

Tax & Ethics

NYU Law Graduate Tax Program – Jerome Manning '52 Tax Salon

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Tax & Ethics

Ethics may not be the first thing we think of when we think about tax, but as tax lawyers, we are the gatekeepers of the U.S. system of voluntary tax compliance. We will discuss the ethical dilemmas that all tax lawyers face in balancing their duties to advance their clients' interests, while at the same time honoring their obligations to the tax system, duties of professional responsibility, personal integrity, and the need to earn a living. Using Circular 230 as a guide, we will examine some common difficult situations and the best approaches to handling them.

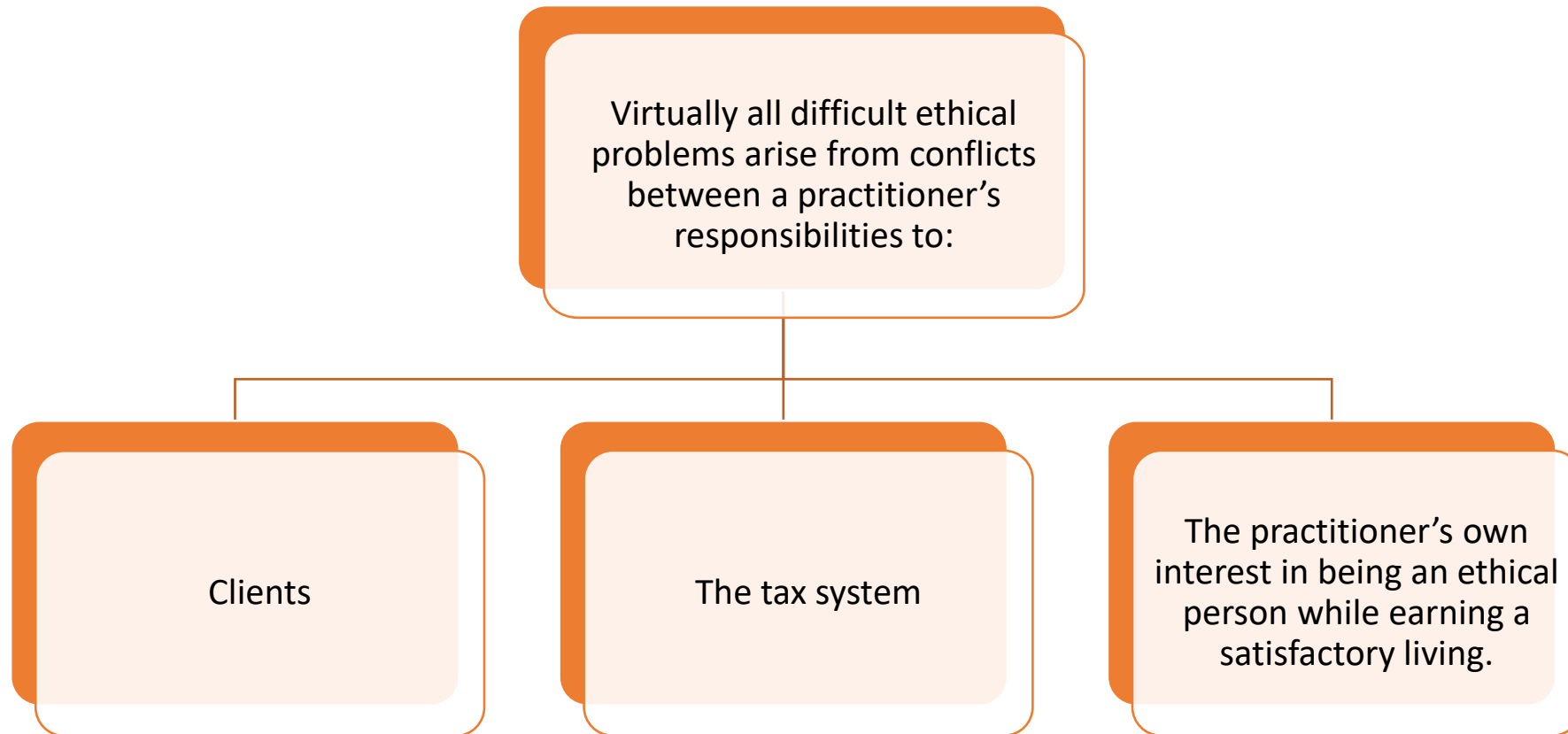
The Tax Law, Ethics, and Morality

Legal: What is allowed by law

Ethical: What is allowed by the Rules of Professional responsibility

Moral: What the lawyer personally believes is right or wrong

3 Sources of Ethical Conflicts



Tax Planning is Legal

- **“Over and over again, courts have said that there is nothing sinister in so arranging one’s affairs as to keep taxes as low as possible. Everybody does so, rich or poor, and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant.”**
 - *Commissioner v. Newman*, 159 F2d 848, 850-51 (2nd Cir. 1947)
(Learned Hand dissenting)

