only phoning to inform clients that their returns are finished, you should always try to have some type of personal, verbal contact prior to completion of the return to assure that all data is in and to discuss the results. Clients who are contacted only by mail tend to drift away to other preparers over time. See Section 101.5.2 for a discussion on managing workloads and prescheduling appointments.

**Interviewing in the office.** Direct personal interviews are an excellent means of reviewing a client's data and enhancing the personal relationship with the client. Many questions that arise during the return preparation process, such as the cost basis of a security sold, can be resolved immediately during the interview. The interview process should accomplish the following:

- Review the client's tax information and compare to last year's return for completeness and reasonableness.
- Explain questionable items.
- Complete the interview checklists (see Exhibits 201-6 and 201-7).
- List open items on a point sheet for which the client will supply additional information (see Exhibit 101-15).
- Give at least a rough indication of tax results or a comparison with last year's.

With a good interview and well-taken notes, the remaining return preparation process becomes purely mechanical. (See the discussion about prescheduling appointments in Section 101.5.2 for ideas on arranging a firm's schedule of appointments.)

Client interviews are likely to be a significant part of the return preparation process, and they require a certain measure of discipline and planning for successful conduct. Since you will bill the client for any interview time, he or she must come away feeling that something concrete has been done.

Because client interviews are such a critical part of the return preparation process, they are normally conducted by more experienced personnel. However, the opportunity exists for "delegating out" certain portions of the interview process. For example, a less experienced staff person might initially meet with the client, be sure the information is assembled and organized properly, and even review and make notes on some of the initial information. The more experienced practitioner might then come into the meeting and address some of the more complex issues associated with the interview to be sure that everything is in proper order. This is analogous to the way many medical personnel operate, with a nurse or dental hygienist performing initial routine tasks, and the doctor or dentist then conducting the actual examination.

**Practice Tip.** Set aside weekday evenings, or Saturday mornings or afternoons, for appointments with working clients. The special appointment times can begin in early February and end with the last week in March or first week in April. These special times are not only an added convenience for your working clients, but they can help increase your client base.

**Before the interview.** Before the client arrives for the interview, a brief review of the prior year's return will acquaint you with the tax situation. Computer-generated organizers with the prior year's information also can serve this purpose. You will find the prior year's information to be a useful interview guide.

Review other file data, such as memos of telephone conversations, for information that may affect the current year's tax return. Avoid giving clients the impression that you are too busy to care about or remember their information. Clients expect you to remember what they told you in previous conversations, even if the conversations took place six months ago. They



become irritated when they must remind you of details discussed in earlier dialogues. Conversely, clients are impressed with an accountant who, briefed by the file memos, appears to remember every important event the client discussed with them throughout the year.

**Practice Tip.** You will also want to reassess the file review sheet developed during the prior off-season. It may contain ideas to suggest during the interview (see Section 101.8, Post-Busy-Season Work, for a discussion of file review sheets and developing project ideas that can be deferred until after tax season).

By preparing for the interview, you create an impression of familiarity and concern about a client's tax situation and reinforce your image as a professional. Clients must have confidence in their tax preparer, just as they have confidence in other professionals such as doctors and lawyers.

**Conducting the interview.** You must guide the interview so that it is a productive use of time. Establish how long the interview is to last, and try to keep the meeting within those bounds. Often, your only meeting with the client is during tax season; clients may want to take up interview time with discussions unrelated to the preparation of the tax return, such as by chatting about general topics or asking questions about managing their personal finances. It is an interview skill to keep the subject matter on target without being abrupt or abrasive. The steps for conducting an actual interview are in Part 3 of Module 1 of Exhibit 101-3.

You can use the prior year's return as a guideline for the interview, working through the return's items of income and deductions. By comparing the current year's information with the prior year's, you can determine the completeness of the information and also avoid duplicating items. Organizers with the client's prior-year information also can serve the same purpose, even if the client did not fill them out. Because organizers contain many questions designed to cover almost every tax situation, they can be useful tools for guiding interviews and raising questions you may otherwise not have thought to ask.

Although existing clients can be provided tax organizers showing the previous year's information, this is generally not possible for new clients. New clients should receive an information worksheet (see Exhibit 201-9). It is usually unnecessary to provide existing clients with both a blank information worksheet *and* a tax organizer. Blank organizers or worksheets may be most useful for unique situations, such as oil and gas taxation.

Because it is seldom possible to work on a return immediately after the information is received, editing notations help reacquaint you with the client's situation when preparing or reviewing the return. Editing notations also provide permanent file documentation. Editing involves explaining and classifying tax information by attaching comments and other notations to the data. Begin the editing process immediately, during the interview, as the client's data is received and discussed. It is important that the interviewer write legibly, to prevent misinterpretation of the words or amounts by the return preparer. The tax return preparation process is described in greater detail in Section 201.2.4. Also, with the increased emphasis on desktop preparation of tax returns (entry of data into the computer directly while meeting with the client), an increased danger of not properly documenting the client information exists. Editing notations are a required part of the tax preparation process, whether the information is handed to another individual for return preparation, or whether the interviewer directly enters the data into the computer during desktop preparation of the return.

Review the source documents the client provides. Clients bring in raw data that must be annotated and reorganized. Sometimes the information is self-explanatory, while other information is misleading or incomplete. Exhibits 201-9 and 201-10 show a more complete example of client tax information from an organizer annotated by an interviewer as well as client interview notes.

**Example.** While most Forms 1099-DIV from dividend payers are straightforward, some clients confuse trust income with personal income and include Forms 1099-DIV paid to a trust in their personal income. You should separate personal dividends from trust dividends, and clearly mark the trust dividends so they are not confused with the client's personal income.

**Example.** A stockbroker's 1099-B only shows a stock's sale date and gross proceeds. You also need to know the stock's purchase date and cost basis to classify the gain as long- or short-term, and to compute the net taxable gain. Attach the notation "stock was received in a trust distribution—refer to John, Sr. trust file for basis," or "client will mail in purchase date and cost basis next week."

As you are wrapping up the interview, review the interview worksheet to decide if there are any questions you still need to discuss. Ask the client if he or she has any questions for you. Once you have answered any questions, you may have the time to prepare a rough calculation of the client's tax liability. This will not always be possible with larger returns. Some interviewers shy away from preparing rough tax calculations because clients can become upset if the liability increases when the actual return is completed. It is, however, an excellent method for gradually preparing the client to accept the "shock" of a higher tax liability and for creating a forum to explain the reasons for the liability.

Consider using tax planner software to estimate the taxable income and expected tax during the interview. As the return moves through the preparation stage, the actual results should be compared to this estimate and any significant discrepancies reconciled.

During the interview, you can occasionally obtain additional work for the firm, such as setting up an accounting system for a client's small business. The post-season file review sheet may have lent you some ideas to share with the client. Perhaps you can schedule another interview after the tax season to further discuss off-season project ideas.

**Practice Tip.** Create a pleasant atmosphere that helps build client confidence and trust. With some clients, the professional image of an accountant behind a large desk boosts their confidence. You may want to interview them in your office. For other clients, being interviewed from across an office desk creates an intimidating environment. If you have a conference room available, use it to put you and your client on a more equal footing in terms of the general surroundings: same size chairs, comparable seating arrangements. Holding an interview at a corner of the conference table allows you to sit next to the clients and still face them. This arrangement allows you to work shoulder to shoulder in an atmosphere the client might find less intimidating. However, conducting tax return interviews in a conference room setting requires the addition of computerized capabilities in the conference room itself, where these capabilities were not previously provided.

**After the interview.** Immediately after the interview, complete the editing process by adding any additional comments while the material is still fresh in your mind. If the client prepared an organizer, foot the client's figures, initial and tic-mark the calculations with a red pencil to show that they have been footed. The interviewer should also initial any changes or comments to show that they were not made by the client. If the client will supply missing information later, make sure the file locator log has been updated to reflect that fact (see Section 101.3.2 for more information about file locator logs).

The interviewer should make a general estimate of the time necessary to complete and review the return. This estimate can serve as a guide for both the preparer and the reviewer so that the return can be done within budget. If there are few differences from the prior year, the time taken to complete the return in the prior year may also be used as a guideline.

**Mailed-in tax information.** New practitioners use interviews to develop working relationships with their clients and to generate possible new client contacts. They need all the contacts they can get to build a client base. Well-established firms may need to restrict the number of interviews in the office to keep their workloads manageable. If your firm prefers to hold office interviews only with those clients who have complex returns, you can encourage other clients to mail in their information rather than come to the office.

The advantages of having your clients mail in their information are—

- Time spent interviewing is reduced, if not eliminated.
- Clients save the time and effort of coming to the office for the interview.

Clients can be encouraged—in the instruction letter accompanying the organizers—to mail their information. The instructions can direct them to mail the completed organizers to arrive at a prescheduled time or to call for an interview appointment.

Some clients may need further encouragement before mailing in their tax information. Using your experience to guide you, prepare a list of established clients you believe would be willing and able to mail in their information in a timely manner. Give the list to the personnel answering the telephone. Rather than automatically scheduling an appointment for these clients, instruct them to pass on the calls to you. After a brief discussion with the client, you can make a suggestion such as, “If you would rather, Mr. Wilson, just mail your information to me. Then let’s set up a time when I can call you, so we can discuss the data on the phone and estimate your tax. It would save you fighting traffic coming down here.” The goal is not to manipulate your clients, but to offer those who already know and trust you an option that is mutually convenient. Do not push! Some clients will always prefer personal interviews, and you should honor that preference.

### **Review and Edit Mailed-In Information**

You should establish a policy of reviewing mailed-in tax information as soon as it arrives. One important goal is to determine if any information is missing. When a client’s data is received, it should be reviewed by a tax practitioner familiar with the client. The completeness of the information determines the return’s status in the system: queue the return for preparation, or put it on hold to wait for the missing information.

Unlike an interview, where each piece of information can be discussed with the client, the immediate review of mailed-in information is precursory and is not expected to be a thorough screening. However, a brief editing by a tax practitioner acquainted with the return can reduce the preparation time for a preparer unfamiliar with the client.

Sometimes a client attaches a note listing missing information, such as K-1s from partnerships, 1099s, and so forth. If a client indicates that he or she knows the information is missing and will send it later, you can initially place the file on hold. Of course, the hold file must be routinely monitored for any returns that are stuck.

At other times, it may be necessary to work with the information to develop a comprehensive list of missing information. However, before contacting the client, try to develop as complete a list as possible to maintain office efficiency and to avoid exasperating the client.

### **Downloading From Client Software**

Several tax preparation software packages allow for data to be directly downloaded from personal finance programs and general ledger software, such as AICPA’s *Accountants Trial Balance*. Such an approach has long-term advantages in providing a direct link between data without requiring separate input. However, the initial setup of the linking process is time-consuming and should probably be avoided if you expect significant changes in the client in future years.

Despite the efficiencies created by the direct input of data, appropriate inquiries should be made regarding the completeness and classification of the amounts on the client’s software package. The client’s data disk or hard copy of the printed reports should be retained in your files to provide an audit trail for the tax return information.

## **201.2.4 The Preparation/Return-Input Process**

Once the tax return interview has been completed (either in person or by telephone) and appropriate editing notations have been made on the materials, the file is ready for the preparation stage. This may involve the completion of computer input forms or direct keying of client information into the computer. The issues discussed in this section are appropriate for either preparation method.

The direct keying of client information removes the requirement of a separate individual to complete computer input forms, often resulting in a more efficient process. However, the direct keying of client information ties up additional time of experienced personnel, potentially resulting in the need for a different skill set in tax personnel. In some cases, direct keying allows the interviewer to spend more time with the client, resulting in the opportunity to discuss

additional client needs, such as financial planning. On the other hand, direct keying of client information may inappropriately tie up the time of individuals capable of performing more complex tasks, and may give clients the impression that the entire tax return preparation process is complete when the client leaves the interviewer's office. This latter issue can normally be overcome by explaining to the client that additional preparation and review steps must be completed before the tax return can be released to the client.

### Organizing Information

When client tax information is thrown into files haphazardly, preparers and reviewers must constantly flip through the files to find the information they need. If the interviewer used mailed-in information and has not already sorted the client's information, the preparer should structure the file in sequence according to the organizer sheets. If it is your firm's policy to keep source documents, Forms 1099, and so on, the preparer can attach supporting source materials to the appropriate organizer sheets. Any additional supporting schedules can be placed behind the organizer and numbered to correlate with the organizer information.

**Practice Tip.** Set up pre-labeled and color-coded envelopes or folders in which all client data can be held while the return is in process. Generally, only four or five envelopes will be required:

- Information to attach to return (often also copied for the file)
- Information to punch into file
- Information to hold loose in file
- Information to return to client
- Information to copy for file and return to client

If the client did not return an organizer, the preparer should assemble the client's information in the same sequence as an organizer. The preparer can then transfer the information directly from client source materials, such as dividend and interest statements, onto the computer or input sheets.

The complete file for the current year's tax return is eventually organized in the following sequence:

- Routing schedule
- Billing invoice
- Return transmittal letter
- Final copy of the return
- Computer diagnostic reports
- Input sheets (if used)
- Checklists
- Workpapers
- Client organizer
- Source materials
- Tax research information

To a certain extent, the file is built from bottom to top over time as the tax information arrives and the return is prepared. The routing schedule is like a cork that continuously pops to the top of the file for easy review.

Organization of the file is a top priority for those preparers with the ability to directly key in the taxpayer's information. Without careful attention to file organization and without proper documentation, the preparer's ability to communicate efficiently with the client or the IRS in future years will be greatly hampered.

### Pro Forma Information

The first step when filling out input sheets or directly keying information is transferring the previous year's information into the current year. The following list contains some of the items that are routinely carried forward from year to year:

- The client's name and address
- The names of family members
- Social Security numbers
- Dividend and interest payers
- Rental property locations
- Schedule C information, such as names, addresses, accounting method, home office questions, etc.
- Depreciation schedules
- Names and addresses of partnership interests
- Federal and state overpayments
- "Exception One" tax for avoiding underpayment penalties
- Carryovers

Tax software programs usually produce pro forma input sheets showing the prior year's information. You must check this information with the client's current material to make certain the details are still correct, particularly if manual corrections were made on the prior-year return.

Most people think of pro forma information as direct carryovers from the prior year to the same line in the current year's return. However, the information may have been moved to a new location in the current year's return, if it is reported at all. For instance, the prior year's state refund may or may not be taxable income on the current year's federal return. Federal and state overpayments applied become part of the current year's schedule of tax payments. Refunds and overpayments applied are part of the process of carrying information from the prior year's return into the current year.

Make sure you have permanent schedules, so you do not have to search for all the carryovers from the prior year, such as capital losses, suspended passive losses, and so forth. When using pro forma input sheets, avoid relying on the computer to handle the carryovers properly. You should check the prior year's return for carryovers and make certain they have been incorporated into the current year's input sheets.

Remember that just about every aspect of pro forma information is subject to change. For example:

- Clients move to new addresses.
- They divorce and change their names.
- They sell the stocks that pay dividends.
- They purchase stocks that pay dividends.
- They change banks.
- They acquire dependents.
- Children no longer qualify as dependents.

You cannot mechanically pass pro forma information into the current year's return or assume that software carried the information forward correctly. If a change in tax processing software or tax processing vendors occurs, extra caution is needed in reviewing the pro forma information. Often, carryforward items are not picked up on the first year pro forma, or are picked up incorrectly.

**Example.** In changing tax processing software, it is usually possible to automatically download depreciation schedule data. However, errors often occur in transferring vehicle depreciation and other assets used less than 100 percent for business purposes. Cost and accumulated depreciation on these assets deserve extra attention.

### Verifying Client Information Against the Source Documentation

Source documents help ensure that there are no errors or omissions on the return. You should place colored pencil checks on the organizer sheets to show that client information and totals have been verified with the source documentation. Perhaps the client misread a 1099. When the preparer's totals do not agree with the client's, make annotations explaining the differences.

Information affecting next year's tax return should be noted with reminders for the following year.

Make it a practice for the preparers to survey the payee name and taxpayer ID number on the client's source documents. Preparers can use a colored pencil to place check marks on the 1099s to show the reviewer that they checked these. Dividend or interest payers and other information reporters may have made a mistake or may simply have incorrect information. Because IRS computers are becoming more and more sophisticated at correlating a taxpayer's income information from various sources, it is increasingly important to determine that the payers have the correct taxpayer ID.

**Example.** A child's bank account opened under the Uniform Gifts to Minors Act might have a parent's Social Security number. The IRS computers would attach the income to the parent, even if the child is over 14 and has filed his or her own return.

### Tax Preparation and Review Checklists

Preparers can use checklists as a guideline while preparing returns to make certain no information was omitted. Later, the reviewer will use the checklist to evaluate the preparer's diligence in drafting the return. The checklist helps a preparer make certain he or she took all the necessary considerations into account. Checklists represent an important element in the quality control process for tax return preparation.

Computerized tax services often try to produce comprehensive input sheets that attempt to allow for every potential tax situation. Because they can be so comprehensive, input sheets sometimes serve as surrogates for a formal checklist. However, because no one tax return uses every type of input sheet, using an input sheet as a checklist will not provide the extensive review of a formally prepared checklist.

Because tax laws change somewhat each year, checklists must be constantly modified. You may find it more practical to obtain your checklists from outside sources rather than spend the time developing your own.

**Practice Tip.** Comprehensive checklists are prepared by the Tax Practice Guide Subcommittee of the AICPA Tax Division. Tax Division members receive them each year as one of their membership benefits. These checklists cover every conceivable tax situation. Firms are expected to modify them to conform to their type of clientele. You can contact the AICPA Tax Division at 1455 Pennsylvania Avenue, N.W., Washington, D.C. 20004-1007, for more information on the Practice Guides and Checklists.

## 201.2.5 Workpapers

Tax return workpapers should provide a trail from the source materials to the final figures on the return. Most firms have adequate workpapers for the preparation of business returns. Often, however, workpapers for individual taxpayers are neglected. Under the crush of the tax season workload, preparers may try to cut corners with workpapers.

Workpapers for individual clients are important to help you review the client's tax situation and, if audited, to substantiate return information. Formal procedures for documenting tax return information strengthen your position that you exercised due diligence in preparing the return. See Section 101.1.1 for further information concerning tax return policies and procedures.

**Practice Tip.** Because entries on a tax return or on computer input sheets are often a combination of two or more numbers, always document which amounts have been summed. During the pressure of tax season, there is a tendency simply to write down totals on the returns or input sheets without showing how the amounts were derived. Not only does this complicate the review of the return, but problems will arise next year when new preparers are trying to follow the previous year's workpapers, and cannot determine how a particular number was obtained. Violations of this procedure should be identified in the internal inspection function, as discussed in Chapter 101.

Showing derivations in the workpapers simplifies the current year's review and the preparation process in the years to follow. Your preparers do not waste time solving mathematical

puzzles and reinventing the wheel. With each passing tax season, the return preparation for continuing clients becomes more routine. The workpapers lay out a specific path for new preparers to follow, and experienced preparers improve their speed and are less inclined to cut corners when the workpapers provide a good guideline. Always carefully document your work and insist on the same from your staff. Set a standard for the staff to follow.

The technological advances and integration of programs can significantly improve the efficiency of a tax practice (i.e., ATB and other trial balance software as well as general ledger packages can be imported into tax processing software). Tax research software can export information into word processing systems that can provide efficient preparation of letters and memorandums. Intellectual software is now available that will facilitate discussions with clients as well as the appropriate tax decisions under varied circumstances.

With more firms now directly entering information into the computer from client worksheets and source documents, the requirement for a proper audit trail from the source information to the return is even more critical. One of the dangers of direct input to the computer is that the preparer will shortcut proper documentation and simply combine numbers as one input item to the computer. Personnel must be clearly directed to properly document the source of all information going into a return, whether preparation occurs via computer input sheets or by keying directly into the computer system.

**Practice Tip.** For individual tax returns, consider using the completed organizer as a guide for setting up workpapers; any required supplementary documentation can be attached directly behind the appropriate page of the organizer. This may eliminate the need for cross-referencing for all but the most complicated returns while still providing easy access of source information if needed.

Tax preparers may need additional training on understanding IRS forms themselves and the way the computer software generates them. Many preparers who previously relied on prior-year input sheets to assist them in preparing the current year's data will have a problem if they now must enter information directly into the computer system. Such individuals will need additional training on understanding the way the computer software works and the output forms are produced, rather than training on the computer input sheets themselves.

Tax software will usually allow a preparer to print an input listing, showing exactly which input fields were used in the return. Preparers should retain this record to assist in next year's preparation. Even if input sheets are used, the input listing would consume significantly less file space while providing the same information.

### Preparer Point Sheets

Point sheets highlight questions raised during the preparation process, and they document the steps taken to resolve the questions. Normally, these questions concern missing or incomplete client information. However, they sometimes revolve around the proper treatment of an item on the return. The issue may be a controversial or vague area of the current tax law. Inform the client of any item that is controversial in nature, and allow the client to make the final decision whether to take a conservative or an aggressive position on the return.

**Caution.** Tax positions that are contrary to the IRS's must be supported by "substantial authority" or face possible penalties for understatement of tax. Substantial authority includes the Code, Regulations, Case law, administrative releases published in the Internal Revenue Bulletin, and private letter rulings. Form 8275 must be attached to the return disclosing the affected item's tax treatment.

It is never a good idea to resolve significant tax issues via a point sheet. Documenting the resolution of significant tax issues has its own place in the workpaper documentation (see Chapter 203, Researching Tax Law, and Section 101.7.3 for more information on documenting tax research).

### Estimating Tax Return Information

You must often rely on estimated information to complete a tax return. For example, many clients do not keep adequate records of stock purchases. The client's broker might not have

the original purchase date and cost if the client changed brokers since the stock was originally purchased. Even if the client did not change brokers, the broker may not have information concerning mergers, stock distributions, stock dividends with fractional shares, splits, and other pertinent information that complicates computing a stock's basis. Ownership of a stock may have passed to the client through a will or trust, and the client may no longer have the documents showing the security's value when ownership was acquired.

The AICPA's Statement on Responsibilities in Tax Practice (SRTP) No. 4 discusses the use of estimates. SRTP No. 4 states that estimates are the responsibility of the client, and he or she should provide them. (See Section 301.3.4 for a further discussion of SRTP No. 4.) Unfortunately, many clients lack the financial sophistication necessary even to begin developing accurate, well documented estimates.

Services such as Commerce Clearing House's *Capital Changes Reporter*, *Moody's, Standard and Poor's*, and the *Wall Street Journal* provide invaluable aid for estimating missing dividends or stock purchase prices. If a client has held a stock under his or her name, the stock transfer agent will be able to provide a purchase date. If a stock was held in a street name, you will need to turn to the broker for that information.

If it is impractical for you to get exact information and the client has prepared a reasonable estimate, you can use the estimate. If you have to develop the estimate, you should contact the client and discuss it. The client should understand that an estimate was used and agree to the amount; otherwise, the estimate is not his or her representation.

**Practice Tip.** Clients should be reminded that estimates do not substitute for good recordkeeping. This underscores the value of encouraging clients to send copies of tax-related documents directly to you.

**Computerizing supporting schedules and computations.** Sometimes, many computations result from supporting schedules that may or may not be in the tax return. Depreciation and amortization schedules are routinely kept with a client's file but are not necessarily attached to the return. Interest penalties on overdue payments are common computations. Each firm normally finds that many schedules and computations are performed routinely throughout the tax season. Consider placing routine schedules and computations on a computer spreadsheet or purchasing specialized software. By computerizing the schedules and computations, you standardize the format and reduce preparation time by automating the computations. Make certain any homemade spreadsheet programs are reviewed, tested, and the computations verified before relying on them. The danger of homemade programs is that they seldom receive the thorough testing of commercial software packages. Without program testing, errors spread rapidly through many tax returns.

**Practice Tip.** If you have a computer but still manually draft any returns, consider obtaining a good tax planning program to verify computations. The tax planning program not only provides confirmation of the preparer's calculations of client income, deductions, and tax liability, it also does AMT calculations, passive loss limitations, charitable contribution limitations and carryovers, and a host of other tax computation intricacies.

## Documenting Tax Research

If a return contains items that are controversial or subject to interpretation, documentation of the preparer's research should be part of the client's file. A brief explanation of the rationale for the return position should accompany the research and a letter explaining the position should be drafted and sent to the client. While the client is ultimately responsible for the return, you may face liability if you did not adequately explain the position and its risks to the client. For a complete discussion of tax research, see Chapter 203.

If you suggest that a client take a position on the return that is contrary to the IRS's stated position, you must believe that the position has a realistic chance of being sustained administratively or judicially if challenged by the IRS, such as a position that is upheld in one federal district court but not in another. You might recommend the return position if the local federal district court's decision had been favorable (see Section 301.3.4 for the AICPA position on disclosure and Section 302.4.2 for penalties on tax preparers that relate to tax return positions).



## Preparing the Input Sheets or Interactive Computer Input

If your firm uses computer input sheets, preparers are responsible for completing the input sheets to the point where they believe they are computer ready. The preparers also should complete a tax return tie-out sheet (see Exhibit 201-11) with totals for items of income, deductions, and the estimated tax liability.

**Practice Tip.** If your firm keys data directly into office computers, preparers can generate a computerized draft of the return for review. They can either print a draft or, if there is an office network, export it to the reviewer's computer.

One advantage of an in-house tax program is the preparer's opportunity to evaluate the return in the IRS format before submitting it for review. This allows the preparer to detect and correct obvious errors before the return continues in the process. The preparer should generally review the diagnostic messages on screen for "fatal flaws" and should also review the more significant totals, such as Adjusted Gross Income or Taxable Income. The preparer may also wish to review certain tax schedules that are more prone to contain errors, such as Employee Business Expenses.

## 201.3 The Review Process

Whenever possible, every tax return should be reviewed by a qualified individual other than the preparer. A sole practitioner without any staff can lay a return aside for awhile to gain a fresh perspective. However, there is a tendency to make the same mistakes. If a sole practitioner has a working relationship with others in the area, perhaps they can arrange for a reciprocal agreement to review each other's returns. If a firm has two or more practitioners, they should review each other's work. The opportunity to obtain a second opinion about the preparation of a return or the treatment of an item under current tax law provides practitioners with an additional avenue for growth and learning as well as a quality control check for the returns.

The exact nature of the review process depends on the method used for tax preparation. For example, if computer input sheets are completed in the preparation process, the review process should include a detailed analysis of all source documents and client organizer data against the computer input sheets. This review should occur prior to the time the computer input sheets are keyed into the system if you are training new preparers. However, experienced preparers will normally find it easier to review draft copies of returns than input sheets.

**Practice Tip.** In-house systems allow the preparer to print a draft copy of the return for a personal review before moving on to the formal review stage. This has the advantage of allowing the reviewer to work directly with the software output rather than strictly reviewing against input sheets.

For a preparation process in which direct keying of tax information occurs from the source documents and taxpayer organizer information, a "draft" copy of the tax return can be printed and the review process then entails a check of the source documents and client organizer information against the draft copy of the tax return.

Using interactive tax preparation software, the review can be done on screen rather than on a printed copy. This may be the best approach for simpler returns containing few forms or those prepared by experienced practitioners. For complex returns on-screen review is generally not efficient because moving from screen to screen can be extremely time-consuming. Many software packages do not allow tick marks to be placed near screen data, thereby raising the possibility that certain items may escape review.

On-screen review is generally most effective when done to recheck changes made before the rerun of a return.

In either approach, all source documents, client organizer information, and other file notes should be compared against the result of the preparation process, whether this is a series of computer input sheets or a draft copy of a tax return.

The IRS's Program Analysis System (PAS) tracks common preparer errors, which IRS staff address through Notices to Preparers and staff alerts. See Exhibit 201-12 for a PAS list of common errors.

If preparer checklists are used, reviewers should verify that all appropriate procedures have been followed. Inexperienced preparers may overlook a step or misinterpret a checklist procedure. Experienced reviewers using and following checklist procedures enhance return quality.

### 201.3.1 Review Comments

A reviewer working through a return should prepare a list of questions raised and errors uncovered. As mentioned before, the reviewer can use the tax preparation and review checklist to verify the diligence of the preparer. The reviewer generally should not make any error corrections. He or she should hand back the return draft or input sheets to the preparer for correction. This allows the preparer to learn from suggestions and changes. In addition, the preparer may have valid reasons to disagree with the reviewer's proposed changes. Once any necessary revisions are made, the preparer should resubmit the return for a final review, unless the reviewer has indicated that a final review will occur at signing.

Occasionally, the reviewer will want to make changes directly rather than returning to the preparer. Justifiable occasions include minor cosmetic changes, those resulting from a software modification after the point of preparation and those resulting from additional client data received. At a minimum, the reviewer should notify the preparer of any changes made so that recurring preparation problems do not develop. It is human nature to learn from mistakes much faster if required to fix one's own errors.

**Practice Tip.** The tax return review process should be used as an opportunity to identify tax planning opportunities. Follow-up forms (see Exhibit 101-18) should be completed for all matters identified.

### 201.3.2 Final Review

As a final step to the review process, the current year's return figures should be compared with the prior year's return. If you prepared a current-year projection, the return can be compared to the projection. The idea is to spot any wide variations in items of income or deductions and determine how the differences arose.

The return should be reviewed to ensure that error-prone areas are correct. Due to computer crashes or seldom-used forms, manual returns might occasionally be prepared. Reviewers of manually prepared returns must be on guard for clients who become subject to the AMT, and they should review the passive loss limitation computations. Most computerized tax preparation programs perform AMT calculations automatically. If there is an overpayment of tax, the reviewer should check on whether the return requests a refund or applies the overpayment to next year's tax, depending on the client's wishes. In addition, carryover items for the following year should be identified in the notes and workpapers on a permanent sheet for uniformity and standardization. The return also should be checked to ensure that the taxpayer's and spouse's names, addresses, and Social Security numbers are correct, and that dependent information, such as the names, ages, and Social Security numbers of minor children, are correct.

**Practice Tip.** The complexity of the return might require additional levels of review. Consider an additional "fatal flaw" review or more comprehensive checklist for all returns reflecting adjusted gross income in excess of, say, \$100,000.

## 201.4 Sending the Return to the Client

### 201.4.1 Signing the Return

The tax preparer accountable for the overall substantive accuracy of the return must manually sign the tax return, unless physically incapable due to a temporary or permanent disability. A

preparer who cannot sign must stamp the return “Unable to Sign” and print his or her name under the signature line. The IRS will not accept a facsimile signature or signed gummed label. You also must show on the tax return your Social Security number, firm name, employer identification number, if any, and office address. Any required information other than your signature may be typed or stamped (see Section 301.2 for a more complete discussion of the rules determining who is a tax preparer).

There is an exception for preparers of large numbers of Forms 1041. They may use a facsimile signature provided they have taken the following three steps to protect themselves from the penalties for failing to manually sign:

1. A letter, manually signed by the preparer, accompanies the Forms 1041 carrying facsimile signatures. The letter must have the preparer’s name, identification number, and a declaration, under penalties of perjury, that the facsimile signature is the signature used by the preparer to sign the returns.
2. Except for arithmetical corrections, no one other than the preparer may alter any of the return entries once the facsimile signature is affixed to the return.
3. The preparer must keep a manually signed copy of the letter that accompanied the returns and a record of any arithmetical errors corrected after the facsimile signature was affixed.

Never sign a return until the preparation process is complete, the return is final, and it is ready for the client’s signature. Otherwise, office personnel might misconstrue an incomplete or incorrect return as a final product.

### Planning Review and Correspondence

Individuals signing tax returns have two major responsibilities in addition to placing their signature on the tax return:

1. They should perform a final review of the return to be sure that the actual results are consistent with results previously communicated, with tax planning projections, and so forth.
2. They should complete client correspondence pointing out major issues that arose in completion of the tax return and recommending potential tax planning opportunities.

In most cases, the final review at the time of tax return signing is a fairly quick process. Assuming tax planning had previously been completed, some projection had been completed for the client at the time of the tax return interview, or some combination of these activities, the final review may be nothing more than comparing the completed return to the preliminary projections. Naturally, any discrepancies should be reconciled and explained to the client. The pages of the tax return itself should be quickly reviewed, to be sure that all required attachments are included and the proper elections have been attached to the tax return. In a nutshell, the signing process allows the practitioner the opportunity to complete one final, high-level review of the completed tax return.

**Practice Tip.** A boiler-plate computer-generated transmittal letter is a poor substitute for personal correspondence. It may be more efficient to use a “canned” letter approach on simple returns, but remember that a personal note written on a form letter will go a long way toward reminding the client of your personal interest and attention. Most tax preparation software packages allow additional text to be added to the paragraphs of the standard computer generated transmittal letter.

During the interview process, and potentially in the process of completing the tax return, certain items that warrant communication to the client might arise. The signing process affords the practitioner an opportunity to pass recommendations and other comments to the client, which often results in additional work opportunities for the firm.

**Example.** The alternative minimum tax might unexpectedly apply, and communication to the client on ways to avoid the alternative minimum tax (e.g., accountable expense reimbursement plan) might be appropriate.

**Example.** Perhaps a warning should be given to the client about the ever-rising self-employment tax, explaining that even at the level estimates are being paid for the current year, significant tax might be due the next year.

**Example.** An explanation of the way the estimates have been set up might be appropriate, whereby the taxpayer is warned that the estimates have been designed simply to avoid penalties and not to prevent any tax from being due the next April 15.

## 201.4.2 Delivering the Return

### Instruction Sheets and Packaging

Include specific filing instructions with the return when it is delivered to the client. Filing instructions carry information on any payment amounts due and the payee, along with the filing address of the appropriate IRS service center or state revenue authority. Many practitioners send clients tax return mailing envelopes preaddressed to the proper federal and state tax authorities. Clients appreciate this additional service.

**Practice Tip.** Professional work deserves professional presentation. The packaging of the client's tax return is a major marketing tool. Because tax returns basically look the same, the packaging around a return helps establish a firm's professional image. Many vendors market covers for tax returns. The more specialized presentation packages include a tabbed divider system to index related data in the tax return. A four- or five-part tab set indexes filing instructions, estimates, federal, state, and city returns.

### When Clients Pick Up Their Returns

You may prefer that local clients come to the office to pick up their returns. By having them come to the office, you avoid the risk of their returns being lost or delayed in the mail until after the filing deadline. You can also speed up the collection of the return preparation fees. When you notify the client that the return is ready, schedule an appointment, inform the client of the final tax due, if any, and your bill. This leaves the client with the impression that payment is expected upon receipt of the return. Not every client will walk in with a check for your fees, but many will.

A knowledgeable staff member should meet the client when he or she picks up the return. Allow the client time to ask questions while minimizing any loss of the preparers' time. If a client asks a question that the staff personnel cannot field, make yourself available to respond immediately. Always consider these questions, because the client may raise a point that will change the return.

Be cautious in giving verbal advice to clients at the time returns are picked up; practitioners have been sued by clients who relied on verbal advice. Stress to less knowledgeable staff that they must know their limits in assisting clients, and instruct them to refer complex questions to an experienced practitioner. Any advice that is rendered verbally at the time that returns are picked up should be documented in the file.

**Practice Tip.** Clients are sometimes ready to sign their returns when they pick them up. When this is the case, consider offering to mail the returns. Clients appreciate the service, and you can box a group of returns together for mailing by certified mail. Of course, you may not be willing to take this added responsibility upon the firm. If you do, beware of holding any return too long for mailing—especially if there is a refund due! Refer to Section 101.3.3 regarding monitoring the delivery and mailing of tax returns.

### Mailing Returns

When mailing returns to a client, send transmittal sheets showing where to sign, and when and where to send the return. Consider including a self-addressed, stamped postcard. You can request either that the client mail the postcard when the return is mailed or that the IRS mail it when the return is received. The postcard should be included in the client's tax file once your firm has received it.

**Practice Tip.** Consider recommending to your clients that they mail their returns certified mail—return receipt requested. Prior to sealing the envelope, write the certified mail reference number on the top of your tax return. This will provide a direct audit trail to prove timely filing of the return. Make sure that clients retain the return receipt. Dissuade clients of the impression that the return receipt can be destroyed once the IRS has received the return. Arrange to have important returns, or those with significant balances due, hand delivered to the local tax office.

When you send a return to a client, mail it in time for the client to review, sign, and forward before the filing deadline. Optimally, returns should be in the mail to clients 10 days before the due date.

Failure to observe this 10-day guideline creates potential client resentment. Clients who are not given reasonable time to review their returns before signing and filing may assume you are taking on a greater responsibility for the return's information. Clients who receive their returns just before the filing deadline often mail them immediately, without review. If an error is uncovered later, they blame you for the mistake and expect an amended return at no charge.

In a worst-case situation, the client may hold the return for review and file it late, subjecting themselves to a late filing penalty. The client may then try to claim that the firm should pay the late penalties. Despite the fact that you generally have no responsibility for late filing penalties if the return was received by the client before the due date, paying the late penalties anyway may be a cost of continuing to do business with that client.

**Practice Tip.** If the 10-day rule cannot be met, arrange for special handling, such as overnight mail. Telephone the client to advise him or her of the pending arrival of the return, the balance due, if any, and the need for an immediate review, signature, and mailing. You might even consider FAXing an unsigned copy of the return so the client can review it before receiving the signed copy the next day. Your staff should follow up the call to make certain the client received the return.

**Practice Tip.** To avoid potential delivery problems, recommend that taxpayers mail returns using certified mail, return receipt requested. The IRS has now authorized a number of private delivery services which are treated the same as the U.S. Postal Service with respect to the "timely mailed is timely filed" rule. However, caution must be exercised with these private delivery services because only specified mailing alternatives with the designated private delivery vendors qualify under the IRS authorization.

### 201.4.3 Electronically Filed Returns

Most firms have started to offer electronic filing of tax returns. Many of these firms operate under an environment in which the traditional preparation of paper returns normally occurs, with electronically filed returns prepared for clients on an exception basis. Other firms have started to move towards a totally electronically filed environment. These firms prepare almost all returns electronically, with the preparation of the traditional paper returns being the exception.

The transition to a more complete electronically filed environment offers many advantages. Personnel previously involved in copying and processing tax returns, preparing envelopes for mailing, and so forth, can now be minimized or eliminated. Paper and postage costs are greatly reduced, as are file storage costs. Additionally, an enhanced client image of a progressive, state-of-the-art firm results, with a similar image projected to internal staff.

On the other hand, as with any significant change, the movement towards a more complete electronically filed environment is not without its disadvantages. Policies and procedures must be rewritten, new lead times may be introduced, and additional processing costs may result. Because additional steps are introduced in obtaining required client signatures, receiving notification of acceptance from the IRS, and so forth, additional support function steps may be involved.

However, it appears that any disadvantages introduced with electronic filing in terms of additional support tasks are primarily at the clerical level, with additional requirements on the part of technical personnel non-existent. Many firms who have moved towards a complete electronically filed environment find that the first few weeks present some efficiency problems,

but once the process is refined and the bugs worked out, a much more efficient overall tax preparation process results. These firms also find that client and staff acceptance of the electronically filed approach is high.

Returns filed electronically with the IRS represent a larger percentage of all returns filed each year. Practitioners not yet participating in the program should apply to the IRS on Form 8633.

Procedurally, electronically filed returns must be handled in a manner different from traditionally filed returns. Since taxpayers' signatures cannot yet be electronically transmitted, Form 8453, Declaration for Electronic Filing, must be signed and mailed to the IRS. However, under the 1998 IRS Restructuring and Reform Act, the Treasury was directed to develop procedures for the acceptance of tax return signatures in digital or other electronic form. When the return is ready for client pickup, consider calling the client, rather than mailing a notification, since electronic filers are generally more anxious to file without delay. Once your client has reviewed the returns and signed the declaration, the return should be transmitted to the IRS service center. Do not transmit returns until the client has had a chance to review the return. A return sent prematurely might require amending should the taxpayer discover an error. Make sure your firm has an adequate control system in place to facilitate client review of the return before filing. For more detail on electronically filed tax returns, see Chapter 204.

**Practice Tip.** Electronic return originators are held to higher standards than other tax return preparers. Violation of these standards may result not only in loss of privilege to use electronic filing, but in criminal and civil penalties as well. The IRS Handbook for Electronic Filers of Individual Income Tax Returns (IRS Publication 1345) should be thoroughly reviewed to be certain all responsibilities associated with electronic filers are being met.

**Practice Tip.** Overall cost savings should result from filing as many returns electronically as possible. While additional clerical steps are involved in processing the return, labor required to copy paper returns is reduced, along with lower paper, postage and supplies expense.

#### 201.4.4 Year-Round Communications

Corresponding with clients to remind them of estimated payment due dates and the amount due maintains contact during the year. In addition, remind clients who are not on a protective estimate that their withholding or estimated tax payments must equal 90 percent of the final total tax, to avoid penalties for underpayment of tax liability. Advise clients to contact you for a revision of their estimate if the circumstances affecting it have changed. Any individual whose income might be expected to increase at least \$40,000 over the previous year should be contacted quarterly regarding possible estimate revisions.

**Practice Tip.** Once a reminder system is set up, you must have a method of confirming that all the reminders were sent. A client may try to hold you responsible for any underpayment of tax penalties due to the nonreceipt of a reminder.

Place the estimated payment schedule in next year's file. The interviewer or preparer should confirm with the client that the estimated payments were made.

If instructions for filing estimates are provided to clients, be wary of advising clients that there is no risk of penalties if estimates are paid in a timely manner. Unexpected higher income may force these clients to revise the estimates upward to avoid penalties.

#### 201.5 Extensions

Sometimes a client does not submit his or her tax information to you in time to complete the return before the deadline, or perhaps the client does not have sufficient time to review the return before the filing deadline. You should prepare and submit extension requests for any returns that cannot be filed on time. Include in the client's file a memorandum documenting the circumstances requiring the extension.

Because an extension request does not extend the date for payment due, any shortfall creating a payment due with the extended return will incur interest. Also, at least 90 percent of the final payment due must be paid by the original filing deadline or the client will be subject to the late payment penalty. In a worst-case situation, unreasonable estimated payments with an extension request can invalidate the request and subject the client to a late filing penalty. In *Crocker*, the Tax Court held that the Internal Revenue Service properly voided the automatic extension Form 4868 when the taxpayer did not properly estimate the tax liability (92 TC 57 (1989)). While the estimated tax need not be exact, a “bona fide and reasonable” belief is required.

IRS Regulation 1.6081-4T(a)(4) provides that the application must show a proper estimate of the full amount due, but need not be accompanied by full payment of the estimated amount of tax for individual taxpayers only. Corporate and other taxpayers still need to remit the full amount of estimated tax due with the extension.

**Practice Tips.** A cover letter transmitting an extension request to the taxpayer provides an excellent opportunity to document that you have informed the client of the penalties for underpayment and the potential for an unreasonable estimate to invalidate the extension request. Whenever possible, have taxpayers sign their extensions, especially if the extensions are prepared on the last day for filing and are based on a belief that there are no additional taxes due.

Calculate payments for the extension request with next year’s first-quarter estimated tax payment. Do this for both federal and state extensions. Consider the two payments as one overall tax payment. The idea is to shift the payment from the first quarter estimate for next year to this year’s extension request. For example, if a client owes \$1,000 on the extension and \$4,000 for the first quarter estimate, shift \$4,000 to the extension. The extension now has a \$5,000 payment. Later, when the client files the return, apply any overpayment to the next year. If you make a mistake and miscalculate the actual tax due with the return, you only risk penalty next year for the underpayment of estimated tax, rather than interest and penalties this year (interest on the underpayment of tax, a late payment penalty, and, potentially, a late filing penalty).

Be aware that a potential disadvantage exists by using this approach on state extensions. By overpaying the extension amount, a state income tax refund results in the following year which increases the taxpayer’s AGI. This increased AGI may cause phase-out of Schedule A itemized deductions in the year of refund. Accordingly, many practitioners use this suggested approach for federal purposes only, but for higher-income taxpayers, properly calculate (and have the client pay) the state extension and estimate amounts.

If an extension request for time to file is denied by the IRS, any elections on the return are jeopardized. The client faces penalties for failure to file and nonpayment of taxes. Therefore, in some situations, you might prefer to file a return with missing or estimated information, if the information is not material. An amended return can be filed in the event that the estimate was not correct. If a final extension is approaching the deadline, you may have to use an estimate to prepare the return. See AICPA SRTP No. 4: Use of estimates (Section 301.3.4, herein) for a discussion of using estimates.

An extension of time to file is usually preferable to filing a return with estimated information and later filing an amended return. For one thing, it generally takes less time to calculate estimated tax and prepare an extension request than it does to prepare an amended return. In addition, an amended return with significant adjustments may result in an audit. From the client’s viewpoint, the fees for an extension request and a completed return will be less than the charge for an original return followed by an amended return. Also, some clients resist filing amended returns when they show an additional tax payment due.

**Practice Tip.** Consider mailing all extensions using certified mail, return receipt requested. Also, extensions can be batched with a cover letter and mailed in bulk. Certified mail with a return receipt protects against the imposition of late filing and late payment (assuming tax due is paid with the extension) penalties.

## 201.6 Errors Found on the Return

Occasionally, you may discover that a previously filed return contained an error or omission. For instance, a client may supply information in the current year's tax data that was missing in the prior year's information. Possibly a new client with several employees might not have filed Form 941, Employer's Quarterly Federal Tax Return. Error discoveries probably occur most often with new clients who prepared their own returns for the prior year.

The AICPA's Statement on Responsibilities in Tax Practice (SRTP) No. 6 requires the CPA to "inform the client promptly" of the discovery of an error or the failure to file a required return. You must recommend to the client the proper measures to correct the error, usually the filing of a late or amended return. If the situation is so serious that the IRS may assert a charge of fraud or other criminal misconduct, you should advise the client to consult legal counsel before taking any action regarding the error. If your firm prepared the return with the error, you may want to seek legal counsel. However, you should never inform the IRS of an error without the client's permission, unless a disclosure is required by law (see Sections 301.3.4 and 301.4 for specific information concerning SRTP No. 6 and disclosure responsibilities).

Firms should have an agreed-upon procedure for handling discovery of errors in prior returns they prepared. Consider whether to inform the client when an error is suspected or after the situation has been investigated. On the other hand, errors in prior returns prepared by others present a marketing opportunity worth exploiting.



# Exhibits

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**Exhibit 201-1: Corporate Organizer to Be Completed by Client****CORPORATION TAX ORGANIZER (1120)**  
**(SHORT VERSION)**

Corporation Name	_____	Tax Period	_____
Address	_____	Federal ID#	_____
	_____	State ID#	_____

Provide a general ledger, trial balance, depreciation schedules, balance sheet and profit and loss statement. In addition, provide the following information:

	<u>DONE</u>	<u>N/A</u>
1. Copies of correspondence with tax authorities regarding changes to prior year returns.	_____	_____
2. Details of changes in stock ownership.	_____	_____
3. For each corporate officer provide SS#, compensation, percentage of ownership and time devoted to business.	_____	_____
4. Schedule of loans to/from shareholders, officers and related parties including interest rates and payment schedules.	_____	_____
5. Detailed analysis of entries in prepaid, accrued, and income tax expense accounts, including dates and amounts of all federal, state and local income tax payments and refunds.	_____	_____
6. Copies of forms 1099, 941, 940, 5500, 1042 and W-2s that have been filed.	_____	_____
7. Schedule of all interest and dividend income.	_____	_____
8. Schedule of assets acquired and/or sold during the year including date acquired, date sold, sales or purchase price, including any trade-in allowance.	_____	_____
9. Copy of the inventory uniform capitalization computation.	_____	_____
10. Schedule of contributions.	_____	_____
11. Detail of any lobbying expenses.	_____	_____
12. List non-deductible expenses, such as penalties and life insurance premiums.	_____	_____
13. Schedule of any club dues paid.	_____	_____
14. Vehicle and mileage data for company-owned passenger vehicles.	_____	_____
15. Details of miscellaneous income/expense accounts.	_____	_____
16. Furnish total of meal and entertainment expenses.	_____	_____
17. List of activities conducted in other states.	_____	_____

SOURCE: Reprinted from AICPA, *1999 Tax Practice Guides and Checklists* (New York, 1999).

**Exhibit 201-1: Corporate Organizer to Be Completed by Client (cont.)**

**CORPORATION TAX ORGANIZER (1120, 1120S)**  
**(EXPANDED VERSION)**

ORGANIZATION NAME \_\_\_\_\_

ADDRESS \_\_\_\_\_

TELEPHONE # \_\_\_\_\_

FAX # \_\_\_\_\_

E-MAIL ADDRESS \_\_\_\_\_

TAX YEAR ENDING \_\_\_\_\_

FEDERAL ID # \_\_\_\_\_

STATE ID # \_\_\_\_\_

This organizer is designed to assist you in gathering the information needed to prepare the Corporation's current year tax returns. Please complete the organizer and answer all questions. Should you have questions regarding any items, please do not hesitate to contact us (me).

**Exhibit 201-1: Corporate Organizer to Be Completed by Client (cont.)**

**CORPORATION TAX ORGANIZER (1120, 1120S)**  
**(EXPANDED VERSION)**

Provide a general ledger, trial balance, depreciation schedules, balance sheet, and profit and loss statement by activity. In addition, the following information is required:

YES   NO   N/A

100) GENERAL INFORMATION

101) If this is the first year we will prepare the tax return, provide the following from your file or your prior accountant:

- Tax returns for the prior three years \_\_\_\_\_
- Depreciation schedules \_\_\_\_\_
- List of all investments \_\_\_\_\_
- All tax carryforward schedules such as NOL, tax credits, contributions, etc. \_\_\_\_\_
- Copy of buy/sell agreement \_\_\_\_\_

S CORPORATION ONLY

- Provide a copy of the S corporation approval. \_\_\_\_\_
- Provide a list of all shareholders and provide the following information: \_\_\_\_\_
  - Name
  - Address
  - ID#
  - Type of entity
  - Number of shares
- If the corporation (1) filed its election to be an S corporation after December 31, 1986; and (2) was a C corporation prior to making the election, provide a copy of the schedule of net built-in gains. \_\_\_\_\_
- Has the corporation elected a fiscal year end? If "yes," provide a schedule of section 444 tax deposits and a copy of Form 8716. \_\_\_\_\_
- Does the corporation engage in more than one trade or business activity? If "yes," list and note those started or acquired after October 22, 1986. \_\_\_\_\_
- Does the corporation engage in any rental activity? If "yes," list and note those started or acquired after October 22, 1986. \_\_\_\_\_

102) Should the address shown on the return be different from last year? If so, what address should be shown on the return? \_\_\_\_\_

103) Has the corporation been notified of any changes to previous returns by any taxing authority? If "yes," provide copies of all correspondence. \_\_\_\_\_

104) Has the corporation received any notices or correspondence from the IRS or any other tax agency? If "yes," provide copies. \_\_\_\_\_

**Exhibit 201-1: Corporate Organizer to Be Completed by Client (cont.)**

**CORPORATION TAX ORGANIZER (1120, 1120S)**  
**(EXPANDED VERSION)**

YES   NO   N/A

- 105) If ownership changed during the year, has there been a change in ownership percentages? Provide a schedule of all changes, including dates and number of shares. \_\_\_\_\_
- 106) Have there been any changes to the shareholders' buy/sell agreement? If "yes," provide a copy. \_\_\_\_\_
- 107) Has the corporation updated its minute book for the year? If "yes," provide copies. \_\_\_\_\_
- 108) Provide the names and telephone numbers of the corporation's advisors:

	Name and Address	Telephone #	Fax #	E-Mail
Attorney				
Banker				
Insurance				
Broker				

- 109) Describe the principal business activity of the corporation:  
\_\_\_\_\_
  - .1) Did the corporation purchase or sell a business or business segment during this year? If "yes," provide a copy of contract or agreement. \_\_\_\_\_
  - .2) Did the corporation engage in any new activities during the year? If "yes," describe new business on an attached sheet. \_\_\_\_\_
  - .3) Did the corporation discontinue operations this year? \_\_\_\_\_
- 110) Does the corporation have any of the following employee benefit plans?
  - .1) Qualified retirement plan(s)? \_\_\_\_\_  
 If "yes," are we to prepare 5500 series form(s)? \_\_\_\_\_  
 Are we to compute the contribution? \_\_\_\_\_
  - .2) SEP or Simple Plan? \_\_\_\_\_  
 If "yes," are we to compute the contribution? \_\_\_\_\_
  - .3) Cafeteria plan? \_\_\_\_\_  
 If "yes," are we to prepare 5500 series form? \_\_\_\_\_

**Exhibit 201-1: Corporate Organizer to Be Completed by Client (cont.)**

**CORPORATION TAX ORGANIZER (1120, 1120S)**  
**(EXPANDED VERSION)**

	<u>YES</u>	<u>NO</u>	<u>N/A</u>
.4) Non-qualified retirement plan(s)? Number of plans ____ (describe) _____ _____	____	____	
If "yes," has the "one time only" filing with the Department of Labor been done?	____	____	
.5) Other benefit plans not described above? If "yes," describe: _____ _____	____	____	
111) Did the corporation include taxable fringe/welfare benefits such as health insurance, group term life insurance, educational assistance, expense allowances and personal use of corporate-owned vehicles as compensation in employee W-2 forms and, if applicable, subject such amounts to payroll taxes?	____	____	____
112) At year end, did the corporation own, directly or indirectly, 50% or more of the voting stock of a domestic corporation? If "yes," provide a copy of that corporation's current tax return.  Ownership percentage: _____	____	____	
113) At year end, did any corporation, individual, partnership, trust or estate own, directly or indirectly, 50% or more of the corporation's voting stock? If "yes":  .1) Name: _____ Address: _____ _____ ID#: _____ Ownership percentage: _____  .2) Was such owner a person other than a U.S. citizen?	____	____	
114) Do the shareholders owning 80% or more of this corporation own 80% or more of any other corporation(s)? If "yes," provide a copy of the other corporate tax returns.	____	____	
115) Is this corporation a shareholder of any foreign corporation? If "yes," identify each corporation.	____	____	
116) Did the corporation at any time during the year have an interest in a foreign bank account? If "yes," provide details.	____	____	
117) Was the corporation the grantor or transferor to a foreign trust during the year? If "yes," provide details.	____	____	

**Exhibit 201-1: Corporate Organizer to Be Completed by Client (cont.)**

**CORPORATION TAX ORGANIZER (1120, 1120S)**  
**(EXPANDED VERSION)**

YES NO N/A

118) During this taxable year, did the corporation pay dividends? If "yes," attach a schedule reflecting date declared, date paid, amount and form of payment (cash, other).

\_\_\_\_

119) Did one foreign person, at any time during the tax year, own directly or indirectly, 25% or more of the total voting power or value of all classes of stock of the corporation? If "yes":

\_\_\_\_

- .1) Enter the percentage owned \_\_\_\_\_
- .2) Enter the owner's country \_\_\_\_\_

120) List income tax deposits below in order of date paid:

	Prior Year Overpayment Applied	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	Extension
FEDERAL						
Date Paid						
Amount	\$					
STATE						
Date Paid						
Amount	\$					

121) Provide a detailed schedule of the activity, for the tax year, in the corporation's general ledger income tax accounts (asset, liability and expense).

122) Circle method of accounting for tax purposes:

Cash Accrual Other (Describe) \_\_\_\_\_

123) Did the corporation establish any new general ledger accounts during the year? If "yes," provide a list with a brief explanation of each new account.

\_\_\_\_

124) Did the corporation post any entries to the retained earnings account during the year? If "yes," provide details of the activity.

\_\_\_\_

125) Provide copies of forms 1099, 941, 940, 1042 and W-2s that have been filed.

\_\_\_\_

126) Did the corporation have loans with shareholder(s) and other related parties during the tax year? If "yes," provide a schedule indicating the amount of the loan, date of transaction, interest rate and payments. Also, provide a copy of the note if not previously provided.

\_\_\_\_

**Exhibit 201-1: Corporate Organizer to Be Completed by Client (cont.)**

**CORPORATION TAX ORGANIZER (1120, 1120S)**  
**(EXPANDED VERSION)**

YES   NO   N/A

127) Did the corporation refinance or restructure any outstanding debt this year? If yes, provide documentation. \_\_\_\_\_

128) Does the corporation do business in more than one state? If "yes," list the states that the corporation did business in during this year: \_\_\_\_\_

.1) Provide copies of supporting schedules reflecting the three factor (property, payroll, sales) multistate apportionment formula. \_\_\_\_\_

.2) Provide a schedule showing any amounts for which there are known timing or treatment differences between federal and state reporting. \_\_\_\_\_

129) How many additional copies of the return do you need? \_\_\_\_\_

200) INCOME

201) Did the corporation receive interest income from the following sources? If "yes," list total amount. \_\_\_\_\_

U.S. Agencies \_\_\_\_\_

U.S. Government \_\_\_\_\_

Tax exempt-in state \_\_\_\_\_

Tax exempt-out of state \_\_\_\_\_

Tax exempt-private activity \_\_\_\_\_

202) Did the corporation sell any stocks, bonds, or securities during the year? If "yes," complete the following: \_\_\_\_\_

Description of Securities Sold	Date Acquired	Cost or Basis Plus Selling Expenses	(Trade Date) Date Sold	Total Sales Price

203) Did the corporation own securities that became worthless during the year? If "yes," provide details. \_\_\_\_\_



**Exhibit 201-1: Corporate Organizer to Be Completed by Client (cont.)**

**CORPORATION TAX ORGANIZER (1120, 1120S)**  
**(EXPANDED VERSION)**

YES   NO   N/A

204) Did the corporation sell or dispose of any assets used in its business? If "yes," provide a schedule listing:

\_\_\_\_

- Description of asset sold
- Date sold
- Sales price
- Selling expenses
- Date acquired
- Original cost or basis
- Depreciation claimed in prior years

205) Provide detail of all items greater than \$ \_\_\_\_ in the miscellaneous income account.

Description	Amount

206) Did the corporation receive dividend income this year? If yes, provide details:

\_\_\_\_

- .1) If dividends are from mutual funds, provide the year-end statements.

207) Did the corporation make any sales qualifying for the installment method of reporting?

\_\_\_\_

If "yes," attach a copy of the agreement, the principal and interest received, and the beginning of the year and end of the year contract balances.

208) Were there any sales or exchanges during the year between the corporation and a shareholder? If "yes," provide a detailed schedule.

\_\_\_\_

209) Did the corporation engage in any bartering activity during the year? If so, provide a schedule of all such activities.

\_\_\_\_

300) DEDUCTIONS

301) Information regarding corporate officers:

**Exhibit 201-1: Corporate Organizer to Be Completed by Client (cont.)**

**CORPORATION TAX ORGANIZER (1120, 1120S)**  
**(EXPANDED VERSION)**

YES NO N/A

Name	Social Security Number	% Time Devoted to Business	% Stock Owned		Compensation
			Common	Preferred	

302) Fiscal year Personal Service Corporation's (PSC): \_\_\_\_\_

.1) Is the corporation a PSC on a fiscal year? If "yes," provide the following information:

Name of Officer/Shareholder	Compensation from Beg. of Fiscal Year to End of Calendar Year	Compensation from Beg. of Subsequent Calendar Year to End of Fiscal Year	Total Compensation

.2) If the PSC has elected a fiscal year end, provide a copy of an approved election (Form 8716) if not previously provided. \_\_\_\_\_

303) Do the Uniform Capitalization Rules under section 263A related to items such as inventory and construction apply? If "yes," provide copies of all schedules supporting the calculation of the amount of general and administrative expenses required to be capitalized in ending inventory or associated with self-constructed assets. \_\_\_\_\_

304) List charitable contributions made or accrued during the year:

NOTE: You need to have written acknowledgment from any charity to which individual donations of \$250 or more were made during the year.

**Exhibit 201-1: Corporate Organizer to Be Completed by Client (cont.)**

**CORPORATION TAX ORGANIZER (1120, 1120S)**  
**(EXPANDED VERSION)**

YES NO N/A

Organization	Amount

- .1) Did the corporation have an accrued charitable contribution at year end? If "yes," provide a copy of minutes authorizing contribution. \_\_\_\_\_
- .2) Did the corporation make a charitable contribution of inventory or property? If "yes," provide details. \_\_\_\_\_
- .3) Did the corporation make political contributions during this tax year? If "yes," enter amount \$ \_\_\_\_\_. (Please note "Corporate political contributions" are illegal.) \_\_\_\_\_
- 305) Did you incur any expenses to influence legislation and "lobbying?" If "yes," provide a schedule of "lobbying expenses" and indicate which accounts these expenses were posted to. \_\_\_\_\_
- 306) Was any computer equipment donated to educational institutions? If yes, provide details. \_\_\_\_\_
- 307) Does the corporation pay life insurance premiums (other than group term life) for officers of the corporation? If "yes," provide the following for each policy: \_\_\_\_\_
  - Face amount
  - Premium paid
  - Insured
  - Cash surrender value at year end
  - Policy owner
  - Loan balance at year end
  - Beneficiary
  - Interest paid on policy loan
  - Type of policy
- To which general ledger accounts have the payments been posted? \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

**Exhibit 201-1: Corporate Organizer to Be Completed by Client (cont.)**

**CORPORATION TAX ORGANIZER (1120, 1120S)**  
**(EXPANDED VERSION)**

YES   NO   N/A

308) Did the corporation pay penalties/fines during the tax year? If "yes," list amount(s) and indicate the reason for the penalty/fine.

\_\_\_ \_\_\_

Description	Amount

309) Did the corporation acquire any assets during the tax year? If "yes," provide a list of assets purchased, including the date placed in service and a copy of the purchase invoice. Include any trade-in information.

\_\_\_ \_\_\_

310) Does the corporation wish to use accelerated depreciation methods?  
Does the corporation wish to use first year section 179 depreciation?

\_\_\_ \_\_\_ \_\_\_  
\_\_\_ \_\_\_ \_\_\_

311) Does the corporation own or lease any vehicles? If "yes," provide the following information for each vehicle (note certain exceptions may apply for companies with more than five vehicles):

\_\_\_ \_\_\_

- Vehicle description
- Other personal miles
- Date placed in service
- Total miles
- Business miles
- Average daily round trip commuting distance
- Commuting miles

.1) Does the corporation have evidence to support the claimed business use?  
If "yes," is the evidence written?

\_\_\_ \_\_\_ \_\_\_  
\_\_\_ \_\_\_ \_\_\_

.2) Were the vehicles available for personal use during off-duty hours?

\_\_\_ \_\_\_ \_\_\_

.3) Were the vehicles used primarily by a more than 5% owner or related person?

\_\_\_ \_\_\_ \_\_\_

.4) Is another vehicle available for personal use?

\_\_\_ \_\_\_ \_\_\_

.5) Provide a copy of the lease for any leased vehicles. If not available, provide the following:

\_\_\_ \_\_\_

- Date of lease
- Fair market value at inception
- Term of the lease
- Lease payments

**Exhibit 201-1: Corporate Organizer to Be Completed by Client (cont.)**

**CORPORATION TAX ORGANIZER (1120, 1120S)**  
**(EXPANDED VERSION)**

YES   NO   N/A

312) Regarding corporate policy for vehicles:

- .1) Does the corporation maintain a written policy statement that prohibits all personal use of vehicles, including commuting, by employees? \_\_\_ \_\_\_ \_\_\_
- .2) Does the corporation maintain a written policy statement that prohibits personal use of vehicles, excluding commuting, by employees? \_\_\_ \_\_\_ \_\_\_
- .3) Does the corporation treat all use of vehicles by employees as personal use? \_\_\_ \_\_\_ \_\_\_
- .4) Does the corporation provide more than five vehicles to employees and retain the information received from employees concerning the use of the vehicles? \_\_\_ \_\_\_ \_\_\_
- .5) Does the corporation require or maintain copies of vehicle logs? \_\_\_ \_\_\_ \_\_\_

313) Are computers or cellular phones or other listed property used by employees for personal purposes? If "yes," complete the following: \_\_\_ \_\_\_

Description	Date Placed in Service	Business Use %	Cost or Basis

- .1) Does the corporation have evidence to support the business use claimed? \_\_\_ \_\_\_ \_\_\_
- .2) If "yes," is evidence written? \_\_\_ \_\_\_ \_\_\_

314) Did the corporation have any meal and/or entertainment expenses? If "yes," to which account(s) were these items posted? \_\_\_ \_\_\_

315) Did the corporation pay any club dues? If "yes," to which account were these items posted? \_\_\_ \_\_\_

316) List all items in the miscellaneous expense account greater than \$ \_\_\_\_\_.

Description	Amount

**Exhibit 201-1: Corporate Organizer to Be Completed by Client (cont.)****CORPORATION TAX ORGANIZER (1120, 1120S)**  
**(EXPANDED VERSION)**

	<u>YES</u>	<u>NO</u>	<u>N/A</u>
317) Will all compensation- related accruals (including vacation pay) be paid within 2½ months of year end? If "no," provide details of unpaid amounts.	_____	_____	_____
318) Are there any accruals to shareholder(s) at year end? If "yes," provide detail.	_____	_____	_____
319) Provide copies of certification for members of target groups and associated wages paid qualifying for Work Opportunities Credit.	_____	_____	_____
<b>400) S CORPORATIONS ONLY</b>			
401) Have fringe benefits paid on behalf of more than 2% shareholders (including but not limited to medical, life insurance, disability, housing, etc.) been included in shareholder's compensation, and included in payroll taxes? Indicate to which accounts these amounts have been posted.	_____	_____	_____

**Exhibit 201-2: S Corporation Organizer to Be Completed by Client**

**S CORPORATION TAX ORGANIZER (1120S)**  
**(SHORT VERSION)**

Corporation Name _____	Tax Period _____	
Address _____	Federal ID# _____	
	State ID# _____	

Provide a general ledger, trial balance, depreciation schedules, balance sheet, and profit and loss statement by activity. In addition, provide the following information:

	<u>DONE</u>	<u>N/A</u>
1. Copies of correspondence with tax authorities regarding changes to prior year returns.	_____	_____
2. Details of changes in stock ownership.	_____	_____
3. For each shareholder provide ID#, compensation, percentage of ownership, time devoted to business, date ownership acquired and detail of distributions received.	_____	_____
4. Schedule of all fringe benefits paid on behalf of more than 2% shareholders and indicate which benefits have been included in their W-2.	_____	_____
5. Schedule of loans to/from shareholders, officers and related parties, including interest rates and payment schedules.	_____	_____
6. Schedule of built-in gains.	_____	_____
7. Detailed analysis of entries in prepaid, accrued, and income tax expense accounts, including dates and amounts of all federal, state and local income tax payments and refunds.	_____	_____
8. Copies of forms 1099, 941, 940, 5500, 1042 and W-2s that have been filed.	_____	_____
9. Schedule of all interest and dividend income.	_____	_____
10. Schedule of assets acquired and/or sold during the year, including date acquired, date sold, sales or purchase price, including any trade-in allowance.	_____	_____
11. Copy of the inventory uniform capitalization computation.	_____	_____
12. Schedule of contributions.	_____	_____
13. Detail of any lobbying expenses.	_____	_____
14. Schedule of any club dues paid.	_____	_____
15. List non-deductible expenses such as penalties and life insurance premiums.	_____	_____
16. Vehicle and mileage data for company -owned passenger vehicles.	_____	_____
17. Details of miscellaneous income/expense accounts.	_____	_____
18. Furnish total of meal and entertainment expenses.	_____	_____
19. List each type of trade or business activity or rental activity and indicate the date started or acquired.	_____	_____
20. List of activities conducted in other states.	_____	_____

**Exhibit 201-3: Partnership Organizer to Be Completed by Client**

**PARTNERSHIP TAX ORGANIZER (1065)**  
**(SHORT VERSION)**

Organization Name	_____	Tax Period	_____
Address	_____	Federal ID#	_____
	_____	State ID#	_____

Provide a general ledger, trial balance, depreciation schedules, balance sheet and profit and loss statement. In addition, provide the following information:

	<u>DONE</u>	<u>N/A</u>
1. Copies of correspondence with tax authorities regarding changes to prior year returns.	_____	_____
2. Details of partner ownership changes.	_____	_____
3. For each partner, provide ID#, address, percentage of ownership, profit/loss %, and general or limited classification. Identify the Tax Matters Partner.	_____	_____
4. Schedule of all payments or distributions to or for partners including descriptions, amounts and the accounts to which these amounts have been posted.	_____	_____
5. Schedule of loans to/from partners and related parties including interest rates and payment schedules.	_____	_____
6. Schedule of all fringe benefits paid on behalf of partners and indicate which benefits have been included in their guaranteed payments.	_____	_____
7. Detailed analysis of entries in prepaid and accrued expense accounts.	_____	_____
8. Forms 1099, 941, 940, 5500, 1042 and W-2s that have been filed.	_____	_____
9. Schedule of all interest and dividend income.	_____	_____
10. Schedule assets acquired and/or sold during the year including date acquired, date sold, sales or purchase price, including any trade-in allowance.	_____	_____
11. Copy of the inventory uniform capitalization computation.	_____	_____
12. Schedule of contributions.	_____	_____
13. Details of any lobbying expenses.	_____	_____
14. Schedule of non-deductible expenses such as penalties and life insurance premiums.	_____	_____
15. Schedule of any club dues paid.	_____	_____
16. Vehicle and mileage data for partnership-owned passenger vehicles.	_____	_____
17. Details of miscellaneous expenses.	_____	_____

SOURCE: Reprinted from AICPA, *1999 Tax Practice Guides and Checklists* (New York, 1999).



**Exhibit 201-3: Partnership Organizer to Be Completed by Client (cont.)**

**PARTNERSHIP TAX ORGANIZER (1065)**  
**(SHORT VERSION)**

	<u>DONE</u>	<u>N/A</u>
18. Details of total of meal and entertainment expenses.	_____	_____
19. List each type of trade or business activity or rental activity and indicate the date started or acquired.	_____	_____
20. List of states activities are conducted in.	_____	_____

**Exhibit 201-3: Partnership Organizer to Be Completed by Client (cont.)**

**PARTNERSHIP TAX ORGANIZER**  
**FORM 1065**  
**(EXPANDED VERSION)**

ORGANIZATION NAME \_\_\_\_\_

ADDRESS \_\_\_\_\_

TELEPHONE # \_\_\_\_\_

FAX # \_\_\_\_\_

E-MAIL ADDRESS \_\_\_\_\_

TAX YEAR ENDING \_\_\_\_\_

FEDERAL ID # \_\_\_\_\_

STATE ID # \_\_\_\_\_

This organizer is designed to assist you in gathering the information needed to prepare the Partnership's current year tax returns. Complete the organizer and answer all questions. Should you have questions regarding any items, please do not hesitate to contact us (me).

**Exhibit 201-3: Partnership Organizer to Be Completed by Client (cont.)**

**PARTNERSHIP TAX ORGANIZER (1065)**  
**(EXPANDED VERSION)**

Provide a general ledger, trial balance, depreciation schedules, balance sheet, and profit and loss statement by activity. In addition, the following information will be needed:

YES   NO   N/A

100) GENERAL INFORMATION

101) If this is the first year we will prepare the tax return(s), provide the following from your file or your prior accountant: \_\_\_\_\_

- Partnership agreement
- Tax returns for the prior three years
- Depreciation schedules
- Partner basis carryforward schedule
- Partner buy/sell agreement
- If the partnership elected a fiscal year end, provide a schedule of section 444 tax deposits and Form 8716.
- Section 704(b) capital account reconciliation

102) Has the partnership been notified of any changes to previous returns by any taxing authority? If "yes," provide copies of all correspondence. \_\_\_\_\_

103) Have there been any amendments to the partnership agreement? If "yes," provide copies of amendments since the last year. \_\_\_\_\_

104) Provide the following information for all partners:

- Name
- Address
- Social Security/Taxpayer Identification Number
- General partner or limited partner
- Type of entity
- Domestic or foreign
- Profit sharing percentage
- Loss sharing percentage
- Percentage ownership
- Changes in partner's ownership interest after 10/22/86 (if not previously provided)
- Capital account reconciliation

105) Which general partner should be designated as the Tax Matters Partner, if applicable? \_\_\_\_\_

106) Has there been a change in ownership since last year? If "yes," provide the following: \_\_\_\_\_

A) Date of Transfer \_\_\_\_ / \_\_\_\_ / \_\_\_\_

- B) Type of Transfer
- a) sale
  - b) gift
  - c) inheritance

**Exhibit 201-3: Partnership Organizer to Be Completed by Client (cont.)**

**PARTNERSHIP TAX ORGANIZER (1065)**  
**(EXPANDED VERSION)**

YES   NO   N/A

C) Sale price or fair market value of partnership interest transferred. (Include FMV from estate return if transfer is due to death)

D) Copy of Form 8308, if applicable.

107) Did any of the partners' taxable years change during the year? If "yes," attach a schedule detailing the change. \_\_\_\_\_

108) List the names and telephone numbers of the partnership's advisors:

	Name & Address	Telephone #	Fax #	E-Mail Address
Attorney				
Banker				
Insurance				
Broker				

109) Does the partnership have any of the following employee benefit plans?

.1) Qualified retirement plan(s)? \_\_\_\_\_  
 If "yes," are we to prepare 5500 series form(s)? \_\_\_\_\_  
 Number of plans \_\_\_\_\_  
 Are we to compute the contribution? \_\_\_\_\_

.2) SEP or Simple plan? \_\_\_\_\_  
 If "yes," are we to compute the contribution? \_\_\_\_\_

.3) Cafeteria plan? \_\_\_\_\_  
 If "yes," are we to prepare 5500 series form? \_\_\_\_\_

.4) Non-qualified retirement plan(s)? \_\_\_\_\_  
 Number of plans \_\_\_\_\_ (describe)  
 \_\_\_\_\_  
 \_\_\_\_\_

If "yes," has the "one time only" filing with the Department of Labor been done? \_\_\_\_\_

.5) Other benefit plans not described above?  
 If "yes," describe:  
 \_\_\_\_\_

**Exhibit 201-3: Partnership Organizer to Be Completed by Client (cont.)**

**PARTNERSHIP TAX ORGANIZER (1065)**  
**(EXPANDED VERSION)**

	<u>YES</u>	<u>NO</u>	<u>N/A</u>
110) Describe the principal business activity of the partnership:  _____			
.1) Did the partnership acquire or dispose of a business or business segment during this tax year? If "yes," attach a copy of the contract or agreement.	_____	_____	
.2) Did the partnership engage in any new activities during this tax year? If "yes," attach a description of the new business.	_____	_____	
.3) Did the partnership discontinue operations for this year?	_____	_____	
111) Does the partnership provide fringe/welfare benefits to employees or partners? If "yes," provide a list of benefits provided.	_____	_____	
112) Did the partnership include taxable fringe/welfare benefits such as health insurance, group life insurance, educational assistance, expense allowances and personal use of company vehicles as compensation in employee's W-2 forms and, if applicable, subject such amounts to payroll taxes?	_____	_____	
113) Provide a schedule, by partner, of fringe benefits paid on behalf of each partner such as medical, life insurance, disability and housing. Indicate which accounts have been charged.	_____	_____	
114) Provide copies of Forms 1099, 941, 940 and W-2 that have been filed.	_____	_____	
115) Did the partnership have loans with partners and/or other related parties during the tax year?  If "yes," attach a schedule indicating the amount of the loan, date of transaction, interest rate and payments. Also, attach a copy of the note if not previously provided.	_____	_____	
116) Should the address shown on the return be different from last year? If so, what address should be shown on the return?  _____ _____ _____	_____	_____	
117) Is the partnership a partner in another partnership? If "yes," provide a copy of other partnership tax return(s).	_____	_____	
118) Circle method of accounting for tax purposes:  Cash    Accrual    Other (Describe) _____			
119) Did the partnership establish any new general ledger accounts during the tax year? If "yes," attach a list with a brief explanation of each account.	_____	_____	

**Exhibit 201-3: Partnership Organizer to Be Completed by Client (cont.)**

**PARTNERSHIP TAX ORGANIZER (1065)**  
**(EXPANDED VERSION)**

	<u>YES</u>	<u>NO</u>	<u>N/A</u>
120) Did the partnership post any entries to the partnership capital accounts during the year? If "yes," provide detail of the activity.	___	___	
121) Was there a distribution of property or a transfer (for example, by sale or death) of a partnership interest during this tax year?	___	___	
If marketable securities were distributed, provide the date of distribution and fair market value at distribution date(s). _____			
122) Has the partnership ever elected to "step up" the basis of any assets in connection with the death of a partner or a change in ownership? (754 election)	___	___	
123) Did the partnership, at any time during the tax year, have an interest in a foreign bank account?	___	___	
124) Was the partnership the grantor of, or transferor to, a foreign trust during the tax year?	___	___	
125) Does the partnership do business in more than one state? If "yes," list the states.	___	___	
.1) Provide copies of supporting schedules reflecting the three factor (property, payroll, sales) multistate apportionment formula.			
.2) Provide a schedule showing any amounts for which there are known timing or treatment differences between federal and applicable state reporting.			
126) How many additional copies of the return do you need? _____			
127) Is this a final return?	___	___	
200) INCOME			
201) Does the partnership engage in more than one trade or business activity? If "yes," provide a list and note those started or acquired after 10/22/86.	___	___	
202) Does the partnership engage in any rental real estate activity? If "yes," provide a list and note those started or acquired after 10/22/86.	___	___	
203) Did the partnership receive interest income from the following sources? If "yes," indicate the amount.	___	___	
U.S. agencies _____			
U.S. government _____			
Tax exempt-out of state _____			
Tax exempt-in state _____			
Tax exempt-private activity _____			
204) Did the partnership sell any stocks, bonds or securities during the year? If "yes," complete the following:	___	___	

**Exhibit 201-3: Partnership Organizer to Be Completed by Client (cont.)**

**PARTNERSHIP TAX ORGANIZER (1065)**  
**(EXPANDED VERSION)**

YES NO N/A

Description of Securities Sold	Dates Acquired	Cost or Basis Plus Selling Expenses	(Trade Date) Date Sold	Total Sales Price

205) Did the partnership own any securities that became worthless during the year? If "yes," provide details. \_\_\_ \_\_\_

206) Did the partnership acquire any "Qualified Small Business Stock"? \_\_\_ \_\_\_

207) Did the partnership own any mutual funds? If "yes," provide year end statement(s). \_\_\_ \_\_\_

208) During the tax year, did the partnership sell or dispose of any assets used in the business? If "yes," provide a schedule listing: \_\_\_ \_\_\_

- Description of asset sold
- Date sold
- Sales price
- Selling expenses
- Date acquired
- Original cost or basis
- Depreciation claimed in prior years

209) Provide detail of all items greater than \$ \_\_\_\_\_ in the miscellaneous income account. \_\_\_

Description	Amount

210) Did the partnership have any sales during the year that qualify for the installment method of reporting? If "yes," provide a copy of the agreement, the principal and interest received, and the beginning of year and end of year contract balances. \_\_\_ \_\_\_

211) Were there any sales or exchanges during the year between the partnership and a partner? If "yes," provide a detailed listing. \_\_\_ \_\_\_

**Exhibit 201-3: Partnership Organizer to Be Completed by Client (cont.)**

**PARTNERSHIP TAX ORGANIZER (1065)**  
**(EXPANDED VERSION)**

YES   NO   N/A

212) Did the partnership engage in any bartering activity during the year? If so, provide a schedule of all such activities.

\_\_\_\_\_

300) DEDUCTIONS

301) Were there any payments to partners during the year for services or for the use of capital determined without regard to income? If "yes," provide the details below:

\_\_\_\_\_

Partner	Description	Amount

302) Do the Uniform Capitalization Rules under section 263A related to items such as inventory and construction apply? If "yes," provide copies of all schedules reflecting the calculation of the amount of general and administrative expenses required to be capitalized in ending inventory or associated with self-constructed assets.

\_\_\_\_\_

303) List all charitable contributions made or accrued during the tax year:

NOTE: You need to have written acknowledgment from any charity to which individual donations of \$250 or more were made during the year.

Organization	Amount

304) Did the partnership make political contributions during the tax year?

\_\_\_\_\_

.1) If "yes," enter the amount. \$ \_\_\_\_\_

.2) If "yes," enter to which accounts were the contributions posted.

\_\_\_\_\_

305) Did you incur any expenses to influence legislation (lobbying)? If "yes," provide a schedule of "lobbying expenses" and indicate to which accounts these expenses were posted.

\_\_\_\_\_

306) Did the partnership pay life insurance premiums (other than group term life) for any partner(s)? If "yes," provide the following for each policy:

\_\_\_\_\_



**Exhibit 201-3: Partnership Organizer to Be Completed by Client (cont.)**

**PARTNERSHIP TAX ORGANIZER (1065)**  
**(EXPANDED VERSION)**

YES NO N/A

- Face amount
- Insured
- Policy owner
- Beneficiary
- Type of policy
- Premium paid
- Cash surrender value at year end
- Loan balance at year end
- Interest paid on policy loan

To which general ledger accounts have the payments been posted?

\_\_\_\_\_

\_\_\_\_\_

307) Did the partnership pay any penalties/fines during the tax year? If "yes," list amount(s) and indicate the reason for the penalty/fine.

\_\_\_\_\_

Description	Amount

308) Did the partnership acquire any assets during the tax year? If "yes," provide a schedule of assets purchased, including the date placed in service, and a copy of the purchase invoice. Include any trade-in information.

\_\_\_\_\_

309) Did any partners contribute any assets to the partnership during the year? If "yes," provide a schedule of such assets received including date placed in service and partner's basis in such assets and fair market value of such asset.

\_\_\_\_\_

310) Does the partnership wish to use accelerated depreciation methods?  
Does the partnership wish to use first year 179 depreciation?

\_\_\_\_\_

\_\_\_\_\_

311) Does the partnership own or lease any vehicles? If "yes," provide the following information for each vehicle (NOTE: certain exceptions may apply for taxpayers with more than five vehicles):

\_\_\_\_\_

- Vehicle description
- Date placed in service
- Business miles
- Commuting miles
- Other personal miles
- Total miles
- Average daily round trip commuting distance

**Exhibit 201-3: Partnership Organizer to Be Completed by Client (cont.)**

**PARTNERSHIP TAX ORGANIZER (1065)**  
**(EXPANDED VERSION)**

- |  | <u>YES</u> | <u>NO</u> | <u>N/A</u> |
|--|------------|-----------|------------|
| .1) Does the partnership have evidence to support the claimed business use? If "yes," is the evidence written?   | ___        | ___       |            |
| .2) Were the vehicles available for personal use during off-duty hours?  | ___        | ___       | ___        |
| .3) Were the vehicles used primarily by a more than 5% owner or related person?  | ___        | ___       | ___        |
| .4) Is another vehicle available for personal use?   | ___        | ___       | ___        |
| .5) Provide a copy of the lease for any leased vehicles. If not available, provide the following: <ul style="list-style-type: none"> <li>• Date of lease</li> <li>• Fair market value at inception</li> <li>• Term of lease</li> <li>• Lease payments</li> </ul> | ___        |           | ___        |
| 312) Regarding partnership policy for vehicles:  |            |           |            |
| .1) Does the partnership maintain a written policy statement that prohibits all personal use of vehicles, <u>including</u> commuting, by employees?  | ___        | ___       | ___        |
| .2) Does the partnership maintain a written policy statement that prohibits personal use of vehicles, <u>excluding</u> commuting, by employees?  | ___        | ___       | ___        |
| .3) Does the partnership treat all use of vehicles by employees as personal use?   | ___        | ___       | ___        |
| .4) Does the partnership provide more than five vehicles to employees and retain the information received from employees concerning the use of vehicles?   | ___        | ___       | ___        |
| .5) Does the partnership require or maintain copies of vehicle logs?   | ___        | ___       | ___        |
| 313) Are computers, cellular phones or other property used for personal purposes? If "yes," complete the following:  |            |           |            |

Description	Date Placed in Service	Business Use %	Cost or Basis

- |   |     |     |     |
|---|-----|-----|-----|
| .1) Does the partnership have evidence to support the business use claimed? | ___ | ___ | ___ |
| .2) If "yes," is the evidence written?                                      | ___ | ___ | ___ |

**Exhibit 201-3: Partnership Organizer to Be Completed by Client (cont.)**

**PARTNERSHIP TAX ORGANIZER (1065)**  
**(EXPANDED VERSION)**

YES   NO   N/A

314) Did the partnership have any meal or entertainment expenses? If "yes," which account(s) were these items posted to?

\_\_\_ \_\_\_

315) Did the partnership pay any social or entertainment club dues? If "yes," provide the amounts \$ \_\_\_\_\_ and to which account these items were posted.

\_\_\_ \_\_\_

316) Schedule below all items in the miscellaneous expense account greater than \$ \_\_\_\_\_.

\_\_\_ \_\_\_

Description	Amount

317) Will all compensation-related accruals (including vacation pay) be paid within 2½ months of year end? If "no," provide details of unpaid amounts.

\_\_\_ \_\_\_ \_\_\_

318) Provide copies of certification for members of target groups and associated wages paid after September 30, 1996 qualifying for Work Opportunities Credit.

\_\_\_ \_\_\_ \_\_\_

319) Provide the following information for all items of interest expense:

Payee	Purpose of Loan	Recourse/ Non-Recourse	Year End Principal Balance	Interest Expense

320) Were there any accruals of interest, compensation or other expenses to partners at year end? If "yes," provide detail.

\_\_\_ \_\_\_

**Exhibit 201-4: Tax-Exempt Organization Organizer to Be Completed by Client**

**ORGANIZER FOR TAX EXEMPT ORGANIZATIONS (990) —(SHORT VERSION)**

Organization Name \_\_\_\_\_ Tax Period \_\_\_\_\_  
 Address \_\_\_\_\_ Federal ID # \_\_\_\_\_  
 \_\_\_\_\_ State ID # \_\_\_\_\_  
 Registration # \_\_\_\_\_ Exempt Under §501(c) \_\_\_\_\_

Provide a general ledger, trial balance, depreciation schedules, balance sheet, and statement of receipts and expenses as of year end. For §501(c)(3) and (c)(4) organizations and §4947(a)(1) trusts, categorize expenses as to program services, management/general, and fund raising. In addition, the following information will be needed:

	<u>DONE</u>	<u>N/A</u>
1. Provide information about any activities new to the organization, which require IRS notification.	_____	_____
2. Provide copies of any changes to the governing documents or information related to a change in organization structure.	_____	_____
3. Provide a list of names and percentage owned of any related organizations and indicate whether they are exempt.	_____	_____
4. List the states with which a copy of this return is to be filed.	_____	_____
5. Provide a list of employee benefit plans for which the organization requires assistance in filing Form 5500.	_____	_____
6. Provide copies of any change notices received from any taxing authority.	_____	_____
7. Provide a schedule of "in-kind" contributions and indicate whether they are included in income.	_____	_____
8. Indicate if you have provided written acknowledgement to donors of individual contributions of \$250 or more.	_____	_____
9. Indicate if you have provided information on the amount of the deductible donation to donors of <i>quid pro quo</i> donations in excess of \$75.	_____	_____
10. Disclose taxes paid during the year for the following:		
a) excess expenditures to influence legislation	_____	_____
b) disqualifying lobbying expenditures	_____	_____
c) political expenditures	_____	_____
d) excess benefit transactions	_____	_____
11. For each area of program service revenue, provide an explanation of how the activity contributes to the organization's exempt purpose.	_____	_____

SOURCE: Reprinted from AICPA, *1999 Tax Practice Guides and Checklists* (New York, 1999).

**Exhibit 201-4: Tax-Exempt Organization Organizer to Be Completed by Client (cont.)**

**ORGANIZER FOR TAX EXEMPT ORGANIZATIONS (990)—(SHORT VERSION)**

	<u>DONE</u>	<u>N/A</u>
12. Attach information related to the income and expenses from unrelated business income.	_____	_____
13. Provide a list of investments at year end including cost and market value of each item.	_____	_____
14. Provide copies of all K-1s received.	_____	_____
15. Provide copies of all royalty agreements.	_____	_____
16. Provide a schedule of donors who gave property with a value of at least \$5,000.	_____	_____
17. Provide a schedule of the three largest fund raising events, describe the event and indicate the amount raised. (Attach a copy of fundraising materials.)	_____	_____
18. Prepare a statement describing the services provided under the four largest program services offered by the organization.	_____	_____
19. How many employees were on the payroll as of March 12th? _____	_____	_____
20. Provide a schedule of wages/compensation, deferred compensation and expense account payments for all officers, directors, trustees, key employees and advisors. Include a schedule of time devoted to fundraising, management, exempt purpose and average hours worked per week.	_____	_____
21. Provide a list of names and addresses of employees (other than officers) who received compensation in excess of \$50,000.	_____	_____
22. Provide a list of officers, directors or key employees who received \$10,000 or more in compensation from a related entity.	_____	_____
23. Provide a list of names and addresses of individuals/entities providing professional services to the organization at fees in excess of \$50,000.	_____	_____
24. Provide information including amounts expended regarding legislative, lobbying or political activities during the year.	_____	_____
25. Provide details regarding all transactions with a trustee, director, principal officer, or creator of the organization.	_____	_____
26. Provide the amount of initiation fees and capital contributions for §501(c)(7) organizations.	_____	_____
27. Attach a detailed computation of the 85% qualification test for §501(c)(12) organizations.	_____	_____
28. For public interest law firms—attach a list of cases litigated during the year and describe the benefit to the general public.	_____	_____
29. How many additional copies of the return are needed? _____	_____	_____

**Exhibit 201-4: Tax-Exempt Organization Organizer to Be Completed by Client (cont.)**

**ORGANIZER FOR TAX EXEMPT ORGANIZATIONS (990)—(SHORT VERSION)**

	<u>DONE</u>	<u>N/A</u>
30. Indicate if you have three years returns and the exemption application available for public inspection.	_____	_____
31. Additional information:	_____	_____
_____		
_____		
_____		
_____		

**Exhibit 201-4: Tax-Exempt Organization Organizer to Be Completed by Client (cont.)**

**ORGANIZER FOR TAX EXEMPT ORGANIZATIONS (990)**  
**(EXPANDED VERSION)**

ORGANIZATION NAME \_\_\_\_\_

ADDRESS \_\_\_\_\_  
\_\_\_\_\_

TAX YEAR ENDING \_\_\_\_\_

FEDERAL ID # \_\_\_\_\_

STATE ID # \_\_\_\_\_

REGISTRATION # \_\_\_\_\_

EXEMPT UNDER §501(c) \_\_\_\_\_

This organizer is designed to assist you in gathering the information needed to prepare the organization's current year tax returns. Complete the organizer and answer all questions. Should you have questions regarding any items, please call.

**Exhibit 201-4: Tax-Exempt Organization Organizer to Be Completed by Client (cont.)**

**ORGANIZER FOR TAX EXEMPT ORGANIZATIONS (990)**  
**(EXPANDED VERSION)**

Provide a copy of the organization's general ledger, trial balance, depreciation schedules, balance sheet, and statement of revenues and expenses as of year-end. For §501(c)(3) and (c)(4) organizations and §4947(a)(1) trusts, categorize expenses as to program services, management/general and fund raising. In addition, the following information will be needed:

YES   NO   N/A

100) GENERAL INFORMATION

101) If this is the first year we will prepare the tax return(s), provide the following from your file or your prior accountant: \_\_\_\_\_

- Tax returns for the prior three years \_\_\_\_\_
- Depreciation schedules \_\_\_\_\_
- IRS notification of exempt status \_\_\_\_\_
- Application for Exemption, Form 1023 or 1024 \_\_\_\_\_
- IRS determination letter for any qualified retirement plans \_\_\_\_\_

102) Is the organization's address different from last year? \_\_\_\_\_

103) List the names and telephone numbers of the organization's advisors.

	Name	Telephone
Attorney		
Banker		
Insurance Agent		
Broker		

104) List the states with which a copy of this return will be filed. \_\_\_\_\_

105) Did the organization engage in any activity not previously reported to the IRS? If "yes," provide a detailed description of each activity. \_\_\_\_\_

106) Were any changes made in the organizing or governing documents? If "yes," attach a copy of the changes and indicate if they have been reported to the IRS. \_\_\_\_\_

107) Did the organization undergo a liquidation, dissolution, termination, or substantial contraction during the year? If "yes," provide details. \_\_\_\_\_

108) Is the organization related (other than by association with a statewide or nationwide organization) through common membership, governing bodies, trustees, officers, etc., to any other organization? If "yes," enter the name of the organization and indicate if it is exempt or non-exempt. \_\_\_\_\_



**Exhibit 201-4: Tax-Exempt Organization Organizer to Be Completed by Client (cont.)**

**ORGANIZER FOR TAX EXEMPT ORGANIZATIONS (990)**  
**(EXPANDED VERSION)**

	<u>YES</u>	<u>NO</u>	<u>N/A</u>
109) Does the organization provide fringe benefits to employees such as health insurance, group term life insurance, education assistance, expense allowances, or personal use of organization owned real or tangible personal property? If "yes," list the benefits provided. _____	_____	_____	
110) Did the organization include taxable fringe benefits as compensation in employee W-2 forms and, if applicable, subject such amounts to payroll taxes?	_____	_____	_____
111) Does the organization sponsor any of the following employee benefit plans?	_____	_____	
.1) Qualified retirement plan(s)? If "yes," are we to prepare Form 5500? Number of plans: _____	_____	_____	
.2) SEP plan? If "yes," are we to calculate contribution?	_____	_____	
.3) Cafeteria plan? If "yes," are we to prepare Form 5500?	_____	_____	
.4) Non-qualified retirement plan(s)? Number of plans: _____	_____	_____	
.5) Other employee benefit plans not described above? If "yes," please describe: _____	_____	_____	
112) Has the organization been notified of any changes to previous returns by any taxing authority? If "yes," provide copies of all correspondence.	_____	_____	
113) Has the organization posted the results of tax changes in its general ledger?	_____	_____	_____
114) Did the organization establish any new general ledger accounts during the tax year? If "yes," provide a list with a brief explanation of each account.	_____	_____	
115) Did the organization receive donated services or the use of materials, equipment, or facilities at no charge or at substantially less than fair rental value? If "yes," provide a detailed list indicating the value of each item and whether it is included in revenue and expense.	_____	_____	
116) Did the organization solicit any contributions or gifts that were not tax deductible? If "yes," did the organization include with every solicitation an express statement that such contributions or gifts were not tax deductible?	_____	_____	
117) For each of the four largest programs services offered by the organization, prepare a statement that fully describes the services provided, the number of persons benefited and other achievements of the program. For §501(c)(3) and (4) organizations, identify the amount of any grants paid to others as part of the program.	_____	_____	

**Exhibit 201-4: Tax-Exempt Organization Organizer to Be Completed by Client (cont.)**

**ORGANIZER FOR TAX EXEMPT ORGANIZATIONS (990)**  
**(EXPANDED VERSION)**

YES NO N/A

118) Complete the following schedule for all officers, directors, trustees and key employees of the organization as of the last day of the tax year.

Name, Address & Title	Average Hours Worked Per Week & % of time devoted to A) Fundraising B) Management C) Exempt Purposes	Compensation	Contribution to Employee Benefit Plans	Expense Account and Other Allowances

119) Did any officer, director, trustee or key employee receive \$10,000 or more in compensation from a related entity?

\_\_\_ \_\_\_

120) Did you incur any expenses to influence legislation, lobbying or other political activities during the year?

\_\_\_ \_\_\_

.1) If yes, provide a schedule of expenses and indicate to which accounts those expenses were posted.

\_\_\_ \_\_\_ \_\_\_

.2) Disclose taxes paid during the year for the following:

- a) excess expenditures to influence legislation
- b) Disqualifying lobby expenditures
- c) political expenditures
- d) excess benefit transactions

\_\_\_ \_\_\_ \_\_\_  
\_\_\_ \_\_\_ \_\_\_  
\_\_\_ \_\_\_ \_\_\_  
\_\_\_ \_\_\_ \_\_\_

.3) Has the organization elected to pay the proxy tax?

\_\_\_ \_\_\_

121) For §501(c)(3) organizations, did the organization file Form 5678, Election/Revocation of Election by an Eligible §501(c)(3) Organization to Influence Legislation?

\_\_\_ \_\_\_ \_\_\_

**Exhibit 201-4: Tax-Exempt Organization Organizer to Be Completed by Client (cont.)**

**ORGANIZER FOR TAX EXEMPT ORGANIZATIONS (990)**  
**(EXPANDED VERSION)**

YES   NO   N/A

122) For §501(c)(7) organizations (clubs):

- .1) Did the organization receive initiation fees or capital contributions? If "yes," indicate the amount. \$ \_\_\_\_\_
- .2) Did the organization receive gross receipts for public use of club facilities? If "yes," indicate the amount. \$ \_\_\_\_\_
- .3) Does the club's governing instrument or any written policy statement provide for discrimination against any person because of race, color, or religion? \_\_\_\_\_

123) For §501(c)(12) organizations, attach a detailed computation of the 85% qualification test, including a detailed listing of gross income received from: (1) members or shareholders and (2) other sources. \_\_\_\_\_

124) For Public interest law firms, attach information describing each case litigated during the year or still in litigation and describe how the litigation will benefit the general public. \_\_\_\_\_

125) Does the organization have a taxable first or second-tier subsidiary? If "yes," complete the following: \_\_\_\_\_

Name, Address, and TIN of Corporation or Partnership	Percentage of Ownership Interest	Nature of Business Activities	Total Income	End-of-year Assets
1)				
2)				
3)				
4)				
5)				

126) Did the organization have unrelated business taxable income (UBTI) as a result of the operation of a trade or business not related to the organization's exempt function? \_\_\_\_\_

Note: UBTI is one of the most critical issues within tax exempt organization reporting. Provide complete information related to your revenue sources to allow proper determination of the income classification.

127) Provide copies of all Schedules K-1 received. \_\_\_\_\_

128) Provide copies of all royalty agreements. \_\_\_\_\_

129) Provide a detailed list of the expenses directly related to the UBTI activity. \_\_\_\_\_

**Exhibit 201-4: Tax-Exempt Organization Organizer to Be Completed by Client (cont.)**

**ORGANIZER FOR TAX EXEMPT ORGANIZATIONS (990)**  
**(EXPANDED VERSION)**

- |   | <u>YES</u> | <u>NO</u> | <u>N/A</u> |
|---|------------|-----------|------------|
| 130) Provide a detailed list and explanation of the allocation method of general expenses allocated to UBTI.  | ___        | ___       | ___        |
| 131) Have cash receipts for UBTI activities over \$10,000 been reported on Form 8300?   | ___        | ___       | ___        |
| 132) How many additional copies of the return are needed? _____   |            |           |            |
| 133) Provide a list, including amounts paid by year of contribution, of persons who contributed \$5,000 or more to the organization. Label each page of the list as "Not Open For Public Inspection."           |            |           | ___        |
| 134) Did the organization comply with the public inspection rules?  | ___        | ___       | ___        |
| 135) Did the organization provide a copy of its exemption application and/or Form 990 to anyone who requested it?   | ___        | ___       | ___        |
| 136) Provide a list of independent contractors, other than professionals such as attorneys and accountants. Indicate amounts paid, nature of work performed and normal working hours.                           | ___        | ___       | ___        |
| 137) Did the organization file all necessary Forms 1099, 1098?  | ___        | ___       | ___        |
| <b>200) §§501(c)(3), 501(e), (f) &amp; (k) ORGANIZATIONS AND §4947(a)(1) TRUSTS</b>   |            |           |            |
| 201) Did the organization pay compensation in excess of \$50,000 to any employee other than officers, directors and/or trustees? If "yes," complete the following schedule for the five highest paid employees. | ___        | ___       | ___        |

Name and Address of Employees Paid More Than \$50,000	Title and Average Hours Per Week Devoted to Position	Compensation	Contributions to Employee Benefit Plans	Expense Account and Other Allowances
1)				
2)				
3)				
4)				
5)				
Total number of other employees paid over \$50,000 _____				

- 202) Did the organization's board approve all compensation, including fringe benefits, travel and loans to all officers, directors and trustees? If so, provide a copy of the minutes where this action was taken.
- \_\_\_

**Exhibit 201-4: Tax-Exempt Organization Organizer to Be Completed by Client (cont.)**

**ORGANIZER FOR TAX EXEMPT ORGANIZATIONS (990)**  
**(EXPANDED VERSION)**

YES   NO   N/A

203) Did the organization pay any individuals or companies in excess of \$50,000 for professional services? If "yes," complete the following schedule for the five highest paid service providers.

\_\_\_\_\_

Name and Address of Persons Paid More Than \$50,000	Type of Service	Compensation
Total number of others receiving over \$50,000 for professional services _____		

204) How many employees were on the payroll as of March 12th? \_\_\_\_\_

205) Provide the actual cash receipts from public support. \$ \_\_\_\_\_

206) During the tax year, has the organization, either directly or indirectly, engaged in any of the following acts with a trustee, director, principal officer or creator of the organization or any taxable organization or corporation with which such person is affiliated as an officer, director, trustee, majority owner, or principal beneficiary? If "yes," provide an explanation of the transaction(s):

\_\_\_\_\_

- .1) Sale, exchange or lease of property? \_\_\_\_\_
- .2) Lending of money or other extension of credit? \_\_\_\_\_
- .3) Furnishing of goods, services, or facilities? \_\_\_\_\_
- .4) Payment of compensation or payment or reimbursement of expenses if more than \$1,000. \_\_\_\_\_
- .5) Transfer any part of the organization's income or assets? If "yes," describe: \_\_\_\_\_

\_\_\_\_\_

207) Does the organization make grants for scholarships, fellowships, student loans, etc.? If "yes," provide a statement explaining how the organization determines that those receiving disbursements from the organization in furtherance of its charitable programs qualify to receive payments.

