

State Ethical Considerations (and Tax Practice)

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Welcome to UC Davis Summer Tax Institute!

- What we will cover:
 - State licensing of tax preparers
 - Only four states have licensing requirements.
 - Ramifications of no licensing in all other states.
 - Unique issues of state practice
 - Confidentiality
 - Standards of practice
 - State tax preparer penalties
 - State disclosure laws
 - State Malpractice
 - Unauthorized Practice of Law
 - State laws that differ from federal laws.

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Professional Regulation

- Review of regulation that governs the practice of tax! This includes:
 - Federal Regulation under Circular 230
 - Preparer Penalties
 - Professional Organizations
 - AICPA
 - State Regulation
 - State Board's of Accountancy
 - State regulation of tax practice
 - State Bar Associations

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Professional Regulation

- Regulation of Tax Practitioners
 - State Boards of Accountancy
 - Rules specify code of conduct
 - Sanction is suspension or revocation of license.
 - State laws licensing tax return preparation
 - AICPA Statements on Standards for Tax Services
 - Rules also specify code of conduct
 - Sanction for violation is expulsion or suspension from membership.
 - A number of states have adopted AICPA Standards into their Code of Conduct.
 - AICPA Code of Professional Conduct
 - Focuses on independence.
 - IRS Circular 230
 - Trump's Budget Proposal expands IRS authority to increase oversight of paid tax return preparers.

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Professional Regulation

- Eligibility to practice in the states.
 - Registered Tax Return Preparer (voluntary) and PTIN (Preparer Tax Return Identification Number) requirements would take a lot of pressure off the states. Since RTRP is in jeopardy – pressure back on states.
 - Four states have registration requirements.
 - California
 - Oregon
 - New York
 - Maryland

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Professional Regulation: Federal

Category	PTIN	Background Check	IRS Test	Continued Education	Practice Rights
Enrolled Agent	Yes	Proposals Pending	Yes	72 hours every three years	Unlimited
CPA	Yes	Proposals Pending	No	Varies	Unlimited
Attorneys	Yes	Proposals Pending	No	Varies	Unlimited
AFSP	Yes			15 hours each year	Limited

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Professional Regulation: States

- Question: Joey runs a used car dealership and also prepares tax returns. He has no experience in the tax field and has never taken a tax course. If someone asks him to do their tax return, he tries to get them a refund (and then use the refund to buy a used car)? Joey lives in Arizona. Is this OK?

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Professional Regulation

- California and Practice of Accounting
 - CPAs governed by California Board of Accounting and defined in B&P Code 5051 to 5053.
 - Includes (amongst many other things) preparing or signing tax returns as a tax preparer.
 - California does allow individual or firm holding valid out of state license to prepare tax returns for CA residents without obtaining a permit to practice from the Board of Accountancy as long as they do not:
 - Enter state to practice public accounting
 - Solicit CA clients
 - Do not hold themselves out as licensed in CA.

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Professional Regulation

- California Board of Accountancy Requirements
 - Pass CPA Exam
 - Continuing Education
 - CBA Reg. sec. 87
 - 80 hours of CE in a two year period. Must complete 20 hours during each renewal period.
 - Must complete 50% of hours in technical subject areas: accounting, auditing, fraud, taxation, consulting, financial planning, ethics, regulatory review, computer and information technology and specialized industry or government practices that focus primarily upon the maintenance/enhancement of public accounting skills and knowledge needed to practice public accounting.
 - The other 50% can be in non-technical areas such as communication skills, word processing, sales, marketing, motivational techniques, negotiation skills, office and practice management and personnel management.
 - 4 of the 80 hours must be in Ethics.
 - Every 6 years must have 2 hours of Regulatory Review.

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Professional Regulation

- California Board of Accountancy Requirements
 - Pass CPA Exam
 - Continuing Education
 - CBA Reg. sec. 87
 - Licensee must complete 24 of 80 units in subject matter that pertains to financial statement preparation, auditing services, compilations, industry accounting, attestation services or assurance services.
 - 4 hours of preventing, detection and / or reporting of fraud affecting financial statements.
 - Other Special Rules for CPAs who participate in government auditing.
 - No special rules for tax.

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Professional Regulation

- California Tax Education Council (CTEC)
 - Requires anyone who prepares tax returns in California for a fee to register with CTEC and meet requirements. (CA Bus. & Prof. Code sec. 22250-22259)
 - Exempts attorneys, CPAs or EAs.
 - No exam required.
 - Requires certain education requirements to get license and then continuing education to renew license.
 - Only applies to paid preparers in the state – out of state are not obligated to meet CA requirements.

