

1 Chapter

The Role of a Tax Consultant

Everything today is taxes. . . . What better seat on the grandstand of life can I offer you than that of tax counsel? . . . Who is the figure behind every great man, the individual who knows his ultimate secrets? A father confessor? Hell no, the tax expert.

—Louis Auchincloss

DISCOVERING OPPORTUNITIES FOR CLIENTS

It was 1980. I was a lowly staff accountant with one of the Big Eight (now Big Five) certified public accounting (CPA) firms in Denver. One day the tax partner came by my cubicle and invited me to lunch. He said he had a client he wanted me to meet. On the way to the restaurant I learned that the person we were to have lunch with was the multimillionaire owner of a local cable TV company. I will call him Mr. X. I also learned that I would



Big Five: Through mergers of the Big Eight, the five largest international CPA firms are now PricewaterhouseCoopers, KPMG, Arthur Andersen, Deloitte & Touche, and Ernst & Young. These are the premier employers for young CPAs entering public practice.

be preparing Mr. and Mrs. X's tax return that year and handling any tax planning needs they might have.

This news made my mouth go dry. Our firm did the audit for Mr. X's cable company, and I had heard about Mr. X from one of the auditors. Word had it that he was so aloof that none of the audit staff had ever seen him. The audit partner on the job dealt with the company's chief financial officer but never Mr. X. It seemed to me that someone so rich, powerful, and haughty would be difficult to work with.

We met Mr. X and Mrs. X at an upscale restaurant. I was surprised to discover that they were both charming and we hit it off. Mr. X did not talk to auditors because he had no interest in auditing. He did, however, have an interest in taxes and liked to talk about taxes a lot. After that day, my audit friends became quite jealous when Mr. X would call me in my little cubicle and talk for long periods. The audit partner in the big corner office was not even allowed to meet him.



Auditors: Those certified public accountants in public practice who audit the books of clients and issue reports to attest the fairness of financial statements. Tax and audit are the two major umbrellas in the public accounting profession.

I did some pretty routine tax planning for Mr. and Mrs. X and showed them how to save a bundle of taxes on their investment transactions. For this Mr. X was very grateful. It was a rush for me. I was making \$19,000 a year then. Mr. X had more than that withheld from his biweekly paycheck to pay his taxes. It was fun to have this wealthy business owner look to me for advice and counsel.



I was the personal tax advisor for Mr. X, who had more money withheld from his biweekly paycheck to pay his taxes than I made in an entire year.

Today I am a tax educator. For several years I have been the coordinator of a volunteer income tax assistance (VITA) site on the University of Minnesota campus to help international students and scholars. In this position I often get inquiries about taxes from nonresidents. Last week I got

an e-mail from a desperate international student from the Czech Republic whom I have never met. She had prepared her return herself and instead of getting the \$300 refund she had expected, she got a bill from the IRS for \$500. She was not living in my area but had heard about me from a friend and wondered if I could help.



Internal Revenue Service (IRS): The federal administration and enforcement agency of the U.S. tax system.

I asked her to fax me her tax return and the letter from the IRS. It turned out the IRS was correct—she had screwed up the return. I asked her a few questions, though, and found that she was eligible for a \$5,000 exemption that she was unaware of (and that the IRS failed to tell her about), under the U.S./Czech tax treaty. Instead of having to make the \$500 payment, she was still due a refund of about \$200. Her e-mail back to me said “Thank you, thank you, thank you, thank you!” She even sent me one of those Web greeting cards. Guess what it said. “Thank you!” This free advice was easy for me to do and took less than a half hour of my time, but it was just as rewarding as helping Mr. X.

This is the essence of the tax profession. You get to help individuals and businesses save money that they would otherwise have to give to the IRS. What could be more gratifying? There are many ways of doing this in various capacities. This chapter offers glimpses into the nature of the work of tax consultants and the legal environment in which they operate. It examines the typical roles played by unlicensed practitioners, enrolled agents, certified public accountants (CPAs), and tax attorneys.



The essence of the tax profession is helping individuals and businesses save money that would otherwise go to the IRS.

TAX CONSULTING VERSUS TAX COMPLIANCE

Throughout this book I use the term “consultant” interchangeably with “professional,” “practitioner,” and “advisor.” In other words, I lump together all of the services of individuals who offer their tax expertise to

clients on a fee basis. Within the industry, services are classified as tax return preparation (compliance) and tax consulting. Tax compliance is the process of reporting past transactions, while tax consulting generally involves planning for future transactions. These two functions are often intertwined, with tax professionals discovering consulting work in the process of return preparation and doing compliance work while engaged in tax consulting. Although the term “consultant” sparks a more professional and attractive image, most tax professionals, except perhaps for attorneys, begin their careers preparing tax returns. Many spend the majority of their time throughout their careers in compliance work.



Tax compliance is the process of filling out tax forms while tax consulting is advising clients on how to save taxes in future transactions.

Both compliance and consulting require the same level of technical expertise. Jay Zack, a tax partner with RSM McGladrey, Inc., said, “We believe that you learn tax consulting best by doing compliance.” The way most tax practitioners become very familiar with the rules for a particular transaction is by working through the IRS forms and instructions in order to report the transaction. Additional details might be learned by reading court cases, IRS regulations and rulings, and expert commentary. Tax consulting often draws from knowledge learned in this manner. It is extremely difficult for tax professionals to consult properly with a client in an area in which they are not familiar with the reporting requirements. Therefore, tax consulting generally grows from a tax compliance background.