\_\_\_\_\_

**Exhibit 201-4: Tax-Exempt Organization Organizer to Be Completed by Client (cont.)**

**ORGANIZER FOR TAX EXEMPT ORGANIZATIONS (990)**  
**(EXPANDED VERSION)**

YES   NO   N/A

208) Did the organization directly or indirectly engage in any of the following with any other organization described in §501(c) (other than §501(c)(3) organizations) or with any organizations described in §527 (relating to political organizations):

- .1) Transfers from the organization to a noncharitable exempt organization of:
  - (a) Cash? \_\_\_\_
  - (b) Other assets? \_\_\_\_
  
- .2) Other transactions:
  - (a) Sales of assets to a noncharitable exempt organization? \_\_\_\_
  - (b) Purchases of assets from a noncharitable exempt organization? \_\_\_\_
  - (c) Rental of facilities or equipment? \_\_\_\_
  - (d) Reimbursement arrangements? \_\_\_\_
  - (e) Loans or loan guarantees? \_\_\_\_
  - (f) Performance of services or membership or fundraising solicitations? \_\_\_\_
  
- .3) Sharing of facilities, equipment, mailing lists or other assets, or paid employees? \_\_\_\_
  
- .4) If the answer to any of the above is "yes," complete the following schedule.

Amount Involved	Name of Noncharitable Exempt Organization	Description of Transfers, Transactions, and Sharing Arrangements

**Exhibit 201-4: Tax-Exempt Organization Organizer to Be Completed by Client (cont.)**

**ORGANIZER FOR TAX EXEMPT ORGANIZATIONS (990)**  
**(EXPANDED VERSION)**

YES   NO   N/A

209) Is the organization directly or indirectly affiliated with, or related to, one or more tax-exempt organizations described in §501(c) (other than §501(c)(3)) or with any organizations described in §527 (relating to political organizations)? If “yes,” complete the following schedule.

\_\_\_\_\_

Name of Organization	Type of Organization	Description of Relationship

**300) PRIVATE SCHOOLS**

301) Does the organization have a racially nondiscriminatory policy toward students by statement in its charter, bylaws, other governing instrument, or in a resolution of its governing body?

\_\_\_\_\_

302) Does the organization include a statement of its racially nondiscriminatory policy toward students in all its brochures, catalogues, and other written communications with the public dealing with student admissions, programs, and scholarships?

\_\_\_\_\_

303) Has the organization publicized its racially nondiscriminatory policy through newspaper or broadcast media during the period of solicitation for students, or during the registration period if it has no solicitation program, in a way that makes the policy known to all parts of the general community served? If “yes,” provide a description; if “no,” provide an explanation.

\_\_\_\_\_

304) Does the organization maintain the following (provide an explanation of any “no” or “n/a” answers):

- .1) Records indicating the racial composition of the student body, faculty, and administrative staff?
- .2) Records documenting that scholarships and other financial assistance are awarded on a racially nondiscriminatory basis?
- .3) Copies of all catalogues, brochures, announcements, and other written communications to the public dealing with student admissions, programs, and scholarships?

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

**Exhibit 201-4: Tax-Exempt Organization Organizer to Be Completed by Client (cont.)**

**ORGANIZER FOR TAX EXEMPT ORGANIZATIONS (990)**  
**(EXPANDED VERSION)**

	<u>YES</u>	<u>NO</u>	<u>N/A</u>
.4) Copies of all material used by the organization or on its behalf to solicit contributions?	_____	_____	_____
305) Did the organization discriminate by race in any way with respect to (provide an explanation for any "yes" answers):			
.1) Students' rights or privileges?	_____	_____	
.2) Admissions policies?	_____	_____	
.3) Employment of faculty or administrative staff?	_____	_____	
.4) Scholarships or other financial assistance?	_____	_____	
.5) Educational policies?	_____	_____	
.6) Use of facilities?	_____	_____	
.7) Athletic programs?	_____	_____	
.8) Other extracurricular activities?	_____	_____	
306) Did the organization receive any financial aid or assistance from a governmental agency? If "yes," provide a schedule and indicate if the organization's right to such aid has ever been revoked or suspended.	_____	_____	
307) Does the organization certify that it has complied with the applicable requirements of §§4.01 through 4.05 of Rev. Proc. 75-50, covering racial nondiscrimination? If "no," provide an explanation.	_____	_____	
<b>400) REVENUE AND SUPPORT</b>			
401) Provide a schedule listing contributors who, during the tax year, gave (directly or indirectly) money, securities or property with a value totaling at least \$5,000 (exclude individual gifts of less than \$1,000). Provide the donor's name, address, total amount contributed and the date(s) contributed. If the organization is exempt under §501(c)(7), (8), (10), or (19), substitute \$1,000 for the \$5,000 above and explain the specific purpose and actual use of each gift. For non-cash contributions, provide a description of the property and its fair market value.	_____	_____	_____
402) Did the organization sell or dispose of any assets (other than inventory) during the tax year? If "yes," provide a schedule listing (sales of publicly traded securities may be aggregated):	_____	_____	
<ul style="list-style-type: none"> <li>• Description of asset</li> <li>• Date acquired</li> <li>• How acquired</li> <li>• Date sold</li> <li>• Buyer</li> <li>• Gross sales price</li> <li>• Cost, other basis, or if donated, value at time acquired (state which)</li> <li>• Expense of sale</li> </ul>			



**Exhibit 201-4: Tax-Exempt Organization Organizer to Be Completed by Client (cont.)**

**ORGANIZER FOR TAX EXEMPT ORGANIZATIONS (990)**  
**(EXPANDED VERSION)**

YES   NO   N/A

- Improvements made after acquisition
- Depreciation since acquisition

403) Did the organization sponsor any special fundraising events? If “yes,” provide a schedule listing the three largest special events conducted, as measured by gross receipts. Describe each of these events and indicate for each event the gross receipts, the amount of contributions included in gross receipts, the gross revenue (gross receipts less contributions), the direct expenses, and the net income (gross revenue less direct expenses). Furnish the same information in total figures for all other special events held that are not among the three largest. Indicate the type and number of the events not listed individually (for example, three dances and two raffles). (Provide copies of fundraising materials.)

\_\_\_\_\_

404) Provide a computation of cost of goods sold for the sale of inventory items.

\_\_\_\_\_

405) Do you provide written acknowledgment to donors of individual contributions of \$250 or more?

\_\_\_\_\_

406) Do you provide information on the amount of the deductible donation to donors of *quid pro quo* donations in excess of \$75?

\_\_\_\_\_

407) If membership dues and contributions have been reported in one income category, provide a breakout.

\_\_\_\_\_

500) EXPENSES

501) For all organizations other than §501(c)(3) and (c)(4) organizations and §4947(a)(1) charitable trusts, does the organization desire to allocate expenses under the classifications of expenses related to management/general, program services, and fundraising? If “yes,” categorize expenses on the organization’s trial balance.

\_\_\_\_\_

502) Did the organization award any grants or other allocations during the tax year? If “yes,” provide a schedule of the following for each class of activity:

\_\_\_\_\_

- Donee’s name and address
- Amount of the grant or allocation
- Relationship of any donee to any person or corporation with an interest in the organization

503) Does the organization provide any of the following benefits to members or dependents (do not include employment-related benefits provided to officers and employees)? If “yes,” provide a schedule showing amounts of:

\_\_\_\_\_

- Death, sickness, hospitalization, or disability benefits
- Unemployment compensation benefits
- Other benefits (describe)

\_\_\_\_\_

\_\_\_\_\_

**Exhibit 201-4: Tax-Exempt Organization Organizer to Be Completed by Client (cont.)****ORGANIZER FOR TAX EXEMPT ORGANIZATIONS (990)**  
**(EXPANDED VERSION)**

	<u>YES</u>	<u>NO</u>	<u>N/A</u>
504) Did the organization make payments to affiliates? If "yes," provide a schedule listing the following:	_____	_____	
• Name and address of each affiliate receiving payments			
• Amount and purpose of the payments			
505) For §501(c)(3), (4) organizations, did the organization evaluate compensation and benefits payments to officers, directors and employees under the excess benefit rules?	_____	_____	_____
506) If the organization incurred joint costs for a combined educational campaign and fundraising solicitation, provide a schedule that allocates the amount incurred among programs services, management and fundraising.	_____		_____
 600) BALANCE SHEET			
601) Does the organization have any loans receivable (include receivables from officers, directors, trustees and key employees) at year-end? If "yes," provide a schedule showing the following information:	_____	_____	
• Borrower's name (identify officers, directors, trustees or key employees)			
• Original amount			
• Balance due at year end			
• Date of note			
• Maturity date			
• Repayment terms			
• Interest rate			
• Security provided by the borrower			
• Purpose of the loan			
• Description and fair market value of the consideration furnished by the lender (for example, cash—\$1,000; or 100 shares of XYZ, Inc. common stock—\$9,000).			
602) Does the organization hold any land, buildings or equipment for investment purposes? If "yes," provide a schedule listing the following:	_____	_____	
• Description			
• Cost or other basis			
• Accumulated depreciation			
• Investment in fixed assets held at year-end			
• Show the cost or other basis, accumulated depreciation, and book value for each asset.			
603) Does the organization hold securities or other investments (other than land, buildings and equipment)? If "yes," provide a schedule describing each of these investments held at year-end, including the cost and end-of-year market value.	_____	_____	

**Exhibit 201-4: Tax-Exempt Organization Organizer to Be Completed by Client (cont.)**

**ORGANIZER FOR TAX EXEMPT ORGANIZATIONS (990)**  
**(EXPANDED VERSION)**

YES   NO   N/A

604) Did the organization receive contributions or grants that contributors or grantors have designated as payable for one or more future years? If "yes," provide a schedule describing each contribution or grant and indicate the total amount of each item and the amount applicable to each future period.

\_\_\_\_\_

605) Does the organization have loans payable at year end? If "yes," provide a schedule showing the following information (identify officers, directors, trustees or key employees):

\_\_\_\_\_

- The name of lender
- Original amount
- Balance due at year end
- Date of note
- Maturity date
- Repayment terms
- Interest rate
- Security provided by the borrower
- Purpose of the loan
- The relationship of the lender to any officer, director, trustee, or key employee of the organization.

606) Did the organization own 50% or greater interest in a taxable corporation or partnership? If yes, provide the name of the organization and describe the nature and amount of any intercompany payments.

\_\_\_\_\_

COMMENTS OR EXPLANATIONS

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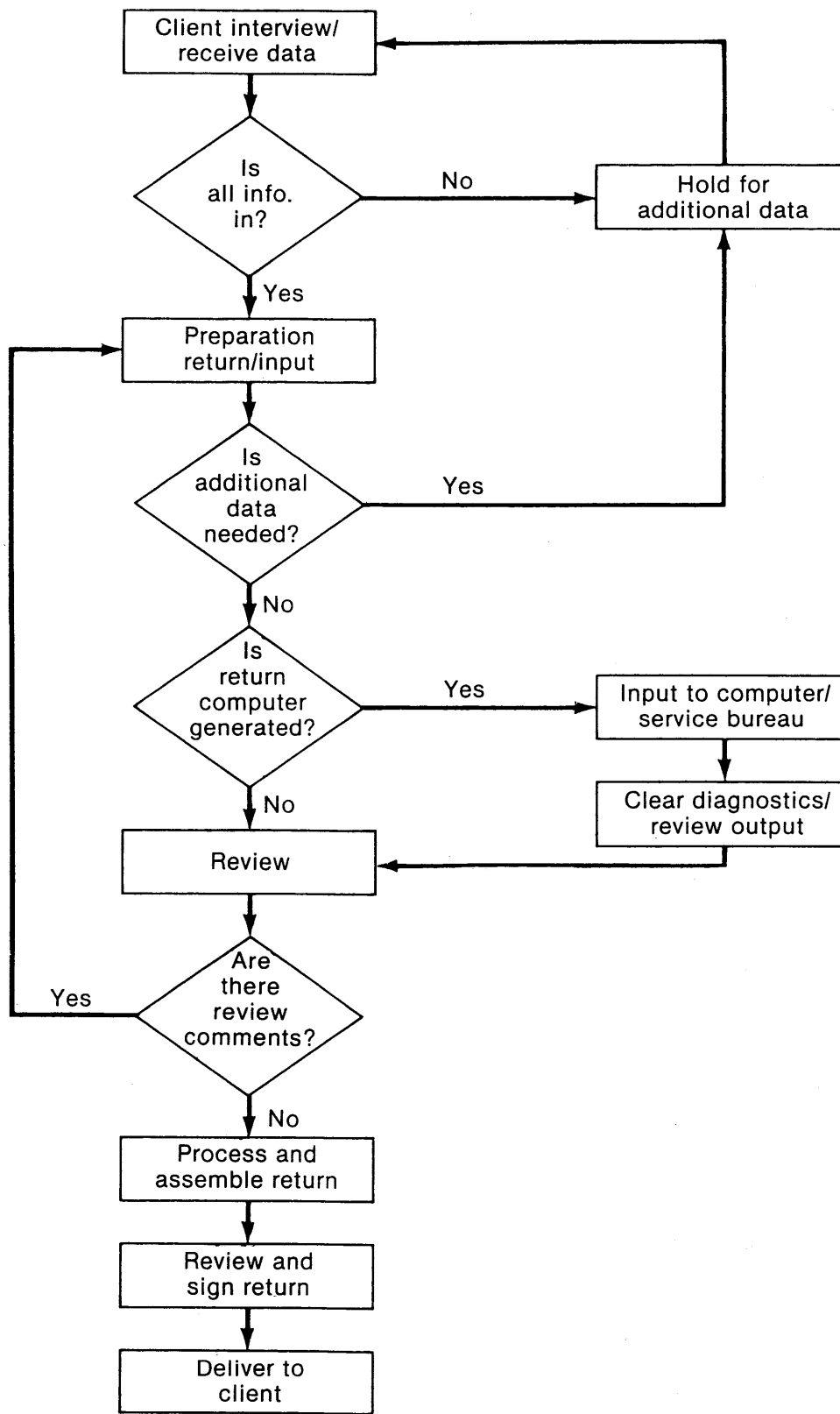
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**Exhibit 201-5: Flowchart of the Tax Return Process**



**Exhibit 201-6: Form 1040 Interview Worksheet**

**FORM 1040 INTERVIEW WORKSHEET**

Client: \_\_\_\_\_

DONE BY: Interviewer \_\_\_\_\_; Preparer \_\_\_\_\_; Reviewer \_\_\_\_\_  
 (initials & date) (initials & date) (initials & date)

Y N N/A COMMENTS

- 1. Has engagement letter been updated?
- 2. **IRAs** a) Any other plans? (See W-2s)
  - b) IRAs to be used? Roth or Traditional?
  - c) Discuss Roth IRA/Rollover/handout
- 3. **Keogh/SEP/SIMPLE:** a) To be used? (\$160K limit)
  - b) Any employees to participate? Spouse?
  - c) Who prepares Form 5500?
- 4. **Kids' returns:**
  - a) Under age 14/\$1,400 unearned income (separate return with Kiddie tax?) (Form 8814?)
  - b) New rules—unearned income < \$250?
- 5. EIC possible? (Watch addbacks)
- 6. EIC/Childcare need Birthdates
- 7. Residential seller financing (need SSN)

Y	N	N/A	COMMENTS

**FARMERS**

- 8. \$-0- tax or Exception 1 **due 4/15?**
- 9. 2/3 **gross receipts** test met?
- 10. If **PIK wages**, need W-2 value *and* Sch. D sale.
- 11. Any CRP payments? Report on Form 4835, or Sch. E
- 12. 1231 Gains/EIC Amended return (1996 & 1997)?
- 13. Futures contracts: Must document if hedge status


**BUSINESS AND FARM RETURNS**

- 14. All **W-2s and 1099s** done? (Who did?)
- 15. Claim **Sec. 179?** (T.I. or \$200,000 limit?)
- 16. % SE **medical insurance?**
- 17. Discontinue residence depreciation on Schedule E?
- 18. Home office/mileage deductible for 1999?
- 19. New business: Pre-opening costs for **start-up election.**
- 20. Enrolled in **AgriPlan/BizPlan?** Documents OK?
- 21. **Passive** activities: Complete/update worksheet.
  - a) Passive/portfolio—change PFX code if loss.
- 22. New **S shareholder?** Add election for loss order rules.
- 23. **Social Security:** Annual Report of Earnings to be filed?
- 24. **S/E tax:** a) Equipment leases?
  - b) Exempt non-recurring fees?



**Exhibit 201-6: Form 1040 Interview Worksheet (cont.)**

- 25. Any **A.M.T.** possibility?
- 26. Discuss 1999 estimates (Use Exception 1?)  
(106% if AGI > \$150,000)
- 27. Convert to LLC? (Employees/High Risk)
- 28. **Y2K issues:** a) What accounting software used?  
b) What version?  
c) How old is computer?
- 29. Any discussion w/client re: **outcome?**

Y	N	N/A	COMMENTS

**Exhibit 201-7: Business Interview Worksheet**

**BUSINESS INTERVIEW WORKSHEET**  
**(for use with Forms 1065, 1120, 1120S)**

Client: \_\_\_\_\_

DONE BY: Interviewer \_\_\_\_\_; Preparer \_\_\_\_\_; Reviewer \_\_\_\_\_  
(initials & date) (initials & date) (initials & date)

	Y	N	NA	Comments
1. Do we have engagement letter?				
2. Any non-deductible life insurance?				
3. Any change in partner P&L-sharing or corp. stock ownership?				
4. Were all W-2s/1099s done?				
5. Claim Sec. 179? (T.I. or \$200,000 limit?)				
6. Complete info. re: vehicle & mileage.				
7. Is personal use of corp. auto handled correctly?				
8. Passive activities: Complete/update worksheet.				
9. New business:				
a) Pre-opening costs for start-up election.				
b) Any MN real estate tax to accrue? Need recurring item election.				
10. Keogh/SEP/SIMPLE:				
a) To be used? (\$160K limit)				
b) Any employees to participate?				
c) Who prepares Form 5500?				
11. Research, work opportunity or welfare to work credit?				
12. Update corporate minute book?				
13. Any discussion w/client re: outcome?				

**FARM ONLY**

14. Are employment agreements current?				
15. Form 4136: Number of gallons.				
16. If PIK wages: Need W-2 value (discuss guidelines).				
17. Futures contracts: Must document/mark transactions (discuss guidelines).				
18. Discuss gifts of grain to charity.				

**FORM 1120 ONLY**

19. Use Exception One estimates? (\$-0- tax)				
--	--	--	--	--

**FORM 1120S ONLY**

20. If formerly a C corp., any 10-yr built-in gains dispositions?				
21. Is med. ins. for owners in W-2 (but not in FICA wages)?				
22. Are shareholder distributions equal?				
23. Any risk of unreasonably low owner W-2?				

**FORM 1065 ONLY**

24. Convert to LLC or LLP?				
25. Enrolled in AgriPlan/Biz Plan?				

**ESTATE PLANNING/BUSINESS TRANSITION**

26. Any ownership transfers/gifts to be made?				
---	--	--	--	--

**Exhibit 201-8: S Corporation Shareholder Basis Calculation****S CORPORATION SHAREHOLDER BASIS SCHEDULE**  
**SHORT VERSION**

Shareholder Name \_\_\_\_\_ Year Ended \_\_\_\_\_

Corporation Name \_\_\_\_\_

# Shares at Year End \_\_\_\_\_

	<u>STOCK</u>	<u>LOANS</u>
<b>Basis at beginning of year *</b>	_____	_____
<b>PLUS</b>		
Non-separately stated income	_____	
Separately stated income items	_____	
Nontaxable income, not including book/tax timing differences	_____	
50% of ITC recapture	_____	
New loans to S corporation		_____
Additional stock/paid-in capital investment	_____	
 <b>PLUS</b>		
Gain recognized for non-dividend distributions in excess of basis	_____	
Gain recognized on debt repayment in excess of basis		_____
 <b>MINUS</b>		
Loan repayments to shareholder		( _____ )
Non-dividend distributions	( _____ )	
 <b>Basis for current year loss</b>	_____ **	
 <b>MINUS</b>		
Non-separately stated loss	( _____ )	( _____ )
Separately stated losses and deductions	( _____ )	( _____ )
Prior year(s) loss carryover utilized in current year	( _____ )	( _____ )
Nondeductible expenses, not including book/tax timing differences***	( _____ )	
Depletion adjustment***		
 <b>Remaining basis</b>	_____	
 Net increase for the year****	_____	_____
 <b>Basis at end of year</b>	_____ *	

SOURCE: Reprinted from AICPA, *1999 Tax Practice Guides and Checklists* (New York, 1999).



**Exhibit 201-8: S Corporation Shareholder Basis Calculation (cont.)**

**S CORPORATION SHAREHOLDER BASIS SCHEDULE**  
**SHORT VERSION**

CARRYOVER LOSSES

Balance at beginning of year

Additional excess losses

Prior year(s) carryover used in current year

Balance at end of year

Deductible	Nondeductible	Total
(       )	(       )	(       )

\*Basis in stock is calculated on a per share/per day basis. Each block of stock must be accounted for separately. Special rules apply if one block of stock has an excess negative adjustment. See final regulations.

\*\* Basis cannot be less than zero. Any unused losses and deductions should be reflected on the attached schedule of carryover losses.

\*\*\* This basis schedule assumes the shareholder made the election to decrease basis by ordinary loss or other item of loss or deduction and depletion before decrease by nondeductible, noncapital expenses. When the election is made, final regulations require nondeductible expenses and depletion in excess of basis to be carried forward and reduce basis in succeeding taxable years.

\*\*\*\* Net increase for the year represents the excess of all increases to basis because of income and net of all decreases for deductible and nondeductible losses and distributions.

Final regulations are silent as to the carryover of nondeductible items when the election is not made, but presumably these items are not carried forward.



**Exhibit 201-8: S Corporation Shareholder Basis Calculation (cont.)**

**S CORPORATION SHAREHOLDER BASIS SCHEDULE**  
**LONG VERSION**

**BASIS IN LOANS FROM SHAREHOLDER**

	Year		
17. Beginning of year (line 24 prior yr. schedule)			
18. Restoration of basis line (line 11)			
19. Additions. (line 14)			
20. Repayments. (line 15)*	( )	( )	( )
21. Subtotal (lines 17 - 20)			
22.A Excess loss from line 6.A or 6.B (ordinary or other deductible losses)*	( )	( )	( )
22.B Excess loss from line 6.C (other nondeductible expenses)*	( )	( )	( )
22.C Subtotal of 22.A & 22.B (not to exceed line 21) (excess to line 26.A or 27.A)			
23.A Deductible loss carryover applied to loans (not to exceed 21 less 22.C and 23.A)			
23.B Nondeductible loss carryover applied to loans (not to exceed 21 less 22.C)			
24. Loan basis end of year (line 21 - 23.B)*			
25. TOTAL TAX BASIS - STOCK & LOANS (line 12 plus line 24)			

**DEDUCTIBLE CARRYOVERS**

26.A Unused loss and deductions from above*			
26.B Deductible loss carryover (prior year schedule, line 26.D)			
26.C Deductible loss used this year (line 8 plus 23.A)	( )	( )	( )
26.D Deductible loss carryover (line 26.A plus 26.B minus 26.C)			

**NONDEDUCTIBLE CARRYOVERS**

27.A Unused nondeductible loss and deductions from above*			
27.B Nondeductible loss carryover (prior year schedule, line 27.D)			
27.C Nondeductible losses used this year (line 9 plus 23.B)	( )	( )	( )
27.D Nondeductible loss carryover (line 27.A plus 27.B minus 27.C)			

**INFORMATION NOT INCLUDED IN K-1**

28.A Ordinary income from loan repayment			
28.B Capital gain income from loan repayment			
28.C Capital gain distribution			

**Exhibit 201-8: S Corporation Shareholder Basis Calculation (cont.)****S CORPORATION SHAREHOLDER BASIS SCHEDULE**  
**LONG VERSION****FOOTNOTES****Line Reference**

- Basis is determined on a per share, per day basis. Each block of stock must be accounted for separately. Special rules apply if one block of stock has an excess negative adjustment. See final regulations.
- 3 Other adjustments necessary to adjust basis would include among other items, a reduction in basis due to gifting some of the stock, elimination of a shareholder due to change in ownership or as a result of the death of a shareholder.
- 4.D Any nondividend distribution in excess of basis in stock is considered as sale of stock and is ordinarily capital gain depending on the holding period. (Short term or long term.) Report on line 28.C.
- 6.C This basis schedule assumes the shareholder made the election to decrease basis by ordinary loss or other item of loss or deduction and depletion before decrease by nondeductible, non-capital expenses. When the election is made, final regulations require nondeductible expenses and depletion in excess of basis to be carried forward and reduce basis in succeeding taxable years.
- 6.A & B Total of these two lines should not exceed line 5. If over, take excess to line 22.A or 22.B.
- 11 Basis in indebtedness increases only if there is a net increase in a shareholder's basis. A net increase results if all income items of § 1367(a)(1) exceed the items described in §1367(a)(2). These restoration rules apply only to indebtedness held by a shareholder as of the beginning of the taxable year. The indebtedness basis can not exceed the adjusted basis in the indebtedness (without reductions of § 1367(b)) as of the beginning of the year.
- 12 Stock basis cannot be less than zero.
- 20 If loan repayment exceeds loan basis, the gain should be shown on line 28.A or B. Only the basis attributable to the repayment should be shown on this line.
- 22.A/26.A Line 22.A should not exceed line 21. Any excess to line 26.A.
- 22.B/27.A Line 22.B should not exceed line 21 less line 22.A. Any excess to line 27.A.
- 24 Loan basis of shareholder should never be less than zero.

**Exhibit 201-9: Annotated New-Client Tax Information Worksheet**

**SWIFT & MARCH COMPANY  
Certified Public Accountants**

**Client Tax Information Worksheet—19X1**

**I. Personal Information**

	Name	Social Security No.	Date of Birth	Occupation
Self:	<u>DONALD J. DOE</u>	<u>123-45-6789</u>	<u>10/17/49</u>	<u>Administrator</u>
Spouse:	<u>Mary J. Doe</u>	<u>489-60-3211</u>	<u>9/26/51</u>	<u>Nurse</u>
Street/Box/Route Address:	<u>710 South Frank Street</u>			
City and State:	<u>St. Paul MN</u>	County:	<u>Ramsey</u>	Zip: <u>58322</u>
Phone:	<u>(612) 555-1234</u>	Fax:	<u>( )</u>	Email Address

Dependents First and Last Name	Social Sec. Number	Date of Birth	Relationship	Number of months lived in your home in 19X1
<u>Jessica Doe</u>	<u>432-61-8911</u>	<u>9/13/86</u>	<u>Daughter</u>	<u>12</u>
<u>Nathan Doe</u>	<u>432-61-8918</u>	<u>10/17/88</u>	<u>Son</u>	<u>12</u>
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____

**NOTE:** Social Security number is mandatory (subject to penalty) for each dependent born before December 1, 1998.

Are you or your spouse legally blind? No

**II. Miscellaneous Questions**

- A. Any correspondence/audits/notices from IRS or state? No
- B. Rent credit: attach landlord's certification of residential rent paid (Form CRP) N/A
- C. Sale of personal residence in 19X1? (Bring settlement statements) No
- D. Did you have moving expenses for a move over 50 miles to a new job location? No
- E. Did you pay any alimony? If yes, enter amount (\$ No ), name ( \_\_\_\_\_ ), and Social Security number ( \_\_\_\_\_ ) of recipient.
- F. Do you wish to allocate \$3 to the Presidential Election Campaign (no increase in tax or reduction in refund)? Self:  yes  no Spouse:  yes  no
- G. Do you wish to allocate \$5 to the State Elections Fund (no increase in tax or reduction in refund)?  

Check one each:	Self	Spouse
Reform	_____	_____
Republican	_____	_____
Democratic Farmer-Labor	_____	_____
Grassroots	_____	_____
Libertarian	_____	_____
Progressive Minnesota	_____	_____
General Campaign Fund	_____	_____
- H. Do you wish to give to the Nongame Wildlife Fund? This will reduce your refund or increase the amount you owe. Fill in the amount here. See Note 1
- I. Did any of your under age 14 dependent children have \$700 or more of non-wage income (interest, dividends, rents) in 19X1? If so, they are required to file a tax return. No

**Exhibit 201-9: Annotated New-Client Tax Information Worksheet (cont.)**

**NOTE: Please round numbers to whole dollars**

III. <u>Income</u>	<u>Number of Forms</u>	<u>Amount</u>	
A. Wages & Salaries (attach Forms W-2)	# 2	\$ 85,641	See note 2
B. Interest income: (Attach Forms 1099; list separately items with no Form 1099)	# 1	\$ 1,239 B	
C. Tax-exempt interest income received (municipal bonds, tax-exempt funds) (attach year-end statement)	# 3	\$ 21,600 NT	See note 4
D. Dividends & other distributions from corporations: (Attach Forms 1099)	# 1	\$ 400 B	See note 3
E. If any of the following apply, please attach detail of receipts and expenditures:			
1) Business income			
2) Rental income			
3) Farm income - complete farm worksheet			
4) Sale or trade of business or investment assets, such as real estate or securities (Form 1099-B must be attached)			
<b>NOTE: We need exact purchase and sale dates and cost to determine the capital gain rate which applies.</b>			
5) Schedules K-1 of partnerships and S corporations			
F. Prior year state tax refund received in 19XI		\$ 956	See note 5
G. State property tax refund received in 19XI		\$ -0-	
H. Income received from:			
Pension or retirement plan (attach Form 1099-R)		\$ _____	
Public retirement plan		\$ _____	
I. Unemployment benefits received (attach form)		\$ _____	
J. Disability payments received		\$ _____	
K. 1998 Social Security benefits received (must attach Social Security year-end benefit report Form SSA-1099)		\$ 3,000 NT	Workmen's Comp
L. Other income:		\$ _____	
Alimony		\$ _____	
Other income: _____		\$ _____	

IV. <u>Quarterly Tax Estimates Paid</u>	<u>Date Pd</u>	<u>Federal</u>	<u>Date Pd</u>	<u>State</u>
1st quarter 19XI	4/14	500	_____	200
2nd quarter 19XI	6/13	500	_____	200
3rd quarter 19XI	9/15	500	_____	200
4th quarter 19XI	11/15 12/31	500	_____	200
Other: _____				
Total estimates paid for 19XI		\$ 2,000		\$ 800
4th quarter 19X0 paid 1/XI		\$ _____		\$ _____
Balance due - 19X0 tax return		\$ _____		\$ _____

**Exhibit 201-9: Annotated New-Client Tax Information Worksheet (cont.)**

**V. Itemized Deductions:**

**a. Medical**

**NOTE:** Only deductible if total exceeds 7.5% of income.

Prescription medicines & drugs \_\_\_\_\_  
 Medical insurance \_\_\_\_\_  
 premiums pd \_\_\_\_\_  
 Long-Term care insurance premiums \_\_\_\_\_  
 Taxpayer \_\_\_\_\_  
 Spouse \_\_\_\_\_  
 Long-Term care expenses \_\_\_\_\_  
 Total insurance reimbursement ( ) \_\_\_\_\_  
 Number of medical miles (10¢/mi) \_\_\_\_\_  
 Lodging (limit of \$50/day/person) \_\_\_\_\_  
 Doctors, dentists, etc. \_\_\_\_\_  
 Hospitals \_\_\_\_\_  
 Lab fees \_\_\_\_\_  
 Eyeglasses & contacts \_\_\_\_\_  
 Other Medical expenses: \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

**b. Taxes**

Real estate: Schedule A  
 Residence 1907  
 Other \_\_\_\_\_  
 Auto license(s) 246  
 Number of vehicles 2

See note 6

**c. Charitable - Schedule A**

Church & other 2613  
 Non-cash (list):  
Goodwill 100  
 \_\_\_\_\_  
 \_\_\_\_\_  
 (Need documentation for any contribution of \$250 or more)  
 Charitable miles (14¢/mile) 200 mi.

**d. Interest expense**

Schedule A  
Residential Interest (principal residence and one vacation residence):  
 House mortgage paid to financial institution (attach Form 1098 received from lender) 5927  
 House mortgage/contract paid to individual:  
 Name \_\_\_\_\_ Soc. Sec. No. \_\_\_\_\_  
 Address \_\_\_\_\_  
Points Paid (To refinance a mortgage or purchase a new residence): \_\_\_\_\_  
Investment Interest (i.e. on debt to carry stocks, bonds, investments):  
 List \_\_\_\_\_  
 \_\_\_\_\_  
 Student loan interest = \$1,000 maximum, limited to interest paid for first 60 months during which interest is due on a loan \_\_\_\_\_

**e. Miscellaneous Deductions (attach detail if applicable)**

Union, business and professional dues 120  
 Professional subscriptions 80  
 Uniforms and protective clothing \_\_\_\_\_  
 Work tools \_\_\_\_\_  
 Education expenses associated with your job \_\_\_\_\_  
 Other business expenses: mileage 5000 miles  
 \_\_\_\_\_  
 Tax Preparation fees 300  
 IRA fees (paid separately) \_\_\_\_\_  
 Safe deposit box rent 15  
 Bad debts/worthless securities \_\_\_\_\_  
 Casualty or theft losses over \$100 & 10% of income \_\_\_\_\_

**Exhibit 201-9: Annotated New-Client Tax Information Worksheet (cont.)**

**VI. Retirement Plans**

IRA: 19XI Contributions made:

	<u>Traditional IRA</u>		<u>Roth IRA</u>	
Taxpayer	Date made <u>12/15</u>	\$ <u>2,000</u>	Date made _____	\$ _____
Spouse	Date made <u>12/15</u>	\$ <u>2,000</u>	Date made _____	\$ _____

Keogh/SEP/SIMPLE plans:

Taxpayer	\$ _____	Date made _____
Spouse	\$ _____	Date made _____
Other Employees	\$ _____	Date made _____

If amount listed is not the maximum, do you want to contribute the maximum? Yes \_\_\_ No \_\_\_

Did you make a retirement plan rollover to a traditional IRA in 19XI? \_\_\_\_\_

Did you make a traditional IRA rollover to a Roth IRA in 19XI? \_\_\_\_\_

Does either spouse participate in an employer plan? \_\_\_\_\_

\_\_\_\_\_  
 \_\_\_\_\_  
 No See note 7

**VII. Child Care Credit**

Child care expenses paid to allow parent to work

*Please estimate amount for each child:*

<u>Child's Name</u>	<u>Amount</u>
_____	_____
_____	_____
_____	_____

TOTAL (Must agree to total paid to each provider listed below.) \$ \_\_\_\_\_

The following information is needed for each provider in order to claim the credit.

Provider Name: \_\_\_\_\_  
 Address: \_\_\_\_\_  
 Soc. Sec./ID No. \_\_\_\_\_  
 Amount Paid \$ \_\_\_\_\_

Provider Name: \_\_\_\_\_  
 Address: \_\_\_\_\_  
 Soc. Sec./ID No. \_\_\_\_\_  
 Amount Paid \$ \_\_\_\_\_

Amount of employee contributions to a cafeteria or flex plan, for child care in 19XI. \$ \_\_\_\_\_



**Exhibit 201-9: Annotated New-Client Tax Information Worksheet (cont.)**

**VIII. Higher Education Credits (HOPE and Lifetime Learning Credits)**

1. Qualified tuition and related expenses<sup>1</sup> paid<sup>2</sup> for student attending eligible education institutions<sup>3</sup> (post high school).

<u>Student</u>	<u>Education level (e.g. Soph., Jr., etc.)</u>	<u>Amount paid</u>
_____	_____	\$ _____
_____	_____	_____
_____	_____	_____

<sup>1</sup>does not include books, meals & lodging

<sup>2</sup>can be paid by either parent or dependent student

<sup>3</sup>institutions offering credit toward a bachelor's degree, an associates degree, or another recognized post-secondary credential

Please note other possible deductions or questions to be discussed during your tax return interview:

- 1) \_\_\_\_\_  
\_\_\_\_\_
- 2) \_\_\_\_\_  
\_\_\_\_\_

I (we) have submitted the information on all worksheets for the sole purpose of preparing my(our) tax return(s). Each item can be substantiated by receipts, canceled checks, or other documents. This information is true, correct, and complete to the best of my(our) knowledge.

Taxpayer Signature Donald J. Doe

Spouse Signature Mary J. Doe

Date 3-30-02

Date 3-30-02

## Exhibit 201-10: Client Interview Notes

**SWIFT, MARCH & COMPANY**  
 CERTIFIED PUBLIC ACCOUNTANTS  
 200 Main Street  
 Noplace, Anystate 00000  
 000-000-0000

Initials: RJC  
 Date: 3-31-X2

DONALD J. DOE  
 19X1 INTERVIEW NOTES

Reference	Comment	Disposition
①	NATHAN'S INTEREST INCOME \$640 WATCH IN 19X2 - MAY GO OVER \$700. -	
②	W-2 INCLUDES 5000 MILES REIMBURSED @ 33¢ - NEED TO DEDUCT 31¢/MILE AS MISCELLANEOUS ITEMIZED DEDUCTION SUBJECT TO 2% LIMITATION	
③	INCLUDES \$50 CAPITAL GAIN DISTRIBUTION SEE FORM 1099 DIV.	
④	ALL OUTSTATE MUNICIPAL BOND INTEREST - FULLY TAXABLE ON STATE RET.	
⑤	NON-TAXABLE REFUND-USED STANDARD DED. LAST YEAR	
⑥	PURCHASED IN 19X1 - COST \$100,000 + \$5,000 IMPROVEMENTS - INFO - ONLY - 3/31/X1	
⑦	STATUS MAY CHANGE IN 19X2	

**Exhibit 201-11: Tax Return Tie-Out Sheet**

**SOFTWARE TIE-OUT SHEET**

Taxpayer \_\_\_\_\_

Wages	_____
Interest	_____
Dividends	_____
State tax refund	_____
Alimony	_____
Sch. C—Gross income	_____
vehicle exp	(_____)
depreciation	(_____)
other exp.	(_____)
Schedule D	_____
Cap. gain not on Sch D	_____
Rent & royalties	_____
Partnerships/S Corp.	_____
Estates & trusts	_____
Form 4835—Gross income	(_____)
depr.	(_____)
other exp.	(_____)
Sch. F—Gross income	(_____)
depreciation	(_____)
other exp.	(_____)
Unemployment comp.	_____
Soc. Sec. (taxable)	_____
Other income	_____
Total Income	\$ _____
IRA deduction	(_____)
Deduction for SE tax	(_____)
Self-empl health ins.	(_____)
Keogh and SEP	(_____)
Penalty-early w/draw	(_____)
Alimony paid	(_____)
Other adjustments	(_____)
AGI	\$ _____
Itemized deductions:	
Medical	_____
Taxes	_____
Interest	_____
Contributions	_____
Moving expense	_____
Misc. item.-2%	_____
Other Misc.	_____
Total Itemized Ded.	\$ _____
AGI	_____
Standard/itemized deduct.	(_____)
Exemptions	(_____)
<b>Federal Taxable Income</b>	\$ _____

<u>Federal Tax Calculation</u>	
Federal tax	_____
Add'l taxes	_____
Total	_____
Child care credit	_____
Elderly credit	_____
Foreign tax cr.	_____
Gen'l bus. cr.	_____
Credit-prior AMT	_____
Other credits	_____
Total credits	(_____)
Self-empl. tax	_____
AMT	_____
ITC recapture	_____
10% penalty	_____
Other taxes	_____
Total taxes	_____
Withholding	_____
Estimates	_____
Earned Inc. Cr.	_____
Form 4868	_____
Excess FICA	_____
Form 4136	_____
Other payments	_____
Total payments	(_____)
Tax Due (Overpayment)	\$ _____

<u>State Tax Calculation</u>	
Federal taxable income	_____
Additions	_____
Subtractions	(_____)
State taxable income	\$ _____
State tax	_____
Withholding	(_____)
Estimates	(_____)
Other credits	(_____)
Tax Due (Overpayment)	\$ _____

**Exhibit 201-12: Common Return Preparation Errors****COMMON RETURN PREPARATION ERRORS**Form 1040

- Omitted one-half of self-employment tax.
- Could have filed Form 1040A instead of Form 1040.
- Omitted total rental and royalty expenses, Schedule E, line 19.
- Did not answer foreign account questions on Schedule B.
- Should not have put amount on line 17a, total pensions.

Form 1040A

- Did not check dependency status box.
- Did not enter standard deduction amount.
- Did not enter total tax amount.
- Should not have put amount on line 11a, total pensions.

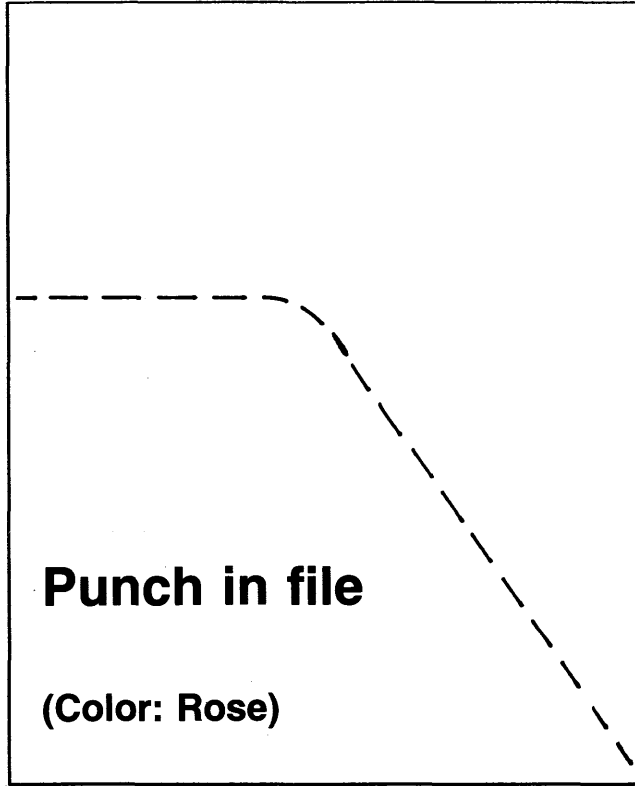
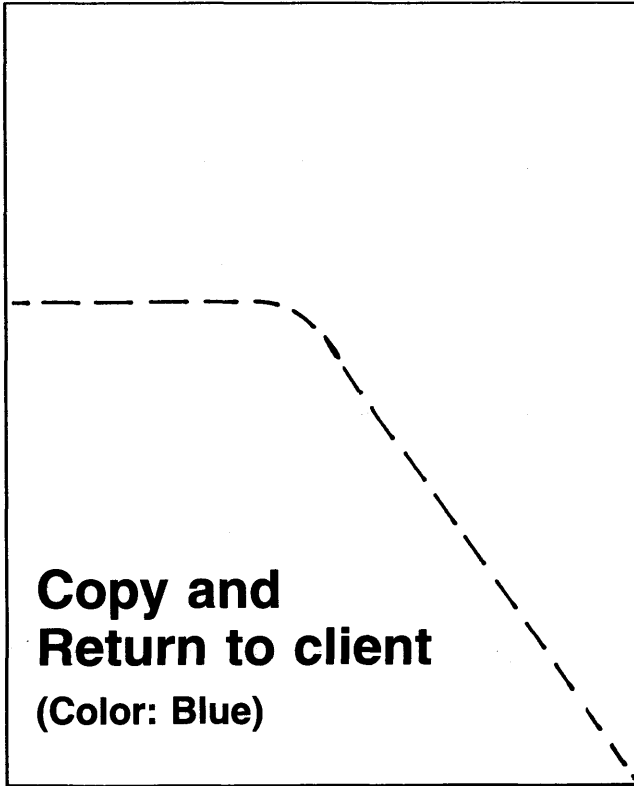
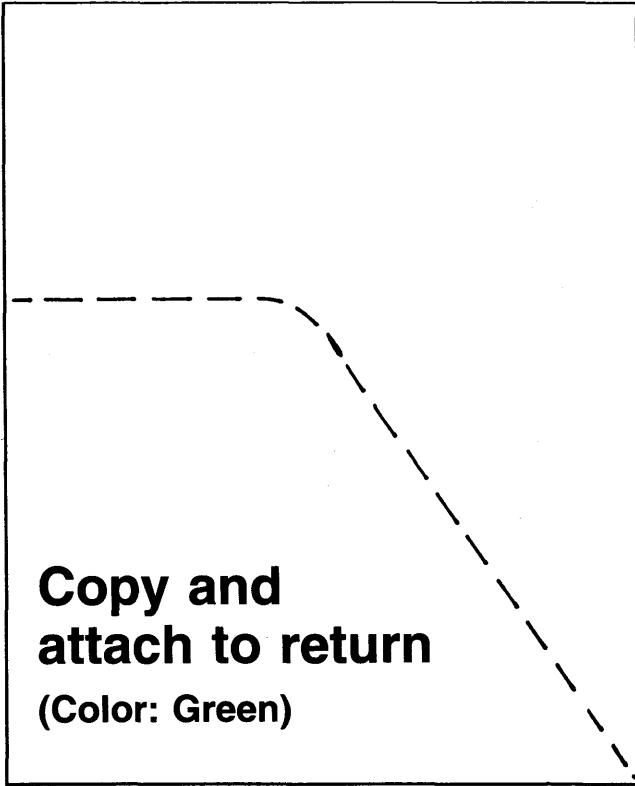
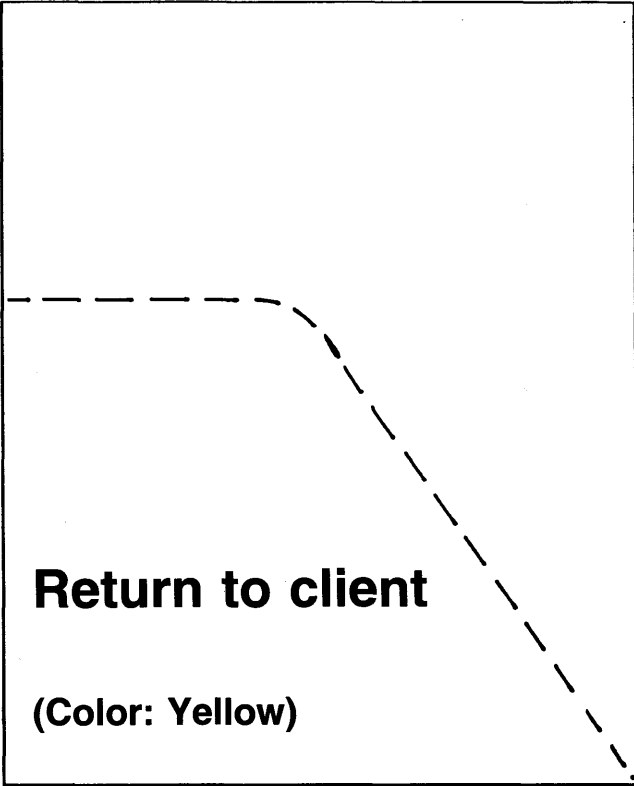
Form 1040EZ

- Did not enter balance due amount, line 10.

Form 941

- No entry for taxable medicare wages and tips, line 7.
- Did not enter taxable social security wages, line 6a.
- Untimely filing of Form 941.
- Did not enter number of employees, line 1.
- Did not enter amounts in the entire Monthly Summary Record of Federal Tax Liability area.
- Did not enter total taxes, line 14.
- Incorrect entries made on the taxable medicare wages and tips, line 7.
- Did not enter balance due amount, line 15.
- Math error for total taxes, line 11.
- Incorrect entry for the name line.

**Exhibit 201-13: Source Document Organization Folders**





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# 202 Computerized Tax Return Preparation

Technological developments continue to have a major impact on tax practice. Practitioners must keep abreast of technological developments to remain competitive and to provide quality client service.

Not long ago, tax practitioners were preparing returns manually. Currently, very few are still doing so. Increasing software capabilities and decreasing costs make computer tax return preparation practical for almost all practitioners.

Computerized tax return preparation takes a number of forms, including the following:

- Computer forms are completed and sent to an outside service bureau for input and processing. The return is printed there and forwarded to the tax preparer.
- Computer forms are completed and input by in-house data-entry personnel. The return can either be processed in-house or the information can be sent to an outside service bureau for processing and printing.
- Tax personnel directly input information to the computer, and then either send the information to an outside service bureau for processing or, more frequently, process and print the completed return in-house.

The investment in computerized tax preparation increases efficiency, quality control, and service value, as follows:

- Efficiencies result because changes can be easily made and computations are automated.
- State returns become a low-cost by-product of the computerized return process.
- The availability of electronic filing and the polished appearance of computer-generated returns are impressive to clients.
- The direct and indirect costs of the computer system can be recovered by adding a computer processing charge to the client billing.

## 202.1 Bringing Tax Preparation In-House

In the 1980's two prevalent methods of computerized tax preparation existed—service bureaus and in-house systems. The spectrum of methods ranged from employing a service bureau for all elements of return preparation to complete in-house sufficiency—from input to output. In recent years, the overwhelming trend has been away from service bureaus and toward in-house systems. In-house systems are faster; they reduce cost per return and give more control to the

practitioner. Because many firms already had automated office equipment and computer systems, bringing return preparation inside simply involved purchasing a software program and trying it out. The time formerly spent filling out IRS forms or service bureau input sheets became devoted to direct data entry. Practitioners appreciated having a printed return in hand moments after completing data entry, and they delighted in the ability to make changes in minutes.

## 202.2 Computerized Tax Preparation

Today's tax preparation increasingly depends on automated processing capabilities. The complexity of the tax laws confuses more and more individuals and businesses. As a result, more of them are bringing their returns to professional preparers. However, the tax law complexities also intensify the practitioner's burden to prepare returns correctly and on time. Computers greatly assist tax practitioners in meeting the demands of the modern practice.

Computerized tax preparation has many advantages, including the following:

- Rapid computation of complex returns
- Simplification of return changes and corrections
- Quality printing of returns
- Electronic filing or printing Forms 1040-PC format returns
- Thorough testing of the program by experts, and feedback from other practitioners and users
- Timely incorporation of the latest tax law changes into the program
- A second opinion on the treatment of tax items

Technological advances and integration of programs can significantly improve the efficiency of a tax practice. For example, ATB and other trial balance software, as well as general ledger packages, can be imported into tax processing software. Tax research software can export information into word processing systems, resulting in the efficient preparation of correspondence and memoranda. Networks enhance the efficiency of multiple office functions, including personnel scheduling, time and billing recordkeeping, word processing, practice development data tracking, and so forth.

### 202.2.1 Rapid Computation and Simplified Changes

You probably have clients with myriad sources of income requiring numerous detailed tax schedules and forms. The treatment of passive loss limitations, investment credit carryovers, alternative minimum tax computations, carryovers of capital losses, and charitable contributions among other items are handled easily with an automated approach. Instructions accompanying a limited partner's K-1 often have expansive diagrams showing the flow of amounts from the K-1 through the numerous tax forms affected. The slightest mistake can require extensive recomputation.

Computerized tax preparation systems can produce tax returns more efficiently and accurately. Additionally, printed schedules are normally produced showing disallowed passive losses, carryovers, depreciation schedules, and other information passing from year to year. This information is automatically transferred into next year's taxpayer information by many systems.

Changes and error corrections are simplified, and the return can then be recomputed in a matter of only a few seconds. For example, if a taxpayer later sends in additional information on an item, extensive changes may be required. The decision by a taxpayer to use an individual retirement account (IRA) contribution after a return has been completed will result in extensive change and recalculation. Page one and page two of Form 1040 would change, Schedule A may change because of the different adjusted gross income amount, Form 6251 will change, and so forth. With a computerized tax return preparation system, the IRA contribution can be added to the previous data (which had been retained in data storage), and the return can be recomputed in a matter of just a few seconds.

### **202.2.2 Polished Appearance**

For years, automated systems have produced returns with tremendous eye appeal. The excellent appearance of these returns gave firms using computers an edge over their competitors. The advent of relatively inexpensive laser printers has brought top-quality printing capabilities inside the firm itself. With a laser printer, you can print and collate a return of high-caliber appearance in minutes.

### **202.2.3 Electronic Filing Capabilities**

Many tax preparation packages offer electronic filing as an add-on module, and service bureaus also offer electronic filing. These programs check a return to see if it qualifies for electronic filing, and place the return data in the required IRS format for electronic transmission.

Some tax preparation software allows the option of filing directly with the IRS or employing a more user-friendly third-party transmitter. The software vendor may work in conjunction with a third-party filing service, or the vendor may itself be the third-party transmitter.

In addition to electronic filing, taxpayers have the option of generating a condensed return using the 1040-PC format. The 1040-PC format return is an answer sheet, generated on a personal computer, signed by the taxpayer and the paid preparer, and mailed to the appropriate service center. The returns can often be condensed from more than a dozen pages down to one or two. The data is computer-generated in a specified format that prints only taxpayer line entries.

See Chapter 204 for a comprehensive discussion of electronic filing capabilities.

### **202.2.4 Program Development by Experts and Feedback From Users**

Tax preparation software programs may include on-line tax reference guides, IRS instructions, and special interactive worksheets that can lead even a novice through complicated tax transactions. Many software companies employ large support and testing teams to develop their tax programs.

Software companies have a large client base of subscribing firms that provide feedback on program results. These companies routinely solicit comments from practitioners. This feedback provides them not only with input on technical enhancements, but also with convenience and documentation suggestions that make products increasingly user-friendly.

### **202.2.5 The Latest Tax Laws and Program Updates**

Companies that develop tax preparation software constantly monitor the tax environment for changing laws, IRS interpretations, regulations, and court rulings. They provide program updates that reflect changing information culled from the IRS, tax publications, and tax information services. Most software developers work closely with the IRS. Their programmers often have direct access to the IRS personnel responsible for specific tax forms.

### **202.2.6 Second Opinions**

Tax preparation software cannot replace a practitioner's professional judgment. However, tax preparation programs can offer a second opinion on the treatment of a particular item in the return. For example, the return preparer must decide which Internal Revenue Code section applies to the sale of a depreciable asset, but the computer program extends guidance for the treatment of the sale in the tax return.

Computer-generated diagnostic programs test for any obvious errors and inconsistencies within a return. For example, entering a dependent without a social security number will likely generate a diagnostic message. Similarly, the dates entered for the acquisition and sale of a capital asset are normally tested to see if the long-term or short-term classification is proper.

When the pressures of a tax season bear down, it is easy to make errors in mathematical computation or to enter a number on the wrong line. Tax preparation programs help catch errors an overworked practitioner might make. In addition, computerized systems offer consistency in appearance and produce consistent returns throughout the tax season.

## 202.3 Data Entry Methods

In-house tax-return systems dominate return preparation activities. Before turning to the three main systems orientations, we will briefly discuss how client data is captured and entered in most in-house systems—batch method or interactive method. The choice of data entry method significantly influences the organization and economics of a tax practice.

### 202.3.1 Batch Entry

Under the batch entry method, customarily used when a service bureau will be responsible for computing the returns, the tax staff fills out input sheets manually. The service bureau processing can occur either outside of the firm, in which case the input sheets are mailed to the outside service bureau, or within the firm, where the input sheets are forwarded to data processing personnel (or a data processing department). These input sheet entries are reviewed for accuracy, and then a data entry person inputs the data to a computer. Data entry items from the input sheets are usually grouped (batched) with other related items that do not necessarily appear on the same IRS tax form. Each data entry field has a unique number or tax-line code associated with it. After the data on the input sheet is entered for a specific client, the computer processes the information, prepares diagnostics or an analysis of computations and report of irregularities and prints the return.

When a service bureau is used, normally a service bureau clerical employee inputs the items on the computer. When an in-house system is in place, the data entry personnel are employed in the office of the tax practitioner. Persons working on input sheets need not be aware of, or have an understanding of, the flow or rationale of the actual completed tax return. However, completed, printed returns must be reviewed by an experienced tax professional.

#### Advantages

- Nonprofessional, lower-level professional, and para-professional preparers can be used to enter original data on input sheets, thus reducing cost.
- Data entry personnel are usually faster at inputting data than tax practitioners.
- A smaller investment in internal computer facilities is required, since every practitioner does not need a terminal input device.

#### Disadvantages

- The tax preparer cannot see the results until the return is processed—either in an off-site service bureau or on the in-house computer.
- Entry-level tax staff are deprived of on-the-job training. They learn how to fill out input sheets, not how to prepare income tax returns.
- Normally less efficient because of the duplication of effort in completing input sheets and entering data to the computer.

### 202.3.2 Interactive Entry

The tax professional enters taxpayer data directly into the computer from client records. The input screen may resemble a government form, it may be similar to input sheets, or it may be a combination of both. The computer program handles the calculations, and the preparer can read and check the results of the input almost instantly. In effect, the tax professional can have a dialogue with the tax return in the course of preparing it. A work copy of the return can be printed for review, including diagnostics. Reviewers check the return by going back to the underlying data and analyzing any relevant questions. Correct draft returns are printed out for final review and signing; returns requiring modification are corrected and then printed again.

#### Advantages

- Reviewers accustomed to reviewing input sheets instead will review actual returns—either printed (preferably) or on the screen. This will make even inexperienced tax staff more conversant with preparation of actual tax returns instead of input forms.

- It can be more efficient for preparers themselves to enter data directly, thus sparing the time to have someone else fill out input sheets and enter the information in the computer.
- Immediate feedback allows a tax preparer to immediately spot errors in data entry or calculations.
- Many practitioners report increased productivity and satisfaction of tax staff.
- The practitioner has more control of work flow and quality of finished product because of the immediate feedback. There is no need for the preparer to refamiliarize himself or herself with the facts of a particular return because of the time lapse between batch entry on input sheets and the production of the tax return.
- Direct entry can allow the practitioner to give the client a preview of prospective tax liability before the return is in its final form.
- There is a shorter learning curve among staff familiar with IRS forms.
- Less paper supplies used and fewer pages of data to save in client files.

### Disadvantages

- The method may require increased expense for computer hardware, since, ideally, every tax practitioner on staff should have access to a computer or a terminal; however, many offices are already networked so this issue is minimized.
- Input must be done by professional staff or at least by experienced para-professionals.
- Efficient use of the interactive entry method depends on the quality of the tax program used and the training and ability of the tax personnel who use it.
- Preparers must be able to move easily and rapidly between source data and the “in-computation” return. Often an inadequate paper trail of the source data makes the data difficult to identify and review.
- May be more difficult for preparers to take work home at night or on weekends since personal computer must be available.

## 202.4 Return Preparation Systems

Computerized processing of tax returns may involve—

- An in-house system.
- Service bureaus.
- A combination of in-house system and service bureaus.

Although this may seem to imply that the processing methods are mutually exclusive, some firms in fact use all of the processing methods. For example, more complex returns may be completed solely in-house, while other returns may be processed at a service bureau from data input at the firm (the service bureaus process and print the return). The choice depends on the type of return and the current workload on the in-house system.

The overwhelming trend today is for total in-house processing. However, with the opportunities afforded by electronic filing (reference Section 202.7.1 and Chapter 204), some firms that use total in-house processing are using a third-party service bureau to handle the electronic filing capabilities. Once again, the growing trend is not only for total in-house processing, but also for in-house handling of electronic filing capabilities.

The processing methods are described below, and advantages and disadvantages of each alternative are stated. Since each tax practice is unique, you will need to determine which method, or combination of methods, best fits your firm's needs.

### 202.4.1 In-House System

With the in-house alternative, data processing equipment and software is purchased or leased. The firm assumes full responsibility for data input and security, computations, turnaround time, and printing of the processed return.

## Advantages

An in-house system offers the following advantages:

### Input

- Source documents do not leave the premises; therefore, privacy is maintained.
- Client data can be entered directly into the system interactively, thereby avoiding transcription onto input forms.
- Correction of errors can occur immediately to improve turnaround time near deadlines.

### Processing

- Priorities can be determined and processing can be modified to produce an operation that is efficient and responsive to the requirements of the firm and the client. The practitioner is in control at all times.

### Output

- Turnaround time is fully dependent on, and under the direct control of, the firm.

### Costs

- Tax return processing can utilize unused computer time.
- With a large volume of returns, per-return costs drop and increased profit results.

### Planning

- Because clients' tax data is in the firm's computer, it is easier to perform "what if" scenarios and retain the data for the next year's planning sessions. Many tax preparation programs provide a link to a tax-planning program, whereby the practitioner can pull information from the previous year's return for the planning process, or move information from the planning program into the actual return preparation process.

## Disadvantages

Scheduling is an important factor with in-house processing. The bulk of tax return processing is concentrated in an approximate 75-day period (February 1–April 15). Required computer capabilities may be unavailable because of other processing commitments.

Besides scheduling, other disadvantages include the following:

### Processing

- Practitioners rely on the software vendor to supply timely updates and maintenance. Software changes for in-house programs often lag behind service bureau changes by several days because of the logistics required to get revised versions into distribution.
- Security and data backup become the practitioner's responsibility.
- A breakdown of computer equipment could be disastrous.

### Output

- All form handling must be done in-house (for handling of Electronic Filing Capabilities, reference Section 202.7.1 and Chapter 204).

### Costs

- Fixed costs as well as equipment commitment exist.
- There may be special physical facilities requirements.

If you already maintain an in-house computer operation, some of the equipment commitment has been made, and the space requirements presumably are already met. However, equipment upgrades may be necessary as programs become more sophisticated.

## 202.4.2 Service Bureaus

Data is usually sent to a service bureau in the form of completed input sheets. The bureau then performs data entry, completes the necessary computations, prints the completed returns, and returns all of the information to the practitioner.

Comparisons between service bureaus can be made easily. The evaluation, however, becomes subjective because each practitioner may have preferences for certain types of input forms and features offered.

In order to resolve inquiries posed by users, many tax processors offer assistance either by on-line terminal or by telephone. They almost always provide detailed instruction manuals explaining the usage of the system and how specific forms are to be completed.

### Advantages

The advantages of using service bureaus include the following:

#### Processing

- Generally, the tax return programs are highly sophisticated.
- Equipment requires little or no space.
- In some cases, returns can be traced, reviewed, and changed by telephone.

#### Output

- Returns are delivered to you collated in the proper sequence and requiring minimum handling.

#### Costs

- No capital investment is necessary.
- Fixed costs are low. (Charges are only for schedules and forms prepared.)

### Disadvantages

The following are some of the disadvantages in using outside service bureaus:

#### Input

- Client information leaves your office, and, despite precautions, may be subject to unauthorized access and/or use.

#### Processing

- The processing center assumes limited responsibility. You assume all responsibility for correct processing just as if processing took place in-house.

#### Output

- Turnaround time not only depends on the service center but, in most cases, on postal delivery as well. (Many services have alleviated this disadvantage by instituting a courier service that charges by location; however, the price of the courier service adds to overall costs.)

#### Costs

- Reprocessing tax returns generally incurs rather substantial additional costs.
- Absent a stated maximum fee, the costs of complex returns can be significant.

## 202.4.3 Combining Service Bureaus and In-House Systems

For some practitioners, a combination of service bureaus and in-house systems provides the best answer. A key feature of this arrangement is flexibility in selecting processing methods on a return-by-return basis. Certain returns can be handled completely in-house. The client input data is directly entered by the preparer and a completed return is output. Certain other returns

can be handled through the completion of input sheets, which are then either forwarded to an outside service bureau that mails the completed return back to the practitioner, or are entered in-house for completion of the return process.

### **Advantages**

The combination of service centers and an in-house system can produce the following advantages:

#### **Input**

- There is flexibility in managing the time spent keying information into the computer. Input data can be keyed in the office, or at the service center.
- For the client data that does not leave your premises, confidentiality is improved.

#### **Processing**

- There is flexibility in the processing requirement. Returns can be processed in the office, or at the service bureau.

#### **Output**

- Turnaround time is short.
- The return may be printed either in-house or at the service center.

### **Disadvantages**

The disadvantages follow the factors listed for in-house and service bureau alternatives, although if returns are properly screened and selected, the disadvantages can almost be eliminated.

## **202.5 Preliminary Considerations Before Selecting and Implementing a Tax Preparation System**

When selecting an automated tax preparation process, your aim is to reduce the time spent per return and improve the quality of the product in a cost-effective manner. However, a tax preparation technique that fits one firm's tax practice may fail to meet the demands of another. You can easily buy more automated capability than you really need. When selecting your system, look for the technique that both meets your needs and is cost effective. Evaluate your firm's current level of automation and computer resources, and consider the direction you would like to take. You can begin by—

- Reevaluating your return preparation methods.
- Evaluating the current computer resources and employee computer abilities.
- Analyzing the additional equipment and personnel needs.
- Evaluating your tax preparation program requirements.
- Considering your corporate, fiduciary, partnership, and state preparation needs.

### **202.5.1 Reevaluating Your Return Preparation Routines**

Before beginning (or renewing) the search for a tax preparation system, you need to consider your approach to return handling and processing. Also, be sure to consider electronic filing issues, as discussed in Section 202.7.1 and Chapter 204. As firms shift to in-house, direct-entry computerized tax return preparation, activities involved in return preparation change rapidly. Your system, too, may be ready for an overhaul. Rethink your return preparation routine. Be aware of the extent of learning and change that you and your staff can tolerate in terms of personal comfort, efficiency, and accuracy.

Remember that the costs of converting to computer tax preparation or to new and improved software are heavy. Charges for new equipment, software, retraining personnel or hiring new staff, and putting data into the new system add up. It is important to purchase software that



can continue to be used through its update versions for many years and which can adapt to your changing requirements as your firm grows.

A new system should be implemented well in advance of the current tax season. Personnel should be trained in a new program by having them enter last year's tax returns into the new program. This automatically checks the operation of the new system and produces pro formas for the coming year.

As discussed in Chapter 201, many firms are now changing their entire approach to tax preparation. Individuals meeting with clients not only gather the required tax information, but prepare the returns directly on-screen. This approach impacts not only the number of lower-level staff, but also the capabilities required in staff involved in the tax preparation process. Individuals involved in the preparation process consult with each other only on substantive issues, and reviews concentrate more on clerical errors. Finally, because personnel spend more time with clients, the opportunity to market other services, such as financial planning, is expanded. Many firms find that client relations improve as personnel are afforded a greater opportunity to directly discuss additional topics with clients.

There are, of course, problems that can arise as a result of use of interactive tax preparation methods. For example, during a hectic tax season, preparers want to quickly enter and process return changes. There is a tendency to bypass documentation of the changes, and, thus, failure to produce return audit trails. Also, because senior tax preparers and firm partners become more directly involved in preparation and input, and are under strong pressure to get the returns out, there is a danger that other firm and client responsibilities may be neglected.

## 202.5.2 Evaluating Current Computer Resources and Employee Abilities

Evaluate the computer resources already in place. Inventory the computers, software, and peripheral equipment already in your office, and estimate their current level of usage. Existing computer equipment nearly fully utilized for other work, such as word processing, may be unavailable for use with a tax preparation system. Knowing the computer resources already available to your firm is the starting point for determining if you need additional equipment to implement a new or expanded tax preparation package, and ultimately, what the additional equipment and its costs will be.

Consider the computer experience of your staff. The computer can be an incredibly frustrating piece of equipment to learn. New programs can be difficult to comprehend at first, and they may require a lot of initial setup and data entry of client information. Equipment and learning costs escalate rapidly with the new system's level of sophistication. Staff with little computer experience face a longer learning curve; the more drastic the change, the longer the curve. Carefully estimate how significant a change in the return preparation process the firm can withstand without totally disrupting the return preparation system.

Hold conferences to allow staff to express their reservations about changing the return preparation process. These meetings will give you a better idea of how comfortable the staff already is with computer systems, and their level of apprehension about change. They may be ready for a change and greet the proposal enthusiastically. Conversely, you may have to sell the idea energetically by highlighting the expected benefits.

**Practice Tip.** Many younger members of your staff have grown up with computers and are very comfortable working with them. Be sure to use the talents of this staff in evaluating your computer resources and any proposed changes.

## 202.5.3 Additional Equipment and Personnel Needs

Even if you have computer equipment in the office, it may already be fully employed performing other tasks. Any additional equipment you might need will add to the cost of installing or upgrading a system. However, these costs are not the hurdle they once were. Equipment has a useful life of several years, spreading out the expense over several tax seasons. Furthermore, the equipment has uses other than tax preparation, such as spreadsheets, tax planning, electronic tax research, and word processing. Be sure your equipment needs adequately address electronic filing capabilities, as discussed in Section 202.7.1 and Chapter 204.

## Office Space and Workstation Requirements

If you are considering a system that will require additional computer equipment, take a look around the office and consider the equipment's placement. Most offices can accommodate a few more desktop computers without any difficulty. However, a network system with numerous workstations and printers requires more attention to layout and space needs. Large network systems require considerable planning and may even require a reevaluation of the office layout and office remodeling.

Long hours will be spent at the computer terminal, especially during tax season. When choosing computer and workstation equipment, consideration must be given to the physical needs and sensitivities of the computer staff. For example, the newer VGA monitors, with their improved resolution, can reduce eyestrain, and some monitors produce less radiation than others during use. Consideration should also be given to—

- Comfortable orthopedically designed seating.
- Leg room.
- Keyboard height and distance.
- Monitor distance and angle.
- Ambient noise levels.

The benefits of a comfortable workstation are difficult to quantify. However, considering the amount of time that will be spent at the workstations, the additional expense of better equipment drops to pennies per hour while immensely improving efficiency and “quality-of-life” of the staff.

## Local Area Network (LAN) Systems

Local area networks, or LANs, connect personal computers (PCs) so the people in an office can share printers, disk drives, software, information, and data files. Thus, LANs utilize hardware more efficiently and eliminate numerous duplications of software and data. Networks can help control access to programs and information while insuring that everyone is working from a common database. Because networks centralize the database and programs, comprehensive system backups and program updates are facilitated. Also, LANs can be linked to each other.

Simple LANs, peer-to-peer systems, allow two or three stand-alone computers to share printers, disk drives, modems, and other peripherals. Intricate LAN systems require a computer to serve solely as a dedicated file server. The server handles LAN operations, controlling the network and serving as the repository for the software programs and database.

For offices with two or three computers, affordable LAN systems are available, and the installation is relatively simple. The increase in productivity normally justifies the cost.

For larger firms, LANs offer the solution to an integrated, consistent approach to computer capabilities. Maybe stand-alone PCs have proliferated around the office, and they now need something to coordinate them into a system. LANs offer an opportunity to integrate the office PCs and peripheral equipment into one system.

Using modems and home-based PC's can allow the LAN to be expanded beyond the walls of your office. The ability to access data on the firm's network from home can allow staff to be productive when kept home due to inclement weather, child-care responsibility, or to perform weekend and evening work.

The increased emphasis on work/life balance issues, including flex-time and part-time arrangements, has placed increased emphasis on telecommuting capabilities. A LAN facilitates the implementation of telecommuting capabilities, resulting in increased efficiency and enhanced work/life capabilities for personnel.

The greatest strain on a firm's LAN system will probably occur during tax season. Therefore, tax department personnel definitely should be involved in the planning for a LAN installation. A network system that cannot handle the information flow during peak periods would be a waste of money. Before installing a network, talk to other LAN users and get their feedback.

**Practice Tips.** Make certain your tax preparation system is compatible with a proposed LAN. Some tax programs are designed for specific networks only. Make sure there is one person in the office designated to oversee and direct the operation of your LAN.

The effectiveness in overall practice management from sharing information over a LAN is a major benefit from installing a network. Although stand-alone PC's may be capable of completing all tasks individually, it is only through networking that the firm can effectively integrate and monitor office-wide information. Such integrated applications include

- Billing systems
- Accounts receivable tracking
- Client continuance evaluation
- Monitoring marketing programs and strategies
- Comprehensive databases
- Monitoring contacts with clients and prospective clients
- Budgeting and scheduling
- Monitoring due dates

### **Personnel**

As discussed in Chapter 201, today's tax preparation capabilities not only allow the direct input of information when meeting with clients, but also other efficiency tools, such as electronic filing capabilities. When evaluating computerized tax preparation systems and the capabilities of these systems, consider the impact on personnel, and the role these individuals will play in the computerized tax preparation process. Remember that younger staff have virtually grown up with computers and their talents should be fully utilized by the firm.

## **202.5.4 Evaluating Tax Preparation Program Requirements**

Evaluate the types of returns your firm prepares. The best tax preparation program is the one that meets your office's needs without a lot of expensive extras. If your firm prepares a number of simple returns directly on the IRS forms, you may only need a basic program that does simple calculations and prints the most common forms. Conversely, the firm that processes many complex returns will benefit from a comprehensive tax preparation program that includes almost all federal forms and schedules, as well as the state returns the firm commonly deals with.

One technique is to sort your client base and list the forms and schedules prepared and the frequency of their preparation. Use the practice profile worksheet in Exhibit 202-1 to list your clients and tally their forms and schedules. By listing the forms and schedules and the frequency of their usage, you can gain an idea of how comprehensive a tax package you really need. For example, you probably would not want to purchase an entire state module simply to prepare one out-of-state return. However, for an additional fee, some preparation software systems allow for activation of an out-of-state module, which is only available for preparation of the specific return. In this manner, capabilities are enhanced but costs are minimized, since the fee (even for in-house processing) is incurred only when the capabilities are used. While a small, inexpensive tax preparation package might have limitations, it may handle 99 percent of the forms and schedules your firm produces. A comprehensive tax service handling all federal and state forms can be expensive, but the diversity of your clients' returns, and the return volume, may justify the increased cost.

## **202.5.5 Corporate, Fiduciary, Partnership, and State Returns**

For corporate, fiduciary, partnership, estate, gift tax, and nonprofit returns, make certain the tax preparation program or in-house tax preparation software you are considering can also handle these entities. Otherwise, you will shoulder the cost of purchasing a second program to handle these returns, or face preparing them manually.

Consider how many different state and city tax returns your firm prepares. If you have clients from many different states, you may benefit from using an outside tax processor, since many handle a wide array of state and city tax forms. In-house programs also offer state modules as additions to their tax preparation packages, but purchasing a number of state modules can become expensive. However, there are now in-house vendors that allow users to link up by

modem and process the occasional out-of-state client without purchasing the module. If you are investigating an outside service, make certain it processes the state returns your firm commonly prepares. Any in-house program under consideration should be able to provide the necessary state return modules.

## 202.6 Selecting a Tax Preparation System

A hands-on approach is the best way to evaluate tax programs. In the late summer or fall, vendors offer practitioners the chance to evaluate last year's tax programs at bargain basement prices or even gratis. Read articles from various books or publications comparing tax software, and select four or five programs for evaluation. Exhibit 202-2 provides a list of leading tax software vendors, their programs, and how users rate their software as reported in the *Journal of Accountancy*. These conclusions are based on a nationwide survey conducted by the National Association of Tax Practitioners (NATP), an organization that provides educational services and research for tax professionals. The inclusion of these exhibits is not to endorse any products, but to show the wide range of alternative products in use.

When examining software programs, look for—

- The comprehensiveness of vendor programs:
  - Forms and schedules produced
  - Printer support
  - Client letters and organizers
  - Tie-in to client write-up work
  - Networking
  - Interface with tax planning or electronic filing
- Accurate computation of the returns:
  - Carrythrough of data from form to form
  - Correct interface with state modules
  - Mathematical correctness
- User-friendliness:
  - Windows or DOS environment
  - Documentation
  - Setup
  - Ease of data entry
  - Data checks
  - Override features
- Reliability of the vendor:
  - Number of years in business
  - Level of user support

You can judge the comprehensiveness of the vendor's software programs on two levels. The first is the overall vendor offering. If your firm completes corporate, partnership, and fiduciary returns, as well as individual returns, you will want to investigate software vendors who offer these program modules. While the various modules from the same vendor may not be identical, they will have similar operating features and keying procedures.

The second level of program comprehensiveness is within the individual program modules. Can the program compute all the forms and schedules you prepare for your clients? State program modules should be able to produce the wide variety of forms states like New York and California require (see Section 202.6.6).

Examine the finished product. The quality of printed returns can vary widely.

- How much printer support does the program provide?
- Can the program produce 1040-PC format returns and provide electronic filing (reference Section 202.7.1 and Chapter 204)?

### 202.6.1 Support Documents, Cover Letters, Invoices, and Filing Instructions

Does the program produce support documents such as client cover letters, invoices, and filing instructions? Can the program furnish client organizers or interview sheets for next year? Client cover letters and organizers may not appear to be critical functions of a tax preparation program; they could be produced with a different word processing program. However, a tax program that produces these documents can save invaluable time by incorporating data from the return into the letters and organizers and avoiding typing and preparing these documents in another program.

**Practice Tip.** Clients especially like organizers that give them last year's return data to refer to when assembling their tax information for the current year. This makes the client's work easier, and the clients appreciate a firm that provides this service. See Section 201.1.2 for further information about client organizers, and turn to Exhibit 202-3 for an example of a client organizer with preprinted information from the prior year.

### 202.6.2 Input Sheets

Systems providing input sheets have tried to design them to be as straightforward and uncomplicated as possible. Examine the particular input sheets along with the training manual and instructions to see how satisfied you are with the overall style. Most vendors offer telephone assistance for input sheet entries, and many offer local training sessions.

Your staff will probably have some problems familiarizing themselves with the input sheets. While some vendors do have programs to train staff, they are usually offered in early January or February, after you have already made a commitment to the system for the coming season. So, you can expect to need and use the manual. Is it well organized and easy to understand, or is it highly technical? Save some questions for the telephone assistance service. Do they seem knowledgeable about tax matters as well as data input? If they need to look up an answer and call back later, how soon do they return your call?

**Practice Tip.** Even if you anticipate doing direct data entry without input sheets, the flow of the input sheets must still be evaluated to determine if it's logical. Each preparer needs to understand the flow of the input sheets to avoid stumbling between input screens in search of the proper field. For this reason, all preparers should have a complete set of input sheets in their desk for reference even if direct entry is used.

### 202.6.3 Pro Forma Information

Pro formas are partially filled out input sheets or data that is rolled over into next year's program. They can save a great deal of preparer time and effort. The data that appears on a tax return may be divided into two categories: (1) information related only to the period to which the return applies, and (2) information applicable to future returns. Pro formas carry repetitive information forward from one year to the next, such as client names and addresses, dividend and interest payers, names and addresses of partnerships, rental properties and their accompanying depreciation schedules, and so forth. Many systems can produce pro forma input sheets based on last year's client information.

If practitioners directly enter client data into the system, pro formas are not required since no input sheets need to be filled out. Many practitioners find this highly advantageous; not only is there a cost-saving in neither producing nor purchasing the pro formas, but the need for file space is significantly reduced by not storing input sheets for each client.

**Practice Tip.** If practitioners directly enter client data into the system, pro formas are not required since no input sheets need to be filled out. However, the lack of the previous year's actual input sheets, both for reference and as a memory refresher, may make it difficult to determine how to handle certain items in the current year.

### 202.6.4 Matching a Program to the Firm's Current Requirements

If you perform write-up work for corporate clients, there are programs that can provide a bridge to transport the information into the tax program. Corporate return preparers find this feature

to be a time saver. Another great productivity tool is audit software that codes general ledger account balances for tax. Some software makes tax groupings and adjustments as a by-product of the financial statements. Other audit programs can tie directly into the tax preparation program. The initial year set-up may be time consuming, but in the following years you can realize an impressive savings of time and effort. However, the procedures should be easy to carry out. If it is faster to enter the data manually than to interface the write-up program with the tax program, it loses its advantage.

If your firm already has an in-house network, make sure all program software will work on it. Not every program and network are compatible. Even if you have no immediate plans for implementing a network, it may be a good idea to look for software packages that operate on one.

**Practice Tip.** If you intend to participate in electronic filing, you should examine a program's electronic filing features. Some programs operate in conjunction with third-party transmitters who receive the information by modem from your office. The transmitter batches your returns with those from other practitioners and electronically files the entire batch with the IRS. Other programs allow you to file electronically directly with the IRS. Since IRS plans call for virtual total electronic filing in the future, this feature may become a must.

### 202.6.5 Assessing a Program's Computing Ability

A good tax program can do more than carry schedule totals to the first page of Form 1040. For instance, behind the computation of the regular federal income tax is the equally important computation of the alternative minimum tax. A good program must do both. Passive activities require loss limitation computations and the carryforward of suspended losses. A tax preparation program should not only handle calculations such as alternative minimum tax, passive loss limitations, investment interest expense, charitable contribution limitations, and foreign tax credits, but carry the suspended passive losses, excess capital losses, and charitable contributions forward for next year's tax program. This can be accomplished either through data files or on pro-forma input sheets the following year.

### 202.6.6 State Return Capabilities

Software vendors have the entire country as a market for their federal tax programs. The state modules, however, have a limited market and often suffer from a lack of developer attention. Software vendors usually offer state modules for New York, California, Illinois, and other major (and high volume) states, but the list often tapers off from there. Furthermore, a program may only produce a limited number of the state forms and require the preparer to fill out the other state forms manually. A good state return program carries data directly from the federal return to the state return and produces the majority of commonly prepared state forms. To test a state module, select a prior year's return with a number of difficult state forms and complete it using the state module.

### 202.6.7 User Friendliness

User friendliness begins with the documentation in a printed manual or on the screen. Both should be clear, concise, and presented in the language used by tax preparers, not computer programmers. It should contain examples of program screens and forms and provide numerous examples of the situations that can occur. Some programs even have separate manuals for practitioners and computer operators.

Documentation also consists of on-line help. With good on-line help, you can inquire about specific field or tax information directly from the computer.

The initial installation of a tax preparation program should not require a lot of time and computer expertise. The setup instructions should be clear and the operation straightforward. The initial setup is your first indication of the ease of the program operation.

The software should be easy to learn and operate. The menu system should clearly lead to program functions. It should not be necessary to search extensively through a program for the proper place to enter rental depreciation information, for example, or the sale of a stock.

Screen displays should not be cluttered, and they should show the kind of information to be entered. For example, as the cursor moves across the screen for capital asset sale entries, a screen display might read “asset title,” or “date purchased,” keying you in to the necessary entries. You should be able to move the cursor quickly through the different data fields and to skip through unused screens without being forced to pass the cursor through every data field.

**Practice Tip.** Check for limits on the number of entries for items like interest or dividends. The program should handle multiple rental or business schedules and be able to match the supporting schedules, such as depreciation.

## 202.6.8 Windows™ Environments

The overwhelming trend in the accounting profession today is toward a Windows environment. Even if your firm still operates under a DOS system, you should evaluate new tax software for compatibility with Windows. Windows operating system allows for convenient toggling between different software applications without needing to exit one program completely before entering another. This is especially useful when working with tax preparation software.

**Example.** In the middle of preparing a complex return, you need to briefly review new IRS Regulations on the accounting treatment of a certain deduction. You can simply bring up the CD-ROM research software and find the pertinent regulations. You then pop into word processing to prepare a file memo, all the while remaining in that client’s tax input file. Finally, you quickly call up the client’s year-end tax projection on the planning software to compare the treatment you gave the deduction in the projection. The time savings from using the Windows approach can be significant.

## 202.6.9 Data Checks

Data checks help you validate return information and avoid inadvertent keystrokes. For example, a program should only allow a number character where a number should go or an alpha character where a name should go. Hash totals for items like interest or depreciation are another form of data check. If a hash total for interest does not agree with the computer’s total interest figure, you know that either an individual interest amount has been incorrectly entered or the hash total is wrong. A program with good data checks can prevent errors, or at least make the errors evident, making it easier to find and correct them.

## 202.6.10 Override Features

Expect any program to have some bugs in it. Once you make that assumption, the question becomes, what override features does the program offer? If you disagree with a return’s results, you should be able to override any number in the return. A program without override features can force you back to manual preparation. However, overrides can create problems for reviewers if they are not easily identified. Software diagnostics should flag any overridden calculations. Normally, it will not be necessary to use an override feature, but an even more exasperating problem ensues when you need one and it is not there.

## 202.6.11 Diagnostics

Most tax preparation systems provide some diagnostics of the return, but the quality of the diagnostics varies from program to program. A return’s diagnostics can range from a simple comparison of return results to hash totals, to proving out items not included in the return. For example, a return subject to regular tax rates might have as a diagnostic an alternative minimum tax computation. A return with a Keogh deduction might have a diagnostic showing the maximum Keogh deduction allowable. Diagnostics can include simple reminder messages such as “Noncash contributions may require supporting documents.”

## 202.6.12 Evaluating the Software Vendor

Purchasing a software program is the beginning of a relationship between you and the software vendor. Some questions you should ask about the vendor are—

- How long has the company been in business?
- When did it issue last year's program—January or March?
- How many updates did it issue to correct problems with the program?
- Are local practitioners using the program? Can they be called?

Remember that updates can represent changes in the law and diligence on the part of the vendor as well as reflect problems in the program. A good software firm should be able to supply a reference list of local users. However, try to find other tax practitioners using the program besides those on the list supplied by the vendor. Call area firms or talk to other practitioners at association meetings to find other program users. Their opinions are more likely to be unbiased.

The first level of user support a software firm offers is documentation. A good manual can answer most questions before the need to call the software vendor arises. Just about every software vendor has a toll-free hotline for user questions, but you should find out if a response occurs in two hours or two days. As you work through the demonstration program, call the hotline with a question to test the response. Do the company's service representatives sound familiar with tax forms, or are they computer programming experts? Again, other local firms using the software are excellent sources of information about the vendor's user support.

**Practice Tip.** After using last year's programs to select the tax preparation software for your firm, enter client pro forma information in the chosen system for carryover into the coming tax season. Entering this information also begins training office personnel in the use of the new system.

## 202.7 Alternative Filing Methods

The IRS offers two alternatives to the traditional paper-filed returns for those tax preparers using computerized tax preparation software. Electronic filing has begun to sweep the nation as the IRS's aggressive publicity campaigns make more and more taxpayers aware of the benefits and as tax preparers expand their services. For those clients or practitioners not comfortable with electronic filing, the Form 1040PC can offer the speed and accuracy of computerized return preparation with an abbreviated paper form.

### 202.7.1 Electronic Filing

IRS plans call for virtually total conversion to electronic filing in the near future. Even if you do not intend to file returns electronically in the immediate future, you should become acquainted with the procedure.

The IRS first introduced electronic filing for 1986 tax returns. In its first year, electronic filing was available to only three areas nationwide. In 1987, the IRS expanded the program to include seven areas. In 1988, 16 IRS districts including 36 states accepted electronic filings. By 1989, the IRS had expanded the system to all 50 states and certain citizens living abroad.

The IRS is approving more forms every year, including business forms such as the Forms 5500, Fiduciary 1041, Partnership 1065, and S Corporation 1120-S, along with the related K-1s. The IRS will accept fiscal-year business returns as well as short-year and balance-due Forms 1041.

Because of improved efficiency and cost reductions, the IRS is actively promoting electronic filing. They report that the expense of processing a paper return averages 73 cents, compared to 3 cents for the electronically filed return. As a result of the conversion, the IRS expects to save more than \$200 million over the next 10 years. Furthermore, the IRS reports that the error rate for electronically filed returns fell to 3 percent from the old paper standard of 20 percent. Several states have also adopted electronic filing for state income tax returns.



The IRS, concerned about the rise in fraudulently filed returns, has tightened controls on new applicants seeking permission to prepare and file electronic returns. New applicants must be at least 21 years old and must be US citizens or have permanent resident alien status. They must authorize a credit check by the IRS and allow the IRS to fingerprint them to check criminal records. However, lawyers, CPA's and enrolled agents only need to show proof of their professional status.

See Chapter 204 for a comprehensive discussion of electronic filing capabilities.

## 202.7.2 Form 1040PC

Form 1040PC is a single answer sheet return that is generated on a personal computer. This return must be prepared using a computer and accepted software. Taxpayers sign the form like an ordinary Form 1040, and, if applicable, the paid preparer also signs. The return is mailed to the appropriate service center. Most forms and schedules with IRS sequence numbers may be filed in the Form 1040PC Format.

The data from Form 1040PC will still be entered manually by IRS data entry operators. However, by formatting all of a return's information on a single sheet, the return is easier for them to process, and the IRS saves on paper handling and storage costs. An example of Form 1040PC is shown in Exhibit 202-4. Form 9356, Application to Participate in the 1040PC Project, is given in Exhibit 202-5.

The IRS has also established an 1120PC pilot program to consider possible expansion of this personal computer approach for other entities.

## 202.8 Computer Security

A firm without adequate computer security is exposed to enormous risks, such as the theft of hardware and software, piracy of confidential information, malicious mischief, and data loss. For these firms, the loss of a single computer, or even a hard disk crash, could be disastrous.

Because computer systems and the information they contain are so vital, safeguards and control procedures are imperative. No computer system is complete without a security and disaster recovery plan.

The strategy behind computer security is to create a series of obstacles through which an intruder must pass, and it centers on the two major areas of security: physical and electronic.

**Practice Tip.** The greatest security comes from maintaining the integrity of a firm's staff—another important goal of recruiting and hiring policies.

### 202.8.1 Physical Security

Physical security procedures safeguard the computers, printers, supplies, printed output, and other equipment. Some physical security areas of greatest concern are—

- Personal computers are easy to carry.
- The 3.5-inch diskettes easily fit in a shirt pocket or purse.
- Printed reports, client returns, and other confidential information are produced by computer systems in great quantities.

As personal computers become smaller and lighter, they are also easier to steal. Steps must be taken to safeguard them. Record every computer's serial number and configuration so they can be reported to police and insurers in the event of theft. In addition to general building security, you can also lock individual offices containing computer equipment, and you can make a routine of storing laptop computers out of sight. Locks are available to prevent individuals from even turning on the machine.

A 3.5" diskette can fit comfortably into a shirt pocket. When diskettes contain confidential information, label them as such and store them in a secure area or locked cabinet. Have staff members log the diskettes in and out. Programs limiting access to file and disk drives are discussed in Section 202.8.2, Electronic Security, and they can help prevent the unauthorized

copying of the diskettes. Also, diskettes are often reused and find their way out of the office; therefore, use a good utility program to completely wipe the diskette clean of information.

**Practice Tip.** Computer systems produce a tremendous amount of printed material containing confidential information. Like client files and other sensitive documents, keep the information secure. The proper disposal of sensitive documents is also imperative. Use a shredder before discarding these materials.

## 202.8.2 Electronic Security

Electronic security procedures safeguard data. They are designed to curtail unauthorized access to computer programs and information; data loss due to drive crashes, accidental or malicious erasure; and virus infestations. Some electronic security measures are—

- Backup devices and procedures.
- User passwords controlling access to the computer and its programs, directories, and files.
- Audit trails of computer use by the operators.
- Virus protection programs and procedures.

### Backup Devices and Procedures

Probably the single most important electronic security procedure is the routine backup of data. Operators can easily erase data by accident or design. No one expects the hard disk drive to crash, the computer to be stolen, or the office to burn down, but these things do happen, and with little or no warning. Backups should be performed on a daily basis, and they should be stored off site to prevent loss due to theft, fire, or natural disaster.

For large systems, reinstalling separate backups of the operating system, programs, and data files onto a new hard drive could prove to be difficult and time consuming. Commercial software programs exist that condense the data, using up fewer diskettes. A number of devices, such as cartridge tape and Bernoulli drives, back up an entire hard disk. These programs and devices make backing up an entire hard drive more practical, allowing for easy restoration in the event of a crash.

Many system operators today perform daily backups of new and altered files, and once a week they back up the entire system. The importance of backups cannot be overemphasized. Computers can be replaced, but businesses have failed at the loss of critical information.

### Passwords

Although no control system can completely protect computer data from the person sophisticated in computer use, some simple techniques can greatly reduce the prospect of a security breach. They do not need to be highly refined and intricate as long as they are in place and it is not immediately obvious how to evade them.

Password programs provide a means of locking out unwanted users when the computer is powered up. Without the proper password, the computer will not boot. Once the computer is running, password programs can limit users to specific programs, files, and even disk drives, while blocking access to others. The system administrator sets the parameters for each authorized user. Password protection is far from foolproof, but it does provide one barrier to accessing computer information.

**Practice Tip.** Be sure to have adequate password protection in accessing the firm's network from a modem. Even firms that have internal password protection among employees might not be protecting external access via the modem. This could inadvertently allow any user in the world access to the firm's tax return information files simply by having knowledge of the modem telephone number.

### Computer Use Audit Trails

Another control device is an audit trail of computer usage. Audit trail programs can provide detailed reports on—

- Users logging onto the computer.
- Times the users log on and off.
- Path and file names accessed.
- Programs used.
- Keystrokes per hour.

Audit trails provide information about who is using the computer, for what reasons, and for how long. They help provide measures of employee productivity.

### **Viruses**

Virus programs have three objectives. The first goal is to infect the computer system. The virus usually invades the system riding aboard a contaminated program or data file downloaded from another computer, particularly through public bulletin board services.

The next objective is to spread. For a time, the virus remains dormant, which gives it an opportunity to spread through the system and to other computers. During this time, the virus infests backups, making decontamination more difficult.

Finally, the virus appears. Sometimes, the virus is benevolent, displaying a message like “Peace on Earth” or “Happy New Year” and then erasing itself. Usually, however, viruses are destructive: dissolving screens, locking up keyboards, filling up hard disk space, or destroying programs and corrupting data.

Viruses are controlled in two ways. One is by limiting the ability to download programs. With the use of the password and user ID programs discussed previously, the ability to download a program from a floppy disk drive or modem can be limited to authorized personnel. Also, programs are available that write-protect hard disks. Users can access programs and information, but they cannot write to the hard disk. In these systems, new spreadsheet files, document files, etc. are written to diskettes.

Second, virus protection software is available to scan new programs and disks for viruses. These programs offer fairly effective protection from many of the viruses that have appeared in recent years. Frankly, however, by the nature of the game, virus protection programs are always a step behind the latest viruses. Still, the protection program developers collect information about the latest infestations, and they issue regular program updates.

# Exhibits

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**Exhibit 202-1: Practice Profile Worksheet****PRACTICE PROFILE WORKSHEET**

The tax return schedules and forms needed in a practice, and the total usage of each, are major determining factors in evaluating alternative computerized tax return methods. Accordingly, to obtain an overview of a particular tax practice, it is imperative to review representative clients' tax return files. By recording the forms included in a client's returns, a tally of the forms used in the practice can be produced.

The example illustrates the use of the worksheet. Of the returns in the example, over 20 percent require Schedules A, B, C, D, E, SE, and ES and Form 4562. Thus, this sample CPA practice should set the availability of these schedules as a minimum requirement for accepting a computerized tax return system.

The worksheet is designed to determine a practitioner's use of individual tax return forms. A similar approach (though without the variety of forms) can be utilized for corporate, partnership, and fiduciary tax preparation.

**Exhibit 202-1: Practice Profile Worksheet (cont.)**

A PRACTICE PROFILE WORKSHEET

NAME	IDENTIFICATION NUMBER	SCHEDULES										FORMS														
		A	B	C	D	E	F	G	R	S	E	1	2	2	2	2	2	3	3	4	4	D	4	4	4	5
William Abbot	123-45-6789	X	X											X												
James Baker	111-22-3333	X																								
Michael Bates	222-33-4444	X	X															X								
Alex Craft	333-44-5678	X	X	X	X						X				X				X				X		X	X
Steven Fox	434-55-6789			X																	X					
David Gary	545-45-4545	X	X						X	X	X				X			X								
Thomas Henderson	666-77-8888				X	X		X		X								X								
David Larson	707-07-0707	X	X	X														X			X					

Paul Simon	007-00-7007	X	X		X													X								
Fred Wright	999-99-9999	X	X		X	X				X	X							X	X	X						
<b>300</b>	<b>TOTALS</b>	100	90	61	43	41	9	44	100	9	41	0	13	6	0	82	10	19	68	0	0	10	10			



**Exhibit 202-2: Tax Software Vendors and Their Ratings****Exhibit 1: How Users Rate Their Tax Software**

Vendor	Tax Program	Number of Surveys Returned	Average Number of Returns Filed by Users
AM Software	AM-Tax Professional 1040	32	231
Arthur Andersen	A-Plus-Tax for Windows	11	570
ATX Forms	Saber 1040	41	209
CCH Computax	ProSystem fx	53	483
Creative Solutions	UltraTax	53	642
Drake Software	Drake	110	860
Dunphy Systems	1040 Professional Tax Preparation	34	523
Intuit	ProSeries	247	354
Lacerte Software	Lacerte 1040 Tax Software	109	612
Micro Vision Software	Tax Relief 1040	57	655
ORRTAX Software	1040 Preferred	27	334
TAASC	The Professional Tax System	72	486
TaxByte	TaxByte Tax Prep Software*	67	655
Tax\$imple	Tax\$imple	26	329
Taxworks By Laser Systems	Taxworks By Laser Systems	20	514
TK Publishing	Tax Shop	14	339
Universal Tax Systems	Taxwise	60	495
Xpress Software	Xpress 1040 Software	10	658
<b>Average for All Respondents</b>			

**Exhibit 2: How Respondents Handled Electronic Filing**

Vendor	Tax Program	Percentage of Respondents Offering Electronic Filing	Percentage of Respondents Offering Electronic Filing	Percentage of Respondents Charging Separate Fee for Service This Year	Percentage Who Plan to Offer Electronic Filing	Percentage Who Will Charge for the Service
AM Software	AM-Tax Professional 1040	44%	33%	64%	63%	65%
Arthur Andersen	A-Plus-Tax for Windows	40	24	75	36	75
ATX Forms	Saber 1040	54	30	68	42	72
CCH Computax	ProSystem fx	51	34	33	69	57
Creative Solutions	UltraTax	50	31	59	78	64
Drake Software	Drake	93	68	32	97	31
Dunphy Systems	1040 Professional Tax Preparation	68	34	57	78	48
Intuit	ProSeries	56	31	74	76	69
Lacerte Software	Lacerte 1040 Tax Software	69	35	59	70	39
Micro Vision Software	Tax Relief 1040	49	28	86	58	81
ORRTAX Software	1040 Preferred	85	50	68	92	74
TAASC	The Professional Tax System	55	47	51	71	44
TaxByte	TaxByte Tax Prep Software*	57	56	54	74	49
Tax\$imple	Tax\$imple	46	16	75	50	67
Taxworks By Laser Systems	Taxworks By Laser Systems	75	55	33	80	44
TK Publishing	Tax Shop	86	51	45	92	42
Universal Tax Systems	Taxwise	88	60	51	92	46
Xpress Software	Xpress 1040 Software	80	50	88	90	56

\*Product discontinued.

SOURCE: Stanley Zarowin, "Rating Tax Software," *Journal of Accountancy*, September 1999, pp. 27-29.