Taxpayers' Attitudes About Paying Taxes

- From IRS's Comprehensive Taxpayer Attitude Survey [Publication 5296 \(Rev. 12-2024\)](#)
- 84% of those surveyed said that it was not at all acceptable to cheat on your income taxes (down from a high of 89% in 2021)
 - What about the other 16%?
- 29% of taxpayers agree with the statement that “If I no longer trust the government will spend taxpayer dollars wisely, it is fair to avoid paying some taxes.”
 - 12% completely agree
 - 17% mostly agree

Most taxpayers believe that they are obligated to pay taxes regardless of their trust in the government...

Attitudes about Cheating and Payment of Fair Share of Taxes

■ Completely Disagree ■ Mostly Disagree ■ Mostly Agree ■ Completely Agree

If people are treated fairly by the tax system, then they will act fairly and honestly in return



I trust the IRS to fairly enforce the tax laws as enacted by Congress



If I no longer trust the government will spend taxpayer dollars wisely, it is fair to avoid paying some taxes



Q5. Please indicate how much you agree with each of the following statements. Select one response per statement. Margin of error is +/- 3.1% at the 95% confidence level. n=1226-1382 blended online and phone respondents in 2024.

The majority of taxpayers agree that burdensome tax law and tax return processes may result in taxpayers not paying their fair share, yet most also trust the IRS to help them understand tax obligations

Attitudes about Cheating and Payment of Fair Share of Taxes

■ Completely Disagree
 ■ Mostly Disagree
 ■ Mostly Agree
 ■ Completely Agree

The more burdensome the tax law and tax return process the less likely people will be to pay their fair share



Taxpayers are given a fair chance to fix mistakes without being immediately penalized



I trust the IRS to help me understand my tax obligations



In this country, people who cheat on their taxes are held accountable



Q5. Please indicate how much you agree with each of the following statements. Select one response per statement. Margin of error is +/- 3.1% at the 95% confidence level. n=1226-1382. Blended online and phone respondents in 2024.

Will There Be a Tax Strike in 2026?

From a March 22, 2026 Substack post by an *attorney*:

“Like many Americans, I filed my taxes this month. This time, I only paid some of them.

Just under a year ago, I left my salaried corporate law job and began working as a 1099 employee, making money through contracting, social media, and occasional speaking fees. H&R Block calculated that I owed about \$9,000 in federal income tax and \$3,000 in state income tax. As I filed, I paid the state of Illinois via direct withdrawal. I did not pay the federal government.

As tax season approached, I thought a lot about whether or not I would pay an outstanding federal balance. The federal government is allocating my tax bill to build out immigration detention and send stormtroopers into our communities to disappear my neighbors. My taxes go to bombs that get dropped on civilians across the globe. The government is not just spending money on things I disagree with politically and morally. It is spending money on these things despite a majority of the country *also* disagreeing politically and morally.

It didn't take long to answer the question of whether or not I *should* pay my federal income tax with a resounding *no*.”

Circular 230

THE GUIDE TO ETHICS IN TAX PRACTICE

Circular 230

Treasury Department Circular 230, "Title 31 Code of Federal Regulations," Subtitle A, Part 10.

- Governs standards of Practice before the IRS
 - Authority to practice before the IRS
 - Duties and restrictions relating to practice before the IRS
 - Sanctions for violating Circular 230
 - Rules applicable to disciplinary hearings for Circular 230 violations
- Circular 230 is administered by IRS Office of Professional Responsibility (OPR) and Return Preparer Office (RPO)

The Horse Act of 1884

- Original statutory basis for Circular 230
- Allowed Treasury to discipline agents who fraudulently claimed reimbursement for veterans whose horses were lost or killed in the Civil War
- Authorizes the IRS to "regulate the practice of representatives of persons before the Department of the Treasury." 31 U.S.C. § 330(a)(1)



Background of Circular 230

Circular 230, 31 C.F.R. Part 10, available at <https://www.irs.gov/pub/irs-pdf/pcir230.pdf>

Provides rules governing practice before the IRS.

