

superfastCPA

REG REVIEW NOTES

2026

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How to Use These Review Notes:

The best way to use these review notes is in the following ways:

1. Read from these review notes as a part of your mini sessions each day. Switch between reading a few pages of these notes and taking quizzes on the SuperfastCPA app. Doing this multiple times a day will get you through the notes at least a couple or more times throughout your study process.
2. When doing your 2-hour main study session each day, before starting a new section or topic, find that topic in these review notes and read through it to get a base understanding of what you are about to study. This doesn't need to be a deep read, just a primer to get you started.
3. Read through these review notes all the way through at least 2-3 times in the two days of your 48-hour cram session before your exam.

AICPA Blueprints and “Representative Tasks”

We have made these review notes to mirror the AICPA blueprints.

You will notice that each section says one of the following:

Remembering and Understanding, Application, Analysis, or Evaluation (Evaluation will only be on the Audit exam).

- If a section says Remembering and Understanding, that means it will almost certainly be tested as a Multiple Choice Question if it is tested.
- If a section says Application, that means it could be tested as either a Multiple Choice Question or a Simulation.
- If a section says either Analysis or Evaluation (for Audit only), it will almost certainly be tested as a Simulation.

A Note on Year-Specific Tax Figures

One thing that's very helpful for you to know, is that with all the year-specific tax figures, such as deduction amounts, credit amounts, phase-outs, and income ranges, etc, is that the AICPA doesn't expect you to memorize all these figures.

What they want to see is that you know **how** to apply the deduction or credit. Therefore, the specific figures will almost always be given to you in the problem itself.

Here's a direct quote from the AICPA Blueprints for REG:

“Candidates will not be tested on their knowledge of specific tax rate percentages, amounts or limitations that are indexed to inflation. Absent any stated assumptions, candidates should assume that transactions or events referenced in the question occurred in the current year and should apply the most recent provisions of the tax law in accordance with the timing specified in the CPA Exam Policy on New Pronouncements.”

Area I – Ethics, Professional Responsibilities and Federal Tax Procedures

A. Ethics and Responsibilities in Tax Practice

1. Regulations Governing Practice Before the Internal Revenue Service


Remembering and Understanding: Recall the regulations governing practice before the Internal Revenue Service.

Circular 230 provides the core rules for anyone authorized to represent taxpayers before the IRS. It explains who may practice and the standards practitioners must follow when preparing returns, giving advice, and communicating with the IRS.

1. Who May Practice Before the IRS:

A limited group of professionals may represent taxpayers in IRS matters.

- CPAs, attorneys, and enrolled agents: These individuals have full practice rights and may represent taxpayers in all stages of IRS proceedings.
- Other qualified individuals: Certain persons, such as enrolled actuaries or qualifying return preparers, may have restricted practice rights tied to their specific role.

 **Key Tip:** Full practice rights mean unrestricted representation in audits, appeals, and collections.

2. Core Duties and Standards of Conduct:

Authorized practitioners are expected to act with competence, accuracy, and sound judgment.

- **Competence:** A practitioner must have the knowledge and preparation needed for the specific matter before the IRS.
- **Diligence:** Practitioners must be thorough in preparing documents and making statements. They should verify facts when something appears inconsistent or incomplete.
- **Accuracy in representations:** Practitioners must ensure that statements made to clients and the IRS are correct and supported by reasonable inquiry.

3. Timeliness and Professional Responsibility:


Practitioners must handle IRS matters responsibly and without delay.

- **Prompt handling:** They must act without causing unnecessary delays in any stage of a matter.
- **Use of disbarred or suspended individuals:** Practitioners cannot assist someone who has lost the right to practice before the IRS in a way that allows them to participate indirectly.
- **Dual roles:** A practitioner who is also a notary may not notarize documents for clients in matters they are handling before the IRS.

4. Fees and Return of Client Records:

Circular 230 places strict expectations on how practitioners manage fees and client documents.

- Reasonable fees: Fees must be fair and appropriate for the services provided.
- Restrictions on contingent fees: Contingent fees are generally prohibited for preparing returns and refund claims, with only narrow exceptions.
- Client records: Practitioners must return client records upon request and cannot withhold them because of payment disputes. They may retain their own workpapers but not client-provided materials.