Tax compliance work usually precedes tax consulting in a typical career path and teaches a tax advisor how to be a good consultant.

Small practitioners rarely get approached for consulting prior to doing compliance work for a client, unless they have established a reputation in a specialized area. Once a small practitioner gains experience and proficiency in a particular area and establishes a reputation for profi-

ciency, pure consulting opportunities become available. Most small and sole practitioners remain actively engaged in compliance throughout their careers, however, because compliance is generally the bread and butter of a small tax practice.

Still, compliance work presents the best opportunities to discover the consulting needs of a client. During the very busy tax season, getting the forms filled out and filed are the primary responsibilities of a small practitioner. In the process of doing so, the practitioner must review and analyze all of the client's financial dealings. This is the best time to take note of a client's potential consulting needs, which can be addressed later during the not-so-busy season. Like a doctor who discovers the health needs of patients during their annual physical, practitioners should be scrutinizing clients' consulting needs when they are financially naked at tax time.



Tax season: The time when most individual tax returns are filed—between January 15 and April 15. Many accountants are busy with tax return extensions and fiscal year filing deadlines throughout the year.

Ed Ryan, president of Edward M. Ryan, CPA, in Minneapolis, began his career in a two-member CPA firm doing primarily compliance work for individuals. Ed was eager to do more on the planning and business side, so he attended school at night to obtain a Master's of Business Taxation degree from the University of Minnesota's Carlson School of Management. After obtaining his master's degree, Ed started his own firm, which has grown to about 15 members.

"The fun is in the planning," said Ed, who now spends about 90 percent of his chargeable time doing consulting. "You have a target that you have to hit, but it is a lot more fun because there is a lot more reward that you are able to share with your clients. Families so often look for opportunities that will assist them in managing not only their business but their personal finances, and tax planning provides great opportunities to assist them in their financial affairs. So it is very self-fulfilling because you can see the results and they are reoccurring. It is really education. They are educating me about their family lifestyle and I am educating them about tax and planning opportunities. That is very rewarding—it's the reason you get up every day."

Working for a larger firm presents more opportunities for initial con-

sulting engagements with clients. Managers and senior managers of larger firms (those with six to 10 years of experience) sometimes spend the majority of their time on consulting engagements while at the same time supervising lower-level personnel. Partners with larger firms generally neither prepare nor review tax returns; these chores are left to lower-level personnel. Many partners in large firms are involved with tax consulting, but often only by supervising work done by managers.



In larger CPA firms, entry-level professionals do compliance work while managers and partners do consulting.

The next section provides a glimpse of the working environment of a tax professional.

FERTILE GROUNDS OF THE U.S. TAX SYSTEM

Some people think it is the IRS that determines how much we pay in federal taxes. Actually the Congress, with the consent of the President, writes federal tax laws. State tax laws are enacted by the various state governments. All federal tax laws are contained in Title 26 of the United States Code, commonly called the Internal Revenue Code (or the Code). The IRS is charged with administering, enforcing, and interpreting the Code, while state revenue departments administer state statutes. Determinations by the enforcement agencies, however, are not the final authority. A knowledgeable tax consultant is a taxpayer's best friend when faced with an IRS or state audit. Although most IRS agents are fair, honest, and ethical individuals, disagreements may arise between the IRS and taxpayers regarding both factual issues and the proper interpretation of the Code. On occasion, a taxpayer is faced with an IRS that is overbearing, abusive, or simply wrong. At such times, the advocacy of a tax professional is invaluable.



The Internal Revenue Code is the primary authority for our federal tax laws, not the IRS.

Specialization Is Essential

Our federal tax system is complex and in a continuous state of change. There are no “tax experts” in the generic sense. The Internal Revenue Code is such a vast body of law that no one person can master it all. Additionally, each state has a different set of rules to follow. That is why tax consultants are compelled to specialize in particular areas of the law or in specific industries.



A tax practitioner must specialize in a particular area of the law to truly be a tax expert.

There are those who specialize in corporate tax, in the taxation of passthrough entities, in individual tax, in the taxation of international businesses and individuals working overseas, in state and local taxation, in the taxation of estates and gifts, or in trust taxation, to name a few. Each of these areas is extensive enough to keep a person busy learning about it for an entire career.

Certain industries are subject to unique tax rules that require special knowledge. Banks and insurance companies come to mind. I once worked almost exclusively with oil and gas independent producers. Many of their transactions are so peculiar that they are not even described in the Internal Revenue Code. It was necessary to look to court decisions (called “case law”) to find the answers. That brings us to a discussion of our judicial system—another component of the tax system that requires the special skill and knowledge of a tax consultant.

Our Territorial Judicial System

In the tax world, the role of the judicial system is to settle disputes between the IRS and taxpayers that the parties were not able to resolve through negotiation. Disputes could involve either factual or legal arguments. A factual dispute might deal with whether a business expense was actually paid by the taxpayer or the value of a work of art given to a charitable organization. A legal dispute, on the other hand, involves the proper interpretation of an IRS ruling or regulation or of a particular section of the Internal Revenue Code. Judicial rulings on legal arguments provide support, for either the IRS or taxpayers, when the same issue comes up again.