**Exhibit 202-2: Tax Software Vendors and Their Ratings (cont.)**

Program in 1998	Program in 1997	Satisfaction With (1 = very dissatisfied and 5 = very satisfied)		Network in 1998	Plan to Use Product Next Year		
		Customer Support in 1998	Customer Support in 1997		Yes	No	Undecided
4.19	4.32	3.94	4.07	4.50	88%	3%	9%
3.82	N/A	4.55	N/A	3.50	55	9	36
3.32	3.41	3.56	N/A	3.33	63	15	23
3.92	4.25	4.02	4.38	4.28	85	6	9
4.12	4.08	4.00	3.76	4.13	91	6	4
4.17	4.21	3.81	4.05	4.29	93	5	2
4.21	4.39	3.97	4.20	3.88	85	0	15
3.99	4.17	3.76	3.89	3.57	85	2	13
4.20	4.50	3.98	4.49	4.17	90	5	6
3.35	4.12	3.14	3.67	3.44	58	16	26
3.56	N/A	3.41	N/A	2.50	74	7	19
3.72	3.97	3.49	3.96	4.11	78	7	15
4.28	4.57	4.20	4.43	4.50	N/A	N/A	N/A
3.72	4.10	3.88	4.4	3.87	85	8	8
3.55	4.15	3.70	4.5	4.00	70	25	5
3.79	3.41	3.57	2.57	N/A	86	7	7
4.21	3.82	3.97	3.8	4.38	93	3	3
3.80	4.29	3.60	4.19	2.67	70	10	20
3.95	4.22	3.81	3.74	4.00			

**Exhibit 3: Tax Software Vendors**

Vendor	Tax Program	Address	Telephone	E-mail address
AM Software	AM-Tax Professional 1040	PO Box 25010, Kansas City, Mo. 64119	800-859-8537	support@amtax.com
Arthur Andersen	A-Plus-Tax for Windows	2805 Fruitville Road, Sarasota, Fla. 34237	800-872-1040	aplustax@arthurandersen.com
ATX Forms	Saber 1040	PO Box 1040, Caribou, Me. 04736	800-944-8883	sales@atxforms.com
CCH Computax	ProSystem fx	21250 Hawthorne Blvd., Torrance, Calif. 90503	800-457-7639	cust_serv@cch.com
Creative Solutions	UltraTax	7322 Newman Blvd., Dexter, Mich. 48130	800-968-8900	sales@CreativeSolutions.com
Drake Software	Drake	235 E. Palmer Street, Franklin, N.C. 28734	800-890-9500	drakeinfo@drake-software.com
Dunphy Systems	1040 Professional Tax Preparation	6740 Huntley Road, Suite 103, Columbus, Ohio 43229	614-431-0846	dunphy@dunphy.com
Intuit	ProSeries	2535 Garcia Avenue, Mountain View, Calif. 94043	800-934-1040	www.proseries.com
Lacerte Software	Lacerte 1040 Tax Software	13155 Noel Road, 22nd Floor, Dallas, Texas 75244-5088	800-765-7777	www.lscsoft.com
Micro Vision Software	Tax Relief 1040	140 Fell Court, Hauppauge, N.Y. 11788	800-829-7354	www.microvisioninc.com
Orrtax Software	1040 Preferred	13208 NE 2 Bellevue, Wash. 98005	800-377-3337	webmaster@orrtax.com
TAASC	The Professional Tax System	6914 S. Yorktown Avenue, Tulsa, Okla. 74136	800-998-9990	sales@taascforce.com
TaxSimple	TaxSimple	8 Emery Avenue, Randolph, N.J. 07869	800-989-8955	sales@taxsimple.com
TaxByte	TaxByte Tax Prep Software	1801 6th Avenue, Moline, Ill. 61265	888-829-2983	taxbyte-inc.com
Taxworks By Laser Systems	Taxworks By Laser Systems	350 North 400 West, Kaysville, Utah 84037	800-230-2322	www.taxworks.com
TK Publishing	Tax Shop	5422 Carrier Drive, Suite 201, Orlando, Fla. 32819	800-639-1040	sales@taxshop.com
Universal Tax Systems	Taxwise	6 Mathis Drive NW, PO Box 2729, Rome, Ga. 30164-2729	800-755-9473	sales@universalsystems.com
Xpress Software	Xpress 1040 Software	203 Bradley Drive, West Columbia, S.C. 29170-2404	800-285-1065	sales@xpresssoftware.com

**Exhibit 202-3: Client Organizer Information**

EXAMPLE 1—TAXPAYER/SPOUSE GENERAL INFORMATION

Taxpayer's First Name and Initial <b>ROBERT R.</b>				Spouse's First Name and Initial <b>RUTH S.</b>				Last Name <b>BOULDER</b>			
Street <b>1201 CRESTVIEW</b>				City <b>ANYTOWN</b>				Taxpayer Year of Birth (4 Digits)	Spouse Year of Birth (4 Digits)		
State <b>ANYSATE</b>		Zip Code <b>XXX13</b>		County <b>JACKSON</b>							
Taxpayer's Soc. Sec. Number <b>2 1 2 3 0 4 7 6 9</b>		Taxpayer's Occupation <b>SALESMAN</b>									
Spouse's Soc. Sec. Number <b>3 3 1 2 6 9 6 1 1</b>		Spouse's Occupation <b>BROKER</b>				<b>1932</b>	<b>1932</b>				

Dependent Children Who Live With You

Enter Total No. of Children Claimed	Taxpayer <b>2</b>	Claimed by Taxpayer <b>JAMES, KENNETH</b>
	Spouse	Claimed by Spouse

EXAMPLE 2—DIVIDENDS

	t s j	Qualifying Portion	Nonqualifying Portion	Capital Gain Portion	Nontaxable Portion
*AMERICAN ELECTRIC POWER CO., INC.	T				
*AMERICAN GENERAL BOND FUND, INC.	T				
*BARNES MORTGAGE INVESTMENT TRUST	T				
*DAYTON HUDSON CORP.	S				
*EXXON CORPORATION	S				
*HOTEL INVESTORS	J				
*ILLINOIS POWER COMPANY	J				
*NATURAL GAS PIPELINE CO. AMERICA	T				
*PUBLIC SERVICE ELECTRIC & GAS CO.	T				

\*This part is computer printed.  
t= taxpayer; s = spouse; j = joint

In some systems, prior year amounts are shown.

EXAMPLE 3—CONTRIBUTIONS

t s j		Amount	Prior Year
T	* HIS UNIVERSITY		200.00 *
J	* UNITED WAY		15.00 *
J	* OUR CHURCH		125.00 *
S	* HER ALMA MATER		200.00 *

\*This part is computer printed. Total Contributions 540.00 \*

Exhibit 202-4: Sample 1040PC Format Return

[ IRS USE ONLY ]

01011998 29 OMB NO. 1545-1309  
 1998 1040PC FORMAT U.S. INDIVIDUAL INCOME TAX RETURN PAGE 01 OF 01

! TESTN<ERTIA 400-01-1001 06  
 !  
 !  
 ! 215 LAID BACK WAY  
 ! LAZY POINT NY 11930-2150  
 !  
 !  
 ! PPECF N SPECF N FS 1 6A-SELF X 6B-SPOUSE X  
 ! DEP RES 01 6D-TOTAL 03

---

DEPD INFO ! 66A--REFUND-----1049 ! 28-----20880  
 6C1--LITTLE>DEAL----- ! PREP-JOHN DOE----- !  
 6C2-----555661111 ! FIRM-TAX SERVICE----- !  
 6C3--DAUGHTER----- ! ADD--310 WHITE STONE-- ! ADD INFO  
 6C4-----X ! CSZ--ANYTOWN NY 10021- ! PDI-----100000000  
 ! SSNP-----000-00-5001 ! SEI-----  
 ! PEIN-----32-0000032 ! SC-----Z9  
 1040 PAGE 1 ! POCC-SALESMAN----- !  
 7-----58500 ! SOCC-CLERK----- !  
 22-----58500 !  
 33-----58500 !  
 ! DIR DEP INFO !  
 ! 66B-----056789123 !  
 1040 PAGE 2 ! 66D--10203040506070809 !  
 34-----58500 ! 66C-----C !  
 35-----20880 !  
 36-----37620 !  
 37-----7950 ! SCHEDULE A - 07 !  
 38-----29670 ! 5-----2150 !  
 39-----4451 ! 6-----980 !  
 46-----4451 ! 9-----3130 !  
 53-----4451 ! 10-----15000 !  
 54-----5500 ! 14-----15000 !  
 60-----5500 ! 15-----2750 !  
 61-----1049 ! 18-----2750 !

TOTAL INCOME LINE 22 58500 TOTAL TAX LINE 56 4451  
 TOTAL PAYMENTS LINE 64 5500 REFUND LINE 66A 1049

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

\_\_\_\_\_  
 Your Signature Date Spouse's Signature Date

\_\_\_\_\_  
 Preparer's Signature Date IRS USE ONLY PAGE 01 OF 01  
 For Paperwork Reduction Act Notice Statement, see Taxpayer Notice 974  
 01011998 29

**Exhibit 202-5: Form 9356**

Form <b>9356</b> (Rev. Sept. 1995)	Department of the Treasury - Internal Revenue Service <b>Application for Software Developers to Participate in the                  1040PC Format for Individual Income Tax Returns</b>	OMB Number 1545-1250
1. Firm Name		2. Contact Person
3. Street Address		4. Telephone Number  (    )
5. City, State, Zip Code		6. Fax Number (if available)  (    )
7. The intended market to use the software developed will be: (Check any that apply)		
This Firm <input type="checkbox"/> Professional Tax Preparers <input type="checkbox"/> Self-preparers/PC <input type="checkbox"/>		
8. Complete this application and return to: Internal Revenue Service Cindy Travis / OP:FS:S:P:S / C5-141 5000 Ellin Rd Lanham, MD 20706 fax (202) 283-4857 Questions/Comments (202) 283-0823 E-Mail - CINDY.L.TRAVIS@CCMAIL.IRS.GOV		9. What type(s) of software will you be submitting for testing i.e., DOS, WINDOWS, MACINTOSH, etc., and how many packages?  Your E-Mail Address (if available):
10. Check the box(es) if your firm's name and address may be made available to the following:		
<input type="checkbox"/> Taxpayers seeking tax preparation software featuring the 1040PC format return <input type="checkbox"/> Preparers seeking tax preparation software featuring the 1040PC format return		
<b>Contractual Agreement</b>	I will comply with all provisions of the Specifications for filing 1040PC format returns. I understand that my not meeting all the criteria will result in my not being allowed to participate in the program.	
11. Name of Firm Representative		12. Title
13. Signature of Firm Representative		14. Date
<p><b>Paperwork Reduction Act Notice</b> - We ask for the information on this form to carry out the Internal Revenue laws of the United States. We need to process your application to file individual tax returns under the 1040PC program. You must give us this information if you wish to participate.</p> <p>The time needed to complete this form will vary depending on individual circumstances. The estimated average time is 15 minutes. If you have comments concerning the accuracy of this estimate or suggestions for making this form simpler we would be happy to hear from you. You can write to the Internal Revenue Service, Washington, DC 20224, Attention: IRS Reports Clearance Officer, T:FP application to this address. Instead, send it to the address shown above.</p> <p>NOTE: The Internal Revenue Service requires that software developers successfully pass an IRS software test. This software test consists of two parts: (a) review of the output of the software program to insure compliance with format specifications and (b) test of the software program itself to ensure compliance with the validity and consistency checks of the specifications.</p>		



# 203 Researching Tax Law and Maintaining a Technical Reference Library

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# 203 Researching Tax Law and Maintaining a Technical Reference Library

Clients rely on their tax practitioners to find the answers to tax questions. Responding to these inquiries is a service practitioners must provide. But the answers are not always at your fingertips. Sometimes research must be done and, if it is to be profitable, research must be effectively managed. In fact, tax research requires the framework of an effective quality control system; otherwise, you may find yourself the target of a lawsuit brought by a disgruntled client.

An effective quality control system for tax research assures that it is done completely and efficiently. Not surprisingly, this is also the key to making the service profitable. Haphazard research will almost always result in underbilling.

Recent tax law revisions have been numerous, frequent, and complex. The demands on you and your firm to find the right answers to tax questions have increased significantly. This chapter provides a framework to assist you to—

- Manage the tax research process.
- Develop effective research strategies.
- Locate the proper resources for answers.

**Practice Tip.** You need a formal approach for scheduling and performing tax research assignments. Estimate the time involved, the expected completion date for the tax research, and monitor the progress of the research.

## 203.1 Research Strategy

To perform effective tax research, use a structured research strategy to control the cost of the research and avoid underbilling the client. While practitioners vary in their specific approaches to tax research, the conventional steps involve the following procedures:

1. Determine the facts.
2. Formulate the question.
3. Locate the applicable authorities.
4. Answer the question.
5. Communicate the research results.

### 203.1.1 Documenting Research

You can't perform research without taking notes detailing the question being researched, the authorities located, and any thoughts, opinions or conclusions you reach. Careful documentation



allows you to quickly recall what research has already been done and to assess what remains to be resolved. Accurate notes are especially important if you are working on several projects simultaneously or if you are returning to a project after some time has elapsed. Notes are the basis for communicating the research results to others and provide evidence of due diligence in the performance of the research. Good documentation provides the basis for efficient future research and often allows past research to answer all or a portion of new questions.

**Practice Tip.** Thorough documentation provides guidance and training for new firm members learning research techniques. Documentation also helps to prepare a detailed client bill and substantiates how the bill was calculated.

### 203.1.2 Determining the Facts

Incorrect fact determination is the major cause of research errors. Keep in mind that the client usually does not know what information you need; therefore, *ask questions* to probe the situation beyond the client's surface description of facts and events. See Exhibit 203-1 for a Tax Research Request Form.

**Example.** Your client is the majority shareholder of a corporation. She calls and tells you she wants to make a loan to the corporation, and asks if interest paid on the loan will be deductible to the corporation. IRC Sec. 385 lists five factors to consider when making a debt-equity determination. Ask questions! Obtain all the facts necessary to assess the five factors. The shareholder probably does not realize the potential problems a loan to the corporation can cause.

**Example.** A client calls and tells you he wants to contribute an office building to a partnership in exchange for an interest in the partnership. He wants to know the tax effects of the proposed transfer. Get the facts! For example, will the partnership assume a mortgage on the building? If the portion of the mortgage debt assumed by the existing partners is greater than the new partner's basis in his partnership interest, the excess will be taxable income to the new partner.

Formulating a clear fact pattern avoids wasting time researching irrelevant situations and is essential to finding similar situations that may provide a precedent. Formulating a clear fact pattern involves—

1. Standard information-gathering forms.
2. Interviews with clients.
3. Detailed review of financial records, client files, correspondence, corporate minutes, bank statements, brokerage account statements, sales and other agreements, and so forth.

#### Planning

When events have not yet occurred and no facts are established, the opportunity to plan exists. Tax planning is actually establishing the optimal set of facts for a particular desired tax result.

1. A client interview or series of interviews establishes the taxpayer's goals and reveals any blocks to achieving those goals.
2. The tax researcher then proposes transactions and procedures—fact patterns—that will achieve those goals.

### 203.1.3 Formulating the Question

To provide a direction for research, write out the question to focus the nature of the problem. Draft a descriptive paragraph detailing the situation and listing the relevant tax issues. Defining the question and the related tax issues prepares the way for the next step, the search for authorities. More often than not, a series of corollary or related questions must be stated and resolved before the researcher can proceed to a conclusion. Raising collateral questions returns

the researcher to fact-gathering, a reciprocal process that continues until all possible inquiries into facts and circumstances pertinent to the issue have been exhausted.

Tax questions fall into two broad categories:

1. Sometimes the facts of the question are subject to interpretation. Determining the proper tax treatment is a matter of interpreting the facts. When the interpretation of the facts is subject to question, your research needs to be directed toward finding similar fact situations to support your interpretations. Problems arise when it appears that two or more laws may apply. Some facts suggest that one Code section is applicable, but others point to another Code section—with conflicting results. Perhaps no Code section or regulation appears to address the specific issue. This category requires *comparison* of the client fact pattern to the fact patterns of case law and regulations to locate the closest likenesses.

**Example.** Your client is a general partner in a partnership. She worked more than 500 hours for the partnership, and you believe she meets the requirements for material participation under the passive activity loss rules. However, some of those hours were spent cleaning the office carpet. An IRS agent might contend that owners manage, but do not customarily perform carpet cleaning, and the cleaning was performed merely to avoid the passive loss limitations.

2. Sometimes the facts are clear. To research the question, you simply need to locate the applicable law or regulation.

#### 203.1.4 Cost/Benefit Analysis

Accounting students take their first look at a tax library and tend to believe it contains the answer to every tax question that might ever arise. Upon entering practice, these same new accountants are surprised to learn how difficult it can be to find authoritative answers for specific tax questions.

Once you have determined the facts and formulated the question, you need to make some important decisions before researching the law, regulations and precedents:

- How much research is the client willing to pay for?
- How great a tax advantage will a favorable result provide, and what would the costs be if the IRS disputed the position?
- How much risk is the client willing to take?
- How much risk are you willing to take?

In other words, what is the cost/benefit tradeoff to you and your client? You need to consider your risks as well as your client's. Tax practitioners as well as their clients can face penalties for incorrect or frivolous tax positions. A mistake on your part could also result in a malpractice suit. The rewards of performing the research should be worth the time and expense after considering the risks facing both the client and the practitioner.

Refer to Section 301.3, the rules governing conduct in tax practice, to help clarify risks and responsibilities when conducting tax research. Section 301.3.1 discusses IRS Circular 230 and Section 301.3.4 discusses the AICPA Statements on Responsibilities in Tax Practice (SRTP). In particular, SRTP No. 1 (1988 Rev.) defines *tax return position*, and provides guidance on the standards a CPA should follow in recommending a tax return position.

**Practice Tip.** Make your clients aware that continual changes in the tax law have increased the amount of research necessary to answer even relatively simple questions.

**Practice Tip.** Emphasis should be placed on training staff in cost effective and efficient techniques. Budgets should be used and clients should be made aware of the costs before a project is begun.

#### 203.1.5 Locating the Applicable Law and Authority

Having formulated the tax question to address, your next step is to locate and review the appropriate authorities. You can begin the research by locating key words of your question in

the index of a tax service. If you are using a computer-assisted tax research service, begin the research by rephrasing the question as a database query (see Sections 203.6 and 203.7). As the research progresses, you may have to redefine the question to narrow its scope. Collateral issues may also arise, requiring research on additional subjects. You may need to go back to the client to obtain more details.

Research using a traditional tax service can begin with either the key word method (also known as the index method) or the Code section method:

- *The key word method* is effective when you are not familiar with the code section that governs the question. Match key words or phrases from the question with the key words and phrases listed in the index of the tax service. The index identifies where in the service the subject is discussed. The text usually contains references to other authorities on the subject.
- *The Code section method* is effective when you are familiar with the appropriate Internal Revenue Code section involved in the question. Some tax services indicate the Code sections covered by each volume on the spines of the binders. The text discussion of the Code section will include references to other authorities covering that section. The Code is often overlooked as the quickest source of an answer.

If you are already familiar with authority relevant to the subject under consideration, you can begin by referring to it directly. For example, if you know of a relevant Tax Court decision, begin by reading the text of the decision. The decision itself is likely to cite other authorities you can pursue. For a discussion of research using a tax service on CD-ROM, see Section 203.7.

**Practice Tip.** Locating relevant articles about the topic you are researching is an effective way to begin tax research. Articles can be quickly located by using an on-line service (the TX-TP library on Westlaw and the WGLTXJ and TNT Libraries on Lexis are good sources) or by using an index of tax articles. (See Section 203.5.6 for a discussion of indexes of tax articles.) Another good resource for locating tax articles can be found at <http://www.riatax.com/journals/jourhom.html>.

### 203.1.6 Updating Authority

Given the dynamic nature of tax law, it is essential that you periodically check authorities you have relied upon to determine if they are still valid. Court cases can be updated by using a citator. (For a discussion of citators, see Section 203.5.5.) New developments that affect the status of other sources of authorities can be found by using a tax service. Electronic databases are the most effective means of checking the current status of your research (see Sections 203.6 and 203.7).

### 203.1.7 Answering the Question

Answering a tax question is not an exact science. The researcher may encounter questionable or conflicting authorities. In fact, it is possible that there is no definitive answer to the question posed. In reaching a conclusion, you must consider the value of any authority relied upon as precedent, as well as the strength of any contrary authorities. In all cases, be sure you review your analysis of the tax issues and your conclusions with another member of the firm. For further information on recommending tax positions, refer to Section 301.3.4, herein, for a discussion of the AICPA's SRTP No. 1: Tax Return Positions.

### 203.1.8 Documenting Research Results

Once you have formulated an answer to a tax question, you should maintain a written record of the research results. The record should include the fact pattern, the relevant tax issues, the conclusions reached, and the logic behind those conclusions. For each conclusion, indicate the authorities relied on, including direct quotations from the sources. Any contrary authorities should also be cited. Exhibit 203-2 contains a Tax Research Results Form that can be used to

document research results for office files and communication with others in the office. Documenting the client's file with the research results and client communications is important to support the tax position taken on the client's return. One of the requirements of the AICPA tax practice review program is that the firm have written guidance material regarding documentation of tax research.

Oftentimes tax preparers undertake research simply to get an idea or indication of what the IRS stance on a tax position may be. This type of research is usually less than formal. It may or may not have been initiated by the client; the preparer may simply be verifying the proper treatment of a client transaction. It often consists of photocopies of the relevant pages from a tax research publication with the pertinent sentences or paragraphs highlighted. While research of this type should be part of the working papers in a client file, it should never be circulated outside of the firm.

**Practice Tip.** Establish an office tax research memoranda file for future reference by other practitioners in your office. Organize it by topic or by Code section. Include copies of relevant articles, newsletters or other materials that you come across. If a similar tax question comes up in the future, the past work can be utilized to speed up the research process. Of course, any research that is used from the file will need updating for changes in the law. You will also need to consider methods of maintaining client confidentiality.

**Practice Tip.** Many computer word processing or database programs will allow you to enter "fields" of information about a document that will help you search and locate documents quickly. If your firm has a computer network, you can do a field search to determine whether another member of the firm has written a memorandum on a particular topic. Field searches are most effective if the firm has a standardized procedure for categorizing documents.

### 203.1.9 Reviewing Research

Ideally, research results and reports should be reviewed to provide an element of quality control. Whenever possible, reviews should be performed by a staff person familiar with the client's file and comfortable with the tax issues covered by the research. The reviewer is responsible for approving the overall conduct of the research and the presentation of the results, that is—

1. Seeing to it that all pertinent facts have been obtained and considered.
2. Determining the economic propriety of a proposed arrangement or transaction.
3. Checking for appropriate authorities.
4. Checking the logical conclusions derived from authorities.
5. Checking accuracy of citations.
6. Editing the report itself for clarity and comprehensibility.

Review can be most efficiently accomplished when research is performed in a standardized fashion. Standardized forms such as those shown in Exhibits 203-1 and 203-2 for Research Requests and Research Results organize information so it can be easily followed by a reviewer. Omissions can be quickly spotted and errors in logic can be rapidly noted.

### 203.1.10 Communicating Research Results to the Client

Research results need to be communicated to clients. Your report should state the conclusions reached and authorities relied upon. When doing this, it is especially important to consider the client's level of tax sophistication and to state the information clearly. Ask the client to review the correctness of the facts you relied on to formulate your answer. State that the conclusions and advice are based on your professional judgment, and avoid presenting research advice as concrete fact. Always advise the client *in writing* of the risks involved in relying on the advice. Clearly warn the client of any potential controversy with the IRS and the possible need for adequate disclosure in the tax return to avoid penalties. Always keep a copy of the report in the client's file. For further information on client communications, refer to Section 301.3.4, herein, for a discussion of the AICPA's SRTP No. 8: Form and Content of Advice to Clients.

**Practice Tip.** When performing research for tax planning purposes, present the findings to the client with a calculation of tax savings as the bottom line. Show the tax results of the various alternatives and highlight the tax savings of the proposed alternative. The client may justify your fees based on the tax savings.

Present formal research findings in a polished format. After all, the research findings are the final product that justifies your fees.

## 203.2 The Creation of Tax Law

Federal income tax law derives from Congressional statutes, which are compiled in the Internal Revenue Code. Before 1939, the federal tax laws were a series of separate revenue acts that stood independently of each other. Because of the inconvenience and confusion that resulted from so many separate tax acts, Congress codified federal tax law into the Internal Revenue Code of 1939.

The 1939 Code separated the various tax measures from the other federal statutes, and arranged the tax laws in a logical sequence. In 1954, Congress again rearranged and recodified the tax provisions in the Internal Revenue Code of 1954. Although Congress did not recodify the tax laws with the Tax Reform Act of 1986, the extent of the changes prompted Congress to rename the federal tax laws the Internal Revenue Code of 1986.

Any statutory amendments to the tax laws are also integrated into the Code. For example, the Deficit Reduction Act of 1984 became part of the Internal Revenue Code of 1986, and the Technical and Miscellaneous Revenue Act of 1988 became part of the Internal Revenue Code of 1986.

The legislative process that generates the tax statutes typically proceeds as follows:

1. A public hearing is held by the Ways and Means Committee of the House of Representatives to discuss potential additions or changes to the tax law.
2. The Ways and Means Committee prepares a tax bill.
3. The House of Representatives votes on the bill and, if the bill passes, sends it to the Senate.
4. The bill is then referred to the Senate Finance Committee, which prepares its own version.
5. The Senate votes on the bill and, if it passes, sends the bill to a Joint Conference Committee, which is composed of members of the House and Senate.
6. The Joint Conference Committee resolves any differences in the two versions of the bill and sends the compromise version to both the House and the Senate.
7. If approved by the House and Senate, the bill is sent to the President.
8. If the President signs the bill, or if a Presidential veto is overridden by Congress, the bill becomes a Public Law.

## 203.3 Sources of Tax Law Information

The most authoritative source for answers to tax questions is the Internal Revenue Code. The language of the Code, however, can be vague and is often subject to interpretation. Thus, you must often look beyond the Code for definitive answers to tax questions. When the Code's language is not explicit enough to provide the answer to a given question, the next step is to locate authoritative interpretations. The following discussions consider the statutory, administrative, and judicial sources for interpreting the tax laws. These sources can be found in a tax library (see Section 203.4), on a CD-ROM (see Section 203.7), in an electronic database accessible by computer (see Section 203.6), or on the Internet (see Section 203.9).

### 203.3.1 Statutory Sources

Statutory sources of tax law include the texts of the tax laws themselves. The legislative history of those laws documents the intent of the legislators who wrote the statutes.

## The Internal Revenue Code

The Internal Revenue Code, Title 26 of the U.S. Code, can readily provide answers to tax questions when the language of the relevant section is sufficiently explicit. The Code is divided into the following subtitles:

- A — Income Taxes
- B — Estate and Gift Taxes
- C — Employment Taxes
- D — Miscellaneous Excise Taxes
- E — Alcohol, Tobacco, and Certain Other Excise Taxes
- F — Procedure and Administration
- G — The Joint Committee on Taxation
- H — Financing of Presidential Election Campaigns
- I — Trust Fund Code
- J — Coal Industry Health Benefits
- K — Group Health Plan Portability, Access, and Review Requirements

Subtitles are divided into chapters that, in turn, are divided into subchapters. Subchapters are divided into sections which are themselves divided as follows:

- Section
  - (a) subsection
    - (1) paragraph
      - (A) subparagraph
        - (i) clause

When it is necessary to trace the history of the Code back from 1986 to 1954 to 1939, and through various revenue acts, Code Volume I of CCH's *Standard Federal Tax Reports* provides cross-reference tables for the Code sections in the 1954 and 1939 laws. Barton's *Federal Tax Laws Correlated* (FTLC), published by Warren Gorham & Lamont, guides researchers between 1939 and 1954 Codes and prior acts and also references Committee Reports. Exhaustive tax legislative history is also available in Tax Management's *Primary Sources* (Bureau of National Affairs), which covers tax law from 1969 through the present.

## Congressional Committee Reports

Researchers are sometimes uncertain whether a Code section applies to the tax situation being researched. By consulting the Congressional committee reports, researchers can often discern the intent of the legislators who wrote the statute. Congressional committee reports are accounts of the various committee deliberations on the provisions of the bill. They are published by the Government Printing Office and can be found in the weekly *Internal Revenue Bulletin* (IRB) and the subsequent compilation of IRBs in the semiannual *Cumulative Bulletin* (CB). These reports are also contained in the *U.S. Code Congressional and Administrative News* (USCCAN), published by West Publishing Company and Tax Management's *Primary Sources* (Bureau of National Affairs). Some of the tax services also include portions of committee reports with the text of the related code sections. Relevant committee reports for tax research include:

- Report of the House Ways and Means Committee
- Report of the Senate Finance Committee
- Conference Report of the Joint Conference Committee

In addition, it may be possible to discern the intent of the legislators by considering their comments during the debate on the proposed bill. Such comments can be found in the *Congressional Record*. Finally, explanations of major tax statutes known as Blue Books are prepared by the staff of the Joint Committee on Taxation and are available from the Government Printing Office.

**Practice Tip.** Congressional committee reports and other legislative materials can be found at <http://thomas.loc.gov>.

## 203.3.2 Administrative Sources

When doing tax research, it may be necessary to know the interpretation of the tax law by the administrative agency charged with enforcing that law—the Treasury Department, or its division, the Internal Revenue Service (IRS).

### Treasury Regulations

Treasury Regulations state the Treasury Department's interpretation and position on the various sections of the Internal Revenue Code. The regulations offer advice and guidance on the intent and application of the Code, and they carry considerable weight in tax cases. There are two types of regulations:

1. *Legislative Regulations.* Under certain sections of the Internal Revenue Code, Congress delegated to the Secretary of the Treasury specific authority to write detailed rules concerning how to interpret the sections. For example, Section 1502 authorized the Treasury to issue the legislative regulations that contain the procedural rules for consolidated returns. As a practical matter, legislative regulations have the force and effect of law. They must be upheld by the courts unless they are unreasonable, exceed the scope of the delegated power, or are contrary to the statute.
2. *Interpretive Regulations* (generally referred to simply as regulations). These contain the IRS's opinion or interpretation of the various sections of the Code. They are also given great weight by the courts, especially if the related statute has been reenacted without changes. An interpretive regulation can be disregarded by a court if the court determines that the regulation is in conflict with the intent of Congress.

Regulations are almost always upheld by the courts. Even when a court invalidates a regulation, the IRS may continue to enforce it until it is overturned by the Supreme Court.

**Temporary and proposed regulations.** New regulations and changes to existing ones are issued in proposed form to allow for public comment on the proposal. Occasionally, when speed is important, the Treasury issues temporary regulations to provide guidance in areas where the tax law has changed. Temporary regulations issued after November 20, 1988, however, must be simultaneously issued in proposed form.

Proposed regulations are published initially in the daily *Federal Register* to allow taxpayers to express their views on the proposal before it is finalized. Proposed regulations are still useful, however, because they represent the IRS's interpretation of the code. Regulations often can remain in proposed form for several years. Final regulations are printed as Treasury Decisions (TD) in the *Federal Register* and are reprinted in Title 26 of the *Code of Federal Regulations* (CFR).

Temporary regulations have the force of law and can remain in effect for up to three years. The IRS issues temporary regulations as stopgap measures until they issue the regulations in final form. Tax law establishes a presumption of the retroactive application of an adopted temporary regulation to the date of issuance as a temporary regulation unless (1) it would be an abuse of the IRS's discretionary rulemaking power, or (2) the IRS specifically states it will not apply the regulation retroactively. To challenge the retroactive application of a regulation, a taxpayer must present substantial evidence that the IRS was abusing its power by issuing the regulation retroactively.

**Practice Tip.** Researchers can search the Federal Register and the Code of Federal Regulations at <http://www.access.gpo.gov>.

### The IRS Rulings Program

The IRS has developed its rulings program over the years in response to the taxpayer's need for assurance regarding the tax consequences of proposed transactions. The ruling program is

broadly divided into two parts: the private letter ruling program and the published rulings program.

**Private letter rulings.** Rulings issued by the national office of the IRS in response to direct written inquiries by individual taxpayers are known as *private letter rulings* or simply *letter rulings*. Letter rulings provide tax practitioners and their clients the opportunity to obtain the IRS's position on a proposed transaction before the transaction has been consummated. In the event of an adverse letter ruling, a client can restructure the transaction to overcome IRS objections.

Letter rulings can be revoked or modified, with retroactive effect. However, because letter rulings are designed to allow taxpayers to know the IRS's position when structuring a transaction, the IRS rarely revokes a ruling retroactively. Also, when letter rulings are revoked, because of the large volume of rulings each year, the IRS is not required to notify each individual taxpayer whose letter ruling was affected by a change in the government's position on prior rulings. Notice of the change may be given in the *Internal Revenue Bulletin*.

The IRS has announced it will no longer issue letter rulings with respect to questions that are clearly and adequately addressed by published authorities. The IRS contends that many letter rulings are needless and are requested by taxpayers as a form of self-insurance. Instead, guidelines will be provided in the form of model documents, rulings, checklists, and "automatic action" procedures that taxpayers may rely on for particular transactions (Rev. Proc. 90-42, 1990-2 C.B. 420). When deciding whether or not to seek a letter ruling, the researcher must determine if the tax question falls into an area the IRS will rule on. Revenue procedures published by the IRS list the areas where the IRS will not issue advance rulings (Rev. Proc. 99-3, 1999-1 I.R.B. 103). Furthermore, the IRS changes the list periodically, so researchers must check for updates.

Under the Freedom of Information Act, letter rulings issued after October 31, 1976, must be made public by the IRS, once the IRS has deleted details identifying the taxpayer. Tax services publish digests of letter rulings, and you also can receive the full text of rulings from the tax services and from the IRS on a subscription basis. In addition the text of letter rulings is available and easily searched on several CD-ROM programs. See Section 203.7.

The IRS, in each of its private letter rulings (and technical advice memoranda), states that a ruling for one taxpayer may not be used or cited as a precedent by another taxpayer per IRC Section 6110(j)(3). Preparers can only cite a private letter ruling as substantial authority when trying to avoid the substantial understatement penalties (see Section 302.3 for further details). In other words, the IRS may disallow a tax position even though the preparer reasonably relied on a similar published private letter ruling.

However, private letter rulings do provide an indication of the IRS stance regarding a tax position. Frequently, private letter rulings are the only guidance available. Practitioners also turn to the rulings for direction because they know revenue agents can consider such rulings on the same question when auditing returns.

**Published rulings.** There are two types of published rulings: revenue rulings and revenue procedures. A revenue ruling tells taxpayers what to do, and a revenue procedure tells taxpayers how to do it. The IRS states its position on substantive tax issues in revenue rulings, and delineates procedural requirements in revenue procedures. Rulings and procedures are discussed below.

**Revenue rulings** are interpretations by the IRS of the tax law as applied to specific transactions. The IRS derives the material for the revenue rulings program from three main sources. The primary source is letter rulings. The IRS selects for publication letter rulings that have substantial merit. Once selected, a letter ruling undergoes extensive editing before being published. The taxpayer's name and any identifying facts are deleted, but a comprehensive examination of the ruling is made to verify that all the relevant facts are still clearly stated. The two other major sources are court decisions and requests for technical advice.

Published revenue rulings are set apart from letter rulings with respect to their reliability. A revenue ruling may be relied upon by a taxpayer in substantially the same circumstances as those of the ruling. As noted above, letter rulings cannot be cited as precedent by any other taxpayer.



Revenue rulings are published weekly in the *Internal Revenue Bulletin* and are compiled semiannually in the *Cumulative Bulletin*. Published rulings can also be found in some loose-leaf services. Electronic database services and CD-ROM programs contain the full texts of published letter rulings. Recent issues of the Internal Revenue Bulletin are available at [http://www.irs.ustreas.gov/prod/bus\\_info/bullet.html](http://www.irs.ustreas.gov/prod/bus_info/bullet.html).

**Practice Tip.** A searchable database of Revenue Rulings can be found at <http://www.taxlinks.com/revrules.htm>. Revenue Procedures can be found at <http://www.revenueprocedures.com>.

**Revenue procedures** inform taxpayers of practices and procedures acceptable to, or required by, the IRS. They are statements of procedure that affect the rights and duties of taxpayers. Revenue procedures are published in the *Internal Revenue Bulletin* and the *Cumulative Bulletin*. Revenue procedures have less force and effect than Treasury regulations, but they are binding on the IRS and may be relied on by taxpayers.

**Notices and announcements** provide quick guidance on technical and procedural matters and are published in the *Internal Revenue Bulletin*. They are the equivalent of revenue rulings and revenue procedures.

### Other Administrative Sources

Other sources of administrative views of the tax law include the following:

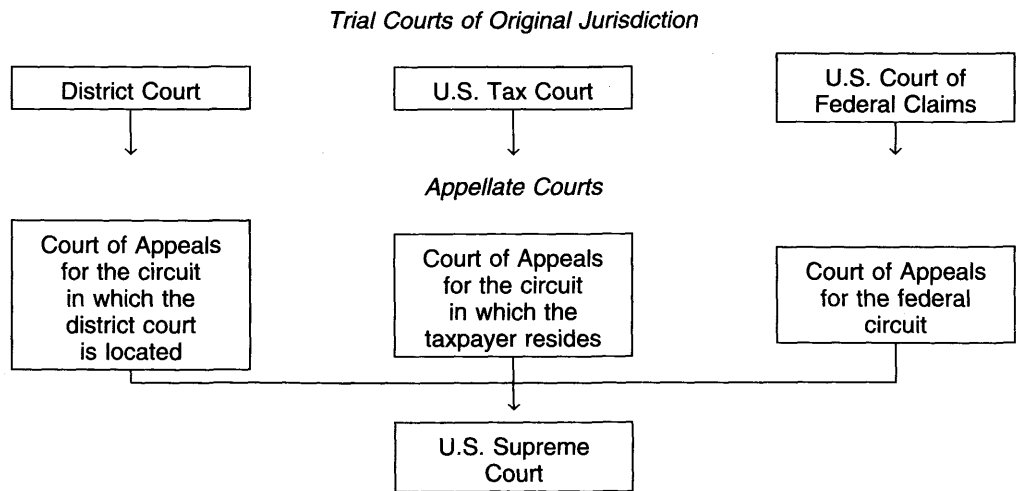
- *Internal Revenue News Releases (IRs)* contain general rather than technical information.
- *Technical Advice Memoranda (TAM)* contain formal technical advice from the national office of the IRS to the district director or appeals office. TAMs can be requested by taxpayers or by revenue agents to assist in settling disagreements. The TAM is binding on the district director (but not on an appeals officer). Therefore, if the TAM is adverse, your client will be foreclosed from any resolution at the district (audit) level.
- *General Counsel Memoranda (GCM)* are legal opinions prepared by the IRS chief counsel's office. GCMs analyze and review proposed revenue rulings, private letter rulings, and technical advice memoranda. GCMs have no value as precedent.
- *Determination letters* are written statements issued by the district director in response to written inquiries that apply principles and precedents previously announced by the national office to specific sets of facts. A determination letter, unlike the letter ruling process, merely informs the taxpayer of a previously established position of the service.
- *IRS Publications* contain a useful, plain English summary of the IRS's position on many different subject areas (see Section 203.5.3).
- *Tax Forms and Instructions* often contain valuable information that can help a practitioner understand the tax result that the IRS is seeking to accomplish (see Section 203.5.8).

## 203.3.3 Judicial Sources

Court decisions indicate the interpretation of the tax law favored by the particular court rendering the decision. When relying on court decisions, however, it is important to consider the authority of the court in question. In addition, since court decisions can be modified, reversed, or overruled by later decisions, it is important to check the current status of the case by using a citator (see Section 203.5.5).

### The Federal Judicial System

The federal judicial system is divided into 13 judicial circuits. The circuits are divided into federal districts, each of which contains a federal district court. The 50 states, Puerto Rico, the Virgin Islands, the Northern Mariana Islands, and Guam are divided into regions, which form the first 11 circuits as follows:

**Figure 203.1: How Cases Proceed Through the Judicial System*****First Circuit***

Maine  
 Massachusetts  
 New Hampshire  
 Rhode Island  
 Puerto Rico

***Second Circuit***

Connecticut  
 New York  
 Vermont

***Third Circuit***

Delaware  
 New Jersey  
 Pennsylvania  
 Virgin Islands

***Fourth Circuit***

Maryland  
 North Carolina  
 South Carolina  
 Virginia  
 West Virginia

***Fifth Circuit***

Louisiana  
 Mississippi  
 Texas

***Sixth Circuit***

Kentucky  
 Michigan  
 Ohio  
 Tennessee

***Seventh Circuit***

Illinois  
 Indiana  
 Wisconsin

***Eighth Circuit***

Arkansas  
 Iowa  
 Minnesota  
 Missouri  
 Nebraska  
 North Dakota  
 South Dakota

***Ninth Circuit***

Alaska  
 Arizona  
 California  
 Hawaii  
 Idaho  
 Montana  
 Nevada  
 Oregon  
 Washington  
 Northern Mariana Islands  
 Guam

***Tenth Circuit***

Colorado  
 Kansas  
 New Mexico  
 Oklahoma  
 Utah  
 Wyoming

***Eleventh Circuit***

Alabama  
 Florida  
 Georgia

The twelfth circuit covers the District of Columbia, and the thirteenth circuit is the federal circuit, which hears appeals on certain types of cases. Each circuit contains a court of appeals that hears appeals from district courts within the circuit.

Tax cases are initiated into the federal judicial system in three different ways: through the district courts, the U.S. Tax Court, or the U.S. Court of Federal Claims (these are described below). Cases from these courts can then be appealed to the federal court of appeals in the appropriate circuit. Cases decided by the federal courts of appeals can be reviewed by the United States Supreme Court.

**Federal District Courts**

Federal district courts can hear tax cases in which a taxpayer sues for a refund after having a claim denied by the IRS. The district court is the only court in which a taxpayer can request

a jury trial in a tax dispute. There are many district courts, at least one per state, and decisions by one are not binding on others. Thus, there may be conflicting authority among them. Decisions by the district courts can be appealed to the federal court of appeals for the circuit in which the district court is located. Decisions are reported in the *Federal Supplement* (F.Supp), published by West Publishing Company. In addition, tax decisions of all courts discussed in this chapter, except for the U.S. Tax Court, are reported in *U.S. Tax Cases* (USTC), published by Commerce Clearing House (CCH), and *American Federal Tax Reports* (AFTR and AFTR2d), published by Research Institute of America (RIA).

## U.S. Tax Court

The U.S. Tax Court hears only tax cases, unlike other courts that hear nontax litigation. The Tax Court has jurisdiction over taxpayers who have received deficiency notices. To be valid, a deficiency notice must contain a *final determination*; generally, this means a 90-day letter is required. The lack of a deficiency notice prevents the court from having jurisdiction.

The tax court is the only court in which the taxpayer can have a tax case heard without first paying the deficiency. However, the taxpayer who loses his or her case in Tax Court is then liable for interest on the deficiency up to the date of payment. To prevent the accrual of interest while waiting for the Tax Court to hear a case, the taxpayer can post a bond equal to or greater than the disputed tax deficiency plus any interest accrued to date.

If the case involves a dispute of \$10,000 or less for any one taxable year, the taxpayer may request to use the Small Tax Case Procedure. These cases are heard by special trial judges and are less formal than the regular procedure. The judge's decisions however are not appealable. Small tax case decisions cannot be used as precedent; the decisions apply only to the taxpayer who litigated the case.

Tax Court decisions, other than small tax cases, are of two types:

1. *Memorandum decisions* are issued in cases involving questions of law that have been previously settled, in which the facts occur only in a limited number of situations. Memorandum decisions may come from cases involving an issue of law that has been decided by the Tax Court and upheld by a court of appeals. Memorandum decisions are not officially published but are contained in *Tax Court Memorandum Decisions* (TCM), published by Commerce Clearing House (CCH) and *Tax Court Memorandum Decisions* (T.C. Mem. Dec.), published by Research Institute of America (RIA).
2. *Regular decisions* are issued by the Tax Court in cases involving unsettled questions of law, and those with facts likely to be found in other cases. Regular decisions are reported in the *Reports of the U.S. Tax Court* (T.C.), published by the Government Printing Office. They are also published in the special Tax Court services of Commerce Clearing House and Research Institute of America.

Individual Tax Court decisions are binding on the IRS, but the service is free to litigate the same issue in other cases. These decisions reveal the position of the Tax Court, however, and Tax Court judges will generally follow other Tax Court precedents. Tax Court decisions can be appealed to the court of appeals for the circuit in which the taxpayer resides.

The IRS can indicate its acceptance (acquiescence) or disagreement (nonacquiescence) with adverse decisions by the Tax Court. Acquiescence (Acq. or A.) and nonacquiescence (Nonacq. or NA.) are issued only in response to regular decisions by the Tax Court. Acquiescence and nonacquiescence apply only to the conclusion of the Tax Court and not to the court's reasoning, and can be withdrawn by the IRS retroactively.

The IRS is not as likely to challenge a tax position taken in reliance on a case on which it has previously acquiesced, but it may well challenge a position that relies on a case it has tagged "nonacquiescence." A case's status with the IRS can be found in the *Internal Revenue Bulletin* and the *Cumulative Bulletin*, and is indicated in the citators of major tax services.

**Practice Tip.** Tax Court opinions issued after January 1, 1999, are available at <http://www.ustaxcourt.gov>.

## U.S. Court of Federal Claims

The U.S. Court of Federal Claims (called the Claims Court before October 1992) which in 1982 replaced the Court of Claims, hears taxpayer claims against the U.S. Government. The court decides cases involving tax refunds. Decisions of the U.S. Court of Federal Claims are reported in the *Federal Claims Reporter* (Fed. Cl.), published by West Publishing Company and in *U.S. Tax Cases* (USTC), published by Commerce Clearinghouse (CCH), and *American Federal Tax Reports* (AFTR and AFTR2d) published by Research Institute of America (RIA). Decisions of the U.S. Court of Federal Claims can be appealed to the court of appeals for the federal circuit.

## Federal Courts of Appeal

The 13 federal courts of appeal hear appeals from federal district courts, the U.S. Claims Court, and the U.S. Tax Court. Although these courts are likely to follow their own precedent when deciding cases, a court of appeals is not bound to follow a decision by another court of appeals. Decisions of the courts of appeals are reported in the *Federal Reporter* (F., F.2d and F.3d), published by West Publishing Company and in *U.S. Tax Cases* (USTC), published by Commerce Clearinghouse (CCH), and *American Federal Tax Reports* (AFTR and AFTR2d) published by Research Institute of America (RIA).

## The United States Supreme Court

Tax cases come before the U.S. Supreme Court upon grant of writ of certiorari—a petition requesting Supreme Court review of a court of appeals decision. The writ can be requested by either the taxpayer or the government. Certiorari is discretionary and is generally granted in tax cases when courts of appeals have reached conflicting decisions on a specific issue of tax law. When the Supreme Court renders a decision in a tax case, the IRS and all lower courts are required to abide by it. Thus, Supreme Court decisions have the force and effect of law unless a different interpretation is legislated by Congress or the Supreme Court reverses its position in a later case. Decisions of the Supreme Court are reported in the *Supreme Court Reporter* (S.Ct.), published by West Publishing Company, in *United States Supreme Court Reports* (U.S.), published by the Government Printing Office and in *United States Supreme Court Reports Lawyer's Edition* (LEd and LEd.2d), published by Lawyers Cooperative Publishing Company and in *U.S. Tax Cases* (USTC), published by Commerce Clearinghouse (CCH), and *American Federal Tax Reports* (AFTR and AFTR2d), published by Research Institute of America (RIA).

**Practice Tip.** U.S. Supreme Court opinions can be located at <http://www.lindlaw.com/casecode/supreme.html>.

## Summary of Court Reporters

Exhibit 203-3 summarizes court reporters and their contents. A tax library is most likely to contain reports published by the Government Printing Office, Commerce Clearing House, or Research Institute of America. Note that tax cases can also be accessed and searched using an online database or a CD-ROM tax service.

### 203.3.4

## Tax Citations

Citations provide documentation of the location of specific sources of information. When taking notes or communicating tax research findings, it is imperative to include the citations so that others may find the documents or cases cited. The volume, *A Uniform System of Citation*, sometimes called the “Harvard Blue Book,” published by the Harvard Law Review Association can be referred to for authoritative styles for citing sources. The following are citations likely to be encountered when doing tax research.

### Citing Legislative Sources

Committee reports appear as follows:

H.R. Rep. No. 93-21

This citation is to the 21st report issued by the House of Representatives during the 93rd Congress. Senate reports are prefaced by "S."

S. Rep. No. 93-21

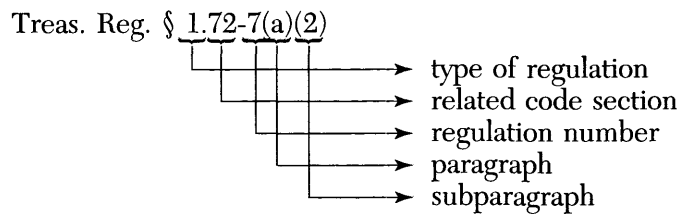
Public laws are cited as follows:

P.L. 99-1

This citation is to the first public law issued by the 99th Congress.

### Citing Administrative Sources

*Treasury Regulations*, originally published in the *Federal Register* and reprinted in the *Code of Federal Regulations* (CFR), are cited as follows:

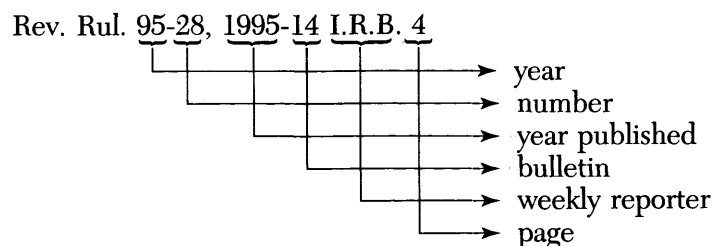


The first number indicates the type of regulation and corresponds to Title 26 of the CFR. Here, the number 1 refers to part 1 of Title 26, which concerns income tax. Title 26 of the CFR is divided into parts as follows:

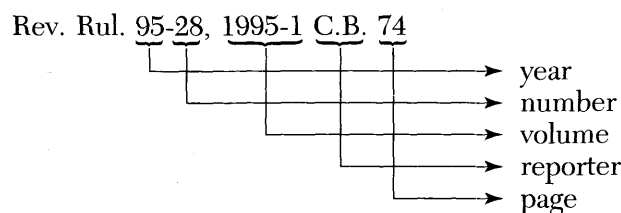
- Part 1: Income Tax
- Part 20: Estate Tax
- Part 25: Gift Tax
- Part 26: Generation-Skipping Transfer Tax
- Part 31: Employment Taxes and Collection of Income Tax at Source
- Parts 48 and 49: Excise Taxes
- Part 301: Procedure and Administration
- Part 601: Procedural Rules

The number following the decimal point indicates the corresponding section of the Internal Revenue Code. The numbers following the hyphen indicate the numbering used within the regulation. Here, the citation is to paragraph (a), subparagraph (2) of the 7th regulation under section 72 of the code.

*Revenue rulings* are published weekly in the *Internal Revenue Bulletin* and compiled semiannually in the *Cumulative Bulletin*. References to rulings which have not yet been compiled appear as follows:



Compiled rulings appear as follows:



The first citation is to the weekly *Internal Revenue Bulletin* and refers to the 28th revenue ruling published in 1995, which can be found in the 14th *Internal Revenue Bulletin* of 1995 at page 4. The second citation is to the same ruling published in the first volume of the 1995 *Cumulative Bulletin* at page 74.

Revenue procedures are published in the *Cumulative Bulletin* and are cited in the same form as revenue rulings except that procedures are prefixed by the abbreviation “Rev. Proc.” For example, Rev. Proc. 95-1, 1995-1 IRB 1, or Rev. Proc. 95-1, 1995-1 CB 313.

Note that, beginning with IRB 1999-28, the page numbers of the *Internal Revenue Bulletin* correspond to the page numbers of the *Cumulative Bulletin*.

### Citing Judicial Sources

Because many judicial sources appear in more than one publication, it is important either to know what publications are accessible to the party reading the citation or to provide optional citations to several publications. When using the latter method, known as *parallel citation*, it is customary to cite first to primary authority (generally publications by West Publishing Company or the Government Printing Office) and then to secondary authority (such as Commerce Clearing House or Research Institute of America). The general format for citing judicial authorities is as follows:

Case name, Volume Number – Reporter – Page or Paragraph (Court – Year).

Exhibit 203-4 illustrates sample primary and secondary citations to judicial sources.

When dealing with citations of judicial authorities, the researcher is likely to encounter many abbreviations. The most common abbreviations are defined in Exhibit 203-5.

## 203.4 Maintaining a Technical Reference Library

Managing a tax research library is a balancing act between maintaining an adequate collection of research materials and minimizing the costs of library services and materials. Large firms enjoy adequate revenues to support the expense of an extensive tax library, and the amount of use the library receives justifies the expense. Sole practitioners may find the time spent traveling to a local law library less expensive than maintaining an extensive tax library of their own.

Three basic concerns for managing a tax research library are—

1. Evaluating the extent and scope of the firm’s library needs.
2. Designating someone to maintain the library.
3. Determining procedures and guidelines for maintaining the library.

**Practice Tip.** Draw up a thorough list of available research tools and their location. Include resources available at the local law and public libraries. Also include a list of in-house and outside consultants by their areas of specialization. Distribute this to all staff members. The staff must have a general knowledge of the tools available to exploit them properly.

### 203.4.1 Evaluating Library Needs

The AICPA Voluntary Tax Practice Review program requires that a firm maintain an adequate technical reference library to assist personnel in resolving tax problems.

The following materials are a required part of every firm's technical library:

- AICPA Code of Professional Conduct
- Treasury Department Circular 230
- *AICPA Statements on Responsibilities in Tax Practice*

Begin an evaluation of your firm's library with an inventory of the books already in your office. You may be surprised to discover that two or three firm members subscribe to the same publications. Knowing what tax research materials are already available is the starting point for determining what new materials, if any, are necessary and deciding which duplicates to discontinue.

You cannot judge a tax library's usefulness to a firm simply by counting the number of books on the shelf. A sole practitioner who researches only two or three major tax issues a year would be throwing away money on an extensive library. However, there are some basic tax research tools every practitioner should have available:

- The Internal Revenue Code
- The Treasury Regulations
- Tax handbooks
- Internal Revenue Service forms, instructions, and publications

The first two suggestions may surprise you. The code and regulations are the first places to turn when probing into unfamiliar tax territory. Copies of the Internal Revenue Code and Treasury Regulations should be kept updated to reflect all changes. The major tax services publish both loose-leaf and paperback editions that are not very expensive to maintain.

A good tax handbook is your ready reference for the everyday tax questions that arise. There are a number of handbooks on the market. Besides those published by major tax services, some of the major accounting firms publish tax handbooks, and some are published by individuals. These are relatively inexpensive. If you do not regularly use one, buy several and try them out. Through the course of a tax season you will probably find one you prefer.

The IRS circulates numerous publications covering a wide variety of tax issues. You can obtain them, as well as the tax forms and their instructions, directly from the IRS either gratis or for a minimal subscription price. In addition, IRS Publications are available on many CD-ROM tax services and most tax forms are readily available on the Internet (See Section 203.9). Tax forms and instructions can also be a source of information concerning everyday tax questions.

It is not too difficult to tell when your firm needs to expand its tax library beyond these minimum requirements. When practitioners are constantly running to a local law library at the county courthouse, or borrowing materials from the tax libraries of other firms in the area, your library needs expansion.

**Practice Tip.** Many of the items found in a traditional tax library can now be found on the Internet. For example, the Internal Revenue Code, Treasury Regulations and IRS publications and tax forms are all available at the IRS Web site (<http://www.ustreas.gov>).

## 203.4.2 Maintaining the Library

Be sure that someone is designated as responsible for maintaining the library. This should ordinarily be a tax partner or a senior technical person who can monitor the library contents and determine necessary changes. The AICPA Tax Voluntary Practice Review Program requires that a responsible person be designated to perform these functions.

One suggested approach to library review is to gather all invoices paid for library materials within the past twelve months and to create a list of all publications by title and cost. This list can then be circulated among staff or reviewed at a staff meeting to determine materials purchased but not used (or infrequently used). Similarly, this discussion can reveal library materials that would be useful and should be considered for purchase.

## 203.4.3 The Tax Research Master File

An essential component of a firm's tax research library is the master file of research projects. A firm's tax research master file should contain the documentation for every major research

project conducted by the firm. With a master file, researchers can avoid duplicating the previous work of other staff members and confine current efforts to updating the research. Also, a later researcher often can identify and consult the individual who compiled the original research. Master files strengthen client file documentation and support the uniform interpretation of tax laws within the firm. Before answering anything more than a routine question, the tax staff should consult the research master file index.

A file index should organize the research projects in files by Code section and/or topic. Each file should contain research projects showing the client name, preparer initials, preparation date, and a brief description of the research topic. When beginning a study, researchers can quickly scan the index for any files that pertain to the question at hand. The file index can be set up on a sortable spreadsheet or database file.

**Practice Tip.** When a client benefits from prior research, consider value billing the client for the true cost of the research rather than just the additional time spent updating the file. Conversely, when the cost of a research project goes beyond what a firm can reasonably bill for, the master file system enables the firm to spread the cost over several clients.

The research files themselves should be kept together, preferably with distinguishable jacket covers. A sign-out sheet or log should be maintained nearby to help keep the system intact.

## 203.5 Tax Research Tools

This section describes the research tools likely to be found in a tax library. (Computer-assisted tax research and CD-ROM are discussed in Sections 203.6 and 203.7.) While an adequate tax library need not contain all of the materials described, consider whether your practice could make use of at least one selection from each of the categories listed below.

### 203.5.1 Tax Services

Tax services are multivolume works, frequently updated, that help researchers locate legislative, administrative, and judicial interpretations of the Code. Most also provide editorial explanations of these interpretations. The index of a tax service is organized by IRC section numbers and/or topical reference terms. Thus, when beginning to research a question, the practitioner can search the index for a key term of a particular subject matter or locate the appropriate Code section.

Public libraries and courthouse law libraries usually subscribe to at least one of the tax services. If your firm rarely performs extensive research, you may want to simply utilize the local library for any major research projects.

If your firm already subscribes to a major tax service, you may want to consider subscribing to a second service if the extent of the firm's tax research warrants it. Because there are usually numerous court cases relevant to each Code section, every tax service makes editorial choices concerning which to include; some services include more cases than others. A researcher can usually find more cases by consulting a second, and even a third, tax service.

Booklets explaining the coverage and usage of the various tax services are available from all publishers free of charge. In addition, some publishers offer free video tapes illustrating the proper usage of their services. Sales representatives of most of the major publishers are also willing to provide firms with free in-house tax research seminars to teach the practitioners how to use the service. The standard tax services are shown in Exhibit 203-6.

### 203.5.2 Tax Handbooks

Tax handbooks provide a handy desktop reference for quick answers to commonly encountered questions. These handbooks are updated and published annually. The major tax services, Commerce Clearing House (CCH), Practitioners Publishing Company (PPC), Research Institute of America (RIA), and Matthew Bender publish handbooks for tax professionals for ready reference



to common questions, but do not limit yourself to these choices. Many excellent tax handbooks targeted for the general public are available through other publishers.

### 203.5.3 Government Publications

A practitioner's tax library will often have a subscription to the *Internal Revenue Bulletin*, the *Cumulative Bulletin*, or both. These publications, issued by the Government Printing Office, contain the text of committee reports on tax bills as well as the text of IRS revenue rulings and revenue procedures.

To make full use of the *Cumulative Bulletin*, the researcher must examine the Government's Bulletin—Index—Digest System. Information on subscriptions can be obtained from:

Superintendent of Documents  
U.S. Government Printing Office  
Washington, D.C. 20022

The IRS also publishes *Your Federal Income Tax* (Publication 17) and *Tax Guide for Small Businesses* (Publication 334) on an annual basis. These publications contain a concise, plain-English summary of tax law and filing procedures. The service publishes numerous publications covering individual tax topics. A list of those publications can be found at the IRS Web site. If the local office does not have the publication you want, it will assist you in ordering. Government publications are also available on many CD-ROM programs and on the internet. Recent issues of the *Internal Revenue Bulletin* are available online at [http://www.irs.ustreas.gov/prod/bus\\_info/bullet.html](http://www.irs.ustreas.gov/prod/bus_info/bullet.html).

### 203.5.4 State and Local Tax Guides and Information

Many of the types of publications listed above also exist for individual states. Tax services publish state handbook guides and even complete multivolume services designed along the lines of their federal counterparts. You may want to consider purchasing a multivolume service for the state in which you practice.

Many states also publish their own "Package X," which is similar to the federal version. These publications contain copies of the various state tax forms and their instructions. There are subscriber services available offering copies of the individual income tax forms and instructions for all the states.

### 203.5.5 Citators

Researchers use a citator to determine which judicial interpretations of tax law have been modified, distinguished or overruled by later decisions. Tax citators contain an alphabetical listing of cases. After each case name, the citator lists any other cases that refer to it. Citators can also be used to check the status of published rulings and other IRS documents. Both CCH and RIA publish tax citators. (See Section 203.6.2 for a discussion of on-line citators.)

### 203.5.6 Tax Magazines

Exhibit 203-7 lists magazines that focus on taxation. Indexes of the articles contained in these magazines are published periodically, usually in June and December. In addition, tax magazines are indexed in *Tax Articles*, published by CCH, and *Index to Federal Tax Articles*, published by Warren, Gorham & Lamont. Another good resource for locating tax articles is <http://www.riatax.com/journals/jourhom.html>.

### 203.5.7 Tax Newsletters

Tax newsletters abound. They are published daily, weekly, and monthly, and provide information on the most current developments in taxation as well as tax planning tips and information.

Some newsletters are geared towards tax clients as well as practitioners. Exhibit 203-8 lists tax newsletters.

**Practice Tip.** Consider providing trial tax newsletter subscriptions for some of your better clients. No one knows a client's tax situation better than the client. They gain from their increased understanding of their tax situation, and appreciate your courtesy in providing the subscription.

### 203.5.8 Tax Forms

Tax forms and their instructions are sources of information that are useful in resolving tax questions. They are available from the government, and are also contained in the following publications:

- *Annotated Tax Forms—Practice and Procedure* (RIA)
- *Federal Tax Forms* (CCH)
- *Tax Action Coordinator—Forms and Agreements* (RIA)
- *Tax Management Portfolios* (Bureau of National Affairs)
- State tax forms are available from the state governments and from such forms vendors as STF Services Corp. (800-541-7197), Tax Forms Library (502-589-7466), Commerce Clearing House (800-449-8114), and Research Institute of America (800-950-1216).
- CD-ROM Forms—federal and state tax forms, including instructions on a single CD-ROM, such as, E Form from CLR/Fast-tax (800-367-6721), IRS Federal Tax Form, U.S. Government Printing Office (202-512-1800), Kleinrock Tax Library (800-678-2315), STF Services Corp (800-541-7197), Tax Form Library (502-589-7466), CCH Inc. (800-449-8114), Best Source Forms (800-570-2378), Forms X Pert (703-528-5400).
- Internet—there are several sites on the Worldwide Web from which practitioners can download federal and state tax forms and instructions. For example, the Internal Revenue Service Home Page (<http://www.irs.ustreas.gov/>). See Section 203.9 for a discussion of the Internet and Exhibit 203-9 for a list of other tax law sites on the Worldwide Web.

**Practice Tip.** Tax return forms and their instructions are an invaluable research tool often overlooked by researchers. Tax forms help the practitioners better understand the results the IRS is trying to accomplish. If a form or instruction contains an error, however, the government is not bound by it.

### 203.5.9 Treatises

There are several well-known and respected treatises on corporations and shareholders and on partnerships that should be part of your tax library:

- *Federal Income Taxation of Corporations and Shareholders*, 6th ed., by Boris I. Bittker and James S. Eustace (Boston: Warren, Gorham & Lamont, 1998). Supplemented three times annually.
- *Partnership Taxation*, 5th ed., by Arthur B. Willis, et al. (Colorado Springs, Col.: McGraw Hill/Shepards, 1994).
- *Federal Taxation of Partnerships and Partners*, 3d ed., by William S. McKee, William F. Nelson, and Robert L. Whitmire (Boston: Warren, Gorham & Lamont, 1997). Supplemented semiannually.
- *Mergers, Acquisitions and Buyouts*, by Martin D. Ginsburg and Jack S. Levin (Little Brown and Company, 1999). Updated semi-annually.

### 203.5.10 In-House and Outside Consultants

Some tax research questions are so technical or extensive that utilizing an in-house specialist or an outside consultant is necessary to ensure a quality result. Sometimes it is also the most practical, least expensive path to answer a research question. For example, a pension plan

question might be directed to the firm's pension expert. Or a firm that generally deals with individual income tax returns might turn to an outside consultant for advice about a corporate liquidation.

Many firms prepare a list of designated in-house and outside consultants to refer to when researching certain tax questions. Checking the list becomes a standard quality control procedure in a research project. Listing a firm's tax professionals by areas of expertise and utilizing them as "in-house consultants" helps a firm employ its professional resources more effectively. Sometimes hiring outside consultants can be more cost efficient than developing the expertise in-house.

**Practice Tip.** You may be able to obtain a list of specialists from your state CPA society.

## 203.6 On-line Computer-Assisted Tax Research

Traditional research involves printed materials. This same information is now contained in electronic databases. Electronic research augments the more traditional research techniques—it does not replace them. However you must have a working knowledge of both the tax law and how it is promulgated in statutes, rulings, regulations, cases, and so forth to effectively use a computerized tax research service. If you don't know how the various documents are structured and what they typically contain, using an electronic database can be a painful, frustrating (and expensive) experience.

In tax research, you must also be thoroughly familiar with printed material before you can perform electronic research efficiently. Electronic research can be more difficult at first than researching print media. It is, however, far more effective if done properly. Electronic research is the only way to review "all available sources." It is physically impossible to review with accuracy the print indexes to *all* private letter rulings, for example. It is equally impossible to review all reported decisions because no effective print indexes exist.

By comparing periodic on-line charges to the cost of acquiring and maintaining infrequently used printed materials, you may discover that signing on with a computerized research service will provide greater research capabilities while reducing overall library costs.

However, because the on-line charges of a computer research service can mount up quickly, it is imperative to train staff members. On line services will often make certain libraries available free of charge to allow researchers to practice their research skills. Establish a plan to certify proficiency. Before staff members are allowed access to the service, they should be able to demonstrate a minimum of required know-how.

**Practice Tip.** Bill your clients for the time spent performing electronic research at a premium, rather than the discount that it is so often billed at. Clients need to be aware that complex issues require expensive resources. Don't sit the computer-wise (but tax-law-immature) staff person down at a terminal and expect to be able to offer inexpensive electronic research.

### 203.6.1 Computer Research Services

The most popular computerized services for tax research are LEXIS®, offered by Reed Elsevier, Inc.; Westlaw®, by West Publishing Company; TAX/RIA® (formerly PHINet®), by Research Institute of America and now part of LEXIS; Access®, by Commerce Clearing House; Tax Base®, by Tax Analysts; and BNA-on-Line® and LCP Membership Group (formerly known as Veralex 2®), a joint venture involving Lawyers Cooperative Publishing Company/Bancroft-Whitney Company, Research Institute of America, and Mead Data Central. Most computer research services can be accessed through the Internet, eliminating the need for specialized computer equipment or software. Specific information on the contents, operation, and organization of the various services is beyond the scope of this chapter and is contained in operations manuals available from the companies offering the services. The following discussion, however, is relevant to computerized research in general.

**Practice Tip.** Do not buy more electronic research services than you need. Both Lexis and Westlaw are great, if you spend a considerable amount of time doing electronic research. Match the services to your needs.

## 203.6.2 Locating Information Electronically

When searching through printed volumes, a researcher can use indexes to locate materials on a given subject. Tax service indexes are organized by code section and subject matter. When using a computer, however, a researcher poses a *query*—a grouping of words and phrases joined by logical connectors (see below). The computer then scans the documents in the database and retrieves those that satisfy the requirements of the query. Thus, a researcher can access the text of all U.S. Tax Court cases containing one phrase, such as “adjusted gross income.”

The researcher controls the scope of the search and can tailor a query to retrieve only documents relevant to a specific question under consideration. While the terminology and commands employed by various services differ, the search capabilities of all services are similar. Methods of regulating the scope of the query typically include:

- *Logical connectors.* Logical connectors are terms such as *and* and *or* that indicate the relationship between the words in the query. Thus, the researcher can retrieve cases that discuss both “depreciable property” and “capital assets.” In addition, a researcher can specify that a particular word occur within a specified distance from another word. For example, a query can specify that the word “commodity” occur within five words (or within the same sentence or the same paragraph) of the word “future.”
- *Root expanders and universal characters.* Root expanders, represented by an exclamation point (!), and the universal character, represented by an asterisk (\*), allow a researcher to search for variations of search terms. (Lexis refers to both the exclamation point and the asterisk as universal characters.) Root expanders are placed at the end of terms and direct the computer to search for all terms with the given root (for example, searching for “liab!” will yield “liable” and “liability”). The universal character replaces a single character and can be placed within a search term (for example, searching for “wom\*n” will yield “woman” and “women”).
- *Segment searching and field searching.* Segment searching, as it is referred to by Lexis, and field searching, as it is referred to by Westlaw, restrict the scope of the search to a specific portion of the selected documents. Thus, a researcher can search for words appearing in the title of the document or in the document’s citation. For example, a search of district court decisions for the word “Stonehouse” restricted to the titles of the cases will yield all cases in which Stonehouse was a named party, but not those cases in which Stonehouse is referred to only in the text of the opinion.
- *Date restriction.* Date restriction, a form of segment or field searching, is particularly useful to tax research. Searches can be restricted by date to retrieve only documents that were written before or after a certain date or during a certain time period. Thus, a query can specify federal district court cases decided after January 1, 1987.

Once the computer has located and counted the requested documents, it will report the number of documents retrieved. The researcher can request to view them on the computer screen, print them, or save them on a computer disk, which can then be read and edited using a word processor. The researcher can also choose to view or print a list of citations of the documents retrieved. In addition, the researcher can request to view the portions of the documents containing the search terms, thus eliminating the need to read the entire document to determine if it is relevant.

### Keeping Information Current

Because tax law is constantly changing, it is essential that tax research tools are updated to remain current. Computer databases are continuously updated. Court opinions can be accessed by computer within hours of rendition and before they are published in any written form. Similarly, state and federal statutes accessed by computer are always current.

## Updating Research

Computers simplify the process of updating research. Lexis features on-line *Shepard's Citations* services that contain information from the supplements and the bound volumes, eliminating the need to consult multiple sources. Furthermore, on-line Shepard's contains information on cases decided within the past several days.

Lexis and Westlaw feature services, known as Auto-Cite® and Insta-Cite™, respectively, that can locate the complete prior history of a case. A researcher can also locate references to a given case or statute by formulating a query that searches for the name or citation of the case or statute (for example, a researcher can use a computer to retrieve all Tax Court references to 20 T.C. 164 by searching for the term "20 T.C. 164").

## Speed and Cost

Perhaps the greatest advantage of computerized research over traditional research is speed. From one desk, a researcher can access an entire tax library and retrieve documents in a fraction of the time it would take to locate the appropriate volumes. Competing with this time savings, however, is expense. While the cost of electronic research has declined in recent years, electronic research is still expensive. Thus, it is important to compare the value of the time saved with the cost of doing electronic research.

## Combining Traditional and Computerized Research

Computers are not a complete substitute for traditional research methods; efficient research generally combines both traditional and computerized methods. Given the cost constraints of computerized research, it is often most efficient to generate a list of citations relevant to the research at hand and to locate these materials in printed volumes or on a CD-ROM. Reading or printing text from the computer may be the only viable option, however, when the needed material is too current to be included in printed volumes or is contained in a source to which the researcher has no access.

### 203.6.3 Basic Query Formulation

In order to save time and money, a researcher should formulate a query before sitting down at the computer. A simple strategy for doing this is to prepare a list of terms that should appear in the document. For example, if a researcher is interested in the tax consequences of meals provided as compensation to employees, the following terms are likely to appear in the relevant documents: *compensation*, *meal*, and *employee*.

Under each term, the researcher should list any synonyms that might appear in place of the words selected:

<u>compensation</u>	<u>meal</u>	<u>employee</u>
reimbursement	breakfast	worker
	lunch	
	dinner	

The words in the columns should be joined by the logical connector *or* (that is, meal *or* breakfast *or* lunch, etc.). The columns should then be joined by the logical connector *and*. Thus, the final query would read "compensation *or* reimbursement *and* meal *or* breakfast *or* lunch *or* dinner *and* employee *or* worker." This query would retrieve documents containing at least one word from each of the three columns. As the researcher becomes increasingly comfortable with computerized searches, more sophisticated searches can be performed using other logical connectors, universal characters, date restriction, and so forth.

### 203.7 The CD-ROM Revolution in Tax Research

Compact disk-read only memory, better known as CD-ROM, offers tax practitioners computer tax research at very affordable prices. CD-ROM draws from the same technology used in CD

audio equipment. The typical CD can store up to 660 megabytes of information, or approximately 300,000 pages of text. For many offices today with a personal computer, the additional costs of utilizing this technology are the CD-ROM disk drive, search software, and the disks themselves.

CD-ROM technology is playing a major role in the CPA tax practice by shrinking library shelf space and placing vast amounts of information at the fingertips of computer users for easier and faster tax research.

The standardization of search software, network compatibility, multiple-disk players, and the increased availability of CD-ROM products are making CDs standard equipment in most CPA firms.

### 203.7.1 Using CD-ROM Technology

For tax research libraries, CD-ROMs are highly effective in a variety of situations. CD-ROMs can—

- Save much time in tax research.
- Render tax research less expensive and easier than ever before.
- Establish fixed and budgetable costs, as compared with on-line services.
- Help integrate old researches with new ones.
- Allow tax practitioners access to a large library of information without expanding the office.
- Help retrace the tax practitioner's steps and fine-tunes the research.
- Provide a second copy of frequently used books and other printed materials without taking up additional shelf space.
- Serve as extension libraries for firms with large office buildings or branch offices.
- Enable cramped libraries to add new materials.
- Permit employees to do research on home computers.
- Eliminate filing loose-leaf tax services, which can easily get lost or misfiled.
- Allow the user the ability to cut and paste between applications with ease.
- Allow the user to add notes to cases or statutes within the database.

In many respects, CD-ROM technology operates like the on-line research services, but without the costly telephone and search charges. Users pay a predictable fixed fee for the use of the disks, and they then have unlimited use of the data without the fear of ballooning on-line charges.

New information cannot be written to a CD-ROM. Whereas the on-line services constantly update their databases, the information on a compact disk is permanent. Consequently, CD-ROM publishers provide new disks that contain all the compiled updates and typically provide on-line services for current developments. There may be an extra charge for on-line updates if they are not included as part of the fixed monthly or quarterly fee. In the near future, many CD-ROM publishers will offer the same information over the Internet which will allow the publishers to update their information on a daily (or more frequent) basis.

**Practice Tip.** When considering a vendor, ask about the schedule for updating disks and whether an on-line service is available.

Because each compact disk holds a tremendous amount of data, finding the information you want can be a challenge. Fortunately, CD-ROM software exists to overcome this problem. The software can perform full-text searches based on key words and phrases, or it can search for references to specific code sections, regulations, and other administrative interpretations.

By simply typing in key-word combinations, the practitioner can browse through every segment of the service where the words are used in proximity. The CD-ROM research disks include Internal Revenue Code, Treasury Regulations, private letter rulings, technical advice memorandums, general counsel memorandums, published rulings as well as tax forms and official IRS publications.

Because of the way information is organized on a CD-ROM, the researcher can automatically jump from one related document to another instantly—from a code section to related regulations, from a citation in context to the full text of the cited decision, or from a case to a list of subsequent citations—and then do an on-line update. CD-ROM technology is flexible and easy to use. Without fear that the meter is always running, you can do research at a more deliberate pace.

**Practice Tip.** Ask a potential vendor if the software has the capability to record client charge information like an on-line service can.

**Practice Tip.** Cases can be printed out in full, directly, or exported to a word processing program. Pulling, thumbing, copying, reshelving, and retyping text from cases into client memoranda are now things of the past.

**Practice Tip.** CD-ROM technology allows practitioners to search the Internal Revenue Manual, which is an invaluable source of information about the IRS' audit and collection procedures and guidelines. Any practitioner that has attempted to locate information in the Internal Revenue Manual by using the Manual's index will instantly appreciate the benefit of CD-ROM technology.

## 203.7.2 CD-ROM Limitations

Currently, data retrieval software for CD-ROM products suffers from a lack of standardization. Each vendor product has its own specific software and search logic techniques. The user of several products must understand and master the techniques of each one. Expert use of each system is only acquired after hours of extensive hands-on experience. A researcher who uses the products infrequently may need to relearn one or more search methods with each research project requiring different sources.

**Practice Tip.** When appraising a new vendor service, ask about the availability of an 800 number help line. Get a product demo and test it. Is it relatively easy to learn? Are the menus well organized? Are there sufficient help menus?

CD-ROM equipment costs can grow rapidly with the size of a firm and the number of users. The persons responsible for the library need to coordinate with the information system staff when making technology decisions. Researchers should not have to compete for access to the personal computer and CD-ROM equipment.

Inexperienced researchers conducting haphazard searches can tie up a computer for interminable periods. Frustration with a system discourages the staff from using it. Once a CD-ROM system is in place, train your staff in the system's operation.

For a CD-ROM installation to succeed, staff members need to have a positive attitude toward computer technology. But remember that new staff members coming out of the colleges and universities are not only trained in computer research techniques, they expect to find the technology in the workplace.

**Practice Tip.** Because of the limitation on the amount of data that can be stored on a single CD-ROM, some CD-ROMs contain summaries (or "headnotes") of private letter rulings, court cases, etc., but not the full text of those materials (which may be included on a separate CD-ROM). A researcher conducting a search on such a CD-ROM will be successful only if the search terms that he or she is seeking are contained in the summary. Thus, the researcher will be successful only if the person that prepared the summary chose to include the search terms in the summary. In sum, research is more likely to yield successful results if the researcher can search the full text of the relevant materials.

## 203.7.3 Hardware Requirements

A CD-ROM drive must search an extensive amount of data. Unfortunately, CD-ROM drives typically retrieve data at a pace slower than hard drives. Furthermore, there is a wide

difference in access times for the various CD drives on the market. You will quickly appreciate a drive with a faster access time. A bargain drive is no bargain if you have to wait twice as long for it to conduct searches. In addition, if the tax research requires more than one CD-ROM disk to do tax research, consider acquiring a multidrive CD player, to avoid continuously swapping disks.

**Practice Tip.** Many research product vendors are more than happy to provide assistance in purchasing a CD-ROM drive. They are also willing to aid with the installation and training.

## 203.7.4 Product Availability

Today, most of the major tax service publishers, such as West Publishing, CCH, and Research Institute of America (see below for addresses and telephone numbers), now offer tax research and information products on CD-ROM. All CD-ROM libraries work on a subscription basis, with replacement disk updates sent periodically. Eventually, virtually every tax library resource available today in print will be offered on CD-ROM. Major vendors have been known to discontinue part of a print product altogether, but still make available the discontinued information on the CD-ROM version of the title.

The U.S. Government Printing Office publishes the U.S. Code on CD-ROM and has set up a bulletin board system to allow registered users to download government documents at a fixed cost per megabyte.

**Practice Tip.** The Onedisk by Tax Analysts and Kleinrock's Tax Library are offering a tax library of original source documents on CD-ROM at a very reasonable cost. The disks cover the basic information the tax practitioner needs, i.e., code, regs, IRS publications, revenue rulings and procedures, tech advice, letter rulings, and court cases.

West CD-ROM Federal Tax Library  
West Publishing Company  
610 Opperman Dr.  
Eagan, MN 55123  
(800) 762-5272

CCH Access CD-ROM  
4025 W. Peterson Avenue  
Chicago, IL 60646  
(800) 739-9998

RIA On Point CD-ROM Tax Library  
Research Institute of America  
90 Fifth Avenue  
New York, NY 10011  
(800) 431-9025

Tax Management Inc.  
The Bureau of National Affairs, Inc.  
1250 23 St. N.W., Ste 200T  
Washington, D.C. 20037-1166  
(800) 223-7270  
[http://www.bna.com/tm/tm\\_front.html](http://www.bna.com/tm/tm_front.html)

THE ONEDISC. (Available in Windows and Mac)  
Tax Analysts  
6830 North Fairfax Dr.  
Arlington, VA 22213-9901  
(800) 955-2444



Kleinrock's Tax Library  
11300 Rockville Pike, #1100  
Rockville, MD 20852  
(800) 890-1503

U.S. Government Printing Office  
P.O. Box 371954  
Pittsburgh, PA 15250-7954  
(202) 512-1800  
FAX: (202) 512-2250

Tax Search  
Practitioners Publishing Co.  
3221 Collinsworth  
Fort Worth, TX 76107  
(800) 323-8724

## 203.8 Interactive Software

Tax Practitioners can now research important tax issues, perform complex calculations, and generate election statements and forms that can be filed with the IRS without changing software. This powerful advanced tax research tool is based on a comprehensive database specific to a defined area of tax law which can be interfaced with the full tax service, if you have a CD-ROM.

CCH Tax Assistant (800-228-8353) is the first to introduce interactive software programs. It now has S Corporation, Business Deduction, Federal Elections, IRS Collections and Multistate Corporate Income Tax modules. The program prompts the user through several screens by asking questions. Each response will trigger additional, more specific questions until all of the pertinent facts to a particular question are given. At that point, the program guides the user to a conclusion and prepares necessary research memoranda, required forms and elections statements.

## 203.9 Tax Research on the Internet

The newest and most exciting frontier for tax research is the Internet. The Internet is an international network of computers, which speak a common language and use a specific set of procedures (protocols) in order to send and receive data. The Internet provides practitioners with access to the Worldwide Web which contains hundreds of useful "sites" containing tax information. Each "page" on the Worldwide Web contains information as well as "hyperlinks" which allow users to move between Web pages with ease. In order to perform tax research on the Worldwide Web, a practitioner must have access to a commercial Internet service provider (as discussed below) and a "Web browser" such as Netscape Navigator or Microsoft Explorer.

### 203.9.1 Web Pages and Gateways

The easiest way to begin tax research on the Worldwide Web is to access a tax "gateway" site. The gateway or home page provides the user with a description of Web pages on a particular topic and provides hyperlinks to those Web pages allowing the user to jump to the desired Web page by a simple click of the mouse.

For example, a tax practitioner with access to the Internet can use a Web browser to view the Yahoo tax gateway site by entering the address or "uniform resource locator" ("URL") <http://www.yahoo.com/Economy/Taxes>. From that gateway, the practitioner can search for specific terms or jump to Web pages for topics such as capital gains, tax shelters and offshore entities. Another helpful tax gateway can be found at <http://www.taxesites.com>. A list of several other useful Web pages and their URLs is provided in Exhibit 203-9. By using your Web browser's bookmark feature you can store useful tax URLs and access them quickly in the future.

As the Internet grows in popularity and ease of use, and as more and more tax practitioners have access to the Internet from their office, home and laptop computers, publishers of tax information are using the Internet as an alternative to CD-ROM and printed materials. By publishing tax information on the Internet, publishers can update information on a daily (or more frequent) basis. In addition, the Internet is more portable than CD-ROM because users can access the Internet from any phone line. One of the primary advantages of Internet-based tax research services versus CD-ROM-based products is the vast amount of information that can be stored on a computer server (as opposed to the limited amount of information that can be stored on a single CD-ROM). Thus, a researcher using an Internet-based tax research service can search an entire library of tax sources without the need to use a CD-ROM “tower” or to change CD-ROMs. For example, a researcher using an Internet-based research service can simultaneously search the full text of the Internal Revenue Code, Treasury regulations, revenue rulings and procedures, private letter rulings and court cases. A single CD-ROM cannot store such a large amount of data.

The Web page maintained by the Internal Revenue Service, located at <http://www.irs.ustreas.gov>, provides researchers with access, free of charge, to certain useful tax source materials including recently issued revenue rulings and issues of the Internal Revenue Bulletin. The Internet Law Library maintained by the U.S. House of Representatives, which can be found at <http://www.house.gov>, allows researchers to search the text of the U.S. Code, Code of Federal Regulations and the Federal Register.

**Practice Tip.** Searching the *Federal Register* is an effective way to locate newly issued Treasury regulations and recent amendments to existing Treasury regulations.

Another excellent source of tax and accounting information that is available on the Internet free of charge are the Web sites maintained by the big five accounting firms. These sites, several of which are listed below, are a particularly good source of information on pending or recently adopted legislation.

Arthur Andersen	<a href="http://www.arthurandersen.com">http://www.arthurandersen.com</a>
Deloitte & Touche	<a href="http://www.dtonline.com">http://www.dtonline.com</a>
Ernst & Young	<a href="http://www.eyi.com">http://www.eyi.com</a>
KPMG	<a href="http://www.us.kpmg.com">http://www.us.kpmg.com</a>
PricewaterhouseCoopers	<a href="http://www.taxnews.com">http://www.taxnews.com</a>

## 203.9.2 Search Engines

Because new pages are added to the Worldwide Web daily, no listing of Web pages containing tax information will remain complete for long. Fortunately, practitioners can locate relevant Web pages by using a “search engine” to locate search terms such as “taxes” or “tax forms.” In addition, many Web browsers and Web pages allow users to perform basic word searches within a document.

The following is a list of some of the search engines that can be used by a researcher to retrieve tax information on the Internet:

Excite	<a href="http://www.excite.com">http://www.excite.com</a>
HotBot	<a href="http://www.hotbot.com">http://www.hotbot.com</a>
Infoseek	<a href="http://www.infoseek.com">http://www.infoseek.com</a>
Yahoo	<a href="http://www.yahoo.com">http://www.yahoo.com</a>

**Practice Tip.** Because all search engines do not search the Internet in precisely the same way, you should use more than one search engine when searching for tax information on the Internet.

**Practice Tip.** Many practitioners followed the progress of the Internal Revenue Service Restructuring and Reform Act of 1998 on the Internet. By accessing the site <http://speakernews.house.gov>, practitioners were able to view and print the text of the bill and the committee report before they received their paper copies in the mail.

### 203.9.3 Federal Sites

The Internet is currently an excellent source of federal and state tax forms and instructions. Most tax forms are in “PDF” format, which requires a user to first download Adobe Acrobat Pagemaker® (which is free of charge) then view and print the forms (<http://www.adobe.com/acrobat/>). Users can then print laser-perfect copies of the forms. The list of URLs in Exhibit 203-9 contains several useful sites for tax forms on the Internet. The IRS Web page (<http://www.irs.ustreas.gov>) allows researchers to download IRS forms and instructions as well as IRS taxpayer information publications (such as Circular E). The laser perfect forms that can be downloaded and printed from the IRS Web site should eliminate the need for most practitioners to subscribe to a tax form service. The IRS is currently testing a service that allows researchers to fill in certain of the forms and then print them.

### 203.9.4 Online Research Products

Almost all publishers of tax research materials currently offer access to some or all of their products through the Internet, or have plans to do so in the near future. While some materials can be viewed free of charge, a researcher generally must obtain a password from the publisher in order to perform searches using the Internet-based service. The annual or monthly access fees charged by the various publishers vary based on the number of users of the Internet services per office location and the number of products to which the researcher has access (many publishers offer a menu of choices so that the user pays only for access to the resources that are most likely to be helpful to the researcher).

**Practice Tip.** Researchers can find the applicable Federal interest rate (AFR) for the current or prior months, free of charge, by visiting <http://www.taxcast.com/prevafr.htm>.

One of the keys to the increasing popularity of Internet-based tax services is the fact that these services now allow users to formulate sophisticated search queries using Boolean connectors (such as “and,” “or,” “within,” etc.) and powerful search engines. Until recently, the search engines available on the Internet were inferior to those used by CD-ROM based research products.

The following is a summary of some of the Internet-based tax research services that are currently available on the Internet. Undoubtedly, the number, scope, and power of these products will increase significantly in the coming year. Accordingly, you should contact the publishers (at the telephone numbers or Web sites provided below) to obtain information regarding the most current Internet-based products offered by those publishers.

**Practice Tip.** Because Internet-based tax research services are relatively new, and because many older materials (such as court cases) must be manually input into electronic format, it is important to know the scope of material included in the electronic database that you are searching. For example, an Internet-based tax research service may not provide access to cases decided or rulings issued before a certain date.

*CCH Incorporated (CCH)* publishes the CCH Internet Tax Research Network, which allows users to perform a “tax tracker” search that updates searches automatically, even when the researcher is offline. The researcher is then notified (either by logging back on to the CCH service or, if requested, by e-mail delivered to the researcher’s designated e-mail address) if any additional documents containing the researcher’s search terms (such as court cases or private letter rulings) have been published since the time of the researcher’s last search. Another useful feature provided by the CCH Internet Tax Research Network is the citator button that retrieves additional documents citing the document that the researcher is viewing. Additional information about the CCH Internet Tax Research Network is available from CCH at 800-344-3734 or by visiting their Web site at <http://www.cch.com>.

*Research Institute of America (RIA)* publishes CheckPoint which features a number of different products focusing on federal income taxes, estate planning and pension and benefits materials. CheckPoint provides access to treatises and articles published by Warren Gorham &

Lamont (WG&L) as well as commentary and analysis prepared by RIA. Additional information about CheckPoint is available from RIA at 800-950-1216 or by visiting their Web site at <http://www.riatax.com>.

*The American Institute of Certified Public Accountants (AICPA)* offers online access free of charge to certain issues of *The Journal of Accountancy*, *The CPA Letter*, *The Practicing CPA*, and *The Tax Advisor* as well as certain materials from the Accounting Standards Executive Committee and ethics guidelines. The AICPA is currently planning to offer additional materials on the Internet, including its *Professional Standards*, *Technical Practice Aids and Audit and Accounting Guides* on a subscription basis. Additional information about online products available from the AICPA is available at 888-777-7077 or visiting their Web site at <http://www.aicpa.org>.

*The Bureau of National Affairs (BNA)* publishes an online version of its *Daily Tax Report*. In addition, subscribers to BNA's *Daily Tax Report* have access to BNA's TaxCore service which provides access to the full text certain materials cited in the *Daily Tax Report*. Additional information about BNA's Internet products is available at 800-372-1033 or by visiting its Web site at <http://www.bna.com>.

*Tax Analysts* publishes TaxBase, an online tax research service. In addition, Tax Analysts plans to make its *Tax Notes*, *State Tax Notes*, *Tax Notes International*, *Tax Practice*, *Exempt Organization Tax Review* and *Insurance Tax Review* publications available on the Internet. Additional information about tax analysts' Internet products is available at 800-955-2444 or by visiting its Web site at <http://www.tax.org>.

*The West Group and LEXIS-NEXIS* offer Internet-based products that provide access to a vast array of tax sources as well as other legal sources. Indeed, subscribers to the West Group's traditional dial-up online research service (WestLaw) can perform WestLaw searches on the Internet. Additional information about the Internet services offered by the West Group is available at 800-WestLaw or by visiting their Web site at <http://www.westlaw.com>. Additional information about the online services offered by LEXIS-NEXIS is available at 800-356-6548 or by visiting their Web site at <http://www.lexis-nexis.com>. Finally, the Thompson Group publishes tax materials, including CCH's *U.S. Master Tax Guide*, on the Internet. Additional information about the Internet-based tax products offered by the Thompson Publishing Group is available at (202) 872-4000 or by visiting their Web site at <http://www.taxlibrary.com>.

As these services continue to expand and improve, it seems likely that Internet research services will eventually replace CD-ROM based products as the method of choice for performing tax research.

## 203.9.5 E-Mail

Presently, one of the most popular uses of Internet is for electronic mail (E-mail), which is being used extensively by many as a quick and inexpensive way of communicating with associates, clients, the AICPA, and many state societies and other professional organizations. All you need to know is the addressee's on-line address. In addition, many firms now have their own home pages on the Worldwide Web providing information to clients (and potential clients) about new developments in the tax law and other topics of current interest.

One area in which E-mail is being used increasingly by tax practitioners is to maintain online discussion groups, bulletin boards, or listservers. Researchers who participate in these forums can post tax questions on the Internet and receive responses from their colleagues throughout the country or the world.

Listservers, or listservs, are e-mail mailing lists to which a researcher can subscribe. Once a person subscribes to a listserv, he or she can post messages to the listserv and receive messages from the listserv by e-mail. A list of useful listservers for tax information is maintained by Tax Analysts and can be found at <http://www.tax.org/notes/default.htm>. Newsgroups are similar to listservs, but researchers must visit the newsgroup's Web site in order to post or receive messages.

**Practice Tip.** It is important to remember that communication sent by e-mail over the Internet may not be secure and may be retrieved by persons other than the intended recipient. Accordingly, you must be cautious when sending confidential or privileged documents or information over the Internet.

In order for your firm to be on Internet, you need a 386 or later computer, a telephone line, a modem and sufficient random access memory on your system. The easiest way to obtain Internet access is to subscribe to one of the commercial firms that offer on-line services. The following is a list of some of the firms that have Internet links and their telephone numbers:

America Online	800-827-6364
CompuServe	800-848-8199
Delphi	800-695-4005
GEnie	800-638-9636
MindSpring	800-719-4660
Pipeline	212-267-3636
Prodigy	800-776-3449

The following books are helpful:

*The Internet: The Complete Reference* by Harley Hahn and Rick Stout, published by Osborne McGraw-Hill, \$29.95.

*The Whole Internet User's Guide & Catalog* by Ed Krol, published by O'Reilly & Associates Inc., \$24.95.

*The Internet for Dummies* by John R. Levine and Carol Baroudi, published by IDG Books, \$19.99.

# Exhibits

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**Exhibit 203-1: Tax Research Request**

**TAX RESEARCH REQUEST**

CLIENT NAME/NUMBER \_\_\_\_\_

SUBJECT MATTER \_\_\_\_\_

REQUESTED BY \_\_\_\_\_ ASSIGNED TO \_\_\_\_\_

DATE OF REQUEST \_\_\_\_\_ DUE DATE \_\_\_\_\_ TIME BUDGET \_\_\_\_\_

**FACTS:**

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**QUESTION(S):**

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**Exhibit 203-2: Tax Research Results**

**TAX RESEARCH RESULTS**

CLIENT NAME/NUMBER \_\_\_\_\_

SUBJECT MATTER \_\_\_\_\_

PREPARED BY \_\_\_\_\_

DATE \_\_\_\_\_

REVIEWED BY \_\_\_\_\_

DATE \_\_\_\_\_

ACTUAL TIME \_\_\_\_\_

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**FINDINGS:** (Attach Research)

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**CONCLUSION(S):**

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Page \_\_\_\_\_ of \_\_\_\_\_



**Exhibit 203-3: Summary of Court Reporters**

Publisher	Tax Court Decisions		U.S. Supreme Court	Court of Appeals	U.S. District Courts	U.S. Court of Claims	U.S. Claims Court <sup>6</sup>	U.S. Court of Federal Claims <sup>7</sup>
	Reg.	Memo						
U.S. Government Official Reports <sup>1</sup>	X		X			X		
West Publishing Co.								
Supreme Court Reporter			X					
Federal Reporters				X		X		
Federal Supplement					X	X <sup>2</sup>		
U.S. Claims Court Reporter							X	
Federal Claims Reporter								X
Commerce Clearing House <sup>3</sup>								
U.S. Tax Cases <sup>4</sup>			X	X	X	X	X	X
T.C. Memo Decisions		X						
Research Institute of America		X						
American Federal Tax Reports <sup>5</sup>			X	X	X	X	X	X
T.C. Memo Decisions		X						

1. Official titles are: Reports of the United States Tax Court  
U.S. Reports  
U.S. Court of Claims Reports
2. Includes early Court of Claims cases.
3. Publishes tax court decisions in looseleaf form.
4. Cited as USTC.
5. 1st and 2nd series, cited as AFTR.
6. In 1982, the U.S. Claims Court replaced the U.S. Court of Claims.
7. In 1992, the U.S. Court of Federal Claims replaced the U.S. Claims Court.

SOURCE: Adapted from AICPA, *Basic Tax Research*, CPE Course Manual (New York: AICPA, 1993).

**Exhibit 203-4: Summary of Primary and Secondary Citations**

	Primary		Secondary	
	Publisher	Standard Citation	Publisher	Standard Citation
Supreme Court <sup>a</sup>	U.S. Government Printing Office	<i>Harris v. Comm.</i> , 340 U.S. 106 (1950)	The Lawyers' Co-Operative Publishing Company	<i>Harris v. Comm.</i> , 95 L.Ed. 111
	West Publishing Company	<i>Harris v. Comm.</i> , 71 S. Ct. 181 (1950)	Research Institute of America Commerce Clearing House	<i>Harris v. Comm.</i> , 39 AFTR 1002 <i>Harris v. Comm.</i> , 1950-2 USTC ¶10,786
Circuit Courts of Appeal <sup>b</sup>	West Publishing Company	<i>Salome Jr. v. U.S.</i> , 395 F.2d 990 (5th Cir. 1968)	Research Institute of America Commerce Clearing House	<i>Salome Jr. v. U.S.</i> , 22 AFTR2d 5039 <i>Salome Jr. v. U.S.</i> , 1968-2 USTC ¶9440
District Courts	West Publishing Company	<i>Whittington v. Jones</i> , 96 F. Supp. 967 (W.D. Okla. 1951)	Research Institute of America	<i>Whittington v. Jones</i> , 40 AFTR 553
			Commerce Clearing House	<i>Whittington v. Jones</i> , 1951-1 USTC ¶9302
Court of Claims <sup>c</sup>	West Publishing Company	<i>Scott v. U.S.</i> , 354 F.2d 292 (Ct. Cl. 1965)	Research Institute of America	<i>Scott v. U.S.</i> , 16 AFTR2d 6087
	U.S. Government Printing Office	<i>Scott v. U.S.</i> , 173 Ct. Cl. 650 (1965)	Commerce Clearing House	<i>Scott v. U.S.</i> , 1966-1 USTC ¶9169
Claims Court <sup>d</sup>	West Publishing Company	<i>Raphan v. U.S.</i> , 3 Cl. Ct. 457 (1983)	Research Institute of America Commerce Clearing House	<i>Raphan v. U.S.</i> , 52 AFTR 2d 83-5987 (Cl. Ct., 1983) <i>Raphan v. U.S.</i> , 83-2 USTC ¶9613 (Cl. Ct., 1983)
Board of Tax Appeals	U.S. Government Printing Office	<i>Charles F. Long</i> , 12 B.T.A. 488 (1928)		
Board of Tax Appeals (memorandum decisions) to 1942	Research Institute of America	<i>Frank L. Owen</i> , 40 B.T.A. 1377, Dock 87811 (Memo), June 6, 1939, 1939 P-H ¶6530		
Tax Court	U.S. Government Printing Office	<i>Mae F. Meurel</i> , 20 T.C. 614 (1953)	Research Institute of America Commerce Clearing House <sup>e</sup>	
Tax Court (memorandum decisions)	Research Institute of America	<i>Stephen L. &amp; Doris M. Morrow</i> , 1967 P-H T.C.M. ¶67,242		
	Commerce Clearing House	<i>Stephen L. &amp; Doris M. Morrow</i> , T.C.M. 1967-1222		

<sup>a</sup>The *Supreme Court Reporter* (West) is considered primary authority prior to publication of the official report by the GPO.

<sup>b</sup>Includes, since 1982, the new U.S. Court of Appeals for the Federal Circuit.

<sup>c</sup>Primary citations to cases decided on the Court of Claims are to either the West publications or the GPO's *Court of Claims Reporter*.

<sup>d</sup>In 1982, the predecessor Court of Claims was merged into the new U.S. Court of Appeals for the Federal District. In its place, the Claims Court was created. The proceedings of the Claims Court can be found in the *United States Claims Court Reporter* (Cl. Ct.) series, published by West Publishing Company. Also, in 1992, the name of the U.S. Claims Court was changed to the United States Court of Federal Claims. The proceedings of the U.S. Court of Federal Claims are published by West Publishing Company in the *Federal Claims Reporter*.

<sup>e</sup>Both RIA and CCH publish "advance sheets" on all Tax Court decisions. Even though they are never *bound*, if a person collected and retained all of the looseleaf (advance sheets) he would in effect have the T.C. reports.

**Exhibit 203-5: Abbreviations Used in Judicial Citations**

The following abbreviations, or variations thereof, are likely to be found in judicial citations:

Acq., Nonacq.; A., NA.	Acquiescence (or nonacquiescence) by the IRS in a Tax Court regular decision
Aff'd	Affirmed by the decision of a higher court
Aff'g	Affirming the decision of a lower court
Certiorari, Cert.	A writ requesting that a court send its case or records of a case to the Supreme Court for inspection
Cert. denied	Litigant's request for writ of certiorari denied by the Court
Rem'g	Remanding (sending back) to the same court out of which the case came
Rev'd	Reversed by the decision of a higher court
Rev'g	Reversing the decision of a lower court

**Exhibit 203-6: Tax Services**

<i>Tax Service</i>	<i>Publisher</i>	<i>Index and Organization</i>	<i>Content of Complete Set</i>	<i>Supplementation</i>
CCH Federal Tax Service (formerly Bender's Federal Tax Service)	Commerce Clearing House, Inc. 4025 W. Peterson Ave. Chicago, IL 60646	Indexed by topic, code section, cases, and rulings. Organized by topic. Available on CD-ROM and Online.	20 volumes with additional binders for weekly newsletters, blank tax forms, and booklets. Has topical analysis and IRC, regulations, and weekly newsletter. Emphasis is on typical analysis.	Updated monthly
Federal Tax Coordinator 2d	Research Institute of America, Inc. 90 Fifth Ave. New York, NY 10011	Indexed by topic, 35 looseleaf volumes organizing federal income, estate, gift, and excise taxes into 24 broad subject categories. Additional indexing by code section, cases, rulings, regulations. Also available on CD-ROM, DOS and Windows.	Thousands of individual self-contained analyses covering specific tax situations, including citations to controlling authorities, applicable code sections, regulations, developments, finding aids, and much more. Analytical approach.	Weekly—print product CD-ROM—monthly
Mertens' Law of Federal Income Taxation	Clark Boardman Callaghan 155 Pfingston Road Deerfield, IL 60015	Organized by topic. Index volume provides key words. Tables and Table of Cases volumes provide the Mertens Chapter and section, which discusses needed IRC, rulings, regulations, and cases.	21 Treatise volumes 19 Rulings volumes 1 Volume paperback code Monthly newsmagazine	Monthly
Rabkin and Johnson Federal Income, Gift and Estate Taxation	Matthew Bender & Co. 2 Park Avenue New York, NY 10016	Indexed by topic, code section, cases, and rulings. Organized by topic.	17 volumes; first eight deal with tax topics, next seven with IRC and legislative history of code sections. Spotlight on commentary, but references included in body of text rather than as footnotes.	Monthly permanent supplements.
Standard Federal Tax Reporter	Commerce Clearing House, Inc. 4025 W. Peterson Ave. Chicago, IL 60646	Indexed by code sections and key words. Organized by code section. Available on CD-ROM.	22 looseleaf volumes, including IRC, regulations, rulings, court decisions, editorial analysis and comment, and a citator.	Weekly—Print and Online Monthly—CD-ROM
Tax Management Portfolio Series	Tax Management, Inc. A subsidiary of the Bureau of National Affairs, Inc. 1250 23rd Street, N.W. Washington, D.C. 20037	Indexed by topics, code sections, and key words. Bibliography at the end of each portfolio refers to other services and sources. Available on CD-ROM.	Series of portfolios dealing with specific problem areas of federal income, estate, gift, trust, and foreign business taxation. Each portfolio includes a detailed analysis, working papers section, and bibliography.	Updated or revised portfolio issued periodically. Biweekly memorandum.