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Professional Regulation

- CTEC: Tax preparer
 - Anyone who for a fee assists with or prepares tax returns for another person, or who assumes responsibility for completed work on a return, or who holds himself out as offering these services.
 - Not the same as federal law.
- CTEC: Tax return
 - Return, declaration, statement, refund claim or other document required by making or filing in connection with state or federal income or franchise taxes

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Professional Regulation

- CTEC requirements
 - 60 hours of qualifying tax education to become a CA Registered Tax Preparer (CRTP)
 - CTEC may consider two years of work experience if:
 - Applicant became CPA, EA or Attorney license in last two years,
 - Applicant employed by CPA, EA or Attorney for last two years, or
 - Applicant moves to state with two years experience.
 - 20 hours of CE per year
 - 10 hours of federal tax, 3 hours of update, 2 hours of ethics and 5 hours of state tax.

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Professional Regulation

- CTEC Requirements
 - Obtain PTIN from IRS (in light of *Loving* decision, no requirement to pass exam).
 - Maintain a \$5,000 tax preparer surety bond.
 - FTB now has authority to penalize unregistered tax return preparers.
 - Penalty is \$2,500 (Rev and TC 19167).

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Professional Regulation

- New York
 - Must register with the state if:
 - Paid to prepare at least one NY state return in calendar year 2017 as a tax return preparer, or
 - Help to issue or administer a refund anticipation loan or refund anticipation check.

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Professional Regulation

- New York
 - Must pay an annual \$100 registration fee as a commercial tax return preparer, facilitator of refund anticipation loans or refund anticipation checks.
 - Do not have to register if:
 - Attorney, CPA or EA
 - Attorney/CPA exempt if licensed anywhere.
 - Volunteer return preparer
 - Employee of a business who prepares that business's tax return.

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Professional Regulation

- New York
 - Commercial Tax Return Preparer: Prepares 10 or more tax returns for compensation in preceding calendar year, and plans to prepare at least one return for compensation this year. (Or fewer than 10 last year, but will prepare at least 10 this year.)
 - Facilitator: Processes, receives or accepts application for refund anticipation loan.

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Professional Regulation

- Question:
 - Joey is a licensed CPA in California. He prepares 15 New York income tax returns in 2016 for compensation. Does Joey have to register in New York as a commercial tax return preparer?
 - A. Yes, as he prepares 10 or more returns for compensation in the prior year and will prepare at least one return in the current year.
 - B. No, because he is not preparing returns in NY and he is a licensed CPA in California.

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Professional Regulation

- New York (N.Y.Comp. Codes R. & Reg. tit. 20)
 - Continuing Education
 - Commercial preparer who prepared 10 or more NY personal income tax returns during years 2014, 2015 and 2016 - 4 hours per year with experience doing tax returns.
 - Commercial preparer who prepares fewer than 10 tax returns during years 2014-2016 - 16 hours per year for less experienced tax return preparers.
 - Competency Exam required
 - Extensive requirements on due diligence.
 - Does not appear that out of state CPAs will have to take exam.

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Professional Regulation

- New York
 - Tax return preparers exclude:
 - Currently licensed CPAs, Enrolled Agents and Licensed Attorneys.,
 - Employees of above who prepare tax returns under the direct supervision of a CPA, EA or attorney.
 - Employees of a business who prepare that business's return or report
 - Clerical employees
 - Volunteer tax return preparers.

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Professional Regulation

- Maryland
 - Individuals who (for a fee) prepare federal and state tax returns for Marylanders are required to be registered by the Maryland Board of Individual Tax Preparers.
 - Exempt:
 - Actively licensed CPAs
 - IRS EAs
 - Attorneys in good standing, and
 - Employees of state, local and federal government employees who perform tax return services in accordance with official duties.

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Professional Regulation

- Maryland
 - Must have a current federal PTIN.
 - Must pass the Maryland Tax Preparers Examination (Cost is \$65 and passing score is 70%).
 - Can substitute 15 consecutive years of tax preparation experience during the period of 2002 to 2016.
 - Prepared on average 50 returns annually, with no less than 25 returns prepared in a given year.
 - Failure to meet these requirements may result in suspensions, revocation of registrations and/or civil penalties not to exceed \$5,000.

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Professional Regulation

- Maryland
 - Out of state preparers
 - Preparing occasional Maryland return – not required to qualify. If preparing Maryland is a significant part of business, then must register with Maryland.
 - Continuing Education
 - Upon renewal (every two years) must complete 16 hours of CE. Four of 16 hours must be in Maryland state tax related subjects.