 **Key Tip:** Workpapers belong to the practitioner, but original client records must be returned immediately when requested.

5. Conflicts of Interest:

A conflict exists when the practitioner's ability to serve one client could be limited by obligations to another.

- Disclosure and consent: The practitioner may proceed only if they reasonably believe they can represent each client competently and each affected client provides informed written consent.
- Withdrawal: If a conflict cannot be resolved properly, the practitioner must discontinue representation for one or more clients.

6. Advertising, Solicitation, and Compensation:

Practitioners must communicate honestly with the public and avoid improper financial arrangements.

- Truthful advertising: All marketing and solicitation must be accurate and not misleading about qualifications, services, or fees.
- No hidden compensation: Practitioners may not receive undisclosed referral fees or commissions.
- Handling of refund checks: Practitioners may not endorse, deposit, or cash a client's refund check under any circumstances.

7. Standards for Advising Clients:

Tax advice must reflect careful evaluation and sound judgment.

- Reasonable assumptions: Advice must be based on factual and legal assumptions that are reasonable.
- Complete consideration of facts: Practitioners cannot rely solely on unsupported client statements and must consider all relevant information.
- Balanced legal analysis: Advice should apply the law fairly and should not ignore key authorities.

8. Standards for Preparing Returns:

Practitioners must avoid actions that would create improperly low tax liabilities or misrepresent taxpayer information.

- Reasonable basis for positions: Practitioners may not sign or prepare a return containing a position that lacks a reasonable basis in fact or law.
- No reckless behavior: Willful, reckless, or grossly negligent preparation is prohibited.
- Responsible judgment: Every position must reflect proper evaluation of the law and accurate application of the facts.

Application: Apply the regulations governing practice before the Internal Revenue Service given a specific scenario.

These scenarios illustrate how practitioners should apply the standards of conduct required under Circular 230. Each situation reflects a realistic issue a practitioner might face, along with the action they should take to remain compliant with IRS practice rules.

1. Correcting Errors in Previously Filed Returns:

When a practitioner discovers a material error in a previously prepared return, they must inform the client promptly and recommend a proper correction.

Example: *A CPA notices that last year's return mistakenly omitted \$8,000 of income. The CPA should inform the client, recommend filing an amended return, and correct the error without charging additional fees for the CPA's own oversight.*

2. Prohibited Fee Arrangements:

Practitioners may not charge fees based on the size of a refund or the outcome of a tax position unless a narrow exception applies.

Example: *A client offers to pay the CPA 10% of their refund instead of a normal fee. The CPA must decline and instead charge a reasonable fee based on the work performed.*

3. Returning Client Records Upon Request:

Client records must be returned promptly when requested, even if there is an outstanding balance.

Example: *A client asks for all documents used for their return preparation, but still owes the CPA money. The CPA must return the records immediately and handle the payment issue separately.*

4. Identifying and Managing Conflicts of Interest:

When circumstances create competing interests between clients, the practitioner must handle the conflict properly.

Example: *A CPA represents two shareholders in a corporation who are now disputing how profits should be allocated. The CPA must disclose the conflict to both parties and obtain informed written consent from each before continuing.*

5. Misleading or Improper Advertising:

All advertising must be truthful and non-deceptive.

Example: *A CPA runs an advertisement that claims “Guaranteed Maximum Refund.” The CPA must remove or correct the advertisement because guarantees of outcomes are misleading and prohibited.*

6. Unsupported or Improper Tax Positions:

Practitioners may not prepare or sign returns containing positions that lack a reasonable basis.

Example: *A client wants to claim personal vacations as business expenses. The CPA must refuse and explain why such a position is improper and potentially harmful.*

7. Prohibited Referral Fees or Undisclosed Commissions:

Compensation arrangements must be transparent and permitted under Circular 230.

Example: *A financial advisor offers the CPA a commission for referring clients to a specific investment. The CPA must decline because undisclosed referral fees are prohibited.*

8. Discovering Prior Noncompliance by Another Preparer:

If a practitioner finds a compliance issue in a return prepared by someone else, they must inform the client and advise on corrective steps.