**Exhibit 203-6: Tax Services (cont.)**

<i>Tax Service</i>	<i>Publisher</i>	<i>Index and Organization</i>	<i>Content of Complete Set</i>	<i>Supplementation</i>
Tax Guides	Research Institute of America Inc. 90 Fifth Avenue New York, NY 10011	One looseleaf version available— <i>Tax Guide</i> , organized by topic. <i>Tax Guide</i> controller's edition available in paperback. Available in CD-ROM and DOS.	Complete coverage of federal tax issues and current tax law. Encompasses income, estate and gift, excise and payroll taxes. Coverage of significant cases and rulings. Valuable tax-planning checklists and tax rate schedules and tables. Weekly tax alert newsletters.	Tax Guide (Monthly)
United States Tax Reporter	Research Institute of America, Inc. 90 Fifth Ave. New York, NY 10011	Master key-word index in volume 1 and Index to Current Matter in volume 11. Available in CD-ROM, DOS and Windows.	20 looseleaf volumes, including IRC, regulations, rulings, court decisions, editorial analysis and comment.	Weekly—print CD-ROM—monthly

**Exhibit 203-7: Tax Magazines**

<i>Magazine</i>	<i>Issues Per Year</i>	<i>Publisher</i>	<i>Coverage</i>
Estate Planning	10	Warren, Gorham & Lamont One Penn Plaza New York, NY 10119	Tax and nontax aspects of areas of interest to estate planners.
The Journal of the American Taxation Association	3	Tax Section c/o The American Accounting Association 5717 Bessie Drive Sarasota, FL 34233	A variety of articles, including those on tax education, policy, and compliance.
The Journal of Corporate Taxation	4	Warren, Gorham & Lamont One Penn Plaza New York, NY 10119	Corporate tax planning articles by tax practitioners.
The Journal of Real Estate Taxation	4	Warren, Gorham & Lamont One Penn Plaza New York, NY 10119	Tax planning with emphasis on real estate transactions.
Journal of Taxation	12	Warren, Gorham & Lamont One Penn Plaza New York, NY 10119	In-depth analysis of current tax developments by leading tax practitioners.
The Monthly Digest of Tax Articles	12	Newkirk Products, Inc. 15 Corporate Circle Albany, NY 12203	Digest of tax articles published in various professional journals, magazines, and lab reviews.
National Tax Journal	4	National Tax Association— Tax Institute of America 725 15th St., NW Ste. 600 Washington, DC 20005-2109	Tax policy orientation; frequent theoretical economic analysis.
Oil and Gas Tax Quarterly	4	Matthew Bender & Co., Inc. 2 Park Ave. New York, NY 10016	Specialized coverage of oil and gas taxation topics.
Taxation for Accountants	12	Warren, Gorham & Lamont One Penn Plaza New York, NY 10119	Specialized articles on taxation for accountants.
The Practical Accountant	12	Faulkner and Gray 11 Penn Plaza, 17th Floor New York, NY 10001	Selected articles on taxation for the general practitioner.
The Real Estate Review	4	Warren, Gorham & Lamont One Penn Plaza New York, NY 10119	Articles dealing with real estate topics.
The Tax Adviser	12	American Institute of CPAs Harborside Financial Center 201 Plaza III Jersey City, NJ 07311	Current tax developments, estate planning techniques, tax practice management.
The Tax Executive	6	Tax Executives Institute, Inc. 1001 Pennsylvania Ave., N.W., Suite 320 Washington, D.C. 20004-2505	In-depth articles of particular interest to corporate tax executives written by tax professionals, scholars, and management.
The Tax Lawyer	4	American Bar Association Section of Taxation 470 15th St., N.W. Washington, D.C. 20005-1009	In-depth coverage of tax topics for the lawyer in tax practice.

**Exhibit 203-7: Tax Magazines (cont.)**

<i>Magazine</i>	<i>Issues Per Year</i>	<i>Publisher</i>	<i>Coverage</i>
Taxation for Accountants	12	Warren, Gorham & Lamont One Penn Plaza New York, NY 10119	General coverage of tax topics for the accountant in general tax practice.
Taxation for Lawyers	6	Warren, Gorham & Lamont One Penn Plaza New York, NY 10119	General coverage of tax topics for the lawyer in general practice.
Taxes—The Tax Magazine	12	Commerce Clearing House, Inc. 4025 West Peterson Ave. Chicago, IL 60646	Selected articles covering current tax developments. Includes a section dealing in tax laws.
Trusts and Estates	12	Communication Channels, Inc. 6151 Powers Rd. N.W. Atlanta, GA 30339	Specialized emphasis on estate and trust taxation and estate planning.

**Exhibit 203-8: Tax Newsletters**

<i>Newsletters</i>	<i>Issues Per Year</i>	<i>Publisher</i>	<i>Coverage</i>
CCH Federal Tax Weekly (formerly Bender's Tax Week)	52	Commerce Clearing House 4025 West Peterson Ave. Chicago, IL 60646	Digest and commentary on current tax developments oriented to assist in tax planning.
Daily Tax Report	250	Bureau of National Affairs, Inc. 1231 25th St. N.W. Washington, D.C. 20037	Summary and analysis of developments in taxation and finance for preceding 24 hours, Mondays through Fridays.
Federal Taxes Weekly Alert	52	Research Institute of America 90 Fifth Ave. New York, NY 10011	Current tax developments written with emphasis on tax planning. Also tax return guides and opportunity checklists.
Internal Revenue Bulletin	52	Research Institute of America, Inc. 90 Fifth Avenue New York, NY 10011	Weekly reprint of bulletin sent to tax service subscribers; general coverage of weekly developments, in federal taxation: new tax rulings, law changes, and recent court decisions.
J.K. Lasser Monthly Tax Service	12	J.K. Lasser Monthly Tax Letter P.O. Box 493 Mount Morris, IL 61054	General coverage of tax developments.
Kiplinger Tax Letter	26	The Kiplinger Washington Editors 1729 H St., N.W. Washington, D.C. 20006	General coverage of major tax developments.
Non-Profit Legal & Tax Letter	18	Organization Management Inc. 8081 Emerald Pool Ct. Mechanicsville, VA 23111	Current developments in taxation affecting tax-exempt organizations.
The Practical Accountant Alert	24	Faulkner & Gray 11 Penn Plaza, 17th Floor New York, NY 10001	Fast-breaking coverage of all the major developments that affect accounting work.
Real Estate Tax Ideas	12	Warren, Gorham & Lamont 210 South St. Boston, MA 02111	Tax analysis of real estate transactions for real estate professionals.
Tax Management Weekly Report	52	Bureau of National Affairs, Inc. 1231 25th St. N.W. Washington, D.C. 20037	Current developments on the tax code.
Tax Notes	52	Tax Analysts 6830 North Fairfax Drive Arlington, VA 22213	Tax analysis prepared by a public interest firm.
Tax Notes Highlights and Documents	250	Tax Analysts 6830 North Fairfax Drive Arlington, VA 22213	Summary and full text of previous day's important tax news.
Taxes on Parade	52	Commerce Clearing House, Inc. 4025 West Peterson Ave. Chicago, IL 60646	Weekly reprint of report sent to tax service subscribers; general coverage of weekly developments.



**Exhibit 203-9: URLs for Tax Information on the Worldwide Web***Legislative Materials*

Internal Revenue Service Home Page	<a href="http://www.irs.ustreas.gov/">http://www.irs.ustreas.gov/</a>
Internal Revenue Code	<a href="http://www.fourmilab.ch/ustax/ustax.html">http://www.fourmilab.ch/ustax/ustax.html</a>
US Code	<a href="http://law.house.gov/usc.htm">http://law.house.gov/usc.htm</a>
Code of Federal Regulations	<a href="http://law.house.gov/cfr/htm">http://law.house.gov/cfr/htm</a>
Treasury Regulations	<a href="http://www.irs.ustreas.gov/prod/tax_regs/index.html">http://www.irs.ustreas.gov/prod/tax_regs/index.html</a>
House of Representatives Home Page	<a href="http://www.house.gov/">http://www.house.gov/</a>
Thomas Legislative Information	<a href="http://thomas.loc.gov/">http://thomas.loc.gov/</a>
Library of Congress	<a href="http://www.loc.gov/">http://www.loc.gov/</a>
Social Security Administration	<a href="http://www.ssa.gov/">http://www.ssa.gov/</a>
Government Printing Office	<a href="http://www.access.gpo.gov">http://www.access.gpo.gov</a>
House Committee on Ways and Means	<a href="http://www.house.gov/ways_means">http://www.house.gov/ways_means</a>
Joint Committee on Taxation	<a href="http://www.house.gov/jct">http://www.house.gov/jct</a>
Senate Finance Committee	<a href="http://www.senate.gov">http://www.senate.gov</a>

*Federal Tax Forms and Publications*

IRS Forms and Instructions	<a href="http://www.irs.ustreas.gov/prod/forms_pubs/forms.html">http://www.irs.ustreas.gov/prod/forms_pubs/forms.html</a>
IRS Publications	<a href="http://www.irs.ustreas.gov/prod/forms_pubs/pubs.html">http://www.irs.ustreas.gov/prod/forms_pubs/pubs.html</a>

*Tax Gateways*

Accounting Gateway	<a href="http://www.rutgers.edu/Accounting/raw/internet.internet.htm">http://www.rutgers.edu/Accounting/raw/internet.internet.htm</a>
Frank McNeil's Tax Sites	<a href="http://www.best.com/~ftmexpat/html/taxsites.html">http://www.best.com/~ftmexpat/html/taxsites.html</a>
Tax Professional's Guide to the Internet	<a href="http://www.ey.com/us/tax/taxprof.htm">http://www.ey.com/us/tax/taxprof.htm</a>
Tax Sites Directory	<a href="http://www.taxsites.com">http://www.taxsites.com</a>
Tax Web	<a href="http://www.taxweb.com/index.html">http://www.taxweb.com/index.html</a>
Yahoo	<a href="http://www.yahoo.com/Economy/Taxes">http://www.yahoo.com/Economy/Taxes</a>

*Tax Publishers*

AICPA	<a href="http://www.aicpa.org/">http://www.aicpa.org/</a>
Bureau of National Affairs (BNA)	<a href="http://www.bna.com/">http://www.bna.com/</a>
Commerce Clearing House (CCH)	<a href="http://www.cch.com/">http://www.cch.com/</a>
Harcourt Brace Professional Publishing	<a href="http://www.hbpp.com/">http://www.hbpp.com/</a>
John Wiley & Sons	<a href="http://www.wiley.com/">http://www.wiley.com/</a>
Research Institute of America	<a href="http://www.riatax.com/">http://www.riatax.com/</a>
Tax Analysts	<a href="http://www.tax.org/">http://www.tax.org/</a>
Warren, Gorham & Lamont	<a href="http://www.wgl.com/">http://www.wgl.com/</a>

*State Tax Information*

California Franchise Tax Board	<a href="http://www.ftb.ca.gov/index.html">http://www.ftb.ca.gov/index.html</a>
Florida Department of Revenue	<a href="http://fcn.state.fl.us/dor/revenue.html">http://fcn.state.fl.us/dor/revenue.html</a>
Massachusetts Department of Revenue	<a href="http://www.magnet.state.ma.us/doe/dorpg.htm">http://www.magnet.state.ma.us/doe/dorpg.htm</a>
New York State Department of Taxation and Finance	<a href="http://gopher://unix2nysed.gov:71/11/agencies/executive/tax">gopher://unix2nysed.gov:71/11/agencies/executive/tax</a>
Texas Comptroller of Public Accounts	<a href="http://www.window.texas.gov/">http://www.window.texas.gov/</a>
State Laws	<a href="http://law.house.gov/17.htm">http://law.house.gov/17.htm</a>
General State Tax Information	<a href="http://ourworld.compuserve.com/homepages/stahl/statinfo.htm">http://ourworld.compuserve.com/homepages/stahl/statinfo.htm</a>

*Foreign Tax Information*

Laws of Foreign Countries	<a href="http://law.house.gov/52.htm">http://law.house.gov/52.htm</a>
Revenue Canada	<a href="http://www.revcan.ca/Emenu.html">http://www.revcan.ca/Emenu.html</a>
Inland Revenue (UK)	<a href="http://www.open.gov.uk/inrev/irhome.htm">http://www.open.gov.uk/inrev/irhome.htm</a>
World Tax	<a href="http://www.eyi.com/itax/">http://www.eyi.com/itax/</a>



# 204 Electronically Filing Tax Returns

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# 204 Electronically Filing Tax Returns

The 1999 individual income tax filing season produced another record number of electronically filed (ELF) returns. Through April 23, 1999, the number of ELF returns was up 19% over 1998, with almost 29 million returns filed electronically. Based on the growing number of users, it appears inevitable that within the next few years all practitioners will be required to electronically file, whether it be mandated by the IRS or by the competitive pressures of the marketplace. If your firm isn't already offering this service to your clients, perhaps it's time to look at this alternative way of filing.

Electronic filing began as a pilot project in 1986 with just five electronic return originators (EROs), one IRS service center, and a limited number of refund-only returns that qualified. Each year additional EROs, service centers, schedules, forms, balance-due returns, and state filings have been added to the program. The 1999 filing season saw over 62 thousand EROs and five service centers nationwide, filing over 28 million returns electronically. That's one in every four taxpayers that filed by April 23rd.

Although Forms 1040, 1040A and 1040EZ make up the majority of electronically filed returns, the following returns can also be filed electronically: Forms 1040NR, 941, 1065, 1041, and 5500 C/R & EZ. In addition, the IRS is presently working on adding Form 1120 to the electronic filing program.

Most firms have started to offer electronic filing of tax returns. In many of these firms, the traditional preparation of paper returns normally occurs, and electronic returns are prepared for clients on an exception basis. Other firms have started to move towards a totally electronically filed environment, with the preparation of the traditional paper returns being the exception.

## 204.1 Advantages

The transition to a more complete electronically filed environment offers many advantages. The most obvious benefit to the practitioner from electronic filing is the economic savings resulting from reduced paper, supply and postage costs. Because both the federal and primary state returns are electronically filed, the number of copies of returns is generally reduced from four to two (one for the preparer's file and one for the client's record). This results in savings of up to 50 percent in paper, printer or copier toner, and envelope costs alone. In addition, larger, special-order envelopes are not required for mailing of returns and the postage budget is also reduced substantially.

While economic benefits are important, some of the biggest advantages to electronic filing of tax returns are quick processing, accuracy, assurance, fast refunds, and convenience. Electronically filed returns allow the IRS and the state to expedite processing of returns, as all information is sent directly to revenue service computers where names, dependent's birth dates, social security numbers and federal I.D. numbers are immediately matched with IRS records.

If a paper return is filed with the IRS and any of this data is incorrect, the processing of the return may be delayed while the IRS manually verifies and corrects the data or issues a notice to the taxpayer requesting additional information. As a result, electronic filing eliminates mail time, paper handling time, and revenue service time in keying and verifying tax return information into their system. In addition it provides 99.5 percent accuracy (82 percent for paper filed returns). Taxpayers and EROs are provided an assurance, in the form of an acknowledgment (electronic acknowledgment to ERO and a mailed acknowledgment to taxpayer), that the returns were received and accepted, thereby eliminating the possibility that the return may have been lost in the mail or mishandled by the IRS.

Expedited processing also means expedited refunds for those taxpayers with overpayments. Generally, the IRS will issue direct deposit refunds within one to two weeks, or two to three weeks if a paper check is preferred. Taxpayers may also request that overpayments be applied to the next year's estimated tax. Balance due returns can be electronically filed as soon as the attestation Form 8453, U.S. Individual Income Tax Declaration for Electronic Filing, is signed by the taxpayer. However, the payment can be delayed and mailed with a separate voucher on or before the due date.

Client reaction to adding the electronic filing service has generally been positive; 98 percent of returns now qualify and more forms are being added each year. It takes the burden of actually filing the returns away from the taxpayer and places it into the ERO's hands, thereby providing more control over the tax filing process. Practitioners know the return is being submitted the way they prepared it without the risk of IRS keypunch errors or omissions. Offering these conveniences for your clients provides a positive perception of the quality and professional service clients demand and indicates the practitioner is on the cutting edge of technology in tax return preparation.

## 204.2 Disadvantages

It wouldn't be fair to highlight the benefits of electronic filing without sharing some of the disadvantages that may occur in implementing the program within your firm. As with anything new and different, there is a learning curve required to train staff and inform clients of the requirements for electronic filing. Initially, electronic filing may cause some inefficiencies until the firm becomes familiar with the forms and schedules the IRS will accept (for example, 1998 returns with the following forms or conditions were not eligible for electronic filing: Forms 3800, 6765, 8271, 8586, 8801, 8824, decedent returns, and returns with more than 30 pages of statements), as well as the filing operation itself. Tax preparation staff need to be informed about what kinds of items will disqualify a return from electronic filing. Policies and procedures must be rewritten and new lead times may be introduced. Some tax software data that is proforma carryover from the prior year may need to be reentered on alternative input screens.

Electronic filing has increased the responsibilities of tax practitioners. Formerly, a practitioner preparing a return was responsible for putting the completed return in the hands of the client in time for the client to file it by the deadline. According to the IRS, filing on time is still ultimately the client's responsibility; however, with electronic filing, the actual filing of the return is now a responsibility of the practitioner.

Monitoring the status of each return throughout the process requires additional administrative time by the support staff, as does the time necessary to monitor returns rejected by the IRS or state and assure that these rejections are cleared, if possible.

For many firms, disadvantages resulting from a complete transition to an electronic filing environment are quickly overcome, resulting in an enhanced firm image, along with reduced personnel and supplies costs.

## 204.3 The Taxpayer's Signature Form and Other Paperwork

Currently, electronic filing does not completely end the paperwork sent to the IRS. Before submitting an electronic return, you will need to get the client's signature on Form 8453, U.S. Individual Income Tax Declaration for Electronic Filing. Form 8453 also has a place for the

preparer's signature. In addition to showing the taxpayer's name, address, and signature, the form requires several figures from the return (total income, total tax, withholding, refund amount or balance due). There is also an optional section for direct deposit. Exhibit 204-1 illustrates a copy of Form 8453.

Form 8453 authenticates the return and authorizes a preparer to transmit using a third-party transmitter. It also serves as a transmittal for attachments such as W-2s, taxpayer declarations, and any supporting statements.

The IRS is conducting a pilot project whereby taxpayers use an "electronic signature" consisting of a PIN Personal Identification Number instead of Form 8453. If successful, this may eventually eliminate the signatures required with Form 8453.

## 204.4 Direct Deposits, Refund Anticipation Loan (RAL) Program, Direct Withdrawal and Credit Card Payments

The Federal direct deposit program allows taxpayers who file electronically to have their refunds deposited directly into their bank accounts. Taxpayers who want this service fill out the direct deposit section of Form 8453, and need to be certain the electronic portion of their return includes the financial institution's name, and routing number, and the taxpayer's checking or savings account number. Taxpayers need to provide the practitioner with proof that their account exists, usually an account identification card or a canceled check.

Many electronic filers also take part in the refund anticipation loan (RAL) program. The taxpayer requests that the IRS directly deposit his or her refund at a qualified lending institution, and authorizes the lender to debit the taxpayer's account when the IRS deposits the refund.

Normally, practitioners who offer RALs to their clients use a telecommunication service to forward the return to the IRS and the lending institution. The telecommunication service sets up the program for the practitioner and acts as the loan administrator. The telecommunication service is usually in addition to the third-party transmitter; there are added fees for using it.

The practitioner sends the return and RAL information to the telecommunication service, which delivers the material to the IRS and the lender. The lender performs the preliminary loan approval procedure while the IRS processes the return. After two days, the IRS sends back its acknowledgment of receipt and indicates whether it has accepted the taxpayer's refund application.

The IRS may reduce or eliminate an income tax refund for any of the following reasons:

- Prior years' taxes
- Outstanding alimony or child support
- Overdue student loan payments
- Debts owed to other federal or state agencies

Once the IRS indicates acceptance of the refund request, the lender makes the loan. Later, the lender will debit the client's account when the IRS deposits the refund.

Taxpayers with balance due amounts are now allowed to elect to pay through a direct debit to their checking or savings account or by charging it to a credit card. The payment must be authorized to be withdrawn on or before April 15th in order to be timely.

The authorization to allow the U.S. Treasury to initiate an ACH debit entry is designated on form 8453 with the corresponding financial institution account information in the electronic portion of the federal income tax return.

Taxpayers wishing to pay with a credit card do so by calling 1-888-2PAY-TAX. Presently, only MasterCard®, American Express® and NOVUS/Discover® Card, as well as other NOVUS brand cards, are allowed. Although the IRS only allows tax payments for Form 1040 filers, it does expect to expand the credit card payment option to other types of taxes in future years.

Taxpayers paying with a credit card are charged a convenience fee as well as any charges and interest that may be assessed by their bank or credit card issuer. More information regarding these fees and this program can be obtained by calling 1-877-754-4413 or on the US AuditexSM Web site at <http://www.usauditex.com>.

## 204.5 Electronic Filing—Getting Started and How it Works

Following is a brief description of the steps necessary to get started with electronic filing and the step-by-step process a return goes through to be electronically filed. This is by no means all inclusive. You should completely familiarize yourself with IRS Publications 1345 and 1345A, as well as Revenue Procedure 98-50 for official requirements and responsibilities. Copies can be downloaded or viewed from the IRS Web site at [www.irs.gov](http://www.irs.gov).

### 204.5.1 Getting Started

- Complete Form 8633 (Exhibit 204-2), *Application to Participate in the IRS e-file Program*, between August 1 and December 1 for new applications. Some applicants may be required to include fingerprint cards; please consult the application form for further details. In general, if you are a licensed CPA, attorney, enrolled agent, or banking official who has been bonded, fingerprint cards should not be required. The application is mailed to the Andover Service Center.
  - You can obtain Form 8633 and fingerprint cards by calling the Andover Service Center at 978-474-1499 or by contacting the IRS.
  - Order publication 1345 & 1345A—*Handbook for Electronic Filing on Individual Income Tax Returns and Supplement*.
  - New applications are accepted from August 1 through December 1; revised applications are accepted year round.
  - Questions relating to the submission or processing of Form 8633 should be directed to the Andover Service Center at 1-800-691-1894.
  - The IRS will send notification of acceptance of Form 8633 and issue an electronic filer identification number (EFIN) within 45 days after receipt of the completed application.
  - Check with your state tax authority on application requirements for participating in FEDSTATE Program or Stand Alone State Programs.
- Check your *tax software* and *equipment*.
  - Research and determine whether you will transmit directly or through a third-party transmitter (often your tax software vendor). Direct transmitters must submit test data for approval to determine that software formats meet IRS specifications.
  - Purchase the electronic filing package offered by your tax software or contact a third-party transmitter for their software and procedures.
  - Change any characters or input forms in order to qualify a return for electronic filing. This can often be done as a project for slower summer times.
  - Acquire the required equipment (computer, modem, printer, communications software) necessary to run the electronic filing software.
- *Communicate* electronic filing benefits and requirements to staff and clients.
  - Develop a client newsletter article.
  - Develop and provide client handouts prior to their tax interview such as the example shown at Exhibit 204-3.
  - Develop a step-by-step process on how your firm will handle electronic returns and incorporate these steps into tax return process sheets. Examples are included in Exhibits 204-4, 204-5 and 204-6.
  - Provide staff training, including updates through brief staff meetings during the filing season.
- Decide how to monitor returns throughout the process. Set up a spreadsheet or use your database software to track the process. (Exhibit 204-7)
  - Decide how to handle rejected returns.
  - Develop client instructions (Exhibit 204-8)

### 204.5.2 How it Works

- Prepare the tax return using IRS approved software. Be certain to use alternative input forms for W-2's, 1099R's, and so forth, if required by your software.



- Print the return including Form 8453 (U.S. Individual Income Tax Declaration for Electronic Filing) and state ELF form if required (Exhibit 204-1). Form 8453 authenticates the return and authorizes a preparer to transmit using a third-party transmitter. It also serves as a transmittal for attachments such as W-2s, taxpayer declarations, and any supporting statements.
- Process the client copy of the return. The ERO must sign the client copy of Form 8453 as well as the filing copy. The 8453 will also indicate if direct deposit is requested for refunds. Balance due returns will need Form 1040-V, Payment Voucher (Exhibit 204-9).
- Obtain taxpayer signatures on Form 8453 and state ELF form if required.
- Transmit electronic return file to IRS Service Center or third-party transmitter for processing.
- The ERO will receive an electronic acknowledgment of accepted returns from the service center or third-party transmitter within two days of transmission (Exhibit 204-10).
- The ERO batch-mails all Forms 8453, W-2's and other attachments to the IRS service center within one workday after ERO receives acknowledgment of acceptance. Send return receipt requested and mail with a completed Declaration Control Record (Exhibit 204-11).
- The ERO (or sometimes the third-party transmitter) mails Form 9325, *Acknowledgment and General Information for Taxpayers Who File Returns Electronically*, to the taxpayer (Exhibit 204-12).
- For refund returns, the direct deposit is transmitted to the taxpayer's bank or a paper check is mailed.
- For balance due returns, the taxpayer must mail payment with Form 1040-V on or before the due date.

## 204.6 Additional Tips

- Hold brief weekly electronic filing staff meetings during the first several weeks to share problems and solutions that can help staff to more quickly master the learning curve associated with electronic filing.
- Choosing the right tax software can save you hours of time. Many tax software packages automatically test each return for qualification and provide diagnostics on any items that need to be changed or that may disqualify a return.
- Educate clients through a newsletter and by providing them with a handout when they come in for their tax interview. This eliminates a lot of questions and dispels doubts.
- Provide explicit instructions with the completed return for signing and returning electronic filing authorizations. This helps ensure client understanding and accuracy in returning the proper forms and making the appropriate payments.
- Monitor the status of each return throughout each step of the electronic filing process. This is crucial to a successful filing season. Establish a tracking system using an electronic spreadsheet to assure that all Forms 8453 are timely signed by the taxpayers, returned to the ERO, electronically transmitted by the due date, accepted by the IRS and Forms 8453 timely mailed to the IRS (the IRS is considering elimination of the signature requirements of Form 8453 in the 1999 filing season). Limit the monitoring function to as few people as possible in order to provide consistency.
- Monitor returns rejected by the IRS or state and make sure that these rejections are cleared, if possible. Some of the most common rejections encountered include: (1) spouse's name does not match social security records due to the name change never being reported to the social security office, (2) incorrect social security numbers for taxpayer, spouse or dependents, (3) dependents being claimed on another return (either their own or the other parent), and (4) inability to match new federal ID number for a number issued in the current processing year. First-year rejection rates are often less than 4 percent. Many of these rejections can be avoided with proper planning and

careful verification of social security cards and dependency qualification. Unfortunately, it seems the IRS has not been notifying return preparers or clients of these problems in the past when paper returns were submitted. The rejections are typically long-standing discrepancies that the IRS should have identified many years earlier.

## 204.7 **Business, Partnership, Fiduciary, or 5500 Electronic Filing Program**

The majority of returns being filed electronically are individual income tax returns. However, Forms 1065, 5500 C/R & 5500 EZ, 1041, and 1040NR can also be filed electronically. Although currently not eligible, the IRS is planning on adding Form 1120 to the electronic filing program in the near future.

To find out more about transmitting partnership returns electronically, write to

Internal Revenue Service  
Andover Service Center Stop 983  
Electronic Filing Branch  
P.O. Box 4050  
Woburn MA 01888-4050 or call: (508) 474-9486

To find out more about transmitting Form 5500 series returns electronically, write to:

Internal Revenue Service  
Andover Service Center Stop 983  
Electronic Filing Unit 3  
P.O. Box 4050  
Woburn MA 01888-4050 or call: (508) 474-9486

To find out more about transmitting Form 1091 Fiduciary and Form 1040NR returns electronically, write to:

Philadelphia Service Center  
Magnetic Media Project Office, DP 115  
11601 Roosevelt Blvd.  
Philadelphia PA 19154 or call: (215) 516-7533

*Practitioners can also find out further information on electronic filing of individual or business returns by contacting the Electronic Tax Administration Coordinator at the IRS District Office for their area. Exhibit 204-13 is a copy of Form 9041, Application for Electronic/Magnetic Media Filing of Business and Employee Benefit Plan Returns.*

## 204.8 **Making the Decision—Client Service**

Electronic filing is primarily a client-service action. From the preparer's standpoint, the savings in photocopying, supplies, and postage probably do not compensate for the conversion costs, at least not in the first year. However, after the first year, the systems are in place, the small percentage of returns with rejection problems have been identified, and the learning curve is behind you. Most importantly, clients know their needs are being met by efficient filing and prompt refunds.

The IRS has launched massive publicity campaigns covering the advantages of electronically filed returns, direct deposit, and the resultant faster refunds. Undoubtedly, your clients have heard these campaigns. If they didn't hear them on the radio or television, they most likely heard them from colleagues and neighbors bragging about their early refunds. Many clients are aware of the benefits of electronic filing and often want this service. Better to offer electronic filing to your clients than wait for them to ask for it.

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**Exhibit 204-1: Form 8453, U.S. Individual Tax Declaration for Electronic Filing**

Declaration Control Number (DCN)

00 - [ ] - [ ] - 0

IRS Use Only—Do not write or staple in this space.

Form **8453**

**U.S. Individual Income Tax Declaration  
for an IRS e-file Return**

OMB No. 1545-0936

**1999**

Department of the Treasury  
Internal Revenue Service

For the year January 1-December 31, 1999

▶ See instructions on back.

Use the  
IRS label.  
Otherwise,  
please  
print or  
type.

L A B E L  H E R E	Your first name and initial		Last name		Your social security number	
	If a joint return, spouse's first name and initial		Last name		Spouse's social security number	
	Home address (number and street). If you have a P.O. box, see instructions.				Apt. no.	
	City, town or post office, state, and ZIP code					
<b>▲ IMPORTANT! ▲</b> You must enter your SSN(s) above.						
Telephone number (optional) ( )						

**Tax Return Information (Whole dollars only)**

1 Total income (Form 1040, line 22; Form 1040A, line 14; Form 1040EZ, line 4)	1	
2 Total tax (Form 1040, line 56; Form 1040A, line 34; Form 1040EZ, line 10)	2	
3 Federal income tax withheld (Form 1040, line 57; Form 1040A, line 35; Form 1040EZ, line 7)	3	
4 Refund (Form 1040, line 66a; Form 1040A, line 41a; Form 1040EZ, line 11a)	4	
5 Amount you owe (Form 1040, line 68; Form 1040A, line 43; Form 1040EZ, line 12)	5	

**Declaration of Taxpayer (Sign only after Part I is completed.)**

- 6a  I consent that my refund be directly deposited as designated in the electronic portion of my 1999 Federal income tax return. If I have filed a joint return, this is an irrevocable appointment of the other spouse as an agent to receive the refund.
- b  I do not want direct deposit of my refund or I am not receiving a refund.
- c  I authorize the U.S. Treasury and its designated Financial Agents to initiate an ACH debit (automatic withdrawal) entry to my financial institution account indicated for payment of my Federal taxes owed, and my financial institution to debit the entry to my account. This authorization is to remain in full force and effect until the U.S. Treasury's Financial Agents receive notification from me of the termination. To revoke this payment authorization, I must contact the U.S. Treasury Financial Agent at 1-888-353-4537 no later than 2 business days prior to the payment (settlement) date. I also authorize the financial institutions involved in the processing of my electronic payment of taxes to receive confidential information necessary to answer inquiries and resolve issues related to my payment.

If I have filed a balance due return, I understand that if the IRS does not receive full and timely payment of my tax liability, I will remain liable for the tax liability and all applicable interest and penalties. If I have filed a joint Federal and state tax return and there is an error on my state return, I understand my Federal return will be rejected.

Under penalties of perjury, I declare that the information I have given my ERO and the amounts in Part I above agree with the amounts on the corresponding lines of the electronic portion of my 1999 Federal income tax return. To the best of my knowledge and belief, my return is true, correct, and complete. I consent to my ERO sending my return, this declaration, and accompanying schedules and statements to the IRS. I also consent to the IRS sending my ERO and/or transmitter an acknowledgment of receipt of transmission and an indication of whether or not my return is accepted, and, if rejected, the reason(s) for the rejection, and, if I am applying for a refund anticipation loan or similar product, an indication of a refund offset. If the processing of my return or refund is delayed, I authorize the IRS to disclose to my ERO and/or transmitter the reason(s) for the delay, or when the refund was sent.

Sign Here	Your signature		Date	Spouse's signature. If a joint return, BOTH must sign.		Date

**Declaration of Electronic Return Originator (ERO) and Paid Preparer (See instructions.)**

I declare that I have reviewed the above taxpayer's return and that the entries on Form 8453 are complete and correct to the best of my knowledge. If I am only a collector, I am not responsible for reviewing the return and only declare that this form accurately reflects the data on the return. The taxpayer will have signed this form before I submit the return. I will give the taxpayer a copy of all forms and information to be filed with the IRS, and have followed all other requirements in Pub. 1345, Handbook for Electronic Return Originators of Individual Income Tax Returns. If I am also the Paid Preparer, under penalties of perjury I declare that I have examined the above taxpayer's return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. This Paid Preparer declaration is based on all information of which I have any knowledge.

ERO's Use Only	ERO's signature	Date	Check if also paid preparer <input type="checkbox"/>	Check if self-employed <input type="checkbox"/>	ERO's SSN or PTIN
	Firm's name (or yours if self-employed) and address				EIN ;
					ZIP code

Under penalties of perjury, I declare that I have examined the above taxpayer's return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. This declaration is based on all information of which I have any knowledge.

Paid Preparer's Use Only	Preparer's signature	Date	Check if self-employed <input type="checkbox"/>	Preparer's SSN or PTIN	
	Firm's name (or yours if self-employed) and address				EIN ;
					ZIP code

For Paperwork Reduction Act Notice, see back of form.

Cat. No. 62766T

Form **8453** (1999)

**Exhibit 204-1: Form 8453, U.S. Individual Tax Declaration for Electronic Filing (cont.)**

Form 8453 (1999)

**General Instructions**

**Purpose of Form**

Use Form 8453 to:

- Authenticate the electronic portion of Form 1040, 1040A, or 1040EZ,
- Send any accompanying paper schedules or statements,
- Authorize the electronic return originator (ERO) to transmit via a third-party transmitter, and
- Provide the taxpayer's consent to directly deposit any refund or authorize an ACH debit (automatic withdrawal).

**When and Where To File**

This form must be mailed to the service center where the electronic return was transmitted within 3 business days after the ERO has received acknowledgment from the IRS that the return was accepted. See **Pub. 1345A**, Filing Season Supplement for Electronic Return Originators, for the address. Only the Andover, Austin, Cincinnati, Memphis, and Ogden Service Centers can accept electronic returns.

**Line Instructions**

**Declaration Control Number (DCN).**

The DCN is a 14-digit number assigned by the ERO to each return. Clearly type or print the DCN in the top left corner of each Form 8453. Enter the number **after** the IRS has acknowledged receipt of the electronic return as follows:

<u>Boxes</u>	<u>Entry</u>
1- 2	File identification number (always "00")
3- 8	Electronic filer identification number (EFIN) assigned by the IRS
9- 11	Batch number (000 to 999) assigned by the ERO
12- 13	Serial number (00 to 99) assigned by the ERO
14	Year digit (for returns filed in 2000, the year digit is "0")

**Example.** The EFIN is 509325. The batch number is 000. The serial number is 56. The DCN is 00-509325-00056-0.

**Name and Address.** If the taxpayer received a peel-off name and address label from the IRS, put the label in the name area. Cross out any errors and print the correct information. Add any missing items, such as apartment number. If the taxpayer did not receive a label, print or type the information in the spaces provided.

**P.O. Box.** Enter the box number **only** if the post office does not deliver mail to the taxpayer's home.

**Note:** *The address must match the address shown on the electronically filed return.*

**Social Security Number (SSN).** Be sure to enter the taxpayer's SSN in the space provided on Form 8453. If a joint return, list the SSNs in the same order as the first names.

**Part I—Tax Return Information**

**Line 5.** Do not include any payment with Form 8453. The method of payment depends on whether the taxpayer checks the box on line 6b or 6c. For details, see the instructions for Part II.

**Part II—Declaration of Taxpayer**

**Note:** *All taxpayers must check the box on line 6a, 6b, or 6c.*

If there is an amount on line 5 and the taxpayer checks the box on line 6b and is paying by check or money order, mail the payment by April 17, 2000, with **Form 1040-V** to the applicable address shown on that form. If the taxpayer checks the box on line 6c, the taxpayer must ensure that the following information relating to the financial institution account is provided in the electronic portion of the tax return.

- Routing number
- Account number
- Type of account (checking or savings)
- Debit amount
- Debit date (date the taxpayer wants the debit to occur, but not later than April 17, 2000).

An electronically transmitted return will not be considered complete, and therefore filed, unless and until a Form 8453 signed by the taxpayer is received by the IRS.

The taxpayer's signature allows the IRS to disclose to the ERO and/or transmitter the reason(s) for a delay in processing the return or refund. In the case of a taxpayer who is applying for a refund anticipation loan or similar product, the taxpayer's signature also allows the IRS to advise the ERO and/or transmitter if a refund offset may occur.

If the ERO makes changes to the electronic return after Form 8453 has been signed by the taxpayer but before it is transmitted and either 1 or 2 below applies, the ERO must have the taxpayer complete and sign a corrected Form 8453.

1. The total income on line 1 differs from the amount on the electronic return by more than \$50, or
2. The total tax on line 2, the Federal income tax withheld on line 3, the refund on line 4, or the amount owed on line 5 differs from the amount on the electronic return by more than \$14.

**Part III—Declaration of Electronic Return Originator (ERO) and Paid Preparer**

The IRS requires the ERO's signature. A paid preparer must sign Form 8453 in the space for **Paid Preparer's Use Only**. Only handwritten signatures are acceptable. But if the paid preparer is also the ERO, do not complete the paid preparer's section. Instead, check the box labeled "Check if also paid preparer."

**Note:** *If the paid preparer's signature cannot be obtained on Form 8453, you may attach a copy of Form 1040, 1040A, or 1040EZ instead. Attach **only** pages 1 and 2, and write "COPY—DO NOT PROCESS" on each page.*

**Refunds.** After the IRS has accepted the return, the refund should be issued within 3 weeks. However, some refunds may be delayed because of compliance reviews to ensure that returns are accurate.

**Refund Information.** Refund information is available on TeleTax. Call 1-800-829-4477.

**Paperwork Reduction Act Notice.** We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by Internal Revenue Code section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is 15 minutes. If you have comments concerning the accuracy of this time estimate or suggestions for making this form simpler, we would be happy to hear from you. You can write to the Tax Forms Committee, Western Area Distribution Center, Rancho Cordova, CA 95743-0001. **DO NOT** send the form to this address. Instead, see **When and Where To File** on this page.



**Exhibit 204-2: Form 8633, Application to Participate in the IRS e-file Program**

Form **8633**

(Rev. July 1999)  
Department of the Treasury  
Internal Revenue Service

**Application to Participate in the  
IRS e-file Program**

**For Official Use Only**  
EFIN: \_\_\_\_\_ ETIN: \_\_\_\_\_  
OMB Number 1545-0991

Please check which box(es) apply to this application:  New  Reapply  
 Foreign filer  On-line filing  Revised (include EFIN and Reason \_\_\_\_\_)

<b>1 a</b> Firm's legal name as shown on firm's tax return				<b>b</b> Firm's employer identification number (EIN) or social security number (SSN)			
<b>c</b> Doing Business As (DBA) (if other than the name in item 1a)				<b>d</b> Is the firm controlled by another electronic filer? <input type="checkbox"/> Yes, complete all controlling office information and section 9 on page 2. Do not complete section 8. <input type="checkbox"/> No, skip to question 1k and complete sections 8 and 9 on page 2.			
<b>e</b> Controlling office name				<b>f</b> ETIN of controlling office		<b>g</b> EFIN of controlling office	
<b>h</b> Controlling office business address				<b>i</b> Signature of <b>RESPONSIBLE OFFICER</b> of the controlling office		<b>j</b> Date	
City	State	ZIP Code	County				
<b>k</b> Check the box at the right that indicates your form of organization (see page 3 of this form) <input type="checkbox"/> Sole proprietorship <input type="checkbox"/> Partnership (number of partners) ▶ _____ <input type="checkbox"/> Corporation <input type="checkbox"/> Other (specify) ▶ _____				<b>l</b> Check this box if you will be providing electronic filing and/or tax preparation as a service <b>NOT FOR PROFIT</b> and not to attract customers who will pay for tax preparation or transmission services. Eligible entities include employers offering IRS e-file as a benefit to their employees, government agencies, VITA sites, etc. Attach to this form an explanation of how you will process returns for IRS e-file ▶ <input type="checkbox"/>			
<b>m</b> Name of contact representative (first, middle, last)				<b>n</b> Business telephone number (include area code)		<b>FAX</b> number	
<b>o</b> Name of alternate contact representative (first, middle, last)				<b>p</b> Business telephone number (include area code)		<b>FAX</b> number	
<b>q</b> Mailing address (street or P.O. box)				<b>r</b> Business address (location of business)		<b>FAX</b> number	
City	State	ZIP Code	County	City	State	ZIP Code	County

**2** List all previous Electronic Filer Identification Number(s) (EFIN) and Electronic Transmitter Identification Number(s) (ETIN) assigned to you or your firm.

<b>3</b> Please answer the following questions by checking the appropriate box(es).			<b>Yes</b>	<b>No</b>	<b>f</b> I expect to transmit to or accept returns for transmission to the following service centers. (Software Developers: Also indicate service centers in whose areas you expect to market your software.) (See page 4 for service center chart.): <input type="checkbox"/> Andover <input type="checkbox"/> Austin <input type="checkbox"/> Cincinnati <input type="checkbox"/> Memphis <input type="checkbox"/> Ogden																													
<b>a</b> Will you transmit tax return data directly to IRS? (Transmitter) If "Yes," see page 3, Line 3 instructions. Transmit using asynchronous communication protocol and indicate the file transfer protocol you will be using (mark only one): <input type="checkbox"/> XMODEM — Checksum <input type="checkbox"/> YMODEM — G <input type="checkbox"/> XMODEM — CRC <input type="checkbox"/> YMODEM — Batch <input type="checkbox"/> XMODEM — 1K <input type="checkbox"/> ZMODEM					<table border="1" style="width:100%; border-collapse: collapse;"> <tr> <td style="width:5%;"></td> <td style="width:5%;"><b>Yes</b></td> <td style="width:5%;"><b>No</b></td> </tr> <tr> <td><b>4</b> Has the firm or any corporate officer, partner, owner or responsible official: (Please attach explanation for all "Yes" responses for 4a through 4d).</td> <td></td> <td></td> </tr> <tr> <td><b>a</b> been assessed any preparer penalties? .....</td> <td></td> <td></td> </tr> <tr> <td><b>b</b> been convicted of a monetary crime? .....</td> <td></td> <td></td> </tr> <tr> <td><b>c</b> failed to file personal or business tax returns, or unpaid tax liabilities? .....</td> <td></td> <td></td> </tr> <tr> <td><b>d</b> been convicted of any criminal offense under the U.S. Internal Revenue laws? .....</td> <td></td> <td></td> </tr> <tr> <td><b>5</b> Do you intend to file <b>Federal/State</b> returns electronically? (If "Yes" see page 3 of this form.)</td> <td></td> <td></td> </tr> <tr> <td><b>6</b> Do you intend to file Forms 2555/2555EZ? .....</td> <td></td> <td></td> </tr> <tr> <td><b>7</b> Is the firm open 12 months a year? .....</td> <td></td> <td></td> </tr> </table>				<b>Yes</b>	<b>No</b>	<b>4</b> Has the firm or any corporate officer, partner, owner or responsible official: (Please attach explanation for all "Yes" responses for 4a through 4d).			<b>a</b> been assessed any preparer penalties? .....			<b>b</b> been convicted of a monetary crime? .....			<b>c</b> failed to file personal or business tax returns, or unpaid tax liabilities? .....			<b>d</b> been convicted of any criminal offense under the U.S. Internal Revenue laws? .....			<b>5</b> Do you intend to file <b>Federal/State</b> returns electronically? (If "Yes" see page 3 of this form.)			<b>6</b> Do you intend to file Forms 2555/2555EZ? .....			<b>7</b> Is the firm open 12 months a year? .....		
	<b>Yes</b>	<b>No</b>																																
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<b>6</b> Do you intend to file Forms 2555/2555EZ? .....																																		
<b>7</b> Is the firm open 12 months a year? .....																																		
<b>b</b> Will you write electronic filing software? (Software Developer)																																		
<b>c</b> Will you prepare tax returns, including Forms 8453, or collect completed returns, including 8453, for the purpose of filing forms electronically? (Electronic Return Originator) .....																																		
<b>d</b> Will you receive tax return information from other electronic filers, format return information and send returns to a transmitter? (Service Bureau) .....																																		
<b>e</b> Do you intend to file Form 4868 and/or Form 9465? .....																																		

If you answer "No" to question 7, give address and telephone number that are available 12 months of the year (include area code).

**8 Principals of Your Firm or Organization (continued on page 2) Complete only if line 1d is "No."**  
Do not complete this section if you checked the box in item 1d "Yes" or checked box 1l of this form. If you are a sole proprietor, list your name, home address, and social security number, and respond to each question. If your firm is a partnership, list the name, home address, social security number, and respond to each question for each partner who has a five percent (5%) or more interest in the partnership. If your firm is a corporation, list the name, title, home address, social security number, and respond to each question for the President, Vice-President, Secretary, and Treasurer of the corporation. If you are a for-profit entity and checked "Other," on line 1k or you are a partnership and no partners have at least 5% interest in the partnership, list the name, title, home address, social security number, and respond to each question for at least one individual authorized to act for the firm in legal and/or tax matters. (You may use continuation sheets.) The signature of each person listed authorizes the Internal Revenue Service to conduct a credit check on that individual.

**Exhibit 204-2: Form 8633, Application to Participate in the IRS e-file Program (cont.)**

Form 8633 (Rev. 7-99)

Page 2

**8 Principals of Your Firm or Organization.** You may use continuation sheets. (Continued) Complete if line 1d is "No."

Unless you marked the box in 1i, or your only "Yes" response in Section 3 is to question b, you must provide a completed fingerprint card for each responsible official, corporate officer, owner, or partner listed below. If a corporate officer, owner, or partner changes, a completed fingerprint card must be provided for each new corporate officer, owner, or partner. If the corporate officer, owner, or partner is an attorney, banking official who is bonded and has been fingerprinted in the last two years, CPA, enrolled agent, or an officer of a publicly owned corporation, evidence of current professional status may be submitted in lieu of the fingerprint card (see Revenue Procedures). Your application will not be processed if you do not provide a completed fingerprint card or evidence of professional status and the signature of each responsible official, corporate officer, partner, and owner.

Type or print name (first, middle, last)	U.S. citizenship? <input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> Legal resident alien	Is the individual: <input type="checkbox"/> an attorney <input type="checkbox"/> a banking official <input type="checkbox"/> a C.P.A.	<input type="checkbox"/> an enrolled agent <input type="checkbox"/> an officer of a publicly owned corporation	Is the individual licensed or bonded in accordance with state or local requirements? <input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> Not applicable
Title:				
Home address	Social Security Number	Signature		<input type="checkbox"/> Add <input type="checkbox"/> Delete
	Date of birth (month, day, year)			

Type or print name (first, middle, last)	U.S. citizenship? <input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> Legal resident alien	Is the individual: <input type="checkbox"/> an attorney <input type="checkbox"/> a banking official <input type="checkbox"/> a C.P.A.	<input type="checkbox"/> an enrolled agent <input type="checkbox"/> an officer of a publicly owned corporation	Is the individual licensed or bonded in accordance with state or local requirements? <input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> Not applicable
Title:				
Home address	Social Security Number	Signature		<input type="checkbox"/> Add <input type="checkbox"/> Delete
	Date of birth (month, day, year)			

Type or print name (first, middle, last)	U.S. citizenship? <input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> Legal resident alien	Is the individual: <input type="checkbox"/> an attorney <input type="checkbox"/> a banking official <input type="checkbox"/> a C.P.A.	<input type="checkbox"/> an enrolled agent <input type="checkbox"/> an officer of a publicly owned corporation	Is the individual licensed or bonded in accordance with state or local requirements? <input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> Not applicable
Title:				
Home address	Social Security Number	Signature		<input type="checkbox"/> Add <input type="checkbox"/> Delete
	Date of birth (month, day, year)			

**9 Responsible Official** (Please complete this section and provide an original signature even if it is the same as Line 8.)

The responsible official is the person who oversees the daily operations of the office listed on line 1r and 11d. A responsible official may be responsible for more than one office (see instructions on page 3). A principal listed in Section 8 may also be a responsible official.

Name of responsible official (first, middle, last)	U.S. citizenship? <input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> Legal resident alien	Is the individual: <input type="checkbox"/> an attorney <input type="checkbox"/> a banking official <input type="checkbox"/> a C.P.A.	<input type="checkbox"/> an enrolled agent <input type="checkbox"/> an officer of a publicly owned corporation	Is the individual licensed or bonded in accordance with state or local requirements? <input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> Not applicable
Title:				
Home address	Social Security Number	Signature		
	Date of birth (month, day, year)			

**10 Drop-Off Collection Points** — Complete this section as specified on page 3. (You may use continuation sheets.)

Name and address of Drop-Off Collection Point	Name of principal contact	Telephone number (include area code)
	(For official use only) CPIN	Does this office operate 12 months? <input type="checkbox"/> Yes <input type="checkbox"/> No
Name and address of Drop-Off Collection Point	Name of principal contact	Telephone number (include area code)
	(For official use only) CPIN	Does this office operate 12 months? <input type="checkbox"/> Yes <input type="checkbox"/> No

**11 Foreign Filer (please provide all information)**

a Name of contact representative (first, middle, last)	c Telephone number of foreign location (please include international access codes, country codes, or city codes)
b Mailing address (including city, country and postal codes, if applicable)	d Business address (of foreign location including city, country and postal codes if applicable)

**Applicant Agreement**

Under the penalties of perjury, I declare that I have examined this application and read all accompanying information, and to the best of my knowledge and belief the information I have provided you is true, correct and complete. This firm and employees will comply with all the provisions of the Revenue Procedure for Electronic Filing of Form 1040, U.S. Individual Income Tax Return, and related publications, for each year of our participation.

Acceptance for participation is not transferable. I understand that if this firm is sold or its organizational structure is changed, a new application must be filed. I further understand that noncompliance will result in the firm and/or the individuals listed on this application no longer being allowed to participate in the program. I am authorized to make and sign this statement on behalf of the firm.

12 Name and title of firm official and/or principal owner (type or print)	13 Signature of firm official and/or principal owner	14 Date
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**Exhibit 204-2: Form 8633, Application to Participate in the IRS e-file Program (cont.)**

Form 8633 (Rev. 7-99)

Page 3

**Filing Requirements**

**Who to Contact for Answers:** If you have questions and don't know where to begin to get answers, you may contact your Electronic Tax Administrative (ETA) Coordinator. Contact information can be found under Electronic Services at the following Internet Address: <http://www.irs.ustreas.gov> in the state-by-state information, or call toll free, 1-800-691-1894 and ask for the ETA Coordinator nearest you.

**Who Must File Form 8633.** (1) Applicant(s) requesting participation in the IRS e-file program for individual income tax returns, and (2) applicant(s) required to revise a previously submitted Form 8633 in accordance with the Revenue Procedure describing Obligations of Participants in the IRS e-file Program for Form 1040, U.S. Individual Income Tax Return. (3) If re-applying, please include the EFIN that was assigned to you when you first entered into the IRS e-file program.

**When to File.** New applications will be accepted through May 31, 2000. To ensure complete and timely review of your application prior to the beginning of the filing season, you must file a new application between August 1 and December 1, 1999. Each change must be identified with a red asterisk (\*) in front of the change on the revised Form 8633. Revised applications are accepted all year.

**Where to File.** Send Form(s) 8633 to the Andover Service Center. See page 4 for the daytime and overnight mailing address. See page 4 for instructions on what service center to check under 3f, page 1, depending on your location and Service Center relationship as an ERO, Transmitter, Service Bureau, Software Developer, or On-Line Transmitter.

**How to Complete the Form****Page 1**

Please check the boxes that apply to this application. If you check "REVISED," you must also provide a reason. The ON-LINE Filing box should be checked **ONLY** if you intend to transmit returns for individual taxpayers who choose the on-line method of filing.

**Note:** See Publication 1345, Section 4, *Acceptance in the Form 1040 IRS e-file Program*, for information on when to file a new and revised application.

**Line 1a.** — If your firm is a sole proprietorship, enter the name of the sole proprietor. If your firm is a partnership or corporation, enter the name shown on the firm's tax return. If submitting a revised application, and the firm's legal name is not changing, be sure this entry is identical to your original application.

**Line 1b.** — If your firm is a partnership or a corporation, provide the firm's employer identification number (EIN). If your firm is a sole proprietorship, with employees, provide the business employer identification number (EIN). If you do not have employees, provide the social security number (SSN).

**Line 1c.** — If, for the purpose of IRS e-file, you or your firm use a "doing business as" (DBA) name(s) other than the name on line 1a, include the name(s) on this line. Use an attachment sheet if necessary to list all names.

**Line 1d.** — Answer this question "No" if your firm does not operate electronic filing businesses at more than one location (see Note below) or if this application is for a controlling office. A controlling office applies to firms that operate IRS e-file businesses at more than one location (see Note below) and the entries in lines 1a and 1b are the same on all applications. The firm must designate one location as the controlling office. Answer this question "Yes" if this application is not for a controlling office and complete lines 1e - 1j and the rest of the form including section 9 on page 2.

**Note:** For the purpose of this question, a drop-off collection point is not considered to be another business location.

**Line 1e - 1h.** — If 1d is "Yes," enter all controlling office information, including the controlling office ETIN and EFIN.

**Line 1i.** — Provide an original signature of the responsible official of the controlling office.

**Line 1k.** — "Other" represents organizations that don't fall within the category of a sole proprietorship, partnership, or corporation. Examples are: Limited Liability for Partners and Partnerships (LLPs), Limited Liability for Corporations (LLCs); associations; credit unions; an employer or organization who offers the service as a benefit to its employees or members; government agencies; Volunteer Income Tax Assistance (VITA) sites.

**Line 1l.** — Generally, few applicants meet the criteria for checking this box. Eligible entities include employers offering IRS e-file as a benefit to their employees, government agencies, VITA sites, etc. If you check this box, you must also attach a description of how you will process electronic returns.

**Lines 1m and 1o.** — Contact representatives must be available on a daily basis to answer IRS questions during testing and throughout the processing year.

**Line 1q.** — Mailing address if different from the business address. Include P.O. box if applicable. Remember, bulk shipments or overnight mail cannot be addressed to a P.O. box. You must provide a year-round mailing address.

**Line 1r.** — Address of the physical location of the firm. A Post Office box (P.O. box) will not be accepted as the location of your firm. Foreign locations must complete line 11 on page 2 of this application.

**Line 3.** — Check all that apply. If you answer "Yes" to 3a, you must use asynchronous communication protocol and transmit directly to IRS. If you mail your application in for processing and later decide you will not transmit directly to IRS, you must file a revised application to change your answer from "Yes" on your original application to "No".

**Line 4a - 4d.** — Misrepresentation when answering these questions may result in the rejection of an application to participate in the IRS e-file Program. Monetary crimes include, but are not limited to, money laundering, embezzlement, etc.

**Line 5.** — A "Yes" entry on this line will be combined with entries you make on line 3e. This will allow your EFIN to be accepted at multiple service centers to enable you to submit Federal/State returns to centers other than your primary service center.

**Line 6.** — If you answer "Yes" to this question, you must check the box in 3f for Andover in addition to any other boxes that are applicable.

**Lines 8 and 9.** — Each individual listed must be a U.S. citizen or lawful permanent resident, have attained the age of 21 as of the date of the application, and if applying to be an Electronic Return Originator, meet state and local licensing and/or bonding requirements. Please check the appropriate boxes if you are revising your application and changing these sections from your original application by adding or deleting a name.

**Page 2**

**Line 9 — Tier I Responsible Officials.** — Include first time applicants, reapplicants, and those individuals who have not otherwise participated in the IRS e-file program as responsible officials during the last two consecutive filing seasons. Tier I responsible officials may be listed on a maximum of ten applications, but if so, the responsible official should be able to physically visit each office on a daily basis.

**Tier II Responsible Officials.** — Must have participated as responsible officials for the last two consecutive filing seasons and have never been suspended from the IRS e-file program. Tier II responsible officials may be listed on a maximum of 20 applications, but if so, the responsible official should be able to physically visit any office on a daily basis.

**Line 10 — Drop-Off Collection Points.** — A drop-off collection point is where taxpayers can deposit their completed tax return, including Form 8453, for the purpose of having you file their returns electronically. Follow the format on page 2 for a listing of your drop-off collection points. If you acquire additional drop-off collection points after you file your application, you will need to submit a revised Form 8633.

**Line 11** — If you complete line 11, then be sure to complete lines 1m, 1n, 1o, 1p, and 1q of Form 8633 for contact representatives in the United States. Do not complete line 1r. Correspondence will occur through the contact representatives you list.

**Lines 12 - 14 — Signature Lines.** — The responsible officer to act and sign for the firm in legal and/or tax matters should complete these lines.



**Exhibit 204-2: Form 8633, Application to Participate in the IRS e-file Program (cont.)**

Mail your application(s) to the address shown below.

Daytime: Internal Revenue Service  
 Andover Service Center  
 Attn: EFU Acceptance  
 Testing Stop 983  
 P.O. Box 4099  
 Woburn, MA 01888-4099

Overnight Mail: Internal Revenue Service  
 Andover Service Center  
 Attn: EFU Acceptance  
 Testing Stop 983  
 310 Lowell Street  
 Andover, MA 05501

Line 3f Chart		
Your Regular Service Center Relationship	Service Center	Additional Service Center Relationships
<p>If you are an <b>ERO</b> and your business location is in one of the following states, check this service center on your application.</p> <p>If you are a <b>Transmitter Service Bureau or Software Developer</b>, check all the service centers where your clients and customers will be transmitting returns.</p> <p>If you are an <b>On-Line Transmitter</b>, check all five service centers.</p>		<p>If you are a <b>Federal/State ERO</b> and your clients file state returns for the states listed below, add the associated service center to your application.</p>
Connecticut, Delaware, District of Columbia, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, Vermont, Virginia	<b>Andover</b>	Connecticut, Delaware, District of Columbia, Maryland, New Jersey, New York, Pennsylvania, Rhode Island, Virginia
Illinois, Iowa, Kansas, Minnesota, Missouri, New Mexico, Oklahoma, Texas, Wisconsin	<b>Austin</b>	Illinois, Iowa, Kansas, Missouri, New Mexico, Oklahoma, Wisconsin
Florida, Indiana, Kentucky, Michigan, Ohio, South Carolina, West Virginia	<b>Cincinnati</b>	Indiana, Kentucky, Michigan, Ohio, South Carolina, West Virginia
Alabama, Arkansas, Georgia, Louisiana, Mississippi, North Carolina, Tennessee	<b>Memphis</b>	Alabama, Arkansas, Georgia, Louisiana, Mississippi, North Carolina
Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, Nebraska, Nevada, North Dakota, Oregon, South Dakota, Utah, Washington, Wyoming	<b>Ogden</b>	Arizona, Colorado, Idaho, Montana, Nebraska, North Dakota, Oregon, Utah
If your clients file Forms 2555 or 2555-EZ with their Forms 1040, add Andover.		

**Privacy Act Notice.** — The Privacy Act of 1974 requires that when we ask for information we tell you our legal right to ask for the information, why we are asking for it, and how it will be used. We must also tell you what could happen if we do not receive it, and whether your response is voluntary, required to obtain a benefit, or mandatory.

Our legal right to ask for information is 5 U.S.C. 301, 5 U.S.C. 500, 551-559, 31 U.S.C. 330, and Executive Order 9397.

We are asking for this information to verify your standing as a person qualified to participate in the electronic filing program. The information you provide may be disclosed to the FBI and other agencies for background checks, to credit bureaus for credit checks, and to third parties to determine your suitability.

The IRS also may be compelled to disclose information to the public. In response to requests made under 5 U.S.C. 552, the Freedom of Information Act, information that may be released could include your name and business address and whether you are licensed or bonded in accordance with state or local requirements.

Your response is voluntary. However, if you do not provide the requested information, you could be disqualified from participating in the IRS e-file program.

If you provide fraudulent information, you may be subject to criminal prosecution.

**Paperwork Reduction Act Notice.** We ask for the information on this form to carry out the Internal Revenue laws of the United States. You must give us the information if you wish to participate in the IRS e-file program. We need it to process your application to file individual income tax returns electronically.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law.

Generally, tax returns and return information are confidential, as required by Code section 6103. The time needed to complete this form will vary depending on the individual circumstances. The estimated time is 60 minutes. If you have comments concerning the accuracy of this time estimate or suggestions for making this form simpler, we would be happy to hear from you.

You can write to the Tax Forms Committee, Western Area Distribution Center, Rancho Cordova, CA 95743-0001. **DO NOT** send this application to this office. Instead, see instructions above for information on where to file.

**Exhibit 204-2: Form 8633, Application to Participate in the IRS e-file Program (cont.)**

Form 8633 (Rev. 7-99)

**FORM 8633 ACCURACY CHECKLIST**

This CHECKLIST should be completed after you have answered all questions on pages 1 and 2 and then verified against Form 8633 to ensure the correct information has been provided. Failure to answer these questions after you complete Form 8633 may result in your application being returned.

1. **Is your Form 8633 the most current application?** \_\_\_\_\_ Yes \_\_\_\_\_ No  
If the revision date is not July 1999, your application may be returned.
2. **Did you answer "Yes" to question 1d?** \_\_\_\_\_ Yes \_\_\_\_\_ No  
If you answered **Yes**, you should also complete 1c, 1e, 1f, 1g, 1h, 1i, 1j and section 9 on page 2. Please verify Form 8633 to ensure all of this information is included. If you answered **No**, please continue with the questions starting with question 1k and complete the rest of page 1; then continue to answer **all** questions on page 2.
3. **Did you provide us with a mailing address for question 1q?** \_\_\_\_\_ Yes \_\_\_\_\_ No  
**Did you provide us with a P.O. box for question 1q?** \_\_\_\_\_ Yes \_\_\_\_\_ No  
If you provided a P.O. Box for 1q you must also provide us with a business address for 1r but it cannot be a P.O. Box. If you provide a complete address for 1q and 1r that is the same, write in 1r "same as 1q".
4. **Did you answer "Yes" to question 3a?** \_\_\_\_\_ Yes \_\_\_\_\_ No  
If you answered **Yes**, you **MAY** be required to purchase software to send returns directly to IRS and later test if suitability is passed. You must "Transmit using asynchronous communication protocol" and also check the last box for "**ZMODEM**." If you do not intend to transmit returns directly to IRS, you should answer **No** for this question and file through a 3rd party. If you do not intend to file directly, after checking the box **Yes** and have mailed your application in for processing, you must file a revised application to change your answer to **No**.
5. **Will some of your clients live in different states?** \_\_\_\_\_ Yes \_\_\_\_\_ No  
If you answered **Yes**, you should check all boxes for question 3f where you expect to transmit returns. See the Service Center chart on page 4 to determine the correct boxes to check for 3f on page 1.
6. **Did you read all of Section 8 beginning at the bottom of page 1 through the top of page 2? Did you provide us with a fingerprint card on all principals of your firm who are not exempt, evidence of professional status on those who are exempt, and all original signatures?** \_\_\_\_\_ Yes \_\_\_\_\_ No  
Acceptable evidence of current professional status consists of the following:  
CPA CERTIFICATION — copy of the certificate. (LPS is not considered exempt)  
ENROLLED AGENT — copy of his or her current enrollment card issued by the IRS  
ATTORNEY — copy of credentials  
BANK OFFICIAL — a copy of the bonding certificate and proof of fingerprinting within the last two years  
OFFICER OF A PUBLICLY OWNED CORPORATION — a copy on corporate letterhead which carries the name of the officer, the stock symbol, the exchange where listed, and the name under which the stock is traded for the individual listed in section 8 or 9 on Form 8633.
7. **Has the owner, principals, responsible officials, and contact persons of your firm reached age 21 as of the date your application is mailed?** \_\_\_\_\_ Yes \_\_\_\_\_ No  
Each individual listed must have attained the age of 21 as of the date of the application. If anyone listed is under the age of 21, your application will be rejected.
8. **If you were suspended, has your prior suspension period been completed?** \_\_\_\_\_ Yes \_\_\_\_\_ No  
If you answered "**No**", your application will be rejected and mailed back to you.
9. **Did you remember to provide original signatures for 1i, 8, 9 and 13?** \_\_\_\_\_ Yes \_\_\_\_\_ No  
If you failed to provide signatures in the areas listed above, your application will be returned.

### **Exhibit 204-3: Client Explanation of Electronic Filing and Direct Deposit**

#### **ELECTRONIC FILING AND DIRECT DEPOSIT FOR INDIVIDUAL FEDERAL TAX RETURNS**

This year, if your return qualifies, you will be joining the growing number of taxpayers who have discovered electronic tax filing. It's faster, safer, and more accurate than mailing your tax return. Why? Because your return is transmitted over telephone lines directly to an IRS computer where it is automatically checked for errors and missing information. It can't get lost in the mail! And if you're due a refund, you can get it faster when you file electronically and faster yet with direct deposit.

If you have a balance due, your return is electronically filed earlier, but you don't mail the balance due until April 15, 200X (March 1, 200X for farmers).

There is no additional cost to file electronically or to use direct deposit. You will still receive a paper copy of your entire return for your file.

#### **HOW DOES ELECTRONIC FILING WORK?**

When we prepare your return we will test to see if it is eligible for electronic filing; if it is, we will produce a Federal Form 8453. When you come in to pick up your returns or if they are mailed to you, we will ask you to sign Form 8453 instead of signing paper copies of your returns. For a joint return, it is imperative that both taxpayer(s) come in to pick up the return as these forms must be signed by both taxpayers. If mailed, return the Form 8453 to us as soon as possible in the envelope provided. Once we have the signed Form 8453, we will transmit your return to the IRS. You will receive a postcard confirming that your return was received by the IRS. It's that easy!!

Although most returns are eligible, some may not qualify. If for some reason your return either does not qualify or is rejected and we cannot fix the reason for the rejection, we will prepare paper returns and provide them to you with filing instructions as we have in the past.

#### **WHAT ABOUT DIRECT DEPOSIT?**

If you are due a refund, you will receive your refund as much as two weeks faster with direct deposit to your checking or savings account by avoiding check processing and mailing time. All we need is a deposit slip with your bank's routing number and your account number. Direct deposit is available through most banks although some small banks and credit unions are not yet able to provide this service. If you are in doubt please check with your bank.

#### **CAN I STILL APPLY MY REFUND TO 200X ESTIMATED TAX?**

Yes, you can still apply all or a portion of your refund to your 200X estimated tax.

#### **HOW DO YOU PAY BALANCE DUES?**

A balance due on the federal return will be paid with a Form 1040-V, a voucher much like the estimated tax payment vouchers. We will provide this to you along with the mailing envelope. It is not due until April 15, 200X (March 1, 200X for farmers).

You also have an option to authorize the Treasury to take money directly from your checking or savings account to pay your federal income taxes, or to use certain credit cards or debit cards. If you are interested in this option, please talk to your tax preparer.

***If you have any additional questions about electronic filing or direct deposit, your tax preparer will be happy to answer them.***

**Exhibit 204-4: Staff Electronic Filing Software Instructions****ELECTRONIC FILING STEP-BY-STEP FOR USE WITH CCH  
PROSYSTEMfx TAX SOFTWARE****CONFIGURE—TAX PREPARATION SOFTWARE****PRINT OPTIONS**

- 1) Do not choose to print negative numbers in parenthesis (This should be in the master file—do not override unless you know it is a paper return).

**MISCELLANEOUS OPTIONS**

- 1) Default to alternative filing of electronic filing including home state.

**BEFORE INTERVIEW**

- 1) Receptionist will provide taxpayers with explanation of electronic filing and direct deposit and how it works.

**INTERVIEWER**

- 1) Ask taxpayer if they have any questions about electronic filing, direct deposit, direct withdrawal or pay by credit card. Obtain check stub or deposit ticket to verify bank information. If small bank, ask taxpayer to verify if bank accepts direct deposit. Direct deposit must be to account in taxpayer's name, and cannot be credit card account.
- 2) Check applicable boxes on tax return process sheet re electronic filing, direct deposit, direct withdrawal or credit card payment.

**PREPARER**

- 1) Enter any relevant information on Form 5, General Information and Qualifications relating to electronic filing.
- 2) Enter Direct Deposit Information at bottom of Form 5.
- 3) Enter W-2 information on Form W-5, indicate if Standard W-2 or Non-Standard. Non-Standard includes altered, handwritten or typed and substitute W-2's. Delete Interview Form W-2.
- 4) Enter Gambling Winnings on Form W-6 and Pension & Annuity Information on Form W-7. Delete Interview Form W-3.
- 5) Do not use #, \*, ., or and. **Do use** the & sign and % for "in care of" in name and address area. If using 1/2 you must have a space before and after (eg. 1201 1/2 First Ave)
- 6) After Calculating, check Diagnostics for any error messages. Correct error messages if possible, recalculate and check Diagnostics again. A diagnostic will tell you whether or not the return is eligible.
- 7) If qualified for electronic filing, pull and fill in client info on "Processing Checklist for Electronic Filing".
- 8) Check box for Qualified or not on Processing Checklist.
- 9) If not, briefly indicate reason.
- 10) Place W-2's, W-3, 1099-R in blue folder.
- 11) If applicable and already have signed copies, include the following in the blue folder:
  - a) Form 2120, Multiple Support Declaration
  - b) A physician's statement for Schedule R or Schedule 3
  - c) Proof of blindness
  - d) Form 8283, Noncash Charitable Contributions (Appraisal Summary)
  - e) Form 8332, Release of Claim to Exemption for Child of Divorced or Separated Parents
  - f) Form 2848, Power of Attorney and Declaration of Representative
- 13) Other information documents and voluntary supporting material.
- 14) Send return to print file and forward to computer room basket labeled "PRINTING (TO REVIEW)" for printing.

**Exhibit 204-4: Staff Electronic Filing Software Instructions (cont.)**

**REVIEWER**

- 1) Review Diagnostics for eligibility.
- 2) On Final Review, check box on processing checklist for qualified or if not, indicate why?
- 3) If applicable and not already in blue folder, pull the following and include in the blue folder:
  - a) Nonfileable Form 8453, verify amounts with tax returns
  - b) Form 2120, Multiple Support Declaration
  - c) A physician's statement for Schedule R or Schedule 3
  - d) Proof of blindness
  - e) Form 8283, Noncash Charitable Contributions (Appraisal Summary)
  - f) Form 8332, Release of Claim to Exemption for Child of Divorced or Separated Parents
  - g) Form 2848, Power of Attorney and Declaration of Representative
  - h) Other information documents and voluntary supporting material including federal elections such as crop hail insurance and CCC and aggregation statement.
- 4) Paper clip any of the above forms that need to be signed by the taxpayer, appraiser, ex-spouse, etc. together.
- 5) Forward to Electronic Return Processor by placing in basket labeled "EXPORT (TO PROCESSING)" in computer room.

**ELECTRONIC RETURN PROCESSOR**

- 1) Open each return in the "CREATE E-FILE" basket by selecting **199X Tax Preparation/Open** then put in the pfx account #. Hit cancel to get rid of the form selection screen.
- 2) Create an electronic return file by selecting **File/Export/Electronic Filing**. A fileable Form 8453 and M-1EF will automatically print.
- 3) Verify that lines 1 through 5 on Form 8453 and M-1EF matches the nonfileable forms in the blue folder. Discard nonfileables if match, return to reviewer if does not match.
- 4) Check box(es) on processing checklist for create electronic file and record DCN number.
- 5) Forward to tax return processors.

**TAX RETURN PROCESSORS**

- 1) One photo copy of entire return for client including all items in blue folder.
- 2) A second copy of all items in blue folder for our file copy.
- 3) Make two copies of Form 8453:
  - a) Put one Form 8453 in front of blue folder with all federal attachments loose behind the Form 8453, put one M-1EF in blue folder with all state attachments loose behind and place in basket labeled "UNSIGNED 8453" in computer room. Empty this basket at least daily and provide to monitors. Monitors file folders with contents alphabetically in a filing cabinet.
  - b) Complete 199X Electronic Tax Return Filing Instructions and paper clip it to one of the Forms 8453 with a stamped return envelope. Any unsigned attachments which came to you paper clipped together must also be paper clipped to this copy of the Form 8453 and check the box on the instruction sheet and write in which forms need to be signed.
  - c) Put one copy of Form 8453 in the gray folder on top of the client copy of the tax returns.
- 4) Punch original copy of return in file in the tax return section.
- 5) Forward to Signer.

**SIGNER**

- 1) Sign both copies of Form 8453, be sure any attachments requiring signatures are paper clipped to one copy with the Instruction Sheet and a return envelope. Make sure balance due or refund is same as paper return.
- 2) Prepare transmittal letter, explain why return not eligible, if client left office thinking it would be.
- 3) Check boxes on processing checklist for 8453 signed by preparer.
- 4) Forward to your Clerical person.

**CLERICAL**

- 1) Log on Excel Spreadsheet, keep processing checklist for electronic filing with the pink copy of Tax Return Process Sheet.
- 2) Check boxes and fill in date and initials on Processing Checklist for Electronic Filing for logged in Excel and if to be mailed, date put in mail. Write date in upper right hand corner of processing checklist for electronic filing.
- 3) Check box and fill in date and initials on Tax Return Process Sheet for pickup card mailed or return mailed to client.
- 4) Forward for pick up or if mailed, the pink copy of tax return process sheet routed to computer room and the processing checklist for electronic filing to basket next to binding machine across from Ann's desk.

**Exhibit 204-4: Staff Electronic Filing Software Instructions (cont.)****DISTRIBUTOR**

- 1) Ask client to sign Form 8453, also any attachments that must be signed:
  - a) Place the Electronic Tax Return Filing Instructions on the left side.
- 2) Pull Processing Checklist for Electronic Filing off pink tax return process sheet and paper clip to signed Form 8453 and attachments. Put in basket labeled "Signed 8453s."
- 3) If signed 8453 is returned in mail, put in "Signed 8453" basket.

**MONITORS**

- 1) Empty basket with signed Forms 8453. It should contain a) processing checklists for returns and 8453s that were mailed and we don't have the signed 8453 back yet (from clerical); b) processing checklists with signed Form 8453s for returns that were picked up and signed by taxpayers (from distributors) and; c) signed 8453s that were returned in the mail.
- 2) Match Processing Checklists for Electronic Filing for returns which do not yet have a signed 8453 with the blue folder in the Monitors filing cabinet (filed alphabetically). Check to make sure clerical person logged mailing date in Excel.
- 3) Match signed 8453 to blue folder (filed alphabetically) from the Monitors filing cabinet; Mark box on Processing Checklist and Log in Excel that 8453 is signed by Taxpayer and the date and your initials. Put process sheet, signed 8453, in blue folder and route to computer room for transmission to IRS.
- 4) Review dates on blue folders in Monitors filing cabinet for those that are more than one week old and need to be followed up on. Check status of return in Excel spreadsheet as to if to be picked up, when, or if mailed what date it was mailed. If mailed more than one week earlier, call client and request they sign and send back the 8453 per their instructions.

**ELECTRONIC RETURN PROCESSOR**

- 1) Release and transmit returns for which we have received the signed Forms 8453. Shred unsigned 8453.
- 2) Open **Electronic Filing**. Select **Release** to display a list of returns which have been qualified but not yet released. Highlight and **Add** all returns for which you have a signed 8453 that day.
- 3) Click **OK** to authorize return release, then **Close** and **Exit**.
- 4) Update Excel Spreadsheet for Released returns and Check box on Processing Checklist.
- 5) Open **Communications**. Select **Communicate**, then **Send/Receive**.
- 6) Be sure the box "Send electronic filing data" and "Receive all host communications" are x'd.
- 7) Click **Communicate** to transmit. When call is finished Exit.
- 8) Update Excel Spreadsheet for Transmitted returns and Check box on Processing Checklist.
- 9) Rubber band alphabetized blue folders for returns transmitted today and place in basket labeled "TRANSMITTED BUT NOT ACCEPTED".
- 10) Copy Signed 8453 for our file. Check box for Copy signed 8453 for our file on processing checklist.
- 11) Open **Electronic Filing**. Select **Reports**. Select **Refresh**. (This will update the status) Then select **Status**. Check to see if any of the returns in the "TRANSMITTED BUT NOT ACCEPTED" file from previous days have been accepted. If accepted pull blue folder, staple W-2s, W-2G and 1099R to front of 8453 and staple the remainder of attachments in blue folder to the back of the Form 8453 with a staple in the upper left hand corner. Put batch of accepted 8453s in pre-addressed IRS envelope and put downstairs to be mailed today. Write each 8453 being sent on Mail Log Sheet and send certified mail, return receipt requested.
- 12) If return was rejected, highlight return and click **Rejection Detail**. Note reason for rejection, fix if possible or refer back to primary accountant.
- 13) Update Excel Spreadsheet for Accepted and Rejected and Mailed to IRS Returns and check boxes on Processing Checklist.
- 14) Print History for each client Accepted by IRS and route to Monitor.
- 15) Route our copy of signed 8453 (with attachments) to filing with processing checklist attached for all accepted returns.

**FILING**

- 1) In Tax Return section of individual file in this order (top to bottom) a) Tax Return Process Sheet page 2; b) Tax Return Process Sheet page 1; c) Processing Checklist for Electronic Filing; d) Signed copy of Form 8453.

**Exhibit 204-5: Tax Return Process Sheet**

**TAX RETURN PROCESS SHEET**

Client Name _____	Interview Date _____
Client Number _____	Promise Date _____
Category Code _____	Mail Out Due Date _____
Interviewer _____	Filing Due Date _____

	<u>Date</u>	<u>Initials</u>	<u>Time</u>		<u>Last Year</u>	<u>This Year</u>
Interview	_____	_____	_____	WIP:	\$ _____	\$ _____
				Fee:	\$ _____	\$ _____
Preparation	_____	_____	_____	Variance:	\$ _____	\$ _____
				Previous Balance		\$ _____
Print	_____	_____	_____	Code	_____	_____
Review	_____	_____	_____		_____	_____
Processing & Assembly	_____	_____	_____		_____	_____
T-letter (clerical)	_____	_____	_____		_____	_____
Signature	_____	_____	_____	Credit Bal.		( _____ )
Return picked up/mailed	_____	_____	_____	Total		\$ _____
T-letter notes: _____						
				Discount Amount		\$ _____
				Discount avail. thru _____		

RETURN DELAYED FOR ADDITIONAL INFORMATION:  See pink information request sheet  
 Other: \_\_\_\_\_ (date)

**ELECTRONIC FILING**  
 File, if eligible - If not, Why? \_\_\_\_\_  Direct Withdrawal \_\_\_\_\_  
 Direct Deposit, if eligible - If not, Why? \_\_\_\_\_  Credit Card Payment \_\_\_\_\_

**TIME AND WRITEDOWN CONTROL:** Approved by \_\_\_\_\_ Date \_\_\_\_\_  
 Explanation: \_\_\_\_\_

**DISPOSITION INSTRUCTIONS:**  
 Send pickup letter \_\_\_\_\_ Date mailed \_\_\_\_\_  Other \_\_\_\_\_  
 Mail \_\_\_\_\_  
 Priority mail \_\_\_\_\_  
 To see interviewer at pickup \_\_\_\_\_

**PROCESSING INSTRUCTIONS:**  
 Attach elections requiring client to sign  Check Service Center \_\_\_\_\_  
 Need engagement letter  Multiple states # \_\_\_\_\_  
 \_\_\_\_\_  Route K-1s to files \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

**Exhibit 204-5: Tax Return Process Sheet (cont.)**

**TAX RETURN PROCESS SHEET**

Client Name \_\_\_\_\_

**ESTIMATES:**

- Exception 1 (105% if > \$150,000 AGI)

<u>Quarter</u>	<u>Federal</u>	<u>Home State</u>	<u>(State)</u>	<u>(State)</u>
1st	\$ _____	\$ _____	\$ _____	\$ _____
2nd	\$ _____	\$ _____	\$ _____	\$ _____
3rd	\$ _____	\$ _____	\$ _____	\$ _____
4th	\$ _____	\$ _____	\$ _____	\$ _____
By Overpayment	\$ _____	\$ _____	\$ _____	\$ _____
Total	\$ _____	\$ _____	\$ _____	\$ _____

**ITEMS TO BE REVIEWED IN PREPARATION OF NEXT YEAR'S RETURN:**

- Tax credit carryover \$ \_\_\_\_\_
- Net operating loss carryover Federal \$ \_\_\_\_\_ State \$ \_\_\_\_\_
- AMT NOL Federal \$ \_\_\_\_\_ State \$ \_\_\_\_\_
- Capital loss carryover Long-term \$ \_\_\_\_\_ Short-term \$ \_\_\_\_\_
- Passive loss carryover \$ \_\_\_\_\_
- Investment interest expense carryover \$ \_\_\_\_\_
- Hail/drought income deferral \$ \_\_\_\_\_
- Minimum tax credit carryover \$ \_\_\_\_\_
- Section 179 suspended carryover \$ \_\_\_\_\_
- Section 1231 loss carryover \$ \_\_\_\_\_
- Contribution carryover \$ \_\_\_\_\_
- 4th quarter state estimate paid 1/\_\_\_\_\_ \$ \_\_\_\_\_
- Basis in commodity wage \$ \_\_\_\_\_
- Amended return/audit during year
- Address Change
- Roth conversion—4-year spread \$ \_\_\_\_\_
- Student loan interest—60 month—date started \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_



**Exhibit 204-6: Processing Checklist for Electronic Filing**

**PROCESSING CHECKLIST FOR ELECTRONIC FILING**

Client: \_\_\_\_\_

Client # \_\_\_\_\_

Interviewer \_\_\_\_\_

Due Date \_\_\_\_\_

DCN# _____	<u>Date</u>	<u>Initials</u>	
_____	_____	_____	Exported
_____	_____	_____	Logged in Excel
_____	_____	_____	8453/M-1EF signed by accountant
_____	_____	_____	8453/M-1EF mailed to taxpayer/to pickup drawer
_____	_____	_____	Return picked up by taxpayer
_____	_____	_____	8453/M-1EF signed by taxpayer
_____	_____	_____	Return transmitted to Pfx
_____	_____	_____	IRS acceptance received
_____	_____	_____	MN acceptance received
_____	_____	_____	Copy signed 8453/M-1EF for our file
_____	_____	_____	Form 8453 mailed to IRS
_____	_____	_____	Log complete

**REJECTION FOLLOWUP**

- Return Rejected - Reason \_\_\_\_\_  
\_\_\_\_\_
- Rejection Fixed \_\_\_\_\_
- Routed back to Interviewer \_\_\_\_\_
- New 8453 - New Checklist \_\_\_\_\_

**ATTACHMENTS**

**Form 8453**

- Federal W-2, W-2G & 1099-R
- Form 2120, Multiple Support Agreement
- Physician's Stmt for Sch R or Sch 3
- Proof of Blindness
- Form 8283, Appraisal Summary for non-cash contributions
- Form 8332, Release of Claim to Exemption
- Form 2848, Power of Attorney
- Other attachments and voluntary supporting data.

**Form M-1EF**

- State W-2, W-2G & 1099-R
- Form CRP or Property Tax Statements



**Exhibit 204-8: Client Instructions for Electronic Tax Return Filing**

**199X ELECTRONIC TAX RETURN FILING INSTRUCTIONS**

Name \_\_\_\_\_

**IMPORTANT:** The returns indicated below will be filed electronically by our office within 2 days after receiving the signed Form 8453 and attachments, if applicable, from you. Please do not delay in returning this to us. As indicated below, if you have a balance due, your payment will be due on the normal due date.

**REVIEW** The returns were prepared primarily from data furnished to us. Before signing the Form 8453, you should review your copies of the return in the client copy folder relative to income, deductions, dependents, etc., reported to determine there are no omissions or misstatements of material facts. Also, please check for correct spelling of name(s), current address and correct Social Security number(s) on **ALL** returns.

**FEDERAL**

**Signatures:**

- The taxpayer(s) must sign the Form 8453 where indicated.
- In addition, be certain proper signatures are attained on the following attachments:

\_\_\_\_\_

\_\_\_\_\_

**Return the signed Form 8453 and any attachments, if applicable, to us immediately, in the envelope provided. We cannot file your return without these. Thank You !!**

**Balance Due:**



\$ \_\_\_\_\_ Remit to "U.S. Treasury". Indicate Social Security number(s) on your check and mark "199X Form 1040". Mail the check with Form 1040-V in the attached envelope on or before \_\_\_\_\_, 200Y.

**Refund:**



\$ \_\_\_\_\_ will be refunded to you  by check or  by direct deposit.  
\$ \_\_\_\_\_ has been applied to your 200Y estimated tax.

**You will receive a postcard when your electronic filed return has been received by the IRS. If you are due a refund, you can expect your refund within two-three weeks after receiving your postcard. If you do not receive your refunds in this time period you can call the IRS automated Tele-Tax system at 1-800-829-4477.**

**MAILING INSTRUCTIONS**

- Envelopes are enclosed for your convenience. Be sure to insert the correct form in the matching pre-addressed envelope.
- The envelopes must be postmarked on or before the **DUE DATE** shown above.
- MAILING YOUR PAYMENTS by certified mail, return receipt, and *retaining* the receipts will assure proof of a timely filed payment.
- Your copy of the return, to be retained for your records, is in the folder, along with information provided to us.

Exhibit 204-9: Form 1040-V, Payment Voucher

# 1999 Form 1040-V



Department of the Treasury  
Internal Revenue Service

## What Is Form 1040-V and Do You Have To Use It?

It is a statement you send with your check or money order for any balance due on line 68 of your **1999 Form 1040**. Using Form 1040-V allows us to process your payment more accurately and efficiently. We strongly encourage you to use Form 1040-V, but there is no penalty if you do not do so.

## How To Fill In Form 1040-V

**Box 1.** Enter the amount you are paying by check or money order.

**Box 2.** Enter the first four letters of your last name. See examples below.

Name	Enter	Name	Enter
John Brown . . .	BROW	Nancy McCarthy . . .	MCCA
Juan DeJesus . . .	DEJE	Helen O'Neill . . .	ONEI
Joan A. Lee . . .	LEE	Pedro Torres-Lopez .	TORR

**Boxes 3 and 4.** Enter your social security number (SSN) in box 3. If you are filing a joint return, enter in box 3 the SSN shown first on your return and in box 4 the SSN shown second.

**Box 5.** Enter your name(s) and address as shown on your return.

## How To Prepare Your Payment

- Make your check or money order payable to the "United States Treasury." Do not send cash.
- Make sure your name and address appear on your check or money order.
- Enter "1999 Form 1040," your daytime telephone number, and your SSN on your check or money order. If you are filing a joint return, enter the SSN shown first on your return.
- To help us process your payment, enter the amount on the right side of your check like this: \$ XXX.XX. Do not use dashes or lines (for example, do not enter "\$ XXX—" or "\$ XXX  $\frac{XX}{100}$ ").

## How To Send In Your Return, Payment, and Form 1040-V

- Detach Form 1040-V along the dotted line.
- Do not staple or otherwise attach your payment or Form 1040-V to your return or to each other. Instead, just put them loose in the envelope.
- If an envelope came with your tax package, please use it to mail your 1999 tax return, payment, and Form 1040-V.
- If you do not have that envelope or you moved or used a paid preparer, mail your tax return, payment, and Form 1040-V to the Internal Revenue Service at the address shown on the back that applies to you.

**Note.** If you filed electronically, send your check or money order and Form 1040-V to the applicable address shown on the back.

**Paperwork Reduction Act Notice.** We ask for the information on Form 1040-V to help us carry out the Internal Revenue laws of the United States. If you use Form 1040-V, you must provide the requested information. Your cooperation will help us ensure that we are collecting the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by Internal Revenue Code section 6103.

The time needed to complete and mail Form 1040-V will vary depending on individual circumstances. The estimated average time is 19 minutes. If you have comments about the accuracy of this time estimate or suggestions for making Form 1040-V simpler, we would be happy to hear from you. See the Instructions for Form 1040.

Cat. No. 20975C

▼ DETACH HERE AND MAIL WITH YOUR PAYMENT ▼

Form 1040-V (1999)

Form **1040-V**

Department of the Treasury  
Internal Revenue Service (99)

## Payment Voucher

OMB No. 1545-0074

▶ Do not staple or attach this voucher to your payment.

**1999**

**1** Enter the amount you are paying by check or money order

▶ \$ .

**2** Enter the first four letters of your last name

\_\_\_\_\_

**3** Enter your social security number

\_\_\_\_\_

**4** If a joint return, enter the SSN shown second on that return



**5** Enter your name(s)

Enter your address

Enter your city, state, and ZIP code

Cat. No. 20975C

**Exhibit 204-9: Form 1040-V, Payment Voucher (cont.)**

Form 1040-V (1999)

Page 2

IF you live in . . .	THEN use this address if you:		
	Prepared your own return . . .	Used a paid preparer . . .	Filed electronically . . .
Florida, South Carolina	Atlanta, GA 39901-0002	P.O. Box 105093 Atlanta, GA 30348-5093	P.O. Box 6223 Chicago, IL 60680-6223
Georgia	Atlanta, GA 39901-0002	P.O. Box 105093 Atlanta, GA 30348-5093	P.O. Box 1214 Charlotte, NC 28201-1214
New Jersey, New York ( <i>New York City and counties of Nassau, Rockland, Suffolk, and Westchester</i> )	Holtsville, NY 00501-0002	P.O. Box 1187 Newark, NJ 07101-1187	P.O. Box 371361 Pittsburgh, PA 15250-7361
New York ( <i>all other counties</i> ), Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont	Andover, MA 05501-0002	P.O. Box 371361 Pittsburgh, PA 15250-7361	P.O. Box 371361 Pittsburgh, PA 15250-7361
Illinois, Iowa, Minnesota, Missouri, Wisconsin	Kansas City, MO 64999-0002	P.O. Box 970011 St. Louis, MO 63197-0011	P.O. Box 970016 St. Louis, MO 63197-0016
Delaware, District of Columbia, Maryland, Pennsylvania, Virginia	Philadelphia, PA 19255-0002	P.O. Box 8530 Philadelphia, PA 19162-8530	P.O. Box 371361 Pittsburgh, PA 15250-7361
Indiana, Kentucky, Michigan, Ohio, West Virginia	Cincinnati, OH 45999-0002	P.O. Box 6223 Chicago, IL 60680-6223	P.O. Box 6223 Chicago, IL 60680-6223
Kansas, New Mexico, Oklahoma, Texas	Austin, TX 73301-0002	P.O. Box 970016 St. Louis, MO 63197-0016	P.O. Box 970016 St. Louis, MO 63197-0016
Alaska, Arizona, California ( <i>counties of Alpine, Amador, Butte, Calaveras, Colusa, Contra Costa, Del Norte, El Dorado, Glenn, Humboldt, Lake, Lassen, Marin, Mendocino, Modoc, Napa, Nevada, Placer, Plumas, Sacramento, San Joaquin, Shasta, Sierra, Siskiyou, Solano, Sonoma, Sutter, Tehama, Trinity, Yolo, and Yuba</i> ), Colorado, Idaho, Montana, Nebraska, Nevada, North Dakota, Oregon, South Dakota, Utah, Washington, Wyoming	Ogden, UT 84201-0002	P.O. Box 7704 San Francisco, CA 94120-7704	P.O. Box 7704 San Francisco, CA 94120-7704
California ( <i>all other counties</i> ), Hawaii	Fresno, CA 93888-0002	P.O. Box 60000 Los Angeles, CA 90060-6000	P.O. Box 7704 San Francisco, CA 94120-7704
Alabama, Arkansas, Louisiana, Mississippi, North Carolina, Tennessee	Memphis, TN 37501-0002	P.O. Box 1214 Charlotte, NC 28201-1214	P.O. Box 1214 Charlotte, NC 28201-1214
All APO and FPO addresses, American Samoa, nonpermanent residents of Guam or the Virgin Islands*, Puerto Rico ( <i>or if excluding income under section 933</i> ), a foreign country ( <i>or if a dual-status alien</i> ): U.S. citizens or those filing Form 2555, Form 2555-EZ, or Form 4563	Philadelphia, PA 19255-0215	P.O. Box 7328 Philadelphia, PA 19162-7328	P.O. Box 371361 Pittsburgh, PA 15250-7361

\* Permanent residents of Guam or the Virgin Islands should not use Form 1040-V.



**Exhibit 204-10: Return History—Acknowledgment of Acceptance**

Return History  
04/07/99 11:09:11

Name:  
Control: 00000000

Return: 3390 \_\_\_\_\_1  
Refund: \$

SSN:  
IRS Center: Austin

---

410041-00000	04/01	Qualified for Electronic Filing
	04/06	Selected for Release
	04/06	Transmitted to ProSystem Center
	04/07	Transmitted to IRS
	04/07	Accepted by IRS



## Exhibit 204-12: Form 9325, Acknowledgment and General Information for Taxpayers Who File Returns Electronically

Form <b>9325</b> (Rev. January 1996)	Department of the Treasury - Internal Revenue Service  <b>Acknowledgement and General Information for          Taxpayers Who File Returns Electronically</b>
---	--

- Thank you for taking part in the IRS Electronic Filing Program.
- Your federal income tax return for tax year \_\_\_\_\_ is being filed electronically with the \_\_\_\_\_ Service Center of the IRS by the services of \_\_\_\_\_.
- Your return was accepted by IRS on \_\_\_\_\_ and the Declaration Control Number (DCN) assigned to your return is \_\_\_\_\_.

Since you are filing your return electronically, PLEASE DO NOT SEND A PAPER COPY OF YOUR RETURN TO THE IRS. IF YOU DO, IT WILL DELAY THE PROCESSING OF THE RETURN.

### If You Need to Make a Change to Your Return

If you need to change or correct the return you filed electronically, you should send a Form 1040X, Amended U.S. Individual Income Tax Return, to the IRS service center that processes paper returns for your area. The address is in your tax forms package, or you can call the IRS toll-free at 1-800-829-1040.

### If You Need to Ask About Your Refund

The IRS will notify your electronic filer when they accept your return, usually within 48 hours. If your return wasn't accepted, IRS will notify your electronic filer of the reasons for rejection. If it has been more than three weeks since the IRS accepted your return and you have not received your refund, you can call the IRS toll-free Tele-Tax return information number, 1-800-829-4477, to check the status of your refund. **You will need to tell us the first social security number shown on your return, your filing status, and the exact amount of the refund you expect.** Tele-Tax should give you the date for mailing or depositing your refund. You should receive your refund check within 30 days of the date given by Tele-Tax, or within one week of that date if you chose direct deposit. If you don't receive it by then, or if Tele-Tax does not give you refund information, call your local IRS office at 1-800-829-1040.

### Refund Anticipation Loans

A refund anticipation loan is a loan made to you based on the refund you expect to receive. This loan is a contract between you and a lender. The IRS is not involved in this contract, can't grant or deny the loan, and can't answer any questions about it. **If you have any questions about a refund anticipation loan, contact your electronic filer or the lender.**

### If You Owe Tax

If your electronically filed return showed tax due, you must pay the amount you owe by April 15. Use the scannable payment voucher you will receive in the mail or you may use Form 1040-V, Payment Voucher, which you can get from your electronic filer. Mail Form 1040-V, Payment voucher with your payments to the lockbox associated with the Service Center where the return was filed. If the IRS doesn't receive your payment by April 15, they will send you a notice that asks for full payment of the tax due **plus penalties and interest.** If you can't pay the amount you owe in full, please complete Form 9465, (Installment Agreement Request), which may be filed electronically in 1997. You can get the form by calling 1-800-829-3676. To avoid delays, you must send or electronically file Form 9465 to the address provided on the instructions on Form 1040-V.



**Exhibit 204-13: Form 9041, Application for Electronic/Magnetic Media Filing of Business and Employee Benefit Plan Returns**

Form **9041**  
 (Rev. September 1999)  
 Department of the Treasury  
 Internal Revenue Service

**Application for Electronic/Magnetic Media Filing of Business and Employee Benefit Plan Returns**

OBM No. 1545-1079

This application is: (check one) new  revised  See the back of this form for line by line instructions

1a Firm's Name	b Employer Identification Number (EIN) (EIN must be 9 digits)
c Mailing Address (Street, P.O. Box, City, State, Zip Code)	d Contact person's name  Daytime telephone number (Include area code.) ( ___ ) _____  FAX telephone number (Include area code.) ( ___ ) _____

2 Indicate which forms you will file by checking each appropriate box.

- |  |   |
|--|---|
| <input type="checkbox"/> Form 5500, Annual Return/Report of Employee Benefit Plan (with 100 or more Participants)<br><input type="checkbox"/> Form 5500-C/R, Return/Report of Employee Benefit Plan (with fewer than 100 Participants)<br><input type="checkbox"/> Form 5500-EZ, Annual Return of One-Participant (Owners and Their Spouses) Retirement Plan | <input type="checkbox"/> Form 1041, U.S. Income Tax Return for Estates and Trusts<br><input type="checkbox"/> Form 1065, U.S. Partnership Return of Income (See back of this form for instructions)<br><input type="checkbox"/> Form _____<br><input type="checkbox"/> Form _____ |
|--|---|

3 List any Electronic Transmitter Identification Number(s) and Magnetic Media Transmitter Identification Number(s) we previously assigned to you or your firm.

4 Please answer the following questions by checking the appropriate box(es):

- a Will you send return data directly to IRS?  Yes  No
- b Will you develop or modify software that prepares returns for electronic/magnetic media filing?  Yes  No
- c Will you file using Magnetic tape?  Floppy Diskette (3 1/2" or 5 1/4")?  Modem?

5 If you know which software company and/or transmission service you will use, please enter the names, addresses and phone numbers below.

Software Company	Transmitter
------------------	-------------

6 Estimated tax return volume to be filed:  
 Form \_\_\_\_\_ K-1 \_\_\_\_\_

**Applicant Agreement**

Under the penalties of perjury, I declare that I have examined this application and any accompanying information, and to the best of my knowledge and belief it is true, correct and complete. This firm and its employees will comply with all the provisions of the procedures for electronic/magnetic media filing of Forms 1041, 1065, 5500, 5500-C/R, or 5500-EZ as applicable. The firm understands that if it is sold or its organizational structure is changed, acceptance for participation is not transferable; a new application must be filed. The firm further understands that noncompliance will result in the firm no longer being allowed to participate in the program. I am authorized to make and sign this statement on behalf of the firm.

Name and title of person responsible for filing this application (Please print or type.)

7 Signature of person responsible for this application	Date
--	------

**Exhibit 204-13: Form 9041, Application for Electronic/Magnetic Media Filing of Business and Employee Benefit Plan Returns (cont.)**

Form 9041 (Rev. 9-1999)

Page 2

**Privacy Act Notice.**—The Privacy Act of 1974 requires that when we ask you for information we tell you our legal right to ask for the information, why we are asking for it, and how it will be used. We must also tell you what could happen if we do not receive it and whether your response is voluntary, required to obtain a benefit, or mandatory.

Our legal right to ask for the information is Internal Revenue Code sections 6001, 6011, and 6012(a) and their regulations. We are asking for this information to verify your status as a person qualified to participate in the electronic filing program. Your response is voluntary. Failure to provide the requested information could result in your disqualification from the electronic filing program. If you provide fraudulent information, you may be subject to criminal prosecution.

**Paperwork Reduction Act Notice.**—We ask for the information on this form to carry out the Internal Revenue laws of the United States. You must give us the information if you wish to participate in the electronic/magnetic media filing program. We need it to process your application to file Business and Employee Benefit Plan Returns on electronic/magnetic media.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by Code section 6103.

The time needed to complete this form will vary depending upon individual circumstances. The estimated average time is 18 minutes. If you have comments concerning the accuracy of this time estimate or suggestions for making this form simpler, we would be happy to hear from you. You can write to the Tax Forms Committee, Western Area Distribution Center, Rancho Cordova, CA 95743-0001. **DO NOT** send this application to this office. Instead, see instructions below for where to file.

**General Instructions**

**Who must file.**—File Form 9041 if you would like to take part in the electronic/magnetic media filing program for Forms 1041, 1065, 5500, 5500-C/R, and 5500-EZ. Only those who did not participate in last year's electronic/magnetic media filing program need apply, and those for whom information in item 1 has changed since we last contacted you. **EXCEPTION:** To take part in the Form 1065 electronic filing program, current and new participants must file Form 9041.