Since 1884, Federal law has authorized the Secretary of the Treasury to regulate practice before the Treasury Department.

31 U.S.C. 330(a) provides that subject to section 500 of title 5, the Secretary may “regulate the practice of representatives of persons before the Department of the Treasury.”

In addition, before admitting a representative to practice, the Secretary may require that the representative demonstrate “good character,” “good reputation,” the “necessary qualifications to enable the representative to provide to persons valuable service,” and “competency to advise and assist persons in presenting their cases.”

Circular 230 has been amended numerous times over the years but not since 2014.

On December 20, 2024, Treasury and the IRS released proposed regulations to amend Circular 230 in various ways to account for changes in the law and the evolving nature of tax practice.

Current 10.2(4) Definition of “Practice”

- All matters connected with a presentation to the IRS relating to a taxpayer’s rights, privileges, or liabilities under laws or regulations administered by the IRS
- Preparing or filing documents, corresponding and communicating with the IRS, rendering written advice, and representing a client at conferences, hearings and meetings

Proposed 10.2(4) Definition of “Practice”

- Eliminates/revises various standards to relate to tax returns prepared, approved, or submitted in connection with representing a client in a matter before the IRS.
- Adds “Any action that supports a presentation to the Internal Revenue Service, including the preparation and submission of tax returns in connection with representing a client in a matter before the Internal Revenue Service, may constitute practice before the Internal Revenue Service.”

Key Provisions of Circular 230

10.2 Definitions

10.20 Information to be furnished

10.21 Knowledge of a client's omission

10.22 Diligence as to accuracy

10.29 Conflicting interests

10.34 Standards with respect to tax returns and other documents

10.35 Competence

10.36 Procedures to ensure compliance

10.37 Requirements for written advice

10.51 Incompetence and disreputable conduct

Three Pillars of Circular 230



Competence

10.35 (be competent)



Diligence as to Accuracy

10.22 (learn the facts)



Standard for Tax Positions

10.34 (properly apply the law to the facts)

Competence

10.35 – Competence



- A practitioner must possess the necessary competence to engage in practice before the Internal Revenue Service
 - “Competent practice requires the appropriate level of knowledge, skill, thoroughness, and preparation necessary for the matter for which the practitioner is engaged.”
- A practitioner may become competent by:
 - consulting with experts; and
 - studying the relevant law.

Diligence as to Accuracy

10.22 – Diligence as to Accuracy



(a) In general. A practitioner must exercise *due diligence* —

- (1) In preparing or assisting in the preparation of, approving, and filing tax returns, documents, affidavits, and other papers relating to Internal Revenue Service matters;
- (2) In determining the correctness of oral or written representations made by the practitioner to the Department of the Treasury; and
- (3) In determining the correctness of oral or written representations made by the practitioner to clients with reference to any matter administered by the Internal Revenue Service.

Relying on Information from Clients and Other Advisors



- Treas. Reg. 1.6694-1(e):
 - In general, a preparer **may rely in good faith without verification** upon information furnished by the taxpayer and other advisors.
 - **Not required to audit or verify** information.
 - However, **cannot ignore the implications** of information furnished to the tax return preparer or actually known by the tax return preparer.
 - **Must make reasonable inquiries** if the information as furnished appears to be incorrect or incomplete.
- Cir. 230, sec. 10.34(d) and AICPA Statements on Standards for Tax Services (SSTS) No. 2.3 have essentially the same standards.

Incomplete Information and Estimates and Reconstructive Methods

- IRS and the Court allow the use of estimates of some business expenses under the “Cohan rule” set out in *Cohan v. Comm’r*, 39 F.2d 540 (2d Cir. 1930).
- Note that some expenses have to be specifically substantiated, such as travel and entertainment.
- Look to IRS Audit Guides for methods of reconstructing income and expenses.
- <https://www.irs.gov/businesses/small-businesses-self-employed/audit-techniques-guides-atgs#R>
 - Examples –
 - Artists and Entertainers: <https://www.irs.gov/pub/irs-pdf/p5774.pdf>
 - Attorneys: <https://www.irs.gov/pub/irs-pdf/p5602.pdf>

Incomplete Information and Estimates and Reconstructive Methods

Unless prohibited by statute, administrative rule, or judicial holdings, may use taxpayer's estimate if:

- Not practical to obtain exact data, and
- You determine estimate is reasonable

Do not imply greater accuracy than exists

SSTS No.2.4

Standards for Tax Positions

10.34(a) – Standards with Respect to Tax Returns



- (1) A practitioner may not willfully, recklessly, or through gross incompetence—
 - (i) Sign a tax return or claim for refund that the practitioner knows or reasonably should know contains a position that—
 - (A) Lacks a reasonable basis;
 - (B) Is an unreasonable position as described in section 6694(a)(2); or
 - (C) Is a willful attempted by the practitioner to understate the liability for tax or a reckless or intentional disregard of rules or regulations by the practitioner as described in section 6694(b)(2).
 - (ii) Advise a client to take a position on tax return or claim for refund . . . that—
 - (A) Lacks a reasonable basis;
 - (B) Is an unreasonable position as described in section 6694(a)(2); or
 - (C) Is a willful attempt by the practitioner to understate the liability for tax or a reckless or intentional disregard of rules or regulations . . . as described in section 6694(b)(2).

Standards for Tax Return Positions



- Cir. 10.34 follows standards stated in IRC 6694 for tax preparer penalties.
- IRC 6694 has same standards as for substantial understatement penalties in IRC 6662 for taxpayers.
- SSTS No. 2.1 – In recommending a return position, a CPA must comply with the standards of the applicable taxing authority (e.g., IRC 6694 and Cir. 230 10.34)

Breaking Down the Standards

A tax return position for a non-tax shelter item must be:

1. Supported by substantial authority or;
2. Supported by a reasonable basis and be adequately disclosed.

Substantial Authority

Substantial Authority is defined in Treas. Reg. 1.6662-4(d)

- Objective standard involving application of the law to the relevant facts.
- The standard is lower than the “more likely than not” standard but higher than the “reasonable basis” standard (shown in later slide).
- A return position that is arguable but unlikely to prevail in court satisfies the reasonable basis standard but not the substantial authority standard.

Substantial Authority (cont.)

There is substantial authority only if the weight of authority supporting the tax treatment is substantial in relation to the weight of authority supporting a contrary treatment.

The weight accorded to an authority depends on its relevance, persuasiveness, and the type of document providing the authority.

Only the authorities listed in Treas. Reg. 1.6662-4(d)(3)(iii) may be considered.

- Includes authorities such as the Internal Revenue Code, temporary and final regulations, revenue rulings and procedures, treaties, cases, congressional intent as reflected in congressional history, private letter rulings, technical advice memos, action on decisions and general counsel memos, IRS notices, announcement and press releases.
- Conclusions reached in treatises, legal periodicals and legal opinions rendered by tax professionals are not authority, but the authorities underlying such expressions of opinion may give rise to substantial authority.

Reasonable Basis

- A position that has a **reasonable basis** is not negligent.
- If a return position is reasonably based on one or more of the authorities used for the substantial authority standard, then the position has a reasonable basis.
 - Objective standard; does not depend on the taxpayer's state of mind.
 - Reasonable basis is a relatively high standard of tax reporting that is significantly higher than “not frivolous” or “not patently improper.”
 - The reasonable basis standard is not satisfied by a return position that is merely arguable or that is merely a colorable claim.

Treas. Reg. 1.6662-3(b).

Adequate Disclosure

- Adequate Disclosure - Treas. Reg. 1.6662-4(f)
 - Form 8275 or 8275-R
 - Special rules via Rev. Proc. 2024-44
 - Schedule UTP

Disclosure Statement

Do not use this form to disclose items or positions that are contrary to Treasury regulations. Instead, use Form 8275-R, Regulation Disclosure Statement.
▶ Information about Form 8275 and its separate instructions is at www.irs.gov/form8275.
▶ Attach to your tax return.

Name(s) shown on return

Identifying number shown on return

If Form 8275 relates to an information return for a foreign entity (for example, Form 5471), enter:

Name of foreign entity ▶

Employer identification number, if any ▶

Reference ID number (see instructions) ▶

Part I General Information (see instructions)

(a) Rev. Rul., Rev. Proc., etc.	(b) Item or Group of Items	(c) Detailed Description of Items	(d) Form or Schedule	(e) Line No.	(f) Amount
1					
2					
3					
4					
5					
6					

Part II Detailed Explanation (see instructions)

1 _____

2 _____

3 _____

4 _____

5 _____

6 _____

Part III Information About Pass-Through Entity. To be completed by partners, shareholders, beneficiaries, or residual interest holders.