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Professional Regulation

- Oregon
 - Licensed by Oregon Board of Tax Practitioners
 - Tax Preparer
 - Enables licensee to prepare personal income tax returns in Oregon for a fee. Must work under supervision of licensed tax consultant, CPA or Attorney.
 - Tax Consultant
 - Enable licenses to prepare personal income tax returns in Oregon for a fee as self-employed or independent tax practitioner.
 - Exempt individuals
 - CPAs, Attorneys and Pas who hold a permit from the Oregon Board of Accountancy.
 - Enrolled Agents
 - Must still get an Oregon tax preparer/consultant permit.

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Professional Regulation

- Oregon

- To be licensed as either preparer or consultant in Oregon, must:
 - Be 18 years of age
 - Possess a high school diploma
 - Possess a PTIN
 - Pass a state-administered exam with a score of 75% or higher.
- Tax Preparer:
 - Successfully complete an 80-hour basic personal income tax class.
- Tax Consultant
 - Have 1,100 hours of verified work experience
 - Complete 15 hours of CE.
 - For EA, do not need experience – only has to pass exam and meet other requirements.

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Professional Regulation

- Oregon

- Registration only applies to returns prepared in Oregon, EXCEPT
 - When a person preparing the returns out of state is actively soliciting Oregon clients through activities such as:
 - having an agent in Oregon,
 - having a "drop-off location" in Oregon, or
 - by advertising in Oregon-based publications - including Oregon area phone books.
- Enrolled agents must hold a consultant license with the Board of Tax Practitioners if they are preparing, assisting or advising in the preparation of individual income tax returns.
 - No license is required if the enrolled agent is merely representing the taxpayer before the IRS.

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Professional Regulation

- Cities also want to regulate tax return preparers!
 - Municipal Code of Chicago (Title 4: Businesses, Occupations and Consumer Affairs, adds new Chapter 4-44 for “Income Tax Preparers”).
 - Includes everyone who prepares tax returns for compensation except:
 - Attorney/CPA and their employees who prepare returns
 - Employee of federal, state or local government
 - Administrator, conservator, guardian, executor, trustee, receiver or other representative appointed by Court.

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Professional Regulation

- Municipal Code of Chicago (MCC sec. 4-44)
 - Must register with city and agree to inform customers of price of each service offered, related fees and estimate of total cost for services purchased.
 - Must inform customers how long wait time if for refund, must provide required disclosures and notify customer of complaint procedure (with Dept. of Business Affairs and Consumer Protection).
 - Penalty is a fine of minimum \$250 (maximum \$750) for each offense. Each violation is a separate offense.

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Professional Regulation

- Confidentiality and state tax matters
 - Federal accountant-client privilege (IRC sect. 7525) only applies to federal proceedings. State has to modify statute to make applicable to state matters.
 - Some states have accountant-client privileges that provide a testimonial privilege (protect against subpoena)
 - More states have an accountant-client privilege that is more of a confidentiality statute – which generally have many exceptions (including a validly issued subpoena).
 - Other states have no statutory accountant – client privilege, and most resort to work product doctrine.

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Professional Regulation

- Question:
 - Auditor in State A requests information that may be privileged in State B.
 - But if I give the auditor in State A the work papers, then I have disclosed the documents and destroyed the privilege in State B. In that case I will have to give State B the work papers too!

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Professional Regulation

- States which have enacted the federal privilege under IRC sect 7525
 - Arizona, California, Hawaii and Iowa.
- State which have enacted a “testimonial privilege”
 - Colorado, Florida, Georgia, Idaho, Illinois, Indiana, Louisiana, Maryland, Missouri, New Mexico, Nevada, Oklahoma.

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Professional Regulation

- States which have enacted a Confidentiality Privilege
 - Alaska, Connecticut , Kansas , Kentucky, Maine , Massachusetts , Michigan , Minnesota , Mississippi , Montana , New Hampshire , New Jersey , North Dakota , Oregon , Pennsylvania , Rhode Island , South Carolina , Tennessee , Texas , Vermont and Washington.
- States with no privilege.
 - New York, North Carolina, Ohio and Virginia.

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Professional Regulation

- California's Privilege
 - Rev and TC 7099.1, 21028 and CUIIC 13019.
 - Applies in noncriminal matters brought before the FTB, BOE and EDD.
 - Only applies to tax matters asserted by agency against taxpayers (therefore does not apply in refund claims).
 - Does not apply if information transmitted to third party.
 - See for example, disclosure of work papers in State B (where there is no privilege). Now auditors in State A (where there is a privilege) can get the work papers.