**When to file.** To ensure complete and timely review of your application, file Form 9041 at least 60 calendar days before you file electronically. IRS uses the postmark date on the envelope to determine whether the application was filed timely.

**Where to file.** Send the completed Form 9041 for **Forms 1041** to:

Internal Revenue Service  
Philadelphia Service Center  
ATT: DP 115  
11601 Roosevelt Blvd.  
Philadelphia, PA 19154  
Phone: 215-516-7533

Send the completed Form 9041 for **Forms 1065** to:

Internal Revenue Service  
Austin Service Center  
Attn: EFU, Stop 6380  
P.O. Box 1231  
Austin, TX 78767  
Phone: 512-460-8900

Send the completed Form 9041 for **Forms 5500, 5500-C/R and 5500-EZ** to:

Internal Revenue Service  
Attn: EFU (EPMF), Stop 261  
P.O. Box 30309, A.M.F.  
Memphis, TN 38130  
Phone: 901-546-2690, ext. 7516

**Line By Line Instructions**

**Line 1a.**—Enter the name as shown on your tax return.

**Line 1c.**—If you have both a post office box and street address, enter both addresses for the firm's main office. We need both addresses in case we need to send information to you by overnight mail.

**Line 1d.**—If this information changes, please notify the IRS Service Center where you originally filed Form 9041. We need this information in case questions arise and to fax revised documentation or the Acknowledgement Report if it is six pages or less.

**Line 2.**—If you want to electronically file a form that isn't listed and you know we've added it to our electronic filing program since this form's revision date (lower right corner), please enter it on one of the blank lines labeled Form. See Publication 1524, procedures for more information about filing Form 1065 electronically.

**Line 5.**—If this information changes, please notify the appropriate service center. If you will use your own software or communication equipment, please indicate this in the space provided. Please include the name, address, phone number, and contact person's name, if applicable.

★ U.S. GPO:1997-423-219/59181



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# 205 Dealing With the IRS

## 205.1 Organization of the Internal Revenue Service

The Internal Revenue Service (IRS) is a branch of the Treasury Department. The IRS commissioner is its top official. From the national office in Washington, D.C., the commissioner oversees operations and sets policy.

There are ten service centers that process returns and conduct correspondence examinations. Taxpayers and tax practitioners have most of their dealings with district offices. The IRS is reorganizing into four regional offices and thirty-three district offices. Office and field audits, collections, and investigations are conducted by divisions of the district offices. The components of the typical district office are these:

- Office of the district director
- Taxpayer service division
- Examination division
- Collection division
- Criminal investigation division
- Employee plans and exempt organizations division

Restructuring of the IRS will establish organizational units serving groups of taxpayers having similar needs, such as individuals, small business, large business, and tax exempts (1998 IRS Restructuring and Reform Act, sec. 1001(a)(3)).

The office of the chief counsel of the IRS is a division of the Treasury Department. Legal counsel are located in each region. Many district offices also have legal counsel. One of the tasks of the counsel's office is to resolve taxpayers' administrative appeals.

Tax examiners, also called office auditors, conduct their examinations within the IRS office, by correspondence or office appointment. Revenue agents handle field examinations at a tax practitioner's or taxpayer's place of business. Revenue officers are agents of the collection division. Special agents pursue criminal investigations.

Exhibit 205-1 shows a breakdown of IRS personnel for 1996.

## 205.2 IRS Procedure for Examining Returns

The 1998 IRS Restructuring and Reform Act requires the IRS to rewrite Publication Number 1, *Your Rights as a Taxpayer*, to include disclosure of the criteria and procedures used to select returns for audit.

### 205.2.1 Initial Review and Screening

The review process for all returns filed begins with routine checks for obvious errors such as mathematical mistakes and omissions of signatures and Social Security numbers. These procedures constitute only a cursory review and fall far short of an audit. An audit, also referred to

as an examination, may require the taxpayer to respond to questions or to provide supporting data or documentation for elements of his or her tax return. Because of the large volume of returns filed each year, the IRS cannot possibly audit every return filed; only about one percent of all returns are audited. To ensure that IRS audit time is expended most productively, the IRS uses several techniques for selecting returns to audit.

### 205.2.2 Discriminate Function System

After the initial checks, information on returns is processed by computers and rated for potential errors by a selection program known as the Discriminate Function system or DIF—a statistical analysis that assigns number values to various items on the return and thereby produces a composite score for each return. There are numerous possible formulas for weighting the data to calculate the composite score, but the exact formulas are withheld from the public. The standards used in developing these formulas are based on the results of examinations from previous years, particularly the results of the TCMP program (see Section 205.2.6, on next page). Representatives from IRS district offices screen those returns that have significant DIF scores. Agents evaluate such returns to determine the potential for adjustment as against costs to perform the examination.

### 205.2.3 Information Returns Project (IRP) Audits

Information Returns Project (IRP) audits match information returns, such as Forms 1099 and W-2, with the amounts reported on tax returns. Incidents of IRS error in matching information returns are numerous. There are many reasons the IRS matching program may suggest under-reporting, including incorrect information returns issued to taxpayers, incorrect information returns reported to the IRS, information reported more than once for the same amount, reporting of an amount on a different form or schedule than the IRS matching program anticipated, reporting of an amount in the name of a financial institution or payor other than the IRS anticipates, and so forth.

**Practice Tip.** Although it will not deter an IRS inquiry, attaching a reconciliation of information return differences to the taxpayer's return will make dealing with the IRP audit inquiry easier in the long run.

Typically, the IRS will send a printout to the taxpayer detailing the amount of under-reporting. The taxpayer can agree with a correction of the tax return by signing and returning a copy of the printout. A taxpayer who doesn't agree may reply by mail or may schedule an interview at a local IRS office.

**Practice Tip.** Inform clients to *always* bring reports of IRS inquiries to you for analysis. Some taxpayers, fearing greater IRS scrutiny if they attempt to defend reported amounts, will quickly pay the IRS on *any* notice received, whether justified or not. Through client seminars and newsletters (Chapter 103), thoroughly inform your clients to bring IRS inquiries to you, so that you can assess the accuracy of any proposed adjustments and respond to the IRS.

If the amounts underreported are substantial, the IRS will process the return as if it were a DIF audit. Other items on the return will be examined, and the taxpayer will be invited in for an interview. Sometimes the IRS printout reports seem to be triggered by trivial discrepancies of the sort that are due to rounding.

### 205.2.4 Market Segments Specialization Program

The IRS Examination Division has prepared a series of industry-specific audit guides. This program, called the Market Segments Specialization Program (MSSP), is intended to tell revenue agents and tax auditors how certain industries operate. The following are *Market Segment Specialization Papers* and *Understandings Papers* issued through September 1999.



Air Charters	Manufacturing Industry
Alaska Commercial Fishing Industry	Ministers
Architects	Mobile Food Vendors
Artists and Art Galleries	Mortuaries
Aviation	Music Industry
Bail Bond Industry	Net Operating Losses for Individuals
Attorneys	Oil & Gas Industry
Auto Body and Repair Industry	Passive Activity Losses
Automobile Industry	Pizza Industry
Bars and Restaurants	The Port Project
Bed & Breakfasts	Reforestation Industry
Beauty and Barber Shops	Rehabilitation Tax Credit
Carpentry and Framing	Retail Liquor Industry
Cattle Industry	RTC Debt Cancellation
Coal	Scrap Metal Industry
Commercial Banking Industry	Taxicabs
Commercial Printing Industry	Tobacco Industry
Computers, Electronics, and High Technology	Tour Bus Industry
Entertainment Industry	Trucking Industry
Farming	Veterinary Medicine
Foreign Athletes & Entertainers	Water Transportation Ports
Furniture Manufacturing	Wine Industry
Garment Contractors	Limousine Industry—Classification of Workers
Garment Manufacturers	Moving Industry—Classification of Workers
Gasoline Retailer Industry	Television Industry—Classification of Workers
Grain Farmers	Tip Rate Agreement—Gaming Industry
Hardwood Timber Industry	Tip Reporting—Hairstyling Industry
Independent Used Car Dealers	Tip Reporting—Food Service Industry
	Farm Labor—Noncash Remuneration

**Practice Tip.** Familiarization with the appropriate guide can help you if you are taking on a new client in an unfamiliar industry. Reminding the IRS agent or auditor of the guide could reduce the time you have to take explaining and justifying a client's accounting practices. The guides are available from the IRS.

**Practice Tip.** Study the industry audit guide in preparation for representing a client in an examination. You will have an insight into the examiner's point of view.

### 205.2.5 Manual Identification

Returns to be audited can also be manually selected for audit. Experienced IRS auditors apply a “sniff” test. Various aspects of the return are considered, including the taxpayer's occupation and the amounts and types of deductions claimed, especially high entertainment or travel expenses. In an effort to curb abuses on tax shelters, the IRS has created an integrated intelligence network that concentrates on tax evasion and abusive use of tax shelters.

### 205.2.6 IRS Instructions to Classifiers and Auditors

IRS instructions are contained in the *Internal Revenue Manual* (IRM). Reviewers and auditors are told to consider—

- The comparative size of an item in relation to income and other expenses.
- Evidence of intent to mislead, such as missing or incomplete information.
- Beneficial effect of the manner of reporting, for example, expenses on a business schedule rather than as an itemized deduction.
- Relationships such as lack of dividend income while there are sales of securities.

## 205.2.7 Chances of Selection

The chance that a return will be selected for audit depends on many factors, including total positive income (TPI), Schedule C or F total gross receipts, Schedule C business code, unusual or high amounts of expenses and deductions, and many other factors. TPI is the sum of all positive income values appearing on a return.

Exhibit 205-2 shows IRS 1996 statistics on examination coverage and results.

## 205.2.8 Items That May Trigger an Audit

While the precise items that may cause the computer to flag a return for audit are not in the public record, and the expertise used in the manual selection process is not quantified, there is general agreement among practitioners that these situations tend to increase the chance of audit:

- Deduction for items not authorized by law
- Large medical deductions without insurance reimbursements
- Large casualty-loss deductions
- Large noncash contributions, particularly when out of proportion with the taxpayer's evident means
- Large deductions for travel and entertainment expense
- Large interest expense in relation to amount of income reported
- Standard deduction used with high gross and low net income
- Large losses on business, rental, or other schedules
- Occupations normally more lucrative than indicated by the return
- Return on an investment is significantly lower than expected
- Taxpayer's occupation is known for its opportunity for receiving income in cash
- Claim filed for a very large refund

## 205.2.9 How to Reduce the Likelihood of an Audit

An audit is an inconvenience and an expense for the taxpayer. In addition, most taxpayers feel considerable stress when under audit, regardless of the good faith and sincerity with which they filed their tax return. Audits, however, are not necessarily damaging to the taxpayer. Every experienced accountant has stories of claims for refunds that were discovered during the course of an audit. Assuming, however, that some risk of additional assessment arises with every audit, here are ways of reducing the likelihood of an audit:

- Attach all W-2 forms and any other forms required to be filed (e.g., Form 1099-R).
- Report all income, itemizing by payee such items as interest and dividends.
- Using your experience as a guide to what may be seen as unusual, include an explanation of unusual items and their calculation (for example, casualty and theft losses).
- Explain, in an attachment to the return, allocations that have been made between personal and business use and between Schedule C and Schedule A.
- Explain any discrepancy between information returns (such as Form 1099) and amounts reported on the tax return.

## 205.2.10 Financial Status Audits

Financial status audits—formerly called economic reality audits—focus on small businesses and their owners. The IRS agent uses indirect auditing techniques to gather information that might lead to unreported income. The types of questions the agent asks probe the taxpayer's lifestyle, such as: "Where did you go on vacation?" and "What automobiles do you own?" A working group of the AICPA's Tax Division provides guidance in *The Tax Adviser*, April 1996 issue, page 218, or you may request information via the FAX hotline, (201) 938-3787, document No. 965.

## 205.3 Types of Examinations

Serious consequences can arise from an audit. Make sure that one of your firm's tax specialists is consulted at the beginning of any IRS examination, regardless of who originally prepared the return.

### 205.3.1 Examinations in or From the IRS Office

#### Correspondence Examinations

Correspondence examinations are generally used in simple situations when information concerning questionable items can be readily furnished by mail. Examples of items a taxpayer might be asked to support (verify) by mail include—

- Interest.
- Taxes.
- Charitable contributions.
- Medical and dental expenses.

You should urge your clients to take seriously any request for verification by correspondence and to refer the matter to you. If you believe the matter cannot adequately be resolved by correspondence, you can request an appointment. An advantage to a reply by correspondence is that the agent cannot easily ask other questions that may be detrimental to the client. Drawbacks to a correspondence audit are that—

- The IRS examiner cannot hear oral arguments and cannot see the sincerity of the taxpayer or the adviser.
- The examiner has the opportunity to review submitted substantiation at his or her convenience, thus providing additional time to discover errors.

If a client receives a notice setting up an appointment for an office interview and you feel that the issues involved can be resolved by a correspondence audit, you can request that the audit be handled by correspondence. To request a correspondence audit, you should send a letter, a power of attorney, and copies of any evidence necessary to substantiate the client's claims directly to the IRS office.

#### Office Examinations

To initiate an office examination, the IRS generally mails an appointment letter directly to the taxpayer, indicating the date and time the person is to be at the IRS office. If the date and time are inconvenient, the taxpayer or adviser should immediately contact the IRS office to reschedule the appointment. These are typical of matters that might be resolved by an office interview:

- Income from tips, pensions, annuities, rents, royalties, and determination of gain or loss as capital or ordinary
- Deductions for employee business expenses
- Property basis determination
- Bad debt deductions
- Questions regarding low income in comparison to exemptions and deductions

The scope of an office examination is normally limited to the two or three items listed on the appointment letter, unless the examiner comes to believe during the examination that he or she has sufficient reason to investigate other matters. If it seems desirable to do so, you can remind the examiner that you are justified in being prepared to support only those matters listed in the letter. Retain the original or copies of any documents given to the agent.

Opinions differ regarding whether the taxpayer, the tax practitioner, or both should attend an office audit. One practitioner says he never lets a client attend an office examination alone. Another says he coaches the client and assists in assembling documents, but prefers not to attend personally because office audits are too time-consuming relative to reasonable fees.

Upon the advance request of a taxpayer, the IRS must allow the taxpayer to make an audio recording of an in-person interview. The recording is made at the taxpayer's own expense and with the taxpayer's own equipment.

The IRS on its own initiative may record an in-person interview if—

- The taxpayer is informed of the recording prior to the interview, and
- The IRS provides a transcript or copy of the recording if the taxpayer requests, at the taxpayer's expense.

Either before or at the initial interview with the taxpayer, the IRS must provide—

- An explanation of the audit process and the taxpayer's rights.
- An explanation of the collection process and taxpayer's rights if the process relates to tax collection.

At any time during an interview (other than an interview initiated by an administrative summons), the taxpayer can terminate the interview by clearly stating a desire to consult with an attorney, CPA, enrolled agent, enrolled actuary, or other authorized person. The IRS must terminate the interview, even if the taxpayer has already answered one or more questions.

Any attorney, CPA, enrolled agent, enrolled actuary, or other person who may represent taxpayers before the IRS and who has a written Power of Attorney executed by a taxpayer can represent the taxpayer before the IRS. The taxpayer is not required to accompany the representative, unless an administrative summons has been issued. See Sec. 303.2.3 of this manual. The IRS can notify the taxpayer directly that the IRS believes the representative is responsible for unreasonable delay or hindrance of the examination or investigation.

The IRS is expected to require a taxpayer or authorized representative to attend an examination at the IRS office located closest to the taxpayer's home. The IRS will not audit a taxpayer at the place of business if doing so in effect requires the taxpayer to close down the business. The possibility of physical danger to an agent will be considered when setting the time and place of an audit.

**Practice Tip.** Warn your clients of the dangers of attending any IRS interview without one of your staff. (Once a slip-of-the-tongue has been made, it can't be taken back.) As to audio recordings: You might consider recording all interviews, and furnishing a transcript to clients as an additional, billable service. However, recording an IRS interview will in many cases irritate the agent and make it more difficult to compromise.

## 205.3.2 Field Examinations

For the majority of business returns, and many large and complex individual returns, the predominant type of audit is the field examination. Revenue agents notify the taxpayer that a return has been selected for examination and schedule an appointment for a mutually convenient time. The examination usually occurs at the taxpayer's place of business. The agent has full license to examine all information (books, records, and the like) necessary to determine the accuracy of the return. The entire return is involved in field examinations, and federal payroll returns and federal excise tax returns may be examined at the same time. Often all open years of corporations are audited as well as the personal returns of officers. Field audits can take several days or weeks.

**Practice Tip.** Prior to an examination that you will attend, discuss with the client any areas of potential exposure. Also, get an engagement letter.

## 205.3.3 Team Examinations

In the case of large corporations, a team of revenue agents may be permanently assigned to examine the tax returns and supporting documentation. Specialists in a variety of fields, such as engineering or valuation, may be included.

### 205.3.4 **Select Employee Plans Return Examination (SEPPE)**

SEPPE is an investigation to determine if there are problems in the returns of tax-exempt organizations. Tax-exempt organizations are supervised by the employee plans and exempt organization division of the district office to make sure that they adhere to the conditions of their tax-exempt status.

### 205.3.5 **Repetitive Examinations**

It has been policy in recent years for the IRS to reduce the incidence of repetitive examinations. The IRS will not conduct an examination on an individual if during the examinations of the two preceding years there were no changes involving the individual, if it is unlikely that a change will be made for the year in question, and if no significant issues were overlooked during previous years. If, however, the current examination is TCMP, these provisions do not apply and the return must be examined. Neither do these provisions apply to business aspects of an individual return (Schedules C and F). The agent responsible for the examination may not have access to the facts of the two preceding years, in which case it is the responsibility of the taxpayer to bring the facts to the agent's attention.

### 205.3.6 **Audits of Partnerships**

Historically, general tax law held that a partnership was not a taxable entity and that tax adjustments had to be made at the partner's level. Now, the tax treatment of partnership items is determined at the partnership level in a unified partnership proceeding. Special rules provide for notice and other types of participation by the individual partners. All entities required to file returns as partnerships are handled under the Tax Equity and Fiscal Responsibility Act (TEFRA) rules, except partnerships where—

- Ten or fewer partners are either natural persons (but not nonresident aliens) or estates (husband and wife are considered one partner for this purpose), and
- Each partner's share of any partnership item is the same as his or her distributive share of every other partnership item.

These small partnerships can elect to be governed by the TEFRA provisions. TEFRA requires that all partners treat partnership items as they were treated on the partnership return. To reduce inconsistencies, the IRS requires that a copy of the information in the partnership return be given to each partner. A partner who decides to treat a partnership item in a way that is inconsistent with the partnership return must disclose the inconsistency to the IRS on Form 8082.

A partner's return should also make a disclosure if the partnership (1) fails to file a return or (2) provides the partner with incorrect information. If an inconsistency in reporting leads to a deficiency in tax payment—for example, attempting to expense the partner's share of an item that was capitalized on the partnership return—yet no notice of inconsistent treatment has been filed by the partner, the IRS will make an adjustment to the partner's return to conform it to the treatment on the partnership return. Any additional tax resulting from this adjustment will be immediately assessed and collected as though it were a mathematical error—that is, without issuing a notice of deficiency to the partner. At that point, the partner's recourse will be to file a claim for refund and sue in U.S. Court of Federal Claims or in a district court. Any underpayment due to inconsistency in reporting, coupled with the taxpayer's failure to file Form 8082, will be treated as intentional or negligent disregard of the rules and regulations and therefore will be subject to penalty. Internal Revenue Code Secs. 6221 through 6233 deal with these partnership matters.

#### **Partnership Audit Procedures**

To begin an audit of a partnership, the IRS first issues a notice of commencement of an administrative proceeding, which is sent to every partner. Audits of partnerships impact all partners, but one specific partner, called the tax matters partner (TMP), should be designated by the partnership to be its primary representative. If a TMP is not selected by the partnership,

the IRS normally will choose the partner with the largest profit interest in the tax year in question (if two or more partners have the same profit interest, the TMP will be chosen alphabetically). Although the person chosen will have been a general partner at some time during the year, this is not necessarily so at the year end (Treas. Regs. Sec. 301.6231(a)(7)-1(r)). The TMP is responsible for keeping all partners informed of the proceedings of the audit and has sole authority to seek judicial review of an audit adjustment. IRC Sec. 6231(a)(7) defines the tax matters partner.

Any partner entitled to notice is known as a *notice partner*. No partner is a notice partner unless the IRS has received the name, address, and indication of interest in profits at least 30 days before it mails a notice to the TMP. The term *notice partner* does not include partners with less than a one percent interest in partnerships consisting of more than 100 partners. In these partnerships, notice to the TMP is considered to be notice to each partner. Thus, the IRS is not obligated to send individual partners, except the TMP, any of the notices. All notice partners, however, must be informed of any change in the identity of the tax-matters partner (TMP)(IRC Sec. 6231(a)(7)). Any group of partners having together a 5 percent or greater interest in profits, however, may designate one of their group as a notice partner.

### Notices to Partners

The IRS must mail notices to every partner as well as to the TMP when it begins the audit proceedings. At the conclusion of the audit, a notice of final partnership administrative adjustments (FPAA) is mailed to the notice partners. The notice of the start of the proceeding must be mailed to the other partners no later than 120 days before the notice of the final adjustment is mailed to the TMP. In other words, there must be a lapse of 120 days between these two events. Notice of the FPAA may be mailed to the other partners no later than 60 days after it is mailed to the TMP.

If, when any notice is mailed, it is too late for a notice partner to join in any judicial proceeding, this partner—while not joining in the proceeding—may still elect to have any decision or agreement apply to him or her and the group the partner represents. Otherwise, partnership items affected in the proceeding are, to that partner, treated as nonpartnership items.

If an item is treated as a nonpartnership item, determination of its treatment at the partnership level is not applicable. Nonpartnership items may not be brought into issue by the IRS or by the partner in a partnership proceeding, and partnership items may not be raised in a nonpartnership-item proceeding. Items become nonpartnership items on the date—

- The IRS enters into a settlement agreement with the partner.
- The IRS fails to make a timely mailing to a partner concerning a partnership proceeding.
- The partner files suit after the IRS has denied his or her request.
- The IRS notifies a partner that a partnership item will be treated as a nonpartnership item.

### Participation by a Partner in an Administrative Proceeding

Any partner may choose to participate in a proceeding relating to the tax treatment of a partnership item. A settlement agreement between the IRS and one or more partners will be binding on the parties to that agreement for the taxable year. Any other partner may obtain the same treatment by requesting it before the expiration of 150 days after the day the FPAA is mailed to the TMP.

### Agreements Binding on Partners

If the TMP enters into a settlement agreement, all partners except notice partners (and members of a 5 percent group who have designated a notice partner) are bound by the agreement. Any partner not wishing to be bound may file a statement with the IRS stating that the TMP does not have authority to enter into such a settlement agreement in this partner's behalf. The time for filing this statement is to be determined by the commissioner.

### Provision of Judicial Review

Once notice of an FPAA is mailed to the TMP, he or she has 90 days to petition for a redetermination. The petition may be addressed to the Tax Court, the U.S. district court, or the U.S. Court of Federal Claims. Except for the Tax Court, petitions require that the additional tax due be paid to the commissioner.

Any notice partner, upon failure of the TMP to do so within the prescribed 90-day period, may file the petition, and has 60 additional days to do so. The first petition filed takes precedence over all such petitions, and the later ones will be dismissed.

### Computational Adjustments

Adjustments of mathematical or clerical errors can be made by the IRS as partnership items, thus affecting the partners, without applying the usual deficiency procedures. Within 60 days after such a correction notice is mailed to him or her, however, a partner may request that the IRS not make the correction.

### Credits or Refunds

A partner may not file suit for a credit or refund arising out of a partnership item without first filing a request for administrative adjustment (RAA). The RAA must be filed within three years after the later of the date of actual filing of the partnership return or the last day prescribed for filing the return without regard to extensions. The RAA must be filed before IRS notice of an FPAA.

If the RAA is not fully allowed, the TMP may file a petition for adjustment of the disallowance with the Tax Court, a district court, or the Claims Court. This petition must be filed after expiration of six months from the filing of the RAA but within two years of the filing. See IRC Sec. 6227(c) for rules regarding RAA filings by partners on their own behalf.

### Limitation Periods for Assessments and Refund Claims

Assessments relating to a partnership item—

- May not be filed before the close of the 150th day after mailing to the TMP notice of an FPAA.
- May not be filed until completion of proceedings in Tax Court (if begun within the 150-day period).
- Must be made within three years following the later of the date of actual filing or the last day prescribed for filing of a partnership return (unless extended by the commissioner).
- May be made within six years if a false return has been filed.
- May be made within six years if partnership income was omitted that exceeded 25 percent of stated gross income.

For refund claims or claims for credit, the time limitations are generally the same as for assessments. When an RAA is timely filed, however, the period with respect to such a request will not expire until the period has expired for filing suit.

## 205.3.7 Audits of S Corporations

New audit procedures were created by the Subchapter S Revision Act of 1982. The intent is to follow the partnership model (Section 205.3.6, above) in a unified corporate proceeding. “Small” S corporations—those having five or fewer shareholders, each of whom is a natural person or an estate—are exempted (Temp. Regs. Sec. 307.6241-1T(c)(2)). Each shareholder must be given notice and an opportunity to participate in administrative or judicial proceedings. They must treat corporate items consistently with their treatment on the S corporation’s return. Rules relating to assessments, limitation periods, and appeals follow the partnership rules (see IRC Secs. 6241, 6242, and 6243).

## 205.4 Examination Preparations

To learn the inside story on IRS audits you should acquire a copy of the IRS's audit technique handbook. It can be ordered from Commerce Clearing House in three volumes entitled Internal Revenue Manual: Audit.

### 205.4.1 Preparing for Office or Field Examinations

The IRS may summon by legal means “the person liable for tax” if the person's presence is requested by the IRS yet he or she declines to appear voluntarily (IRC Sec. 7602(a)(2)). The Taxpayer Bill of Rights states that the taxpayer's representative, armed with a power of attorney (for example, IRS Form 2848), can attend interviews in place of the taxpayer unless the taxpayer is specifically summoned (IRC Sec. 7520).

If an audit is begun without your presence, your client may at any time announce to the examiner that things are getting too complex and he or she must request a new appointment at which you will be present. This right is made explicit in the Taxpayer Bill of Rights.

You should advise your clients of the advantages of your professional presence and representation at office audits and at the beginning of a field audit, deriving from your knowledge of tax law and regulations and your familiarity with the audit process. Some practitioners advise attending office audits without the client. Others prefer to send the client after coaching and assisting with assembling documentation.

**Practice Tip.** Make clear to your clients, at the time a return is prepared (or in the engagement letter), that your presence at an audit is an additional service for an additional fee. Although some practitioners are now setting an all-inclusive fee for preparing a return, including prepaid audit representation, this is not the usual practice.

### 205.4.2 Burden of Proof: Documenting the Taxpayer's Position

The burden of proof during an IRS audit is on the taxpayer; and you, the practitioner, must be prepared to defend your client's tax return. Be overprepared rather than underprepared. You should assume the responsibility of organizing the evidence, such as receipts and canceled checks, relevant to the items in question. Verify all numerical evidence with adding machine tape and check all items questioned by the IRS against documentation provided by the client. Prepare photocopies of important documents to leave with the agent. Keep the originals in the slight chance they might be needed in litigation.

If errors that *immaterially* understate the tax liability are noted at this time, the client should be urged to reveal them to the examiner up front *if* they can be explained as instances of inadvertent omission or inadvertent mistake. Voluntary disclosure by the taxpayer, accompanied by good-faith (even if not full) payment, may have the effect of avoiding prosecution. On the other hand, if you present the IRS with a voluntary admission of *fraud*—that is, *intentional* overstatement of deductions or understatement of income plus the documentation to back it up—the taxpayer is in a precarious position. Voluntary admissions by a taxpayer's agent may be admissible in evidence against the taxpayer.

**Practice Tip.** Tax practitioners disagree about the wisdom of making voluntary disclosures without first consulting legal counsel. The decision is a worrisome one, to be made on the basis of the nature and amount of the error, whether the same error was repeated over several tax years, the likelihood of other problems with this taxpayer's compliance, and other factors. See further discussion in Chapter 303.

If, while preparing for a tax audit, you discover a clear instance of taxpayer dishonesty involving significant amounts you should refer your client to a criminal tax attorney. You, yourself, may wish to consult with a tax attorney in some instances.

The 1998 IRS Restructuring and Reform Act shifts the burden of proof to the IRS in court proceedings as long as the taxpayer has fulfilled certain preconditions, including cooperation with the IRS, producing credible evidence and maintaining records and substantiation (IRC Sec. 7491(a)(2)(A) and (B)). As a consequence, some believe, the IRS will be more intrusive at the



audit level and may demand a level of cooperation that assures them of the facts needed to sustain their increased burden of proof.

### 205.4.3 **Beginning the Examination**

At the start of the examination, you should ask the IRS examiner the nature of the examination. A proper question is, “This is only a civil exam, isn’t it?” The answer may reassure you that the examination is not a criminal tax-fraud investigation, at least at its start. There have been instances in which IRS special agents apparently failed to identify themselves adequately or to give the IRS’s modified form of the Miranda warning before the taxpayer had made damaging admissions. (An experienced tax lawyer will ordinarily be able to suppress this evidence in court. In most cases, however, the special agent will identify himself or herself properly.) Should the examination turn out to be a fraud investigation, or should circumstances cause you to believe the examiner is in the process of deciding to refer the case to the criminal division, you should have the proceedings suspended immediately and refer the client to a lawyer, preferably to one with criminal tax-fraud experience. The presence of two examiners at an office audit should suggest to you that one of them is a special agent from the criminal examination division. Some practitioners routinely ask to see the examiner’s identification at the start of an audit.

#### **Tips for Conduct**

Experienced practitioners agree on these tips for behavior during an examination:

- Contact the IRS agent—if one has been assigned—before the audit to determine his or her perspective on the case.
- Review the facts and the law relevant to the case well in advance of the audit date; know facts and the law better than the IRS agent.
- Organize documentation for presentation to the auditor.
- Determine the client’s attitude toward the audit, and counsel prudent behavior or suggest he or she not be present.
- At the beginning of the audit, establish a courteous and congenial yet businesslike rapport with the agent.
- Allow the agent to select the order in which the disputed items are to be covered; attempting to direct the approach will usually antagonize an agent.
- Answer questions briefly, completely, and substantiate them by evidence.
- Present only evidence asked for by the agent; do not give open access to the taxpayer’s files or records, and do not volunteer information in areas not requested by the agent.

#### **Negotiation and Settlement**

It is almost always advisable to settle a case at the lowest level of inquiry, which is usually the revenue agent. The revenue agent assigned to the case will be the most familiar with the facts and circumstances of the case in question. While revenue agents technically have no authority to make settlements, they do have discretion in some matters, typically those involving factual issues. Negotiation may be entered into regarding items for which the agent proposes an adjustment.

If the issue in question is solely a legal one, the agent will take the IRS’s stated position. Once this stance has been taken, any attempt at a different settlement will usually lead to an impasse. The IRS offers an alternative solution for resolving legal issues. In an effort to assist IRS personnel in settling cases, the national office may provide technical advice memorandums. The advice can be received during the examination or during an appeal. Regardless of the conclusion of the memorandum, the taxpayer may still decide in favor of litigation. The revenue agent will have further information on obtaining a technical advice memorandum, which can be done at the agent’s or the taxpayer’s request.

If you believe that a serious situation has arisen involving an agent’s conduct of the examination, or if you believe the agent has taken a clearly unreasonable position, you may request to speak to his or her supervisor or to the problem resolution office of the district office.

**Practice Tip.** You might consider writing a letter to the client contrasting the cost of the issues originally raised by the IRS examiner with the settlement you have negotiated for the client.

## 205.5 Results of the Examination

### 205.5.1 Consent to Assessment: Form 870

When the IRS revenue agent has completed the examination, you or the taxpayer will have an opportunity to discuss the proposed adjustments, if any. Negotiation, compromise, trade-off, horsetrading: These are all terms for the process that can occur before the agent writes a report. Experienced tax practitioners believe they can do a better job here than the taxpayer can. You should candidly explain this fact to your client. (The IRS agent may act in a more conciliatory fashion when dealing with a fellow professional who may be perceived as a peer seeking a common goal, that of reaching a reasonable, mutually agreeable, and prompt resolution.)

If the taxpayer and the IRS agent reach an agreement as to the taxpayer's liability, the agent will ask the taxpayer to sign a waiver, Form 870. This form sets forth the taxpayer's name, taxable year, amount of tax due (including any penalties incurred) or amount of refund due. A similar consent form, Form 4549, may be presented by the agent at the conclusion of a field audit. Agreements at the district office level are not binding on either the taxpayer or the IRS, but the agent's recommendations will normally be accepted. The taxpayer who subsequently wishes to change position, however, must pay the assessment and file a claim for a refund.

You should advise your clients to sign the waiver if they agree to an assessment based on *obvious errors* they made in the return. It is also best not to dispute a small assessment under the guise of standing up for a principle. Interest charges stop running 30 days after signing the waiver. On the other hand, no taxpayer who feels the assessment is seriously overstated should sign the waiver.

If the taxpayer and the agent cannot agree on all the issues in question, they may still be able to reach a partial agreement and execute a waiver. A taxpayer who can conclude a partial agreement with the agent (1) will be able to compute dollar amounts for at least some previously unresolved issues, (2) will thus be able to calculate the additional tax, and (3) will pay a reduced amount of interest. The taxpayer must decide, however, whether to yield on uncertain issues and save money on interest payments or take a chance that a better agreement can be reached on all issues at the appeals level.

Form 870-AD is a somewhat similar but alternative agreement form that the taxpayer might be asked to sign. Form 870-AD is significantly different from Form 870 in that it specifies in the taxpayer's agreement that "no claim for refund or credit shall be filed or prosecuted for the year(s) [covered by the agreement] other than for amounts attributed to carrybacks provided by law." On the other hand, signing Form 870 will not prevent a taxpayer from paying the tax and then filing a claim for refund for any concessions he or she agreed to but then decided were erroneous.

**Practice Tip.** You should advise your clients that signing a Form 870-AD (but not Form 870) will make it unlikely they will be able to recover on a concession they later decide was unwise.

### 205.5.2 Extending the Statute of Limitations

If negotiations at the examination stage (or later) have lasted to the point at which the statute of limitations may run out, the IRS agent may ask the taxpayer to extend the statute. Form 872 extends the statute for assessment of taxes under examination to a time specified in the form. Form 872-A extends the statute for a period that may end 90 days after Form 872-T is mailed or 150 days after the IRS mails a notice of deficiency. (Form 872-T terminates the consent given on Form 872-A.)

**Practice Tip.** Consider getting a restrictive consent to extend that applies only to certain issues in the return. For example, the IRS may request an extension of a shareholder's

Form 1040 pending completion of the corporation's audit. Suggest that the extension be limited to those items passing to the shareholder from the corporation, such as salary, rent payments, dividends, and so forth.

If the taxpayer refuses to agree to extend the statute, the IRS will normally issue a notice of deficiency requiring payment or filing of a petition to the Tax Court within 90 days. Extending the statute extends the period during which negotiation or compromise can take place. Extension for a shorter period of time than that requested by the IRS can be requested and could be of value to the taxpayer.

**Practice Tip.** You may gain an advantage by refusing to extend the statute. If the IRS agent has been dilatory in beginning the audit, he or she may be rushed into preparing a notice with unsupported details. This will generally work to the client's advantage in later negotiations, because the IRS has less time to deliberate than if it had a carefully drawn and researched notice.

The 1998 IRS Restructuring and Reform Act requires the IRS to notify taxpayers of their right either to refuse to extend the limitations period or to limit the extension to particular issues or periods of time (IRC Sec. 6501(c)(4)).

### 205.5.3 **IRS Review of Agreed Cases**

While most agreed cases are not changed later, their returns are subject to review by the review staff of the district office. This provides the IRS a safety valve to guard against improper agreements by inexperienced agents. Once a district examination case is closed, however, it will not be reopened except in the case of fraud, collusion, concealment, or misrepresentation of a material fact, or if there has been an error in the agreement based on the IRS position at the time of the agreement.

## 205.6 **Assessment and Collection of Tax**

### 205.6.1 **Assessment**

The first step in the collection process is the assessment of the tax owed. Any tax, interest, and penalties the taxpayer owes to the government become an account receivable. Assessment officers sign summary records of assessment for each taxable period. The date the summary assessment is signed is considered the date of the assessment. Taxpayers who wish to receive a copy of their assessments may do so upon request.

### 205.6.2 **What the IRS May Assess**

Once a taxpayer has filed a return, the IRS has the authority to assess the amount of tax shown on the return with adjustments made for any mathematical or clerical errors appearing on the return. The IRS has authority to assess additional tax in the case of a deficiency.

#### **Deficiency**

A deficiency is the portion of an income tax liability (or estate, gift, and other tax liability) that exceeds the tax previously paid for a particular period. If the IRS determines that a deficiency is present, the IRS must mail a notice of deficiency to the taxpayer by either certified or registered mail. Once the notice has been received, the taxpayer has the right to file a petition with the Tax Court asking that it be redetermined. If the taxpayer chooses to do this, the IRS cannot assess the deficiency until the Tax Court issues a ruling on the case. If the taxpayer fails to file such a petition within 90 days of receiving a notice of deficiency (150 days if the notice was addressed to a taxpayer outside the United States), or if the taxpayer waives the right to formal notice of the determination of a deficiency, the IRS may assess the deficiency.

### Exceptions to the Regular Deficiency Notice Procedure

In several situations the IRS can follow a procedure other than the deficiency notice procedure described above:

- *Mathematical and clerical errors.* If the IRS discovers mathematical or clerical errors on a return, it must mail the taxpayer notice of assessment of the additional tax and allow the taxpayer 60 days after receipt of the notice to file a request for abatement of the assessment. During this 60-day period, the IRS can make no efforts to collect the assessment. If the taxpayer chooses to file a request for abatement, the IRS must abate the assessment and make any reassessments using the regular notice of deficiency procedure.
- *Voluntary payments before assessment.* The taxpayer may make a voluntary payment to prevent the accumulation of interest. Once the IRS receives the payment, it may assess the tax for the purpose of balancing its books. If the taxpayer wishes to take the case to the Tax Court, he or she must wait until after the IRS issues a notice of deficiency before submitting the payment because making the payment before the notice is received would eliminate the deficiency and cause the Tax Court to lose its jurisdiction over the case.
- *Appeals of Tax Court decisions.* If a deficiency in tax is found by the Tax Court, the tax will be assessed and collected even if the Tax Court's decision is not yet final. This will not be the case if the taxpayer posts a bond.
- *Bankruptcies and receiverships.* In the case of bankruptcies and receiverships, assessments are made immediately. See Exhibit 205-4 on Dischargeability of Taxes in Bankruptcy.
- *Waiver of restrictions.* The taxpayer who chooses to waive the restrictions on assessment may do so by filing Form 870 (Form 4549 if the matter is in the audit division, or Form 870-AD if the matter is at the appeals office). Filing a waiver of restriction allows the IRS to assess the deficiency immediately and terminates interest charges beginning 30 days after the effective date of the waiver.

### Statute of Limitations on Assessment

The general statute of limitations on assessments is three years after the later of the date the return was filed or the date the return was due. Before expiration of the three-year period, the taxpayer may consent to extend the period of assessment (except for estate taxes). Extensions may benefit taxpayers who expect that they can eventually negotiate a favorable settlement with the IRS. If a taxpayer refuses to consent to the extension, the IRS will issue a 90-day letter (notice of deficiency) to protect itself against expiration of the assessment period. Taxpayer consent is indicated on Form 872. There are exceptions, however. The following situations extend the statute of limitations to six years:

- Omission of more than 25 percent of gross income
- Failure to report foreign personal holding company income
- Failure to provide the information requested on Schedule 1120PH by a domestic personal holding company

In addition, deficiencies that result from the deduction of a carryback of a net operating loss can be assessed within the time period applicable to the year in which the net operating loss originated. If a false or fraudulent return has been filed with the intent to evade tax, or if no return is filed, there is no limitation on the period for assessment. Subsequent filing of an amended return showing correct information does not limit the open-ended assessment period if the original return was false.

### 205.6.3 Collection

If the taxpayer fails to take advantage of opportunities to appeal an IRS decision to assess additional tax (see Section 205.7), the IRS will use its powers of levy and distraint (seizure) to collect the tax (IRC Sec. 6331(b)). Within 60 days after the expiration of the period begun with

the mailing of a 90-day deficiency letter, the IRS will issue a notice and demand for payment. Collection cannot be enjoined by the taxpayer if the assessment itself is valid. At this point, the proper procedure for the taxpayer is to pay the tax and file a claim for refund. If the claim is disallowed, the taxpayer can file an action in U.S. district court or in the U.S. Court of Federal Claims.

If the taxpayer fails to pay, the additional tax plus penalties and interest become a lien on property owned by the taxpayer or acquired after the lien is effective. The IRS has ten years to collect. The lien is not valid against certain claims, such as mortgages and other recorded liens, until a notice of tax lien (Form 668) is filed.

A notice of levy (Form 668-A) must be either (1) given to the taxpayer in person, (2) left at the taxpayer's home or usual place of business, or (3) sent to the taxpayer by registered or certified mail. Levies against personal property are valid when notice is given to the *holder* of the property, such as a bank that holds the taxpayer's checking or savings account. Notice to the taxpayer may be made afterward. The effect of a levy is to transfer "constructive possession" of the property to the government; any subsequent attempted assignment of the property by the taxpayer is invalid. A levy covers property owned by the taxpayer at the date of the levy or later acquired. A levy on salary or wages (Form 668-W) continues in effect until the liability is satisfied or the statutory period (ten years under IRC Sec. 6502) expires. Once the property has been levied upon, the taxpayer may redeem it by purchase from the IRS (satisfying the tax deficiency) prior to public sale. Real property may be redeemed by the former owner within 180 days *after* its public sale by payment of the sale price plus 20 percent per annum to the purchaser (IRC Sec. 6337(b)). Certain property is exempt from IRS seizure, including—

- Clothing, food, fuel, and schoolbooks.
- Furniture and personal effects (limit of \$6,250).
- Books and tools used in a trade, business, or profession (limit of \$3,125).
- Unemployment and workers' compensation payments.
- Salary, wages, or other income to the extent ordered by a court to support minor children.
- Payments for disabilities in connection with military service.
- Other items specified in Regs. Sec. 301.6334-1 through 301.6334-7.

In addition, by IRS policy, levies will not be made against qualified pension plan benefits or against Social Security, Medicare, or welfare payments (Internal Revenue Manual 5331.6). State laws exempting certain property from seizure, including "homestead" property, are irrelevant. The Taxpayer Bill of Rights, however, requires approval in writing by an assistant district IRS director prior to levy against a principal residence. The automatic provisions of the Bankruptcy Act suspend IRS-enforced collection procedures. Generally, however, taxes owed for three years prior to the petition are *not* discharged.

### **Transferee (Nominee) Liens and Levies**

The IRS may exercise its power of lien and levy against property that the delinquent taxpayer has transferred to another, the transferee. Tax practitioners are sometimes called upon to advise their clients concerning these transferee liens and levies.

The authority of the IRS over transferees arises under the Service's general collection powers. The theory relied upon by the IRS is that a transfer made by the taxpayer to the transferee is void because it is fraudulent.

A transferee is anyone who receives property of the taxpayer without full, fair, and adequate consideration, to the prejudice of the rights of creditors—in this case, the Treasury. IRC Sec. 6901 extends the term to include a donee, heir, legatee, devisee, and distributee. An example of a distributee is a shareholder of a dissolved corporation. Donees include friends and relatives who receive large gifts from taxpayers unable or unwilling to pay their taxes. According to the Internal Revenue Manual (IRM 57(16)0), fraudulent conveyances from a taxpayer to a transferee are suggested by "badges" or indicators of fraud such as these:

- Inadequacy of consideration for transfers between the taxpayer and close relatives or a closely held corporation

- Insolvency or heavy indebtedness of the taxpayer at the time of the transfer
- Close relationships between taxpayer and transferee
- Transfers made while an IRS investigation is pending
- Transactions not in the usual course of business, such as sales made outside of usual business hours or failure to record the receipt of notes or accounts receivable.

#### 205.6.4 Compromise

One additional recourse may be available after the 90-day period has expired, but before payment. It may be to the taxpayer's advantage to attempt a compromise with the IRS. In exchange for a speedy and relatively certain settlement, the IRS may be willing to accept less than the full amount of liability. Acceptance of an offer in compromise (Form 656) is discretionary with the IRS.

A compromise must have as its basis doubt about either liability or collectibility. A compromise offer based on doubt about liability will be rejected by the IRS if the liability has been determined by the Tax Court or by the IRS appeals office. No compromise will be accepted unless the taxpayer agrees to extend the period of limitation on collection for the time the offer is under consideration, plus one year (Regs. Sec. 301.7122-1(f)). An offer to compromise based on collectibility must be accompanied by a statement on Form 433 of the taxpayer's assets, liabilities, income, and living expenses, since the taxpayer's argument is that he or she will be unable to pay the amount of tax that was assessed.

**Practice Tip.** When the client first seeks your professional help with collection following expiration of both the 30-day period for administrative appeal and the 90-day period for filing in Tax Court, you can still help. The offer in compromise generally suspends collection efforts while it is under consideration. If the IRS assessment is based on gross receipts without considering expenses, you can work up corrected calculations of liability and base the offer on doubt as to liability thereby getting around the fact that all periods for challenging the assessment have expired.

According to the Internal Revenue Manual IRM 57(10)(0), current policy is to accept an offer-in-compromise when both of the following conditions exist:

1. It is unlikely that the full amount of the tax liability can be collected.
2. The amount offered by the taxpayer reasonably reflects collection potential.

During the period that an offer-in-compromise is pending with the IRS, no levy may be made against the taxpayer's property. The 10-year statute on collection is similarly suspended (IRC Sec. 6331(b)(1) and (3)).

Reasonable collection potential is based on a quick-sale valuation of the assets available to the taxpayer and on the taxpayer's future income. The IRS will accept not less than 20 percent of the equity in property held by the taxpayer and spouse where the assessment is made against only one spouse.

The IRS will now accept the present value of the taxpayer's future earned and unearned income. This payment of discounted value is an alternative to making future installment payments. Tables of present value are provided in the Internal Revenue Manual.

Collateral agreements are to be secured only when a significant recovery is expected. The taxpayer may increase the amount of the offer by the amount the IRS could expect to recover under a future income collateral agreement. Taxpayers must agree that—

1. Their taxes will not be abated or tax liens released until they pay the full amount that is offered.
2. They waive all tax refunds and credits arising before or during the year in which the offer is accepted.
3. Interest begins to accrue from the date the offer is accepted to the date the offer is paid.
4. They must comply with all subsequent tax return filings and payments for a five-year period.

Previously, by IRS policy, a debtor who had filed for bankruptcy protection was denied use of the compromise procedure. Two Tax Court cases in 1999 make it clear the Service must consider a bankrupt's offer of compromise. Acceptance of the offer by the IRS is discretionary. *Mills and Mills v. U.S.* 84AFTR2d Par. 99-5069 and *Chapman and Chapman v. U.S.* 84AFTR2d Par. 99-5068.

### 205.6.5 Installment Payment of Tax Liability (IRC Sec. 6159)

The IRS is required by the 1998 IRS Restructuring and Reform Act to enter into a written agreement with any taxpayer, thereby allowing satisfaction of a tax liability by means of installment plan payments if such a plan facilitates the collection of the liability and if three conditions are fulfilled: The taxpayer, within the previous five years—

- Must not have failed to file a tax return.
- Must not have failed to pay any income tax.
- Must not have entered into an installment agreement (IRC Sec. 6159(c) and (d)).

The IRS Divisions of Appeals, Employee Plans and Exempt Organizations, Examination, Problem Resolution, Returns Processing (in service centers), and Taxpayer Service are all authorized to make installment agreements up to \$10,000. Their authority extends over individual accounts, corporate accounts involving Form 1120, and out-of-business sole proprietor accounts. Larger amounts are addressed by the Collection Division.

It is not necessary for a taxpayer to be assessed a deficiency in order to open the possibility of installment payment. On IRS Form 9465, Installment Agreement Request (Exhibit 205-5), the taxpayer proposes a monthly payment at any time he or she is unable to satisfy the tax liability. The IRS will respond within thirty days, approving or denying the request or asking for more information.

**Practice Tip.** Be sure to remind clients that in all agreements, interest and penalties continue to accrue until the liability is satisfied. It is well to be aware that financial sources other than the U.S. Treasury may provide lower rates of interest.

Generally, an agreement entered into will remain in effect for the full term of the agreement. On thirty-days notice, however, the government may alter or terminate the agreement if it finds any of the following:

- The taxpayer provided information, before the date of the agreement, which was inaccurate or incomplete.
- The collection of the tax is in jeopardy.
- The financial condition of the taxpayer has significantly changed.

**Practice Tip.** Taxpayers should propose an installment agreement rather than become delinquent on a payment. Installment agreements are more likely to be acceptable to the IRS if the taxpayer's record is *clean*, meaning that the taxpayer has met previous filing and payment deadlines.

Individual taxpayers who owe \$10,000 or more in unpaid taxes now face budgeting procedures mandated by the IRS. If no readily available assets can be liquidated to pay the delinquency, minimum acceptable installment payments are calculated. The rules impose expense limits for housing, transportation, food, housekeeping supplies, clothing, and personal care products. The expense limits are based on regional or national standards compiled by the IRS and reported in IRM Sec. 5323.

### 205.6.6 Levy and Distraint

The period from the date the IRS provides written notice prior to collection to a taxpayer to collect tax via levy is 30 days. The notice and waiting period requirements do not apply if the IRS feels that the collection is in jeopardy.

The written notice indicating intent to levy must include a brief statement in simple and nontechnical terms that includes

- The provisions of law relating to levy and sale of property.
- The procedures applicable under law to the levy and sale of property.
- The administrative appeals available to the taxpayer with respect to the levy and sale and the procedures relating to an appeal.
- The alternatives available to the taxpayer to prevent the levy on the property, including the possibility of an installment agreement under IRC Sec. 6159.
- The provisions of law relating to the redemption of property and the release of liens on property.
- The procedures under law applicable to the redemption of property and the release of a lien on property.

A levy on a taxpayer's salary or wages continues from the date the levy is first made until the levy is released under IRC Sec. 6343.

The following public assistance payments are exempt from levy:

- Payments under Title IV (aid to families with dependent children) or Title XVI (supplemental security income for the aged, blind, and disabled) of the Social Security Act
- State or local government public assistance or public welfare programs that determine eligibility by a needs or income test
- Amounts payable to a participant under the Job Training Partnership Act

A bank, as defined in IRC Sec. 408(n), is required to hold accounts garnished by the IRS for 21 days after receiving the IRS notice of levy. This provides taxpayers an opportunity to notify the IRS of errors concerning the garnished accounts.

- Any interest accruing on the garnished accounts during the 21-day period is to be surrendered to the IRS if the funds are in fact transmitted.
- A levy on any account may be released before the end of the 21-day period with the permission of the IRS.

The wages exempt from levy for each week are equal to the sum of the taxpayer's standard deduction and the amount of personal exemption deductions allowable for the year in which the levy occurs, divided by 52. If the taxpayer does not supply the IRS with sufficient information to determine the taxpayer's proper standard deduction or number of exemptions, the wages exempt from levy are the standard deduction for a married individual filing separately plus one personal exemption, divided by 52.

A levy cannot be placed on the principal residence (within the meaning of IRC Sec. 1034) of a taxpayer, unless—

- A district director or assistant district director of the IRS personally approves *in writing* the levy of the property, or
- The Treasury finds that the collection of tax is in jeopardy.

The IRS is not allowed to levy on any property if the Treasury's estimated expenses concerning the levy and property sale exceed the fair market value of the property at the time of the levy. The IRS is restricted from placing a levy on a taxpayer's property on any day on which the taxpayer (or an officer or employee of the taxpayer) is required to appear in response to an IRS summons for the purpose of collecting underpaid tax. An exception exists if the IRS feels the collection of tax is in jeopardy.

There is a \$6,250 exemption from levy for fuel, provisions, furniture, and personal household effects, and a \$3,125 exemption from levy for books, tools, machinery, or equipment necessary for the trade, business, or profession of the taxpayer.

Rather than exempting tangible personal property that is essential to the taxpayer's trade or business from levy, the IRS provides an accelerated appeals process when this property is levied upon, to determine whether the levy should be released due to any of the applicable statutory grounds. Examples of such statutory grounds include—



- IRS determination that releasing a levy would facilitate the collection of tax.
- IRS determination that the levy is creating an economic hardship due to the financial condition of the taxpayer.
- IRS determination that the fair market value of the property exceeds the liability, and that releasing the levy on part of the property would not hinder tax collection.

The IRS has been directed to prescribe regulations whereby a levy on all or part of property can be released and prompt notification can be given the taxpayer that the levy was released if—

- The liability for which the levy was made is satisfied or becomes unenforceable due to lapse of time.
- The IRS determines that release will facilitate the collection of a liability.
- An installment payment agreement has been executed with respect to the liability. (The levy is not required to be released, however, if release would jeopardize the Treasury's secured creditor status.)
- The IRS determines that the levy is creating an economic hardship due to the taxpayer's financial condition.
- The fair market value of the property exceeds the liability and partial release would not hinder collection of the tax and related costs owed to the IRS.

The release of a levy does not prevent the IRS from subsequently levying on the same property. The owner of property seized by levy may request that it be sold within 60 days after the taxpayer's request, or within a longer period specified by the taxpayer. The IRS must comply with the request unless it determines that compliance would not be in the best interest of the United States, and so notifies the owner of the property within the 60-day period.

## 205.6.7 Review of Jeopardy Procedures

The rules relating to the review of jeopardy assessments are extended to the review of jeopardy levies. (Jeopardy levies and assessments are resorted to if the IRS believes the taxpayer is about to leave the country or place assets beyond the reach of the U.S. Government.) Upon a request for review, the Treasury must redetermine whether or not the creation of the assessment under IRC Sec. 6851, 6861, or 6862 is reasonable under the circumstances, and the amount assessed and demanded as a result of the action taken under these sections is appropriate under the circumstances. Alternatively, the Treasury can determine whether or not the levy is reasonable under the circumstances.

Taxpayers are allowed to bring a civil action against the United States for a redetermination within 90 days after the earlier of the day the Treasury notifies the taxpayer of the determination, or the sixteenth day after the request described in IRC Sec. 7429(a)(2) related to review of jeopardy assessments.

U.S. district courts have exclusive jurisdiction over any civil action for a redetermination, with the following exception. The Tax Court also has jurisdiction over any civil action for a determination of all taxes and taxable periods included in the written statement. This is true if a petition for a redetermination of a deficiency under IRC Sec. 6213(a) was timely filed with the Tax Court before an assessment or levy occurred subject to the review procedures, and if one or more of the issues before the Tax Court is also included in the written statement provided to the taxpayer.

If a taxpayer brings a civil action against the United States for a determination in the court with jurisdiction, the court must determine within 20 days after a proceeding is commenced whether or not the assessment under IRC Sec. 6851, 6861, or 6862 is reasonable under the circumstances, and the amount assessed or demanded as a result of these sections is appropriate in the circumstances. The court has the same time frame to determine whether or not the levy is reasonable under the circumstances.

If within five days after the proceeding began, the court determines that proper service was not made on the United States or on the Treasury, the 20-day period does not begin before proper service is made.

Courts can order the Treasury to release a levy, to abate an assessment, to redetermine the amount assessed or demanded in tax, either in whole or in part, or to take other appropriate action if the court determines that the levy is unreasonable, that the assessment is unreasonable, or that the amount assessed or demanded is inappropriate.

If a civil action is filed with the Tax Court, and if the court finds a jurisdictional issue under the jurisdiction provisions of IRC Sec. 1402(b)(2), then the Tax Court can transfer the case to the district court in which it could have been brought when filed, if the Tax Court determines this is in the best interest of justice. Any such transfer proceeds as if the action had been filed in the district court on the date on which it was actually filed in the Tax Court (IRC Sec. 7429).

### 205.6.8 Damages for Failure to Release Lien

Taxpayers can sue the federal government in federal district court if any IRS employee knowingly or negligently fails to release a lien on the taxpayer's property, as required under IRC Sec. 6325. Recovery for the taxpayer is limited to actual, direct economic damages sustained that, except for the actions of the IRS, would not have been sustained, along with the costs of the action. The taxpayer will not be awarded a judgment for damages unless the court determines that the administrative remedies available within the IRS were pursued. The damages awarded to the taxpayer are reduced by the amount of damages that could have reasonably been mitigated by the taxpayer.

A taxpayer action to enforce liability and recover damages must be brought within two years after the date the right of action accrues, and may be brought without regard to the amount in controversy (IRC Sec. 7432).

The IRS has been directed to issue regulations prescribing reasonable procedures for a taxpayer to notify the IRS of the failure to release a lien. The specific authority granted to the IRS to administratively settle claims due to failure to release a lien is removed. Treasury Decision 8393 explains how to bring an action in district court when the IRS negligently fails to release a tax lien.

Third-party owners of property against which a tax lien has been filed may obtain a certificate of discharge of the lien by a deposit of money or the posting of a bond.

### 205.6.9 Damages for Unauthorized Actions by the IRS

A taxpayer may bring a civil action for damages against the United States in a district court if any IRS officer or employee recklessly or intentionally disregards any provision of the law in connection with the collection of that taxpayer's federal tax. The provision is limited to reckless or intentional disregard in connection with the *collection* of tax, not alleged reckless or intentional disregard in connection with the *determination* of tax. The provision is also limited to reckless or intentional disregard of the Internal Revenue Code and the regulations thereunder. No action may be brought under the provision based on an alleged violation of a federal law other than the code or the regulations (IRC Sec. 7434).

If the United States is found to be liable in an action brought by a taxpayer, the United States shall be liable to the taxpayer for the lesser of \$1,000,000 or the sum of the actual direct economic damages sustained by the taxpayer as a proximate result of the reckless or intentional actions of the IRS, and the cost of the action. Damages will not be awarded to a taxpayer unless the court determines that the taxpayer exhausted the administrative remedies available within the IRS. The amount of damages awarded to the taxpayer are reduced by the amount of damages that could have reasonably been mitigated by the taxpayer.

Action by the taxpayer must be brought within two years after the date the right of action accrues, without regard to the amount in controversy.

If it appears to the court that the taxpayer proceedings under this charge are frivolous or groundless, the court may award the government damages not to exceed \$10,000, which must be paid upon notice and demand from the Treasury. This provision extends the damages for frivolous or groundless claims currently described at IRC Sec. 6673.

Except as provided by new IRC Sec. 7432, this provision is the exclusive remedy for recovery damages resulting from reckless or intentional disregard of the Internal Revenue Code

and its regulations by an IRS employee engaged in the collection of federal tax. Treasury Decision 8392 explains procedures for bringing a district court action when you believe an IRS official is disregarding an Internal Revenue Code or Treasury Regulations provision.

The 1998 IRS Restructuring and Reform Act provides for recovery of damages from certain negligent acts by officers and employees of the IRS (IRS Sec. 7431(c) and 7433(a) and (b)).

## 205.6.10 Bankruptcy

Filing a petition in bankruptcy stays IRS assessment and collection procedures, giving the taxpayer–debtor some relief from IRS action (11 USC 362(a)). For this reason, it is not wise to discuss the bankruptcy option with a revenue officer or other IRS agent who might then act in haste to levy against the taxpayer’s property.

Thirty days after the IRS receives notice of the appointment of a receiver, the stay on assessment is removed. Although an immediate assessment can then be made, the debtor’s assets generally are under the control of the Bankruptcy Court and cannot be levied upon by the IRS (IRC Sec. 6871(a)). If the debtor is reorganizing, prior seizure of assets by the IRS can be set aside by the Bankruptcy Court (*U.S. v. Whiting Pools, Inc.*, 462 US 198, (83-1 USTC 9394)).

The IRS normally will file a proof of claim against the bankrupt’s assets. The court will consider the claim as it does other creditors’ claims. The 90-day period during which a taxpayer can petition the Tax Court for a redetermination of a deficiency is suspended during bankruptcy proceedings and for 60 days thereafter, unless the stay is lifted by the court (11 USC 362(a)(8)).

A discharge in bankruptcy relieves the debtor of liability for most taxes. In some instances, the Bankruptcy Court may have the power to determine the debtor’s personal liability for otherwise nondischargeable taxes. Nondischargeable debts ordinarily include—

- Debts due within the last two years but for which a late return or no return was filed.
- Debts for which the debtor filed a fraudulent return or otherwise tried to evade or defeat his or her tax liability.
- Debts for which federal law has given priority status, such as trust fund taxes (11 USC 523(a)(1)).

Exhibit 205-4 presents a flowchart that can be used to determine the dischargeability of tax liability in a bankruptcy proceeding. An excellent, practical treatment of bankruptcy can be found in the chapter on Bankruptcy/Insolvency of the *Accountant’s Business Manual* published by the American Institute of Certified Public Accountants.

## 205.7 The Appeals Process

A taxpayer who disagrees with a decision rendered by the revenue agent has the right to appeal it. The appeals process begins when the taxpayer refuses to sign an agreement form (Form 870 or Form 870A) that has been offered by the revenue agent. (See Section 205.5.1.) Once the taxpayer refuses to sign, the agent will prepare a report that will be reviewed by a supervisor for obvious errors and sent to the technical branch of the district office examination division. At the technical branch, a member of the review staff will further examine the report for errors. Once examination is complete, the reviewer has two options:

1. *If errors are found.* If the reviewer feels that the revenue agent has made an error when assessing the tax against the taxpayer, he or she prepares a report stating conclusions and mails this report to the revenue agent.
2. *If no errors are found.* If the reviewer agrees with the decisions made by the revenue agent, the taxpayer is sent a “30-day letter.”

In most cases, the findings of the revenue agent are not upset by the reviewer.

## 205.7.1 The 30-Day Letter

The 30-day letter is a notice to the taxpayer of proposed changes in his or her tax liability. In addition, it invites the taxpayer to a hearing before the appeals office. Practitioners who are of record as the taxpayer's representative will receive the letter instead of the taxpayer. For this to be done, a power of attorney or authorization (Form 2848) must be on file.

As the name implies, the taxpayer has 30 days to respond to a 30-day letter. The IRS is required to inform a taxpayer about its examination and collection procedures. If the audit was either a correspondence audit or was handled by an IRS office auditor, or if the proposed additional tax is less than \$2,500 for any given year, the taxpayer can request a hearing in the appeals office. In all other cases, the taxpayer has the option—

- To file a protest (a procedure described in IRS Publication 5, included with the 30-day letter) to permit a hearing in the appeals office.
- To agree to the changes by signing a Form 870, included with the 30-day letter.
- To request that a notice of deficiency (90-day letter) be issued immediately.
- To allow the 30-day period to expire, at which time the IRS will issue a notice of deficiency—a 90-day letter—to the taxpayer; at this point, the right to have the case considered by the appeals office is lost.

### Request for Appeal: Protest

Upon receipt of a 30-day letter that proposes a deficiency, the taxpayer may request a conference with the appeals office. An oral request is sufficient if the deficiency resulted either from a field examination and the proposed deficiency is \$2,500 or less, or from an office or correspondence examination. If the deficiency resulted from a field examination, from which the proposed amount exceeds \$2,500 but not \$10,000, a *simple* written recitation to the appeals office of disputed issues is sufficient to get consideration.

If the deficiency arises from a field examination and is over \$10,000, a formal, written protest must be filed. In addition, a written protest is required in cases involving these matters:

- All employee plan and exempt organization cases
- All partnership and S corporation cases

The dollar limitations are calculated by including proposed additional tax, including penalties, proposed overassessment, or claimed refund (or, in an offer in compromise, the total amount of assessed tax, penalty, and interest sought to be compromised) (CFR 601.106(a)(iii)). A formal protest, when filed, must contain—

- A statement that the taxpayer wishes to appeal the findings of the IRS agent.
- The taxpayer's name, address, and tax identification number.
- Identification of the years or periods involved.
- An itemized schedule of the proposed adjustment with which the taxpayer disagrees.
- A statement of facts that support the taxpayer's position, declared to be true under penalties of perjury.
- A statement of the law or other authority relied upon by the taxpayer.

If you submit the protest, it must state whether you know *personally* that the statement of facts is true and correct. The written protest must be submitted within the period covered by the 30-day letter. An extension of time to file should be requested when the issues are complicated and require additional time for analysis and research. Guidance regarding protests is given in IRS Publication No. 5, *Appeals Rights and Preparation of Protests*.

**Practice Tip.** Appeals officers are not precluded from bringing up issues not previously raised. You should consider—based on your knowledge of the return—the likelihood that new issues might be raised that would damage the taxpayer.

### The Appeals Office

Hearings at the appeals office are informal sessions in which no sworn testimony is taken. In matters where facts are being alleged, however, affidavits may be required; or it may be required

that facts be declared true under the penalties of perjury. You should have a power of attorney from your client if you attend the hearing.

### **The Appeals Officer**

Appeals officers settle legal and factual issues raised by agents. They do not reopen issues that have been agreed upon by the taxpayer, but they may raise new issues if they feel there is a substantial reason for doing so. Appeals officers can request technical advice from the national office if either they or the taxpayer desires. They are obligated to follow technical advice that is favorable to the taxpayer but may still negotiate if the advice is unfavorable to the taxpayer. A taxpayer who reaches an agreement with an appeals officer signs Form 870-AD. If no agreement can be reached, a notice of deficiency is issued and the taxpayer is invited to start proceedings in Tax Court. Even if an agreement is reached, the officer's offer of agreement is not binding on the IRS unless the officer is the associate chief or chief of the appeals branch office.

## **205.7.2 The 90-Day Letter**

The 90-day letter is the notice of deficiency from the IRS if no settlement is reached in the appeals office, or if the taxpayer either does not respond to the 30-day letter or wishes to have his or her case taken to the courts directly. A taxpayer who receives a 90-day letter has 90 days to file a petition with the Tax Court (150 days if it was addressed to a taxpayer outside the United States). Anyone who chooses to appear before the Tax Court does not have to pay the proposed deficiency first. If, however, the taxpayer fails to respond to the 90-day letter within the given time period, the deficiency is assessed and he or she loses the right to have his or her case reviewed by the Tax Court. A taxpayer who chooses to have the case reviewed by the U.S. district court or the U.S. Court of Federal Claims must pay the tax and then file for a refund.

## **205.7.3 Appeals Before the Courts**

### **The U.S. Tax Court**

If a settlement is not reached in the IRS appeals office, or if the taxpayer wishes to go directly to court and chooses not to respond to a 30-day letter, the IRS will issue a 90-day letter (notice of deficiency), or it can be requested by a taxpayer who desires to go to Tax Court as soon as possible. Timing is critical when petitioning the Tax Court. The petition must be received by the court no more than 90 days from the date the deficiency notice was *mailed* to the taxpayer. This is the taxpayer's entry into court, because he or she can go to Tax Court without first paying the alleged deficiency.

If the case is at the appeals office before the 90-day letter is issued, IRS regional counsel has jurisdiction from the time the taxpayer files a petition in Tax Court. If the case is not at the appeals office, regional counsel will refer it there. If the appeals office sees no prospect for settlement, and the deficiency is more than \$10,000, the case will promptly be returned to regional counsel for trial preparation. If the deficiency is \$10,000 or less, the appeals office will retain jurisdiction for at least six months, which may be extended if there appears to be likelihood of settlement. In most cases, it will be to the taxpayer's benefit to achieve settlement as rapidly as possible.

When jurisdiction of a case passes to IRS regional counsel, all relevant facts and legal positions will be pieced together to develop the case for trial. Once the case is developed, regional counsel may attempt to settle with the taxpayer, regardless of prior settlement attempts by the IRS appeals division.

In contrast to other U.S. courts, representation before the U.S. Tax Court is not limited to attorneys. A taxpayer can represent himself or herself, or may be represented by anyone authorized to practice, before the Tax Court. Upon passing an examination on Tax Court procedure, a CPA may be admitted to practice there. (Very few CPAs seek to practice before this court.)

One advantage of having a case heard by the Tax Court is that members of that court hear only tax cases and are therefore well accustomed to the complexities of the Internal

Revenue Code. Cases heard by the Tax Court can be appealed to the U.S. Court of Appeals and can, in some few cases, be heard by the U.S. Supreme Court.

In cases involving disputes of \$50,000 or less for a taxable year, the taxpayer has the option of choosing to use the Small Tax Case Procedure, which uses special trial judges whose decisions are not appealable and cannot be used as a precedent for any other case. Overall, the Small Tax Case Procedure is quicker, less expensive, and less formal; however, there is no appeal.

Recent statistics indicate that the IRS achieves a clear victory in 45 percent to 60 percent of the cases, regardless of the forum (Tax Court, district court, or Court of Federal Claims), although “split decisions” carrying some benefit to the taxpayer are more common in Tax Court. (The booklet *Election of Small Tax Case Procedure and Preparation of Petitions* is available from the Clerk of the Tax Court, 400 Second Street, N.W., Washington, D.C. 20217.) Once filed, a petition to the Tax Court cannot be withdrawn, except with IRS counsel’s agreement.

### **The U.S. District Court and the U.S. Court of Federal Claims**

If a taxpayer has paid the assessed tax and has filed a claim for a refund that has been denied with a notice of disallowance or has not been acted upon within six months from the date it was filed, he or she may have the case heard by a U.S. district court or the U.S. Court of Federal Claims. In almost all district courts and the Claims Court, the government is represented by attorneys from the tax division of the Department of Justice.

District courts provide the opportunity to have the case decided by a jury. In addition, since the district court is a local court, its members are likely to be familiar with local conditions and circumstances that may have a bearing on the case. The U.S. Court of Federal Claims is not local, but the trial may be held in or near the taxpayer’s home locale. Since the judge in a Claims Court case will hear evidence at several locations for the convenience of parties involved, the Claims Court can often ease problems created by witnesses residing in widely scattered locations.

Decisions made by a district court are appealable to the respective court of appeals and the Supreme Court. Decisions made by the Claims Court can be appealed to the U.S. court of appeals for the federal circuit and the Supreme Court.

## **205.8 Obtaining a Refund**

### **205.8.1 Claims Procedures**

A taxpayer who has made an overpayment of taxes to the IRS is eligible for a refund. An overpayment exists when the taxpayer has made tax payments exceeding the correct tax liability on a return. Overpayments caused by overwithholding or overestimation are claimed for refund when the tax return is filed. A previously filed return that overstated and overpaid the amount of tax due must be corrected by a claim for refund. Payments of taxes assessed or collected after the expiration of the statute of limitations on assessment are eligible for a refund.

Taxpayers who discover they have overpaid should file a claim for refund. Filing a properly stated claim before the expiration of the statute of limitations is a protective measure, buying further time to negotiate an issue with the IRS.

A claim must be filed before three years from the time the return was filed or two years from the time the tax was paid, whichever is later. If no return was filed, the claim must be filed within two years of payment. Longer terms are provided in certain situations, such as the seven-year period for bad debts and worthless securities (IRC Sec. 6511).

No lawsuit for a refund may be brought in court unless a claim has been timely filed. In certain instances, IRC Sections 1311 through 1314 can mitigate the effect of these time limitations. For example, a taxpayer may have paid taxes on income returned in Year 1, a year now barred from a refund claim by the statute. The IRS determines that the income should have been reported in Year 2 and assesses a deficiency. IRC Sec. 1314 provides for an adjustment to prevent inequity.

**Practice Tip.** A client that has failed to file a timely refund claim possibly may still be helped. A written communication that is proven to have been sent by the taxpayer to the

IRS before the expiration of the statute may qualify as an informal, but valid, refund claim (*American Radiator & Standard Sanitary Corp. v. U.S.*, 318 F.2d 915 (Ct. Cl. 1963)).

The IRS must not issue a refund or credit of income tax in excess of \$1 million until thirty days from the date a report is made to the Joint Committee on Taxation. Many practitioners believe filing a refund claim can trigger an audit, particularly in the case of large amounts, such as \$500,000.

Refund claims for income taxes normally should be made on Form 1040X (individuals) and 1120X (corporations). The most important part of the claim is a statement of the reason for the refund, accompanied by facts supporting the claim. It is upon these stated grounds and facts that the claim will be accepted or denied by the IRS. Any later court suit that might be necessary to recover the overpayment must be based upon these facts.

## 205.8.2 Quick Refund Procedures

Taxpayers may use the quick refund procedure if they file within 12 months of the close of the tax year from which the refund derives. An individual uses Form 1045, and a corporation uses Form 1139. Filing one of these forms constitutes an application for a tentative carryback adjustment of the tax for the prior taxable year, but only if that year was affected by—

- A net operating loss carryback.
- An investment credit carryback.
- A work-incentive program carryback.
- A capital loss carryback.

Refunds applied for in this manner are referred to as “quick” or “speedy” because the government—within 90 days from the later of either the date the application was filed or the last day of the month the return was due (considering extensions)—must pay the refund or deny the application. Even if the refund is paid, the IRS may later audit the return and disallow the refund.

**Practice Tip.** Remind your client that money received via the speedy refund procedure may have to be repaid if the IRS later audits the return and retroactively denies the claim.

## 205.8.3 Interest on Refunds

For refunds due to overpayments claimed on a tax return, interest is not paid if the refund is made within 45 days of the day the tax was due (without regard to extension of time). If the refund is not paid within that time, interest is paid from when the tax was overpaid to a date 30 days or less preceding the day the refund check is finally issued. If the return is filed after the due date, the 45-day period begins at the filing date.

For refunds due to net operating loss carrybacks, capital loss carrybacks, or business credit carrybacks (IRC Sec. 6511(d)(4)(C)), the 45-day interest-free period begins with the filing of the claim for refund. (If a refund claim based on a carryback is filed but a speedy refund claim is subsequently filed, the 45-day period begins when the speedy refund claim is filed (IRC Sec. 6611).) You should consult a tax newsletter (or tax service) to learn rates currently paid on refunds.

## 205.9 Rulings, Determinations, Technical Advice

### 205.9.1 Private Letter Rulings

A private letter ruling or letter ruling is a written statement from the national office of the IRS specifying the tax treatment to be accorded a transaction or proposed transaction prior to its inclusion in a tax return. To you, a letter ruling is a planning tool, enabling taxpayers to obtain definitive guidance in structuring transactions. This is particularly important if substantial

amounts are involved and the transaction can be structured in different ways, depending on the IRS view. The ruling may also motivate a taxpayer to avoid an as-yet-uncompleted transaction.

Rulings may not be cited as authority for another taxpayer's situation nor, technically, are they binding on the IRS. Only in rare instances, however, do examining agents not follow the ruling, in which case it should be called to their attention. Rulings, with identifying characteristics removed, are available for public scrutiny and appear in tax publications. A ruling has no value, even to the taxpayer who received it, if the facts of the transaction do not agree with those supplied when the ruling was requested.

A conference at the national office might initially be requested to sound out the IRS position, particularly if the transaction is complex or unique, without fully exposing the taxpayer's proposed situation. Taxpayers should go to a conference prepared with a draft of their request; nothing said at the presubmission conference is binding on either party. It is normal procedure to file the request and receive one conference as a matter of right. However, a phone call to the deputy associate chief counsel for technical matters in the national office, before filing, may help discover whether the IRS is likely to issue a ruling on the fact situation the taxpayer will present. No ruling, however, is made orally. The telephone call can also be used to straighten out procedural questions regarding the form of the submission. A telephone conference proceeds on a "time available" basis at the discretion of the deputy counsel.

Each year, the IRS publishes Document 6613, the *Code and Subject Directory*. This document lists, for each code section, the name and telephone number of a person to contact for information in connection with a ruling. Copies of Document 6613 are available from the office of the chief counsel (technical) at the address given below.

If a formal ruling is sought, the request must be in writing and should be accompanied by copies of financial statements, minutes of meetings, and other pertinent documents. These are not returned if the ruling is denied, but become part of the taxpayer's file at the district level. Tax returns reflecting transactions carried out despite a prior unfavorable ruling are likely to be audited. The following is a summary of relevant guidelines as detailed in Rev. Proc. 90-1.

- Submit in duplicate if more than one issue is requested, or if a closing agreement is requested.
- Address your request to
  - Associate Chief Counsel (Technical)
  - Attention CC: Corp: T: Room 6545
  - P.O. Box 7604
  - Ben Franklin Station
  - Washington, DC 20044
- Do not submit alternative plans as backup in case your ruling is denied.
- Include complete facts, names, addresses, and the identification numbers of all interested parties; copies of all pertinent documents should have an attestation that they are the same as the originals.
- Include a balance sheet nearest the date of the transaction.
- Include analyses that tie together the business reasons for the transaction.
- Give appropriate grounds and authority for the ruling.
- State the outcome of any previous request for rulings on similar issues for the taxpayer.
- State whether the same issue is in the taxpayer's return that is (1) under examination or appeal and without a closing agreement, or (2) is in litigation.
- The taxpayer's attorney, CPA, or enrolled representative must sign the request (if the taxpayer does not) and submit it with power of attorney and evidence of enrollment (or other qualification); unenrolled preparers may not sign requests for rulings or determination letters. The taxpayer must sign a statement attesting to the accuracy of the facts submitted in the filing.
- Normally, consider whether to request a conference prior to issuance of a ruling that the IRS has indicated will be unfavorable.
- Although disclosure of unfavorable authority may speed the process, this may weigh against the taxpayer's position unless the position is well argued.



Ordinarily, the taxpayer or you, the representative, is contacted by the IRS national office within 21 days of receipt of the ruling request. A 30-day period is then allowed for submission of missing information. A conference can be requested during this period. The taxpayer may withdraw a request prior to the IRS ruling.

Current procedures for requesting rulings and determination letters are spelled out in a revenue procedure issued during the first quarter of each year, for example, Rev. Proc. 92-1. Each year, also, a revenue procedure (e.g., Rev. Proc. 89-3) lists matters for which no rulings will be issued. The current procedure should be consulted before making a request. Later in the year, if it becomes necessary, additional revenue procedures are issued to explain changes.

**Practice Tip.** IRS policy is in a state of flux regarding “comfort rulings” involving issues the IRS feels are adequately addressed in published authorities. Rev. Proc. 89-34, 1989-20 IRB 145 limited the issuance of comfort rulings. The effective date of this procedure has several times been postponed. IRS Announcement 90-65 stated an *intent* to replace comfort rulings with a variety of measures such as specific no-rule areas, model documents, and automatic-action revenue procedures. Guidelines will be issued by the IRS. No letter ruling should be requested prior to research into current IRS policy and procedure.

According to Rev. Proc. 89-34, any request for a ruling “must contain a statement supporting the taxpayer’s judgment that the issue in the ruling request is not clearly and adequately addressed by statute, regulation, decision of the Supreme Court, tax treaty, revenue ruling, revenue procedure, notice, or other authority published in the Internal Revenue Bulletin.” The national office may issue an “information letter” if it believes that providing general information would be helpful, in lieu of the requested letter ruling.

## 205.9.2 Determination Letters

A determination letter issued by a district director at the taxpayer’s request, is a written response to a set of facts regarding a completed transaction. The determination is made only if it can be based on precedents and policies previously expressed by the national office. Procedures for requesting determinations are the same as for letter rulings, but the request should be directed to the district director. Forms are available for determining the tax qualified status of tax-exempt organizations (Form 1023), or pension, profit-sharing, or retirement plans and the trust or custodial arrangements associated with them (forms in the 5300 series). Rev. Proc. 93-3 updates IRS procedures for issuing determination letters in connection with pension, profit sharing, stock bonus and annuity plans, ESOPs, and certain Section 401(a) trusts and custodial accounts.

## 205.9.3 User’s Fees for Rulings and Determination Letters

Fees are payable in advance upon filing a request for the following changes:

- Accounting period (Form 1128 or 2553). (No fee if an automatic change is allowed in a revenue procedure) and extensions of time for these filings.
- Accounting method (Form 3115). (No fee if an automatic change is allowed in a revenue procedure.)
- All other rulings for individuals, trusts, and estates that reported less than an annually specified amount of total income on their return for the last tax year ending before the date their ruling request is filed, and for organizations exempt under Subchapter F with gross receipts of less than an annually specified amount (includes accounting period, accounting method, and earnings and profits requests other than those submitted on Form 1128, 2553, 3115, or 5452).
- All other rulings (includes accounting period, accounting method, and earnings and profits requests other than those submitted on Form 1128, 2553, 3115, or 5452).

**Practice Tip.** These fees may be changed by the IRS at any time. Always check a current tax service for applicable Revenue Procedures prior to filing a request for a ruling.

## 205.9.4 Technical Advice Memoranda (TAM)

TAMs are written statements by the national office. They provide instruction to a district or appeals office regarding national office view of the treatment of a technical matter on a return under examination. They have other uses; for example, a district director might request technical advice concerning a taxpayer's request for a determination letter. Although the formal request to the national office must come from the district office, a taxpayer may make the request.

You usually encounter these memos when they are requested by an examining agent. Taxpayers may submit their arguments either in writing or orally, before the national office writes its memo. A TAM may be particularly useful for the taxpayer who believes that there is a lack of uniformity in the treatment of an issue, or that the issue is unusual enough to justify national office attention, while at the same time believing the national office will endorse the taxpayer's point of view, even if the examining agent does not.

Some caution is necessary. Once an examiner has received a TAM, he or she is bound to follow its guidance. The legal issue involved may not be negotiated at the examination or at the conference level, although a factual or monetary compromise may still be possible. The taxpayer's only other recourse is to go to court. If the taxpayer requests, but the examiner declines to request, a TAM, the taxpayer, within 10 calendar days, should appeal this decision in writing to the Chief, Examinations Office, or the Chief, Appeals Office. If another denial is received, the taxpayer has another 10 days to request that all data regarding the matter be submitted to the national office. Details may be found in Statement of Procedural Rules 601.105(b)(5).

## 205.9.5 Closing Agreements

IRC Sec. 7121 authorizes the IRS to enter into agreements in writing that "shall be final and conclusive" regarding a person's tax liability. Shareholders desiring to sell a closely held corporation might seek a closing agreement to definitely establish the amount of the corporation's tax liability. An individual might seek a closing agreement to present to other creditors to help prove his or her financial position. Other examples are to fix the tax liability in the following circumstances:

- A personal holding company, to determine the amount of deficiency dividend to be paid to avoid personal holding company tax
- An estate, to release the executor from liability
- A trust or receivership, to determine the amount of a final distribution

According to Statement of Procedural Rules 601.202 (26 CFR 601.202), a taxpayer request for a closing agreement should be submitted to one of these IRS officials:

- The district director with whom the return was filed
- The appeals division, if the matter is under appeal
- The commissioner of internal revenue, if the matter relates only to a subsequent period

Forms 866 and 906 are closing agreement forms. Form 866, Agreement of Final Determination of Tax Liability, closes out the total tax liability of the taxpayer. This form is often used by a fiduciary seeking to close an estate or by a corporation being liquidated.

Form 906 is a closing agreement covering specific issues. It might be used for matters having a continuing relevance to future tax years, such as to settle the basis of property or method of depreciation.

## 205.9.6 Freedom of Information Act

The Freedom of Information Act (5 USC 552) requires the IRS to make available information if it has not already been published in the Federal Register, including—

- Final opinions and other orders made in the adjudication of cases.
- Statements of policy and interpretations adopted by the IRS.
- Administrative staff manuals and instructions to staff that affect a member of the public.

Public reading rooms where these and other materials are available are maintained in the national office and in each regional office. Subject to exceptions set out in Statement of Procedural Rules 601.701(b)(1), a taxpayer may request the IRS to make available its “reasonably described records” concerning the taxpayer. (Exceptions relate primarily to IRS personnel rules and to enforcement tactics, including criteria for selection of returns for audit.) A request for records and files must be made in writing, stating it is made pursuant to the Freedom of Information Act, and sent to the IRS official responsible for the records. Addresses for the responsible district officers, as well as details for making the requests, may be found in Statement of Procedural Rules 601.702. IRS Publication 876 gives information about the nature and possible use of IRS data banks.

## 205.10 Programs for Problem Resolution

Taxpayers who are unsuccessful in resolving problems with the IRS can request that a Taxpayer Assistance Order (TAO) be issued by the Taxpayer Advocate (TA)—formerly the ombudsman of the Problem Resolution Office (PRO). A tax practitioner, duly authorized by a taxpayer, may file on the taxpayer’s behalf. Detailed information about when to contact the *service center* PRO versus the *district* PRO is available from local district offices. Exhibit 205-3 lists district Problem Resolution Offices, their addresses and phone numbers.

The TA must be satisfied that a taxpayer has been unable to get relief through usual IRS channels. If, as determined by the TA, the taxpayer is suffering or is about to suffer a significant hardship as a result of the service’s administration of tax laws, a TAO will be issued. A TAO may require the IRS immediately to take one of these actions:

1. Release the taxpayer’s property that is levied upon.
2. Cease any action, or refrain from taking any action, with respect to the taxpayer under
  - a. Chapter 64 (relative to collections)
  - b. Subchapter B of Chapter 70 (relative to bankruptcy and receiverships)
  - c. Chapter 78 (relative to discovery of liability and enforcement of title)
  - d. Any other provision of law specifically described by the TA in such order.

The TAO suspends the statute of limitations related to the subject of the order (for example, under IRC Sec. 6501, relative to the assessment or collection of tax), and immediately stops an IRS action or proposed action (such as a levy on the taxpayer’s property). The suspension begins on the date of the taxpayer’s application for a TAO and ends on the date of the TA’s decision. In addition, the TA can specify any further suspension period in the TAO.

The IRS has told its employees that it is never wrong to stop collection activities once a TAO has been requested. TAs are expected to refer a case to the IRS district director if other IRS officials ignore a TAO.

A TAO is binding on the IRS unless modified by the TA, a district director, a service center director, a compliance center director, a regional director of appeals, or any superior of these officers.

**Practice Tip.** Try these steps when dealing with the PRO:

1. Phone the district office to learn what the TA believes are the steps you or the taxpayer must take before a TAO will be issued.
2. Tell the officer you are sending the application for a TAO and get his or her name for follow-up.
3. Send the application, then verify with the PRO that it has been received and ask if more information is needed. Give them all the help they request.

Form 911 is used to request the TAO, but the IRS says that a written statement serves as well, if the form is not available. The “significant hardship” described in the statute is defined as

More than an inconvenience to the taxpayer or a financial hardship, as such, but rather as a hardship from which the resultant disruption caused or to be caused to the taxpayer by the Internal Revenue Service’s action or proposed action is such that it would offend the sense of fairness of taxpayers in general were they aware of all the surrounding facts and circumstances.

Significant hardships sometimes occur during IRS action to collect tax. Examples are

- The threat of a poor credit rating caused by erroneous enforcement action.
- The possible loss of employment.
- Pending eviction.
- The refusal of the IRS to rescind an erroneous statutory notice (90-day letter).
- A significant personal emergency, such as counting on a tax refund check to pay for medical treatment.
- Imminent bankruptcy.
- Inability to meet payroll.

The IRS has announced another program of value to practitioners. The Practitioner Priority Case program and a practitioners hotline are designed to give extra IRS attention to taxpayer problems that require special handling but do not fit the criteria for PRO. These programs are administered by an IRS district office. Acknowledgment or final response is promised within 14 days of the date the IRS receives the case. You can get further information about this program and about the practitioner's hotline by contacting your IRS district office.

## **205.11 Taxpayer Bill of Rights 2**

The Taxpayer Bill of Rights 2 (Public Law 104-168 enacted July 30, 1996) gives taxpayers certain rights in dealing with the IRS, provides procedures for taxpayers regarding the IRS, adds levy, lien, and collection provisions and extends the Tax Court's jurisdiction.

### **205.11.1 Taxpayer Rights and IRS Obligations**

The IRS is required to issue regulations enumerating standards for determining whether the selection of a time and place for interviewing a taxpayer is reasonable. Either the taxpayer or the IRS, upon advance notice, may make an audio recording of the interview. If the IRS does, it may provide a transcript or copy to the taxpayer at his or her cost. Further, a taxpayer is entitled to be represented during an interview by anyone authorized to do so. If the taxpayer, during an interview, indicates that he wishes to consult with a representative, the interview must be suspended for a reasonable time to allow him to do so.

The IRS is required to abate any portion of any penalty or addition to tax attributable to erroneous advice furnished to the taxpayer in writing by an IRS officer or employee in response to a specific written request by the taxpayer. However, the portion of the penalty or addition to tax may not be the result of a failure by the taxpayer to provide adequate or accurate information.

Upon application by the taxpayer to the Office of Taxpayer Advocate, the TA may issue a Taxpayer Assistance Order if he determines that the taxpayer is suffering or is about to suffer a significant hardship as a result of how the internal revenue laws are being administered. The order may require the IRS to release levied property or to cease or refrain from action.

The IRS cannot use records of tax enforcement results to evaluate its employees or their supervisors directly involved in collection activities or impose or suggest production quotas or goals for those individuals.

All temporary regulations issued must also be issued as proposed regulations. Further, any temporary regulation will expire within three years after issuance.

Notices demanding payment of tax, notices of deficiencies, notices generated out of information reporting matching programs, or first letters of proposed deficiency must describe the basis for and identify the amounts (if any) of tax due, interest, additional amounts, additions to tax and assessable penalties. An inadequate description of these amounts, however, will not invalidate the notice.

The IRS may enter into a written agreement with a taxpayer allowing payment of taxes on an installment basis if it will facilitate collection. An agreement may be terminated if information provided by the taxpayer before the agreement date was inaccurate or incomplete. Similarly, the IRS may terminate the agreement if collection of the tax is thought to be in

jeopardy. A significant change in the financial condition of a taxpayer party to an agreement can cause modification or termination of the agreement. Further, the agreement may be altered, modified or terminated if the taxpayer fails to make timely payment of any installment or any other tax liability or to provide a financial condition update upon request by the IRS.

The Office of Taxpayer Services, under an assistant commissioner of internal revenue, is responsible for telephone, walk-in, and taxpayer educational services, as well as the design and production of tax and informational forms.

### **205.11.2 Proceedings by Taxpayers**

A taxpayer who substantially prevails with respect to the amount in controversy or the most significant issues in a tax case in any federal court may be awarded reasonable litigation costs if the government's position was not substantially justified. The taxpayer may recover reasonable litigation costs plus reasonable administrative costs. Reasonable litigation costs will not be awarded in any court proceeding unless the court determines the taxpayer has exhausted all reasonable administrative remedies available.

A taxpayer may sue for damages resulting from the IRS's knowing or negligent failure to release a lien on the taxpayer's property if required to do so by the Internal Revenue Code. An action must be brought in federal district court within two years of the date on which the right of action accrued. The taxpayer may recover only the costs of the action, plus the actual, direct economic damages due to the actions of the IRS. The taxpayer must have exhausted all administrative remedies. The award will be reduced for any amount the taxpayer could have reasonably mitigated.

A taxpayer may also sue for reckless or intentional disregard of the Code or regulations in connection with the collection of tax. An action must be commenced in federal district court within two years after the date when the right of action has accrued. The taxpayer may be awarded the cost of the actions plus actual, direct economic damages sustained, but not in excess of \$1,000,000. Also, damages awarded will be reduced by the amount the taxpayer could have reasonably mitigated. The taxpayer must exhaust all administrative remedies and may be held liable for damages if he or she brings a frivolous or groundless action under this provision.

Disclosure or use by a tax return preparer of information furnished for preparation of a return for purposes other than preparation will subject the preparer to a penalty. The penalty is \$250 per disclosure, but the annual total of such penalties may not exceed \$100,000. For this purpose, a tax return preparer includes anyone who is in the tax return preparation business, provides services in connection with tax return preparation, or prepares returns for compensation. This penalty is not imposed if disclosure is pursuant to a Code provision permitting disclosure or pursuant to a court order.

### **205.11.3 Levy and Lien Provisions**

The period from the date that the IRS provides written notice to a taxpayer to the first permissible date of collection of the tax is 30 days. The notice must contain a brief nontechnical statement describing procedures relating to the levy and sale of property. Specific provisions cover levy on salary and wages, exemption from levy, and the sale of levied property.

A taxpayer whose property has been subject to a jeopardy levy must be given a written statement of the information on which the levy is based within five days after the day the levy is made. The Tax Court is provided jurisdiction if the taxpayer has filed a petition with the Tax Court prior to the making of the assessment or levy with respect to any deficiency covered by the jeopardy assessment or jeopardy levy notice. The federal district courts continue to have jurisdiction over all other cases.

The IRS is required to issue regulations that provide taxpayers with an administrative procedure to obtain review of the filing of a notice of a lien in the public record and an opportunity to petition for the release of that lien.

### **205.11.4 Tax Court Jurisdiction**

The Tax Court is granted jurisdiction, concurrent with federal district courts, to restrain the assessment and collection of any tax by the IRS if the deficiency is the subject of a timely filed petition pending before the Tax Court.

If, after a Tax Court decision has become final, the taxpayer has not been refunded an overpayment determined by the Tax Court along with interest due, upon motion by the taxpayer, the Tax Court has jurisdiction to order the refund of the overpayment and interest.

The Tax Court also has jurisdiction during the pendency of proceedings before it to review the IRS's determination to sell seized property under one of the exceptions to the stay of sale.

If a dispute over the IRS's computation of the interest due on a deficiency arises, the taxpayer has one year from the date the Tax Court deficiency decision becomes final to move to reopen the Tax Court decision for a determination of the interest due. The taxpayer, however, must pay the deficiency and interest determined before challenging the IRS's interest computation.

In addition, the Tax Court is given the authority to modify a final decision in an estate tax case solely to reflect the estate's entitlement to a deduction for interest paid during an extended payment period on the estate tax liability. Thus, the Tax Court could enter a final decision in an estate tax case in which an extended payment period is elected and subsequently, if necessary, modify the decision at the end of the period to reflect interest actually paid by the estate.

## 205.12 Correspondence

The first notice a taxpayer receives indicating a balance due is called an adjustment/error notice. There are several different adjustment/error "CP" notices to alert the taxpayer to the existence of an outstanding balance as shown in Figure 205.1.

**Figure 205.1: Time Frames for IRS Notices**

### *Balance-Due Accounts*

#### Individual Tax Accounts: Adjustment/Error Notice

- 5 weeks—1st Notice, CP501
- +5 weeks—2nd Notice, CP502 (see note 1)
- +5 weeks—3rd Notice, CP503 (see note 1)
- +5 weeks—4th Notice, CP504

#### Business Tax Accounts: Adjustment/Error Notice

- 5 weeks—1st Notice, CP503 (see note 1)
- +4 weeks—Final Notice, CP504

### *Return Delinquency*

#### Individual Tax Accounts: 1st Notice, CP515

- 8 weeks—2nd Notice, CP516 (see note 1)
- +6 weeks—3rd Notice, CP517
- +6 weeks—4th Notice, CP518

#### Business Tax Accounts: 1st Notice, CP515

- 10 weeks—2nd Notice, CP517
- +6 weeks—3rd Notice, CP518

Note 1: In February, 1996, the IRS eliminated these notices as part of its program to reduce the volume of correspondence it sends to taxpayers.

