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Austin, Texas**Avoiding Tax Malpractice****Kip Dellinger, CPA**Author Contact Information:
Kip Dellinger
Cooper Moss Resnick Klein & Co. LLP
Sherman Oaks, Californiakip@cmrkcpa.com
818.728.98698

Avoiding Malpractice in Tax Engagements

Malpractice claims and lawsuits against tax attorneys and certified public accountants are a painful fact of life in today's litigious society and they come at tax professionals in various sizes and shapes.

The Nature of Malpractice Claims

While there are any variety of types of malpractice cases, this writer's experience is that they generally split into two major categories: (1) breach of duties arising from administrative or ministerial obligations to plaintiffs or (2) breach of standard care of substantive obligations to clients – mainly related to providing erroneous tax advice or a failure to provide critical tax advice, or breach of an ethical obligation to the plaintiff such as failure to identify and address conflicts of interest.

Claims can arise in any of the *three major activities of attorneys and CPAs in the tax arena*, that is (1) compliance (generally the preparation of tax returns), (2) representation of taxpayers in controversy before federal, state, foreign and local tax authorities, and (3) providing tax planning advice to taxpayers.

In everyday tax practice, the preponderance of malpractice claims against CPAs are generally broader in scope than those against attorneys and include a far larger number of claims related to administrative or ministerial malpractice. This is largely a result of the fact that CPAs undertake preparation of 'more complicated, high income-large net worth taxpayers and business tax returns, where attorneys generally function in a consultative, transactions advisory practice or in significant tax controversy matters. Obviously, there are millions of income tax returns filed every year, but substantially fewer situations where attorneys provide advice. Nonetheless, attorneys are sometimes subject to similar claims.

The administrative-ministerial malpractice claims arena usually includes claims such as:

- Late filing of returns, including late amended returns (for attorneys it's often improper advice in advising clients of due dates or filing obligations; for the CPA, it is likely to include oversight in scheduling the scheduling of returns)
- Failure to make timely extensions
- Failure to make timely elections (CPAs are generally confronted with any number of elections that may be required and overlooked, attorneys usually face these issues when preparing or advising on estate and gift tax returns)
- Failure to advise on foreign disclosure requirements (for CPAs – often the 'gatekeeper' for advising on client disclosure – this area is full of malpractice landmines).

Substantive malpractice claims generally arise from:

- Incorrect or incomplete tax advice in a given matter requested by a client (for CPAs this includes the analysis attendant to the mere placement of items on a tax return; attorneys more commonly advise clients on requested transactional items and do so in writing)
- Improper tax planning advice
- Failing to provide tax advice that client believes should have been provided. For example, attorney estate planners not recommending certain well known estate planning techniques employed to reduce estate taxes such as a family limited partnership. Or, for CPAs, the failure to advise properly a client with regard to alternative entity structures or to utilize available tax credits or other tax benefit opportunities such as cost segregation in the income tax arena.
- Failing to properly advise a client about potential penalties that may apply in certain circumstances where aggressive tax strategies are undertaken.
- Ethical breaches such as failure to appropriately address conflicts of interest (attorneys are generally attuned to recognize and deal with conflict situations, and do deal with them regularly as advisers on transactional matters; CPAs often overlook potential conflicts that arise during the course of services to clients that often include providing tax return and advisory services to entities and multiple owners, or fiduciaries and grantors and beneficiaries and married couples)

In addition, the CPA is confronted with practice issues particular to the nature of their services and their profession license that may give rise to damages to a client and result in a malpractice claim

- Unauthorized practice of law: a CPA is not a lawyer. While it has generally long been recognized that a CPA may advise clients on matters of federal tax law (tacitly acknowledged by the permission granted to 'practice' before the Treasury in U.S. Code Section 330 and pursuant the regulations in Treasury Dept. Circular 230), the CPA often oversteps his bounds by interpreting non-tax law to enable him to form a conclusion with regard to the application of tax law (for example, making community v. separate property determinations, or interpreting partnership law or estate, gift and trust law under state provisions).
- Damaging a client by failing to realize that most, if not virtually all, communications with a client do not fall under either attorney-client, the statutory Internal Revenue Code Section 7525, or work-product privilege and are not protected by discovery from the government. Most CPAs are unaware that communications with and the related

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