Judicial rulings also create gray areas, however, because they tend to have only limited authority. Although the laws are written without regard to where taxpayers live, most of the federal appellate courts that decide tax issues have only regional jurisdiction. One appellate court is not required to follow decisions of other appellate courts. It might, therefore, rule in favor of the taxpayer, after another appellate court has ruled in favor of the IRS on the same issue involving a different taxpayer. All appellate courts must follow decisions of the Supreme Court, but the Supreme Court is often reluctant to hear tax cases, so few tax disputes are settled there.



Most tax disputes never go higher than a regional appellate court because the Supreme Court is reluctant to hear tax issues. This causes uncertainty because of the limited authority of the appellate courts.

Do Not Try This at Home

The fractured and ever-changing nature of the judicial system, along with the overwhelming complexity of the tax code, give the IRS an immense advantage when dealing directly with the typical layperson about a tax matter. To a knowledgeable tax advisor, however, these are fertile grounds, ripe with opportunities.



The IRS has an immense advantage when dealing directly with the typical layperson.

Opportunities have their limits, however. As tax consultants are advocates for taxpayers, the IRS is an advocate for the federal government. Both tax advisors and the IRS are restricted by law from becoming overzealous. Some of these rules are discussed next.

LEGAL RESPONSIBILITIES OF TAX CONSULTANTS

Besides the common-law rules relating to the relationship between a principal and an agent, strict standards must be followed when a tax

advisor is dealing with the IRS on behalf of a client. The director of practice of the IRS is responsible for enforcing the rules governing practice before the IRS. These rules are published by the government as “Treasury Department Circular 230.” Responsibilities of the director of practice include deciding who gets to practice before the IRS and conducting disciplinary proceedings relating to those who are allowed to practice.



Treasury Department Circular 230: Contains the standards that must be followed by a tax advisor in dealing with the IRS on behalf of clients.

Practice Before the Internal Revenue Service

The term “practice before the IRS,” as used in Circular 230, refers to the performance of specific activities. They include only the following duties:

- ✓ Communicating with the IRS for a taxpayer regarding the taxpayer’s rights, privileges, or liabilities under the laws and regulations administered by the IRS.
- ✓ Representing a taxpayer at conferences, hearings, or meetings with the IRS.
- ✓ Preparing and filing necessary documents with the IRS for a taxpayer.

Anything else that a tax consultant can do for a client is not within the scope of practicing before the IRS. For example, furnishing information at the request of the IRS, or appearing as a witness for the taxpayer, is not considered practicing before the IRS.

Only attorneys, certified public accountants, enrolled agents, and, for limited purposes, enrolled actuaries can practice before the IRS. Any time one of these individuals wants to represent a client, a written declaration must be filed with the IRS stating that he or she is qualified and



Only attorneys, CPAs, enrolled agents, and enrolled actuaries in good standing can practice before the IRS.

authorized to represent the client. This declaration is made on IRS Form 2848, "Power of Attorney and Declaration of Representative."¹

You cannot practice before the IRS if you have been convicted of a criminal offense under the tax laws of the United States or of any offense involving dishonesty or breach of trust. You are also banned if you are under disbarment or suspension from practicing as an attorney, CPA, public accountant, or actuary.

Also, individuals who are authorized to practice before the IRS but who do not follow the rules can be suspended or disbarred from practice by the director of practice. For example, they must not refuse to submit records or information requested by IRS agents; they must not misappropriate, or fail to promptly remit, funds received from clients for payment of taxes; and they must not knowingly give false or misleading information to the IRS in connection with an audit of a client.

Anyone who prepares a tax return for someone else and is not authorized to practice before the IRS is considered an unenrolled return preparer. An unenrolled return preparer can represent a taxpayer only before the Examination Division of the IRS and only with respect to the tax liability for the year covered by the return. An unenrolled return preparer cannot represent clients before the appeals, collection, or any other division of the IRS. Unenrolled return preparers are subject to the IRS rules of practice with respect to their limited privileges.

Civil and Criminal Penalties for Return Preparers

As indicated under the rules for practicing before the IRS, certain behavior in dealing with clients, and certain conduct toward the IRS on behalf of clients, will result in civil or criminal penalties. A penalty could result in a preparer being barred from practice before the IRS, a CPA losing his or her certification, or an attorney being disbarred. Penalties (either civil or criminal, or both) will be imposed when a tax practitioner has cheated or defrauded a client. This could result in jail time, depending on the level of deceit. A penalty might also apply when a tax preparer is simply overly aggressive on behalf of a client, although such cases are more difficult to call.



Penalties for negligent or illegal acts of tax return preparers range from a fine, to loss of license to practice, to a jail sentence.

For example, a \$1,000 penalty is imposed on a preparer for willfully attempting to understate tax on a client's tax return or reckless disregard for the rules.² This penalty cannot be imposed if the return position that the preparer has taken has a "realistic possibility of success." Therein lies the rub. A realistic possibility of success has been interpreted in regulations to mean at least a one in three chance of winning the issue in court. This standard can never be applied precisely. It is based on personal opinion given the evidence at hand.



Do not take on more than you can handle and always deal fairly with clients and the IRS, or suffer potentially dire consequences.