Example: *A CPA reviewing a new client's prior return finds an improper credit claim. The CPA must tell the client and recommend filing an amended return.*

9. Requests for False or Misleading Testimony:

Practitioners must be truthful in all statements to the IRS and other authorities.

Example: *A client pressures the CPA to "embellish" facts during an IRS appeals conference. The CPA must decline and provide only accurate, factual information.*

10. Notary Limitations When Acting as a Practitioner:

A practitioner who is also a notary cannot notarize documents for a matter they are handling before the IRS.

Example: *A CPA representing a client in an audit is asked to notarize supporting documents. The CPA must decline and direct the client to another notary.*

11. Verifying Suspicious IRS Communications:

Practitioners must exercise care before sharing client information.

Example: *A CPA receives a suspicious email requesting detailed taxpayer records. The CPA must verify the request directly with the IRS before providing anything.*

12. Handling Suspicious or Altered Documents from Clients:

Practitioners cannot rely on documents that appear false or manipulated.

Example: *A client brings receipts that appear altered and insists they be used. The CPA must refuse to use them and explain the legal risks of submitting fraudulent information.*

13. Addressing Colleague Misconduct:

Practitioners must not assist or ignore conduct that violates Circular 230.

Example: *A CPA notices a colleague endorsing clients' refund checks. The CPA must take appropriate internal action to stop the misconduct and avoid involvement.*

14. Correcting Firm-Wide Recurring Errors:

When a practitioner discovers a pattern of errors affecting multiple clients, they must take corrective action.

Example: A CPA finds that several returns prepared by the firm misreported basis calculations. The CPA must inform affected clients and correct the returns without charging for the firm's errors.

15. Applying the Rules on Prompt Handling of IRS Matters:

Practitioners may not unnecessarily delay the progression of an IRS matter.

Example: An IRS agent requests documentation within 30 days, and the CPA receives the documents from the client within a week. Waiting an additional month to respond without a valid reason would violate the timeliness requirement.

16. Prohibited Assistance to Suspended or Disbarred Individuals:

A practitioner may not enable a suspended or disbarred individual to practice indirectly.

Example: A suspended preparer drafts a protest letter and asks the CPA to sign it. The CPA must refuse and avoid any assistance that effectively allows the suspended person to practice.

17. Responsibly Handling Questionable Client Requests:

Practitioners must refuse involvement in fraudulent or intentionally misleading tax behavior.

Example: A client admits they plan to omit offshore income. The CPA must strongly advise them against it and withdraw from representation if the client insists.

2. Internal Revenue Code and Regulations Related to Tax Return Preparers

Remembering and Understanding: Recall who is a tax return preparer.

1. Who Is a Tax Return Preparer:

A tax return preparer is any person who prepares a tax return or claim for refund for compensation, or who employs others to prepare one for compensation. The key element is payment. Someone who helps without receiving compensation is not considered a tax return preparer under this definition.

- A practitioner such as a CPA, attorney, or enrolled agent becomes a tax return preparer when they prepare returns for compensation.
- Not all tax return preparers are practitioners. Some preparers may prepare returns for compensation but do not have the authority to represent taxpayers before the IRS.

2. Individuals Not Considered Tax Return Preparers:

Certain people are excluded from the definition because they do not exercise judgment in tax matters.

- Individuals who provide only typing, data entry, reproduction, or other mechanical assistance are not treated as tax return preparers.
- Someone who gives general tax information without preparing a specific return is also not considered a preparer.

3. Requirements for Tax Return Preparers:

Anyone who meets the definition must comply with IRS requirements and basic professional standards.

- Preparers must register with the IRS and obtain a Preparer Tax Identification Number (PTIN) before preparing returns for compensation.
- Preparers are subject to ethical and due diligence rules, including accuracy, confidentiality of taxpayer information, and compliance with other regulations that apply to tax return preparation.

Remembering and Understanding: Recall situations that would result in tax return preparer penalties, and Application: Apply potential tax return preparer penalties given a specific scenario.

These scenarios outline common situations that trigger tax return preparer (TRP) penalties and show how the penalty rules apply in practice. They reflect the core requirements under the Internal Revenue Code and Circular 230.

1. Knowingly Understating a Taxpayer's Liability:

A tax return preparer who knowingly claims improper deductions or credits is subject to penalty.