# Exhibits

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**Exhibit 205-1: Internal Revenue Service Personnel Summary**

Location and Type	Average Positions Realized		Number of Employees at Close of Year	
	1995*	1996	1995*	1996
<b>Service Total</b>	<b>113,931</b>	<b>107,751</b>	<b>114,064</b>	<b>102,082</b>
Permanent	95,195	92,845	96,787	91,832
Temporary	18,736	14,905	17,276	10,250
<b>National Office</b>	<b>9,566</b>	<b>9,277</b>	<b>9,738</b>	<b>9,290</b>
<b>Field Offices</b>	<b>104,365</b>	<b>98,474</b>	<b>104,326</b>	<b>92,792</b>
<b>Tax Fraud &amp; Financial Investigations</b>	<b>5,188</b>	<b>5,179</b>	<b>5,383</b>	<b>5,060</b>
Special Agents	3,240	3,347	3,363	3,352
<b>Examination</b>	<b>28,723</b>	<b>27,375</b>	<b>29,502</b>	<b>27,433</b>
Revenue Agents	15,669	15,083	16,078	15,153
<b>Collection</b>	<b>18,374</b>	<b>17,458</b>	<b>19,272</b>	<b>17,610</b>
Revenue Officers	8,059	7,561	8,139	7,472
<b>Submission Processing</b>	<b>22,309</b>	<b>21,195</b>	<b>21,403</b>	<b>16,725</b>
<b>Informations Systems</b>	<b>8,016</b>	<b>7,392</b>	<b>8,261</b>	<b>7,652</b>
<b>Taxpayer Services</b>	<b>7,903</b>	<b>7,044</b>	<b>7,657</b>	<b>6,538</b>
<b>Resources Management</b>	<b>6,446</b>	<b>5,997</b>	<b>6,487</b>	<b>5,544</b>
<b>Document Matching</b>	<b>3,323</b>	<b>2,086</b>	<b>2,124</b>	<b>1,546</b>
<b>Counsel</b>	<b>2,951</b>	<b>2,844</b>	<b>3,038</b>	<b>2,795</b>
<b>Appeals</b>	<b>2,348</b>	<b>2,171</b>	<b>2,296</b>	<b>2,151</b>
<b>Employee Plans/Exempt Organizations</b>	<b>2,307</b>	<b>2,197</b>	<b>2,350</b>	<b>2,194</b>
<b>Management Services</b>	<b>1,629</b>	<b>1,789</b>	<b>1,664</b>	<b>1,759</b>
<b>Inspection</b>	<b>1,317</b>	<b>1,305</b>	<b>1,368</b>	<b>1,273</b>
<b>Compliance Research/SOI</b>	<b>881</b>	<b>914</b>	<b>844</b>	<b>835</b>
<b>Customer Service Sites</b>	<b>871</b>	<b>1,577</b>	<b>1,048</b>	<b>1,777</b>
<b>Field Financial Operations</b>	<b>758</b>	<b>679</b>	<b>782</b>	<b>649</b>
<b>International</b>	<b>587</b>	<b>548</b>	<b>585</b>	<b>541</b>



**Exhibit 205-2: Returns Filed and Examination Coverage (1996)**

September 30, 1995–September 27, 1996

	Returns Examined						
	Returns Filed CY 1995 (1)	Revenue Agent		Tax Auditor (4)	Service Center (5)	Total (6)	Percent Coverage (7)
		Non CEP (2)	CEP (3)				
<b>Grand Total</b>	<b>155,279,600</b>	<b>420,851</b>	<b>7,282</b>	<b>520,292</b>	<b>1,188,394</b>	<b>2,136,819</b>	<b>1.38</b>
<b>Income, Estate &amp; Gift, Total**</b>	<b>125,811,900</b>	<b>346,007</b>	<b>3,710</b>	<b>509,420</b>	<b>1,188,177</b>	<b>2,047,314</b>	<b>1.63</b>
<b>Individual, Total**</b>	<b>116,059,700</b>	<b>252,185</b>	<b>245</b>	<b>509,420</b>	<b>1,179,696</b>	<b>1,941,546</b>	<b>1.67</b>
1040A, TPI < \$25,000	45,984,600	42,917	2	145,426	733,475	921,820	2.00
Non 1040A, TPI < \$25,000	13,227,100	18,304	2	60,690	76,129	155,125	1.17
TPI \$25,000 < \$50,000	27,263,900	26,507	11	110,824	122,452	259,794	.95
TPI \$50,000 < \$100,000	17,019,200	22,973	9	77,171	96,429	196,582	1.16
TPI \$100,000 and over	4,540,800	39,746	154	36,909	52,511	129,320	2.85
Sch C-TGR < \$25,000	2,436,300	23,928	—	32,445	46,185	102,558	4.21
Sch C-TGR \$25,000 < \$100,000	3,082,000	29,366	2	30,629	27,694	87,691	2.85
Sch C-TGR \$100,000 and over	1,738,300	43,469	61	11,180	16,340	71,050	4.09
Sch F-TGR < \$100,000	500,800	1,641	—	2,583	3,720	7,944	1.59
Sch F-TGR \$100,000 and over	267,600	3,334	4	1,563	4,761	9,662	3.61
<b>Corporation, Total**</b>	<b>2,553,300</b>	<b>55,201</b>	<b>2,808</b>	<b>—</b>	<b>1,823</b>	<b>59,832</b>	<b>2.34</b>
No Balance Sheet	289,500	2,819	118	—	338	3,275	1.13
Under \$250,000	1,567,400	15,557	5	—	667	16,229	1.04
\$250,000 < \$1 Mil	423,300	11,430	18	—	227	11,675	2.76
\$1 Mil < \$5 Mil	176,400	11,496	33	—	184	11,713	6.64
\$5 Mil < \$10 Mil	26,100	3,578	37	—	61	3,676	14.08
\$10 Mil < \$50 Mil	29,300	5,540	169	—	117	5,826	19.88
\$50 Mil < \$100 Mil	7,600	1,479	96	—	43	1,618	21.29
\$100 Mil < \$250 Mil	6,800	1,574	260	—	41	1,875	27.57
\$250 Mil and over	7,200	1,440	2,028	—	104	3,572	49.61
Form 1120F	19,700	288	44	—	41	373	1.89
<b>Fiduciary**</b>	<b>3,190,900</b>	<b>1,290</b>	<b>274</b>	<b>—</b>	<b>3,137</b>	<b>4,701</b>	<b>.15</b>
<b>Estate Total**</b>	<b>81,500</b>	<b>11,498</b>	<b>4</b>	<b>—</b>	<b>292</b>	<b>11,794</b>	<b>14.47</b>
Gross Estate < \$1 Mil	47,300	3,547	—	—	168	3,715	7.85
Gross Estate \$1 Mil < \$5 Mil	31,500	6,643	3	—	101	6,747	21.42
Gross Estate \$5 Mil and over	2,700	1,308	1	—	23	1,332	49.33
<b>Gift**</b>	<b>216,200</b>	<b>1,929</b>	<b>1</b>	<b>—</b>	<b>4</b>	<b>1,934</b>	<b>.89</b>
<b>Employment</b>	<b>28,679,100</b>	<b>44,656</b>	<b>1,942</b>	<b>3,287</b>	<b>201</b>	<b>50,086</b>	<b>.17</b>
<b>Employment ROE ***</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>6,109</b>	<b>—</b>	<b>6,109</b>	<b>—</b>
<b>Excise</b>	<b>788,600</b>	<b>29,955</b>	<b>1,468</b>	<b>1,476</b>	<b>1</b>	<b>32,900</b>	<b>4.17</b>
<b>Miscellaneous Taxable</b>	<b>—</b>	<b>233</b>	<b>162</b>	<b>—</b>	<b>15</b>	<b>410</b>	<b>—</b>
<b>Partnerships**</b>	<b>1,549,300</b>	<b>4,944</b>	<b>316</b>	<b>—</b>	<b>2,376</b>	<b>7,636</b>	<b>.49</b>
<b>S-Corporations**</b>	<b>2,161,000</b>	<b>18,918</b>	<b>42</b>	<b>—</b>	<b>849</b>	<b>19,809</b>	<b>.92</b>
<b>Miscellaneous Nontaxable**</b>	<b>—</b>	<b>42</b>	<b>20</b>	<b>—</b>	<b>—</b>	<b>62</b>	<b>—</b>

No Change Percent			Recommended Additional Tax and Penalties (in thousands of dollars)					Average Tax and Penalty Per Return			
Revenue Agent (8)	Tax Auditor (9)	Service Center (10)	Revenue Agent		Tax Auditor (13)	Service Center (14)	Total (15)	Revenue Agent		Tax Auditor (18)	Service Center (19)
			Non CEP (11)	CEP (12)				Non CEP (16)	CEP (17)		
			9,207,258	15,182,130	1,607,737	2,059,500	28,056,625				
13	14	36	8,445,099	14,834,098	1,554,142	2,059,165	26,892,504	24,407	3,998,409	3,051	1,733
8	14	35	3,827,395	196,876	1,554,142	2,021,778	7,600,191	15,177	803,576	3,051	1,714
3	10	26	632,684	—	438,706	1,347,060	2,418,450	14,742	—	3,017	1,837
8	12	38	130,896	3	116,046	124,357	371,302	7,151	1,400	1,912	1,634
9	14	54	190,756	278	223,468	94,118	508,620	7,196	25,242	2,016	769
9	17	73	221,758	62	180,886	54,251	456,957	9,653	6,851	2,344	563
10	30	52	1,241,673	81,712	189,126	200,886	1,713,396	31,240	530,594	5,124	3,826
5	10	35	181,359	—	124,744	103,539	409,642	7,579	—	3,845	2,242
7	12	44	287,403	—	155,022	36,666	479,092	9,787	—	5,061	1,324
13	18	47	866,511	112,673	117,485	51,953	1,148,622	19,934	1,847,096	10,509	3,180
14	26	32	9,930	—	4,360	2,511	16,801	6,051	—	1,688	675
15	16	24	64,425	2,150	4,298	6,436	77,309	19,324	537,393	2,750	1,352
24	—	47	3,412,650	14,520,074	—	26,127	17,958,850	61,822	5,170,966	—	14,332
22	—	28	80,315	296,100	—	2,057	378,471	28,490	2,509,320	—	6,084
28	—	53	141,028	218	—	11,822	153,067	9,065	43,502	—	17,724
27	—	45	187,846	147	—	1,180	189,172	16,434	8,139	—	5,197
25	—	54	299,748	17,047	—	1,056	317,851	26,074	516,565	—	5,741
25	—	59	193,258	7,274	—	619	201,152	54,013	196,607	—	10,150
21	—	58	493,027	30,837	—	4,679	528,542	88,994	182,465	—	39,993
15	—	30	531,020	42,915	—	937	574,872	359,040	447,029	—	21,795
11	—	59	458,627	600,835	—	1,072	1,060,534	291,376	2,310,903	—	26,150
4	—	54	938,271	13,455,579	—	2,647	14,396,497	651,577	6,634,901	—	25,451
18	—	51	89,511	69,124	—	58	158,692	310,803	1,570,990	—	1,406
21	—	77	21,958	1,306	—	1,455	24,718	17,021	4,765	—	464
9	—	5	948,259	—	—	9,806	958,064	82,472	—	—	33,582
11	—	5	88,617	—	—	8,170	96,786	24,984	—	—	48,630
9	—	6	371,736	—	—	1,629	373,365	55,959	—	—	16,125
8	—	—	487,906	—	—	7	487,913	373,017	—	—	324
21	—	—	234,837	115,843	—	—	350,680	121,741	115,842,999	—	—
7	6	47	436,689	242,755	13,628	53	693,125	9,779	125,002	4,146	265
—	11	—	—	—	38,866	—	38,866	—	—	6,362	—
11	2	—	256,225	81,058	1,101	43	338,428	8,554	55,217	746	43,416
15	—	47	69,246	24,219	—	238	93,703	297,192	149,498	—	15,879
31	—	43									
30	—	47									
13	—	—									

**Exhibit 205-3: PRO Program**

# District Problem Resolution Offices

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Correspondence and facsimile transmissions should be addressed to:

Problem Resolution Office  
Internal Revenue Service

with the appropriate address from the following list.

**ALABAMA**

801 Tom Martin Drive  
RM-150-PR  
Birmingham, AL 35211  
(205) 912-5107  
FAX: (205) 912-5632

**ALASKA**

949 East 36th Ave.  
Stop A-405  
Anchorage, AK 99508  
(907) 271-6877  
FAX: (907) 271-6824

**ARIZONA**

210 E. Earll Dr.  
(Stop 1005 PX)  
Phoenix, AZ 85012-2623  
(602) 207-8240  
FAX: (602) 207-8250

**ARKANSAS**

700 West Capital St.  
(Stop 1005 LIT)  
Little Rock, AR 72201  
(501) 324-6269  
FAX: (501) 324-5183

**CALIFORNIA**

**Laguna Niguel District**  
P. O. Box 30207  
Laguna Niguel, CA  
92607-0207  
or  
24000 Avila Rd., Room  
3362  
Laguna Niguel, CA 92677-  
3491  
(949) 360-2175  
FAX: (949) 360-2463

**Los Angeles District**

300 N. Los Angeles St.  
Stop 1005 LA, Room 5206  
Los Angeles, CA 90012  
(213) 894-6954  
FAX: (213) 894-6365

**Sacramento District**

4330 Watt Ave.  
North Highlands, CA 95660  
(916) 974-5007  
FAX: (916) 974-5902

**San Francisco District**

1301 Clay St.  
Suite 15405  
Oakland, CA 94612-5210  
(510) 637-2703  
FAX: (510) 632-2715

**San Jose District**

P. O. Box 100  
(Stop HQ0004)  
San Jose, CA 95103  
or  
55 S. Market St., Room 900  
San Jose, CA 95113  
(408) 494-8210  
FAX: (408) 494-8065

**COLORADO**

600 17th St.,  
Stop 1005  
Denver, CO 80202-2490  
(303) 446-1012  
FAX: (303) 446-1011

**CONNECTICUT**

135 High St. (Stop 219)  
Hartford, CT 06103  
(860) 240-4179  
FAX: (860) 240-4023

**DELAWARE**

409 Silverside Rd.  
Wilmington, DE 19809  
(302) 791-4502  
FAX: (302) 791-4511

**DISTRICT OF COLUMBIA**

P. O. Box 1553  
Room 1130  
Baltimore, MD 21203  
or  
31 Hopkins Plaza  
Room 1130  
Baltimore, MD 21201  
(410) 962-2082  
FAX: (410) 962-9340

**FLORIDA**

**Ft. Lauderdale District**  
P. O. Box 17167  
Plantation, FL 33318  
or  
One North University Dr.  
Room A-312  
Plantation, FL 33324  
(954) 423-7677  
FAX: (954) 423-7685

**Jacksonville District**

400 West Bay St., Ste.  
35045  
Stop D:DTA  
Room 116  
Jacksonville, FL 32202-  
4437  
(904) 232-3440  
FAX: (904) 232-2266

**GEORGIA**

P. O. Box 1065  
Stop 202-D, Room 1520  
Atlanta, GA 30370  
or  
401 West Peachtree St., NW  
Summit Bldg., Room 1520  
Stop 202-D  
Atlanta, GA 30365  
(404) 331-5232  
FAX: (404) 730-3438

**HAWAII**

300 Ala Moana Blvd., Stop  
H-405  
Honolulu, HI 96850-4992  
(808) 541-1158  
FAX: (808) 541-3379

**IDAHO**

550 West Fort St., Box 041  
Boise, ID 83724  
(208) 334-1324  
FAX: (208) 334-9240

**ILLINOIS**

**Chicago District**  
230 S. Dearborn St.  
Room 3214-Stop 1005-CHI  
Chicago, IL 60604  
(312) 886-9183  
FAX: (312) 886-1564

**Springfield District**

320 West Washington St.,  
Stop 1005 SPD  
Springfield, IL 62701  
(217) 527-6382  
FAX: (217) 527-6332

**INDIANA**

P. O. Box 44687  
(Stop 11)  
Indianapolis, IN 46244  
or  
575 N. Pennsylvania St.  
Stop 11  
Indianapolis, IN 46204  
(317) 226-6332  
FAX: (317) 226-6222

**IOWA**

210 Walnut St. (Stop 1005)  
Des Moines, IA 50309-2109  
(515) 284-4780  
FAX: (515) 284-6645

**KANSAS**

271 W. 3rd St., N  
Stop 1005 WIC  
Wichita, KS 67202  
(316) 352-7506  
FAX: (316) 352-7212

**KENTUCKY**

600 Dr. Martin Luther King  
Jr. Pl.  
Federal Bldg., Rm. 363  
Louisville, KY 40202  
(502) 582-6030  
FAX: (502) 582-6463

**LOUISIANA**

600 South Maestri Place  
(Stop 12)  
New Orleans, LA 70130  
(504) 558-3001  
FAX: (504) 558-3250

**MAINE**

68 Sewall St.  
Rm. 311  
Augusta, ME 04330  
(207) 622-8528  
FAX: (207) 622-8458

**MARYLAND**

P. O. Box 1553  
Room 1130  
Baltimore, MD 21203  
or  
31 Hopkins Plaza  
Room 1130  
Baltimore, MD 21201  
(410) 962-2082  
FAX: (410) 962-9340

**MASSACHUSETTS**

25 New Sudbury St.  
Boston, MA 02203  
(617) 565-1857  
FAX: (617) 565-4959

**MICHIGAN**

P. O. Box 330500 (Stop 7)  
Detroit, MI 48232-6500  
or  
McNamara Federal  
Building  
477 Michigan Ave., Room  
2492  
Detroit, MI 48226-2597  
(313) 628-3670  
FAX: (313) 628-3669

**MINNESOTA**

316 N. Robert St.  
Stop 1005  
St. Paul, MN 55101  
(612) 290-3628  
FAX: (612) 290-4236

**Exhibit 205-3: PRO Program (cont.)****MISSISSIPPI**

100 W. Capitol St. (JK 31)  
Jackson, MS 39269  
(601) 965-4800  
FAX: (601) 965-5251

**MISSOURI**

P. O. Box 66776, Stop  
1005-STL  
St. Louis, MO 63166  
or  
Robert A. Young Bldg.  
1222 Spruce St.  
Mail Stop 1005-STL  
St. Louis, MO 63103  
(314) 539-6770  
FAX: (314) 539-2362

**MONTANA**

Federal Building  
301 S. Park, Stop 1005 HEL  
Helena, MT 59626-0016  
(406) 441-1022  
FAX: (406) 441-1035

**NEBRASKA**

106 S. 15th St. (Stop  
1005-OMA)  
Omaha, NE 68102  
(402) 221-4181  
FAX: (402) 221-3051

**NEVADA**

4750 W. Oakey Blvd.  
Room 303  
Las Vegas, NV 89102  
(702) 455-1241  
FAX: (702) 455-1216

**NEW HAMPSHIRE**

P. O. Box 720  
Portsmouth, NH 03802  
or  
Federal Office Bldg.  
80 Daniel St.  
Portsmouth, NH 03801  
(603) 433-0571  
FAX: (603) 433-0739

**NEW JERSEY**

P. O. Box 1143  
Newark, NJ 07102  
or  
970 Broad St.  
Newark, NJ 07102  
(973) 921-4043  
FAX: (973) 921-4355

**NEW MEXICO**

5338 Montgomery Blvd.,  
N.E.  
Stop 1005 ALB  
Albuquerque, NM 87109-  
1311  
(505) 837-5505  
FAX: (505) 837-5519

**NEW YORK****Albany District**

Leo O'Brien Federal Bldg.,  
Room 617  
Clinton Ave. & N. Pearl St.  
Albany, NY 12207  
(518) 431-4435  
FAX: (518) 431-4697

**Brooklyn District**

G.P.O. Box R  
Brooklyn, NY 11202  
or  
10 MetroTech Center  
625 Fulton St.  
Brooklyn, NY 11201  
(718) 488-2080  
FAX: (718) 488-3100

**Buffalo District**

P. O. Box 500  
Niagara Square Station  
Buffalo, NY 14201  
or  
111 West Huron St.  
Thaddeus J. Dulski FOB  
Buffalo, NY 14202  
(716) 551-4574  
FAX: (716) 551-5860

**Manhattan District**

P. O. Box 408  
Church Street Station  
New York, NY 10008  
or  
290 Broadway, 7th Fl.  
New York, NY 10007  
(212) 436-1011  
FAX: (212) 436-1900

**NORTH CAROLINA**

320 Federal Place  
Room 125  
Greensboro, NC 27401  
(336) 378-2180  
FAX: (336) 378-2495

**NORTH DAKOTA**

657 Second Ave., N.  
Fargo, ND 58102  
(701) 239-5141  
FAX: (701) 239-5104

**OHIO****Cincinnati District**

550 Main St., Room 7010  
Cincinnati, OH 45202  
(513) 684-3094  
FAX: (513) 684-6417

**Cleveland District**

P. O. Box 99709  
Cleveland, OH 44199-0709  
or  
1240 E. Ninth Street  
Cleveland, OH 44199-2002  
(216) 522-7134  
FAX: (216) 522-2914

**OKLAHOMA**

55 N. Robinson  
Stop 1005 OKC  
Oklahoma City, OK 73102-  
9229  
(405) 297-4055  
FAX: (405) 297-4056

**OREGON**

1220 S.W. 3rd Ave.  
(Stop D-405)  
Portland, OR 97204  
(503) 326-2333  
FAX: (503) 326-5453

**PENNSYLVANIA****Philadelphia District**

P. O. Box 12010  
Philadelphia, PA 19106  
or  
600 Arch St., Room 7214  
Philadelphia, PA 19106  
(215) 597-3377  
FAX: (215) 597-7341

**Pittsburgh District**

P. O. Box 705  
Pittsburgh, PA 15230  
or  
1000 Liberty Ave.  
Room 1102  
Pittsburgh, PA 15222  
(412) 395-5987  
FAX: (412) 395-4769

**RHODE ISLAND**

380 Westminster St.  
Providence, RI 02903  
(401) 528-4492  
FAX: (401) 528-4312

**SOUTH CAROLINA**

1835 Assembly St.  
Room 571, MDP 03  
Columbia, SC 29201  
(803) 253-3029  
FAX: (803) 253-3910  
TDD: (803) 765-5752

**SOUTH DAKOTA**

115 4th Ave. Southeast  
(Stop 1005-ABE)  
Aberdeen, SD 57401  
(605) 226-7248  
FAX: (605) 226-7270

**TENNESSEE**

P. O. Box 1107 (Stop 22)  
Nashville, TN 37202  
or  
801 Broadway  
Stop 22  
Nashville, TN 37203  
(615) 736-5219  
FAX: (615) 736-7489

**TEXAS****Austin District**

300 E. 8th St.  
Stop 1005 AUS  
Austin, TX 78701  
(512) 499-5875  
FAX: (512) 499-5687

**Dallas District**

1100 Commerce St.  
MC 1005 DAL  
Dallas, TX 75242  
(214) 767-1289  
FAX: (214) 767-0040

**Houston District**

1919 Smith St.  
(Stop 1005-HOU)  
Houston, TX 77002  
(713) 209-3660  
FAX: (713) 209-3708

**UTAH**

50 South 200 East  
Stop 1005 SLC  
Salt Lake City, UT 84111  
(801) 799-6958  
FAX: (801) 799-6957

**VERMONT**

Courthouse Plaza  
199 Main St.  
Burlington, VT 05401  
(802) 860-2008  
FAX: (802) 860-2006

**VIRGINIA**

P. O. Box 10113  
Room 5502  
Richmond, VA 23240  
or  
400 N. 8th St.  
Richmond, VA 23240  
(804) 771-2643  
FAX: (804) 771-2008

**WASHINGTON**

915 Second Avenue, Stop  
W405  
Seattle, WA 98174  
(206) 220-6037  
FAX: (206) 220-6047

**WEST VIRGINIA**

P. O. Box 1040, Room 1004  
Parkersburg, WV 26102  
or  
425 Juliana St.  
Parkersburg, WV 26101  
(304) 420-6616  
FAX: (304) 420-6682

**WISCONSIN**

310 W. Wisconsin Ave.  
Room M-28 (Stop 1005-  
MIL)  
Milwaukee, WI 53203  
(414) 297-3046  
FAX: (414) 297-3362

**Exhibit 205-3: PRO Program (cont.)**

**WYOMING**

5353 Yellowstone Road  
(Stop 1005 CHE)  
Cheyenne, WY 82009  
(307) 633-0800  
FAX: (307) 633-0880

**NATIONAL OFFICE**

1111 Constitution Ave.,  
N.W.  
Room 107 C:PRP  
Washington, DC 20224  
(202) 622-6100  
FAX: (202) 622-4318

Taxpayers residing overseas or in the U.S. territories should write to:

Problem Resolution Office  
Internal Revenue Service  
Assistant Commissioner  
(International)

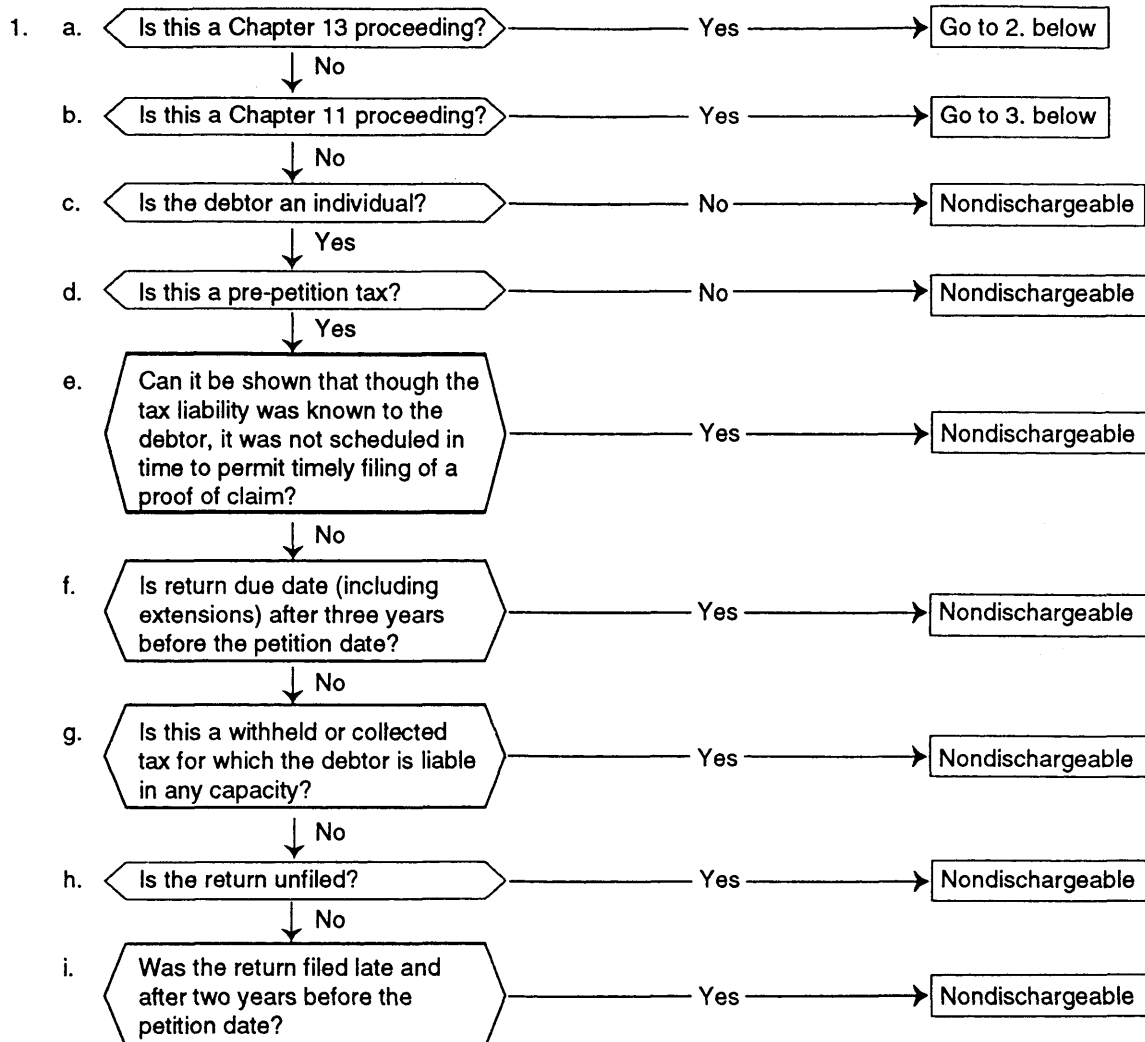
P. O. Box 44817  
L'Enfant Plaza Station  
Washington, DC 20024-4817

or

950 L'Enfant Plaza South, S.W.  
Washington, DC 20024  
(202) 874-1930  
FAX: (202) 874-1705

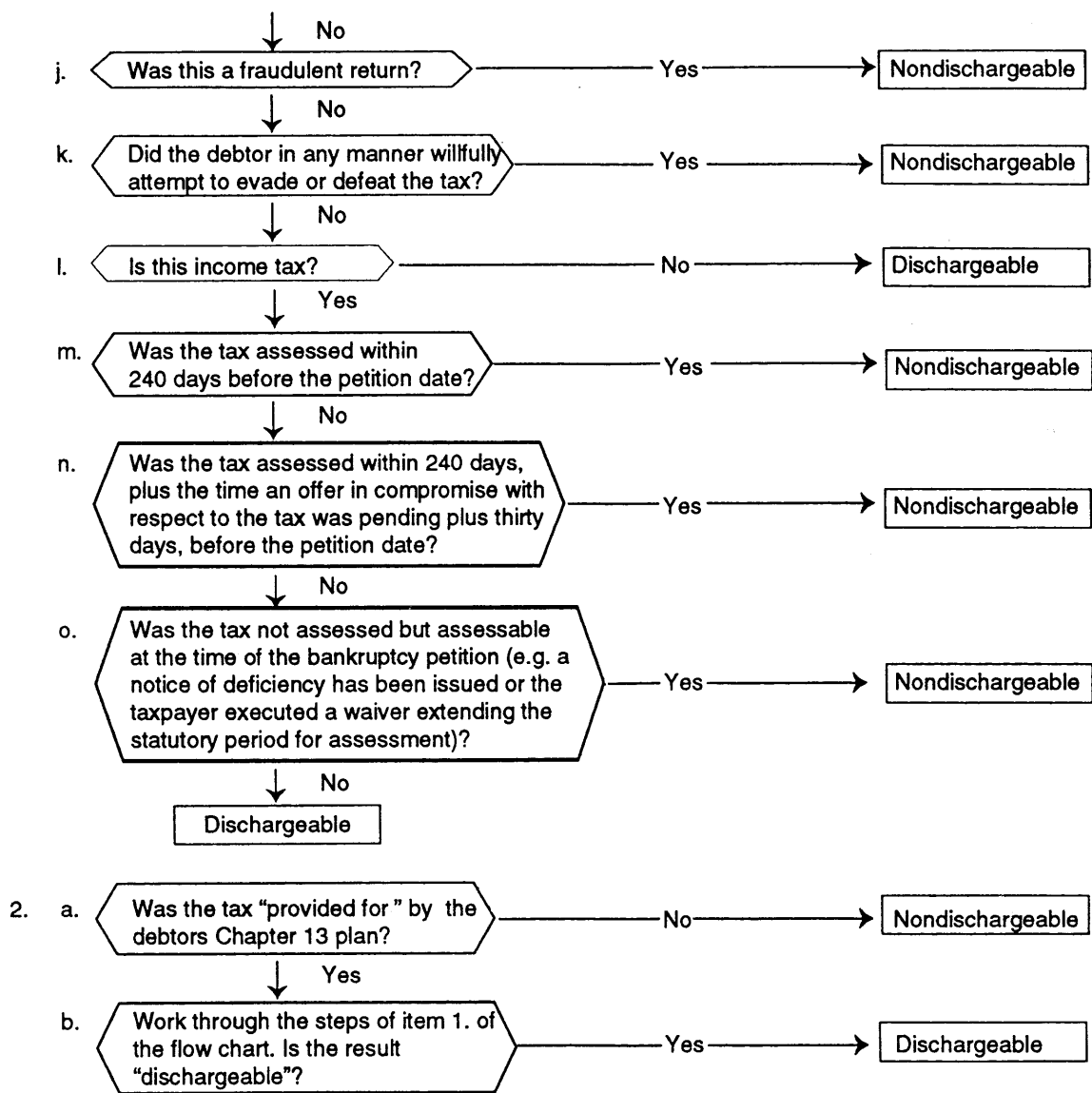
**Exhibit 205-4: Dischargeability of Taxes in Bankruptcy**

This chart should be used to determine whether a specific tax liability has been discharged in the proceeding.



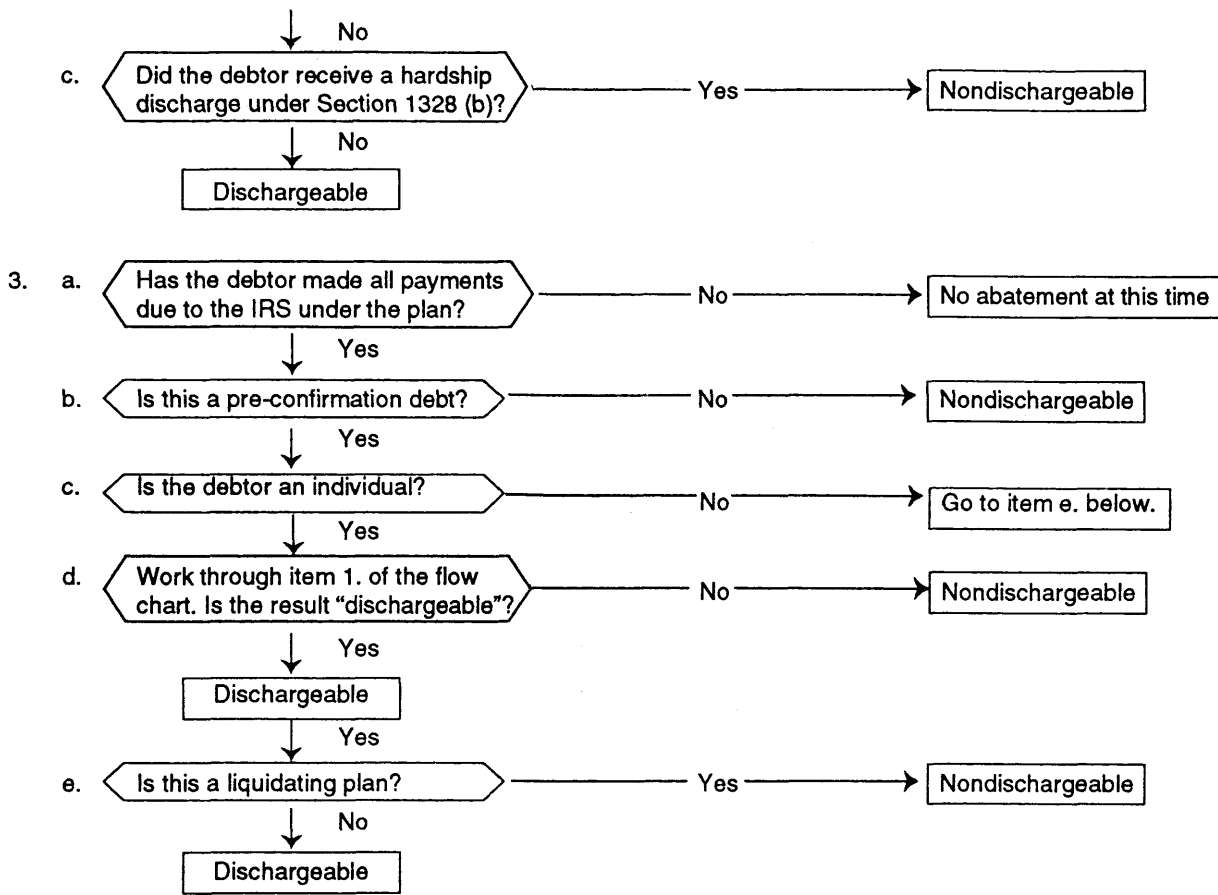
(continued)

**Exhibit 205-4: Dischargeability of Taxes in Bankruptcy (cont.)**



(continued)

**Exhibit 205-4: Dischargeability of Taxes in Bankruptcy (cont.)**



\* In cases not involving provision for full payment of priority and secured claims and provision equal to other creditors for other claims, and payment according to the terms of the plan, refer to counsel, if the debtor alleges or SPf believes that the taxes were "provided for" by the Chapter 13 plan.



**Exhibit 205-5: Installment Agreement Request—Form 9465**

Form **9465**  
 (Rev. January 1996)  
 Department of the Treasury  
 Internal Revenue Service

**Installment Agreement Request**

OMB No. 1545-1350

▶ See instructions below and on back.

**Note:** Do not file this form if you are currently making payments on an installment agreement. You must pay your other Federal tax liabilities in full or you will be in default on your agreement.

If you can't pay the full amount you owe, you can ask to make monthly installment payments. If we approve your request, you will be charged a \$43 fee. **Do not include the fee with this form.** We will deduct the fee from your first payment after we approve your request, unless you choose **Direct Debit** (see the line 13 instructions). We will usually let you know within 30 days after we receive your request whether it is approved or denied. But if this request is for tax due on a return you filed after March 31, it may take us longer than 30 days to reply.

To ask for an installment agreement, complete this form. Attach it to the front of your return when you file. If you have already filed your return or you are filing this form in response to a notice, see **How Do I File Form 9465?** on page 2. If you have any questions about this request, call 1-800-829-1040.

**Caution:** A Notice of Federal Tax Lien may be filed to protect the government's interest until you pay in full.

<b>1</b>	Your first name and initial _____ Last name _____	Your social security number _____
	If a joint return, spouse's first name and initial _____ Last name _____	Spouse's social security number _____
	Your current address (number and street). If you have a P.O. box and no home delivery, show box number. _____ Apt. number _____	
	City, town or post office, state, and ZIP code. If a foreign address, show city, state or province, postal code, and full name of country. _____	
<b>2</b>	If this address is new since you filed your last tax return, check here . . . . . ▶ <input type="checkbox"/>	
<b>3</b>	( ) _____ Your home phone number _____ Best time for us to call _____	<b>4</b>
		( ) _____ Your work phone number _____ Ext. _____ Best time for us to call _____
<b>5</b>	Name of your bank or other financial institution: _____	<b>6</b>
	Address _____	Your employer's name: _____
	City, state, and ZIP code _____	Address _____
		City, state, and ZIP code _____
<b>7</b>	Enter the tax return for which you are making this request (for example, Form 1040). But if you are filing this form in response to a notice, don't complete lines 7 through 9. Instead, attach the bottom section of the notice to this form and go to line 10. . . . . ▶ _____	
<b>8</b>	Enter the tax year for which you are making this request (for example, 1995) . . . . . ▶ _____	
<b>9</b>	Enter the total amount you owe as shown on your tax return . . . . . ▶ \$ _____	
<b>10</b>	Enter the amount of any payment you are making with your tax return (or notice). See instructions . ▶ \$ _____	
<b>11</b>	Enter the amount you can pay each month. <b>Make your payments as large as possible to limit interest and penalty charges.</b> The charges will continue until you pay in full . . . . . ▶ \$ _____	
<b>12</b>	Enter the date you want to make your payment each month. Do not enter a date later than the 28th ▶ _____	
<b>13</b>	If you would like to make your monthly payments using <b>Direct Debit</b> (automatic withdrawals from your bank account), check here. . . . . ▶ <input type="checkbox"/>	
	Your signature _____	Date _____
	Spouse's signature. If a joint return, BOTH must sign. _____	
	Date _____	

**Privacy Act and Paperwork Reduction Act Notice.**—Our legal right to ask for the information on this form is Internal Revenue Code sections 6001, 6011, 6012(a), 6109, and 6159 and their regulations. We will use the information to process your request for an installment agreement. The reason we need your name and social security number is to secure proper identification. We require this information to gain

access to the tax information in our files and properly respond to your request. If you do not enter the information, we may not be able to process your request. We may give this information to the Department of Justice as provided by law. We may also give it to cities, states, and the District of Columbia to carry out their tax laws.

**Exhibit 205-5: Installment Agreement Request—Form 9465 (cont.)**

Form 9465 (Rev. 1-96)

Page 2

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is: **Learning about the law or the form**, 2 min.; **Preparing the form**, 24 min.; and **Copying, assembling, and sending the form to the IRS**, 20 min.

If you have comments concerning the accuracy of this time estimate or suggestions for making this form simpler, we would be happy to hear from you. You can write to the Tax Forms Committee, Western Area Distribution Center, Rancho Cordova, CA 95743-0001. **DO NOT** send the form to this address. Instead, see **How Do I File Form 9465?** on this page.

**General Instructions**

If you cannot pay the full amount you owe shown on your tax return (or on a notice we sent you), you can ask to make monthly installment payments. But before requesting an installment agreement, you should consider other less costly alternatives, such as a bank loan.

You will be charged interest and may be charged a late payment penalty on any tax not paid by its due date, even if your request to pay in installments is granted. To limit interest and penalty charges, file your return on time and pay as much of the tax as possible with your return (or notice).

You will be charged a \$43 fee if your request is approved. **Do not include the fee with this form.** We will send you a letter telling you your request has been approved, how to pay the fee, and how to make your first installment payment. After we receive each payment, we will send you a letter showing the remaining amount you owe, and the due date and amount of your next payment.

By approving your request, we agree to let you pay the tax you owe in monthly installments instead of immediately paying the amount in full. In return, you agree to make your monthly payments on time. **You also agree to meet all your future tax liabilities.** This means that you must have adequate withholding or estimated tax payments so that your tax liability for future years is paid in full when you timely file your return. If you do not make your payments on time or have an outstanding past-due amount in a future year, you will be in default on your agreement and we may take enforcement actions to collect the entire amount you owe.

**Bankruptcy—Offer-in-Compromise.**—If you are in bankruptcy or we have accepted your offer-in-compromise, **do not** file this form. Instead, call your local IRS District Office Special Procedures function. You can get the number by calling 1-800-829-1040.

**Specific Instructions****Line 1**

If you are making this request for a joint tax return, show the names and SSNs in the same order as on your tax return.

**Line 10**

Even if you can't pay the full amount you owe now, you should pay as much of it as possible to limit penalty and interest charges. If you are filing this form with your tax return, make the payment with your return. If you are filing this form by itself, for example, in response to a notice, include a check or money order payable to the Internal Revenue Service with this form. **Do not** send cash. On your payment, write your name, address, social security number, daytime phone number, and the tax year and tax return for which you are making this request (for example, "1995 Form 1040").

**Line 11**

You should try to make your payments large enough so that your balance due will be paid off by the due date of your next tax return.

**Line 12**

You can choose the date your monthly payment is due. For example, if your rent or mortgage payment is due on the first of the month, you may want to make your installment payments on the 15th. When we approve your request, we will tell you the month and date that your first payment is due. If we have not replied by the date you choose for your first payment, you may send the first payment to the Internal Revenue Service Center at the address shown on this page for the place where you live. Make your check or money order payable to the Internal Revenue Service. See the instructions for line 10 for what to write on your payment.

**Line 13**

Check the box on line 13 if you want your monthly payments automatically deducted (**Direct Debit**) from your bank account. If your installment agreement request is approved, we will send you the required Direct Debit enrollment form and you must include the \$43 fee when you return it.

**How Do I File Form 9465?**

- If you haven't filed your return, attach Form 9465 to the front of your return.
- If you have already filed your return, you are filing your return electronically, or you are filing this form in response to a notice, mail it to the **Internal Revenue Service Center** at the address shown below for the place where you live. No street address is needed.

<b>If you live in:</b>	<b>Use this address:</b>
Florida, Georgia, South Carolina	Atlanta, GA 39901
New Jersey, New York (New York City and counties of Nassau, Rockland, Suffolk, and Westchester)	Holtsville, NY 00501
New York (all other counties), Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont	Andover, MA 05501
Illinois, Iowa, Minnesota, Missouri, Wisconsin	Kansas City, MO 64999
Delaware, District of Columbia, Maryland, Pennsylvania, Virginia	Philadelphia, PA 19255
Indiana, Kentucky, Michigan, Ohio, West Virginia	Cincinnati, OH 45999
Kansas, New Mexico, Oklahoma, Texas	Austin, TX 73301
Alaska, Arizona, California (counties of Alpine, Amador, Butte, Calaveras, Colusa, Contra Costa, Del Norte, El Dorado, Glenn, Humboldt, Lake, Lassen, Marin, Mendocino, Modoc, Napa, Nevada, Placer, Plumas, Sacramento, San Joaquin, Shasta, Sierra, Siskiyou, Solano, Sonoma, Sutter, Tehama, Trinity, Yolo, and Yuba), Colorado, Idaho, Montana, Nebraska, Nevada, North Dakota, Oregon, South Dakota, Utah, Washington, Wyoming	Ogden, UT 84201
California (all other counties), Hawaii	Fresno, CA 93888
Alabama, Arkansas, Louisiana, Mississippi, North Carolina, Tennessee	Memphis, TN 37501
American Samoa	
Guam: Nonpermanent residents only*	
Puerto Rico (or if excluding income under section 933)	Philadelphia, PA 19255
Virgin Islands: Nonpermanent residents only*	
Foreign country (or if a dual-status alien): U.S. citizens and those filing Form 2555, 2555-EZ, or 4563	
All APO and FPO addresses	

\*Permanent residents of Guam and the Virgin Islands cannot use Form 9465.





Part III

# Legal Liability





# 301 Standards of Tax Practice

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# 301 Standards of Tax Practice

Tax practitioners are fortunate in that explicit, written standards of practice are available to guide their actions and the actions of their staff. There is no reason to guess, for example, whether you should inform an IRS examining agent—in the face of the client’s objection—that the client took an improper deduction. (The AICPA Code of Professional Ethics prohibits revealing confidential client information. The AICPA’s Statement on Responsibilities in Tax Practice No. 7 requires that the CPA advise the client but *not* advise the IRS.) The flip side is that you have to be familiar with the standards. That’s what this chapter is about.

This chapter discusses the standards of practice that derive from the IRS publication titled *Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, Enrolled Actuaries and Appraisers Before the Internal Revenue Service* (Circular No. 230). We also tackle the AICPA’s Statements on Responsibilities in Tax Practice (SRTP). Where we consider them relevant to a discussion of standards of practice, we will also touch on certain Treasury regulations and portions of the IRS’s *Internal Revenue Manual*. We consider, also, the ramifications of malpractice, the availability of professional liability insurance, and the means that are available for reducing the risks of practice.

Every reference to an official source, for example Circular 230, is condensed and paraphrased to keep the length of this chapter within reasonable bounds. If you have any questions or doubts about your adherence to professional standards, consult the official publication. (Also for reasons of length, we have had to omit any specific references to state statutes governing CPAs or tax preparers.)

## 301.1 Practice Before the IRS

Anyone with sufficient skill may prepare a tax return. The right to “practice before the IRS,” or to “appear” on behalf of another person, however—the right to “represent” that other person—is governed by the provisions of Circular No. 230.

**Practice Tip.** You *must* have Circular 230 handy for reference when questions arise. It is reprinted in many of the commercial tax services or may be obtained from the IRS.

Generally, the right to practice is limited to employees (who may represent their employers), to individuals (who may represent immediate family members), and to *attorneys, certified public accountants, enrolled actuaries, and enrolled agents*. With proper authorization from the taxpayer, these representatives can be given practically all the rights the taxpayer has to correspond, negotiate, and settle with the IRS. Exhibit 301-1 summarizes recognition and authorization requirements for appearance before the IRS.

### 301.1.1 IRS Definition of Practice

According to Regs. Sec. 601.101, practice before the Internal Revenue Service encompasses:

All matters connected with presentation to the Internal Revenue Service or any of its officers or employees relating to a client’s rights, privileges, or liabilities under laws or regulations administered by the Internal Revenue Service. Such presentations include the preparation

and filing of necessary documents, correspondence with and communications to the Internal Revenue Service, and the representation of a client at conferences, hearings, and meetings.

### 301.1.2 Authorizations to Represent Another

IRS employees are required to verify the authority of any person who seeks access to a taxpayer's records or who wishes in any manner to represent the taxpayer. The extent of this authority should be indicated by the taxpayer on IRS Form 2848. The form may be filed by FAX. IRS Form 8821 can be used to authorize disclosure of information. If the taxpayer's authorization is on file, IRS employees are told to extend the "courtesy of having all arrangements in furtherance of the matter" made through the representative. Additionally, the representative has a right to be present when the taxpayer is interviewed and to receive copies of all written communication from the IRS (*Internal Revenue Manual*, Sec. 4055). The taxpayer must also be present at an IRS interview if required to do so by an IRS summons. (The IRS will issue a summons if it is not provided with documents it requests by letter, memo, or phone conversation.)

**Practice Tip.** In the rare instance that your client attends an IRS conference without you, have the client present either an information authorization or a power of attorney, naming you, at the beginning of the interview. The IRS agent will be put on notice that your client has a "backup team" standing on the sideline, and you will be assured of receiving copies of subsequent IRS correspondence.

### 301.1.3 Form 8821

IRS Form 8821, Tax Information Authorization, replaces now-obsolete Form 2848-D. With this form the taxpayer authorizes another person to inspect at an IRS office, or to receive by mail, all tax information, notices, or other written communication related to a specifically identified tax matter. No authority to represent the taxpayer is granted. A newly filed information authorization revokes one previously filed concerning the same tax matters.

### 301.1.4 Form 2848

IRS Form 2848, Power-of-Attorney and Declaration of Representative, can be used to grant a representative the power to—

- Inspect and receive tax information, notices, and communications.
- Receive (but not negotiate) the taxpayer's refund check.
- Sign a tax return, in certain cases, on behalf of the taxpayer (Regs. Sec. 1.6012-1(a)(5)).
- Execute waivers and offers of waivers of restrictions on assessment or collection of deficiencies in tax and waivers of notice of disallowance of a claim for refund or credit.
- Execute consents extending the statute of limitations.
- Execute a closing agreement (IRC Sec. 7121).
- Delegate authority or substitute another representative, if so expressly authorized by the taxpayer.

Form 2848 may be executed on behalf of the taxpayer by an attorney-in-fact designated as such in a non-IRS document such as a general, limited, or durable power of attorney. Note that a taxpayer must be present at an IRS interview if so required by an IRS summons.

**Practice Tip.** If an IRS agent calls there is a better chance of resolving any questions if *two* of a firm's CPAs have qualified by signing Form 2848. That way, if one of the CPAs is not available to respond to the IRS inquiry, the other has the authority to do so.

**Practice Tip.** It may be advisable to file a power of attorney (Form 2848) or at least an information authorization (Form 8821) for each client for whom you prepare a return. You will receive subsequent correspondence from the IRS and can take the initiative in providing further service to your client.



### 301.1.5 IRS Identification of Representatives: CAF

The IRS assigns a centralized authorization file (CAF) number to each person granted authority to represent another. This is used to ascertain the authority of a practitioner who seeks to represent a taxpayer. A practitioner has *only one* CAF number, regardless of the number of clients. Each new power of attorney is entered into the representative's file. (Current IRS capabilities allow a maximum of two CAF numbers—for two practitioners—to be referenced in any one taxpayer's return records.)

The IRS will assign a CAF number to a practitioner when the first Form 8821 or 2848 designating the practitioner as an authorized representative by the taxpayer is received by the IRS.

Once you have been notified of your CAF number, note it in all correspondence and have it handy when you phone the IRS.

**Practice Tip.** If, through IRS error, you have been assigned more than one CAF number, choose one to use and cite it exclusively when dealing with the IRS.

## 301.2 Persons Authorized to Practice

When a return is audited, the person who prepared it may represent the taxpayer in connection with *that particular return* if given authority to do so by the taxpayer on Form 2848. The taxpayer need not be present unless served with a summons. Tax return preparers who are not CPAs or attorneys, and who have not qualified as enrolled agents or enrolled actuaries, may represent the taxpayer only before revenue agents and examining officers of the examination division in the offices of district directors. They cannot sign waivers or agreements on the taxpayer's behalf, and have no authority before the collection or appeals divisions. Such persons are subject to the rules of conduct of Circular 230.

### 301.2.1 Attorneys

Any member in good standing of the bar of the highest court of any state, possession, territory, commonwealth, or the District of Columbia who is not currently under suspension or disbarment from practice before the IRS, may practice before the IRS, provided that he or she has the taxpayer's written authorization. Attorneys who wish to represent a client in Tax Court or another federal court must be admitted to practice before that court.

### 301.2.2 CPAs

Accountants qualified to practice as a CPA in any state, possession, territory, commonwealth, or the District of Columbia and not currently under suspension may practice before the IRS. Written authorization—Form 2848—from the client is required. CPAs may not, however, practice law, including most aspects of tax litigation such as filing a petition or pleading with any court. A CPA may practice before the Tax Court by passing an examination on Tax Court procedure, although it is unusual for a CPA to do so.

### 301.2.3 Enrolled Persons

A person who is not an attorney or a CPA may nevertheless practice before the IRS after passing an examination on technical aspects of taxation. This practitioner is called an enrolled agent (E.A.). The examination is given in September of each year; application must be made on Form 2587 by August 15. (A sample exam is in IRS Publication 693.) IRS employees who were engaged in applying and interpreting tax matters for a minimum of five years may apply to become enrolled agents, without sitting for the exam, by filing Form 23 within three years of leaving the IRS. For renewal of enrollment by any E.A., Section 10.4 of Circular 230 specifies that a minimum of 72 hours of continuing education credit must be completed during each three-year period, known as an "enrollment cycle."

Actuaries who are qualified by the Joint Board for the Enrollment of Actuaries may practice before the IRS. Their representation is limited to certain matters, enumerated in Circular 230. Both enrolled agents and enrolled actuaries must have written authorization from the client.

Circular 230 provides that attorneys and CPAs desiring enrolled agent status must comply with regulations governing eligibility for enrollment. That is, attorneys and CPAs who do not qualify for enrolled status on the basis of prior employment with the Service must pass the examination for enrollment administered by the Director of Practice.

### 301.2.4 Limited Practice and Special Appearances

Section 10.7 of Circular 230 describes when unenrolled persons can practice. These persons must adhere to the standards set in Circular 230. Taxpayers have the right, in *all* matters, to represent themselves before the IRS. They also have the right to be represented by an authorized person. In addition, any person determined necessary to explain facts may appear before the IRS as a *witness*. Circular 230 names these persons allowed to appear and the entities they may represent:

<i>Person allowed to appear</i>	<i>To represent</i>
Full-time employee	Employer
Partner	Partnership
Individual	Immediate family
Officer	Corporation
Trustee	Trust
Receiver	Receivership
Guardian	Guardianship
Administrator/executor	Estate

In connection with authorized representatives of partnerships and S corporations, see the discussion of the tax matters partner (TMP) in Sections 205.3.6 and 205.3.7.

### 301.2.5 Tax Return Preparer Program

In an attempt to identify and rectify improper practices by a small number of tax practitioners, the IRS has instituted a Tax Return Preparer Program (*Internal Revenue Manual*, Sec. 4297). IRS examiners are told to be alert to evidence that a paid tax return preparer may have negligently, intentionally, or willfully understated a client's liability. (Anyone else may report the conduct of a practitioner by notifying the Director of Practice, a district director, or any IRS employee.)

An examiner who finds evidence of a violation by a preparer must develop the facts sufficiently to determine whether a penalty investigation should be instituted. This must be done without discussing the case with either the taxpayer or the preparer.

The Program Action Case is an identification procedure that examines returns selected because they share the same practitioner—not because of any other characteristic. Under these procedures (instituted in 1983), a return preparers coordinator in each district maintains files concerning alleged misconduct by preparers. Information is gathered, including the number of returns prepared, the names of taxpayers, taxable income, tax liability, refunds, contributions, and so on. If a pattern of noncompliance develops, the preparer may be recommended for the Program Action Case examination. The district director or assistant district director makes the final approval to examine a preparer's clients.

The Director of Practice decides whether to proceed against a practitioner who is an attorney, CPA, or E.A. (Unenrolled return preparers are under the jurisdiction of the district director, not the Director of Practice.) Ordinarily, the practitioner is first given an opportunity to “demonstrate or achieve compliance” (Circular 230, Sec. 10.54). This opportunity to bring a practice into compliance does not have to be offered, however, in cases of willfulness, or

where time or the public interest do not permit. Details regarding service of the complaint by the Director, holding a conference with the practitioner, answers, motions, proof, and so on, are dealt with in Sections 10.54 through 10.76 of Circular 230.

IRS employees are required to report to the Director of Practice what they believe to be violations of the rules of Circular 230. Any report should spell out each alleged violation and provide supporting information in the form of documents or exhibits (*Internal Revenue Manual*, Sec. 4297.9).

### 301.2.6 Government Officers and Employees

An officer and employee of the United States in the executive, legislative, or judicial branch may *not* practice before the IRS except to represent: (1) a member of his or her immediate family, or (2) any other person or estate for which the person serves as guardian, executor, administrator, trustee, or other personal fiduciary (18 USC 205). In addition, no member of Congress or resident commissioner (elect or serving) may practice before the IRS in connection with any matter for which he or she directly or indirectly receives, agrees to receive, or seeks any compensation.

Officers and employees of a state or local government whose jobs include passing upon, investigating, or dealing with tax matters of their locale may not practice before the IRS if their employment may disclose facts or information applicable to federal tax matters. In addition, Circular 230 proscribes practice before the IRS for certain *former* government employees, their partners and associates, and for those whose partners are employees of the executive branch.

## 301.3 Tax Practice Conduct

For CPAs, the primary ethical and legal constraints on tax practice are governed by requirements to be found in—

- Treasury Circular 230.
- The Internal Revenue Code and Treasury Regulations.
- The Statements on Responsibilities in Tax Practice (SRTP) and the Code of Professional Conduct of the American Institute of CPAs.

State statutes governing practice must also be considered but are beyond the scope of this manual.

### 301.3.1 Circular 230: Duties and Restrictions

Subpart B of Circular 230 lists duties and restrictions relating to practice before the IRS. In the discussion that follows, the term *practitioner* refers to attorneys, CPAs, and enrolled agents. We are paraphrasing from Circular 230; the section numbers in parentheses are found there.

- No practitioner shall neglect or refuse to submit records or information upon proper request, unless he or she believes in good faith and on reasonable grounds that the information is privileged or the request is of doubtful legality (Circular 230, Sec. 10.20(a)).

**Practice Tip.** Practitioners must maintain and make available to the IRS district director, upon request, copies of tax returns and refund claims or lists of taxpayers and taxpayer ID numbers for returns and refund claims prepared (IRC Sec. 6107(b)). Practitioners must also retain and make available a list of tax preparers employed and their identification numbers (IRC Sec. 6060(a)). Although cooperation with the IRS is often the best policy, it is wise to seek the client's permission before providing an agent with information beyond that referred to in IRC Sec. 6107(b). If you suspect a criminal tax investigation is in process, you should advise your client to consult with a criminal tax attorney. Also, see Chapter 303 for a discussion of the IRS summons.

- Practitioners must provide the IRS with any information they may have concerning violation of Circular 230 regulations, and testify in any proceeding for the disbarment

or suspension of a practitioner unless they have a good faith belief, on reasonable grounds, that such information is privileged or that the request is of doubtful legality (Sec. 10.20(b)).

- A practitioner who knows that a client has not complied with U.S. revenue laws must advise the client promptly (Sec. 10.21). This duty to inform the client (but not the IRS) is essentially the same as that specified in the AICPA's SRTP No. 6. The penalty for violation of Circular 230 is suspension or disbarment from practice before the IRS, rather than suspension or expulsion from the AICPA.
- Each practitioner shall exercise *due diligence*
  - In preparing (or assisting in the preparation of), approving, and filing returns, documents, affidavits, and other papers relating to IRS matters.
  - In determining the correctness of oral or written representation made to the Department of the Treasury.
  - In determining the correctness of oral or written statements to clients about any matter administered by the Internal Revenue Service (Sec. 10.22).
- Preparer standards of conduct expressed in Sec. 10.34(b) expose a practitioner to discipline under Circular 230 if failure to comply with the realistic possibility standard is *willful, reckless, or a result of gross incompetence*. If there was reasonable cause for a tax return position, and the practitioner acted in good faith, the standard will not have been breached. In applying this standard, the IRS will consider whether a pattern of conduct indicates recklessness or gross incompetence. Further, in Sec. 10.51(j), *reckless conduct* is defined as highly unreasonable omission or misrepresentation involving an extreme departure from the standards of ordinary care that a practitioner should observe under the circumstances.
- In order for a position to be taken on a return, it must have a realistic possibility of being sustained on its merits (realistic possibility standard). A practitioner may neither advise a taxpayer to take a position on a return nor prepare a return unless the realistic possibility standard has been met. (See also Section 302.4.2.) If the realistic possibility standard has not been met, the return may not be prepared unless there is disclosure of the aggressive position. A nonsigning, as well as a signing, practitioner must advise a client of any opportunity to avoid a penalty by disclosure.
- A taxpayer must be advised of any penalties likely to apply and of any appropriate manner of avoiding the penalty, e.g., through disclosure.
- A taxpayer may not be advised to take a position on a return and a practitioner may not prepare a return if the position is frivolous (patently improper).
- In certain instances, the Director of Practice is authorized to summarily suspend a practitioner. This can be done only if one of the following three circumstances has occurred:
  1. The practitioner has been convicted of a crime under the revenue laws.
  2. The practitioner has been convicted of a felony under Title 18 of the U.S. Code.
  3. The practitioner has been suspended or disbarred for cause by a state bar or a state board of accountancy.

The practitioner then may request and receive a full administrative hearing.
- No practitioner shall unreasonably delay the prompt disposition of any matter before the IRS (Sec. 10.23).
- No practitioner shall employ, accept assistance, accept employment from, or act as associate, correspondent, or subagent with, or share fees with any person under disbarment or suspension before the IRS (Sec. 10.24).
- Former government employees are subject to numerous restrictions with regard to federal tax matters relating, primarily, to their former official duties (Sec. 10.26).
- No practitioner shall sign as a notary in matters in which he or she is counsel, attorney, or agent, or may be in any way interested before the IRS (Sec. 10.27).
- No practitioner shall charge an unconscionable fee to represent a client before the IRS. Neither may a practitioner charge a contingent fee for preparing an original return. A contingent fee may be charged for preparing an amended return or a claim for refund

(other than a claim for refund made on an original return), but only if the practitioner reasonably anticipates that the amended return or claim will receive substantive review by the Service. A contingent fee is one that is based on (1) a percentage of the refund shown on a return, (2) a percentage of the taxes saved, or that otherwise depends upon the results achieved (Sec. 10.28).

- No practitioner shall represent conflicting interests, except by express consent of all parties after full disclosure (Sec. 10.29).
- Practitioners must not use false, fraudulent, misleading, or unfair advertising. Truthful, nonmisleading advertising is permitted. Statements about the quality of services, claims to specialized expertise, and so on are prohibited unless verifiable. Claims that the ingenuity of the practitioner is more important than the merit of the matter under consideration by the IRS are prohibited (Sec. 10.30(a)(1)).
- Uninvited solicitation of employment (in connection with tax matters) is prohibited. The prohibition includes both in-person and telephone solicitation and also the making of unsolicited mailings to a taxpayer that relate to specifics of that taxpayer's unique circumstance (Sec. 10.30(a)(2)).

It appears that this rule allows a bulk mailing to nonclients that spells out changes enacted in the tax code, but prohibits, for example, a mailing suggesting to a nonclient seller of real estate that the practitioner could find ways to minimize the gain tax. A Supreme Court decision, however, has by implication overruled this provision of Circular 230 in *Shapero v. Kentucky Bar Ass'n* (108 S.Ct. 1916 (1988)). The court said a state cannot categorically prohibit lawyers from soliciting business by sending nondeceptive letters to potential clients known to face particular legal problems.

- Solicitation of former clients is allowed, as is solicitation by the employees of the exempt organizations referred to in IRC Sec. 501(c)(3) and (4) (Sec. 10.30(a)(2)).
- According to Sec. 10.30(c), practitioners are permitted to advertise the following in a dignified manner (for radio or TV advertising, the broadcast must be prerecorded and the practitioner must retain a recording of the actual audio transmission):
  - The name, address, telephone number, and office hours of the firm
  - The names of individuals associated with the firm
  - A factual description of the services offered
  - Acceptance of credit cards or other credit arrangements
  - Foreign language ability
  - Membership in pertinent, professional organizations
  - Pertinent professional licenses
  - A statement that practice is limited to certain areas
  - The phrase “enrolled to represent taxpayers before the IRS,” or a similar phrase, used by enrolled agents
  - Other relevant facts that are not prohibited by Circular 230
- Customary biographical insertions in professional lists, journals, and directories (as well as professional cards, letterheads, and announcements) are acceptable, *provided that* the applicable standards of the following organizations are not violated: American Bar Association, American Institute of CPAs, the National Society of Public Accountants, or the National Association of Enrolled Agents.
- Fee information, such as the amount of fixed fees or hourly rates, may be published. (Whatever fees are publicized must be charged by the practitioner for a reasonable period of time, but at least for 30 days.)
- Attorneys, CPAs, and enrolled agents who are also income tax return preparers must not endorse or negotiate a check made with respect to income taxes that is issued to a taxpayer other than the practitioner (Sec. 10.31). The effect of this rule is to prevent you from operating a check-cashing service or from having a client sign over a refund check to you.
- Practitioners who analyze and give opinions about the federal tax effects of a tax shelter investment are subject to detailed conditions that we can only roughly summarize here.

- Sec. 10.33 defines terms such as *tax shelter opinion* and *material*. In brief, this section states that practitioners, when giving an opinion on a tax shelter, must
- Inquire about all relevant facts and reasonably believe them to be true.
  - Relate law to the facts and identify assumptions.
  - Identify material issues, including all material federal tax issues.
  - Give an opinion on each material issue.
  - Where possible, provide an overall evaluation as to whether the material tax benefits are more likely than not to be realized.
  - Make sure that the offering materials correctly represent the nature and extent of the practitioner's opinion.

**Practice Tip.** Consider having a tax library in your firm that includes copies of IRS Circular 230, appropriate information on preparer penalties, and the AICPA *Statements of Responsibilities in Tax Practice*, and require all tax personnel to become familiar with these publications (one frequently asked question by the independent reviewer of the Voluntary Tax Practice Review team is whether or not there is a copy of Circular 230 in the office). Also, hold a tax season kick-off meeting in January of each year for the purpose of reviewing all CPA tax ethics and Circular 230. That way all firm tax personnel are aware of what is expected of them regarding ethics in tax practice.

### 301.3.2 Incompetent, Disreputable, or Fraudulent Conduct

Sec. 10.51 of Subpart C of Circular 230 provides rules about possible IRS disciplinary proceedings against practitioners. A practitioner who is shown to be incompetent or disreputable; who refuses to comply with the rules and regulations; or who, with intent to defraud, in any way deceives, misleads, or threatens by word, letter, or advertisement, will be suspended or disbarred from practice before the IRS. More specifically, disreputable conduct for which a practitioner may be disbarred or suspended includes—

- Conviction of any criminal offense under the revenue laws or of any offense involving dishonesty or breach of trust.
- Giving false or misleading information on tax returns or enrollment applications or in other submissions to the Treasury Department.
- Solicitation of employment as prohibited under Sec. 10.30.
- Willfully failing to make a federal tax return, or evading any federal tax; knowingly counseling or suggesting an illegal plan for a client to evade taxes; or concealing assets.  
*Example:* A practitioner was disbarred from practice before the IRS for five years on the grounds of willful late filing of his own tax returns.
- Misappropriation of, or failure to promptly remit, funds received from a client for payment of taxes or other obligations due the United States.
- Attempting to influence the official action of any employee of the IRS by use of threats, false accusations, duress or coercion, offers of inducements, promises of advantage, or by bestowing anything of value.
- Disbarment or suspension from practice as an attorney, CPA, public accountant, or actuary.
- Knowingly aiding and abetting a practitioner to practice before the IRS during his or her suspension, or maintaining a partnership with that person.
- Contemptuous conduct before the IRS, including use of abusive language, making false accusations, or circulating malicious or libelous matter.
- Giving a false opinion knowingly or recklessly, or providing incompetent opinions on federal tax laws.

**Practice Tip.** Before hiring a new employee, be sure you contact the previous employer. Ask explicitly if the employee had any problems with the IRS or faced any disciplinary action.

**Practice Tip.** You might be able to stimulate interest in Circular 230 by pretending unfamiliarity with some aspect of its rules. As a challenge, throw the issue out for clarification in front of any informal gathering of your staff. Alternatively, you can schedule a formal discussion at a staff meeting.

### 301.3.3 Rules for Limited Practice

Rev. Proc. 81-38 defines the limits of authority and the ethics and conduct expected of individuals who wish to qualify for “limited” practice, such as unenrolled—and otherwise unqualified—preparers who seek to represent taxpayers before the examination division in a local office concerning the return they prepare. Except for limiting the preparer’s authority, the rules are roughly similar to those in Circular 230 regarding practice by attorneys, CPAs, and enrolled agents as far as cooperation with the IRS, due diligence, and solicitation and advertising.

### 301.3.4 AICPA Standards

If you want to conform your practice to ethical principles supported by the American Institute of Certified Public Accountants (AICPA), you must consider both the Statements on Responsibilities in Tax Practice and the Code of Professional Conduct. Compliance with the SRTPs is in no way intended to dilute the value of the service provided to clients by a CPA. Although these standards are not enforceable by the AICPA, a practitioner’s state of licensure may have incorporated them into its rules of professional practice. As such, a CPA might face legal action for failure to observe a standard. We will discuss each of these in turn.

#### Statements on Responsibilities in Tax Practice (SRTP)

The Federal Tax Division of the AICPA has adopted standards for tax practice—the eight Statements on Responsibilities in Tax Practice. Although the SRTP are published for the education and guidance of members of the Institute and, according to the Tax Division, “the authority of these standards rests on their general acceptability,” their significance extends much further.

**Practice Tip.** It has been reported that the office of the director of practice of the IRS views the SRTP as extensions to and interpretations of the duties and restrictions set out in Treasury Circular 230. In addition, a plaintiff’s attorney in an action charging a practitioner with negligence might cite these standards, along with Circular 230, as constituting the generally accepted standards of tax practice. You should read over and observe these standards.

**SRTP No. 1: Tax return positions.** A tax return position is one that you have specifically advised the client to follow, or one about which you, the signer, know all material facts. This statement guides the CPA when recommending a tax return position (even though the CPA doesn’t sign the return) and when signing a return as preparer.

SRTP No. 1 says that the CPA should not recommend a position unless he or she has a *good faith belief that the position has a realistic possibility of being sustained administratively or judicially* on its merits if challenged (see Section 302.4.2). (No position should be taken, for example, merely to obtain leverage in negotiating a settlement.)

Nevertheless, a CPA may recommend a position not fulfilling these requirements if it is not frivolous *and* if it is adequately disclosed on the return. (A frivolous position is one that is knowingly advanced in bad faith and is patently improper.)

You should not sign a return that is frivolous. Examples are those returns filed by protesters who refuse to provide any information or who claim that the income tax is unconstitutional.

Neither should you sign a return containing a tax position that does not have a realistic possibility of being sustained, *unless that tax position is disclosed*. You should advise your client of the potential penalties that might result from taking the position.

The guidance given in SRTP No. 1 is significant in that this standard is incorporated by the Omnibus Budget Reconciliation Act of 1989 into amended Internal Revenue Code Section 6694(a), which reads as follows:

If (1) any part of any understatement of liability with respect to any return or claim for refund is due to a position for which there was not a realistic possibility of its being sustained on its merits, and (2) any person who is an income tax return preparer with respect to such return or claim knew (or reasonably should have known) of such position, such person shall pay a penalty of \$250 with respect to such return or claim. (3) Such position was not disclosed as provided in IRC Sec. 6662(d)(2)(b)(ii) or was frivolous, such person shall pay a penalty of \$250 unless it is shown that there was reasonable cause for the understatement and such person acted in good faith.

Interpretation No. 1-1 of SRTP No. 1 states that the realistic possibility standard is less stringent than the “substantial authority” standard and the “more likely than not” standard applicable to substantial understatements of liability under the Internal Revenue Code (IRC Sec. 6662). Thus, sources of tax authority that would not meet the substantial authority criteria might nevertheless be relied upon to demonstrate that a tax return position possessed a realistic possibility of being sustained, as long as the position is not frivolous.

According to the interpretation, to determine if a tax position has a realistic possibility of being sustained, a CPA may rely on treatises, articles in recognized professional tax publications, and other reference tools and sources of well-reasoned tax analyses commonly used by tax advisers and return preparers. Sources cited by Congress and by the Internal Revenue Code that may be relied upon in order to avoid the substantial understatement penalty are listed in Chapter 302 of this manual, which covers Internal Revenue Code penalties on tax preparers.

**SRTP No. 2: Answers to questions on returns.** Before signing as preparer, you should make a *reasonable effort to obtain from the client and provide appropriate answers* to all questions. The fact that an answer might prove disadvantageous to the client does not justify omitting an answer.

You should be concerned to see that all questions are answered because (1) the question may be important when you determine tax liability; and (2) you must sign the preparer’s declaration stating that the return is true, correct, and complete.

If there are reasonable grounds to omit an answer, you are not required to provide an explanation for the omission. Reasonable grounds include the following:

- The information is not readily available and the answer is not significant in terms of taxable income or loss or the tax liability.
- There is genuine uncertainty about the meaning of the question in relation to the particular return.
- The answer is voluminous; in such cases, assurance should be given on the return that the data will be supplied upon examination.

**SRTP No. 3: Procedural aspects: Need to verify supporting data or consider other information.** *You may rely on information furnished by the client or by third parties unless it appears to be incorrect, incomplete, or inconsistent.* You may rely on unsupported data from the client, such as dividends, contributions, and medical expenses, unless the data appears to be faulty. Where a *condition* to a tax treatment is imposed—for example, adequate substantiating documentation in the case of a deduction—you should inquire to determine whether the taxpayer has met the condition. There is, however, no requirement that you examine underlying documentation. You should look at the client’s prior years’ tax returns wherever feasible as a guide to evaluating the information provided for the current year’s return.

**Practice Tip.** Despite SRTP No. 3, you may feel you can give the client better service and prevent inadvertent error by asking to see supporting documentation, particularly that which is also provided to the IRS, such as Forms K-1, 1099-INT, 1099-DIV, 1099-R, 1099-B, and so forth.

**SRTP No. 4: Use of estimates.** This statement considers the CPA’s responsibilities when using a taxpayer’s estimates in the preparation of a tax return. In this context, appraisals or valuations are not considered to be estimates.

*The client has responsibility for the estimated data and should be the one who provides it.* (This presumes that any estimates the client puts together with your assistance remain the responsibility of the client.)



You may prepare and sign a tax return involving the use of a taxpayer's estimates *if it is impracticable to obtain exact data, and the estimated amounts are reasonable*. Estimates should not be presented so as to imply greater accuracy than exists. (Note: This presumably means that cash contributions for which no exact amount can be calculated should not be stated as, for example, \$568.24.)

Only in unusual circumstances is it normally necessary to disclose that an estimate is presented. For example:

- The taxpayer has died or is ill (and is presumably unable to participate in providing the estimates).
- The taxpayer has not received a K-1 from a flow-through entity.
- Litigation is pending that impacts the return; for example, bankruptcy proceedings.
- Fire or computer failure destroyed the relevant records.

**Practice Tip.** Estimates should not be used where record-keeping is a condition for the deduction, such as to document the extent of business use of listed property and social clubs and for travel and entertainment expenses.

**SRTP No. 5: Departure from a position previously concluded.** This SRTP guides you in recommending a tax return position different from that in a prior return that was subject to an administrative or court proceeding. (“Administrative proceeding” includes an examination by the IRS or an appeals conference relating to a return or a claim for refund.)

*Unless the taxpayer is bound to a specified treatment in the later year, for example, by a formal closing agreement, a different treatment may be recommended.* After considering the consent the taxpayer gave in an earlier proceeding or an unfavorable court decision, you may prepare and sign a tax return containing this different treatment. Keep in mind, however, that SRTP No. 1 requires that you have a good faith belief in the sustainability of every tax return position. Similarly, IRC Sec. 6694(a)(1) provides penalties for the preparer who knows or should have known that a position did not have a realistic possibility of being sustained on its merits.

**Practice Tip.** Practitioners should be wary of reliance upon SRTP No. 5. In *Hyslep v. Commissioner*, T.C.M. 1988-289, the Tax Court said a taxpayer was estopped (prevented) from ignoring an earlier court finding that the taxpayer's out-of-town employment was indefinite (and not temporary). The court awarded the government \$5,000 for the taxpayer's frivolous litigation (IRC Sec. 6673).

**SRTP No. 6: Knowledge of error in a tax return or failure to file.** This statement advises a CPA who learns of an error in a client's previously filed tax return or of the client's failure to file. Excluded from this statement are instances in which (1) the original position taken by the client satisfied SRTP No. 1, (2) the matter in question has no more than an insignificant effect on the client's tax, or (3) an erroneous method of accounting was continued in the prior year under circumstances that required the permission of the IRS to change.

*You should inform your client promptly upon becoming aware of an error or failure to file and should recommend the measures to be taken.* The advice may be given orally.

**Practice Tip.** To prevent later dispute, follow up in writing the advice you have orally given the client.

It is the client's responsibility to decide whether to correct the error. If the client fails to take what you believe to be appropriate action, you should *consider withdrawing from preparing the return and whether to continue a professional relationship* with the client. (Note: Circular 230 similarly requires that a practitioner inform the client when an error has been found.) You may not inform the IRS except with the client's permission or when required to do so by law.

**SRTP No. 7: Knowledge of error detected during an administrative proceeding of the IRS.** Regardless of who prepared or signed the return that contains an error, *you should inform your client promptly upon becoming aware of an error, and recommend the measures to be taken.* The advice can be given orally. You should not inform the IRS without your client's permission unless required to do so by law.

Request the client's agreement to disclose the error to the IRS, but the decision whether to do so is the client's responsibility. Advise your client to consult legal counsel before taking any action, particularly where the IRS might assert fraud or other criminal misconduct. Lacking the client's agreement to disclose the error to the IRS, you should consider withdrawing from further representation of the client.

SRTP No. 7 advises that the CPA should *consider* withdrawing if the client refuses to allow an error to be corrected. No directive is given that a CPA *should* withdraw. An ethical dilemma arises in that a CPA's withdrawal during the audit of a client's return sends a signal to the IRS. You may wish to consult your attorney prior to withdrawal.

**SRTP No. 8: Form and content of advice to clients.** This statement considers several procedural aspects of providing tax advice. For example, SRTP No. 8 suggests that advice given to a client need not follow a standard format but should reflect professional competence and serve the client's needs.

Although you may choose to communicate with a client when subsequent developments affect previously provided advice, *there is no responsibility to update previously given advice unless by specific agreement or unless you are assisting in implementing the advice.* You should specifically inform your client that your advice reflects professional judgment based on the existing situation, that subsequent developments could affect previous professional advice, and that the advice is based on facts as stated and on authorities that are subject to change.

**Practice Tip.** Some practitioners are considering using their computer's database to create different mailing lists that contain the names of clients who have similar tax problems. That way, information on new developments can be sent only to those clients interested in, for example, passive activities or capital gains. Clients might be asked annually to indicate their interests from among those on a checklist.

## AICPA Code of Professional Conduct

Rule 302 of the Code of Professional Conduct of the American Institute of CPAs cautions its members that

Professional services shall not be offered or rendered under an arrangement whereby no fee will be charged unless a specified finding or result is attained, or where the fee is otherwise contingent upon the finding or results of such services. However, a member's fees may vary depending, for example, on the complexity of services rendered.

Fees are not regarded as being contingent if fixed by courts or other public authorities, or, in tax matters, if determined based on the results of judicial proceedings or the findings of governmental agencies.

The tax practitioner who performs no attest functions for a client is prohibited from offering to prepare or from preparing for a contingent fee original or amended tax returns or claims for tax refunds. Contingent fees are allowed when review by the IRS is expected, for example, when representing a client in an audit or when seeking a private ruling, influencing the drafting of laws or regulations, seeking reduced property valuations, or filing claims or amended returns when government review can reasonably be expected. However, contingent fees are prohibited for *any* professional service—including a tax service—performed for a client for whom a member also performs an audit, review, examination of prospective financial information, or compilation for third-party use (unless the compilation report discloses the lack of independence). Additionally, acceptance of a contingent fee by CPAs is prohibited by the laws of most states or by state boards of accountancy rules governing practice. Some malpractice insurance policies specifically exclude coverage for services performed for a commission or a contingent fee.

## Discreditable Acts

Rule 501 of the AICPA's Code of Professional Conduct states, "A member shall not commit an act discreditable to the profession." Disciplinary actions have been taken against AICPA members in connection with income tax violations. For example, a practitioner was given a 90-day membership suspension for assisting a client in preparing a return that included an improper depreciation deduction related to a tax shelter.

## Disciplinary Actions

The Bylaws of the AICPA provide for a trial board to hear charges of violations of the bylaws or of the Code of Professional Conduct. Disciplinary actions against members are reported in the *CPA Letter*, the semimonthly newsletter of the AICPA.

Membership can be suspended without a hearing, and then terminated upon final conviction, for these offenses:

- A crime punishable by imprisonment for more than one year
- The willful failure to file any income tax return that he or she, as an individual taxpayer, is required by law to file
- The filing of a false or fraudulent income tax return on his or her or a client's behalf
- The willful aiding in the preparation and presentation of a false and fraudulent income tax return of a client (AICPA Bylaws, Sec. 7.3.1)

There is close coordination of disciplinary action between the AICPA and state societies of CPAs. On the other hand, state boards of accountancy—the agencies that regulate licensing for public practice—follow their own course. It is not unheard of to find that a CPA has been suspended or expelled from the AICPA or from a state society but continues to practice without interference by the state licensing board.

**Practice Tip.** Some practitioners feel that they show a spirit of cooperation if they appear before a disciplinary board unrepresented by legal counsel. If you are unfortunate enough to be called for a hearing before a disciplinary board, you should consult with an attorney experienced in administrative law even if you intend to appear without counsel.

### 301.3.5 Advocacy and Integrity

The AICPA “Statement on Guidelines for Tax Practice Quality Control” from the AICPA Voluntary Tax Practice Review Program states that firms should establish policies and procedures to provide reasonable assurance that staff at all organizational levels pursue client advocacy with professional integrity. That is, as client advocates, they should seek to advance client positions as long as those positions and staff efforts are within standards set by law and other appropriate professional bodies.

The relevant literature, as discussed above, is composed of the Code and Regulations, Treasury Circular 230, and the AICPA Code of Professional Conduct and Standards of Tax Practice. Your firm's quality control policies and procedures document should set forth measures by which the firm will assure compliance with standards and guidelines (see Chapter 101, Exhibit 101-2).

### 301.4 Due Diligence

*Due diligence* is the duty to make adequate inquiries when engaged in tax practice. This is the standard of care required of a practitioner. The concept of due diligence in tax practice arises in Sec. 10.22 of Circular 230, (see Section 301.3.1 of this manual), and in IRC 6694(a) and (b). Due diligence in connection with IRC 6694 is covered in Chapter 302.

Section 10.22 of Circular 230 requires that a practitioner exercise due diligence when determining the correctness of any oral or written representation made either to the Department of the Treasury or to a client concerning any matter under the attention and administration of the IRS.

Due diligence may be described as the duty to investigate or inquire, although you are not required to audit, examine, or review books and records (Rev. Proc. 80-40, 1980-2 C.B. 774). A circuit court of appeals cited this revenue procedure, commenting that “if the information supplied would lead a reasonable, prudent preparer to seek additional information, it is negligent not to do so” (*Brockhouse v. U. S.*, 749 F.2d 1248 (7th Cir. 1984) aff'g 577 F.Supp. 55 (N.D. Ill. 1983)). We will look at examples of due diligence, as quoted from several IRS sources.

**Example.** A taxpayer claimed to have incurred deductible entertainment expenses. The preparer failed to inquire whether the taxpayer had the records for substantiation required in IRC Sec. 274(d). The IRS subsequently audited the return and disallowed a portion of the deduction because substantiation could not be provided by the taxpayer. The preparer is subject to the penalty for negligent disregard of rules or regulations because he failed to make the necessary inquiry (Rev. Rul. 80-266, 1980-2 CB 378).

**Example.** A taxpayer stated to a preparer that he had paid \$2,500 in medical bills and \$4,000 in deductible travel and entertainment expenses. In fact, he had paid smaller amounts. The preparer properly calculated deductions for medical and for travel and entertainment. The preparer asked the taxpayer and was reasonably satisfied that the taxpayer had corroborative evidence for the \$4,000 deduction. Since the preparer had no reason to believe the information was incorrect or incomplete, he has exercised due diligence and is not subject to penalty for either negligent or willful understatement of a tax liability (Regs. Sec. 1.6694-1(b)(2)(iii)).

**Practice Tip.** Where code or regulations require that the taxpayer have and retain a particular form of documentation—for example, records of how and when a country club was used for business entertainment—your interview sheets, engagement letter, or other records should show that you made an inquiry and received a satisfactory answer.

## 301.5 Malpractice by Tax Preparers

Although not as dramatic as million-dollar suits against accountants in connection with SEC investigations of audit clients, claims for damages arising from tax practice occur frequently. Insurance carriers report that a significant portion of claims filed against CPAs arise from tax practice. Typical claims include those in which the client has been assessed penalties for late filing, has missed a deadline for making an election, or has overpaid taxes while the statute of limitations bars a refund. Failure to use the alternative valuation date when filing an estate tax return also results in claims. The client's attorney can assert that the tax practitioner caused the loss through negligence and should bear the cost of the error, together with the attorney's fees.

**Practice Tip.** If it's clear that you have erred or if it's a close call as to whether you or the client is responsible, consider paying the IRS penalties—without admitting fault—before the client consults a lawyer. You will at least minimize lost time, and you have a shot at retaining the client's confidence and goodwill. (As a further goodwill gesture, some practitioners pay the interest due on the underpayment, particularly if the amount is small, even though the client has had the use of the money and thus presumably has earnings to offset the interest charges.)

Proprietors or partners of firms are liable for the errors of their employees. One or more of several legal theories can be brought up by the plaintiff's attorney. A common one is that the proprietor or partner turned over the client's affairs to an employee and then failed to train the employee or to exercise adequate supervision. You must guard yourself against negligent, careless, or untrained acts of employees.

Generally speaking, the best safeguards are hiring qualified people, continuing their education, and establishing quality controls that minimize the chance that an error could be made and remain undetected. Highly desirable is a quality control document that spells out your firm's requirements for preparation checklists, review procedures, training, supervision, and peer review. Be sure to look at Section 201.3 of this book, concerning the review process, and Chapter 104, Personnel Issues.

**Practice Tip.** Give paid release time for employees to attend tax education seminars, and consider paying all fees and expenses. Some practitioners believe good "team spirit" lowers the chances of error, so they try to foster this by "half-time" (mid-tax-season) pep talks

and recreational outings and by providing lunches on weekend work days near the end of the season.

In addition to the risks of civil suits from clients, you must be alert for circumstances in which an employee could violate an Internal Revenue Code penalty provision, such as the unauthorized disclosure of taxpayer information. Preparer penalties are discussed in Chapter 302.

### 301.5.1 Negligence and the Standard of Due Care

The rule of law is that a person who claims to be qualified in a particular field—whether attorney, physician, CPA, or tax preparer—is expected to perform with the competence and care customarily found in someone of that profession. In other words, a carpenter who performs surgery while masquerading as a physician would be held to the performance skills of a surgeon, and is liable for injuries caused by failing to use those skills. The carpenter can't evade responsibility by saying, "That's the best incision any carpenter could make."

CPAs are expected to be experts in tax matters. They are sought out because of their special skills. They have a duty to exercise their skills with the standard of care and diligence ordinarily found among other CPAs in tax practice. If you fall below this level of performance, and injure another, you are liable for your own *negligence*. The person who is injured—in tax practice, almost always the client rather than a nonclient—can bring a civil legal action against you.

The norm of practice expected of you (and of any other professional) is referred to as the standard of reasonable care, of due care, or of due professional care. This standard does not require infallibility. You can be wrong and yet not be liable if the advice you gave or the tax return you prepared was the result of the proper exercise of skill and judgment. Unfortunately, you may have to go to court to defend your skill when sued by a client.

In assessing whether or not a practitioner has acted reasonably and *not* negligently, the accepted standards of the profession are viewed as a minimum level of conduct. For tax practitioners, these standards consist of the rules of practice found in Circular 230, provisions of the Internal Revenue Code and Treasury Regulations relating to practitioners, and the codes of professional conduct or responsibility (ethics) of state licensing boards, professional societies, and the AICPA. Compliance with your firm's quality control document is a necessity.

If a malpractice case against a tax practitioner goes to court, the plaintiff's attorney attempts to find experts—who practice the same profession as the defendant practitioner—to testify that the practitioner violated the accepted standards of the profession. The practitioner's attorney seeks to show that the practitioner exercised the level of skill customarily expected.

Your contract with a client also defines a standard of care. That is, you have a duty to perform in accordance with your contract with the client (and to do so with professional due care). It doesn't matter whether the terms of this contract are explicit and in writing—as, for example, in an engagement letter—or whether they are merely implied by the nature of the business relationship. For example, it is implied that you have agreed to prepare a return in time for filing by the due date if the taxpayer submits all necessary data in a timely fashion. There doesn't need to be a written statement or oral agreement that you will do your job in time to meet a deadline.

**Practice Tip.** If a client's (or someone else's) failure to provide data appears likely to cause a final filing date to be missed, don't assume it is "obvious" that the fault is not yours. Beware of your client's conveniently short memory. Your best protection regarding any tax deadline is to have in your files an acknowledgment from your client that *states the date* by which you have to have data necessary for the filing or other action. You should establish a deadline for the receipt of all data from the client—for example, April 1 for preparation of a Form 1040—after which, if the data has not been received, you will prepare an application for an extension. Notice of this policy should be written into your tax engagement letter.

**Practice Tip.** Never routinely prepare extension requests for clients who have not provided complete records. An extension request extends the time for filing but not for payment.

An extension request that substantially understates the amount of taxes owed is void. The IRS will assess the delinquency penalty of 5 percent per month for failure to file plus interest. In *Crocker v. Commissioner*, 92 T.C. 899 (1989), the Tax Court voided the applications for extension on Form 4868 and held that reliance on voided extensions, excessive workload, or lack of information was not reasonable cause. The court then assessed the delinquency penalty and the negligence penalty. The *Crocker* case represents long-standing IRS policy. See Rev. Rul. 79-113, Rev. Rul. 83-27, and “Filing Extension No Green Light to Underestimated Tax,” *Journal of Taxation*, October 1983, p. 283. Many CPAs who participated in filing extensions that underestimated tax are now reimbursing thousands of dollars in IRS penalties. See Section 201.5 of this manual for a discussion of filing for an extension.

### 301.5.2 Civil Damage Suits

Most claims against tax practitioners are settled outside of public view for the amount attributable to the practitioner’s alleged negligence. These cases are the “garden-variety.” They are frustrating and embarrassing but not financially damaging.

Only more serious cases get to trial. Examples of more serious cases are:

- A CPA whose contract with a client specified that tax returns would be filed in a timely manner was liable for the penalties for late filing (*L. B. Laboratories, Inc. v. Mitchell*, 39 Cal. 2d 56 (1952)).
- An attorney who failed to file a federal estate tax return by the due date was liable to the estate for \$28,000 for extra taxes caused by failure to use the alternate valuation date (*Cameron v. Montgomery*, 255 N.W. 2d 154 (Iowa 1975)).
- A preparer was ruled guilty of fraud for assigning employees who were untrained and who lacked basic skills to prepare returns while advertising the high level of their expertise and accomplishment. The preparer’s advertisements cited “guaranteed accurate tax preparation.” Punitive damages of \$100,000 were awarded against the preparer (*Midwest Supply, Inc. v. Waters*, 89 Nev. 210, 510 P.2d 876 (1973)).
- A preparer who refused to complete a tax return until fees were paid was liable to the client for the reasonable cost of paying another preparer to finish the work (*Whitlock v. PKW Supply Co.*, 269 S.E. 2d 36 (Ga. App. 1980)).
- A CPA was liable for the taxes that resulted when the taxpayer relied on the CPA’s wrong advice concerning the taxability of the sale of stock in one controlled corporation to another controlled corporation. The CPA lacked knowledge of a new provision in the code (*Bancroft v. Indemnity Ins. Co. of N. Am.*, 203 F.Supp. 49 (W.D.La. 1962) aff’d 309 F.2d 959 (5th Cir. 1962)).
- A preparer who computed a net operating loss by deducting from gross income cash that had been expended for personal expenses was liable to the client for interest and penalties. The client, however, failed to recover from the preparer on a claim for “mental anguish” supposedly arising because the IRS referred the case to its criminal investigation division (*H&R Block, Inc. v. Testerman*, 275 Md. 36, 338 A.2d 48 (1975)).

### 301.5.3 Defenses

The first and best defense to the threat of a legal action is offense: Do good work and don’t make mistakes. You do good work by observing these practices:

- Be selective when taking on new clients and periodically reconsider continuing with those who give you problems. Avoid new clients who are in financial difficulty or in long-running disputes with the IRS.
- Don’t accept a client unless your firm is qualified to do the work fully and in a timely fashion.
- Use data gathering or interview sheets. Have them signed or initialed by the taxpayer. Give a copy to the taxpayer along with a copy of the return and include a notice that the return was prepared from the data on the interview sheet. State that the client must notify you immediately if the information or the return is incorrect.

- Investigate fully all relevant facts. You need not disbelieve what the client tells you, but further investigation or, at least, further inquiry may be wise in some cases. Study returns filed in past years and in other jurisdictions.
- Maintain written documentation. Keep written records of conversations with the client in a call log and in the client file. Send written reminders to the client that you need to receive the documentation, such as a K-1, if you take data over the telephone.
- Document adherence to the AICPA's Statements on Responsibilities in Tax Practice. For example, research notes should be retained that show your good faith belief in the sustainability of a tax return position (SRTP No. 1).
- Notify the client orally (but then *put it in writing*) about matters that affect the tax return. Document that you warned the client of the risks of tax return positions that could be subject to penalty, or that you notified the client of an error in a previously filed tax return.
- Meet your deadlines. A tax control docket system or "tickler" file is a necessity.
- Conduct research when it's needed. Frequent changes in tax law make this imperative. Be aware of the necessity for research when dealing with multistate returns. If the client asks for your advice in matters that you are not familiar with, be sure you have the expertise or are willing to do the research.
- Practice quality control. The greatest single element of quality control in preparing and filing is provision for a fresh, or cold, review of each return. Follow this rule: One prepares, another reviews.
- Avoid conflict of interest. Don't advise both parties in a divorce proceeding. Also, be careful in circumstances in which one client has an interest that may be adverse to another client. Adverse interests might exist in some estate planning situations where you may be advising a client to make arrangements that are detrimental to the financial interests of another client. Similarly, don't try to advise both sides in a business buy-out.
- Never discuss with a client the possibility of playing the "audit lottery."
- Don't let a client's bill get too large or too old.
- Sue to collect fees only as a last resort. Some say, *never sue*. These suits often stimulate a client to countersue, charging a deficiency in your work.
- Always use an engagement letter.
- Adopt a written statement of quality control. This quality control document should spell out your firm's adoption of the procedures listed above.

### 301.5.4 Tax Planning and Personal Financial Planning

Your duty as a tax preparer is to abide by the terms of the engagement contract and to perform up to a standard of professional due care. If you step into the role of adviser—for example to give counsel on future courses of action, or to recommend an investment product that might lower a client's taxes—it is possible that a court may subsequently hold you to a higher standard of care, that of a *fiduciary*. (Reported cases are rare that hold a practitioner to a fiduciary duty when the CPA's *only* service to a client was that of tax preparer.)

A fiduciary has a duty to a client to exercise the utmost honesty and candor. This means, at a minimum, that you should never recommend that the client take a course of action, sell an asset, or purchase an investment product without fully disclosing *any* business interest in or benefit you might have from the transaction. You should make clear any professional relationship you have with the other party to the transaction.

For example, you might be asked to review and evaluate a limited partnership investment that your client was considering. If you receive any fees for services to the promoter or to one of the general partners, whether in connection with the investment or otherwise, be sure you spell this out to the client. Document that you informed the client of your relationship with the other party.

**Practice Tip.** Some malpractice insurance policies exclude coverage for services involving analysis, recommendation, or sale of securities. Also, if you are a financial planner be

aware that, in some instances, the SEC might consider you to be an *investment adviser*, subject to registration under Section 203(a) of the Investment Advisers Act of 1940. See the AICPA's Personal Financial Planning Practice Aid 1: *Issues Involving Registration Under the Investment Advisers Act of 1940* (New York: AICPA, 1986).

### 301.5.5 Time Limits on Recovery of Damages

The time within which a civil lawsuit must be filed is determined by state statute. If a suit is filed *after* the time period specified in the state's statute of limitations, it will be dismissed as untimely. Statutes of limitations for negligence or breach of contract suits against practitioners vary from state to state. In New York, for instance, the statute specifies three years for torts (including negligence) and six years for contract claims. In Florida, the statutes specify two years for professional malpractice claims, whether founded on tort or on contract principles. In a majority of states, these time periods begin to run when the contract is entered into or, in the case of negligence, when the party demanding recovery becomes aware of the injury (or when they should have become aware with the exercise of reasonable care). There are exceptions. Here is a case that demonstrates the importance of the statute of limitations.

**Example.** In a recent decision, the Arkansas Supreme Court held that the state's three-year statute began to run on the date the taxpayer was notified of a tax deficiency and not on the later date the amount was assessed. As a result, the malpractice lawsuit against the accountant was dismissed as not timely filed (*Ford's Inc. v. Russell Brown & Co.*, 299 Ark. 426; 773 S.W.2d 90 (Ark.Sup.Ct. 1989)).

The statute of limitations is considered by a client's attorney when deciding to file a suit that is presenting a claim based on contract or on tort principles. (The length of the statute of limitations may be different in contract claims versus tort claims.) An attorney can advise you whether it is possible, by terms of the engagement letter, to limit the time period within which a legal action may be brought. That is one reason for asking your attorney to look over your engagement letter. See Exhibit 301-9 for engagement letter wording that might be used to limit the period of time for bringing a legal action, if approved by your attorney.

### 301.5.6 Malpractice Insurance

Professional liability insurance (malpractice insurance) provides indemnity—that is, reimbursement—for payments the insured becomes legally obligated to pay as damages, except for bodily injury or property damage, as the result of an error or omission made by the insured. Damages are usually described as arising out of the performance of professional services for others in the insured's capacity as an accountant, including breach of contract, provided that the breach was not intentional.

Malpractice insurance is designed to cover damages assessed because of unintentional, negligent performance, and not to provide reimbursement for dishonesty. Physical injury and property damage are excluded from coverage. Disciplinary actions by governmental agencies such as the IRS and the Securities and Exchange Commission are not encompassed in malpractice coverage; neither are proceedings by state licensing boards or voluntary associations such as the AICPA or state societies.

Practically all policies are called *claims-made*; that is, they cover only claims reported during the period the policy is in effect.

**Practice Tip.** Practitioners who are retiring or who are switching to a new insurer should inquire about the availability of protection for claims that may not arise until *after* the primary period of coverage.

Professional liability policies also impose upon the insurance company (the carrier) the duty of providing and paying for a legal defense for the insured. The provision for defense is extremely valuable due to the proliferation of frivolous lawsuits against all types of professionals. Whether the suit appears groundless or not, the carrier will provide a defense. (The carrier is, after all, looking after its own best interests in assuring that a strong defense is put forward.)



In the most desirable policies, the amount of coverage available to pay claims would not be reduced by the costs of mounting a defense; these costs would be borne wholly by the carrier; such policies may be difficult to find.

As a condition of coverage, policies require that notice must be given to the insurance company of an occurrence that could lead to a claim. Failure to give notice of such an occurrence may result in denial of coverage.

Attempting to negotiate a settlement with a dissatisfied client may cause loss of coverage. If a lawsuit subsequently is filed, the insurance carrier may attempt to avoid coverage on the grounds of lack of notice. Additionally, an attempt to negotiate with the disgruntled client may constitute a breach of the insurance contract that gives the carrier the right to control settlements. On the other hand, practitioners rightly fear what might be the reaction of their carrier should they report *every* instance in which they have had a falling out with a client over the quality of service performed. It is difficult to give advice that would cover every situation and the reaction of every client and every insurer. In general, you should communicate with the insurance carrier whenever it is clear that you have made an error that will cost the client and the client threatens legal action. In case of doubt, consult your own attorney.

In some instances, the best interests of the insurance company may differ from those of the practitioner facing a lawsuit. You may wish to go to court if necessary to prove your innocence, for example, while the insurer wants a quick and cheap settlement even if it leaves in doubt the quality of your professional practice.

**Practice Tip.** Schedule a conference with your own attorney if you feel that your insurance carrier's actions are not in your best interest.

## 301.6 Risk Management in Tax Practice

The bulk of the instances in which tax practitioners pay damages to their clients arise from one or the other of two causes:

- Failure to file a return on time.
- Preparation of a return in ignorance of the code, regulations, and rulings.

Errors seem to occur most frequently after changes have taken place in tax law. Problems also arise with requests for extensions. Be sure you and the client have agreed on whose responsibility it is to file for an extension.

Getting the return completed and mailed on time is a matter of in-house control, including tickler files and methods of tracking a return so that its location and stage of completion is always known. Control is discussed in this book at Chapter 101, The Overall Control System, and at Section 201.2, The Tax Return Process.

Hire competent people and require them to keep up with tax law. For suggestions about hiring and training staff, see Chapters 104, Personnel Issues, and 105, Professional Tax Education.

Risk management is addressed largely by close attention to maintaining a system of quality control. AICPA tax practice quality control guidelines set forth nine elements of control designed to ensure that personnel are properly qualified, supervised, and trained and that clients of integrity are advised in accordance with professional standards. The AICPA's Voluntary Tax Practice Review Program, discussed throughout this manual, is designed to assist practitioners in improving not only the quality but also the efficiency and profitability of their practices.

### 301.6.1 Chronic Nonfilers, Fraudulent Filers, and Tax Protesters

You should always be on the alert to recognize nonfilers and those who have filed false returns. Neither you nor the taxpayer wants documentation placed in your files concerning a fraudulent past filing, even if the taxpayer is now repentant. Your files and your testimony can be summoned by IRS or court order. If you are approached by a taxpayer desiring to amend a previously filed return that was admittedly false, you should refer the matter to a tax attorney to whom the client can safely reveal the transgressions.

You need not ordinarily anticipate any particular trouble from the IRS for your involvement with *late* filers who are now ready to mend their ways, provided the IRS does not view the delinquency as *willful* (or as the result of your intentionally wrong advice). Remember, however, that willful failure to file a return is a crime—a misdemeanor, under IRC Sec. 7203.

One practitioner states that he first explains the nature of the late filing penalties and interest that might be assessed, then he asks for a cash retainer because the client may again have a change of heart. Next, he notifies the IRS that he has been retained to make these late filings, names the taxpayer, and requests Forms W-2, 1099, and any other records and information that the IRS might have regarding that taxpayer, including with his request Form 4506 (Request for Copy of Tax Information).

A request to the IRS for information on Form 4506 may reveal if a problem exists that practitioners sometimes encounter: a taxpayer who has filed a fraudulent return and then seeks help in “setting things right,” but without telling the practitioner the full story. The IRS has developed a “Nonfilers Initiative,” under which taxpayers who have failed to file returns and who voluntarily come forward will be assisted by the IRS with installment agreements and, where appropriate, penalty abatements and offers in compromise. Nonfiling tax practitioners who voluntarily come forward under this program normally can expect to receive only a formal reprimand from the Director of Practice, unless the facts and circumstances show egregious misconduct. The IRS will continue to monitor a tax practitioner’s compliance for five years. If the practitioner willfully fails to file a tax return during that period, the IRS will take a “no holds barred” approach to discipline and will consider the original willful failure to file in determining sanctions for the later misconduct.

**Practice Tip.** Always accompany delinquent filings with payments of at least part of the taxes owed, together with a suggested schedule of installment payments backed up with documentation of your client’s ability to pay. Also, to attempt to abate penalties, attach the client’s affidavit spelling out the cause of the tardiness.

Referral of your tardy client’s case from the collection division of the IRS—that generally handles delinquency cases—to the criminal investigation division (CID) may take place. This referral is likely to be made if the revenue officer in charge of the case finds that several years’ returns are delinquent and the tax liability appears substantial, and *if* the officer believes there is evidence that the taxpayer’s failure to file was *willful*.

**Practice Tip.** If you suspect a referral to CID is taking place, you must direct your client immediately to a criminal tax attorney. See Section 303.1.1 for further discussion of this aspect of practice.

Tax protesters, that is, persons having taxable income who express their distaste for paying taxes by refusing to file or to pay or by writing unnecessary comments—such as “paid under threat of coercion”—should not be assisted. Tax protesters continue to receive sanctions up to \$25,000 in Tax Court for delay (IRC Sec. 6673) and penalties up to \$10,000 in other U.S. courts for groundless or frivolous positions (IRC Sec. 7433).

Tax protesters base their unsuccessful objections to filing or paying taxes on various grounds, for example:

- Filing violates their First, Fourth, and Fifth amendment rights: *Butler, Kenneth O., et ux v. Comm.* T.C. Memo 1999-263
- Filing is a “voluntary practice”; *McDougle, Ronald v. Comm.* T.C. Memo 1999-264
- Wages are not income and taxing wages violates the Sixteenth Amendment: (1) *Bohnet, Kenneth G., et ux v. Comm.* T.C. Memo 1999-238 and (2) *Morin, Timie A. v. Comm.* T.C. Memo 1999-239
- The constitution forbids taxation of compensation received for services. *Williams, Williams C. v. Comm.* T.C. Memo 1999-270

## 301.6.2 Avoiding or Eliminating Undesirable Clients

A great part of risk management in tax practice consists of having the right clients, that is, those who pay when they are billed and who play it straight with both you and the IRS.

You must be selective when accepting a new client. Although it would be futile (and insulting to the taxpayer) to ask for a reference from the previous preparer, you should do the next best thing: If feasible, accept a client only on the condition that you first review two or three years' prior tax returns, together with whatever IRS communication has resulted from those returns. That way, you get a picture of the client's affairs and an insight into the "aggressiveness" of the positions that he or she has become accustomed to take. See Section 201.1 for a discussion of client information. Also, be sure to get a signed engagement letter spelling out the extent of your services and the billing arrangements.

As for existing clients: A change in your fee structure might be a good time to look the situation over. Practically any other change in your firm could be cited to a client as a reason for termination (supposing that you are trying to put the best light on the termination). One practitioner writes to clients as follows.

Accounting firms that are growing rapidly, as ours is, find that periodically they must reevaluate the nature of the services they provide to clients. Because of changes in the nature of our practice we regretfully have concluded that we are no longer able to provide you with the services you need at a fee that would be fair to you.

A merger with another firm or the retirement of a partner could also be the occasion for change to be cited in such a letter.