Carl Was a Rising Star

I happened to meet a very personable former tax professional while doing research for this book. His story is interesting and is one that all aspiring tax consultants should hear. Carl (not his real name) began his college career as a history major in a private liberal arts school. His dad, who was a doctor, had died, and Carl was unsure of what he wanted to do with his life. After his first two years of college, Carl's uncle convinced him to study accounting. He transferred to a public university that had a business school and found a mentor in the chairman of the Accounting Department, who was a CPA and an attorney. Enthralled with the world of business, Carl graduated with a degree in accounting and went straight to law school. Graduating magna cum laude, Carl had his pick of employers and went with one of the Big Eight (now Big Five) CPA firms. He passed the CPA exam, rose quickly in the firm, and became a leader in the state society of CPAs. He came to be sought after as a speaker and was asked to teach taxation part time at the local university. During this time Carl had gotten married and was raising a family. After about six years at the large firm, Carl's entrepreneurial spirit beckoned. He quit the firm and opened his own CPA practice.

Things went well for Carl's business at first—perhaps too well. Carl soon became overwhelmed and could not keep up with the volume of tax returns he was asked to file for his clients. I did not probe into why he did not hire help or turn clients over to someone else. He simply offered that the situation got out of hand, his record keeping was "lousy," and the result was a couple of tax returns not being filed at all. These were returns that had money owing rather than refunds due. So the clients sent the money to Carl, but unbeknownst to the clients, he did not send it to the IRS.

Everything was fine until a couple of years later when the business of one of Carl's clients was audited and the IRS discovered that the client had not filed a personal income tax return for that year. Things went downhill quickly for Carl after that. "The IRS had no sense of humor about this at all," he said. Carl was convicted of a criminal offense that carried a heavy fine and a two-year prison sentence. He lost his business, his license to practice law, and his CPA certificate, and his wife divorced him.



Carl lost his business, his license to practice law, his CPA certificate, and his wife.

When asked what advice he might have for someone getting started in tax consulting, Carl smiled and said the obvious: "Don't do what I did." It appears that he has learned his lesson. He has been dealing honestly with clients in an unrelated business for the past 20 years. Representing clients in tax matters can be an enjoyable enterprise, but it is also serious business. Be straightforward and up front in your business dealings and you will sleep soundly at night and be successful.



As long as I am telling stories, here is one about my Uncle Fred. It was 1960. Fred and his partner, Clinton Joerding, had just started their CPA practice and were eager for any new business. They received a call to meet with some prospective audit clients at a warehouse in South Phoenix, down by the railroad tracks. They met with several men, one of whom told Fred he expected everything to be done on the "up and up." Fred took exception to this comment and proceeded to tell him in no uncertain terms, while shaking his finger at him, that their firm did only that kind of business. He noticed that the longer he talked about it, the more nervous his partner, Clinton, seemed to get. Clinton finally ended the meeting, saying it was getting late and they should be leaving. As they drove off, the color had drained from Clinton's face and he would not talk for two blocks. When Fred asked Clinton what the problem was, he learned that he had been shaking his finger in the face of Joe Bonano, Jr., the reputed Mafia boss.

LIMITATIONS ON INTERNAL REVENUE SERVICE POWERS

We all have our own particular phobias. What scares one person silly, someone else can take in stride. Yet the one thing that strikes fear in the heart of every citizen who is required to file a tax return is the prospect of an IRS audit. Most taxpayers are not sure what to expect and are ill equipped to defeat a tax adjustment by an IRS agent. An experienced tax advisor knows the boundaries of IRS power and authority and can use this knowledge to save clients money and trepidation. Following is an example of how a skilled tax practitioner can serve a taxpayer during the unpleasant task of dealing with an IRS audit.



An experienced tax advisor saves clients money and the fear of an IRS audit.

Audit of Bubba and Bertha

Permit me to introduce Bubba and Bertha. They are imaginary clients whose quandaries, questions, and concerns I have used as examples for my introductory tax classes over the years. Leonard is their astute tax advisor. He is a self-employed CPA with about 15 years of experience.

Issues In addition to his regular job, Bubba was in a paid donor program for blood plasma. Bubba's blood type was in sufficient demand to make the needles in the arm and the weekly trips to the plasma lab worth the money. He would travel about 20 miles to and from the lab approximately once a week, and incurred about \$650 in transportation expenses during the year in question. He was also required to eat a high-protein diet to retain a proper concentration of iron, protein, and antibodies in his blood. When he went to the lab, his blood was tested for the right stuff, and if it was deficient the doctors would not allow him to give plasma that week. Bubba paid about \$800 for protein and mineral supplements during the year.



An experienced tax advisor can find deductions in unusual circumstances.

Before Leonard prepared Bubba and Bertha's return, he considered the nature of Bubba's blood activity. Leonard determined that Bubba was actively engaged in the continual and regular process of producing and selling blood plasma to the lab for profit, which qualified as a business. Leonard was aware that, generally, commuting is not deductible as a business expense, and meals are generally only deductible for entertainment or away-from-home expenses. However, Leonard found a Tax Court case that was pretty much on point. The case of *Green v. Commissioner*, 74 TC 1229 (1980) involved a taxpayer who was in essentially the same situation as Bubba, and the Tax Court allowed all of that taxpayer's claimed expenses as business deductions on Schedule C ("Profit or Loss from Business").



United States Tax Court: A federal trial court of national jurisdiction in federal tax matters. Learn about the legal system and how to find court cases in Chapter 7.

