

Conflicts of Interest Concerns for Tax Professionals

Presented

By:

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Mr. Coleman's practice concentrates on federal tax related controversy matters, including litigation in Federal District Court, the United States Tax Court, and the Court of Federal Claims. Mr. Coleman also represents taxpayers in Internal Revenue Service audits, appeals, and collection actions. Mr. Coleman has been admitted to the Fifth Circuit Court of Appeals Bar, the District of Columbia Circuit Bar, the Northern District of Texas, the Eastern District of Texas, the District of Colorado, and the United States Tax Court.

In addition to tax controversy, Mr. Coleman also represents clients in estate and business planning as well as asset protection. His practice includes entity formation, asset transfers, and wills and trusts.

Education

LL.M. in Taxation, Dedman School of Law, Southern Methodist University, 1999

J.D., Oklahoma City University School of Law, 1998

B.A. in Finance, University of Central Oklahoma, 1995

Bar Admissions

State Bar of Texas

State Bar of Oklahoma

Professional Associations and Memberships

State Bar of Texas

State Bar of Oklahoma

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CONFLICTS OF INTEREST CONCERNS FOR TAX PROFESSIONALS

Introduction

Tax professionals are prohibited from representing taxpayers in situations where there may be a conflict of interest, except where the practitioners reasonably believe that they are able to provide competent and diligent representation to each affected client. The potential for a conflict of interest exists when the representation of one client will, or may, be adverse to another client, or if there is a significant risk that the representation of one client will be materially limited by the practitioner's responsibility to another client, former client, third person, or his or her personal interest.

Under Circular 230, the Treasury Regulations governing ethical standards applicable to practice before the IRS, conflict of interests is defined for tax professionals under Section 10.29 (31 C.F.R. §10.29). Under Circular 230, the tax professional must make full disclosure to all potentially interested parties and all affected clients must provide their express written consent for representation after a detailed disclosure of the potential or actual conflict is explained. The tax professional must retain copies of all written consents for three years from the date of the conclusion of the representation and provide such written consent to the IRS upon request.

There are two reasons why tax professionals should be aware of and follow the requirements of Circular 230. One, a violation of Circular 230 may provide a basis for a referral to the Office of Professional Responsibility which can sanction or even disbar a tax professional from practicing before the Internal Revenue Service. Two, failure to follow Circular 230 may be used by a litigant in a lawsuit for malpractice as a demonstration of a breach of a standard of care exposing the tax professional to potential civil liability.

This outline and case study will help you identify potential conflicts and give you a step-by-step guide to resolving the conflict. We will first look to the actual language used in Section 10.29. We will also look at selected Internal Revenue Manual ("IRM") provisions. We will then review actual conflict of interest scenarios from our practice and discuss how those conflicts can be resolved.

Circular 230

Circular 230 Section 10.29 states as follows:

§ 10.29 Conflicting Interests.

- (a) Except as provided by paragraph (b) of this section, a practitioner shall not represent a client before the Internal Revenue Service if the representation involves a conflict of interest. A conflict of interest exists if —
 - (1) The representation of one client will be directly adverse to another client; or
 - (2) There is a significant risk that the representation of one or more clients will be materially limited by the practitioner's responsibilities to another client, a former client or a third person, or by a personal interest of the practitioner.
- (b) Notwithstanding the existence of a conflict of interest under paragraph (a) of this section, the practitioner may represent a client if —
 - (1) The practitioner reasonably believes that the practitioner will be able to provide competent and diligent representation to each affected client;
 - (2) The representation is not prohibited by law; and
 - (3) Each affected client waives the conflict of interest and gives informed consent, confirmed in writing by each affected client, at the time the existence of the conflict of interest is known by the practitioner. The confirmation may be made within a reasonable period of time after the informed consent, but in no event later than 30 days.
- (c) Copies of the written consents must be retained by the practitioner for at least 36 months from the date of the conclusion of the representation of the affected clients, and the written consents must be provided to any officer or employee of the Internal Revenue Service on request.

- (d) *Effective/applicability date.* This section is applicable on September 26, 2007.

