

Minimize Liability This Tax Season

In times of economic turmoil, being diligent about organization and documentation can protect your reputation and your firm.

These days, business is booming for CPAs and Enrolled Agents, according to Glen Wielandt, vice president of operations for the Sacramento, Calif.-based Roni Deutch Tax Center franchise. Because of the economic downturn, widespread financial uncertainty and a slew of tax law changes passed by Congress, Americans are turning to their tax advisers for help.

“It’s a great year for the industry,” Wielandt says. “We have a new president, a struggling economy – which usually means people turn to their accountants looking for extra money, loopholes and deductions – foreclosures, bankruptcies and new tax laws.”

While current events are translating into increased business for CPAs and Enrolled Agents, they’re also translating into increased risk. One wrong move, and clients are likely to call foul not on themselves, but on those who manage their money.

To protect yourself and your firm from unwarranted scapegoating, as well as legitimate error, you should prepare for this year’s tax season with continuing education, open communication and diligent documentation.

Understand your risks

To mitigate risks, you should first understand them, says Enrolled Agent Karla Dennis, CEO of Cohesive, a Cypress, Calif.-based tax preparation and advisory firm.

“Currently, I think the biggest risks most tax professionals face are preparer penalties and lawsuits by clients for taxes, interest and penalties owed as a result of an additional tax assessment,” she says.

The risks are real, echoes Northridge, Calif.-based Enrolled Agent Eva Rosenberg, who operates the tax Web site TaxMama.com. Not only should CPAs and Enrolled Agents have the right answers, she says, but you should arrive at those answers the way that the IRS wants you to.

Review and revisit IRS Circular 230

Because IRS guidelines are so important, CPAs and Enrolled Agents who wish to protect themselves from litigation and liability must begin by studying them, Rosenberg suggests. A good place to start is IRS Circular 230, which sets the rules of the game for those who practice before the IRS.

“All tax professionals who are governed by IRS Circular 230 are very vulnerable right now,” she says. “The IRS has updated it several times in the last few years because they’re concerned

about the positions CPAs and Enrolled Agents take on tax returns and how those positions are supported.”

According to Rosenberg, Circular 230 rules include two basic standards designed to protect you from professional liability, each applicable in different situations. The first is the “realistic possibility” standard, which says that tax preparers will avoid penalties only if their positions have a one in three chance of being sustained on their merits. The second, the “more likely than not” standard, says tax preparers’ positions must have a greater than 50% chance of standing up to IRS scrutiny.

The rules are confusing, Rosenberg admits, but the message is clear. “Before you take a position on something, do your research, instead of relying on someone else’s. Your opinion needs to be solid.”

Prepare in order to prevent

In light of Circular 230 standards, there are several strategies you can employ to strengthen your positions and, in turn, your professional defenses. For example:

- **Stay current.** According to Wielandt, all CPAs and Enrolled Agents should stay abreast of tax law changes, of which there are many this year due to the federal government’s recent economic stimulus efforts. To keep up, Dennis suggests subscribing to a reputable tax update service, such as CCH (www.cch.com) or BNA (www.bna.com).
- **Do your homework.** Because you can’t know everything, Rosenberg recommends subscribing to a tax research service, which for a small fee will locate IRS codes and regulations to help support your positions.
- **Know your limits** If clients ask you to prepare returns that are outside your area of expertise, you’re best off referring their business to a colleague, according to Dennis, as you’ll be more prone to errors if you’re working with unfamiliar subject matter.

Equally important are strategies that can help you minimize errors and defend data, regardless of your opinions or their merits. For instance, you should:

- **Get it in writing.** Your best defense is always documentation, according to Dennis, who recommends accepting client data and requests only in written form by fax, mail or email.
- **Understand your software.** Because many accounting tasks are automated, learning your software programs and manually checking all of your electronic work for mistakes is crucial, Wielandt says.
- **Communicate often and openly.** Wielandt suggests calling and meeting with clients regularly throughout the calendar year in order to build trust and rapport, both of which are deterrents to legal action. Similarly, Rosenberg suggests starting each year off with a letter of engagement that outlines for clients exactly what services you’ll provide and under what terms.
- **Train your staff.** Because lower-level staff often is in charge of executing tax interviews and preparing client returns, Wielandt recommends ongoing training so that employees can properly recognize and correct potential errors.
- **Get insured.** If you don’t already have it, Dennis recommends purchasing professional liability insurance, also known as errors and omissions insurance, to cover legal costs in the event of litigation.

Finally, Rosenberg advises, trust your gut. “Don’t let clients bully you into doing something that makes you uncomfortable,” she says. “Nothing is worth risking your license and reputation.”

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