Leonard made sure that Bubba had all of the receipts and records necessary to substantiate his deductions. He then prepared Schedule C for Bubba and Bertha's return, claiming deductions for the protein and mineral supplements and the transportation. He advised Bubba and Bertha that claiming these deductions was a fairly aggressive position, even though the Tax Court supported them. Bubba asked if the deductions would increase the risk of being audited. Bertha said they did not want to have to go to court to claim a few hundred dollars in deductions. Leonard explained that although the risk was increased, their chances of audit were still quite low. "The only way to know if these deductions will be allowed is to claim them," he argued. "If you are audited, I will help you settle the matter quickly with the IRS, win or lose, without going to court." Both Bubba and Bertha agreed that they should go for the deductions.



"The only way to know if these deductions will be allowed is to claim them," Leonard argued.

The Letter About a year after their tax return was filed, Bubba and Bertha were unfortunate enough to receive one of those menacing letters

from the IRS. The letter requested that they go to the IRS office to see Chad, an IRS agent, and to bring their tax records for the year in question. Bubba called Leonard about the letter, and Leonard knew exactly what to do. Leonard had Bubba and Bertha sign a power of attorney giving Leonard the right to discuss their case with the IRS, and faxed the form to Chad. Leonard then called Chad and said that he would be representing Bubba and Bertha at the audit. Chad told Leonard that he was primarily concerned about some business expenses claimed on Bubba's Schedule C. Leonard gave Bubba and Bertha the option of going along or letting him handle it on his own. Bubba said he would like to go along. Leonard said, "That's okay, Bubba, but please allow me to do the talking. Remember, a closed mouth gathers no feet."

Meeting with the Agent Fast-forward to Leonard and Bubba sitting in Chad's office. Bubba's large posterior filled the chair in which he was sitting. Leonard was a slow-moving, lanky fellow who slumped in his chair, forcing his knees to protrude well beyond Bubba's. Chad was cordial and confident, and greeted them with a handshake before they sat down. He was a fit 30-something who seemed to enjoy his work. His desk was clean, with a computer monitor and a keyboard at one end. Chad studied Bubba and thought about chatting a little with him before they got started.

"So, Bubba, you look like a guy who likes to fish," Chad said with an inviting smile. Before Bubba could open his mouth, Leonard intervened.



Agents are trained to be chatty with their victims and encourage them to talk about themselves as much as possible. This is particularly helpful when a tax advisor does not accompany the taxpayer, and the agent believes there is a chance of discovering unclaimed income from what the taxpayer reveals. For example, the agent might ask a taxpayer if he likes to fish. The taxpayer, relieved that the agent is actually someone he can talk to, might say he loves to fish, and begin to talk about the new bass boat he has at home. The agent, who is now doing the fishing, might be wondering what other new toys the taxpayer has in his driveway and whether he has a lake cabin, and how he can afford all that stuff on a reported income of \$30,000 a year.



IRS agents are trained to encourage taxpayers to talk about themselves, in hopes of causing the taxpayer to reveal unreported income.

“I know you’re busy, Chad. I’m busy and Bubba’s busy, so let’s just talk about why you had us come down.” Chad was put on notice that he was dealing with an experienced tax advisor in Leonard. He found that his fishing expedition for unreported income was not going anywhere. Besides, he thought, he already had this guy hooked for a sizable tax adjustment. It was simply a matter of getting him on board.



An IRS fishing expedition does not work with an experienced tax advisor present.

“Fine,” said Chad, as he picked up Bubba’s Schedule C and turned to Leonard. “I’m afraid I have a problem allowing any of these business expenses at all. I don’t think what Bubba has here is a business. He is simply giving blood for some extra income, and he is claiming the cost of a high-protein diet and transportation to and from the lab as business expenses. Even if he was running a business, meals are not deductible unless you are entertaining, and commuting to and from work is not deductible. I am going to have to disallow all of these deductions.”

While Chad was talking, Leonard was busily rummaging through his briefcase looking for something, and showing Chad that he was completely unconcerned. He finally pulled out a copy of *Green v. Commissioner* and handed it to Chad. “The Tax Court says you’re wrong,” Leonard said casually as he leaned back in his chair.

Chad looked skeptically at the papers Leonard had handed him. He had not even gone to the trouble of looking for a case with these oddball facts. He had simply jotted down some cases that said business expenses must be ordinary and necessary and not personal. He read the headnote of *Green* and was surprised to find that the case was remarkably similar to Bubba’s situation. “Let me see what we have on this case,” he said to Leonard. Turning to his computer, Chad dialed up the Internet tax database to which the IRS subscribed. He checked to see if the IRS had appealed the Tax Court decision, or nonacquiesced to it, and if other opinions by different courts had followed or disagreed with *Green*. He found that the Tax Court ruling was not appealed, the IRS did not nonac-

quiesce, and a couple of other cases mentioned *Green* favorably. Chad was beginning to develop a knot in his stomach.

“It looks to me like the IRS should have nonacquiesced in the *Green* case,” he told Leonard. “Anyway, it is the position of the IRS that personal expenses, like groceries and commuting, are not ordinary and necessary business expenses.”

“Why cause all of us a lot more work and trouble when we all know what the answer is going to be in the end?” Leonard argued. “The case is on point. If I have Bubba and Bertha file a petition in the Tax Court, the IRS is going to lose again on this.” At this point Bubba began to fidget in his chair. Leonard had promised him they were not going to go to court.

“The Tax Court might see the light and change its mind,” Chad suggested. He knew the IRS would not litigate this case. But he also suspected that Bubba and Bertha were not willing to take it that far either. “I’ll tell you what. If we can agree that the protein supplements and transportation to and from the lab are not deductible, I will not bother to look at any of the rest of the return.”