Internal Revenue Manual

There are a number of Internal Revenue (“IRM”) Sections that deal with potential or actual conflicts of interest. A selection of IRM provisions are as follows:

35.4.1.8.1.2 (02-07-2013)

Claims for Relief from Joint and Several Liability under Section 6015 or Duress Cases

1. A specific type of dual representation conflict of interest involves innocent spouse claims. ABA Model Rule 1.7 and Tax Court Rule 24(g) are directly implicated when petitioner’s counsel represents both spouses who filed one or more joint returns in a case in which the underlying deficiency is contested and a claim for relief under section 6015 is or may be asserted. Similarly, petitioner’s counsel may have a conflict of interest when one petitioner claims that the return was signed under duress by the other spouse, invalidating the joint election. *Harbin v. Commissioner*, 137 T.C. 93, illustrates the conflict that may appear when joint filers separate during the course of a Tax Court case. Persons representing joint filers should be aware of the discussion in *Harbin*. If joint petitioners separate or divorce during the course of a Tax Court case, a conflict of interest letter should be sent to petitioners’ counsel. Exhibit 35.11.1–78, Sample Letter To Attorneys in Conflict Situations Involving Multiple Representation; IRC § 6015 at Issue, is a sample conflict letter to petitioner’s counsel for use in this situation.

35.4.1.8.1 (02-07-2013)

Petitioner’s Counsel’s Conflicts of Interest

1. Conflicts of interest are governed by the ABA Model Rules of Professional Conduct (which the Tax Court has adopted) and in the Tax Court Rules, in particular ABA Model Rule 1.7 and Tax Court Rule 24(g).
2. Conflicts of interest for petitioner’s counsel and other ethical issues related to representation of a client may arise in a number of ways, including:

- The attorney has business connections to a person who is not a party to the case (such as a tax shelter promoter), and that person's interests do or potentially could conflict with petitioner's interests.
- The attorney has other personal or financial interests that may conflict with the interests of petitioner.
- The attorney promoted, or was otherwise involved, in the planning, organization, sale, or related activity of a tax shelter or similar transaction or arrangement at issue in the case.
- The attorney represents more than one petitioner (either in the same case or in different cases), and the interests of the petitioners are adverse (e.g., husband and wife petitioners in a joint deficiency case in which one of them claims innocent spouse relief under section 6015).
- The attorney will be called as a witness for either side.

3. These common conflicts are discussed in more detail below.

35.4.1.8.1.1 (02-07-2013)

Conflict of Interest Based on Planning, Promoting, or Operating a Shelter, or Dual Representation

1. T.C. Rule 24(g) provides that if any counsel of record was involved in planning or promoting a transaction, or operating an entity, that is connected to any issue in the case, or represents more than one person with differing interests as to any issue in a case, then counsel must either:
 - Secure the informed consent of the client,
 - Withdraw from the case, or
 - Take whatever other steps are necessary to obviate a conflict of interest or other violation of the ABA Model Rules of Professional Conduct.

Note:

The court may inquire into the circumstances of counsel's employment in order to deter violations. *See* T.C. Rule 201

2. In addition, ABA Model Rule 1.7(a) provides that an attorney has a conflict of interest if the attorney represents clients with directly adverse interests or if there is a significant risk that the attorney's representation of a client will be materially limited by the attorney's responsibility to another current client, former client, or third person, or by a personal interest of the attorney.
3. A sample letter, addressed to opposing counsel, for use in this situation is set forth in Exhibit 35.11.1-77, Sample Letter To Attorneys in Conflict Situations Involving Planning, Promoting or Operating a Tax Shelter.

25.5.5.5 (12-18-2015)

Dual Representation

1. Treasury Department Circular 230 (Regulations Governing Practice before the Internal Revenue Service) (Rev. 6-2014) provides the following with respect to dual representation:
Section 10.29 Conflicting interests. "(a) Except as provided by paragraph (b) of this section, a practitioner shall not represent a client before the Internal Revenue Service if the representation involves a conflict of interest."
2. Paragraph (b) of Section 10.29 provides for an exception to the general prohibition against conflict of interest. A practitioner may represent clients having conflicting interests if:
 - A. The practitioner reasonably believes that the practitioner will be able to provide "competent and diligent representation" to each affected client;
 - B. The representation is not prohibited by law; and
 - C. Each affected client waives the conflict of interest and gives informed consent at the time the practitioner learns of the conflict. The client's informed consent must be confirmed in writing no later than 30 days after the clients gave their consent.

3. Dual representation exists when a summoned third-party witness is represented by an attorney, certified public accountant, enrolled agent, or other person who also represents the taxpayer or another interested party. It may also occur when an attorney under investigation represents a third-party witness in that investigation, or when an attorney-witness seeks to represent another witness in the same investigation. An interested party is one who has a significant pecuniary interest in the testimony of the witness or who, by virtue of the nature of the investigation and the known facts, may be incriminated by the witness. When dual representation exists, notify the Group Manager, and consult Associate Area Counsel, if necessary, to determine the appropriate course of action.