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Professional Regulation

- States with a testimonial privilege
 - Statutes operate more like a privilege in that they do not include exception for discovery, subpoena or other legal process which would create evidence in a civil action. GA statute protects accountant from having to turn over documents in discovery request.
 - *Choice Acquisition Ltd. V. Whitley, Inc.* (826 So. 2d 1165 (2002))
 - Buyer sues seller for alleged overstatement of assets associated with sale of business. Seller responds by arguing that Buyer did not rely on Seller's representations, but rather that of CPA firm who they hired to do due diligence review.
 - The seller tried to get the work done by CPA firm to prove this point. CPA firm refused to disclose under the privilege. Court upheld CPA firm.

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Professional Regulation

- States with a Confidentiality Privilege
 - These statutes are similar to Connecticut.
 - Accountant must keep information confidential – however no protection provided from disclosure that is required by a court order.
 - Work paper ownership statutes
 - Delaware provides that all “records” by “permit holder” remain property of permit holder in absence of agreement with client.
 - Not really protection against disclosure in litigation.

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Professional Regulation

- Question (continued):
 - IRS has issued summons for production of documents produced by Andy. Are they covered by IRC 7525?
 - If the subject of the communication has been disclosed on the tax return (as is the case here) then probably waived the privilege.
 - Dilemma of IRC 7525: Only applies to tax advice that also constitutes legal advice. But wouldn't providing legal advice be the unauthorized practice of law?

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Professional Regulation

- Tax Return Preparer Penalty
 - California (Rev and TC 19166).
 - Conforms to federal and uses substantial authority.
 - Amount of penalty is greater of \$250 or 50% of what you charge client.
 - Substantial Authority
 - Not well defined.
 - Administrative agency cannot declare statute unconstitutional.
 - Statute, regulations or appellate/supreme court decision should all qualify.

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Professional Regulation

- Other administrative guidance:
 - Chief Counsel Ruling (like IRS private letter ruling) – As applied to specific taxpayer who requested ruling.
 - FTB Legal Rulings and Notices should qualify as long as law has not changed.
 - FTB Legal Rulings (like an IRS Revenue Ruling) – can be relied upon as long as law has not changed.
 - FTB Notice (like IRS Revenue Procedure).
 - News releases, press releases are informal advice that would not constitute substantial authority.

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Professional Regulation

- California
 - SBE Opinions
 - SBE is administrative appellate body for appeals from FTB's denial of protests and claims for refund.
 - SBE Opinions can be issued in writing and issued as a precedential opinion, or unpublished (and nonprecedential)
 - Precedential can be cited as authority (not very many of these).
 - Nonprecedential cannot be cited as authority
 - Letter decisions – Provide decision based on whether taxpayer met burden of proof - no analysis of facts or legal authority
 - All SBE decisions are binding on FTB. Adverse rulings cannot be appealed by FTB.

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Professional Regulation

- Publication of BOE Decisions
 - R&TC 40 added to statute which requires BOE to publish written formal, memorandum and summary opinions on its website within 120 days of decision if amount in controversy exceeds \$500,000 (determined without interest or penalties).
 - Applies to all taxes administered by BOE.
 - Formal or memo opinions may be cited as precedent in proceedings before Board unless they have been de-published, overruled or superseded.

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Professional Regulation

- State Malpractice
 - Generally based on tort (negligence claim) or breach of contract.
 - Tort theory – Practitioner owes a duty to client based on level of skill, care and diligence exercised by other members of profession in similar circumstances.
 - Contract theory – Generally obligated by contract to perform the task undertaken diligently and competently.
 - Standards pretty close, with exception of statutes of limitation.

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Professional Regulation

- State Malpractice Claims
 - Case comes up after the fact – at the time of the audit, IRS has already concluded that tax strategy does not work. At the time that the return was prepared, it was not so clear.
 - Defendant can offer affirmative defense.
 - “Error in judgment” rule. Rule holds that mere error in judgment on an unsettled proposition of law is not malpractice.
- OR, file complaint with CBA
 - You won’t get anything, but CPA might lose his license.

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Professional Regulation

- Right to “practice before the IRS”
 - Federal law trumps state law (*Sperry v. Florida*, 373 US 379 (1963)). Federal law authorizes CPAs to represent taxpayers before IRS.
 - Circular 230 also allows practice before the IRS.
- Unauthorized practice of law (CA Bus & Prof Code 6125)
 - Giving legal advice
 - Preparing legal instruments (other than tax forms)
 - Preparing contracts which relate to legal advice
 - Engaging in negotiations with opposing counsel regarding settlements.