“I’m afraid we’ll have to stick to our guns on this one, Chad,” said Leonard. “Frankly, I believe it is an abuse of discretion on your part not to follow relevant judicial authority. I would like to take this up with your supervisor.” He knew that the rest of Bubba’s return was clean. Had there been questionable items elsewhere on the return, Leonard might have been ready to negotiate.



When the IRS nonacquiesces to a court decision that has gone in favor of the taxpayer, it is announcing to the world that it will refuse to follow that decision as precedent. That means, regardless of the fact that it lost the case, the IRS will continue to argue the same interpretation of the law that was rejected by the court. The IRS can legally nonacquiesce to a tax decision by any court other than the Supreme Court.

Appeals Conference Unfortunately, Chad’s supervisor backed the agent up on the adjustment. They both thought that Chad’s argument was correct on the merits of the case and that *Green* was an aberration. Besides, because of the small dollar amount involved, Bubba was more likely to settle with the appeals officer than to take the case to court. Consequently, Chad wrote up the adjustment and sent Bubba and Bertha a “Notice of Proposed Deficiency,” commonly called a “30-day letter.” This notice contained a copy of the examination report explaining

Chad's proposed changes, and told Bubba and Bertha about their right to appeal the proposed changes to the IRS Appeals Office within 30 days.



Notice of Proposed Deficiency: Commonly called a 30-day letter, it details the proposed adjustment by the IRS and gives the taxpayer 30 days to schedule an appeals conference with an IRS appeals officer.

Several weeks after the notice arrived, Leonard and Bubba were sitting at the desk of the appeals officer. Leanne was a stocky woman who had been with the IRS for about 20 years and in appeals for 10 years. Leonard braced himself for battle as he slid down in his chair. He knew that he must convince Leanne that his case for Bubba's deductions was strong and that he was willing to test it in the Tax Court, even though he had promised Bubba and Bertha that their protest would end here.

"Interesting case," said Leanne, who was paging through Chad's report. "Our goal here is to settle cases so that neither of us has to spend the time and money going to court," She looked directly at Bubba and ignored Leonard.

"If the agent had been reasonable, we wouldn't even be here," Leonard chimed in with the first volley. It was not his nature to be combative, but he believed that might be the best approach with Leanne. He had warned Bubba before the meeting not to be alarmed by his tenacity with the appeals officer.

Leanne turned to Leonard with a concerned look. "The IRS does have the right to take issue with court decisions that it believes are incorrectly decided. Now, the *Green* case was decided by the Tax Court over 20 years ago, and the Tax Court has not been asked to decide a similar case since. Perhaps it's time to test this issue again in the Tax Court and see if we can get the precedent back on our side."

As he had done when Chad was trying to make a strong point, Leonard was busy fishing around for something in his briefcase during the entire time Leanne was addressing him and had not even looked at her. He finally found what he was looking for just as she finished.

"The Tax Court hasn't had this come up again because this is a pretty unusual business that Bubba is in," he said. "There has been no indication from recent cases that the Tax Court is unhappy with its ruling in *Green*, and if we went to court with this we would definitely win." Leonard sat looking at Leanne with a slight grin on his lips. The stack of papers he had pulled from his briefcase was dangling from the fingers of his right hand.

Limitations on Internal Revenue Service Powers

Leanne realized that Leonard was going for the dramatic pause effect. She asked a little impatiently, “Do you have something there to show me?”

“Oh, yes.” Leonard passed the papers over the desk. “Are you familiar with *Yapp v. Commissioner*?³ The IRS had nonacquiesced to a Tax Court decision that it had lost, then it went back in with the same argument with another taxpayer. The Tax Court judge said, ‘We told you that you were wrong before, and you’re still wrong.’” Leonard chuckled. “Then do you know what the Tax Court judge did? He told the taxpayers they should file for litigation costs under Section 7430, because this case was definitely not justified on the part of the IRS.”



Section 7430 of the Internal Revenue Code allows the awarding of court costs, attorney’s fees, and certain administrative costs to taxpayers by the government if it is determined that the IRS was not “substantially justified” in litigating an issue.

Leanne was familiar with the *Yapp* case. She was impressed with Leonard, because he was the only tax practitioner that she had faced who knew of the case. “It doesn’t look like you’re in a compromising mood,” she said. “Let me study all of this and write up my report. You should have it in a couple of weeks.”

Leanne already knew that she was going to issue a no-change report and close the file. She didn’t want to give Leonard or Bubba the satisfaction of knowing that now, though. “Let them squirm for a couple of weeks,” she thought. She believed that Bubba’s expenses should not be allowed. Nevertheless, Tax Court precedent was against her, and Leonard had demonstrated that he knew the system and the law so well that the hazards of going forward with the case were unacceptable.



Leonard demonstrated to the hearing officer that he knew the system and the law so well that the best thing for the IRS to do was to concede the adjustment.

New Customer-Oriented Internal Revenue Service

Aside from the limitations alluded to in the above example, there are many congressionally mandated controls on IRS practices and procedures.

Hearings before Congress in 1998 detailing IRS abuses resulted in the IRS Restructuring and Reform Act of 1998. This legislation expanded taxpayer protections in several areas.