- Penalty: The greater of \$1,000 or 50% of the income earned from preparing the return. If the understatement is willful or reckless, the penalty increases to the greater of \$5,000 or 75% of the income earned.

2. Failure to Furnish a Copy of the Return to the Taxpayer:

A preparer must provide the taxpayer with a copy of the return or refund claim.

- 2024 Penalty: \$60 for each failure, up to \$30,000 per year.
- 2025 Penalty: \$60 for each failure, up to \$31,500 per year.

3. Failure to Sign a Tax Return or Claim for Refund:

A preparer must sign each return they prepare.

- 2024 Penalty: \$60 for each unsigned return, up to \$30,000 per year.
- 2025 Penalty: \$60 for each unsigned return, up to \$31,500 per year.

4. Failure to Include the Preparer Tax Identification Number (PTIN):

A preparer must place their PTIN on the return or claim.

- 2024 Penalty: \$60 for each omission, up to \$30,000 per year.
- 2025 Penalty: \$60 for each omission, up to \$31,500 per year.

5. Failure to Retain a Copy or List of Prepared Returns:

Preparers must retain either a copy or a list of returns they prepare.

- 2024 Penalty: \$60 for each failure to retain, up to \$30,000 per year.
- 2025 Penalty: \$60 for each failure to retain, up to \$31,500 per year.

6. Failure to File Required Information Returns:

Preparers must file required information returns relating to their preparation activity.

- 2024 Penalty: \$60 for each incorrect or missing filing, up to \$30,000 per year.
- 2025 Penalty: \$60 for each incorrect or missing filing, up to \$31,500 per year.

7. Improper Endorsement or Negotiation of a Taxpayer's Refund Check:

A preparer may not endorse or deposit a taxpayer's refund check.

- 2024 Penalty: \$600 for each improper endorsement.
- 2025 Penalty: \$635 for each improper endorsement.

8. Lack of Due Diligence for Certain Credits and Filing Status:

Preparers must exercise due diligence for Head of Household filing status and certain refundable or partially refundable credits.

- 2024 Penalty: \$600 for each due diligence failure.
- 2025 Penalty: \$635 for each due diligence failure.

9. Promoting Abusive Tax Shelters:

Individuals who organize or sell abusive tax shelters face significant penalties.

- Penalty: For false statements about tax benefits, 50% of the gross income derived. For gross valuation overstatements, the lesser of \$1,000 or 100% of the gross income derived, applied per entity or arrangement and per sale.

10. Assisting in Understating Tax Liability:

Anyone who aids or assists in understating tax liability can be penalized.

- Penalty: \$1,000 for individual returns and \$10,000 for corporate returns. Only one penalty applies per taxpayer per tax period.

11. Unauthorized Disclosure or Use of Tax Return Information (Post–July 1, 2019):

Tax return information must be used only to prepare that return.

- Penalty: \$250 per unauthorized disclosure or use, capped at \$10,000 per year. If connected to identity theft, \$1,000 per instance, capped at \$50,000.

12. Fraud or False Statements on Returns:

Fraudulent conduct on tax returns carries criminal consequences.

- Penalty: Up to \$100,000 in fines (\$500,000 for corporations), up to 3 years in prison, and liability for prosecution costs.

13. Preparing Fraudulent Returns or Documents:

Knowingly preparing fraudulent returns or documents triggers separate penalties.

- Penalty: Up to \$10,000 in fines (\$50,000 for corporations) and up to 1 year in prison.

14. Knowingly or Recklessly Misusing Taxpayer Information:

A preparer must not use or disclose taxpayer information for personal gain.

- Penalty: Up to \$1,000 in fines, up to 1 year in prison, and liability for prosecution costs.

15. Unlawful Conduct Involving Tax Shelters or Reportable Transactions:

Improper conduct relating to abusive or reportable transactions can lead to injunctions.

- Penalty: The U.S. government may seek a federal court order to stop the conduct, especially when it violates Circular 230 or other rules governing practice before the IRS.

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B. Licensing and Disciplinary Systems

Remembering and Understanding: Understand and explain the role and authority of state boards of accountancy.