Note:

When dual representation is in question, continue the summons appearance date to allow time for a resolution of the matter if the attorney-witness refuses to testify or produce documents. See IRM 25.5.3.4(5), **Time and Place of Examination Set by Summons.**

4. Except as provided below, the mere existence of a dual representation situation which may potentially have an adverse impact on the investigation will not, without some action by the attorney to impede or obstruct the investigation, provide a sufficient basis for seeking a disqualification. However, where an attorney's representation has substantially prejudiced the questioning of a third-party witness and, as a result, has significantly impaired the progress of the investigation, the Service will request the Department of Justice to seek a court order, as part of the summons enforcement proceeding, to disqualify that attorney as counsel for that witness.
5. In view of the well-established principle granting a person the right to counsel of one's choice, this disqualification procedure will only be used in extreme circumstances, such as where an attorney has taken some action to improperly or unlawfully impede or obstruct the investigation. It is essential the interviewing officer have sufficient facts to support such allegations.
6. If the taxpayer-attorney who is the target of the interview represents a third party witness in an interview, refer to *IRM 25.5.5.5.4, Procedures for Exclusion of Attorney Prior to Interview of Witness.*

7. The provisions referring to "attorneys" apply to other representatives (non-attorneys) who represent witnesses or taxpayers.

Case Studies

The following are a selection of not so hypothetical factual scenarios that we have seen in our office.

EXAMPLE 1: You have prepared the form 1040 US Individual Income Tax Return for Joe and Donna Smith for the last 10 years. Joe runs a successful family business that sells ball bearings used in industrial manufacturing. Donna has not worked outside the home for the last 10 years. Joe's annual income is \$750,000.00. For the past 10 years, Joe and Donna have always filed a joint return. On April 15th, the Form 1120S return for the ball bearing company was not prepared. As a result, you filed an extension for their joint return. It is now October 2nd, and you have begun preparing the Form 1040. At this point, you learn that Joe and Donna have been legally separated since August. They are currently going through divorce proceedings.

Can you represent both Joe and Donna in filing a joint return?

Can you represent Joe and Donna as married filing separately?

You have known and been friends with Donna long before she married Joe.

In fact, Donna's father and brother are clients of yours and you have prepared their returns for the last 25 years. You want to keep Donna as a client, and no longer represent Joe. Does this present a problem?

The ball bearing factory is owned by a separate entity, Ball Bearing, Inc. which is a C Corporation. Rent is paid monthly in the amount of \$10,000.00. You also prepare the return for the C Corporation and know that Joe is the 100% shareholder of the company. Donna is unaware that the C Corporation exists. Does this change any of your answers above.

You refer Joe to your friend who is also an Enrolled Agent. For every former client you refer to your friend, he pays you a referral fee of \$1,000.00. Does this present a conflict of interest?

EXAMPLE 2: You prepare a Form 1120S return for the law firm of Kyle Coleman, PC. You also prepare Mr. Coleman's individual Form 1040. One of your assistants prepared the Form 1120S and K-1 for the company. Your assistant mistakenly reported a \$35,000.00 loss which should have been a \$35,000.00 gain. You do not discover the error during the review process. Unfortunately, Mr. Coleman has been selected for audit. In preparing for the audit, you discovered the mistake. Does this fact situation present a possible conflict of interest?

You also discover during the preparation for the audit, that an extension was prepared for the Professional Corporation, but was never filed. In addition, the Form 1120S return for the company was prepared and used to prepare Mr. Coleman's individual return, but was never filed. You find a signed copy of the return in your file. Does this fact situation present a conflict of interest?

EXAMPLE 3: You represent a Real Estate Partnership and have prepared the Partnership's returns for a number of years. The Real Estate partnership is owned by 10 different individuals. Two of the Partners, a husband and wife, are the General Partners and own a 51% interest in the Partnership. You prepare both of their returns as well. You do not represent any of the other Limited Partners. Does this factual scenario represent a potential conflict of interest?

The Partnership Agreement allocates 100% of the losses to the General Partners in any year where a loss occurs. The Partnership has been approached by a third party seeking to purchase a parcel of real property owned by the Partnership. At the proposed sales price, the Partnership would incur a \$100,000.00 loss. The General Partners come to you and request your advice. Does this factual scenario represent a conflict of interest?

EXAMPLE 4: You represent clients who own an oil and gas company in West Texas. They are a long time client and you have always prepared the returns for the oil company and for its owners. Recently, another oil company has made an offer to purchase either all the stock in the company or all the company's assets. In addition, the proposed purchaser has requested audited financials for the company for the last five years. The owners of the company come to you and ask you to prepare the audited financials. Does this present a possible conflict of interest?