Some CPAs feel that forgiving small amounts of unpaid fees when a client is voluntarily terminated serves to placate the client. Other practitioners fear that would mark themselves as a soft touch and stimulate the client to search for other means of extracting money. One practitioner states that she has sent copies of client termination letters to her attorney and makes it clear that she has done so. Another practitioner says he believes it better to have a heart-to-heart conversation alone with the client and to put nothing in writing.

Techniques for termination differ because reasons differ and people differ. Most CPAs agree that terminating an undesirable client is never fun, but it's better to fight the battle once-and-for-all than to live for years under its threat.

Whether you or the client terminate the relationship, you need to practice risk management even as the client is heading out the door. There is a danger that the former client will fail to file the returns you have been preparing and then deny knowledge that you are no longer the preparer. Send a termination letter containing the elements spelled out in Exhibit 301-8. (Depending upon the "heat" generated by the termination, you may wish to send the letter certified with a return receipt requested.)

### 301.6.3 Tax Engagement Letters

A tax engagement letter spells out the services that you have been hired to perform. It also tells what actions are expected of the client—for instance, to provide certain information by a specified date. An engagement letter constitutes your contract with your client.

A properly written engagement letter can prevent misunderstandings on the part of a client who might assume, for example, that an audit or an accounting service was also contemplated, or that you will prepare multistate tax returns when you thought only one state was involved. Also, a letter that spells out the financial terms of the engagement can minimize the chance of disagreements over fees and billing arrangements.

For most CPAs, obtaining engagement letters from audit clients is standard practice. Engagement letters should also be routine for tax clients. Here are some tips about tax engagement letters:

- Point out in the letter that the IRS views the tax return as the taxpayer's responsibility. Warn that you are not being hired to verify any of the information and that you are accepting the client's input as being correct.
- Refer to the risks that apply with taking an aggressive tax return position and to the possibility and consequences of an audit.
- Warn that penalties may apply for inaccurate, late, or underpaid returns. State that the client is responsible for timely payment of quarterly estimates and other payments.

- Counsel the client to retain supporting documentation and to conform to tax authority requirements for documenting travel and entertainment expenses, appraisals, business use of vehicles and other “listed” property, and barter transactions.
- State that you are not responsible for disallowance of deductions, inclusion of unreported income, or any resulting taxes, interest, or penalties.
- Tell how your fees will be determined and when payments are due. State your policy regarding additional fees for additional services such as representation during a tax examination or when responding to IRS inquiries.
- Spell out the duties you are undertaking in precise language. Avoid saying, “We will prepare all necessary tax returns.” That phrase is appropriate only if you really do accept responsibility for knowing the totality of the client’s business affairs and all the taxing jurisdictions in which they are located. Instead, name the federal, state, and local returns you’ll prepare and the time periods covered. Make explicit that no other tax matters or returns are contemplated.
- Identify worksheets or schedules that the client will provide. State that the client will present you with true and complete information and the dates by which you have to have the data. State procedures for applying for extensions.
- State that you will use an outside computer service, if that is the case (because this affects the degree of confidentiality of the client’s tax information).
- State that you will furnish copies of joint tax returns and supporting schedules to either spouse who requests them upon payment of applicable charges.
- Name the duration of the agreement. In a later engagement, if you change the contents of your engagement letter from the one previously used, alert the client to the changes.
- Review your engagement letter with your attorney every few years and after you make significant changes.
- Retain a copy signed by the client.

Exhibits 301-2 through 301-7 present sample engagement letters and related materials provided by the Federal Tax Division of the AICPA. Exhibit 301-8 presents the elements that should be included in a termination letter. Exhibit 301-9 is a statement attempting to limit liability that might be included in an engagement letter, but only if approved by your attorney. These samples are intended for use as a guide only and do not represent an official AICPA position.

**Practice Tip.** Your malpractice insurance carrier may have suggested engagement letters for your use.

# Exhibits

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**Exhibit 301-1: Summary of Requirements for Appearance Before the IRS****RECOGNITION AND AUTHORIZATION REQUIREMENTS  
FOR PERSONS APPEARING BEFORE THE IRS**

<i>Capacity of Person Appearing</i>  (Each category includes all categories listed below it)	<i>Attorneys and CPA's</i>	<i>Enrolled Agents</i>	<i>Unenrolled Persons Who Are Not Attorneys or CPA's</i>		
			<i>Qualified for Limited Practice Under Sec. 10.7 of Cir. No. 230</i>	<i>Return Preparers</i>	<i>All Others</i>
1. As an advocate who is to perform certain acts for taxpayer as prescribed in 26 CFR 601.502(c)(1) (Constitutes "Practice" as defined in Cir. No. 230).	P/A and D Exception (2) may apply	P/A and E	Ineligible	P/A Exception (2) may apply	Ineligible
2. As an advocate (Constitutes "Practice as defined in Cir. No. 230) who may receive tax information of a confidential nature but is not to perform other acts for taxpayer as prescribed in 26 CFR 601.502 (c)(1).	TIA and D Exception (1), (2) or (3) may apply	TIA and E Exception (3) may apply	TIA Exception (4) applies	TIA Exception (2) or (3) may apply	Ineligible
3. As a witness who may receive or inspect tax information of a confidential nature (Does not include "Practice" as defined in Cir. No. 230).	TIA Exception (1) or (2) may apply	TIA	TIA	TIA Exception (2) may apply	TIA
4. As a witness for taxpayer to present his books, records or returns to the examining officer (Does not include "Practice" as defined in Cir. No. 230).	No requirements	No requirements	No requirements	No requirements	No requirements

**CODE FOR REQUIREMENTS**

P/A — Must present or have Power of Attorney on file.

TIA — Must present or have a Tax Information Authorization (or Power of Attorney) on file if taxpayer is not also present.

D — Must present or have a Declaration on file. Declaration may be in combination with a TIA or Power of Attorney.

E — Must present evidence of current enrolled status or temporary recognition status.

**EXCEPTIONS**

(1) An attorney who prepared the estate tax return and is the attorney of record for the estate will not be required to have a TIA on file, but a Declaration must be on file. (26 CFR 601.502(c)(3)(ii))

(2) A trustee, receiver, or an attorney (designated to represent a trustee, receiver or debtor in possession) may substitute a proper court certificate or a copy of a district court order approving bond in lieu of a P/A or TIA. (26 CFR 601.502(c)(3)(iii))

(3) A TIA is not required if the advocacy can be performed without necessitating Service disclosure of tax information of a confidential nature. (26 CFR 601.502(c))

(4) Unenrolled return preparers are limited to representation of persons during the examination process (ineligible for practice at Appeals Conferences). (Sec. 10.7(a)(7) Cir. No. 230)

SOURCE: *Internal Revenue Manual—Audit.*

**Exhibit 301-2: 1040—Individual Tax Return Engagement Letter**

1040 - INDIVIDUAL TAX RETURN ENGAGEMENT LETTER

Dear Client:

This letter is to confirm and specify the terms of our/my engagement with you and to clarify the nature and extent of the services we/I will provide. In order to ensure an understanding of our mutual responsibilities, we/I ask all clients for whom returns are prepared to confirm the following arrangements.

We/I will prepare your 199\_\_ federal and requested state income tax returns from information that you will furnish us/me. We/I will not audit or otherwise verify the data you submit, although it may be necessary to ask you for clarification of some of the information. We/I will furnish you with questionnaires and/or worksheets to guide you in gathering the necessary information. Your use of such forms will assist in keeping pertinent information from being overlooked.

It is your responsibility to provide all the information required for the preparation of complete and accurate returns. You should retain all the documents, canceled checks and other data that form the basis of income and deductions. These may be necessary to prove the accuracy and completeness of the returns to a taxing authority. You have the final responsibility for the income tax returns and, therefore, you should review them carefully before you sign them.

Our/My work in connection with the preparation of your income tax returns does not include any procedures designed to discover defalcations or other irregularities, should any exist. We/I will render such accounting and bookkeeping assistance as determined to be necessary for preparation of the income tax returns.

We/I will use professional judgment in resolving questions where the tax law is unclear, or where there may be conflicts between the taxing authorities' interpretations of the law and other supportable positions. Unless otherwise instructed by you, we/I will resolve such questions in your favor whenever possible.

**Exhibit 301-2: 1040—Individual Tax Return Engagement Letter (cont.)**

The law provides various penalties that may be imposed when taxpayers understate their tax liability. If you would like information on the amount or the circumstances of these penalties, please contact us/me.

Your returns may be selected for review by the taxing authorities. Any proposed adjustments by the examining agent are subject to certain rights of appeal. In the event of such government tax examination, we/I will be available upon request to represent you and will render additional invoices for the time and expenses incurred.

Our/My fee for these services will be based upon the amount of time required at standard billing rates plus out-of-pocket expenses. All invoices are due and payable upon presentation.

If the foregoing fairly sets forth your understanding, please sign the enclosed copy of this letter in the space indicated and return it to our/my office. However, if there are other tax returns you expect us/me to prepare, such as gift and/or property, please inform us/me by noting so at the end of the returned copy of this letter.

We/I want to express our appreciation for this opportunity to work with you.

Very truly yours,

Accepted By: \_\_\_\_\_

Date: \_\_\_\_\_

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**Exhibit 301-3: 1120S—S Corporation Tax Return Engagement Letter**

1120S - S CORPORATION TAX RETURN ENGAGEMENT LETTER

Dear Client:

This letter is to confirm and specify the terms of our/my engagement with (Name of S Corporation) for the year ended (\_\_\_\_) and to clarify the nature and extent of the services we/I will provide. Also, by sending you the engagement letter, we/I have assumed that you are the person responsible for the tax matters of the corporation. If this is not a correct assumption, please furnish us/me with the name of the tax matters person.

Our/My engagement will be designed to perform the following services:

1. Prepare the federal, state, and local income tax returns with supporting schedules.
2. Perform any bookkeeping necessary for preparation of the income tax returns.

Our/My work in connection with the preparation of your income tax returns does not include any procedures designed to discover defalcations or other irregularities, should any exist.

We/I will use our/my judgment in resolving questions where the tax law is unclear, or where there may be conflicts between the taxing authorities' interpretations of the law and other supportable positions. Unless otherwise instructed by you, we/I will resolve such questions in your favor whenever possible.

The law provides various penalties that may be imposed when taxpayers understate their tax liability. If you would like information on the amount or circumstances of these penalties, please contact us/me. Because an S corporation is an entity whose tax attributes generally flow through to its shareholders, the penalty for substantial understatement of tax relating to S corporation items may be imposed at either the corporate or shareholder level.

Management is responsible for the proper recording of transactions in the books of accounts, for the safeguarding of assets, and for the substantial accuracy of the financial records. You have the final responsibility for the income tax returns and, therefore, you should review them carefully before you sign and file them.

**Exhibit 301-3: 1120S—S Corporation Tax Return Engagement Letter (cont.)**

Your returns may be selected for review by the taxing authorities. Any proposed adjustments by the examining agent are subject to certain rights of appeal. In the event of such government tax examination, we/I will be available upon request to represent you and will render additional invoices for the time and expenses incurred.

Our/My fee for these services will be based upon the amount of time required at standard billing rates plus out-of-pocket expenses. All invoices are due and payable upon presentation.

If the foregoing fairly sets forth your understanding, please sign the enclosed copy of this letter in the space indicated and return it to our office. However, if there are additional returns you expect us/me to prepare, please note this at the end of the returned copy of this letter, just below your signature.

We/I want to express our/my appreciation for this opportunity to work with you.

Very truly yours,

Accepted By: \_\_\_\_\_

Title: \_\_\_\_\_

Date: \_\_\_\_\_

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**Exhibit 301-4: 1120—Corporation Tax Return Engagement Letter**

1120 - CORPORATION TAX RETURN ENGAGEMENT LETTER

Dear Client:

This letter is to confirm and specify the terms of our/my engagement with (Name of Corporation) for the year ended (\_\_\_\_) and to clarify the nature and extent of the services we/I will provide. Also, by sending you this engagement letter we/I have assumed that you are the person responsible for the tax matters of the corporation. If this is not a correct assumption, please furnish us/me with the name of the individual with whom this work should be coordinated.

Our/My engagement will be designed to perform the following services:

1. Prepare the federal, state, and local income tax returns with supporting schedules.
2. Perform any bookkeeping necessary for preparation of the income tax returns.

Our/My work in connection with the preparation of your income tax returns does not include any procedures designed to discover defalcations or other irregularities, should any exist.

We/I will use our/my judgment in resolving questions where the tax law is unclear, or where there may be conflicts between the taxing authorities' interpretations of the law and other supportable positions. Unless otherwise instructed by you, we/I will resolve such questions in your favor whenever possible.

The law provides various penalties that may be imposed when taxpayers understate their tax liability. If you would like information on the amount or circumstances of these penalties, please contact us/me.

Management is responsible for the proper recording of transactions in the books of accounts, for the safeguarding of assets, and for the substantial accuracy of the financial records. You have the final responsibility for the income tax returns and, therefore, you should review them carefully before you sign and file them.

Your returns may be selected for review by the taxing authorities. Any proposed adjustments by the examining agent are subject to certain rights of appeal. In the event of such government tax examination, we/I will be available upon request to represent you and will render additional invoices for the time and expenses incurred.

**Exhibit 301-4: 1120—Corporation Tax Return Engagement Letter (cont.)**

Our/My fee for these services will be based upon the amount of time required at standard billing rates plus out-of-pocket expenses. All invoices are due and payable upon presentation.

If the foregoing fairly sets forth your understanding, please sign the enclosed copy of this letter in the space indicated and return it to our/my office. However, if there are any additional returns you expect us/me to prepare, please note this at the end of the returned copy of this letter, just below your signature.

We/I want to express our appreciation for this opportunity to work with you.

Very truly yours,

Accepted By: \_\_\_\_\_

Title: \_\_\_\_\_

Date: \_\_\_\_\_

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**Exhibit 301-5: 1065—Partnership/LLP/LLC Tax Return Engagement Letter**

1065 - PARTNERSHIP/LLP/LLC TAX RETURN ENGAGEMENT LETTER

Dear Client:

This letter is to confirm and specify the terms of our/my engagement with (Name of Partnership or Limited Liability Company) for the year ended (\_\_\_\_) and to clarify the nature and extent of the services we/I will provide. Also, by sending you this engagement letter we/I have assumed that you are the person responsible for the tax matters of the partnership. If this is not a correct assumption, please furnish us/me with the name of the tax matters partner.

Our/My engagement will be designed to perform the following services:

1. Prepare the federal, state, and local income tax returns with supporting schedules.
2. Perform any bookkeeping necessary for preparation of the income tax returns.

Our/My work in connection with the preparation of your income tax returns does not include any procedures designed to discover defalcations or other irregularities, should any exist.

We/I will use our/my judgment in resolving questions where the tax law is unclear, or where there may be conflicts between the taxing authorities' interpretations of the law and other supportable positions. Unless otherwise instructed by you, we/I will resolve such questions in your favor, whenever possible.

The law provides various penalties that may be imposed when taxpayers understate their tax liability. If you would like information on the amount or circumstances of these penalties, please contact us/me. Because this is an entity whose tax attributes flow through to its partners or members, the penalty for substantial understatement of tax relating to this entity may be imposed on the partners or members.

Management is responsible for the proper recording of transactions in the books of accounts, for the safeguarding of assets, and for the substantial accuracy of the financial records. You have the final responsibility for the income tax returns and, therefore, you should review them carefully before you sign and file them.

**Exhibit 301-5: 1065—Partnership/LLP/LLC Tax Return Engagement Letter (cont.)**

Your returns may be selected for review by the taxing authorities. Any proposed adjustments by the examining agent are subject to certain rights of appeal. In the event of such government tax examination, we/I will be available upon request to represent you and will render additional invoices for the time and expenses incurred.

Our/My fee for these services will be based upon the amount of time required at standard billing rates plus out-of-pocket expenses. All invoices are due and payable upon presentation.

If the foregoing fairly sets forth your understanding, please sign the enclosed copy of this letter in the space indicated and return it to our/my office. However, if there are any additional returns you expect us/me to prepare, please note this at the end of the returned copy of this letter, just below your signature.

We/I want to express our/my appreciation for this opportunity to work with you.

Very truly yours,

Accepted By: \_\_\_\_\_

Title: \_\_\_\_\_

Date: \_\_\_\_\_

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**Exhibit 301-6: Optional Paragraphs for Inclusion in Tax Engagement Letters**

OPTIONAL PARAGRAPHS FOR INCLUSION IN  
TAX ENGAGEMENT LETTERS

A) Accuracy-Related Penalty Disclosures

1. For Individuals:

The law provides for a penalty to be imposed where a taxpayer makes a substantial understatement of their tax liability. For individual taxpayers, a substantial understatement exists when the understatement for the year exceeds the greater of 10 percent of the tax required to be shown on the return, or \$5,000. The penalty is 20 percent of the tax underpayment. Taxpayers may seek to avoid all or part of the penalty by showing (1) that they acted in good faith and there was reasonable cause for the understatement, (2) that the understatement was based on substantial authority, or (3) that the relevant facts affecting the item's tax treatment were adequately disclosed on Form 8275 or 8275-R attached to the return and there was reasonable basis for the position. You agree to advise us/me if you wish disclosure to be made in your returns or if you desire us/me to identify or perform further research with respect to any material tax issues for the purpose of ascertaining whether, in our/my opinion, there is "substantial authority" for the position proposed to be taken on such issue in your returns.

2. For Partnerships and Limited Liability Companies:

The law provides for a penalty to be imposed where a taxpayer makes a substantial understatement of their tax liability. For partnerships and individual taxpayers, a substantial understatement exists when the understatement for the year exceeds the greater of 10 percent of the tax required to be shown on the return, or \$5,000. The penalty is 20 percent of the tax underpayment. Taxpayers other than "tax shelters" may seek to avoid all or part of the penalty by showing (1) that they acted in good faith and there was reasonable cause for the understatement, (2) that the understatement was based on substantial authority, or (3) that the relevant facts affecting the item's tax treatment were adequately disclosed on Form 8275 or 8275-R attached to the return and there was reasonable basis for the position. A taxpayer is considered a "tax shelter" if its principal purpose is to avoid federal income tax. Because a partnership is an entity whose tax attributes flow through to its partners, the penalty for substantial understatement of tax relating to partnership items may be imposed on the partner. You agree to advise us/me if you wish disclosure to be made in your returns or if you desire us/me to identify or perform further research with respect to any material tax issues for the purpose of ascertaining whether, in our/my opinion, there is "substantial authority" for the position proposed to be taken on such issue in your returns.

**Exhibit 301-6: Optional Paragraphs for Inclusion in Tax Engagement Letters (cont.)**

## 3. For C Corporations:

The law provides for a penalty to be imposed where a taxpayer makes a substantial understatement of their tax liability. For corporate taxpayers, a substantial understatement exists when the understatement for the year exceeds the greater of 10 percent of the tax required to be shown on the return, or \$10,000. The penalty is 20 percent of the tax underpayment. Taxpayers may seek to avoid all or part of the penalty by showing (1) that they acted in good faith and there was reasonable cause for the understatement, (2) that the understatement was based on substantial authority, or (3) that the relevant facts affecting the item's tax treatment were adequately disclosed on Form 8275 or 8275-R attached to the return and there was reasonable basis for the position. You agree to advise us/me if you wish disclosure to be made in your returns or if you desire us/me to identify or perform further research with respect to any material tax issues for the purposes of ascertaining whether, in our/my opinion, there is "substantial authority" for the position proposed to be taken on such issue in your returns.

## 4. For S Corporations:

The law provides for a penalty to be imposed where a taxpayer makes a substantial understatement of their tax liability. For S corporations and individual taxpayers, a substantial understatement exists when the understatement for the year exceeds the greater of 10 percent of the tax required to be shown on the return, or \$5,000. The penalty is 20 percent of the tax underpayment. Taxpayers other than "tax shelters" may seek to avoid all or part of the penalty by showing (1) that they acted in good faith and there was reasonable cause for the understatement, (2) that the understatement was based on substantial authority, or (3) that the relevant facts affecting the item's tax treatment were adequately disclosed on Form 8275 or 8275-R attached to the return and there was reasonable basis for the position. A taxpayer is considered a "tax shelter" if its principal purpose is to avoid Federal income tax. Because an S corporation is an entity whose tax attributes generally flow through to its shareholders, the penalty for substantial understatement of tax relating to S corporation items may be imposed at either the corporate or shareholder level. You agree to advise us/me if you wish disclosure to be made in your returns or if you desire us/me to identify or perform further research with respect to any material tax issues for the purpose of ascertaining whether, in our/my opinion, there is "substantial authority" for the position proposed to be taken on such issue in your returns.



**Exhibit 301-6: Optional Paragraphs for Inclusion in Tax Engagement Letters (cont.)**

5. For Fiduciaries (Estates and Trusts):

The law provides for a penalty to be imposed where a taxpayer makes a substantial understatement of its tax liability. For fiduciary taxpayers, a substantial understatement exists when the understatement for the year exceeds the greater of 10 percent of the tax required to be shown on the return, or \$5,000. The penalty is 20 percent of the tax underpayment. Fiduciaries may seek to avoid all or part of the penalty by showing (1) that they acted in good faith and there was reasonable cause for the understatement, (2) that the understatement was based on substantial authority, or (3) that the relevant facts affecting the item's tax treatment were adequately disclosed on Form 8275 or 8275-R attached to the return and there was reasonable basis for the position. You agree to advise us/me if you wish disclosure to be made in the returns or if you desire us/me to identify or perform further research with respect to any material tax issues for the purpose of ascertaining whether, in our/my opinion, there is "substantial authority" for the position proposed to be taken on such issue in the returns.

- B) The engagement does not include any services not specifically stated in this letter. However, we/I would be pleased to consult with you regarding the income tax matters such as proposed or completed transactions, income tax projections, and for research in connection with such matters. We/I will render additional invoices for such services at our/my standard billing rates.
- C) You represent that the information you are supplying to us/me is accurate and complete to the best of your knowledge and that your expenses for meals, entertainment, travel, business gifts, charitable contributions, dues and memberships, and vehicle use are supported by records as required by law. We/I will not verify the information you give us/me. However, we/I may ask you for clarification of some of the information.
- D) Your tax return will be processed by an outside tax computer processing center. Please advise us/me if you prefer that we/I request extra security or forego the outside processing altogether.
- E) We/I subscribe to a program of peer review for maintenance of quality control in our/my office. As part of this program, your return may be selected for review by other CPAs under strict rules of confidentiality. Your acceptance below constitutes your agreement for disclosure under the program.
- F) A late payment charge of \_\_\_ percent per month will be assessed on any unpaid balance after deduction of current payments, credits, and allowances made within 30 days of date of billing. This is an Annual Percentage Rate of \_\_\_ percent.

**Exhibit 301-6: Optional Paragraphs for Inclusion in Tax Engagement Letters (cont.)**

- G) The law provides for a penalty of 20 percent to be imposed on any underpayment that results from negligence or disregard of rules or regulations. Negligence “includes any failure to make a reasonable attempt to comply ...” with the code. Disregard “includes any careless, reckless or intentional disregard.” Taxpayers may seek to avoid all or part of the penalty by showing they acted in good faith and can demonstrate reasonable basis for the understatement.
- H) You may choose to have us/me file your return electronically with the Internal Revenue Service Center. You must review and sign the return before it can be electronically transmitted. We/I are/am not responsible for the length of time it takes the IRS to process your return. Our/my fee for this service is \_\_\_\_\_.
- I) We/I have attached a tax organizer. It is designed to assist you in gathering the data necessary for us/me to prepare a complete and accurate return.
- J) The Internal Revenue Service Restructuring and Reform Act of 1998 provides for limited confidentiality privilege related to certain communications between our firm and you involving tax advice. This privilege does not cover items other than tax advice such as your tax records, tax return preparation, state tax proceedings, criminal proceedings, or private civil litigation. Any disclosure of qualifying confidential information to the government or third parties may result in waiver of the confidentiality privilege. To protect your right to privileged communication, please contact us if you have any questions or need further information.

**Exhibit 301-7: Tax Examination Engagement Letter**

TAX EXAMINATION ENGAGEMENT LETTER

Dear Client:

This letter will confirm the arrangements for our/my representation of you with respect to the Internal Revenue Service examination of your \_\_\_\_\_ Federal income tax return. As part of this engagement, we/I request that you sign the attached Form 2848, *Power of Attorney and Declaration of Representative*, which will notify the IRS that we/I are your authorized representative.

We/I will represent you before the Internal Revenue Service during this examination, unless the arrangement is terminated in writing by either party. Furthermore, in the event we/I cannot resolve all of the issues at the examination level, we/I will be available to appeal any proposed deficiency at the Appeals Division of the Internal Revenue Service, although that appeal is not part of this engagement.

We/I will not audit, or otherwise verify, any information provided by you for presentation to the Internal Revenue Service during the course of the examination, unless we/I deem it necessary or you specifically request us to do so in writing. However, we/I may ask you for further clarification and expect you to provide that clarification promptly and candidly.

Our communications are “confidential,” not “privileged.” That is, they may not be disclosed unless you approve under *most* circumstances. On the other hand, privileged communications are not permitted to be disclosed, even in court. There is no CPA-client privilege in Federal matters. Accordingly, if we/I are served by a properly issued administrative summons compelling us/me to testify in court proceedings, even our/my confidential communications are subject to disclosure.

The Internal Revenue Service has recently begun emphasizing a number of procedures during examinations to ascertain that taxpayers have reported all of their income. These procedures have led to a growing number of requests by examining agents to interview the taxpayer directly. However, you do have a statutory right to be represented, and *not* to meet with the examining agent (unless you are served with an enforceable administrative summons). It is in your best interest to refer any questions or other contact from the agent to us/me without discussing the case with the agent. By signing this engagement letter you acknowledge that any direct contact by the IRS will be promptly referred to us/me as your authorized representative. It is hereby acknowledged that if you choose to appear before or discuss this case with the agent against our/my advice, you do so at your own risk.

**Exhibit 301-7: Tax Examination Engagement Letter (cont.)**

Fees for our/my representation (plus out-of-pocket expenses) will be billed as incurred. We/I also require a retainer of \$\_\_\_\_\_, payable on acceptance of this agreement.

Fees and expenses are due and payable upon presentation of our invoice to you. Bills rendered to you will not be applied against the \$\_\_\_\_\_ retainer. Our/my fee for representing you will be based upon our/my time, billed at our/my customary rates. We/I estimate our/my fees to be \$\_\_\_\_\_ or on average \$\_\_\_\_\_ per hour. If we/I have not received payment in accordance with the stated terms, we/I reserve the right to terminate this engagement with no further notice.

If this letter reflects your understanding of the terms of our engagement, please sign below and return one copy in the enclosed envelope.

We/I look forward to serving you.

Very truly yours,

Accepted By: \_\_\_\_\_

Title: \_\_\_\_\_

Date: \_\_\_\_\_

**Exhibit 301-8: Contents of a Termination Letter**

1. A statement that the relationship is terminated and the date of termination.
2. A listing of services that the CPA used to perform and that all prior understandings related to services or responsibilities of the CPA, except for confidentiality, to the client are terminated.
3. A warning that the former client should make arrangements immediately for continuity in tax return preparation and compliance.
4. A listing of due dates related to the returns previously prepared.
5. A warning describing late filing and late payment penalties.
6. Statements regarding fees for services performed, but not yet billed, and additional fees for time spent with the new service provider and/or the former client, as well as photocopy costs.
7. Signature block for the CPA.
8. Acceptance statement and signature block for the client.

Since some former clients will not sign a termination agreement, we advise sending the letter certified mail to provide the CPA with proof of delivery of the termination letter.

**Exhibit 301-9: Statement to Limit Liability**

**LIMITS OF LIABILITY**

The Client agrees that (the CPA's) liability hereunder for damages, regardless of the form of action, shall not exceed the total amount paid for services under the applicable engagement letter or in the authorization for the particular service if no engagement letter is made. This shall be the client's exclusive remedy.

The client further agrees that (the CPA) will not be liable for any lost profits, or for any claim or demand against the client by any other party.

No action, regardless of form, arising out of the services under the engagement, may be brought by either party more than one year after the cause of action has accrued, except that an action for non-payment may be brought within one year of the date of last payment.

In no event will (the CPA) be liable for consequential damages even if (the CPA) has been advised of the possibility of such damages.



# 302 Penalties on Tax Preparers

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# 302 Penalties on Tax Preparers

Tax return preparers are regulated by the federal government, primarily through the Internal Revenue Code and the provisions of Treasury Circular 230. In addition, various materials clarify and interpret the code or indicate the position or procedures of the IRS. In particular, these are

- Treasury Regulations (Regs.)
- Revenue procedures (Rev. Proc.)
- General Counsel Memoranda (GCM)
- Revenue rulings (Rev. Rul.)
- Letter rulings (LR)
- The Internal Revenue Manual (IRM)

For a discussion of the uses of these authorities in researching tax issues, see Chapter 203 of this manual.

## 302.1 Risks Facing Tax Return Preparers

Standards for practice before the IRS are covered in Circular 230, which is discussed along with the Statements on Responsibilities in Tax Practice of the AICPA in Chapter 301. This chapter deals with these major penalty areas of the Internal Revenue Code that apply to tax practitioners:

- The requirements that tax returns be verified (IRC Sec. 6065), manually signed (IRC Sec. 6061), and an identifying number provided (IRC Sec. 6109).
- The requirements that a copy of the return be furnished to the taxpayer and that a copy or list be retained by the preparer (IRC Sec. 6107).
- The requirement that a record of names of preparers, their identification numbers, and place of work be retained for a period of three years (IRC Sec. 6060).
- The penalty for negotiating or endorsing refund checks (IRC Sec. 6695(f)).
- The penalty for an understatement of tax liability due to a position (known to the tax preparer) for which there was no realistic possibility of its being sustained on its merits (IRC Sec. 6694(a)).
- The penalty for understatements of tax liability due to a willful attempt to understate the liability or to any reckless or intentional disregard of provisions of the code (IRC Sec. 6694(b)).
- The penalty for disclosing or using information received in connection with the preparation of a return (IRC Sec. 7216).
- The penalty for aiding and abetting an understatement of tax liability (IRC Sec. 6701).
- The penalty for failure by a “responsible person” to pay withholding taxes (IRC Sec. 6672).

Since most of these requirements and penalties apply only to those whom tax law considers to be tax return preparers, two essential questions have to be answered: What are “income tax returns?” Who are “tax return preparers?”

### 302.1.1 What Constitutes an Income Tax Return

Penalties on preparers apply only to the preparation of certain specified forms that constitute “a return of tax imposed by Subtitle A or any claim for refund under Subtitle A” (IRC Sec. 7701(a)(36)). (Subtitle A deals with income taxes.)

“Return of tax” is spelled out in Regs. Sec. 301.7701-15(c) and covers returns and claims for refunds of *income tax*, including these filings with the IRS:

- Individual or corporate income tax return
- Information return filed by or on behalf of a person or entity that is not a taxable entity and that reports information that is or that may be reported on the return of a taxpayer
- Fiduciary income tax return for an estate or trust
- Undistributed capital gains tax return for a regulated investment company
- Charitable remainder trust return
- Return by a transferor of stock or securities to a foreign corporation, foreign trust, or foreign partnership
- Partnership return of income
- Small business corporation (S Corporation) income tax return
- Return for a Domestic International Sales Corporation (DISC)
- Claim for refund of tax under Subtitle A
- Claim for credit against any tax under Subtitle A

#### Documents That Are Not Tax Returns

These documents are *not* considered to be income tax returns:

- Gift or estate tax returns (these are *transfer* rather than *income taxes*)
- Returns of excise tax or of income tax collected at the source on wages
- Individual or corporate declarations of estimated tax
- Applications for an extension of time to file an individual or corporation income tax return
- Informational statements on Forms 990, 1099, or a similar form (Regs. Sec. 301.7701-15(c)(1))

Another source of information is LR 8035069. However, these schedules and summaries (listed below), prepared by a farm cooperative for its members, are not, by themselves, considered to be income tax returns or claims for refund, even if filed with the IRS:

- Cash summary listing
- Detailed list of entries
- General summary providing detailed physical and dollar information on inventories
- Enterprise summary, providing detailed information on an entity-by-entity basis
- Payroll summary
- Tentative depreciable and other asset schedule providing information relating to asset balances, depreciation, and investment tax credit
- Tax planning worksheet summarizing year-end information pertinent to the estimation of taxable income and tax liability
- Tax audit listing providing month-by-month summaries of receipts and expenses
- Completed Schedule F, for use in the preparation of Form 1040
- Form W-2
- Form 941

**Practice Tip.** If you prepare a schedule—for example, the cost recovery deduction—that forms the basis for an entry that constitutes a “substantial portion” of a tax return, you will be considered one of the tax preparers of that return. (See Section 302.1.3 of this manual.)

### Sufficiency of a Return

Filing a *tax return* starts the three-year statute of limitations running, and precludes the IRS from asserting a penalty against a taxpayer for failure to file. However, the document that is filed must contain sufficient information, or it is not a tax return. A signed Form 1040 that lacks adequate information on gross income, deductions, and credits is not a tax return. Three cases further illustrate the thinking of the courts.

- A “tentative” return that correctly computed taxable income but omitted the occupations and Social Security numbers of the taxpayers was *not* sufficient to start the running of the statute of limitations (*J.L. Foutz*, 24 TC 1109 (1955)).
- A taxpayer who provided nothing more than name, address, and Social Security number was held not to have filed a tax return and was convicted on criminal charges for failure to file (*U.S. v. Jordan*, 508 F.2d 750 (7th Cir. 1975), 75-1 USTC 9154).
- Omission of Form W-2 from a tax return did not make the return incomplete. The statute of limitations began to run when the return (*sans* Form W-2) was originally filed (*Blount v. Commissioner*, 86 TC 383 (1986)).

### Right of the IRS to Prepare a Return

Anyone who fails to make a tax return may find that the IRS prepares it for them. IRC Sec. 6020(a) authorizes the IRS to make a return when the taxpayer assents to disclosing the necessary information and agrees to sign the return. IRC Sec. 6020(b)(1) takes the taxpayer completely out of the picture by authorizing the Secretary of the Treasury to make the return, “from his own knowledge,” if the taxpayer has either failed to file or has filed a false or fraudulent return. This IRS-prepared return is considered a *prima facie* return, good and sufficient for all legal purposes. The advantage, from the point of view of the IRS, is that once the return is filed—even though by the IRS—a Notice of Deficiency can be sent to the taxpayer and the process begun to assess and collect the tax.

The IRS, however, cannot be relied upon to file the return that a taxpayer might desire. Because the taxpayers themselves did not file, the IRS prepared a substitute return under Sec. 6020(b)—that, evidently, did not show a refund due. When the taxpayers in 1990 and again in 1991 finally prepared a refund claim for taxes withheld during the 1986 tax year, the court dismissed their claim because it was not timely. *Miller v. U.S.*, 38 F3d 473 (9th Cir. 1994), 94-2 USTC. The Tax Court sustained a determination by the IRS that a tax return preparer had substantial unreported income. The Service reconstructed the preparer’s income from her receipt books, notary journal, and copies of client tax returns. *Gail Carelette Dixon v. Comm.* T.C. Memo 1999-246.

The IRS is not required to prepare a return for a taxpayer who fails to do so. *U.S. v. Krenzelok* (7th Cir. 1992).

Employment and excise tax returns may also be handled on this basis. IRS employees in the collection division may prepare and execute (sign) these documents:

- Employment-related tax filings, including Forms 940, 941, 942, and 943
- Form 2290, Highway Use Tax Return
- Form 1065, Partnership Income Tax Return
- Form CT-1, Employer’s Annual Railroad Retirement Tax Return
- Form 720, Quarterly Federal Excise Tax Return

One tax practitioner states, perhaps facetiously, that he attempts to spur on clients who are tardy in submitting data by telling them that the IRS will file for them and bill them for the taxes, which will ultimately cost more than if he had been allowed to do the preparation on time.

### 302.1.2 Definition of Income Tax Return Preparer

An income tax return preparer is *any* person—regardless of educational qualifications and professional status—who prepares for compensation, or who engages one or more persons to prepare for compensation, all or a substantial portion of any tax return under Subtitle A (Income Taxes) of the code.

The person considered to be the preparer does not have to physically enter the figures on the form or schedule, nor does entering these figures automatically make a person a preparer (IRC Sec. 7701). Someone who prepares a return for a relative or friend for free is not considered to be a preparer, even if a favor—such as an invitation to a meal—is given in return (Regs. Sec. 301.7701-15(a)(4)). On the other hand, a practitioner who prepared returns in a bartered-for transaction—for example, in exchange for dental services—would be held to the responsibilities of a “preparer.”

A person can be a tax preparer even if the return is completely filled out when it comes into his or her hands. For example, anyone may be a preparer (even without signing the return) who—

- Provides advice that reduces the subsequent filling out of a return to a mere mechanical or clerical task.
- Provides tax advice about completed transactions directly relating to a specific entry on a return.
- Recommends substantial changes in a draft of a return (even if the draft was prepared by the taxpayer) and the taxpayer follows these recommendations.
- Reviews the return, concludes that no changes are required, and files (mails in) the return under the taxpayer’s instructions.
- Makes entries on one return (such as a partnership return) that constitute a substantial portion of another return (e.g., the practitioner may be considered a preparer of the partnership return and the returns of each partner).

**Example.** Goulding, a founder and general partner of three research and development limited partnerships, prepared the partnerships’ Form 1065, Schedule K, and Schedule K-1 for three tax years. He listed himself as the partnerships’ paid tax return preparer. More than \$4 million in losses were passed through to the limited partners. The IRS disallowed these losses, and assessed IRC Sec. 6694(c) penalties in the amount of \$44,600 against Goulding. Goulding contested the penalty, contending that he was not the preparer of the limited partners’ returns. A U.S. district court upheld the penalties, concluding that the Schedules K-1 constituted a substantial portion of the limited partners’ individual tax returns (*Randall S. Goulding v. United States*, 957 F.2d 1420, 92-1 USTC 50174 (7th Cir. Ill. 1992)).

GCM No. 39,322 casts additional light on who should be considered a preparer. Several examples are given in the Memorandum; two follow.

**Example.** The taxpayer submits books and records to a tax consultant, who sends back a statement detailing what the taxpayer has to enter on the return in what will be a mere mechanical process. The consultant is held to be a preparer and is required to ask the taxpayer to submit the final form for the consultant’s signature.

In reference to this example, the GCM goes on to say that, “Should the taxpayer not honor the consultant’s request, the consultant could discharge his obligation by actually preparing a return, signing it, and then submitting it to the taxpayer.” You should avoid this latter course of action, because you would then be trying to collect fees from the taxpayer for preparing an unrequested tax return.

**Example.** The taxpayer prepares and submits to the consultant a final signed return. The consultant reviews it in its entirety, finds it to be correct, and mails it to the IRS as the taxpayer requests. The consultant *is* considered to be a tax return preparer.

You need to be alert to the instances in which you may be considered a tax return preparer, even though you did not fill out or sign a tax return. For example, suppose a taxpayer prepares his or her own return, then submits it to you to be checked over, for a fee, before filing. If the review covers arithmetical checks *only*, and in-house documentation so indicates, you are not a preparer. If, on the other hand, you review a return “in its entirety”—to use the words of the Memorandum in the second example above—then you are considered a preparer. A practitioner who reviews a return to evaluate one specific issue of tax law and the liability associated with it is considered a preparer—as long as resolution of that issue constitutes a substantial portion of the return.

Giving advice regarding the taxability of *proposed* transactions does not make one a preparer, nor does advising about the financial accounting treatment of a tax-related matter such as an accrual for a deferred tax liability under generally accepted accounting principles. Regs. Sec. 301.7701-15(d) further delineates the question of, “Who is the preparer?”

### Persons Who Are Not Preparers

In addition to those who prepare returns without compensation (except in the form of small favors) a person is *not* considered to be a preparer if he or she—

- Merely types, photocopies, or performs mechanical assistance in the preparation of the return.
- While regularly and continuously employed by an employer, prepares a return for that employer, an officer of the employer, or for a fellow employee.
- While a general partner of a partnership, or regularly and continuously employed by that partnership, prepares a return for an officer, general partner, or employee of that partnership.

**Example.** Doe, as an employee of X, a 100-percent-owned subsidiary of Y, prepares X’s income tax return as part of his job. He also prepares Y’s income tax return and the individual income tax returns of the officers of both companies. Doe is *not* a tax return preparer with respect to any of these returns.

Similarly, a person is *not* considered to be a preparer if he or she—

- Prepares a return for an estate or trust (including a guardianship, committee, or similar arrangement for a taxpayer under a legal disability) of which he or she is a fiduciary, or an officer, general partner, or employee of the fiduciary.
- Prepares a return with no explicit or implicit agreement for compensation, even though receiving a gift, return service, or favor.
- Provides tax assistance under a Volunteer Income Tax Assistance (VITA) program.
- Provides tax counseling for the elderly under a program established pursuant to Section 163 of the Revenue Act of 1978. (This also applies to any organization sponsoring or administering such a program.)
- Prepares a claim for refund for a taxpayer in response to a notice of deficiency, or a waiver of restriction, after the initiation of an audit of the taxpayer (or of another person whose audit affects the tax liability of the taxpayer). (Note: this appears to be a narrow exception, and should be approached with caution.)

**Example.** If Doe prepares the refund claim for the sole shareholder of a corporation, as the result of an audit adjustment of the corporation, Doe is not a *preparer* of the claim. (Regs. Sec. 301.7701-15(d) and S. Rep. No. 938, Pt. 1, 94th Cong., 2d Sess. 352–53 (1976))

Computerized services are not considered to be return preparers because they mechanically fill out returns from information provided by the taxpayer (or a tax practitioner) and do not give instructions as to what deductions to take or what to include in income (LR 81-11-071).

If you prepare or advise on only a portion of a return—for example, a schedule—a determination of who is the preparer will be made according to the rules of substantial preparation.

### Multiple Preparers Within a Firm

Regs. Sec. 1.6694-1(b) provides that if a signing preparer is associated with a firm, that individual and no other individual associated with the firm will be considered a preparer of the return or claim for refund. In other words, only one person from any firm that provides input to the return can be considered a preparer of that return. The preparer who signs may not rely on the advice of another within the preparer's firm to avoid penalties.

If an individual not associated with the firm provides advice regarding the return, this nonsigning individual will be considered to be a preparer. If this nonsigning preparer is a member of a firm and more than one individual within the firm provides advice, the individual with supervisory authority will be considered to be the preparer. These regulations relate only to the definition of a preparer in connection with IRC Sec. 6694.

### 302.1.3 Preparation of a Substantial Portion of a Return

The code identifies as a preparer any person who, for compensation, prepares a "substantial portion" of a return. This means the IRS can look at each schedule, portion, or individual entry on a return to establish who may have been the preparer for that section of the return. If that represents a "substantial portion" of the return, whoever did that section is considered one of the preparers of the return. (See, however, the "safe harbor" rule, below.)

Any one or several of the many entries or schedules of a return—depending upon the significance of each—might be considered a substantial portion. *There can be more than one preparer of a single return* but no more than one preparer from one firm. For example, if practitioner A fills out Schedule C and practitioner B fills out Schedule E for a taxpayer who then prepares his or her own return, both A and B are considered preparers, and each is potentially subject to discipline under Circular 230 or to penalties under the code for the work performed. (Only the person primarily responsible for the accuracy of the return—in this case the taxpayer—need sign the return.)

**Practice Tip.** If an item passed through is a substantial portion of a partner's or shareholder's return, you, as the preparer of a return of a passthrough entity such as a partnership or an S Corporation, can be held to be a preparer for the returns of *each* of the partners or shareholders, and subject to preparer penalties on each of numerous returns (Regs. Sec. 301.7701-15(b)(3)). (See, also, the *Goulding* case in Section 302.1.2, above.)

There are guidelines to clarify what constitutes a substantial portion of a return. One source relates to advice. Regs. Sec. 301.7701-15(b)(1) states that a person who renders advice directly relevant to the determination of the existence, characterization, or amount of an entry on a return is regarded as having prepared that *entry*. Whether that person will consequently be considered to be a *preparer of the return* depends upon the length, complexity, and amount of the tax liability (or refund) associated with that entry when it is viewed in comparison with the return in its entirety. Several examples, based on the following fact pattern, are provided in LR 79-02-033.

#### Problem Case

A client's own tax department prepares a complete income tax return. All positions taken on the return are separately researched by this department; the final decision as to treatment is made by the client's tax director. All detailed support for the return is maintained by the tax department, in the normal books and records.

**Example.** A CPA is engaged to review the return so that the client's management has assurance that all tax planning opportunities have been explored. The client asks the CPA not to sign the return. The review consists of the following:

- Referencing major items of income and deductions to the client's books and records
- Checking to see that all required elections have been made, are timely, and are in the required form
- Determining that special information required to be included in the return is adequate, complete, and set forth properly in all material respects

- Comparing the tax return to the previous year's tax return and accounting for timing differences
- Reconciling tax return income to book income and accounting for variations
- Reviewing board of directors' minutes for matters of tax significance
- Determining that carryforward items from revenue agents' prior reports and prior tax returns have been reflected in the tax return
- Determining that the return is complete on its face and internally consistent, and that the tax due has been correctly computed based on the information provided in the return

The IRS determined that the CPA's review did constitute a substantial portion of the return. Therefore, the CPA was a tax return preparer. The outcome is the same whether the CPA recommended no changes to the return, or recommended an alternative treatment having a significant effect that was then adopted by the client (LR 79-02-033). (Note: Even though considered to be a preparer of the return in this example, the CPA is *not* required to sign the return. Because the client's tax director retained the right to make the final decision about the treatment of any item—and thus had primary responsibility for preparing the return—the tax director must sign.)

**Example.** Assuming the same basic fact situation, suppose the CPA is requested to review only a portion of the information that underlies and supports the return, for example the documentation included in the return that supports the nontaxability of a corporate reorganization that took place during the year, or the treatment of certain executive compensation transactions. In that case, since the dollar effect of these items is substantial, the CPA is held to be a preparer of the return on the basis of the advice given.

The IRS held similarly that the CPA was a preparer when the CPA's role was limited, as in these fact situations:

- The CPA was asked to prepare a study determining the gain to be reported for the already-completed sale of one of a corporation's major subsidiaries. The client's corporate tax department would review the CPA's work before reflecting it in the tax return.
- The CPA was asked to review a client's computation of its deduction using the LIFO inventory method, which the client intended to adopt when filing its return.

You must be alert to the risks associated with the subsequent or related use of your work. For example, a tax-loss carryforward computed by you in year 1 may result in your being considered a preparer of the next year's return, even though this second return is actually researched, filled out, and signed by a different practitioner (Rev. Rul. 81-171, 1981-1 CB 589).

### Safe Harbor to Define Substantial Portion

A "safe harbor" definition is provided in Regs. Secs. 301.7701-15(b)(2)(i) and (ii). The schedule, entry, or other portion of a return or claim for refund that involves amounts of gross income, deduction, or amounts on the basis of which credits are determined is *not* considered to be a substantial portion of the return or claim if it is

- Less than \$2,000, or
- Less than \$100,000, and also less than 20 percent of the gross income (or adjusted gross income if the taxpayer is an individual) as shown on the return or claim for refund.

An example of aggregation of portions of a return is given in the regulation. If you prepare a schedule for dividend income totaling \$1,500, and also give advice making you a preparer of a schedule of medical expenses that results in a \$1,500 medical expense deduction, you are not a preparer if the taxpayer's adjusted gross income shown on the return is more than \$15,000.

Proposed regulations provide that if a signing preparer is associated with a firm, that individual, and no other individual associated with the firm, will be considered a preparer of the return or claim for refund. This definition of preparer applies only in connection with IRC Sec. 6694, Understatement of Liability by the Preparer (Regs. Sec. 1.6694-1(b)).



## 302.1.4 Verification of Returns and the Manual Signature Requirement

Returns (or other documents, declarations, or statements) must contain or be verified by a written statement that it was made under penalties of perjury. The requirement applies to preparers in connection with a client's tax return (Regs. Sec. 6065-1(b)(1)).

No penalty is provided for failure to verify a return. The penalty prescribed, however, is \$50 for each failure by a preparer to *sign* a return, unless it is shown that the failure is due to reasonable cause and not to willful neglect. There is a maximum penalty in one calendar year of \$25,000 (IRC Sec. 6695(b)).

Tax return preparers must manually sign the return or claim for refund. The requirement is spelled out in Regs. Sec. 1.6695-1(b) as follows (emphasis added):

An individual who is an income tax preparer with respect to a return of tax under subtitle A of Internal Revenue Code of 1986 or a claim for refund of tax under subtitle A of the Internal Revenue Code of 1986 shall *manually sign* the return or claim for refund (which may be a photocopy) in the appropriate space provided on the return or claim for refund *after it is completed and before it is presented to the taxpayer* (or nontaxable entity) for signature.

A strict reading of the regulations suggests that the preparer's *original manual* signature need not be on the return that is filed. (Regs. Sec. 1.6695-1(b)(4)(i)). Despite these regulations, the IRS sometimes rejects returns bearing photocopies of preparer's signatures. It is clearly not acceptable to merely initial the return (LR 82-14-006).

A preparer who is physically unable to sign because of a disability must type or stamp the words "Unable to Sign" on the preparer signature line, and be identified by name and identification number (Rev. Proc. 79-7, 1979-1 CB 486).

Only in limited cases may an agent sign a return on behalf of a taxpayer. The conditions are spelled out in Regs. Sec. 1.6012-1(a)(5), and refer to the disease, injury, or continuing absence of the taxpayer from the United States. Under circumstances described in the regulation, one spouse may sign the other's name to a joint return. Also, taxpayers may seek permission from their district director for an agent to file. Any return made by an agent must be accompanied by a power of attorney; Form 2848 is satisfactory.

After a return is signed by the preparer, no person may alter it except to correct clerical or mathematical errors. A record must be retained of corrections made after the preparer's signature (Regs. Sec. 1.6695-1(b)(4)(ii)). If several persons are involved in the preparation of a return, only the primary preparer—the person responsible for the overall accuracy of the return—need sign it.

There appears to be *no* requirement that any signatures appear on or in connection with the return other than those of the taxpayer and of the *one* preparer who has primary responsibility for the accuracy of the return.

### Modified Signature Requirements

A facsimile stamped signature or gummed label is, in most cases, not acceptable. One exception applies if the return is for a nonresident alien individual, for whom the preparer is authorized to sign. In that case, the preparer's facsimile signature can also be used. A letter must be included with each return or batch of returns, manually signed by the preparer, identifying each return or claim bearing the facsimile. This letter must declare that the facsimile signature is the signature used by the preparer. A manually signed copy of the letter must be retained (Regs. Sec. 1.6695-1(b)(4)(iii)). See below for the modified signature requirements related to computer-generated returns. (Another exception for facsimile signatures, related to the filing of Form 1041, U.S. Fiduciary Income Tax Return, can be found in Notice 89-48, 1989-1 CB 688.)

While a facsimile signature or gummed label is not acceptable, a photocopy of the return that contains the manual signature may be submitted.

**Example.** A return is prepared, signed by the preparer, and photocopied. The copy is reviewed and signed by the taxpayer and filed with the IRS. The return that was manually signed by the preparer must be retained and made available upon request from the IRS.

If the original preparer is unavailable, another can manually sign the return (or refund claim), but only after reviewing its entire preparation. If more than one preparer is involved, the one with the primary responsibility for overall substantive accuracy must sign.

**Example.** A national accounting firm prepares returns for compensation. Two employees complete the tax return for a client, including the gathering of information, application of the tax laws, and performance of computations. Another employee checks through the math, then a supervisor reviews the return, checking the information provided by the taxpayer and the application of tax law. The policies of the firm require that a partner review the return, making a final determination as to proper application of tax law in determining the client's tax liability. The partner should sign the return as preparer (Regs. Sec. 1.6695-1(b)(3) Ex.(2)).

The preparer who signs must also affix his or her identifying number, that of his or her employer, or both (IRC Sec. 6109(a)(4)). Regulations say, however, that if there is a partnership or employment relationship between two or more preparers, the identifying number of the partnership or employer must *also* appear on the return (Regs. Sec. 1.6109-2(a)).

**Practice Tip.** If your computer or service bureau automatically prints an identifying number on each return, that number should be your firm's employer ID number. Whoever signs the return should include his or her own Social Security number.

IRS Publication 1045 explains and gives examples of the signature requirements.

### Preparation by Computer

Although use of outside service bureaus for return preparation has declined, a discussion of the issues involved may still be relevant to some practitioners. According to the code, a person who only types, reproduces, or performs mechanical assistance is not considered a preparer (IRC Sec. 7701(a)(36)(B)(i)). Computerized services are not return preparers in that they mechanically fill out returns from information provided by the taxpayer (or a tax practitioner) and do not give instructions as to what deductions to take or what to include in income (LR 8111071).

Generally, this means that a computerized service that takes an input sheet from a practitioner and sends back a completed tax return is not a preparer. The practitioner, in these cases, must sign the return. (Note: The computer service, although not considered to be a preparer, is subject to the prohibition on unauthorized use or disclosure of the information received in connection with providing tax services. See Section 302.2.1, below.)

In some instances, a computer service or computer program vendor might go beyond mechanical assistance (see Rev. Rul. 85-187, 1985-2 CB 338 and Rev. Rul. 85-189, 1985-2 CB 341). In both examples, the computer was programmed to calculate the amount of deductions and credits, and to print them on the returns. The IRS ruled that this computation exceeded the bounds of mere mechanical assistance, making the vendor a preparer.

The manual signature requirement of the code is modified when a return is prepared by computer. The modification appears in Regs. Sec. 1.6695-1(b)(4)(ii), and states the following:

If mechanical preparation of the return or claim for refund is accomplished by computer not under the control of the individual preparer, then the manual signature requirement . . . may be satisfied by a manually signed attestation by the individual preparer attached to the return or claim for refund that all the information contained in the return or claim for refund was obtained from the taxpayer and is true and correct to the best of his knowledge, but only if that information . . . is not altered . . . by another person.

Evidently, this modification is intended to cover the infrequent situation in which the completed return is mailed by the computer service directly to the taxpayer, and the preparer has no opportunity to sign the return. An attestation suggested in IRS Publication 1045 reads as follows:

I attest that all information contained in this income tax return was obtained from [name of taxpayer] and is true and correct to the best of my knowledge. [Preparer's signature]

### Signature Requirements for Electronic Filing

Form 8453, U.S. Individual Income Declaration for Electronic Filing, satisfies the manual signature requirement. The form is to be signed after notice has been received of the acceptance of the filing. For further details on electronic filing see Section 202.6 of this manual.

## 302.2 Preparer Penalties Not Related to Accuracy

### 302.2.1 Unauthorized Disclosure of Tax Return Information

The unauthorized disclosure or use of information received in connection with tax return preparation is punishable by a fine of not more than \$1,000 or imprisonment for not more than one year (or both), together with costs of prosecution (IRC Sec. 7216).

“Tax return information” means any information furnished in any manner in connection with the preparation of a tax return, including but not limited to a taxpayer’s name, address, or identifying number. Disclosures or uses that are made “for any purpose other than to prepare, or assist in preparing, any such return” are prohibited. For the fine or imprisonment to be imposed, the disclosure or use must be made “knowingly or recklessly” (Regs. Sec. 301.7216-1(b)(3)).

The Technical and Miscellaneous Revenue Act of 1988 added a civil penalty of \$250 for each disclosure or use (IRC Sec. 6712). The total amount imposed in civil penalties on a person for any calendar year may not exceed \$10,000.

Both criminal and civil sanctions for unauthorized disclosure apply to any person who receives the tax return information and who

- Is engaged in the business of preparing income tax returns (or holds himself out a person who prepares tax returns, whether or not for compensation), or
- Provides services in connection with the preparation of tax returns as a business, or
- Prepares or assists in preparing returns for remuneration, or
- As part of his duties or employment with any person described above, performs services that assist in a tax return’s preparation or in providing services in connection with the preparation of a return.

A “tax return” for purposes of IRC Sec. 7216 is any income tax return imposed by Chapter 1 (normal taxes and surtaxes) and Chapter 2 (tax on self-employment income) of the code, or any declaration of estimated tax made under IRC Sec. 6015. (Any information received from the client in connection with an amendment to a previous filing is also covered.) Included are returns and declarations of estimated tax on the following entities:

- Individuals
- Corporations
- Exempt organizations such as private foundations
- Banking institutions
- Estates, trusts, decedents
- Partnerships
- Insurance companies
- Regulated investment companies, real estate investment trusts

The purpose of IRC Sec. 7216 is to silence *anyone* who, while being paid, has access to information provided by a taxpayer seeking to have a return prepared. Computerized tax services and franchisers who review tax returns prepared by franchisees are included in the regulation (LR 8242034), as are clerical employees of preparers. A person is *not* subject to the statute who, on a casual basis and without remuneration, prepares a return for a relative, friend, or acquaintance.

**Practice Tip.** Be sure to caution all your staff that they must make no reference outside the office to any aspect of a client’s affairs, including even the identity of your clients.

Although your permanent professional staff will be aware of this prohibition, part timers, interns, and nonprofessionals may not be. It is probably wise to have each person in your office sign—as a reminder—a brief statement acknowledging that they understand that all information relating to clients is confidential.

### Disclosure or Use Without the Formal Consent of the Taxpayer

Disclosure or use are allowed under Regs. Sec. 301.7216-2—even without the taxpayer's consent—in these situations:

- By a preparer when preparing state and local tax returns and declarations of estimated tax.
- Pursuant to an order of a court or of a federal or state agency (including state agencies that regulate licensure). Revenue Ruling 85-5, 1985-1 CB 385 states that an accountant may disclose returns and workpapers at the order of a state board of accountancy charged with licensing and quality review.
- Pursuant to the Internal Revenue Code and regulations, for example, to an officer or employee of the IRS.

Other important exceptions are:

- For quality or peer review (IRC Sec. 7216(b)).
- When a preparer transfers copies of returns and information in connection with the sale or other disposition (gift or inheritance) of the tax preparation business (Regs. Sec. 301.7216-2(m); Rev. Rul. 79-400, 1979-2 CB 403; LR 8016117).
- When a preparer transfers information to a computer processing service for computation of the tax liability and preparation of the return. (Note, however, that the processing service is then subject to the nondisclosure requirements.)
- When a list is compiled of the preparer's clients for the sole use of the preparer in offering additional tax-related services. This list may not be transferred except in connection with the sale or other disposition of the tax preparation business.
- When preparing the tax return of a taxpayer related to another as spouse, child or parent, grandchild or grandparent, partner and partnership, trust or estate, beneficiary, fiduciary, or in connection with corporations and their shareholders, or members of a controlled group of corporations; and if the interests of the taxpayers are not adverse and the first taxpayer has not prohibited the use.
- To an employee of the IRS, or to the preparer's attorney, for use in connection with an investigation of the preparer.
- To any person who is expected to use the information to monitor and audit the quality and accuracy of a preparer's tax preparation, accounting, and auditing services (Prop. Regs. Sec. 301.7216-2(o)).
- To assist the tax return preparer or his legal representative in operating the business in the event of the preparer's incapacity or death (Prop. Regs. Sec. 301.7216-2(o)).

**Practice Tip.** These states regulate disclosure of information received by preparers in connection with state or federal tax returns: Alabama, Arizona, California, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Maine, Maryland, Massachusetts, Minnesota, Nebraska, North Carolina, Ohio, Tennessee, Vermont, Virginia, and Wisconsin. You should research your state's laws regulating the preparation of tax returns.

### Disclosure Exceptions for Attorneys and Accountants

Exceptions are provided in Regs. Sec. 301.7216-2(e)(1) for preparers who are attorneys and accountants. They may use a taxpayer's information to perform other legal or accounting services that the taxpayer desires, such as estate planning or the preparation of journal entries, workpapers, or financial statements. These services can be performed by another member of the same legal or accounting firm; the transfer of information within the firm does not constitute an unauthorized disclosure.

Regulations state that in the normal course of rendering legal or accounting services, an attorney or accountant may, “with the express or implied consent of the taxpayer, make tax return information available to third parties, such as stockholders, management, suppliers, or lenders” (Regs. Sec. 301.7216-2(e)(1)). Even in the absence of the regulation, it appears obvious that a client could expressly authorize an accountant to disclose any information to any person the client names. No examples, however, are given of the types of *implied* consent that might result in acceptable disclosure. The reference to stockholders and management is perhaps not difficult to imagine. Evidently, the reference to suppliers and lenders is intended to cover situations in which the taxpayer supplies these persons with financial statements or data in connection with securing and maintaining credit.

**Practice Tip.** Beware of the implied consent exception since no examples are provided in the regulation. In addition, recall that CPAs are subject to the confidentiality provisions of the Code of Professional Conduct of the AICPA. You should get the taxpayer’s express, written authorization for every disclosure of tax return information and for any use that is not related to that taxpayer’s financial affairs. For an acceptable consent form, see Exhibit 302-1.

The regulations provide a further exception relating to attorneys and accountants. This allows these professionals to take taxpayer-provided information into account and to act on it, within the firm, where its consideration “is necessary for the proper performance” of legal or accounting services *for another client*.

**Example.** John Doe, a member of an accounting firm, renders an opinion on a financial statement of Q Corporation that is filed with the SEC as part of a registration. After the filing but before the effective date, Mary Smith, a member of the same accounting firm, prepares an income tax return for N Corporation. She discovers that N does business with Q, and concludes that information regarding N should be considered by Doe in determining whether Q’s financial statements are true or misleading. Doe considers this new information and determines that there is an omission of a material fact in the registration statement. He advises both Q Corporation and the SEC of the need to amend the registration, but without revealing either the tax return information or the identity of the taxpayer, N. Excepted from the sanctions of Sec. 7216 are the disclosure by Smith to Doe *and* the use of the information by Doe in notifying Q and the SEC of the need for amending the registration. (Note that Doe would be prohibited from revealing to Q and the SEC that the information was received from Smith.)

**Example.** John Doe is conducting an audit of M Corporation. Mary Smith is preparing an income tax return for an officer of M. From information received from this officer when preparing his tax return, Smith discovers that he has been receiving kickbacks from suppliers. Smith discloses this information to Doe. Doe searches for indications in the audit for such a kickback scheme, and discovers audit sources that independently reveal the kickbacks. Doe informs M Corporation of the kickbacks received by its officer. This disclosure is excepted from the sanctions of Sec. 7216.

### Disclosure or Use by Formal Consent of the Taxpayer

Use or disclosure of tax return information for purposes of solicitation is normally prohibited. Solicitation of the taxpayer may be made by the preparer, however, for *additional current business services—in matters not related to the Internal Revenue Service*—if (1) the preparer provides and offers these services to the public, and (2) the taxpayer gives express consent in writing (Regs. Sec. 301.7216-3(a)). (Solicitation of *employment* in matters related to the IRS is prohibited by Circular 230, Sec. 10.30; see Section 301.3.1 of this manual.) Three examples are provided in Regs. Sec. 301.7216-3(c).

**Example.** A bank advertises that it is in the business of preparing tax returns. After a taxpayer’s return has been prepared, a bank employee points out that the taxpayer owes \$400 in taxes and that the bank’s loan department may be able to help. For the bank to

use the information given to the preparer by the taxpayer, the bank must first have the taxpayer execute a written consent to that use.

**Example.** An individual who prepares tax returns also sells life insurance and mutual fund shares. This preparer wants to use tax return information provided by a taxpayer. If the preparer wishes to solicit both insurance and mutual fund sales, *two* separate written consents must be executed by the taxpayer.

**Example.** Under facts similar to the above example, the preparer wishes to solicit for sales in several mutual funds (but not for insurance sales). Only one consent is required as long as the solicitations take place at one time; two consents are needed if the solicitations are to take place at different times.

Once the taxpayer has given express, written consent to do so, a preparer may disclose the information to such third persons as the taxpayer directs.

**Practice Tip.** A preparer who desires to offer other products to a client—for example, financial planning—should get as many consents as there are products, paying particular attention to the requirement of Regs. Sec. 301.7216-3(a)(1) that “the *request* for the consent may not be made later than the time the taxpayer receives his completed tax return from the tax return preparer” (emphasis added). Presumably, the taxpayer’s actual written consent can be executed at a later date, provided the preparer retains documentation to show that the request was made by the required date. (A follow-up request, however, is expressly prohibited.)

### Form of Taxpayer’s Consent

A separate written consent, signed by the taxpayer or his duly authorized agent or fiduciary, must be obtained for each separate use or disclosure. The regulation spells out the contents of this consent, as follows:

- The name of the tax return preparer
- The name of the taxpayer
- The reason the consent is being furnished
- The date on which the consent is signed
- A statement that the tax return information may not be disclosed or used by the preparer for any purpose (not otherwise permitted under the regulations) other than that stated in the consent
- A statement by the taxpayer, or his agent or fiduciary, that he consents to the disclosure or use of such information for the purpose described

Although no sample or model letter is included in the regulation, Exhibit 302-1 illustrates a form based on LR 8429052 for an insurance agency that also prepared income tax returns for its customers, and shows the necessary elements of such a consent. This form is adequate to procure a written consent to (1) solicit other (non-IRS-related) business, (2) indicate the taxpayer’s consent to disclosure to any such persons that the taxpayer directs, and (3) give the taxpayer’s consent to use the information in connection with another person’s return.

## 302.2.2 Information Returns Required of Income Tax Return Preparers

Preparers or their employers must retain, for three years after the close of the return period, a record of the name, tax identification number (ordinarily, the Social Security number for an employee), and place of work of each employed preparer who is required to sign the return or claim (Regs. Sec. 1.6060-1). These records must be available for inspection by the district director.

The penalty is \$50 for each failure to comply or to set forth an item required in the section, unless due to reasonable cause and no willful neglect. The maximum penalty on any person for any return period is \$25,000 (IRC Sec. 6695(e)).

### 302.2.3 Identifying Numbers

The preparer who is required to sign must include his or her identifying number. If there is a partnership or employment relationship between two or more preparers, the identifying number of the partnership or the employer (or engager) must *also* appear on the return (Regs. Sec. 1.6109-2(a)). Each failure to furnish an identifying number leads to a penalty of \$50 with a \$25,000 ceiling during a calendar year (IRC Sec. 6695(c)).

### 302.2.4 Copies of the Return

You must furnish a completed copy of a return or claim for refund to your client no later than the time the return or claim is presented for the taxpayer's signature (IRC Sec. 6107). (The copy retained by the taxpayer need not bear your signature if a record is maintained under Regs. Sec. 1.6107-1(b)(2) of the agency preparer.)

For three years after the close of the return period, you must keep either a completed copy of the return or claim, or a list with the names, taxpayer identification numbers, and the types of returns or claims of your client, along with the name of the individual preparer. You must make the copy or list available for inspection by the IRS. A preparer's employer is considered to be the preparer for purposes of furnishing copies and retaining lists (Regs. Sec. 1.6107-1(b)(2)).

If the corporation or partnership responsible for retaining lists is dissolved prior to the end of the three-year period, state law must be consulted to determine who is responsible for record retention.

**Practice Tip.** To establish a record of compliance with these requirements, you should get a simple acknowledgment of receipt when passing the original and the copy of the return on to the client.

Penalties are \$50 for each failure to retain a copy or list and each failure to furnish a copy to the taxpayer, unless due to reasonable cause and not willful neglect. The maximum penalty is \$25,000 for all documents filed during one calendar year (IRC Sec. 6695(a)).

### 302.2.5 Prohibition Against Endorsing a Refund Check

An income tax return preparer is prohibited from endorsing or otherwise negotiating a tax refund check that is issued to a taxpayer other than the preparer (IRC Sec. 6695(f)). (The refund referred to is made in connection with taxes imposed by Subtitle A (Income Taxes).) A penalty of \$500 is prescribed for each endorsed or negotiated check. A similar prohibition is specifically directed at attorneys, certified public accountants, and enrolled agents and is contained in Sec. 10.31 of Circular 230. We will examine several aspects of this prohibition.

- The IRS has used as a definition of negotiation Section 3-202(1) of the Uniform Commercial Code, which says that negotiation is "the transfer of an instrument in such form that the transferee becomes a holder," (but not necessarily a holder in due course) (Rev. Rul. 80-35, 1980-1 CB 305). That is, the check must be delivered to the transferee and must bear any necessary endorsement.
- A refund check would be negotiated by a preparer if the taxpayer endorsed it "pay to the order of [the preparer]" or "in blank," that is, with his or her signature only, and the preparer then deposits or cashes the check for the preparer's own account and benefit.
- A power of attorney cannot be written that will be sufficient to give a *tax return preparer* the right, in contravention of IRC Sec. 6695(f), to endorse, negotiate, or acquire title to a tax client's refund check.
- According to Letter Ruling 7907008, there is no provision for excuse of the penalty on the grounds of "reasonable cause."
- Banks that are tax preparers are excepted in several circumstances spelled out in Regs. Sec. 1.6695-1(f), unless they have made a loan to the taxpayer on the basis of the anticipated refund.

**Practice Tip.** You are apparently “safe,” despite this code provision, if you deliver to a bank *for deposit to a taxpayer-client’s account, and on the client’s instructions*, a refund check that the client has endorsed with his or her name only, or “For deposit only,” or “Pay to the order of [bank].” In this circumstance, you seem to fall under the exception spelled out in Rev. Rul. 80-35, 1980-1 CB 305 in connection with a client’s business manager who performs the deposit duties, in effect, as an agent (and who has check signing power over the account into which the deposit was made). We presume also that you could deposit, at the request of a client, an unendorsed check to the client’s account bearing the bank’s stamp containing such words as “For credit to the within named payee.” Don’t endorse the check with your name.

### 302.2.6 Reasonable Cause for Delinquent Filings

IRM Section 5172.12 (11-15-85) lists these guidelines concerning when not to assert penalties or to abate them due to reasonable cause:

- The taxpayer, or a member of the immediate family, has died or is seriously ill.
- The taxpayer is unavoidably absent. (In the case of an entity such as a corporation, the individual having sole authority to file the return must have been absent (*not* the person preparing the return).)
- The taxpayer’s residence, place of business, or business records have been destroyed by fire, other casualty, or civil disturbance.
- The taxpayer is unable to obtain records necessary to determine the amount of tax due, for reasons beyond his or her control.
- The taxpayer mailed the return or payment on time but, through no fault of the taxpayer, the return was not delivered on time.
- The IRS provided erroneous information or failed to provide tax forms and instructions in response to the taxpayer’s timely request.
- A competent tax advisor, provided with necessary and relevant information, incorrectly advised that the filing of a return was not required.

### 302.2.7 Cash Receipts

Any person in a trade or business—including that of tax preparer—who receives more than \$10,000 in cash (in either a single transaction or related transactions) is required by 6050I to file an information return on Form 8300. Financial institutions and casinos report on Forms 4789 and 8362. A “person” is defined as an individual, company, corporation, partnership, association, or estate. “Cash” consists of coins and currency (of U.S. or foreign issue), cashier’s checks, bank drafts, traveler’s checks, and money orders. Related transactions are those that occur within a twenty-four hour period. If more than twenty-four hours pass between receipts of cash, and the total is greater than \$10,000, the transactions must be reported if the recipient knows or has reason to know that each is one of a series of connected transactions.

Form 8300 must be filed within fifteen days of receipt of a payment. After filing, a new count of cash receipts begins. Additional receipts of over \$10,000 must also be reported. A written statement must be given to each payer named on any Form 8300 showing the name and address of the person reporting and the amount reported. This statement must be sent by January 31 of the year following the year in which the cash that triggered the IRS filing was received. A copy of Form 8300 must be retained for five years.

Civil penalties of \$50 for each failure to file are imposed by Sec. 6723 (criminal penalties for intentional or willful disregard are provided in the amount of \$25,000 (\$100,000 for corporations) or the amount of cash received in the transaction or related transactions (but no more than \$100,000)), and a sentence of up to five years in prison, or both. An example of a criminal act is structuring a transaction to make it appear unnecessary to file a report.

Voluntary filings may be made of cash transactions under \$10,000 if the transaction appears to be suspicious. A transaction is suspicious if—



- It provides an indication of possible illegal activity.
- It indicates an attempt by the payer to convince the recipient not to file Form 8300, or to file a false or incomplete form.
- The payer's appearance, demeanor, statements, or any other facts or circumstances arouse the suspicion of the recipient.

Additional information is given in IRS Publication 1544, *Rules for Reporting Large Cash Payments*. Section 6050I(f) was added in 1988 to forbid structuring transactions to evade the reporting requirements by dividing a transaction and by other means.

### 302.3 Taxpayer Accuracy-Related Penalties

A single accuracy-related penalty in IRC Sec. 6662 has replaced several former penalties. We will touch briefly on Sec. 6662—which impacts taxpayers—and then move on in Sec. 302.4 to penalties on preparers. The new Internal Revenue Code section creates a 20 percent penalty for underpayments of tax due to one or more of the following causes (in the case of certain gross valuation misstatements the penalty is 40 percent):

- Negligence or disregard of rules or regulations
- Any substantial understatement of income tax
- Any substantial valuation misstatement in connection with income tax
- Any substantial overstatement of pension liabilities
- Any substantial estate or gift tax valuation understatement

The negligence penalty applies only to the portion of the underpayment that is attributable to negligence, not to the total amount of underpayment. There is no “stacking” of components of the accuracy-related penalty. The maximum accuracy-related penalty cannot exceed 20 percent (40 percent in the case of certain gross valuation misstatements) even if more than one type of misconduct is present.

An understatement of tax is substantial if it exceeds the greater of 10% of the tax required to be shown on the return or \$5,000. Any amount of substantial understatement is reduced by the portion attributable to tax treatments (1) for which the taxpayer had substantial authority or (2) for which relevant facts are adequately disclosed in the return or attached to the return (IRC Sec. 6662(d)(2)(B)). In the case of tax shelters, adequacy of disclosure is not relevant to abate the penalty and the substantial authority requirement doesn't apply unless the taxpayer reasonably believed that the tax treatment was more likely than not proper (IRC Sec. 6662(d)(2)(C)).

Disclosure is inadequate unless there is a reasonable basis for the position. Abatement of taxpayer penalties in the case of reasonable cause and good faith is explained in Regs. Sec. 1.6664-4(b).

#### 302.3.1 Substantial Authority

Tax return positions for which the taxpayer has substantial authority are treated as if properly shown on the return. The following sources are considered substantial authority (Regs. Sec. 1.6662-4(d)(3)(iii)):

- Internal Revenue Code and other statutory provisions
- Proposed, temporary, and final regulations
- Revenue rulings and revenue procedures
- Federal court cases interpreting tax statutes
- Administrative pronouncements (including revenue rulings and revenue procedures)
- Tax treaties and regulations thereunder, and Treasury Department explanations of treaties

- Congressional intent as reflected in committee reports, joint explanatory statements of managers included in conference committee reports, and floor statements made before enactment by one of the bill's managers
- Private letter rulings and technical advice memoranda issued after October 31, 1976
- Actions on decisions and general counsel memoranda issued after March 12, 1981, as well as memoranda published in pre-1955 volumes of the Cumulative Bulletin
- Information releases or press releases, notices, and any other similar pronouncements published in the Internal Revenue Bulletin
- General Explanations of tax legislation prepared by the Joint Committee on Taxation (called the "Blue Book")

The Omnibus Budget Reconciliation Act of 1989 (OBRA) requires the IRS to publish not less frequently than annually a list of tax return positions for which the IRS believes there is no substantial authority and that affect a significant number of taxpayers. The purpose of this list is to assist taxpayers in determining whether a position should be disclosed to avoid the penalties for substantial understatement provided in IRC Sec. 6662(d).

**Practice Tip.** You should give particular attention to this list that OBRA requires of the IRS. If a taxpayer takes a position that is enumerated on the list, you can advise that the position be disclosed to avoid possible imposition of the substantial-understatement component of the accuracy-related penalty (IRC Sec. 6662(d)). See current year revenue procedures and Sec. 302.4.6, herein, for IRS disclosure guidelines. On the other hand, disclosure does not necessarily prevent imposition of the negligence penalty (IRC Sec. 6662(b)), *but does call attention to the position*. (Taking a frivolous position on the return, even if disclosed, could still result in a negligence penalty.)

## 302.4 Return-Preparer Understatement Accuracy Penalty

Preparer penalty provisions complement the accuracy-related penalties of IRC Sec. 6662 applying to taxpayers. We will discuss subsections (a) and (b) of IRC Sec. 6694 and methods of avoiding penalties or reducing their amount.

Preparer penalties apply to understatements of tax liability (or overstatements of refunds) with respect to a tax imposed under Subtitle A—a tax on income (IRC Sec. 6696(e)). Additions to tax for failure to make estimated tax payments (IRC Secs. 6654 and 6655) are not included when computing an understatement of tax (Regs. Sec. 1.6694-1(c)). See Section 302.1.1 for further discussion of the documents that constitute a return or claim for refund.

A preparer is penalized \$250 for an understatement due to an unrealistic position if: there was not a realistic possibility of the position being sustained on its merits, the preparer knew or should have known of the position, and the position was not disclosed or was frivolous. IRC Sec. 6694(a)

### 302.4.1 Willful or Reckless Conduct

If any part of any understatement of liability is due to a willful attempt by the preparer to understate liability or to any reckless or intentional disregard of rules or regulations, the penalty is \$1,000 for each return or claim (IRC Sec. 6694(b)(1), (2)). The importance of disclosure is emphasized by Regs. Sec. 1.6694-3(c)(2), which states that a preparer who adequately discloses a position that is not frivolous is not considered to have recklessly or intentionally disregarded a rule or regulation. Regs. Sec. 1.6694-3(d) further spells out several examples, such as that of a preparer who disregards information received from the taxpayer.

**Example.** A client's bookkeeper testified she had been aware that the corporation paid personal expenses for the shareholders. The expenses were claimed as corporate business deductions. She also testified that she communicated this information to the preparer, who said, "Don't worry about it." The preparer was held to be subject to the penalty for willful understatement, because he ignored information that he had a duty to pursue (*Pickering v. U.S.*, 691 F.2d 853 (8th Cir. 1982)) 82-2 USTC 9653, aff'g 82-1 USTC 9735.

Sec. 10.51 of Circular 230 defines *reckless conduct* as a highly unreasonable omission or misrepresentation involving an extreme departure from the standard of care that a practitioner should observe under the circumstances.

### 302.4.2 Realistic Possibility

Regs. Sec. 1.6694-2(b)(1) explains that a position will be considered to have a realistic possibility of being sustained on its merits if a reasonable and well-informed analysis by a person knowledgeable in the tax law would lead such a person to conclude that the position has approximately a one in three, or greater, likelihood of being sustained on its merits. In reaching that conclusion, the authorities permitted for consideration are those identified in the accuracy-related penalties regulations. (See Section 301.3.1.) The possibility that the taxpayer's return may not be audited or that the issue may not be raised on audit must not be taken into account.

For purposes of determining whether a position satisfies the realistic possibility standard, Regs. Sec. 1.6696-2(b)(2) refers to the authorities listed in Regs. Sec. 1.6662-4(d)(3)(iii). See Section 302.3.1 of this manual; *satisfaction of the substantial authority standard appears to satisfy the realistic possibility standard*. The regulations give nine examples relating to realistic possibility that should be consulted (Regs. 1.6694-2(a)(3)). For further analysis of this issue, see "The Realistic Possibility Standard," *The Tax Adviser*, May 1991.

Sec. 10.34 of Circular 230 closely reflects the *realistic possibility* standard of Regs. 1.6694. It states that a practitioner may not advise a client to take a tax return position (and may not sign a return on which such a position is taken) unless—

- There is a realistic possibility that the position will be sustained on its merits, or
- The position is not frivolous and the practitioner advises the taxpayer to disclose the position.

### 302.4.3 Reasonable Cause and Good Faith

With a showing of reasonable cause and good faith, a preparer can avoid the understatement penalty of IRC Sec. 6694(a). Regs. Sec. 1.6694-2(d) names five factors to be considered in evaluating reasonable cause and good faith. The examples we cite in connection with the factors predate the proposed regulation but are presumed still to be relevant.

#### Nature of Error Causing Understatement

If a general review of the return would have disclosed the error—such as a large mathematical mistake—there is negligence. On the other hand, isolated clerical or mathematical errors will not be penalized. There will be no penalty if the misapplied IRC provision was so complex, uncommon, or highly technical that a competent preparer might reasonably be unaware or mistaken. If the understatement results from disregard of a rule or regulation that is so usual or simple that the preparer should have been aware of it, then the penalty *will* apply.

**Example.** A preparer pleaded that he was not familiar with IRC Sec. 1374 that limits an S corporation's loss deductions to a shareholder's adjusted basis. The court reasoned that since the preparer had claimed the IRC Sec. 1374(c) loss deduction, he was negligent in disregarding the limits expressed in the same section (*Papermaster*, 81-1 USTC 9217 (E.D. Wis. 1980)).

#### Frequency of Error

Proposed regulations state the penalty will not be asserted for an isolated error, unless it is sufficiently obvious, flagrant, or material. The reasonable-cause-and-good-faith exception will not apply where there is a *pattern* of errors. Under prior IRS guidelines a pattern of errors would similarly create a presumption of negligence (Rev. Rul. 80-263, 1980-2 CB 376).

**Example.** Where the amount of the understatement of tax liability was not substantial and there were no other errors on a return, a preparer was not penalized who overlooked one out of several of a taxpayer's Forms 1099-INT. Nor was a preparer penalized who

properly listed all of the amounts of interest but struck an incorrect total. The result would be the opposite if the error was conspicuous and should have been detected (Rev. Rul. 80-262, 1980-2 CB 375).

### Materiality of the Errors

If the tax understatement is relatively immaterial in comparison with the correct liability, no penalty will be asserted. This exception will not apply if the immaterial error or errors are sufficiently obvious or numerous.

**Example.** The preparer failed to list on Schedule B one Form 1099-INT and one Form 1099-DIV, although all the Forms had been provided by the taxpayer. Also, the preparer incorrectly totaled Schedule A and used the wrong tax table in calculating the tax. The IRS decided that the errors taken together suggest that the return was negligently prepared (Rev. Rul. 80-263, 1980-2 CB 376).

### Preparer's Normal Office Practice

No penalty will be imposed if evidence indicates that normal office practices of the preparer would cause the error to occur only rarely, and that these normal practices are being followed. Normal office practice should include a system designed to promote accuracy and consistency in the preparation of returns. As a minimum, in the case of a signing preparer, office practice generally must involve checklists, a method of obtaining information from the taxpayer, examination of the prior year's return, and review procedures (see Chapters 101 and 201 of this manual).

**Example.** A preparer failed to report a minimum tax liability that resulted from a net capital gain deduction. The preparer conceded the error but demonstrated that normal office practice included a checklist containing a requirement that the minimum tax must be considered. The IRS decided that a penalty would *not* be asserted in this instance. The preparer's normal office practice indicated that the error would rarely occur. These normal practices were followed; the error did occur, but was not considered a "flagrant" one (Rev. Rul. 80-264, 1980-2 CB 377). Although this example is based upon older tax law, the principle is the same now: Procedures normally used by a practitioner should be designed to eliminate error.

**Practice Tip.** Your office procedures should be designed to promote accuracy and consistency. Retain a "paper trail" that demonstrates that you followed these procedures in preparing each return. Use checklists showing you were alert to such matters as the alternative minimum tax and that you inspected last year's return. Use data sheets to collect information from the taxpayer, and consider having the client sign them. Make notes for the file to record telephone communications. In short, procedures for review must be formalized and spelled out in your firm's quality control document.

### Reasonable Reliance on Another Preparer

Proposed regulations state that no IRC Sec. 6694(a) penalty will be imposed on a preparer that relied in good faith on the advice of another individual. The preparer must have reason to believe the adviser was competent to render the advice. The advice may be oral or written, but the burden of proof is on the preparer in either case. Contemporaneous records—notes for the file—should be kept of oral advice. Reliance on another individual within the signing preparer's firm will not avoid the penalty. The preparer is not considered to have relied on another in good faith if—

- The advice is unreasonable on its face.
- The preparer knew or should have known that the other preparer was not aware of all relevant facts.
- The preparer knew or should have known that the advice was no longer reliable due to developments in the law since the time the advice was given.

**Example.** Clients inform their preparer that their outside professional adviser, such as an attorney or CPA, believes a “family trust” to be an acceptable means of avoiding income taxes. The preparer, however, knows these trusts are illegal as indicated in Revenue Ruling 75-257, 1975-2 CB 251. The good faith view of the preparer should take precedence, and the view of the professional adviser is considered irrelevant (LR 7813019).

### 302.4.4 Reliance on Information Supplied by the Taxpayer

A preparer acting in good faith may rely without verification on information furnished by the taxpayer. The preparer is not required to audit or investigate documents or other evidence. The preparer must not ignore implications of the information furnished and must make reasonable inquiries if the information appears to be incorrect or incomplete (Regs. Sec. 1.6694-1(e)(1)).

**Example.** A taxpayer stated to his preparer that he had paid \$6,500 in doctor bills and \$5,000 in deductible travel and entertainment expenses. The preparer was satisfied based on inquiry that the taxpayer had documentation for the travel and entertainment expenses. The preparer had no reason to believe the information was incorrect and had no duty to inquire further or to examine documentation. Even if the deductions are fraudulent, the preparer is *not* subject to penalty. (In this instance due diligence did not require further inquiry.)

A preparer, however, must not ignore the implication of information furnished to or known by the preparer (Rev. Proc. 80-40, 1980-2 CB 774).

**Example.** The preparer completed returns for both a shareholder and the corporation from which the shareholder received interest. The corporation reported to the preparer the name of the shareholder receiving interest. The shareholder failed to report the interest to the preparer. The preparer is held liable for penalties, because he or she had reason to believe that the shareholder’s information was faulty and should have made further inquiries (Rev. Rul. 80-265, 1980-2 CB 378). (See, for a similar holding on similar facts, *Brockhouse v. U.S.*, 749 F.2d 1248 (7th Cir. 1984).)

### 302.4.5 Negligence

Negligence includes any failure by a taxpayer to make a reasonable attempt to comply with the provisions of IRC Sec. 6662. Negligence is further defined in Prop. Regs. Sec. 1.6662-3(b) as any failure to make a reasonable attempt to comply with law or to exercise ordinary or reasonable care. It is the failure to do what a prudent person would do under the circumstances (Rev. Proc. 80-40 1980-2 CB 774); (*Brockhouse v. U. S.*, 749 F.2d 1248 (7th Cir. 1984); IRM Sec. 4297.2).

For example, failure to keep adequate books and records is negligent, as is adoption of a disclosed tax position for which there is not a reasonable basis. Temp. Regs. Sec. 1.6662-7T(d)(2), interpreting amendments to IRC 6662 included in the Revenue Reconciliation Act of 1993, state that the reasonable basis standard is significantly higher than the previous “not frivolous” standard.

This reasonableness standard is echoed in IRC Sec. 6694(a), which states that a tax preparer is subject to a \$250 penalty for an understatement of a taxpayer’s liability in connection with an unrealistic position *if*

- the preparer *should reasonably have known* of the position
- and the position is not properly disclosed (see Sec. 302.4.6)
- or the position is frivolous.

This penalty—in essence a penalty for negligence—can be avoided by the preparer’s reasonable cause and good faith. See Sec. 302.4.3 of this manual for a discussion of reasonable cause and good faith.

The Fifth Amendment privilege against self-incrimination is not available for a preparer who is charged with civil negligence under IRC Sec. 6694 since this is not a criminal charge.

(*Mertsching, William v. U.S.*, (1983, CA10) 51 AFTR2d 83-1081, 704 F.2d 505, 83-1 USTC 9297.)

An employer (or partnership) can be assessed penalties for *participation* in the negligent, intentional, willful conduct of the person who is technically considered to be the preparer (Regs. Sec. 1.6694-1(a)(1)). Proposed regulations expose to the penalty an employer or partnership of a preparer if the person knew or should have known of an unrealistic position (Regs. Sec. 1.6694-2(a)(2)). Previously, congressional comments suggest negligence might be attributed to a supervisor or reviewer who had responsibility for determining that rules and regulations were being followed, but failed to do so (S. Rep. No. 938, Pt. 1, 94th Cong., 2d Sess. 355 (1976)). There appears to be no significant distinction between avoiding negligence and acting in good faith with reasonable cause.

These examples relate to the imposition of a negligence penalty.

- For several different clients, a CPA advised one spouse to claim the other spouse as an employee and to deduct the cost of medical care and of meals and lodging furnished on the home premises. The court expressed the belief that no “reasonably prudent CPA” would have believed there was a legitimate, bona fide employer-employee relationship (*Weidmann v. U.S.*, Dept. of Treas. Nos. 84-958L, 84-1245L (W.D. Pa. 1989; 63 AFTR 2d 89-1065)).
- A preparer failed to follow a revenue ruling that prohibited “family trust” deductions (*Benson v. U.S.*, 85-1 USTC 9424 (E.D. Cal. 1985)).
- A preparer deducted as a casualty loss the amount the taxpayer paid as a settlement in an auto accident (*Swart v. U.S.*, 83-2 USTC 9545 (C.D. Calif. 1982), 568 F. Supp. 763, 52 AFTR 2d 83-5660, *aff’d without opinion*; *Swart v. U.S.*, 714 F.2d 154 (9th Cir., 1983)).
- A preparer who was a CPA and attorney deducted a client’s losses in excess of basis in an S Corporation (*Papermaster v. U.S.*, 81-1 USTC 9217 (E.D. Wis. 1980)).

**Practice Tip.** Avoid preparing a return that involves tax laws you are not familiar with. A consolidated corporate return might not be worth the effort and risk for a practitioner whose practice consisted mostly of Form 1040s. Insist that your staff keep up with changing tax laws.

### 302.4.6 Disclosure

Adequate disclosure avoids the taxpayer understatement penalty of Sec. 6662(a) and the preparer understatement penalties of Sec. 6694(a) and (b). For a taxpayer to take advantage of the disclosure exception there must be a reasonable basis for the tax treatment. (IRC 6662(d)(2)(B)(ii) (II), added by The Revenue Reconciliation Act of 1993). The Act removes the “not frivolous” requirement of previous law from the taxpayer penalty provision but not from the preparer penalty provision. (Note: Sec. 6702 proscribes the filing of a frivolous tax *return*, such as are sometimes filed by tax protestors.) Regulations do not provide a definition of “reasonable basis.” In echoing the Congressional Conference Report Regs. Sec. 1.6662-7(d)(2) indicates the reasonable basis standard applying to taxpayers is significantly higher than the previous “not frivolous” standard.

Disclosure of a tax return position should be made on IRS Form 8275 or 8275-R. Disclosure is deemed adequate if made on the return itself if this treatment is prescribed by an annual revenue procedure. Rev. Proc. 94-36, IRB 1994-20 identifies tax return items for which additional disclosure, *e.g.* via Form 8275, is unnecessary if a specified form or attachment is completed in clear manner and according to instructions. The identified items are numerous and include such matters as medical and dental expenses for which completion of lines 1 through 4 on Schedule A of Form 1040 is considered adequate disclosure. For all items cited in the Revenue Procedure the money amount must be entered in good faith and must be verifiable, that is, upon audit the taxpayer must be able to demonstrate the origin of the number even if the number is ultimately not accepted by the IRS.

**Practice Tip.** Your files should document the substantial authority relied upon in connection with a questionable tax return position, including your reasons for reliance and your

conclusion that there is a realistic possibility for the position to be sustained. Satisfaction in a taxpayer's return of the substantial authority standard of Sec. 6662(d)(2)(B)(i) appears adequate to sustain the realistic possibility standard of Sec. 6694(a) applying to preparers. Senate Report 97-496 (7-12-82) indicates that accountants' workpapers analyzing doubtful reporting positions should not be scrutinized by the IRS.

### 302.4.7 Abatement of Penalty

The statute provides for abatement (removal) of a penalty that has been assessed (IRC Sec. 6694(d)). According to Regs. Sec. 1.6694-1(c), understatement of a taxpayer's tax liability is an essential element of a preparer's offense. If at any time in a final administrative determination or a final judicial decision it is established that there was no understatement of liability, no penalty applies. Any penalty collected for that tax year must be refunded.

*Understatement of liability* means understatement of the net amount payable with respect to any tax imposed by Subtitle A (an income tax) or any overstatement of the net amount creditable or refundable (IRC Sec. 6694(d)). If there is no understatement, there is no penalty. An overstatement of deductions *and* income by an equal amount will not be penalized (Rev. Rul. 82-25, 1982-1 CB 214). A later-generated loss carryback that wipes out an understatement of liability on an earlier return does *not* abate the penalty (Rev. Rul. 82-25, 1982-1 CB 214). Generally, the IRS will not assert the penalty in the case of an immaterial amount of understatement (Rev. Proc. 80-40, 1980-2 CB 774).

**Example.** Preparer A negligently overstated expenses on taxpayer B's return, but failed to claim other deductions. The IRS disallowed the overstated expenses, and assessed a deficiency that B agreed to and paid. The IRS assessed a penalty against A under IRC Sec. 6694(a). B later filed a claim for refund based on the other deductions mistakenly omitted. Because there was then no understatement of tax liability, the penalty on the preparer must be abated (Rev. Rul. 82-25, 1982-1 CB 214).

**Practice Tip.** A practitioner unfortunate enough to be charged with understatement of liability on a taxpayer's return (or overstatement on a refund claim) should scrutinize the taxpayer's financial affairs. The understatement might be offset by deductions mistakenly omitted for that tax year.

## 302.5 Penalties for Aiding and Abetting Understatement of Tax Liability

Any person (including a tax return preparer) shall pay a penalty under IRC Sec. 6701 who—

- Aids or assists in, procures, or advises with respect to, the preparation or presentation of any portion of a return, affidavit, claim, or other document, and
- Knows (or has reason to believe) that such portion (if so used) would result in an understatement of the liability for tax of another person.

\$1,000 penalties are provided for each document (\$10,000 if the return or other document relates to the tax liability of a corporation). The penalty can be asserted against an adviser who recommends a course of conduct knowing that an understatement of liability will result. It is not necessary that the taxpayer be aware that the return is faulty for the penalty to be imposed. No statute of limitations from the Internal Revenue Code applies to this penalty, but see *Lamb v. U.S.*, 7793 F. Supp. 116, 92-1 USTC 50166 (W.D. Ark. 1991), where the court applied the federal judiciary five-year statute in 28 U.S.C. 2462. The tax return preparer was involved in presenting energy management system tax shelters to her clients.

**Practice Tip.** This penalty has important implications for the supervision of employees. The term *procures* in the statute includes these actions:

- Ordering (or otherwise causing) a subordinate to do an act.
- Knowing of, and not attempting to prevent, participation by a subordinate in an act.

A recent court case shows an interpretation of the statute that resulted in multiple penalties. In *William T. Kuchan v. U.S.*, 679 F.Supp. 764 (N.D.Ill. 1988), 62 AFTR2d 88-5128, a CPA transmitted three cover letters and copies of Schedule C showing a loss on coal mining activities. The letters and schedules were to be duplicated and sent to investors in a tax shelter. While only three documents (letters) were prepared by the CPA, the court endorsed the government's theory that 191 instances of penalty were involved, at \$1,000 each, because the CPA knew that the letter was to be duplicated.

## 302.6 Failure to Collect and Pay Over Tax

Anyone required to collect, truthfully account for, and pay over taxes (to the government) can be personally liable for the unpaid taxes (IRC Sec. 6672). This has become known as the “responsible person” penalty, or the “100 percent penalty.”

**Practice Tip.** Voluntary payments by a taxpayer should be clearly designated as income tax and employee FICA tax (employment-withheld) taxes. Otherwise, the IRS will apply the payments first to non-trust-fund taxes that may also be delinquent.

The purpose of the provision is to assure that employment taxes withheld from employees are properly paid over to the Treasury. Officers or employees are most likely to be held to be responsible persons, but—in rare cases—outsiders such as bankers, public accountants, and tax practitioners may be, too.

The IRS can attempt to levy penalties against *any* person who is influential in the delinquent taxpayer's business affairs who knows that creditors are being paid while withheld “trust fund” taxes are not being forwarded to the Treasury. The IRS apparently also views as potentially responsible anyone who is an authorized check signer. The IRS is required to notify an individual it has determined to be a responsible person at least 60 days prior to a demand for penalty.

**Practice Tip.** You should never advise a client to pay other creditors first if employees' taxes that have been withheld are due to the federal government.

Among the cases that have gone to court, no single factor has determined who, if anyone, will be held personally liable. That person's failure to pay or to cause payment to be made must have been *willful*, that is, voluntary, conscious, and intentional. Courts that have considered the issue have tended to find responsibility among those who have one or more of the following roles:

- Authorized check signers
- Officers, directors, shareholders, or others who have an entrepreneurial stake in the success of the business
- Those who prepared employment tax returns
- Those who made employee hiring decisions
- Those who had effective control of financial affairs, making the final decisions as to which bills to pay

The courts have ruled that the following persons were personally responsible for delinquent taxes:

- An attorney who served as treasurer for a corporation was held liable for unpaid federal employment taxes (*J. Allen Dougherty v. U.S.*, 18 Ct. Cl. 335 (1989), 89-2 USTC 958).
- The president and treasurer, who was also a shareholder, was held liable for failing to pay over taxes withheld by a bankrupt corporation (*Robert H. Clements, et al. v. U.S.*, Bankr. D. Wyo. 1989) 90-1 USTC 50024.
- An office manager—who kept his employer's books and had signature authority on its bank accounts—attempted to work out a payment schedule with the IRS for the corporation's employment taxes. The IRS assessed responsible-person penalties against him and the two shareholders and seized his personal bank account. The district court



granted summary judgment for a refund, saying that the manager was not a responsible person since he did not have ultimate authority over payment of the bills, and even if he were responsible, he did not willfully fail to pay over the taxes (*John L. Corrigan v. U.S.*, No. C88-523C, U.S. Dist. Ct., Decided and filed March 31, 1989 (W.D. Wash. 1989)).

- A company treasurer and shareholder was held liable for delinquent withholding taxes as a responsible person, despite the fact that he had attempted to fully delegate the payment duties to another (*Edgar B. Thomsen, Jr., v. U.S.*, 887 F.2d 12 (1st Cir. 1989), 89-2 USTC 9575).
- An accounting firm prepared the payroll, distributed paychecks, and prepared and filed all of the client's federal, state, and local tax returns. The firm advised the client which bills to pay, since there wasn't enough cash to pay them all. The accounting firm was held to be responsible when the client was unable to pay employment taxes. (In re: Quattrone Accountants, Inc., 895 F.2d 921, 90-1 USTC 50103 (3rd Cir. Pa. 1990). This case is discussed in *The Journal of Accountancy*, April 1989, p. 131.

**Practice Tip.** An administrative hearing with the IRS Appeals Division can be requested prior to paying an assessment as a responsible person. Alternatively, the tax withheld for one employee for one quarter might be paid. Then a refund claim might be filed and an administrative hearing requested. If the refund claim is disallowed, suit could be brought in district court or Court of Federal Claims.

## 302.7 Tax Return Preparer Program

In an attempt to identify and rectify the poor practices of a small group of tax practitioners, the IRS instituted a Tax Return Preparer Program in 1981 (IRM Sec. 4297).

IRS examiners are told to be alert to evidence in every field and office examination that a paid tax return preparer may have negligently, intentionally, or willfully understated the liability on a client's tax return, or may have failed to identify himself or herself on the return. If the return under examination lacks a preparer's signature, the taxpayer will be asked if someone else assisted in preparing it.

Anyone who wishes to make a report concerning the conduct of a practitioner may do so to the Director of Practice, to a district director, or to any IRS employee.

An examiner who finds evidence of a violation by a preparer is told to develop the facts sufficiently to determine whether a penalty investigation should be instituted against that preparer, but without discussing the case with either the taxpayer or the preparer. The examiner who believes an investigation should be entered fills out Form 6459, Return Preparer's Checksheet (Exhibit 302-2). The approval of the examiner's group manager officially institutes the investigation.

At this point the examiner contacts the practitioner and documents his or her views concerning the questionable conduct on Form 5808, Return Preparer—Penalty Follow-Up (Exhibit 302-3).

The preparer is given an opportunity to agree or disagree to immediate assessment and payment of the penalty on Form 5816, Report of Income Tax Return Preparer Penalty (Exhibit 302-4).

Where the penalty being asserted is for negligent or intentional disregard of rules and regulations or for willful understatement of liability, the IRS gives the preparer an opportunity for an Appeals Office conference—a final administrative review, to be scheduled within 30 days of receiving Letter 1125 (Exhibit 302-5). There is no 90-day letter procedure and no opportunity to have the penalty reviewed in Tax Court. (Certain other penalties—those in IRC Sec. 6695, for example—are preassessable, that is, the right to appeal to the appeals office comes about after the penalties have been assessed.)

If the practitioner is successful, a “no-change” letter will be issued. If the appeal goes against the practitioner, he or she will be asked to sign a waiver on Form 5838 (Exhibit 302-6) or 872D (Exhibit 302-7).

**Practice Tip.** No waiver of any sort should be signed without full understanding of its consequences, best achieved through consultation with an attorney who is familiar with IRS penalties and the administrative and judicial appeals processes. Careful consideration must be given to the likely referral of the preparer to the IRS Director of Practice (when the preparer is a CPA, attorney, or enrolled agent) for a Sec. 6694(b) violation and often even for a Sec. 6694(a) violation.