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Professional Regulation

- Conflicts of Law
 - Prop. 64: Marijuana Legalization.
 - Legalizes sale of marijuana for adults 21 years of age or older. Can possess marijuana in limited quantities, but cannot sell marijuana for recreational use until after Jan. 1, 2018.
 - Prohibited while driving a car or anywhere else that smoking is prohibited.
 - Federal law continues to list marijuana as a Schedule 1 Controlled Substance (or an illegal drug).

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Professional Regulation

- Prop 64: Marijuana legalization.
 - Effective Nov. 9, 2016 medical marijuana is exempt from sales tax.
 - Effective Jan. 1, 2018 the following excise taxes apply:
 - 15% excise tax on retail purchasers based on gross receipts from retail sale.
 - Tax on cultivators imposed as follows:
 - \$9.25 per dry-weight ounce of marijuana flowers
 - \$2.75 per dry-weight ounce of marijuana leaves
 - Gross receipts taxes on sales of marijuana passed in 31 cities/counties – rates vary.

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Professional Regulation

- Prop. 64 Marijuana Legalization
 - Regulated by Bureau of Marijuana Control
 - Regulates distribution, transportation, testing, and dispensaries. Agency has established four license categories. Have not determined fee.
 - Regulated by Dept. of Food and Agriculture
 - Regulates cultivation. Has 14 licenses.
 - Nonrefundable license application fee \$60 - \$4,260
 - Annual license fee: \$560 - \$38,350
 - Regulated by Dept. of Public Health
 - Regulates manufacturing. Has 4 licenses.
 - Nonrefundable license application fee: \$1,000
 - Annual license fee: \$2,000 - \$50,000

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Professional Regulation

- Income Tax Issues – Medical Marijuana (now all sales of marijuana).
 - Personal Income Tax
 - CA conforms to IRC 280E (no deduction for business expenses , but deduction allowed for cost of goods sold).
 - For CA purposes, no deduction allowed for CGS if taxpayer engaged in “criminal profiteering” or related activities (includes drug trafficking). Selling marijuana for medical purposes (or for recreational use after Jan. 1, 2018) would not be drug trafficking. (Rev & TC 17282).

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Professional Regulation

- Income Tax Issues – Medical Marijuana (now all sales of marijuana).
 - Personal Income Tax
 - CCA 201504011
 - Clarifies that CGS for a taxpayer subject to IRC 280E uses IRC 471 to compute the cost of inventory (which means that additional IRC 263A costs are not capitalized into inventory).
 - If allowed, then costs that are not deductible would become deductible – not purpose of IRC 263A.
 - *Californians Helping to Alleviate Medical Problems, Inc.* (128 T.C. 173 (2007)).
 - Taxpayer was able to show that they also operated a caregiving business for people with AIDS and cancer. Expenses associated with this activity were deductible.

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Professional Regulation

- Income Tax Issues – Medical Marijuana (and now all sales of marijuana).
 - Corporation Tax Law
 - Statute does not conform to IRC 280E, therefore both CGS and Business expenses are deductible (unless engaging in “drug trafficking”).
 - Federal Law:
 - Marijuana is a controlled substance (under Controlled Substance Act) and is not deductible as a medical expense even if purchased (and used) for medical purposes.
 - CA conforms to IRC 213 and would disallow the medical expense deduction even if qualified as medical use.

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Professional Regulation

- Ethical Issues related to CPAs providing services to the marijuana industry:
 - CA Board of Accountancy will be reviewing this issue – no statement yet.
 - Consider likelihood of DEA or DOJ action against client for operating an illegal business. (Note that Jeff Sessions (a prohibitionist) is new Attorney General).
 - How will offering these services affect malpractice insurance?
 - Minimum, need to be sure that client understands risk of operating this type of business.
 - Not aware of any State Boards that have taken action against CPA for advising these clients.

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Professional Regulation

- Ethical Issues related to CPAs providing services to the marijuana industry:
 - Other concerns:
 - Most banks are prohibited from opening accounts for businesses whose activities are illegal under federal law. This means that client may be forced to use a cash method – literally.
 - Issue is the Bank Secrecy Act – if a bank that wants to accept cash from business selling a federally illegal substance, must get approval from FinCEN.
 - FinCEN has issued guidance (but not statutory reform) that will allow banks and credit unions to handle the cash if reported quarterly on a Suspicious Activity Report. Additional reporting can make these accounts expensive for the bank/credit union.

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Professional Regulation

- Ethical Issues related to CPAs providing services to the marijuana industry:
 - Always have an engagement letter which states that client knows requirements of state law and intends to comply.
 - Know what is covered under your professional liability insurance policy.
 - Document all work and conversations with client.

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