Complete this part only if you are making adequate disclosure for a pass-through item.

Note: A pass-through entity is a partnership, S corporation, estate, trust, regulated investment company (RIC), real estate investment trust (REIT), or real estate mortgage investment conduit (REMIC).

Don't Play the Audit Lottery

Circular 230, § 10.37(a)(2)(vi)

The Practitioner must not, "in evaluating a Federal tax matter, take into account the possibility that a tax return will not be audited or that a matter will not be raised on audit."

SSTS No. 2.1.8

A member should not recommend a tax return position or prepare or sign a tax return reflecting a position that the member knows:

- Exploits the audit selection process of a taxing authority; or
- Serves as a mere arguing position advanced solely to obtain leverage in a negotiation with a taxing authority.

Knowledge of a Client's Error or Omission

Current Circular 230 10.21

Knowledge of a Client's Omission

- A practitioner who, having been retained by a client with respect to a matter administered by the Internal Revenue Service, knows that the client has not complied with the revenue laws of the United States or has made an error in or omission from any return, document, affidavit, or other paper which the client submitted or executed under the revenue laws of the United States, must advise the client promptly of the fact of such noncompliance, error, or omission.
- **The practitioner must advise the client of the consequences as provided under the Code and regulations of such noncompliance, error, or omission.**

Proposed Amendment to Circular 230

10.21 Knowledge of a Client's Omission

When a practitioner, while representing a client before the IRS, knows that the client, the practitioner, or another practitioner, has failed to comply with the law, or has made an error or omission with respect to any return or other document executed in connection with the internal revenue laws, the practitioner:

Proposed Amendment to Circular 230

10.21 Knowledge of a Client's Omission

- (i) must advise the client of the existence and consequences of the error under the tax law;
- (ii) must recommend that corrective action, such as disclosure, be taken;
- (iii) should request the client's agreement to disclose the error;
- (iv) must take reasonable steps to ensure that the error is not repeated in subsequent submissions; and
- (v) should consider withdrawal if the client does not agree to disclose the error.

Taxpayer's Options

- Do nothing
- File an amended return
- File a Qualified Amended Return
- Make a Voluntary Disclosure

Amended Return?

- No Internal Revenue Code provision, Regulation, or caselaw requirement to file amended returns
 - In *Badaracco v. Comm’r*, 464 U.S. 386 (1984): “[t]he Internal Revenue Code does not explicitly provide either for a taxpayer's filing, or for the Commissioner's acceptance, of an amended return; instead, an amended return is a creature of administrative origin and grace.”
- Qualified Amended Return
 - A QAR is an amended return that corrects an error in a previously filed tax return before the IRS contacts the taxpayer about that return.
 - It is a defense to substantial understatement penalties under IRC 6662.
 - In order to be a QAR, the taxpayer must file the amended return before he or she is first contacted by the IRS about an examination (including a criminal investigation) of the return at issue, and before the IRS contacts a passthrough entity of which the taxpayer is a partner or a member about an audit of its return, or the taxpayer is subject to a John Doe summons. Treas. Reg. 6664-2(c)(3)(i).

Voluntary Disclosure?

- IRS Voluntary Disclosure Practice

“The Voluntary Disclosure Practice is a longstanding practice of IRS Criminal Investigation (CI). CI takes timely, accurate, and complete voluntary disclosures under consideration when determining whether to recommend criminal prosecution. A voluntary disclosure will not automatically guarantee immunity from prosecution; however, a voluntary disclosure may result in prosecution not being recommended.”

<https://www.irs.gov/compliance/criminal-investigation/irs-criminal-investigation-voluntary-disclosure-practice>

Note: The IRS is in the process of revising its Voluntary Disclosure Practice .

Working with Incomplete Information

Cir. 230, 10.36(b) – Procedures to Ensure Compliance

- Any practitioner who has (or practitioners who have or share) principal authority and responsibility for overseeing a firm's practice of preparing tax returns, claims for refunds, or other documents for submission to the Internal Revenue Service must take reasonable steps to ensure that the firm has adequate procedures in effect for all members, associates, and employees for purposes of complying with Circular 230.
- Any practitioner who has (or practitioners who have or share) this principal authority will be subject to discipline for failing to comply with the requirements of this paragraph if– (see subparts in regs).

Thank You!