One new provision permits a taxpayer to recover up to \$100,000 in civil damages arising from an IRS officer's or employee's negligent disregard of any provision of the Internal Revenue Code or of the Treasury regulations in connection with the collection of tax from the taxpayer.⁴ Additionally, a taxpayer who can prove that an IRS officer or employee has *recklessly or intentionally* disregarded the provisions of the Code or regulations can collect up to \$1 million in civil damages.

When a taxpayer encounters a problem with the IRS that results in a "significant hardship" as a consequence of a completed or pending IRS action, there are now standard procedures to get help.⁵ A taxpayer can get a release of a property lien or an order to cease any action by the IRS through the National Taxpayer Advocate. The taxpayer, or the taxpayer's tax advisor, can apply for relief by completing and filing the aptly numbered Form 911, "Application for Taxpayer Assistance Order to Relieve Hardship." For more information about the taxpayer advocate, see Chapter 9, under "Role of the Taxpayer Advocate" on page 247.

The IRS now states that its mission is to "provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all."⁶ According to the IRS commissioner, Charles Rossotti, "Our goal is to provide the easiest and most efficient ways for you to get the information, service, and assistance you need not only during the tax filing season, but throughout the year." Still, the tax advisor's role is as vital as ever, because differences of opinion will always exist between taxpayers and the IRS, however honorable the intentions of both parties. See Chapter 9 for more information on dealing with the IRS.



The IRS Restructuring and Reform Act of 1998 expanded taxpayer protection in several areas, but the tax advisor's role is as vital as ever.

VARIOUS FACES OF THE TAX CONSULTANT

The term "tax consultant" is generic, not limited to a single occupation or type of tax. The designations "unenrolled practitioner" and "enrolled

agent” are not subsets of broader fields, although such individuals might sell insurance, do bookkeeping, or provide a variety of other services as well as tax return preparation and consulting. The designation “CPA,” however, denotes a broad array of services that might be offered by such individuals. Tax consulting is just one specialization in which a CPA might be trained. Likewise, an attorney might specialize in any area of the law as well as in tax law. Additionally, although most tax consultants might share a common body of knowledge, specialization in specific areas of law or in specific industries requires special knowledge and training. Following are examples of typical services performed by tax consultants under the specific designations.

Unenrolled Tax Practitioner

An unenrolled tax practitioner is anyone who prepares tax returns for someone else and is not authorized to practice before the IRS. In most states today, people actually can become unenrolled practitioners by preparing tax returns and advising clients, even if they have not graduated from high school yet. Except for residents of California and Oregon, there are virtually no minimum education or training requirements. Continuing education is vital, however, for anyone who hopes to survive and prosper in the tax business.



Unenrolled tax practitioner: Anyone who prepares tax returns for someone else and is not authorized to practice before the IRS.

One unenrolled tax practitioner who has built a very successful practice is Bob Lindgren of Bloomington, Minnesota. Bob specializes in tax return preparation for individuals and is able to charge as much for his services as many CPAs because he has developed a reputation of competency. “The first year I started in this business I did 55 returns all season,” Bob told me. “But I spent 12 to 14 hours per day in the office. Those hours in the office, when I was not preparing returns, were spent poring over IRS publications and instructions.” Today Bob prepares over 700 returns annually. He takes great pride in finding deductions that other practitioners might miss. He can do this only because he has learned the tax rules very well. “The hard work has paid off,” he said. “Even people who don’t like me come to me to have their taxes done because they know I can save them money.”

Ben Ostfield of Property Tax Management Group Ltd. in Edina, Minnesota, is an unenrolled practitioner who works in a less conventional area of taxation. Ben saw an opportunity several years ago when real estate property values were on the decline. Ben is in the business of protesting property tax valuations for commercial real estate. “In the early 1980s commercial real estate values skyrocketed because of tax laws that were favorable to property development as tax shelters,” Ben explained. “But the 1986 Tax Reform Act put an end to that, and property values soon began to plummet. When property values were on the rise, assessed values followed suit. But when prices plummeted, assessed values tended to remain substantially higher than the cash value of the properties.” Ben said he has always been a strong negotiator, and he saw a niche to work on behalf of property owners to negotiate lower assessed values, hence lower property taxes. He did a considerable amount of research in the area, then, in 1990, began working exclusively in real estate tax reduction for commercial property owners.

Ben started by purchasing lists from local counties of properties with assessed values between \$500,000 and \$5 million. He targeted owners of properties with those values, because he believed that owners of higher-priced properties were more likely to deal with attorneys or large firms. Ben then developed a direct mailing campaign to market his services to those property owners.

Ben said, “Since my fees are simply a percentage of the tax reductions I negotiate, the first couple of years were pretty lean. But I stuck it out and have had some major successes in this business, while creating many satisfied clients. I took one guy a check for \$10,000, and he said, ‘You know, Ben, over the years I have had all kinds of people tell me how they could save me money, but you really did—you brought it to me.’” Ben is contemplating retirement now but will still have a steady stream of income for the next three years because all of his settlements have been negotiated on a three-year basis.

Being an Enrolled Agent Opens More Doors

Unlicensed practitioners are somewhat limited in the services they can perform for clients. They cannot “practice before the IRS,” which means they can only represent clients before the examination division of the IRS—not the appeals, collection, or any other division. Enrolled agents are admitted to practice before the IRS. They also have the advantage of documented tax proficiency. The designation “Enrolled Agent” is evidence that a tax professional has demonstrated technical

competence in the field of taxation. This generally translates into higher fees for services.