A preparer who fails to prevail at the appeals conference and wishes to contest further a penalty assessment must first pay the penalty, file for a refund and—if the refund claim is unsuccessful, as it is most likely to be—then bring an action for a refund in federal district court. (Alternatively, Regs. Sec. 1.6694-2(a)(4)(ii) allows a preparer to pay at least 15 percent of the penalty within 30 days of a demand for payment and then file for a refund in a district court within 6 months.)

The IRS has instituted a Program Action Case (PAC), in which taxpayers' returns are selected for audit solely because they share the same preparer and not because of other characteristics of the return. Evidently, the preparer's ID number is the common factor searched for by IRS computer. IRM Sec. 4297.7 stipulates that a *pattern* of noncompliance by a preparer is necessary for inauguration of a PAC.

Under the PAC procedures (instituted in 1983) a Return Preparers Coordinator in each district maintains Preparer Research Files concerning alleged misconduct by preparers. Information is gathered about the number of returns prepared, names of the taxpayers, taxable income, tax liability, refunds, contributions, and so forth. The district or assistant district director makes the final approval for examination of a preparer's clients. Preparer penalties reached through the PAC procedure are consolidated and treated as a single case.

**Practice Tip.** A practitioner who is tempted to pay a small penalty and forget about the matter—not taking it to court—should consider that a “preparer's file” is being accumulated by the IRS. Contents of this file can accumulate to target the practitioner for increased IRS scrutiny, including examinations of clients under the PAC procedure and attempts to enjoin the practitioner from further practice. You may decide it is best to contest the imposition of even a small penalty.

## 302.8 Injunctions Against Preparers

IRC Sec. 7407 authorizes the IRS to seek from a federal district court an injunction to enjoin (forbid) a preparer from certain specified conduct. The court must feel that injunctive relief is the appropriate measure to prevent recurrence. If the court finds that a preparer has “continually or repeatedly” engaged in this conduct, the court may prohibit the person from any practice whatsoever as an income tax return preparer (IRC Sec. 7407(b)(2)).

The previous code provision in Regs. Sec. 1.7407(c) under which a preparer might stay the injunction by filing a bond in the amount of \$50,000 as surety for payment of penalties under IRC Secs. 6694 and 6695 *was repealed by the 1989 Revenue Reconciliation Act*. Conduct by a preparer for which an injunction is appropriate includes the following actions (IRC Sec. 7407(b)):

- Engaging in any conduct subject to penalty under Section 6694 or 6695, or subject to any criminal penalty provided by the title
- Misrepresenting his or her eligibility to practice before the Internal Revenue Service, or otherwise misrepresenting his or her experience or education as an income tax return preparer
- Guaranteeing the payment of any tax refund or the allowance of any tax credit
- Engaging in any other fraudulent or deceptive conduct that substantially interferes with the proper administration of the internal revenue laws

The IRS may file for an injunction in any federal district where a taxpayer resides for whom the practitioner is considered a preparer. (See Section 302.1.3 for a warning concerning a preparer's liability where pass-through entities are involved.) Except where the IRS feels it

has to act post haste to halt flagrant abuse, a preparer is ordinarily aware that an investigation is underway through the tax preparer's program (see Section 302.7 of this manual). The IRS is *not* required, however, to notify a preparer before seeking an injunction.

Injunctions have been used against preparers in numerous instances. In *U.S. v. Venie*, 691 F. Supp 834 (M.D. Pa. 1988, 88-1 USTC 9326) a preparer was enjoined from improperly using head of household status in computing his client's taxes and from increasing child care expenses above the amounts submitted by taxpayers. The IRS was able to establish that the preparer—a sole practitioner who did 1,000 returns in 1986—had guaranteed a refund “on at least one occasion.” See *U.S. v. Hutchinson*, 83-1 USTC 9322 (S.D. Cal. 1983), 51 AFTR2d 83-1141, for an injunction in connection with violation of IRC Sec. 6694. *U.S. v. Ernst & Whinney*, 735 F.2d 1296, 1306 (11th Cir. 1984), 84-2 USTC 9618, also involved an injunction, against advice on inappropriate investment tax credit claims.

An Appeals Court affirmed in 1996 a penalty of \$75,000, together with a lifetime injunction against a preparer who the court found had willfully failed to furnish to the IRS either copies of returns or a list of taxpayer names and identification numbers. (*U.S. v. Nordbrock*, 38 F3d 440 (9th Cir. 1996) 74 AFTR 2d 94-5517, 94-2 USTC 50,532).

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**Exhibit 302-1: Consent for Use or Disclosure**

**CONSENT FOR USE OR DISCLOSURE OF TAX RETURN INFORMATION  
UNDER TREASURY REGULATION 301.7216-3(b)**

**CONSENT**

The undersigned taxpayer(s) hereby consent(s), for the specific purpose described herein, to the use or disclosure of any and all tax return information as described in Treasury Regulation Section 301.7216-3(b) with respect to the tax return filed on Form \_\_\_\_\_ for the period ending \_\_\_\_\_, by \_\_\_\_\_, the preparer of that tax return.

**PURPOSE OF CONSENT**

The consent is granted specifically and only for the purpose of \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

**LIMITATION ON USE OF CONSENT**

The tax return information referred to herein may not be used or disclosed for any purpose other than that stated herein (unless otherwise permitted under Treasury Regulation 301.7216-2).

\_\_\_\_\_  
Date

\_\_\_\_\_  
Signature of Taxpayer

\_\_\_\_\_  
Signature of Taxpayer

(NOTE: According to the Regulation, "the request for such consent may not be made later than the time the taxpayer receives his completed tax return from the tax return preparer." No follow-up request is allowed.)

**Exhibit 302-2: IRS Form 6459, Return Preparer's Checksheet**

**Return Preparer's Checksheet**

(IRC 6694 and IRC 6695)

**Instructions:** This checksheet should be completed any time that a decision is made to pursue a preparer penalty. The form should be prepared in duplicate. One copy will be attached to the workpapers of the related income tax case and the other copy will be included in the preparer case file.

Part I – Applicability of Return Preparers Provisions	Yes	No
A. Was the return prepared by a return preparer?		
B. Was the return prepared for a fee?		
<i>(If response to A or B is "No," no further entries are necessary.)</i>		
<i>(If response to A and B is "Yes," continue with questionnaire.)</i>		

Part II – Identification Penalties (IRC 6695)	Yes	No
A. Did the preparer furnish a copy of the completed return to the taxpayer when the original was presented for signature?		
B. Did the preparer sign the return and furnish his/her SSN/EIN? <i>(The identification penalty should only be considered if both the preparer's signature and SSN/EIN is missing. Otherwise the Service Center will assess the penalty on the missing identification item.)</i>		
If "No" to A or B, please furnish:		
Name and Address of Preparer	SSN/EIN	
	Phone Number	
C. If a refund return, was the check mailed directly to and endorsed by the taxpayer?		
<i>(If the response to any of the above is "No," consideration should be given to applying identification penalties under IRC 6695.)</i>		

Part III – Conduct Penalties (IRC 6694)	Yes	No
A. Did the examination result in an understatement of tax liability?  <i>(If response is "No," no further entries are necessary.)</i> <i>(If response is "Yes," continue with questionnaire.)</i>		
B. Do facts indicate that the preparer's negligence caused any part of the deficiency?		
C. Do facts indicate the preparer willfully attempted to understate the tax liability?		
<i>(If the answers to either (B) or (C) are "Yes," discuss with the Group Manager. The Group Manager will indicate approval for the pursuit of a conduct penalty investigation by signing the line provided in this section. (See IRM 426(27).)</i>		

Penalty Investigation Approved: <i>(Signature of Group Manager)</i>	Date
---	------

**Exhibit 302-3: IRS Form 5808, Return Preparer—Penalty Follow-Up**

<b>Return Preparer – Penalty Follow-Up</b> <small>(See IRM 4297)</small>	Form number of related return
---	-------------------------------

<input type="checkbox"/> Identification penalty—No preparer participation	<input type="checkbox"/> Conduct penalty
---	--

**Information Available to Examiners**

1. Name and address of preparer
  
2. SSN or EIN
  
3. Income tax return under examination. *(Include periods involved and statute expiration dates of potential preparer penalties.)*
  
4. Facts supporting assertion of the penalty or possible follow up action. *(Use reverse side and additional sheets if necessary.)*

Examiner's Signature	Date
Group Managers initials <i>(reviewed and concurred)</i>	Date

**Copies:** To income tax case file and preparer penalty case file if penalty is pursued. Information copy to district RPC if appropriate. *(See IRM 4414.8 for appropriate disposition of preparer penalty case file copy.)*

**Exhibit 302-4: IRS Form 5816, Report of Income Tax Return Preparer Penalty**

Department of the Treasury – Internal Revenue Service	
Form <b>5816</b> (Rev. August 1990)	<b>Report of Income Tax Return Preparer Penalty Case</b>
Name and address of preparer	
Check one box below Preparer is: Employer preparer <input type="checkbox"/> Self-employed preparer <input type="checkbox"/> Employee preparer <input type="checkbox"/>	
Preparer's social security or employer identification number	Examining district
Agreement <input type="checkbox"/> Full <input type="checkbox"/> None	
Name and title of person with whom penalty was discussed	
Date of report	In reply refer to:
<b>The following information identifies the tax return or claim for which penalty is being charged:</b>	
Taxpayer's name and address	Taxpayer's social security or employer identification number
Tax period	Master file tax code
<b>Kind of Preparer Penalty Charged</b>	<b>Amount</b>
A. Understatement of tax due to unrealistic positions	
B. Understatement of tax due to willful or reckless conduct.	
C. Negotiating or endorsing a Federal income tax check issued to a taxpayer (other than the preparer)	
D. Failure to keep a copy or list of the returns or claims prepared	
E. Failure to sign return or claim	
F. Failure to provide preparer's social security or employer identification number on return or claim	
G. Failure to furnish a copy of the return or claim to the taxpayer by the time it was presented for taxpayer's signature	
H. Disclosure or use of information, other than to prepare or assist in preparing returns.	
<b>Total penalties</b>	
Other Information	Examiner's signature

**Note: Examiner Remove Appeals Message on Unagreed Cases**

I have read the information on the back of this form that explains these penalties as they relate to income tax return preparers. I agree to comply with those provisions in the future.

**Consent to Assessment and Collection** – I do not wish to exercise my appeal rights with the Internal Revenue Service or to contest in the United States District Court the findings in this report, therefore, I give my consent to the immediate assessment and collection of the tax return preparer penalty.

Preparer's signature and date



**Exhibit 302-5: IRS Letter 1125**

Internal Revenue Service  
District Director

Department of the Treasury

**Date:**

**In Reply Refer To:**

**Person to Contact:**

**Contact Telephone Number:**

▷

We have enclosed a copy of our examination report explaining why we are proposing the tax return preparer penalty.

If you accept our findings, please sign and return the enclosed Form 5838. If a penalty amount is due, you may want to pay it now. Otherwise, we will bill you.

If you do not accept our findings, we recommend that you request a hearing with the Office of Regional Director of Appeals. If the total penalties in our report are \$2,500 or less, a written protest is unnecessary. You may, however, want to send us a statement of your reasons for not accepting our findings along with your request for a hearing. To arrange a hearing in the case of total penalties of more than \$2,500, a written protest is necessary.

The written protest should contain:

1. A statement that you want to appeal the findings of the examining officer to the Office of Regional Director of Appeals;
2. Your name and address;
3. The date and symbols from this letter;
4. Information to identify the taxpayer's return for which the penalty is being charged;
5. A statement of facts explaining your position and outlining the law or other authority upon which you rely.

A statement of facts, under 5 above, must be declared true under penalties of perjury. This may be done by adding to the protest the following signed declaration:

"Under the penalties of perjury, I declare that I have examined the statement of facts presented in this protest and in any accompanying schedules and statements and, to the best of my knowledge and belief, they are true, correct, and complete."

(over)

**Exhibit 302-5: IRS Letter 1125 (cont.)**

If your representative submits the protest for you, a declaration may be substituted stating:

- (1) That the representative prepared the protest and accompanying documents; and
- (2) Whether the representative knows personally that the statements of fact contained in the protest and accompanying documents are true and correct.

Your representative must have a power of attorney if he or she attends a hearing without you.

Appeals to the court will be to a United States District Court. We will be glad to explain how to appeal to the court.

If we do not hear from you within 30 days, we will have to process your case on the basis of the findings in the examination report. If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

An addressed envelope is enclosed for your convenience.

Thank you for your cooperation.

Sincerely yours,

A handwritten signature in black ink, appearing to read "James J. Ryan". The signature is fluid and cursive, with a large initial "J" and "R".

District Director

Enclosures:  
Examination Report  
Form 5838  
Envelope

**Exhibit 302-6: IRS Waiver Form 5838**

Form <b>5838</b> (Rev. Oct. 1980)	Department of the Treasury - Internal Revenue Service  <b>Waiver of Restrictions on Assessment and Collection of Tax Return Preparer Penalty</b>	Date received by Internal Revenue Service
--------------------------------------	--	--

I consent to the immediate assessment and collection of any tax return preparer penalty and accept any overassessment (decrease in preparers penalty) shown below, plus any interest provided by law. I do not want to exercise my appeal rights with the Internal Revenue Service, or United States District Court.

<b>Preparer penalties</b>					
Form number of return for which penalty is being charged	Taxpayer's name as shown on return	Taxpayer's identifying number	Tax period	Kind of penalty	Amount of penalty

<b>Decrease in preparer penalties</b>					
Form number of return for which penalty was charged	Taxpayer's name as shown on return	Taxpayer's identifying number	Tax period	Kind of penalty	Amount of penalty

Name and address of preparer (Number, street, city or town, State, and ZIP code)

\_\_\_\_\_  
Signature Date

\_\_\_\_\_  
Signature Title Date

By

**NOTE:** If you consent to the assessment of the preparer penalties shown in this waiver, please sign and return the form in order to limit any interest charge and expedite the adjustment to your account. Your consent will not prevent you from filing a claim for refund if you later believe you are so entitled.

penalties determined by the Internal Revenue Service, shown above, provided this waiver is signed and filed within the period established by law for making such a claim.

**Who Must Sign**

The waiver should be signed by the preparer. An attorney or agent may sign this waiver if specifically authorized by a power of attorney which, if not previously filed, must accompany this form.

We will consider this waiver a valid claim for refund or credit of any overpayment due resulting from any decrease in

**Exhibit 302-7: IRS Waiver Form 872-D**

Form <b>872-D</b> (January 1992)	Department of the Treasury—Internal Revenue Service <b>Consent to Extend the Time on Assessment                  of Tax Return Preparer Penalty</b>	In reply refer to:  Taxpayer Identification Number
-------------------------------------	--	---

\_\_\_\_\_, a tax return preparer, of  
 \_\_\_\_\_  
 (Name)

\_\_\_\_\_ and the District Director  
 \_\_\_\_\_  
 (Number, Street, Town or City, State, and ZIP Code)

of Internal Revenue or the Regional Director of Appeals consent and agree as follows:

(1) The penalty imposed by section 6694(a) and/or 6695 of the Internal Revenue Code may be assessed against the above named tax return preparer at any time on or before \_\_\_\_\_ with respect to the tax return(s) or claim(s) for refund of the taxpayers named below.

(2) The tax return preparer may file a claim for credit or refund and the Internal Revenue Service may credit or refund the penalty(ies) within 6 months after this agreement ends.

Form number of return for which penalty is being charged	Taxpayer's name as shown on return	Taxpayer's identification number	Tax period

**Making this consent will not deprive the tax return preparer of any appeal rights to which the tax return preparer would otherwise be entitled.**

<p><b>Who must sign</b></p> <p>The consent should be signed by the preparer. An attorney or agent may sign this consent if specifically authorized by a power of attorney which, if not previously filed, must accompany this form.</p>	_____ (Signature)
	_____ (Date)

\_\_\_\_\_  
 District Director of Internal Revenue

\_\_\_\_\_  
 Regional Director of Appeals

By \_\_\_\_\_  
 \_\_\_\_\_  
 (Signature) (Date)



# 303 Criminal and Civil Tax Fraud

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# 303 Criminal and Civil Tax Fraud

The purpose of this chapter is to discuss how the IRS investigates tax fraud. We have chosen this topic to provide you with background information so that you can answer clients' questions. Also, we want to point out what you should do to protect yourself in the event that the IRS focuses a fraud examination on one of your clients.

Our plan in this chapter is first to explain criminal and civil tax fraud and then to explore the clues that lead the IRS to initiate an investigation. Then, we will go over the methods by which the IRS seeks to establish evidence that fraud has taken place, such as the net worth method. (Methods of investigation are important to a tax practitioner whose client is the object of an investigation, because the IRS may believe the proof it seeks is in the hands of the practitioner.) Last, we present an overview of the federal tax crimes most frequently charged against taxpayers—and in some instances against practitioners.

## 303.1 Criminal and Civil Tax Fraud Compared

*Civil* tax fraud differs from *criminal* tax fraud in that the latter is punishable by *imprisonment*, by fines, or by both. Civil tax fraud, on the other hand, is punishable exclusively by a financial penalty. An example is the severe 75 percent civil penalty provided in IRC Sec. 6663 for underpayments of tax that are due to fraud.

IRS special agents—members of the Criminal Investigation Division (CID)—seek first of all to discover and build a case for the prosecution of criminal fraud, because that is their mission. According to the Internal Revenue Manual, however, CID is responsible for recommending and supporting with evidence whatever civil penalties may also be appropriate. If the criminal case fails, the IRS may propose civil fraud penalties. Acquittal of the criminal charges does *not* act to bar further pursuit of the taxpayer for civil fraud penalties (*Helvering v. Mitchell*, 303 U.S. 391 (1938); *Spear v. Commissioner*, 91 TC No. 63 (1988)). Thus, the starting point for most investigations is suspicion of criminal fraud.

Some federal tax crimes are felonies, carrying possible incarceration for longer than one year. Assisting in the preparation of a false tax return (IRC Sec. 7206(2)), for example, is a felony. It carries a maximum three-year jail sentence.

Certain other federal tax crimes are misdemeanors, punishable by imprisonment for one year or less. Failure to file a return, IRC Sec. 7203, is a misdemeanor, carrying a maximum jail term of one year.

The standard of persuasion (also called the standard of proof) for any criminal conviction is that of proof of guilt *beyond a reasonable doubt*. This means that the government not only has the burden of proof but also that, for a criminal fraud conviction, this proof must leave no reasonable doubt about the guilt of the person charged.

The burden is also on the government to prove fraud when it is an element in an offense for which a civil penalty is prescribed. Ordinarily, the standard of persuasion, however, is less in a civil case. Proof generally need be only by a *preponderance of the evidence*. The phrase is interpreted to mean that the great weight and merit of the evidence (over half) is against



the defendant. In the U.S. Tax Court, however, that court's Rule 142 requires that the government sustain its burden of proof of fraud by *clear and convincing evidence*, a more demanding standard than *preponderance* but less than *reasonable doubt*. (For further discussion of the Tax Court's standard, see *Amos v. Commissioner*, 43 T.C. No. 50 (1964), *aff'd*, 360 F.2d 358 (4th Cir. 1965).)

Because the standard of criminal proof, once achieved by the government, is higher than that for civil proof, the IRS will ordinarily recommend the 75 percent civil fraud penalty of IRC Sec. 6663 whenever a taxpayer is found guilty of a tax crime (or pleads no contest). The civil fraud penalty, in a sense, rides on the coattails of the proof of criminal culpability. On the other hand, acquittal on the criminal charges does not preclude a civil penalty as long as the lesser standard of civil proof—that of clear and convincing evidence—has been met. This is not considered to be double jeopardy. Tax (money) penalties are not deemed to be *criminal punishment* and are, thus, *civil* in nature. There is no double jeopardy violation for a tax protester who was hit with tax penalties following conviction for criminal tax evasion. *U.S. v. James C. Dunkel* 84 AFTR2d Par. 99-5078.

"Willfulness," an element of all of the major Internal Revenue Code tax crimes listed later in this chapter (and also an element in those statutes that prescribe civil penalties for fraud) refers to an intent to perform the illegal act: a voluntary, intentional violation of a known duty. An act done inadvertently or by mistake, on the other hand, is not a crime.

**Example.** A tax practitioner who for training purposes directed an employee to prepare a refund claim for a hypothetical client would not be guilty of a crime if a different employee inadvertently filed the claim with the IRS.

Some IRC sections specify civil penalties only, and the element of willfulness or intent to evade taxes is not pertinent. An example is IRC Sec. 6698, concerning failure to file a partnership return. In the case of a violation of these and similar statutes, penalties against a taxpayer or practitioner may be assessed by the IRS in a manner similar to the assessment of taxes. If the IRS cannot be convinced to remove the penalty administratively, the burden of proof in court is on the person against whom the penalty is assessed.

Willfulness, as an element alleged by the IRS in both civil and criminal fraud prosecutions, requires the IRS to bear the burden of proof. An IRS notice of deficiency has, in Tax Court practice, carried a presumption of correctness that had to be overcome in court by the taxpayer. The 1998 IRS Restructuring and Reform Act shifts this burden to the IRS, but only if the taxpayer has introduced credible evidence regarding any factual issue relevant to determining the taxpayer's liability, and has—

- Complied with Code and Regulations requirements to substantiate an item.
- Maintained required records.
- Cooperated with IRS requests regarding witnesses, information, documents, meetings, and interviews.

IRC Sec. 6351 provides a period of limitation on prosecution. An indictment (or information) must be filed within three years after the commission of the offense. The period is extended to six years in the case of fraud or willful attempt to evade taxes. These statutory periods begin to run from the later of the date the false return was filed or the date the false statement or other criminal act was committed. The period is suspended while the taxpayer is outside the United States or is a fugitive from justice. No benefit accrues to a taxpayer who signs, at the IRS' request, a waiver to extend the statute.

### 303.1.1 How to Detect That a Fraud Referral Has Been Made

Fraud investigations ordinarily begin with a referral from the examination division to the criminal investigation division of the IRS, but may also arise from a tip provided by the taxpayer's spouse or employee, from a newspaper article, or from a lead supplied through another government program—drug enforcement, for example. The money laundering act, which requires any person to report on IRS Form 8300 currency transactions of more than \$10,000 in the course of a trade or business, may also trigger an investigation.

Most fraud cases, however, arise by referral from an IRS agent who is examining a tax return. A *referral* is a transfer to CID, whose special agents probe into the possibility that fraud has been committed. These agents have access to powerful investigative tools, such as the search warrant and administrative summons. Special agents are law enforcement agents. They carry guns when it is warranted, and they can make arrests.

You must be alert to detect a fraud referral because your role vis-à-vis the client changes significantly. (For example, you should tell your client *not* to discuss further with you the tax years and returns that are under investigation, and not to give you documents, because your files may be summoned and you may be forced to testify in court against the client.) In addition, because of the possibility of imprisonment and the necessity of preserving constitutional safeguards, you should advise your client to consult an experienced criminal tax attorney whenever a fraud investigation appears imminent. A referral to CID should be suspected whenever an examining agent—

- Suddenly postpones or suspends the examination without stating a convincing reason and seems uncertain when it will be continued.
- Directs questions in detail to a client's employees, suppliers, bankers, stockbrokers, or other persons about their dealings with the taxpayer.
- Issues a summons for records or information that seem otherwise readily available.
- Shows unusual interest in tracing the flow of cash and in establishing the cash balance at the beginning of any year.
- Asks probing questions about personal cash expenditures.
- Prepares lists of cash-related documentation such as deposit slips, bank statements, and canceled checks.
- Asks for permission to search through the taxpayer's files.
- Asks for photocopies of income-related items such as sales and accounts receivable records, shipping records, and bank statements.
- Makes lists of the names of customers and suppliers.
- Asks for written statements of personal net worth, sources of cash, or expenditures of cash.

**Practice Tip.** Upon first notice of an IRS audit of a client, you should interview the client to detect whether there is potential criminal exposure without, however, eliciting any incriminating statement. (Remember, your discussion with the client is not protected by legal privilege.) If the return to be audited carries a potential criminal aspect, both the taxpayer and the preparer should consult their attorneys. Without legal advice on how to proceed, the taxpayer or preparer may make either false or incriminating statements to the IRS agent.

### 303.1.2 The Badges of Fraud

The courts may infer fraudulent intent from various kinds of circumstantial evidence, including these “badges of fraud,” understatement of income, and implausible or inconsistent explanation of behavior.” 796 F2d 303, 307 (9th Cir. 1986) aff’g TC Memo 1984-601. Same result in *Meier v. Commissioner*, 91 TC 1998-273, 297-298. Among the indications of possible incidents of fraud—called the “badges of fraud”—that suggest that a revenue agent might make a fraud referral are (paraphrased from the Internal Revenue Manual Sec. 940)—

- Omission of specific items of income when similar items are included; for example, reporting a \$50 dividend from one investment but failing to report a \$1,000 dividend from another.
- Omission of an entire source of income; for example, failing to report income derived from tips.
- Unexplained deposits in a taxpayer's bank account; for example, reporting gross receipts of \$50,000 when deposits total \$100,000.

- Substantial unexplained increases in net worth over a period of years; for example, taxable income on the taxpayer's return did not increase substantially during a three-year period but net worth increased threefold.
- Substantial excess of expenditures over available resources; for example, a taxpayer's total expenditures exceed total known sources of funds by a very substantial amount.
- Concealment of bank or brokerage accounts and other property by putting them in the name of corporations that are mere shells or in the names of minor children.
- Repeated failure to deposit receipts to taxpayer's business account even though that is contrary to normal practices in the industry.
- Failure to file a tax return for several years although substantial amounts of taxable income were received.
- Attempts to cover up sources of income by false description of the source.
- Substantial overstatements of deductions; for example, claiming \$5,000 in travel expenses when the actual expense was \$1,000.
- Fictitious deductions; for example, claiming rental loss of \$10,000 when taxpayer owns no property.
- Substantial deductions of personal expenditures claimed as business expenses; for example, deducting rent on a personal residence but claiming a business rent deduction.
- Clearly unallowable items included in unrelated accounts; for example, deducting veterinary expenses for pets by including them in cost of goods sold.
- Two or more sets of books or no books.
- False entries or alterations on the books and records, backdated documents, or false invoices.
- Adequate records not kept, particularly if put on notice by IRS in a prior audit.
- Concealment or refusal to make records available.
- Over- or underfooting journals or ledgers.
- Amounts stated on tax returns that are not in agreement with the same items on the books of accounts.
- Income included on the tax return of a related taxpayer who is in a significantly lower tax bracket.
- Hindering an examination by failure to answer pertinent questions or by repeatedly canceling appointments.
- Destruction of books and records, particularly without a plausible explanation, after an examination has begun.
- Diversion of a portion of business income into a personal bank account.
- Exhibiting a serious lack of cooperation.
- Adjustments of income agreed upon too quickly, or undue concern expressed about immediately closing the case.
- Illegal activities.
- Altering significant records in any way.

In addition to the badges of fraud listed in the Internal Revenue Manual, experienced practitioners believe the following signs can motivate an examining agent to consider making a referral to CID:

- Substantial understatements of income
- Bank or brokerage accounts listed in different variations of the taxpayer's name (John A. Smith, J. Anthony Smith, J.A. Smith, Sr.), accompanied by attempts to use incorrect Social Security numbers
- A pattern of using large amounts of currency (for example, in making business expenditures) instead of checking accounts
- Numerous bank deposits identified by the taxpayer as loans, gifts, or inheritances, without convincing documentation of their source
- Failure to file tax returns for a period of years while living luxuriously

- Forged, false, or suspicious documentary evidence provided to the IRS agent, or false statements made to the agent
- A pattern of fictitious or otherwise improper deductions and credits
- Claiming to have kept no books despite obvious business needs
- Books and records that have been stolen, accidentally destroyed, or that have mysteriously disappeared *after* an IRS examination has begun
- Submission of “evidence” to the agent in the form of self-serving statements backed either by no documentary proof or by documents later proved false
- Consistent pattern of underpayment of taxes over several years

**Practice Tip.** An experienced former IRS attorney advises that one of the clearest badges of fraud, in his view, consists of making false statements to an IRS agent during an investigation.

## 303.2 The Practitioner’s Role in Tax Fraud Investigations

When seeking to establish that a taxpayer committed a crime, the government must prove beyond a reasonable doubt not only the violation of a legal duty (violation of a tax statute) but also willful or intentional conduct by the taxpayer. The government’s most pressing problem, ordinarily, is to prove that the taxpayer—

- Is the person responsible for what appears or does not appear on the tax return.
- Had full knowledge of what appears in or was omitted from the return.
- Understood his or her legal duty regarding the return at the time it was filed.

The taxpayer knows the true story about these matters but is protected by the Constitution from being compelled to make self-incriminating statements. Lacking full access to the taxpayer, the IRS will sometimes seek out any tax practitioner who might have information. The practitioner may be required to hand over documents and, at trial, may be called as a government witness to testify about information received from or about the client.

No legal privilege protects communications between you and the client, whether made prior to or after initiation of the fraud examination, unless you received the communication acting as an agent of the client’s attorney. To stave off further potential harm, as soon as special agents of CID begin a fraud examination, you should neither discuss the matter further nor accept additional documents from the client.

When a criminal fraud examination begins, you must advise your client that he or she *must* consult a criminal tax attorney, if he or she has not already done so. (See Practice Tip in Section 303.1.1.) Communications between attorney and client for the purpose of securing legal advice are shielded by the attorney-client privilege in a manner not applicable to communications between a client and a tax practitioner who is not an attorney, unless the practitioner is acting as agent for the attorney. See further discussion in Section 303.2.1, however, for changes brought about by the 1998 IRS Restructuring and Reform Act.

### 303.2.1 Accountant-Client Privileged Communications

A privilege is said to exist in the eyes of the law when the court-ordered production of testimony or documents may be resisted without penalty. *State* statutes that provide for an accountant-client privilege do not apply to federal tax matters. (A recent case based on state law held that the state’s accountant-client privilege did not apply when the public accountant was acting as an appraiser.)

The attorney-client privilege (303.2.2) has been extended by the 1998 IRS Restructuring and Reform Act to cover all federally authorized tax practitioners, including accountants and enrolled agents, in their role of giving tax advice (IRC Sec. 7525(a)(1)). The privilege does not apply to written communication between the practitioner and a representative of a corporation in connection with the participation of the corporation in any tax shelter.

Judicial decisions over many years have clarified the extent of the *attorney-client* privilege. Questions remain unanswered about the newly created privilege, such as whether it covers—

- the nonattorney *practitioner's* work product (see discussion of attorneys' work product in 303.2.2),
- public accountants' audit work papers.

Since information given by the taxpayer to the practitioner for the purpose of preparing a tax return was provided with no expectation that the tax return itself would be confidential, such information (and related documentation) presumably is not privileged.

The new privilege applies only to noncriminal investigations by the IRS. Controversy may arise as to the timing of an IRS decision to open a criminal investigation.

Practitioners might be wise to proceed as under previous law until present uncertainties are clarified.

### 303.2.2 Accountant's Use of the Attorney-Client Privilege

The most commonly asserted privileges in tax investigations are the attorney-client privilege and the privilege against self-incrimination. The attorney-client privilege, where it is applicable, is asserted by an attorney on behalf of the client in order to block disclosure of information revealed to the attorney.

The Fifth Amendment to the Constitution provides that no person can be compelled in any criminal case to be a witness against himself. This is commonly known as the privilege against self-incrimination. It protects an individual from being compelled to give testimony in any proceeding that might tend to incriminate him under either state or federal law. (*U.S. v. Harper, Robin* (1975 DC PA) 35 AFTR2d 75-1232, 397 F Supp 983, 75-1 USTC 9394.) It protects, and may be claimed only by, the person who would otherwise be incriminated.

The Fifth Amendment privilege against self-incrimination is not available for a preparer who is charged with civil negligence under IRC Sec. 6694 since this is not a criminal charge. (*Mertsching, William v. U.S.*, (1983, CA10) 51 AFTR2d 83-1081, 704 F.2d 505, 83-1 USTC 9297.)

Another means of shielding information from the IRS is the attorney's work-product doctrine. Rule 26 of the Federal Rules of Civil Procedure protects the tangible documentation of the attorney's deliberations (work product) because it may reveal the mental processes the attorney pursued in defense of the client—the attorney's impressions, conclusions, theories, and opinions. This doctrine provides qualified protection against forced disclosure for the materials that meet the definition.

The work product must have been prepared in an engagement to provide legal advice. Where an attorney gets data from a client in order solely to prepare a tax return, neither the privilege nor the work-product doctrine may be applicable. Generally, material furnished to a tax preparer for the sole purpose of preparing a tax return, regardless of the preparer's profession, cannot be shielded from court-ordered disclosure. This is so because there was *no expectation* of privacy when the material was given to the preparer and, in any case, the disclosure that comes about through the filing of the return waives any privilege on the underlying supporting documentation.

Disputes arise as to whether particular documents in the hands of a lawyer contain material not revealed in a tax return and whether these materials are privileged. These questions have to be settled in court.

Work papers prepared by an accountant or other tax practitioner are *not* shielded by transferring them to an attorney in an attempt to take advantage of either the attorney-client privilege or the work-product doctrine. When an accountant, however, is *hired* by an attorney to assist in providing *legal* advice to a client—for example, after an IRS fraud examination has begun—the accountant's work after that point will be protected. Ordinarily, the same accountant who prepared the questionable tax returns will *not* be employed, since this person may be called as a government witness.

These guidelines should be followed:

- The attorney should retain the accountant in a written agreement expressly stating the purpose of providing legal advice to the attorney's client. (See Exhibit 303-2 for a sample attorney's engagement letter.)
- The accountant's bill should be addressed to and paid by the attorney.
- No communication should take place between the accountant and the taxpayer concerning tax matters except in the presence or under the direction of the attorney.

The written agreement between accountant and attorney should spell out that the work is being performed to assist the attorney in giving legal advice to the client in a privileged and confidential relationship, and that the attorney-client privilege and the work-product doctrine are being relied upon.

**Practice Tip.** The accountant should have *no* conversations with the client, even on the street corner or the golf course, concerning the matters under investigation, except when acting on the express direction of the attorney. A court of law might not view such discussions as falling within the attorney-client privilege, and the accountant might be called to testify about their contents.

### 303.2.3 The IRS Administrative Summons

In pursuing its duty to enforce compliance with federal tax laws, the IRS is required to “inquire after” all persons who may be liable to pay any tax (IRC Sec. 7601). The means for this inquiry include the power to issue an IRS *administrative summons* for documents and testimony, and to “examine any books, papers, records, or other data which may be relevant or material to such inquiry, and to summon . . . any person having possession, custody, or care of books of account . . . and to produce such books, paper, records, or other data . . .” (IRC Sec. 7602(a)). Ordinarily, the IRS will issue a summons only when informal requests, such as letters, memoranda, and telephone calls, fail to elicit the requested support documents.

A summons is a notice of required appearance. Although seldom expressly invoked as such, every tax audit is performed under threat of use of the summons power. While it is not necessary for the IRS to establish probable cause that a crime has been committed, guidelines have been enunciated in *U.S. v. Powell* (379 U.S. 48 (1964)):

- The summons must be issued pursuant to a legitimate investigative purpose—a civil or criminal tax investigation.
- There must be a showing of relevance, that is, that the information that is sought throws light upon the correctness of a tax return.
- The information sought must not already be within the possession of the IRS.
- Administrative steps specified in the IRC must have been followed, for example, that only one inspection of the books of account ordinarily may be made for each taxable year (IRC Sec. 7605(b)).

The summons must be properly “served.” Service consists of delivering the summons by hand to the person to whom it is addressed or by registered or certified mail or by leaving it at his last and usual place of abode. The actual document constituting a summons is IRS Form 2039. A sample is shown as Exhibit 303-1.

The IRS summons specifies a date and time when the summoned party must appear. To be enforceable, the summons must be legible and understandable, and documents to be delivered must be described with reasonable certainty. Evidence gained by an improper summons may be suppressed at trial.

Any person summoned who neglects to appear or to produce documents in response to a valid summons is subject to prosecution under IRC Sec. 7210, and is subject to a fine not exceeding \$1,000 or imprisonment for not more than a year, or both. Noncompliance is not subject to prosecution when the summons is attacked in good faith.

The IRS has no power of enforcement of the summons. Instead, if the summoned party refuses to comply, an attorney for the Department of Justice will apply to a United States district court to compel compliance (IRC Sec. 7402(b)). The court will hold a show cause hearing to give the summoned party an opportunity to argue why the summons should not be

enforced. If the IRS prevails, the summoned party must comply or be held in civil or criminal contempt of court.

**Practice Tip.** Don't ignore a summons. Contact your client and your attorney for instructions.

Authority to issue a summons is delegated down from the Secretary of the Treasury to IRS employees, typically revenue agents and revenue officers engaged in examination and collection procedures. IRS guidelines admonish agents to resort to their summons power only when these conditions prevail:

- Other techniques, such as written reference to the summons power, have been unsuccessful.
- The matter is sufficiently important to justify follow-through to judicial enforcement, if that becomes necessary.

### **Recordkeeper Summons Issued to an Accountant**

The Internal Revenue Code in Sec. 7609(a)(3) sets out stipulations for summonses to be issued to "third-party recordkeepers." Third-party recordkeepers are these persons or entities:

- Any bank, credit union, mutual savings bank, savings and loan, or similar association
- Any consumer reporting agency
- Any person extending credit through credit cards
- Any broker (as defined in the Securities Exchange Act of 1934)
- Any attorney
- Any accountant or enrolled agent
- Parties to a barter exchange

The law requires that notice must also be given within three days to anyone identified in the summons' description of records to be handed over. This notice must be given at least 23 days before the records are to be examined (IRC Sec. 7609(a)(1)). Any person entitled to receive notice of the summons may file a motion in district court to quash it; this motion must be filed within 20 days after receiving the notice (IRC Sec. 7609(b)(2)).

No notice is required when the purpose of the summons is solely to determine if the records in question are in the possession of the recordkeeper, or to determine the identity of the owner of a numbered account or similar arrangement.

No notice is required if the person summoned is not a recordkeeper. An income tax preparer who is not a "registered, licensed, or certified" accountant is not a recordkeeper.

Either the person summoned or the person against whom the testimony or document might be used may be able legally to challenge enforcement of the summons. Legal grounds for a challenge must be developed by an attorney, but may include these (or other) defenses (IRC Sec. 7603):

- Nonexistent records
- Unnecessary and repetitive IRS investigation
- Attorney-client privilege
- Improper purpose for an administrative summons in that a criminal investigation is in progress

When a summons has been served upon a third-party recordkeeper, any notice required must be served personally or by certified or registered mail to the last known address. If the IRS has no address for the person to whom they must give notice, it can be left with the recordkeeper (IRC Sec. 7609(a)(2)).

Once a summons has been received, it must be given attention. You—or any other recordkeeper—should notify the client that you have received the summons and ask for instructions.

**Practice Tip.** Once you receive a summons relating to client documents, you should insist on written instructions if your client's intention is to challenge the summons.

On occasion, a taxpayer may choose immediately to waive the right to quash (suppress) a summons in order to establish a record of cooperation that might later serve to mitigate punishment. IRC Sec. 7609(i)(2) provides that, if no proceeding to quash the summons is begun within the time allowed, or if the taxpayer consents, the IRS may issue a certificate to this effect to the recordkeeper. Statutes explicitly free the recordkeeper from liability to the client or customer *if* disclosure of summoned information is made in good-faith reliance on the certificate referred to in IRC Sec. 7609(i)(2) or upon a court order (IRC Sec. 7609(i)(3)).

A practitioner should provide an IRS agent with copies of a client's tax return if requested to do so (IRC Sec. 6107(b)). The American Institute of CPAs (and the authorities of certain states) prohibit disclosure of confidential client information except under compulsion of a "validly issued and enforceable subpoena or summons" (Rule 301, AICPA Code of Professional Conduct). On more practical grounds, a practitioner who became known as an informer for the IRS would soon have no clients.

**Practice Tip.** A practitioner wishing to cooperate with the IRS by voluntarily giving them more information than a copy of the client's tax return should get either the client's permission or a summons followed by the certificate referred to in IRC Sec. 7609(i)(2) (or a court order). A summons issued to a person who wishes to cooperate is sometimes referred to as a "friendly" or "courtesy" summons. (See also Section 301.3 of this manual.)

The code requires that a recordkeeper who is served with an IRS summons begin to assemble the records requested and be prepared to produce them on the stated date (IRC Sec. 7609(i)(1) and Regs. Sec. 301.7609-2(c)(1)). Third-party recordkeepers are entitled to recover from their client the cost of assembling these materials (as well as the costs of appearing as a witness), or from the government if there is no client (IRC Sec. 7610(b)(2)).

On occasion, the recordkeeper's attorney may find that the recordkeeper personally has grounds for a challenge. For example, a demand for records not in the recordkeeper's possession can be resisted. Also, the recordkeeper generally cannot be required to create documents not already in existence. For example, you could not be required to prepare and hand over a bank reconciliation when you hadn't already prepared one.

A government demand for personal records violates the Constitutional protection against self-incrimination. Additionally, according to recent cases, an individual taxpayer may not be compelled to produce his or her business records because the *act* of producing them may constitute an incriminating statement. Also improper is a demand issued by the IRS that client records be produced by a recordkeeper in connection with a criminal investigation of the recordkeeper if the IRS has already made a referral of the case to the Justice Department (IRC Sec. 7602(c)). Individuals' tax return information and the records of corporations, partnerships, or other business entities are not protected.

Some experienced practitioners advise attempting to inactivate the summons after it has been issued so that the IRS will not attempt enforcement in the courts. If you decide to take this approach, you would appear at the appointed time, but without the records, and explain the grounds upon which noncompliance is based. By confronting the IRS agent with a defense that you intend to pursue in court, you may be able to persuade the agent to reconsider the need for the testimony or records that were demanded. If you are able to learn the purpose for summoning the information, you may be able to suggest an alternate—and less objectionable—source of the same data. Alternatively, you might convince the agent that the testimony or data will be of such small value to the examination that the matter can be dropped.

The objective of this tactic is to redirect attention away from the summons, in a gamble that the IRS agent can be convinced not to seek court enforcement. The tactic should not be attempted if the only motive is to hinder the investigation without legal grounds to do so. Lack of a good-faith legal challenge could result in IRC Sec. 7210 sanctions.

If the identity of one of the parties to a transaction is not known, the IRS may go to court to seek a John Doe summons. Such summonses have been used, for example, to learn from an accounting firm the names of clients involved in tax-credit transactions that caught the attention of IRS auditors (*U.S. v. Ernst & Whinney* (N.D. Ohio 1984), 84-1 USTC 9342).



In order to discourage fishing expeditions by IRS agents, standards governing issuance of a John Doe summons are higher than for the more usual administrative summons. The IRS must establish to a court's satisfaction that—

- The summons relates to the investigation of a particular person or ascertainable group or class of persons.
- There is a reasonable basis for believing that that person or group may have failed to comply with a provision of an internal revenue law.
- The information sought and the identity of the persons are not readily available from other sources (IRC Sec. 7609(f)).

### **IRS Access to Accountant's Tax Accrual Workpapers**

No state-created privilege has been recognized in tax litigation governed by federal law. As a consequence, the IRS summons power apparently can be exercised over any files, created in connection with a client engagement, that are in the possession of any auditor or tax practitioner (including a CPA). When summoned to produce records, the public accounting firm of Arthur Young & Co. fought to retain workpapers prepared in connection with verification of the tax accrual liability of an audit client. The Supreme Court considered the case and in 1984 reaffirmed earlier cases in holding that there is *no* confidential accountant-client privilege under federal law, even in connection with the special relationship created by an audit (*U.S. v. Arthur Young & Co.*, 104 S.Ct. 1495 (1984)).

IRS guidelines announced since the Arthur Young case provide that access will be sought to audit workpapers only in “unusual circumstances.” The examining agent is required to use all reasonable means to obtain the information from the taxpayer before issuing a summons to the independent auditor. The IRS's Internal Revenue Manual–Audit states that prior written approval must be obtained from the chief of the examination division before an examining agent may summon tax accrual workpapers.

See discussion in Sec. 303.2.1 of changes created by the 1998 IRS Restructuring and Reform Act.

**Practice Tip.** If you believe an agent is ignoring the guidelines concerning audit workpapers, you should call them to the agent's attention and if necessary contact the agent's supervisor.

### **Procedure for Compliance With a Summons**

Compliance with a summons means attendance at the time and place specified in the summons, bringing whatever documents are requested unless a defense will be asserted against production of the documents. A party complying with an IRS summons should be familiar with certain procedural formalities:

- The summoned party may be represented by legal counsel.
- Summoned parties will be placed under oath.
- Several IRS employees may observe the questioning.
- IRS employees must present their credentials for inspection.
- Each question must be answered or a defense may be asserted to that question.
- After questioning, the party will be asked to sign a statement containing the IRS questions and the taxpayer answers given. If the statement is signed, a copy should be retained.
- With advance notice to the IRS, the proceedings may be audio recorded (except in criminal investigations (IRC Sec. 7521)).
- The summoned party may terminate the interview and leave the premises, since the administrative summons by itself does not give the IRS power to hold a party in custody.
- Any person summoned can claim fees for time and expenses from his or her client, if retained by a client, or from the government.

### **303.2.4 Notice Regarding Third Parties**

Reasonable notice to the taxpayer is required by the 1998 IRS Restructuring and Reform Act prior to IRS contact with third parties regarding examination or collection activities (IRC Sec.

7602(c)(1). The IRS is required to give notice periodically as to the identity of third parties contacted. Exceptions to both these requirements are—

- Contacts authorized by the taxpayer.
- IRS judgment that notice would jeopardize collection.
- Criminal investigations (IRC Sec. 7602(c)(3)).

### 303.3 IRS Procedures in a Criminal Investigation

IRS criminal investigations are carried out by CID special agents. On occasion, investigations are handled jointly with the IRS civil staff or with the Department of Justice.

Considering the millions of tax returns filed annually, criminal investigations are relatively rare, but the cases that are prosecuted have been carefully chosen by the government for their high probability of success. Investigators are successful in developing for prosecution about 2,000 cases each year, fully 90 percent of which result in convictions. More than half of the persons who are convicted spend time in jail.

Special agents do not announce their intention to investigate a return. Usually, taxpayers learn that a criminal investigation against them is in progress by a tipoff from a third party the agent has questioned: a customer, supplier, lender, or business associate.

In the typical robbery or murder investigation by the police, the fact of the crime is obvious. The identity of the guilty person, however, may be in doubt. When special agents enter a criminal tax case, on the other hand, the target of the investigation ordinarily has been identified. The element in doubt is whether a *prosecutable* crime has been committed. Special agents attempt to develop this evidence. That is, they try to put together a case that this taxpayer (or tax preparer) intentionally violated a law that is punishable by imprisonment, and that the available evidence indicates a high probability of conviction. Now, let's take a look at the legal tools the IRS (and the Justice Department) use for criminal investigations.

#### 303.3.1 IRS Power to Summon in Criminal Cases

Because the administrative summons power granted to the IRS under IRC Sec. 7602 is for the purpose of determining or collecting a tax, prior to 1982 courts sometimes held that the IRS could not use an administrative summons solely for gathering information for a criminal prosecution. To do so would seem to violate the requirement that the summons serve purposes legitimate to the IRS's mission of collecting taxes—not investigating crimes.

The Tax Equity and Fiscal Responsibility Act of 1982, however, added Sec. 7602(b) to the Internal Revenue Code, clearly specifying that an administrative summons may be used in connection with the investigation of *any* offense connected with the administration and enforcement of the internal revenue laws. This provision allows the IRS to issue its summons in investigation of possible criminal tax activities. Once a referral to the Justice Department is in effect, however, the IRS summons loses its legitimacy (IRC Sec. 7602(c)). See Exhibit 303-1 for an example of an IRS summons.

**Practice Tip.** When attending an IRS proceeding under the compulsion of a summons, you should insist on identifying all IRS employees who are present. The presence of a special agent—a member of the criminal investigation division—is a signal that you *must* consult a criminal tax attorney.

#### 303.3.2 Search Warrants

A properly executed search warrant gives a government agent the power to enter business or personal premises, to search for articles named in the warrant, and to take these articles away from the premises. (Contrast the seizure powers conveyed by a search warrant with the demand for cooperation that is the message of a summons.) Search and seizure of evidence in connection with a criminal investigation are subject to safeguards guaranteed by the Fourth Amendment to the Constitution. There must be probable cause to believe that a crime has been or is being

committed. The items sought must be named with particularity; the scope of the warrant must not be overly broad.

**Example.** An employee reported that her employer, a dentist, kept memoranda of unreported income received from emergency patients on yellow sheets and green cards apart from his usual accounting records. The warrant called for the seizure of “all books and records,” and was held to be overly broad when it resulted in seizure of all the accounting records. None of the evidence that was seized could be used in court *except* the yellow sheets and green cards (*VonderAhe v. Howland*, 508 F.2d 364 (9th Cir. 1975)).

As long as the legal requirements of probable cause and particularity have been satisfied, there is almost no restriction upon a special agent’s power to search through and take possession of documents in an investigation of tax evasion, whether the papers are in the hands of the taxpayer or of a tax practitioner. Special agents desiring a search warrant must receive approval from the chief counsel and from the Department of Justice (or the United States Attorney). Then, they must present to an issuing authority, ordinarily a United States magistrate, an affidavit establishing grounds for the warrant. The search must be conducted within 10 days after the warrant is issued. After the search, the agent reports to the magistrate with an inventory identifying the property seized.

**Practice Tip.** When confronted with a search warrant, your most practical course of action is to allow the search to take place, after (1) examining the agents’ credentials, and (2) receiving a copy of the warrant. You should remain on the scene to insist that the seizure does not exceed the precise limits of the warrant, to receive an inventory of what has been taken, and to minimize disruption of your records. Contact your attorney. If justified, a challenge to the warrant can be made in court by your attorney at a later time. (Documents seized in an improper search cannot be used as evidence.)

### 303.3.3 Miranda Warnings

The law does not require that Miranda warnings of the “You have the right to remain silent” type be given to taxpayers in *noncustodial* interrogations, that is, when the person who is questioned is not under arrest and is free to come and go. On the other hand, the Internal Revenue Manual requires special agents to advise taxpayers in a manner similar to this, prior to questioning in a criminal investigation, even though they are not in custody (per the IRM):

In connection with my investigation of your tax liability I would like to ask you some questions. However, first I advise you that under the Fifth Amendment to the Constitution of the United States I cannot compel you to answer any questions or to submit any information if such answers or information might tend to incriminate you in any way. I also advise you that anything that you say and any documents that you submit may be used against you in any criminal proceeding that may be undertaken. I advise you further that you may, if you wish, seek the assistance of an attorney before responding.

The Miranda warning was not necessary in a 1995 case. An employee was not given the warning when he was questioned concerning a criminal tax investigation of his employer. Since the employee was not himself in custody, his Fifth Amendment rights were not violated by failure to advise him of his rights. His conviction for conspiring to defraud the IRS was upheld. *U.S. v. Gene M. Erekson* (10th Cir. 1995), Docket No. 94-4228, Date of Decision November 21, 1995, Judge James E. Barrett.

When this warning is required on IRS procedural grounds only, an IRS agent’s failure to warn is *not* by itself sufficient grounds for suppression of the evidence thereby gained (*U.S. v. Nuth*, 605 F.2d 229 (6th Cir. 1979)).

One of the effects of this legally unnecessary warning may be to shock the taxpayer into making unwise admissions. To forestall this result, a person receiving a Miranda-type warning should provide the IRS with no information or documents before first consulting an attorney experienced in criminal tax law.

**Practice Tip.** If you or your client receives a Miranda-type warning, it means an IRS criminal investigation is in progress. Provide the IRS with no information until you contact your attorney.

### 303.3.4 Grand Jury Subpoena

Some criminal tax cases originate in a grand jury investigation. Grand jury subpoenas require that the recipient testify and, perhaps, bring records. They are powerful means of gathering evidence.

Grand juries deliberate in secret and are not bound by the rules of evidence or many of the other procedural safeguards encountered in a criminal trial. No showing need be made as a condition of issuance of a grand jury subpoena that there is probable cause that a crime has been committed. Through established procedures, the IRS, particularly in connection with a criminal tax investigation, can gain access to information revealed to a grand jury.

Third parties, such as accountants and other tax practitioners, may be subpoenaed. The target of the investigation does not need to be notified when the third party is subpoenaed. Anyone testifying before a grand jury should be assisted outside the jury room by legal counsel and should testify truthfully under penalty of perjury and contempt.

### 303.3.5 IRS Policy on Voluntary Disclosure

A taxpayer who files an amended return to report previously omitted income or to admit claiming improper or inflated deductions—and does so prior to believing that an audit of the original return will take place—is making a *voluntary disclosure*. Filing a delinquent return prior to an IRS request also constitutes a voluntary disclosure.

Prior to 1952, the IRS had a written, but unpublicized, policy not to bring a *criminal* prosecution on the basis of voluntary disclosures. The taxpayer was, however, expected to pay tax, interest, and civil penalties. This policy has been withdrawn. Current practice seems to be that voluntary disclosure does not necessarily preclude criminal prosecution, and that the IRS will weigh the voluntary disclosure, *along with other facts and circumstances*, in deciding whether to recommend criminal prosecution. The exact outcome of a taxpayer's voluntary disclosure cannot be predicted with certainty.

In a case in which a taxpayer filed a fraudulent return, the Supreme Court held that the subsequent filing of a correct, amended return did *not* start the running of the three-year limitation period on deficiency assessments (*Badaracco v. U.S.*, 464 U.S. 386 (1984)).

Criminal prosecution is probably more likely if the amounts of tax involved are substantial and the taxpayer has a high profile in the community. The IRS expects that press coverage of such a case will impress upon other taxpayers that tax crime does not pay. (In order to avoid the impression that only the big cases are pursued, however, the service on occasion will also go after small offenders.)

Disclosure that takes place under the threat of IRS audit is not considered to be truly voluntary, and the taxpayer should expect no leniency. In *United States v. Hebel*, for example, the taxpayers made what they interpreted to be a voluntary disclosure—but *after* their return had been selected for audit. They were then successfully prosecuted for tax evasion (669 F.2d 995 (8th Cir. 1982), *cert. denied*, 456 U.S. 946 (1982)).

Your role in the event of a client's—or prospective client's—voluntary disclosure is no different from when disclosure is prompted by IRS audit or by receipt of a delinquent return request (IRS Form 500-2-21). First of all, you must judge whether the IRS will likely view the client's action or inaction as deriving from the “willfulness” that signals tax fraud. (See the discussions of willfulness in Section 303.1, and of fraud referrals in Section 303.1.1 of this chapter.)

**Practice Tip.** If you feel your client has criminal exposure for failure to file or for tax evasion, you *must* immediately refer him to an attorney. The client may be on the brink of revealing damaging information in regard to motive or intent to you. There is an added risk: The longer you discuss the client's situation, the more likely it is that you may inadvertently give “legal advice” that either the government or the client will take you to court for.

Remember that contact the client has with an attorney for purposes of securing legal advice are protected by the attorney-client privilege, but not so communications between the client and a nonattorney practitioner (see Section 303.2.1 of this chapter). In some instances, you may expect to be employed by the attorney to prepare the returns (see Section 303.2.2 of this chapter).

On the other hand, if you feel there is no present indication of taxpayer fraud and little likelihood of interest on the part of the IRS's criminal investigation division, you may choose to prepare the client's returns. For tips from other practitioners about how they handle delinquent filers, see Section 301.6.1 of this manual. If, after an interview, you refer the prospective client to an attorney or to another tax practitioner, it's best to put a record of this advice in a letter that you give to the taxpayer on the spot. Keep a copy.

### 303.3.6 **Methods Used by IRS to Prove Taxpayer's Income**

If possible, the IRS uses a direct method to establish and prove a taxpayer's unreported income. Sometimes called the specific items method, the direct method identifies a specific transaction in which the taxpayer has not properly reported income—for example, a real estate transaction producing unreported gains. A comparison of the taxpayer's tax return, which omits the transaction, with the closing statement that details the transaction, together with canceled checks or other evidences of the taxpayer's cost for the real estate, establishes proof of underreporting of income.

Bank deposits are often analyzed to answer the question, "Where did the money come from?" IRS examiners are advised to pay attention to the size and frequency of deposits, as well as to the kind of deposit (cash versus check) and the location of the bank upon which a deposited check was drawn in order to ferret out specific transactions the taxpayer may have reported incorrectly.

Checks drawn against the taxpayer's account are analyzed to determine the amount of nondeductible expenditures and purchases of investments. This can lead to a judgment about the reliability or unreliability of other records the taxpayer attempts to rely upon. A dry cleaning or storage bill may point to an expensive mink coat that was purchased with unreported income. Checks written for safe deposit box rental may lead to undisclosed investment securities.

The job of the IRS is not often this easy, however, and indirect methods of proof are often used to provide an *inference* of unreported income. According to *United States v. Massie* (355 U.S. 595 (1958)), the government must then produce additional evidence to support the inference.

The indirect methods of proof are described in Chapter 800 of the Internal Revenue Manual, "Tax Audit Guidelines for Internal Revenue Examiners." The IRS may combine two or more methods; for example, the cash expenditure method is often combined with the net worth or bank deposit method. We briefly discuss the five methods listed in the manual.

#### **Net Worth Method**

Increases or decreases in a taxpayer's net worth, after adjusting for nontaxable expenditures and nontaxable income, must be the result of taxable income. A taxpayer's net worth (assets less liabilities) is determined at the beginning and at the end of the taxable year, using the same accounting method that the taxpayer uses. The difference between these two amounts is the increase or decrease in net worth. Personal and other nondeductible expenses are added to this change; nontaxable income, such as gifts, and tax-exempt interest are subtracted. The IRS infers that the result of this computation represents taxable income.

A plausible defense to this inference is that the IRS failed to compute net worth correctly at the beginning of the period. Suppose, for instance, that the taxpayer had worked regularly for 10 years, had reported all income, but had systematically set aside \$1,500 in *cash* each year. Distrusting banks or fearing the greed of relatives, the taxpayer secreted the cash in the basement. During the year under audit, the taxpayer decided to spend or deposit the cash hoard, which made it visible to an investigator. The IRS's inference of unreported income is wrong. The increase in observable net worth was due to reasons other than unreported income. (Although the taxpayer's explanation is farfetched, it constitutes a plausible defense from which a sympathetic jury might conclude that the government had not proved its case.)

### Source and Use-of-Funds Method

This is sometimes called the cash expenditure method. The IRS first figures out how much the taxpayer spent during a year, whether for assets, to pay off liabilities, or for expenses. From this total, the IRS subtracts known sources of funds, such as loans, sale of assets, and reported income. The excess of expenditures over known and reported sources is inferred by the IRS to be due to unreported income.

### Bank Deposits

This is an indirect approach. An analysis of bank deposits determines gross receipts that can then be compared against those the taxpayer reported. The IRS seeks to establish that gross receipts are greatly in excess of what the taxpayer reported *and* that the taxpayer is engaged in an income-producing business for which other records are inadequate.

### Percentage Computations

Once the IRS determines to its satisfaction the amount of sales generated by the taxpayer's business, the examiner can then infer what gross profit and net income *would have been* had typical percentage relationships held true. The IRS manual warns examiners to tailor the percentages to fit the type of merchandise, the size and locality of the business, the economic characteristics of the time period, and the company's merchandising markup policy.

### Unit and Volume

The IRS may be able to determine the taxpayer's volume of business from data obtained from regulatory agencies, from parties having contracts with the taxpayer, from direct observations by IRS agents, or from the taxpayer's own records. For example, a funeral director may be required to report each burial to a public agency; a manufacturer may be required to buy union labels and to sew them into each garment that is produced. From records of these transactions secured from sources external to the taxpayer, the IRS can infer the volume of business from which an estimate of total receipts can be calculated.

## 303.4 Overview of Federal Tax Crimes and Civil Fraud Penalties

Most offenses named as crimes in the Internal Revenue Code involve mail fraud, the submission of false documents, or the submission of false claims—all of which can be prosecuted under the criminal provisions of Title 18 of the United States Code, rather than under the Internal Revenue Code (Title 26 of the United States Code). In fact, however, the Justice Department most frequently proceeds under the tax code.

The government wants to create a high profile for the pitfalls of tax evasion, failure to file a tax return, or filing false income tax returns. The dual goals of prosecution of a tax crime are to punish the immediate offender and to deter others from similar attempts to evade taxes.

Any tax practitioner found guilty of tax fraud—whether criminal or civil—can expect severe limitations on his or her future career. The practitioner will be denied the right to practice before the IRS. In several instances, state boards have withdrawn a CPA's right to practice public accounting.

The Internal Revenue Code contains numerous civil penalties or criminal sanctions, for instance in Sections 7201 through 7216 and in Sections 7231, 7232, 7240, 7261, 7262, 7268 through 7273, and 7275. The Omnibus Budget Reconciliation Act of 1989 imposes a 75 percent fraud penalty for underpayment of tax (IRC Sec. 6663). In addition, several criminal offenses defined in Title 18 of the United States Code might be applicable to tax matters. We are restricting our overview to the criminal provisions of the Internal Revenue Code and of Title 18 that are most frequently used by the government in prosecutions and thus have the most interest to a tax practitioner.

Regardless of the fine indicated in the Internal Revenue Code, the Criminal Fines Enforcement Act of 1984 (18 U.S.C. 3623) increased the maximum fines for most federal criminal offenses and for all federal tax offenses. The maximum fines provided in this act are \$250,000

for individuals convicted of felonies, \$500,000 for corporations convicted of felonies, and \$100,000 for individuals or corporations convicted of misdemeanors.

### 303.4.1 Willful Evasion of Tax

Section 7201 makes it a crime to attempt willfully to evade or defeat a tax. (Willfulness means an intent to do the illegal act; motive for doing so is irrelevant.)

Authorized penalties are a maximum five-year imprisonment and/or a \$100,000 fine. (For a corporation, the fine may be \$500,000.) Prosecution is not normally attempted unless the deficiency or tax due is “substantial,” a term that has no exact definition in the law. The elements of the crime are—

- An attempt to evade or defeat payment of tax (in any manner).
- The existence of a tax deficiency or tax due.
- An affirmative act of fraud or wrongdoing.
- Willfulness.

**Example.** A tax preparer was convicted under Section 7201 when he collected the amount of the tax from his client but then intentionally and willfully failed to file the client’s return or pay the tax over to the government (*U.S. v. Gase*, 248 F.Supp. 704 (N.D. Ohio 1965)).

**Example.** A conviction for corporate and individual tax evasion was upheld by a U.S. District Court (Kansas). The court saw willfulness in the taxpayers’ failure to heed the advice of their return preparer and others of the necessity to keep corporate and personal income separate. *U.S. v. Mounkes, William, et ux.* 84AFTR2d Par. 99-5380.

### 303.4.2 Filing a False Return

The false return statute, Section 7206(1), makes it a crime to file a return that is false in any *material* matter. The possible penalties are three years in prison and/or a \$100,000 fine (\$500,000 for a corporation). Taxpayers have been convicted under Section 7206 when they—

- Falsely stated the *source* of their income.
- Failed to report income.

The elements of this crime are—

- Making and signing a return or any document that is signed under penalty of perjury.
- Knowledge that the document is not true as to any *material* matter.
- Willfulness.

### 303.4.3 Assisting in Preparation of a False Return

Section 7206(2), assisting in preparation of a false return, is of particular concern to tax practitioners because it extends the crime of filing a false return or other document to anyone who aids, assists, or advises in the filing. If you *knowingly assist* in the falsity defined under IRC Sec. 7206(1), the elements of crime are satisfied. The penalties are the same as for filing a false return.

You can be prosecuted under this provision, even if your client didn’t participate in or have any knowledge of the falsity of the return. Neither is it necessary—for prosecution—that an understatement of taxes result from the filing. Typically, there will be an understatement. (Section 302.5 discusses the civil penalties on a preparer who aids and abets an understatement of tax liability.)

A material *omission* from the return can also constitute a falsity. Practitioners have been convicted who knowingly—

- Twice wrote off the same bad debt.
- Depreciated a fully depreciated asset.
- Back-dated documents in order to charge off more depreciation in the year of purchase.

### 303.4.4 Failure to File

The Omnibus Budget Reconciliation Act of 1989 added a subsection regarding *fraudulent* or *intentional* failure to file to IRC Sec. 6651. (That section relates to failure to file a tax return or to pay tax.) This new section specifies an increase to the penalties of IRC Sec. 6651 by substituting, as an addition to tax, “15 percent” for “5 percent” each place it appears, and by substituting “75 percent” for the “25 percent” maximum to be added. The elements of the offense are—

- A failure to file returns required under specified chapters of the code, or to pay the tax shown.
- Fraudulent or intentional failure to file.

**Example.** “Fires and riots” near the taxpayers was rejected as a reason for non-filing. *Terrell, Franklin D., et ux. v. Comm.* T.C. Memo 1999-248.

**Example.** A return by the taxpayer’s attorney and subscribed “under power of attorney” was rejected as an invalid return because no Form 2848 power of attorney accompanied the return. *Herbert Elliot v. Comm.* 113 T.C. No. 7 (August 10, 1999).

The charge of *willful* failure to file (IRC Sec. 7203) is a misdemeanor that carries a maximum penalty of one year in prison and/or a \$25,000 fine (\$100,000 for a corporation). (Where a failure to file estimated tax is concerned, it is necessary that an addition to tax ensue under IRC Sec. 6654 or 6655.) Elements of the offense are—

- A duty to file a return, keep records, supply information, or pay any tax or estimated tax.
- Willful failure to comply with that duty.

### 303.4.5 Delivering False Documents

Section 7207 makes it a misdemeanor to deliver or disclose a fraudulent list, account, statement, return, or other document to the IRS. It is not necessary that the act be done in an attempt to evade or defeat any tax.

Penalties are one year in prison and/or a \$10,000 fine (\$50,000 for a corporation). Larger penalties are provided when the false statement is by an owner-employee (as identified in IRC Sec. 6047(b)) concerning the information required to be provided in connection with qualified plans or annuities (IRC Sec. 6704). Elements of the crime are—

- Delivery or disclosure of information to the IRS.
- Knowledge that the information is false.
- Willfulness.

### 303.4.6 Unlawful Disclosure or Use of Tax Return Information

This is a misdemeanor punishable by a fine of up to \$1,000, imprisonment for up to one year, or both (Section 7216). Information gained in connection with preparing a tax return must not be used for any other purpose. This means that names of clients cannot be disclosed to third parties or used to solicit non-tax-related business such as insurance or investments without the client’s express consent for each instance of use or solicitation, unless an exception or exemption pertains. Because this offense has such obvious significance for tax practitioners, Section 302.2.1 of this manual treats it in more detail.

### 303.4.7 Conspiracy to Defraud

Federal statutes other than the Internal Revenue Code may provide the basis for criminal tax cases. Section 371 of Title 18 of the U.S. Code makes conspiracy to defraud the government a felony punishable by a maximum penalty of five years in prison and/or a \$10,000 fine (except where the object of the conspiracy is a misdemeanor).



**Example.** A certified public accountant was convicted of conspiracy with his employees to fraudulently inflate deductions for contributions and medical and auto expenses on clients' tax returns to increase the accountant's fees. Clients were unaware, having signed the blank returns. The accountant's fees were contingently based on the amount of refund achieved (*U.S. v. Warden*, 545 F.2d 32 (7th Cir. 1976)). The elements of the crime of conspiracy are

- An agreement between two or more persons to commit an offense against or to defraud the United States.
- An overt act in furtherance of the conspiracy.

**Example.** Preparers advised clients how to falsify diaries and prepared returns without client input, also failing to report cash transactions of \$10,000 or more. They were convicted of conspiracy to defraud the U.S. by impeding collection of taxes by the IRS. *U.S. v. Seth Wapnick, et al.* (2d Cir. 1995), Docket No. 94-1206, decided July 10, 1995, Judge Cabranes.

### 303.4.8 False Statements

A criminal tax case may also involve a false statement charge under Section 1001 of Title 18. Any false statement, written or oral, sworn or unsworn, could invoke this charge if made to a federal agency. Punishment is a five-year prison sentence and/or a \$10,000 fine. The statute of limitations is five years.

Court decisions have established that, for conviction, the defendant must have acted aggressively or deliberately in affirmatively interfering with a government function.

**Example.** A public accountant was convicted when he told an IRS auditor that he had "discovered" a previously unclaimed deduction in the form of a \$25,000 canceled check that he said represented a charitable contribution to a church. In reality the check—as the accountant knew—was ultimately handled as a loan in an involved series of transactions in which the client was not out-of-pocket any funds (*U.S. v. Fern*, 83-1 USTC 9151 (9th Cir. 1983)).

Successful prosecution may hinge on what constitutes a false statement. In one case, a knowingly incorrect "No" answer to a tax return question regarding a foreign bank account was held not to be a "statement" within the meaning of the statute (*U.S. v. Hajecate*, 83-1 USTC 9192 (5th Cir. 1982)).

The elements of the offense are

- The falsification or concealment of a material fact, the making of a false statement, or the use of a false document.
- Willfulness.

# Exhibits

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Exhibit 303-1: IRS Summons

# Summons



Department of the Treasury  
Internal Revenue Service

In the matter of \_\_\_\_\_  
Internal Revenue District of \_\_\_\_\_ Periods \_\_\_\_\_  
The Commissioner of Internal Revenue \_\_\_\_\_  
To \_\_\_\_\_  
At \_\_\_\_\_

You are hereby summoned and required to appear before \_\_\_\_\_  
an officer of the Internal Revenue Service, to give testimony and to bring with you and to produce for examination the following books, records, papers, and  
other data relating to the tax liability or the collection of the tax liability or for the purpose of inquiring into any offense connected with the administration or  
enforcement of the internal revenue laws concerning the person identified above for the periods shown.

---

**DO NOT WRITE IN THIS SPACE**

Business address and telephone number of Internal Revenue Service officer named above:

Place and time for appearance:

at \_\_\_\_\_  
on the \_\_\_\_\_ day of \_\_\_\_\_, 20\_\_ at \_\_\_\_\_ o'clock \_\_ m.  
Issued under authority of the Internal Revenue Code this \_\_\_\_\_ day of \_\_\_\_\_, 20\_\_

\_\_\_\_\_  
Signature of Issuing Officer

\_\_\_\_\_  
Title

\_\_\_\_\_  
Signature of Approving Officer (if applicable)

\_\_\_\_\_  
Title

Original to be kept by IRS

Form 2039 (Rev. 04-97)  
Cat. No. 21405J

**Exhibit 303-1: IRS Summons (cont.)**

# Service of Summons, Notice and Recordkeeper Certificates



(Pursuant to section 7603, Internal Revenue Code)

I certify that I served the summons shown on the front of this form on:

Date	Time
------	------

**How Summons Was Served**

I handed an attested copy of the summons to the person to whom it was directed.

\_\_\_\_\_

\_\_\_\_\_

I left an attested copy of the summons at the last and usual place of abode of the person to whom it was directed. I left the copy with the following person (if any):

\_\_\_\_\_

\_\_\_\_\_

Signature	Title
-----------	-------

This certificate is made to show compliance with section 7609, Internal Revenue Code. This certificate applies only to summonses served on third-party recordkeepers and not to summonses served on other third parties or any officer or employee of the person to whose liability the summons relates nor to summonses in aid of collection, to determine the identity of a person having a numbered account or similar arrangement, or to determine whether or not records of the business transactions or affairs of an identified person have been made or kept.

I certify that, within 3 days of serving the summons, I gave notice (Form 2039-D) to the person named below on the date and in the manner indicated.

Date of Giving Notice \_\_\_\_\_ Time: \_\_\_\_\_

Name of Noticee: \_\_\_\_\_

Address of Noticee (if mailed): \_\_\_\_\_

**How Notice Was Given**

- I gave notice by certified or registered mail to the last known address of the noticee.
- In the absence of a last known address of the noticee, I left the notice with the person summoned.

- I gave notice by handing it to the noticee.
- I left the notice at the last and usual place of abode of the noticee. I left the copy with the following person (if any).
- No notice is required.

Signature	Title
-----------	-------

I certify that the period prescribed for beginning a proceeding to quash this summons has expired and that no such proceeding was instituted or that the noticee consents to the examination.

Signature	Title
-----------	-------

Exhibit 303-1: IRS Summons (cont.)

# Summons



Department of the Treasury  
Internal Revenue Service

In the matter of \_\_\_\_\_  
Internal Revenue District of \_\_\_\_\_ Periods \_\_\_\_\_  
The Commissioner of Internal Revenue \_\_\_\_\_  
To \_\_\_\_\_  
At \_\_\_\_\_

You are hereby summoned and required to appear before \_\_\_\_\_  
an officer of the Internal Revenue Service, to give testimony and to bring with you and to produce for examination the following books, records, papers, and  
other data relating to the tax liability or the collection of the tax liability or for the purpose of inquiring into any offense connected with the administration or  
enforcement of the internal revenue laws concerning the person identified above for the periods shown.

\_\_\_\_\_  
"I hereby certify that I have examined and compared this copy of the summons with the original and that it is a  
true and correct copy of the original."

\_\_\_\_\_  
Signature of IRS Official Serving the Summons

\_\_\_\_\_  
Title

Business address and telephone number of Internal Revenue Service officer named above:  
\_\_\_\_\_

Place and time for appearance:

at \_\_\_\_\_  
on the \_\_\_\_\_ day of \_\_\_\_\_, 20\_\_\_\_ at \_\_\_\_\_ o'clock \_\_\_\_ m.

Issued under authority of the Internal Revenue Code this \_\_\_\_\_ day of \_\_\_\_\_, 20\_\_\_\_

\_\_\_\_\_  
Signature of Issuing Officer

\_\_\_\_\_  
Title

\_\_\_\_\_  
Signature of Approving Officer (if applicable)

\_\_\_\_\_  
Title

Part A — To be given to person summoned

Form 2039 (Rev. 04-97)

**Exhibit 303-1: IRS Summons (cont.)****Provisions of the Internal Revenue Code****Sec. 7602. Examination of books and witnesses**

(a) Authority to Summon, Etc.—For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability, the Secretary is authorized—

(1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry;

(2) To summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary may deem proper, to appear before the Secretary at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry; and

(3) To take such testimony of the person concerned, under oath, as may be relevant or material to such inquiry.

(b) Purpose May Include Inquiry Into Offense.—The purposes for which the Secretary may take any action described in paragraph (1), (2), or (3) of subsection (a) include the purpose of inquiring into any offense connected with the administration or enforcement of the internal revenue laws.

(c) No Administrative Summons When There Is Justice Department Referral.—

(1) Limitation of authority.—No summons may be issued under this title, and the Secretary may not begin any action under section 7604 to enforce any summons, with respect to any person if a Justice Department referral is in effect with respect to such person.

(2) Justice Department referral in effect.—For purposes of this subsection—

(A) In general.—A Justice Department referral is in effect with respect to any person if—

(i) the Secretary has recommended to the Attorney General a grand jury investigation of, or the criminal prosecution of, such person for any offense connected with the administration or enforcement of the internal revenue laws, or

(ii) any request is made under section 6103(h) (3)(B) for the disclosure of any return or return information (within the meaning of section 6103(b)) relating to such person.

(B) Termination.—A Justice Department referral shall cease to be in effect with respect to a person when—

(i) the Attorney General notifies the Secretary, in writing, that—

(I) he will not prosecute such person for any offense connected with the administration or enforcement of the internal revenue laws,

(II) he will not authorize a grand jury investigation of such person with respect to such an offense, or

(III) he will discontinue such a grand jury investigation,

(ii) a final disposition has been made of any criminal proceeding pertaining to the enforcement of the internal revenue laws which was instituted by the Attorney General against such person, or

(iii) the Attorney General notifies the Secretary, in writing, that he will not prosecute such person for any offense connected with the administration or enforcement of the internal revenue laws relating to the request described in subparagraph (A)(ii).

(3) Taxable years, etc., treated separately.—For purposes of this subsection, each taxable period (or, if there is no taxable period, each taxable event) and each tax imposed by a separate chapter of this title shall be treated separately.

**Sec. 7603. Service of summons**

A summons issued under section 6420(e)(2), 6421(g)(2), 6427(j)(2), or 7602 shall be served by the Secretary, by an attested copy delivered in hand to the person to whom it is directed, or left at his last and usual place of abode; and the certificate of service signed by the person serving the summons shall be evidence of the facts it states on the hearing of an application for the enforcement of the summons. When the summons requires the production of books, papers, records, or other data, it shall be sufficient if such books, papers, records, or other data are described with reasonable certainty.

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**Sec. 7604. Enforcement of summons**

(a) Jurisdiction of District Court.—If any person is summoned under the internal revenue laws to appear, to testify, or to produce books, papers, records, or other data, the United States district court for the district in which such person resides or is found shall have jurisdiction by appropriate process to compel such attendance, testimony, or production of books, papers, records, or other data.

(b) Enforcement.—Whenever any person summoned under section 6420 (e) (2), 6421(g) (2), 6427 (j) (2), or 7602 neglects or refuses to obey such summons, or to produce books, papers, records, or other data, or to give testimony, as required, the Secretary may apply to the judge of the district court or to a United States commissioner<sup>1</sup> for the district within which the person so summoned resides or is found for an attachment against him as for a contempt. It shall be the duty of the judge or commissioner<sup>1</sup> to hear the application, and, if satisfactory proof is made, to issue an attachment, directed to some proper officer, for the arrest of such person, and upon his being brought before him to proceed to a hearing of the case; and upon such hearing the judge or the United States commissioner<sup>1</sup> shall have power to make such order as he shall deem proper, not inconsistent with the law for the punishment of contempts, to enforce obedience to the requirements of the summons and to punish such person for his default or disobedience.

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**Sec. 7605. Time and place of examination**

(a) Time and Place.—The time and place of examination pursuant to the provisions of section 6420 (e) (2), 6421 (g) (2), 6427 (j) (2), or 7602 shall be such time and place as may be fixed by the Secretary and as are reasonable under the circumstances. In the case of a summons under authority of paragraph (2) of section 7602, or under the corresponding authority of section 6420(e)(2), 6421(g)(2), or 6427(j)(2), the date fixed for appearance before the Secretary shall not be less than 10 days from the date of the summons.

<sup>1</sup>Or United States magistrate, pursuant to P.L. 90-578.

**Sec. 7610. Fees and costs for witnesses**

(a) In General.—The Secretary shall by regulations establish the rates and conditions under which payment may be made of—

(1) fees and mileage to persons who are summoned to appear before the Secretary, and

(2) reimbursement for such costs that are reasonably necessary which have been directly incurred in searching for, reproducing, or transporting books, papers, records, or other data required to be produced by summons.

(b) Exceptions.—No payment may be made under paragraph (2) of subsection (a) if—

(1) the person with respect to whose liability the summons is issued has a proprietary interest in the books, papers, records or other data required to be produced, or

(2) the person summoned is the person with respect to whose liability the summons is issued or an officer, employee, agent, accountant, or attorney of such person who, at the time the summons is served, is acting as such.

(c) Summons to Which Section Applies.—This section applies with respect to any summons authorized under section 6420(e)(2), 6421(g)(2), 6427(j) (2), or 7602.

**Sec. 7210. Failure to obey summons**

Any person who, being duly summoned to appear to testify, or to appear and produce books, accounts, records, memoranda, or other papers, as required under sections 6420 (e) (2), 6421(g) (2), 6427 (j) (2), 7602, 7603, and 7604 (b), neglects to appear or to produce such books, accounts, records, memoranda, or other papers, shall, upon conviction thereof, be fined not more than \$1,000, or imprisoned not more than 1 year, or both, together with costs of prosecution.

Authority to examine books and witnesses is also provided under sec. 6420 (e)(2)—Gasoline used on farms; sec. 6421(g)(2)—Gasoline used for certain nonhighway purposes by local transit systems, or sold for certain exempt purposes; and sec. 6427(j)(2)—Fuels not used for taxable purposes.

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**Exhibit 303-1: IRS Summons (cont.)****NOTICE TO THIRD-PARTY RECIPIENT  
OF IRS SUMMONS**

As a third-party recipient of a summons, you may be entitled to receive payment for certain costs directly incurred which are reasonably necessary to search for, reproduce, or transport records in order to comply with a summons.

This payment is made only at the rates established by the Internal Revenue Service to certain persons served with a summons to produce records or information in which the taxpayer does not have an ownership interest. The taxpayer to whose liability the summons relates and the taxpayer's officer, employee, agent, accountant, or attorney are not entitled to this payment. No payment will be made for any costs which you have charged or billed to other persons.

The rate for search costs is \$8.50 an hour or fraction of an hour and is limited to the total amount of personnel time spent in locating and retrieving documents or information requested by the summons. Specific salaries of such persons may not be included in search costs. In addition, search costs do not include salaries, fees, or similar costs for analysis of material or for managerial or legal advice, expertise, research, or time spent for any of these activities. If itemized separately, search costs may include the actual costs of extracting information stored by computer in the format in which it is normally produced, based on computer time and necessary supplies; however, personnel time for computer search may be paid for only at the Internal Revenue Service rate specified above.

The rate for reproduction costs for making copies or duplicates of summoned documents, transcripts, and other similar material is 20 cents for each page. Photographs, films, and other material are reimbursed at cost.

The rate for transportation costs is the same as the actual cost necessary to transport personnel to locate and

retrieve summoned records or information, or costs incurred solely by the need to transport the summoned material to the place of examination.

In addition to payment for search, reproduction, and transportation costs, persons who appear before an Internal Revenue Service officer in response to a summons may request payment for authorized witness fees and mileage fees. You may make this request by contacting the Internal Revenue Service officer or by claiming these costs separately on the itemized bill or invoice as explained below.

**Instructions For Requesting Payment**

After the summons is served, you should keep an accurate record of personnel search time, computer costs, number of reproductions made, and transportation costs. Upon satisfactory compliance, you may submit an itemized bill or invoice to the Internal Revenue Service officer before whom you were summoned to appear, either in person or by mail to the address furnished by the Internal Revenue Service officer. Please write on the itemized bill or invoice the name of the taxpayer to whose liability the summons relates.

If you wish, Form 6863 (Invoice and Authorization for Payment of Administrative Summons Expenses) may be used to request payment for search, reproduction, and transportation costs. Standard Form 1157 (Claims for Witness Attendance Fees, Travel, and Miscellaneous Expenses) may be used to request payment for authorized witness fees and mileage fees. These forms are available from the Internal Revenue Service Officer who issued the summons.

If you have any questions about the payment, please contact the Internal Revenue Service officer before whom you were summoned to appear.

Anyone submitting false claims for payment is subject to possible criminal prosecution.

**Exhibit 303-1: IRS Summons (cont.)****Sec. 7609. Special procedures for third-party summonses.****(a) Notice—****(1) In General.—If—**

(A) any summons described in subsection (c) is served on any person who is a third-party recordkeeper, and

(B) the summons requires the production of any portion of records made or kept of the business transactions or affairs of any person (other than the person summoned) who is identified in the description of the records contained in the summons.

then notice of the summons shall be given to any person so identified within 3 days of the day on which such service is made, but no later than the 23rd day before the day fixed in the summons as the day upon which such records are to be examined. Such notice shall be accompanied by a copy of the summons which has been served and shall contain an explanation of the right under subsection (b) (2) to bring a proceeding to quash the summons.

(2) Sufficiency of notice.—Such notice shall be sufficient if, on or before such third day, such notice is served in the manner provided in section 7603 (relating to service of summons) upon the person entitled to notice, or is mailed by certified or registered mail to the last known address of such person, or, in the absence of a last known address, is left with the person summoned. If such notice is mailed, it shall be sufficient if mailed to the last known address of the person entitled to notice or, in the case of notice to the Secretary under section 6903 of the existence of a fiduciary relationship, to the last known address of the fiduciary of such person, even if such person or fiduciary is then deceased, under a legal disability, or no longer in existence.

(3) Third-party recordkeeper defined.—For purposes of this subsection, the term "third-party recordkeeper" means—

(A) any mutual savings bank, cooperative bank, domestic building and loan association, or other savings institution chartered and supervised as a savings and loan or similar association under Federal or State law, any bank (as defined in section 581), or any credit union (within the meaning of section 501 (c) (14) (A));

(B) any consumer reporting agency (as defined under section 603 of the Fair Credit Reporting Act (15 U.S.C. 1681 a (f)));

(C) any person extending credit through the use of credit cards or similar devices;

(D) any broker (as defined in section 3 (a) (4) of the Securities Exchange Act of 1934 (15 U.S.C. 78c (a) (4)));

(E) any attorney;

(F) any accountant;

(G) any barter exchange (as defined in section 6045(c)(3)); and

(H) any regulated investment company (as defined in section 851) and any agent of such regulated investment company when acting as an agent thereof.

**(4) Exceptions.—Paragraph (1) shall not apply to any summons—**

(A) served on the person with respect to whose liability the summons is issued, or any officer or employee of such person,

(B) to determine whether or not records of the business transactions or affairs of an identified person have been made or kept, or

(C) described in subsection (f).

(5) Nature of summons.—Any summons to which this subsection applies (and any summons in aid of collection described in subsection (c) (2) (B)) shall identify the taxpayer to whom the summons relates or the other person to whom the records pertain and shall provide such other information as will enable the person summoned to locate the records required under the summons.

**(b) Right to Intervene: Right to Proceeding to Quash.—****(1) Intervention.—**

Notwithstanding any other law or rule of law, any person who is entitled to notice of a summons under subsection (a) shall have the right to intervene in any proceeding with respect to the enforcement of such summons under section 7604.

**(2) Proceeding to quash.—**

(A) In general.—Notwithstanding any other law or rule of law, any person who is entitled to notice of a summons under subsection (a) shall have the right to begin a proceeding to quash such summons not later than the 20th day after the day such notice is given in the manner provided in subsection (a) (2). In any such proceeding, the Secretary may seek to compel compliance with the summons.

(B) Requirement of notice to person summoned and to secretary.—If any person begins a proceeding under subparagraph (A) with respect to any summons, not later than the close of the 20-day period referred to in subparagraph (A) such person shall mail by registered or certified mail a copy of the petition to the person summoned and to such office as the Secretary may direct in the notice referred to in subsection (a) (1).

(C) Intervention; etc.—Notwithstanding any other law or rule of law, the person summoned shall have the right to intervene in any proceeding under subparagraph (A). Such person shall be bound by the decision in such proceeding (whether or not the person intervenes in such proceeding).

**(c) Summons to Which Section Applies.—**

(1) In General.—Except as provided in paragraph (2), a summons is described in this subsection if it is issued under paragraph (2) of section 7602 (a) or under section 6420 (e) (2), 6421 (g) (2), or 6427 (j) (2) (or 6427 (i) (2) for gasoline removed before January 1, 1988) and requires the production of records.

(2) Exceptions.—A summons shall not be treated as described in this subsection if—

(A) it is solely to determine the identity of any person having a numbered account (or similar arrangement) with a bank or other institution described in subsection (a)(3)(A), or

(B) it is in aid of the collection of—

(i) the liability of any person against whom an assessment has been made or judgment rendered, or

(ii) the liability at law or in equity of any transferee or fiduciary of any person referred to in clause (i).

**(3) Records; Certain Related Testimony.—For purposes of this section—**

(A) the term "records" includes books, papers, or other data, and

(B) a summons requiring the giving of testimony relating to records shall be treated as a summons requiring the production of such records.

(d) Restriction on Examination of Records.—No examination of any records required to be produced under a summons as to which notice is required under subsection (a) may be made—

(1) before the close of the 23rd day after the day notice with respect to the summons is given in the manner provided in subsection (a) (2), or

(2) where a proceeding under subsection (b) (2) (A) was begun within the 20-day period referred to in such subsection and the requirements of subsection (b) (2) (B) have been met, except in accordance with an order of the court having jurisdiction of such proceeding or with the consent of the person beginning the proceeding to quash.

**(e) Suspension of Statute of Limitations.—**

(1) Subsection (b) Action.—If any person takes any action as provided in subsection (b) and such person is the person with respect to whose liability the summons is issued (or is the agent, nominee, or other person acting under the direction or control of such person), then the running of any period of limitations under section 6501 (relating to the assessment and collection of tax) or under section 6531 (relating to criminal prosecutions) with respect to such person shall be suspended for the period during which a proceeding, and appeals therein, with respect to the enforcement of such summons is pending.

(2) Suspension after 6 months of service of summons.—In the absence of the resolution of the third-party recordkeeper's response to the summons described in subsection (c), or the summoned party's response to a summons described in subsection (f), the running of any period of limitations under section 6501 or under section 6531 with respect to any person with respect to whose liability the summons is issued other (other than a person taking action as provided in subsection (b)) shall be suspended for the period—

(A) beginning on the date which is 6 months after the service of such summons, and

(B) ending with the final resolution of such response.

(f) Additional Requirement in the Case of a John Doe Summons.— Any summons described in subsection (c) which does not identify the person with respect to whose liability the summons is issued may be served only after a court proceeding in which the Secretary establishes that—

(1) the summons relates to the investigation of a particular person or ascertainable group or class of persons,

(2) there is a reasonable basis for believing that such person or group or class of persons may fail or may have failed to comply with any provision of any internal revenue law, and

(3) the information sought to be obtained from the examination of the records (and the identity of the person or persons with respect to whose liability the summons is issued) is not readily available from other sources.

(g) Special Exception for Certain Summonses.—In the case of any summons described in subsection (c), the provisions of subsections (a) (1) and (b) shall not apply if, upon petition by the Secretary, the court determines, on the basis of the facts and circumstances alleged, that there is reasonable cause to believe the giving of notice may lead to attempts to conceal, destroy, or alter records relevant to the examination, to prevent the communication of information from other persons through intimidation, bribery, or collusion, or to flee to avoid prosecution, testifying, or production of records.

**(h) Jurisdiction of District Court; Etc.—**

(1) Jurisdiction.—The United States district court for the district within which the person to be summoned resides or is found shall have jurisdiction to hear and determine any proceedings brought under subsection (b) (2), (f), or (g). An order denying the petition shall be deemed a final order which may be appealed.

(2) Special rule for proceedings under subsections (f) and (g).—The determinations required to be made under subsections (f) and (g) shall be made ex parte and shall be made solely on the petition and supporting affidavits.

**(i) Duty of Third-Party Recordkeeper.—**

(1) Recordkeeper must assemble records and be prepared to produce records.— On receipt of a summons described in subsection (c), the third-party recordkeeper shall proceed to assemble the records requested, or such portion thereof as the Secretary may prescribe, and shall be prepared to produce the records pursuant to the summons on the day on which the records are to be examined.

(2) Secretary may give recordkeeper certificate.—The Secretary may issue a certificate to the third-party recordkeeper that the period prescribed for beginning a proceeding to quash a summons has expired and that no such proceeding began within such period, or that the taxpayer consents to the examination.

(3) Protection to recordkeeper who discloses.—Any third-party recordkeeper, or agent or employee thereof, making a disclosure of records pursuant to this section in good-faith reliance on the certificate of the Secretary or an order of a court requiring production of records shall not be liable to any customer or other person for such disclosure.

(4) Notice of suspension of statute of limitations in the case of a John Doe summons.—In the case of a summons described in subsection (f) with respect to which any period of limitations has been suspended under subsection (e)(2), the summoned party shall provide notice of such suspension to any person described in subsection (f).



**Exhibit 303-1: IRS Summons (cont.)**

To:

Date:

Address:

Enclosed is a copy of a summons served by the IRS to examine records or to request testimony relating to records which have been made or kept of your business transactions or affairs by the person summoned. If you object to the summons, you are permitted to file a lawsuit in the United States district court in the form of a petition to quash the summons in order to contest the merits of the summons.

**GENERAL DIRECTIONS**

1. You must file your petition to quash in the United States district court for the district where the person summoned resides or is found.
2. You must file your petition within 20 days from the date of this notice and pay a filing fee as may be required by the clerk of the court.
3. You must comply with the Federal Rules of Civil Procedure and local rules of the United States district court. To assist you, Federal Rules of Civil Procedure 4(a), 4(b),

- 4(c)(1), 4(d), 4(d)(4), 7(a), 8(a), 8(e), 10(a), 10(b), 10(c), and 11 (in part) are reprinted for you.
4. You must also, within 20 days from the date of this notice, send a copy of your petition to quash by certified or registered mail to (a) the person summoned, and (b) the Internal Revenue Service at the address shown on the summons to the attention of the Internal Revenue Service officer before whom the summoned person is to appear.
5. A copy of your petition to quash must also be served

on (a) the United States Attorney for the district where your petition is filed, and (b) the Attorney General of the United States, Tax Division, United States Department of Justice, Washington D.C. 20530, pursuant to Federal Rules of Civil Procedure 4(c) and 4(d) (4).

6. You must also comply with the service of process requirements contained in Rule 4 of the Federal Rules of Civil Procedure. The United States District Court Clerk's Office has preprinted forms for this purpose.

**INSTRUCTIONS FOR PREPARING PETITION TO QUASH**

1. Entitle your petition "Petition to Quash Summons."
2. Name the person or entity to whom this notice is directed as the petitioner.
3. Name the United States as the respondent.
4. State the basis for the court's jurisdiction, as required by Federal Rule of Civil Procedure 8(a). See Internal Revenue Code Section 7609(h).
5. State the name and address of the person or entity to whom this notice is directed and state that the records sought by the summons relate to that person or entity.
6. Identify and attach a copy of the summons.

7. State in detail every legal argument supporting the relief requested in your petition. See Federal Rules of Civil Procedure 8(a), 8(e), and 10(b). Note that in some courts you may be required to support your request for relief by a sworn declaration or affidavit supporting any issue you wish to contest.
8. Your petition must be signed as required by Federal Rule of Civil Procedure 11.

The court will decide whether the person summoned should be required to comply with the summons request. Your filing of a petition to quash may suspend the running

of the statute of limitations for civil liability or for criminal prosecution for offenses under the tax laws for the tax periods to which the summons relates. The suspension is in effect while any proceeding (or appeal) with respect to the summons is pending.

The relevant provisions of the Internal Revenue Code are enclosed with this notice. If you have any questions, please contact the Internal Revenue Service officer before whom the person summoned is to appear. The officer's name and telephone number are shown on the summons.

**FEDERAL RULES OF CIVIL PROCEDURE****Rule 4. Process**

(a) **Summons: Issuance.** Upon the filing of the complaint the clerk shall forthwith issue a summons and deliver the summons to the plaintiff or the plaintiff's attorney, who shall be responsible for prompt service of the summons and a copy of the complaint. Upon request of the plaintiff separate or additional summons shall issue against any defendants.

(b) **Same: Form.** The summons shall be signed by the clerk, be under the seal of the court, contain the name of the court and the names of the parties, be directed to the defendant, state the name and address of the plaintiff's attorney, if any, otherwise the plaintiff's address, and the time within which these rules require the defendant to appear and defend, and shall notify him that in case of his failure to do so judgment by default will be rendered against him for the relief demanded in the complaint. When, under Rule 4(e), service is made pursuant to a statute or rule of court of a state, the summons, or notice, or order in lieu of summons shall correspond as nearly as may be to that required by the state or rule.

**(c) Service.**

(1) Process, other than a subpoena or a summons and complaint, shall be served by a United States marshal or deputy United States marshal, or by a person specially appointed for that purpose.

(d) **Summons and Complaint: Person to be Served.** The summons and complaint shall be served together. The plaintiff shall furnish the person making service with such copies as are necessary. Service shall be made as follows:

(4) Upon the United States, by delivering a copy of the summons and of the complaint to the United States attorney for the district in which the action is brought or to an assistant United States attorney or clerical employee designated by the United States attorney in a writing filed with the clerk of the court and by sending a copy of the summons and of the complaint by registered or certified mail to the Attorney General of the United States at Washington, District of Columbia, and in any action attacking the validity of an order of an officer or agency of the United States not made a party, by also sending a copy of the summons and of the complaint by registered or certified mail to such officer or agency.

**Rule 7. Pleadings Allowed; Form of Motions**

(a) **Pleadings.** There shall be a complaint and an answer; a reply to a counterclaim denominated as such; an answer to a cross-claim, if the answer contains a cross-claim; a third-party complaint, if a person who was not an original party is summoned under the provisions of Rule 14; and a third-party answer, if a third-party complaint is served. No other pleading shall be allowed, except that the court may order a reply to an answer or a third-party answer.

**Rule 8. General Rules of Pleading**

(a) **Claims for Relief.** A pleading which sets forth a claim for relief, whether an original claim, counterclaim, cross-claim, or third-party claim, shall contain (1) a short and plain statement of the grounds upon which the court's jurisdiction depends, unless the court already has jurisdiction and the claim needs no new grounds of jurisdiction to support it, (2) a short and plain statement of the claim showing that the pleader is entitled to relief, and (3) a demand for judgment for the relief to which he deems himself entitled. Relief in the alternative or of several different types may be demanded.

**(e) Pleading to be Concise and Direct; Consistency.**

(1) Each averment of a pleading shall be simple, concise, and direct. No technical forms of pleading or motions are required.

(2) A party may set forth two or more statements of claim or defense alternately or hypothetically, either in one count or defense or in separate counts or defenses. When two or more statements are made in the alternative and one of them if made independently would be sufficient, the pleading is not made insufficient by the insufficiency of one or more of the alternative statements. A party may also state as many separate claims or defenses as he has regardless of consistency and whether based on legal, equitable, or maritime grounds. All statements shall be made subject to the obligations set forth in Rule 11.

**Rule 10. Form of Pleadings**

(a) **Caption; Names of Parties.** Every pleading shall contain a caption setting forth the name of the court, the title of the action, the file number and a designation as in Rule 7(a). In the complaint the title of the action shall include

the names of all the parties, but in other pleadings it is sufficient to state the name of the first party on each side with an appropriate indication of other parties.

(b) **Paragraphs; Separate Statements.** All averments of claim or defense shall be made in numbered paragraphs, the contents of each of which shall be limited as far as practicable to a statement of a single set of circumstances; and a paragraph may be referred to by number in all succeeding pleadings. Each claim founded upon a separate transaction or occurrence and each defense other than denials shall be stated in a separate court of defense whenever a separation facilitates the clear presentation of the matters set forth.

(c) **Adoption by Reference; Exhibits.** Statements in a pleading may be adopted by reference in a different part of the same pleading or in another pleading or in any motion. A copy of any written instrument which is an exhibit to a pleading is a part thereof for all purposes.

**Rule 11. Signing of Pleadings, Motions, and Other Papers; Sanctions (in part)**

Every pleading, motion, and other paper of a party represented by an attorney shall be signed by at least one attorney of record in his individual name, whose address shall be stated. A party who is not represented by an attorney shall sign his pleading, motion, or other paper and state his address. Except when otherwise specifically provided by rule or statute, pleadings need not be verified or accompanied by affidavit. The rule in equity that the averments of an answer under oath must be overcome by the testimony of two witnesses or of one witness sustained by corroborating circumstances is abolished. The signature of an attorney or party constitutes a certificate by him that he has read the pleading, motion, or other paper; that to the best of his knowledge, information, and belief formed after reasonable inquiry it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation.

**Exhibit 303-2: Sample Attorney's Engagement Letter to a CPA**

December 1, 20XX

RE:

Dear Mr.

The purpose of this letter is to document and confirm my engagement of your services on (date) to provide services relating to the analysis of (taxpayer) income tax liability for the year \_\_\_\_.

As we discussed, I am engaging your firm to provide an accounting analysis of (taxpayer's) records for the above mentioned tax year for the specific purpose of enabling me to render tax advice and counsel to (taxpayer). In order to enable you to provide the necessary analysis, I hereby authorize you to retain bank records and other documents you currently have in your possession relating to (taxpayer's) tax year.

It is my understanding that you will charge for your services on an hourly basis at a rate of \_\_\_\_ per hour and that you will bill me for your services from time to time. I will be responsible for the payment of your fees and your statement should come directly to my attention:

My engagement of you with respect to this matter is intended to constitute an agency relationship. Accordingly, any records of (taxpayer) that I have authorized you to retain or that I may deliver to you, or that (taxpayer) delivers directly to you with respect to this matter and your work product are intended to remain confidential and you are specifically directed not to disclose any information discovered by you with respect to this matter to any party other than myself or deliver any documents delivered to you to any other party except employees in your office.

It is my understanding that to complete the work requested by me, it will be necessary from time to time for you to contact (taxpayer) with specific questions. I hereby authorize you to contact (taxpayer) directly to the extent necessary and represent to him that you are working for me with respect to this matter. By photostatic copy of this letter I am advising (taxpayer) that I have retained you to assist me in this matter and directing him to provide you with any assistance necessary to enable you to perform the work for which you have been engaged.

**Exhibit 303-2: Sample Attorney's Engagement Letter to a CPA (cont.)**

Page 2

If your understanding of our agreement deviates in any way from the content of this letter, please let me know. Otherwise, if this letter accurately reflects our agreement, please sign the attached copy where indicated and return the executed copy to me for my file.

I look forward to working with you with respect to this matter. Please do not hesitate to contact me if you have any questions with respect to the content of this letter.

Sincerely,

Accepted this \_\_\_ day \_\_\_\_\_, 20XX.

By: \_\_\_\_\_



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