State boards of accountancy regulate the CPA profession within their individual states. They are established under state law and have the legal authority to license CPAs, regulate CPA firms, enforce ethical and professional standards, and protect the public. Their oversight applies to anyone holding a CPA license in that state, as well as firms offering services that require licensure.

1. Licensing and Renewal:

State boards determine who may become a CPA.

- They set the education, examination, and experience requirements for obtaining a CPA license and handle license renewals.
- CPA firms must register with the board to provide audit, review, or other attestation services.
- Boards manage reciprocity when CPAs licensed in one state seek a license in another.

2. Setting and Enforcing Professional Standards:

State boards adopt rules of professional conduct that CPAs must follow.

- Many states incorporate AICPA standards, but boards can set additional or stricter requirements.
- These standards govern independence, integrity, objectivity, confidentiality, and other core responsibilities.

3. Continuing Professional Education (CPE) and Ongoing Competence:

Boards ensure CPAs maintain competence throughout their careers.

- They establish CPE requirements and may audit CPAs to verify compliance.
- Many states require periodic ethics courses or state-specific regulatory updates.

4. Oversight of CPA Firms and Quality Control:


State boards regulate accounting firms that provide attestation services.

- Firms may be required to undergo peer review to ensure audit quality.
- Boards can discipline firms with recurring deficiencies or quality-control issues.

5. Enforcement and Disciplinary Authority:

State boards investigate misconduct and enforce discipline.

- They may issue penalties such as reprimands, fines, suspension, or license revocation.
- Boards also act against unlicensed practice or misuse of the CPA title.

 **Key Tip:** Only the state board has the authority to suspend or revoke a CPA license. Neither NASBA nor the AICPA can remove a CPA's state-issued license.

6. Public Protection and Advisory Responsibilities:

State boards exist to protect the public interest.

- They ensure only qualified, ethical CPAs and firms offer services that the public relies on.
- Boards may advise state legislatures on laws affecting the accounting profession.

C. Federal Tax Procedures

1. Audits, Appeals and the Judicial Process

Remembering and Understanding: Explain the audit and appeals process as it relates to tax matters.

The IRS audit and appeals process is designed to verify the accuracy of tax returns and resolve disputes efficiently. It moves step-by-step from return selection to potential court review. These notes outline the essential stages and the key rules that candidates must understand.

1. How Tax Returns Are Selected for Audit:

The IRS selects returns for several reasons.

- Some returns are chosen because they contain unusual items, mismatches with third-party documents, or patterns that commonly produce errors.
- Related returns, such as those of business partners, may also be pulled in.
- Some are selected randomly for compliance studies.

2. Statute of Limitations:

- The IRS generally has 3 years from the date a return is filed to initiate an audit.
- If more than 25% of gross income is omitted, the period extends to 6 years.
- If no return is filed, the IRS may initiate an audit and assess tax at any time.

- If a fraudulent return is filed, the IRS may initiate an audit and assess tax at any time.

3. Types of IRS Audits:

The IRS conducts different kinds of audits depending on complexity.

- A correspondence audit is handled entirely by mail and focuses on a few specific items.
- An office audit requires the taxpayer to meet with the IRS at a local office for a more detailed review.
- A field audit is the most comprehensive and takes place at the taxpayer's home, business, or representative's office.

4. Responding to IRS Notices:

Taxpayers typically have 30 days to respond to an initial audit notice.

- Failure to respond can lead the IRS to assess tax based on the information it has, including penalties and interest.

5. The Audit Examination:

During the audit, the IRS requests documentation to support items on the return.

- Records may include receipts, statements, invoices, contracts, or logs.
- Taxpayers may represent themselves or be represented by a CPA, attorney, or enrolled agent.

6. Audit Outcomes:


An audit can conclude in one of three ways.

- No Change: The IRS accepts the return as filed.
- Agreed: The taxpayer accepts the proposed adjustments and signs the agreement.
- Disagreed: The taxpayer does not agree and may pursue further review.

7. Challenging an Audit Result:

When the taxpayer disagrees with the audit findings:

- They may first request a meeting with the IRS manager overseeing the case.
- If still unresolved, the taxpayer may request Fast Track Mediation, which aims to settle the dispute within 60–120 days.
- The next step is appealing to the IRS Independent Office of Appeals, which is separate from the audit function and evaluates disputes based on the hazards of litigation.