Enrolled agent: Currently the only nondegree designation for tax advisors that indicates proficiency in the field of taxation.

Enrolled agents are tax professionals who have been licensed by the IRS. The enrolled agent designation is earned either by passing a difficult two-day examination administered by the IRS covering major tax topics or by working for the IRS for a minimum of five years as a revenue agent.

Edward Pyle is an enrolled agent who owns the Tax Wise Shop in Bloomington, Minnesota. Ed entered the tax business full time in 1990, after what he described as “corporate cutbacks.” He decided he did not want to go the CPA route because of the time required. However, he thought professional tax credentials would help his business, so he became an enrolled agent in 1993. Ed prepares mostly individual tax returns but also has some small businesses as clients, including self-employed individuals, partnerships, and S corporations. During the off-season (between April 15 and of the end of the year), Ed manages to keep quite busy with clients who have received notices from the IRS for various reasons, new clients who have neglected to file returns, and clients needing tax planning for future transactions. Ed’s office is located in a modern strip mall on a busy street and has a large lighted sign in front saying “Tax Wise Shop,” which attracts a significant number of walk-in clients.

Various Roles of a CPA

Certified public accountants (CPAs) are qualified to audit businesses and attest to their financial well-being. They are well-respected strategic business advisors and decision makers. CPAs who specialize in taxation advise both individuals and businesses on all aspects of compliance with the tax laws.

Becoming a CPA is not a simple matter. You must meet the minimum requirements of the state in which you wish to practice. That generally means completing a program of study in accounting at a college



CPAs are qualified to work in many different capacities involving a client's financial affairs.

or university of at least 150 credit hours. You then must pass the uniform CPA Examination, which is developed and graded by the American Institute of Certified Public Accountants (AICPA). This rigorous two-day exam consists of four sections: Business Law and Professional Responsibilities; Auditing; Accounting and Reporting—Taxation, Managerial, Governmental and Not-for-Profit Organizations; and Financial Accounting and Reporting—Business Enterprises.



To become a CPA, you must complete 150 hours of college course work and pass a rigorous two-day exam.

Rita Benassi is a CPA with the international accounting firm of Deloitte & Touche. She came up through the ranks in the tax department of the Minneapolis office and has been a partner for several years. Rita is a generalist in corporate tax and often acts as a quarterback when bringing teams of corporate tax specialists together for a project.

“I have loved this job from the day I started,” said Rita. “I have a real passion for it. There is a lot of authority and responsibility. When I am really busy and under stress and the adrenaline is pumping—that is a real rush for me. “I think it's a very powerful position to be able to advise, in my case, from a corporate tax perspective, some of the top companies in the world.”

Law Degree Provides Many Options

The broad-based education and training of attorneys gives them the basic tools to work in any area of legal, business, or financial consulting. Law school preparation is general rather than vocational, however. To obtain on-the-job training in taxation, many attorneys begin their careers in the tax department of a CPA firm. Some go on to law firms to specialize in a particular area of taxation or to practice litigation, or they go into private industry. Others, however, stay with a CPA firm after learning that the work there is similar to what they would do in a

law firm. Many attorneys who wish to specialize in taxation obtain an advanced degree in taxation, either an LLM (master of laws) in taxation from a law school or a master's in taxation degree from a business school.



Many attorneys specializing in taxation begin their careers with a CPA firm to gain tax experience. Some remain with CPA firms while others go on to practice law.

E. Burke Hinds is an attorney practicing in estate planning for the law firm of Messerli & Kramer, P.A., in Minneapolis. Burke determined early that he had a facility for numbers, so he went to business school at the University of Nebraska to get a degree in accounting. He was fascinated by a senior tax course that he took and decided to concentrate in taxation. Burke took the CPA exam while finishing his undergraduate degree and passed all four parts, then went on to law school. When Burke was looking around for a summer clerking position after his first year in law school, he got an opportunity to work as an intern for a large CPA firm, which happened to pay much more than a clerking position. After law school he accepted a position with the CPA firm and was exposed to various areas of taxation. After a couple of years with the CPA firm, Burke moved to a law firm to specialize in estate planning. "As my clients grew, my estate planning sophistication grew," Burke told me, "largely because of a mentor who urged me to get additional training in the area. That's how my practice has grown over time. So now I market myself to entrepreneurs who are high-net-worth individuals." Burke's clients generally have a net worth between \$10 million and \$200 million.

When asked what he likes about his work, Burke said that trying to work through family-type issues in order to achieve estate-planning objectives can be a fascinating process. "This [family conflicts] is one of the strongest reasons why individuals do not do the estate planning that they should," said Burke. "It has nothing to do with the money, it is the psychological background." Burke also enjoys the puzzle making involved in putting incredibly diverse pieces together into a consolidated whole. His sophisticated practice is tailored to specific situations. "The diversity in the estate planning area is interesting because you play off the gift tax against the estate tax against the fiduciary tax against both the corporate

and individual income tax,” Burke explained, “and this draws on my broad-based background.”

CONCLUSION

The field of tax advising is a growing and vital component of the U.S. economy. Tax professionals are in high demand. Of course, just about everyone is in high demand in today's economy. What are the chances that things will change? Could the industry be destroyed by an act of Congress that repeals the income tax and shuts down the IRS? How likely is that to happen? Of course, no one knows for certain what the future holds, but Chapter 2 provides insight into the future of the tax industry, and the prospects for basic tax reform, by examining the past.