EXAMPLE 5: You have been contacted by potential new clients who are husband and wife. They are the 100% owners of the Home Health Care Agency which is behind on its Form 941 employment taxes. The company received a visit last week from an IRS Revenue Officer. He is demanding full payment of outstanding employment tax liability or he is intending to seize company assets. You agree to represent the company with its employment tax issues. After speaking with the Revenue Officer, he states that he intends to assert a trust fund penalty against the husband and wife that own the Home Health Care Agency. They ask you to represent them as to the Trust Fund penalty case. Does this situation present a potential conflict of interest? You later learn that the husband is the one in charge of the day to day operations of the company and he has sole check writing authority on all company accounts. The wife's sole function in the company is to provide nursing services. Does this change your answer?

EXAMPLE 6: A husband and wife have been referred to you by another Tax Professional. The IRS has prepared substitute form returns for the tax years 2014 – 2016 for the wife. The SFR's are based upon a 1099 submitted to the IRS by Construction Consulting, Inc. The wife tells you that during the tax years in question she did not work outside the home. However, the husband was a consultant for the tax years 2002 – 2004 for the company. He agrees that the income should have been reported by him, and not his wife. You also learn that during the tax years at issue, the couple was not married. You also learn that the husband has not filed returns for the last 10 years. Does this factual scenario present a conflict of interest?

EXAMPLE 7: You have a current client that owes \$150,000.00 in Form 1040 income taxes. You have submitted a Form 433A financial statement and supporting documents to the revenue officer and plan on negotiating an installment agreement. The Revenue Officer requests a full year of bank statements to support the installment and you provide those statements. The Revenue Officer notices that every month there is a payment of \$775.00 to your client's brother-in-law. The Revenue Officer issues a summons for your client's brother-in-law to appear and provide documents regarding any financial dealings between your client and his brother-in-law. The client asks you to go with his brother-in-law in response to the summons. Does this factual situation present a possible conflict of interest?

Before responding to the summons, you speak with both your client and his brother-in-law and discover that the payments are related to a 55-foot cabin

cruiser boat and slip maintained at Lake Lewisville. The boat is not listed on your client's Form 433A as an asset which he owns. Does this change your answer?

Also, prior to responding to the summons, you discover that the brother-in-law owns the boat through a 100% wholly owned S Corporation. When not used personally, the brother-in-law rents the boat on an hourly basis. Advertising is done over the internet and through marketing at the local marina. There is no income reported by the brother-in-law related to this rental activity. Does this change your answer?

EXAMPLE 8: You have been referred two clients, a husband and wife. The husband is retired and receives a modest retirement income and social security. The wife is a practicing Dentist, who recently sold her practice and at the age of 46, enlisted in the U.S. Army. Although the dental practice was sold for a substantial profit, no estimated tax payments were made and there is \$150,000.00 tax liability due associated with the sale of the dental practice. After enlisting in the Army, the wife was transferred from her home in Texas and is stationed in Ft. Sill, in Oklahoma. To complicate matters, due to the distance and change in career, the client has informed you that the marriage is slowly deteriorating and that a divorce is probable.

Prior to selling her practice, the wife was a very successful Dentist earning approximately \$400,000.00 a year. She was very involved in her dental practice, the husband had no involvement with the practice. Based upon this fact scenario, is there a potential conflict of interest?

EXAMPLE 9: A long time client requests a meeting to discuss her plans to get married. She is concerned, however, because she has a \$750,000.00 outstanding liability for Form 1040 income taxes with the IRS. Her fiancé is very wealthy, she is concerned that if they were to become married, his assets would be subject to the payment of her liability. She would like you to secure an installment agreement or an offer and compromise with the IRS within the next six months, and she does not want her fiancé to know about her tax problems. Under this factual scenario, do you see a potential conflict of interest?

Unfortunately, the client did not heed your advice. She married her fiancé without disclosing the tax issue. Now, the IRS has levied on one half of the new husband's wages. The client mentioned something called a post-

nuptial agreement, and would like to discuss it with you. Can you represent both the husband and wife in regards to a post-nuptial agreement?

EXAMPLE 10: John and Mary, who have not filed tax returns for 2012, 2012 and 2013 come to you as their new EA. Mary was not aware of any delinquent tax returns until a notice was recently received from the IRS. John has always handled all of their financial matters. John reveals that he did not report all of their income on their 2012 joint tax return. This is the first time that Mary has been aware of this fact. Substantial taxes will be owed for the years for which returns have not been filed, but Mary has enough separate property she inherited from her father to pay the taxes in full. John and Mary live in Texas.

- (a) What advice should the EA give, and to whom with respect to the 2012 tax return?
- (b) Should the EA recommend that John and Mary file joint or separate tax returns?
- (c) Are there any ethical problems with the EA advising them to file joint tax returns?
- (d) Do John and Mary need to be represented by separate EA's or attorneys?