 **Key Tip:** Appeals does not perform a second audit. Its role is to settle disputes fairly and efficiently.

8. Appeals Process:

- Appeals reviews the case and meets with the taxpayer or representative in an informal conference.
- If a settlement is reached, the taxpayer signs the appropriate forms and the case closes.
- If no agreement is reached, Appeals issues a Statutory Notice of Deficiency (the “90-day letter”).

9. Statutory Notice of Deficiency and Tax Court:

- The taxpayer has 90 days to file a petition with the U.S. Tax Court (150 days if the notice is addressed outside the United States).
- Filing a petition allows the case to be heard without paying the tax first.
- Many cases settle after the petition is filed, sometimes with Appeals involvement again.

10. Tax Court and Beyond:

- If the case proceeds to trial, the judge will issue a decision.
- If the taxpayer disagrees with the Tax Court decision, they may appeal to a higher federal court.

11. Resolution and Collection:

If the IRS determination stands, whether through agreement or final ruling, the IRS issues a bill for any tax, penalties, and interest due. Payment is expected, but installment agreements or other arrangements may be available.

Remembering and Understanding: Explain the different levels of the judicial process as they relate to tax matters.

When taxpayers dispute IRS determinations, several courts may become involved depending on the type of claim and whether the disputed tax has already been paid. The following summarizes the key courts and their roles in tax disputes.

1. U.S. Tax Court:

This is the primary court for tax disputes.

- Taxpayers may petition the Tax Court without paying the disputed tax first.
- It hears cases involving notices of deficiency and certain other IRS determinations.
- Decisions may be appealed to the appropriate U.S. Court of Appeals.

2. Federal District Court:

This court is an option when the taxpayer has paid the tax in full and seeks a refund.

- The taxpayer sues the United States for a refund in the federal district court for their geographic area.
- District courts handle a wide range of federal matters, including tax.
- Decisions may be appealed to the relevant U.S. Court of Appeals.

3. U.S. Court of Federal Claims:

This court, located in Washington, D.C., also hears refund suits after the disputed tax has been paid.

- It focuses on monetary claims against the U.S. government, including tax refunds.
- Decisions are appealed to the U.S. Court of Appeals for the Federal Circuit.

4. U.S. Court of Appeals:

This is the intermediate appellate level for federal courts.

- Tax Court decisions are appealed to the circuit covering the taxpayer's residence.
- Federal District Court decisions go to the circuit covering that district.
- Court of Federal Claims decisions always go to the Federal Circuit.
- Decisions can be appealed, but only at the Supreme Court's discretion.

5. U.S. Supreme Court:

This is the highest court in the United States.

- It chooses which cases it will hear and accepts very few tax cases.
- Its decisions are final and set nationwide precedent.

6. Collection Due Process (CDP) Hearings:

While not part of the traditional court hierarchy, CDP hearings provide important taxpayer protections.

- Before the IRS can levy assets, the taxpayer may request a CDP hearing with the IRS Independent Office of Appeals.
- The taxpayer may challenge the amount owed (in limited situations) or propose alternatives such as installment agreements or offers in compromise.
- If the taxpayer disagrees with the CDP determination, they may petition the U.S. Tax Court.

7. Administrative Appeals and Mediation:

Most tax disputes are resolved before reaching court.

- The IRS Independent Office of Appeals evaluates disputes based on the hazards of litigation and attempts to settle them.
- Fast track mediation offers a quicker, more informal method of resolving issues while still in the examination process.

2. Substantiation and Disclosure

Remembering and Understanding: Summarize the requirements for the appropriate disclosure of a tax return position.

Disclosure is required when a taxpayer takes a tax position that does not meet the substantial-authority standard but still has a reasonable basis. Proper disclosure helps reduce the risk of accuracy-related penalties when the IRS disagrees with the position. To be effective, disclosure must be clear, complete, and properly documented.

1. When Disclosure Is Required:

Disclosure is needed when a tax position:

- has a reasonable basis but does *not* rise to the level of substantial authority, and
- could lead to a potential understatement of tax if the IRS disagrees.

Disclosure cannot rescue a position lacking a reasonable basis. Those positions are always unacceptable.

2. How to Disclose a Tax Position:

Taxpayers may disclose a position in one of two ways.

- Form 8275, Disclosure Statement: Used for positions that are not clearly shown on the return or need additional explanation.
- Form 8275-R, Regulation Disclosure Statement: Used when the taxpayer takes a position that is contrary to a Treasury regulation.

Both forms require enough detail to allow the IRS to understand the facts, the amount involved, and the legal basis for the position.

3. Effect of Adequate Disclosure:

Proper disclosure can help the taxpayer avoid the 20% accuracy-related penalty under IRC §6662 when the position has a reasonable basis.

- Disclosure does *not* guarantee that the IRS will accept the position—it only prevents certain penalties.
- To avoid accuracy-related penalties:
 - Substantial authority is generally required without disclosure, or
 - Adequate disclosure + reasonable basis may suffice for non-tax shelter positions.
- The more-likely-than-not standard applies only to specific situations (e.g., certain tax shelters or reportable transactions).

4. Reportable Transactions:

Certain transactions identified by the IRS as abusive or high-risk must be disclosed separately.

- These transactions are reported on Form 8886, Reportable Transaction Disclosure Statement.
- Penalties for failing to disclose these transactions are significant and apply even if the underlying tax position is arguable.

5. Required Elements of Adequate Disclosure:

A proper disclosure must:

- clearly describe the relevant facts,
- identify the specific item or adjustment, and
- explain the legal basis for the position.

If a specific IRS form or schedule is not available for disclosure, a separate written statement must be attached.

6. Preparer Responsibilities:

Tax return preparers must ensure that positions requiring disclosure are handled correctly.

- A preparer may not take or sign a position lacking a reasonable basis.
- When disclosure is needed, the preparer must advise the taxpayer and complete the disclosure if requested.

Remembering and Understanding: Recall requirements to report foreign bank accounts.

U.S. persons must report certain foreign financial accounts when the total value of those accounts exceeds specific thresholds. The two primary reporting requirements are the FBAR (FinCEN Form 114) and IRS Form 8938. Each has separate filing rules and penalties.

1. Who Must File an FBAR (FinCEN Form 114):

The FBAR is required under the Bank Secrecy Act.

- U.S. persons—including citizens, resident aliens, domestic entities, trusts, and estates—must file if they have a financial interest in or signature authority over foreign financial accounts.
- Filing is required when the aggregate value of all foreign accounts exceeds \$10,000 at any time during the calendar year.
- Accounts include foreign bank accounts, brokerage accounts, mutual fund accounts, and certain foreign retirement accounts.

2. Accounts Not Required to Be Reported:

Some foreign accounts are excluded from FBAR reporting.

- Accounts held in U.S. retirement plans (like IRAs).
- Certain foreign retirement accounts.
- Some trust beneficiaries may be exempt depending on the type of interest and access to information.


3. FBAR Filing Requirements:

- Filed electronically using FinCEN Form 114—not with the IRS.
- Due April 15, with an automatic extension to October 15 every year.
- Signature authority alone can create a filing requirement, even without a financial interest.

4. Form 8938 (Statement of Specified Foreign Financial Assets):

Form 8938 is a separate reporting requirement under FATCA.

- Filed with the taxpayer's Form 1040.
- Thresholds depend on filing status and residency:
 - Single or MFS (U.S. residents): Over \$50,000 at year-end or \$75,000 anytime.
 - MFJ (U.S. residents): Over \$100,000 at year-end or \$150,000 anytime.
 - Higher thresholds apply to taxpayers living abroad.
- Taxpayers may need to file both Form 8938 and the FBAR.

 **Key Tip:** FBAR and Form 8938 have different thresholds and filing rules. Filing one does not satisfy the requirement to file the other.

Application: Identify situations in which disclosure of tax return positions is required.

Disclosure is required when a tax position does not meet the substantial-authority standard but still has a reasonable basis. In these situations, disclosure helps avoid accuracy-related penalties and alerts the IRS to the reasoning behind the position.

1. Uncertain or Ambiguous Tax Positions:

A position based on unclear or incomplete authority may require disclosure.

Example: *A freelancer claims a home office deduction for a separate area used exclusively and regularly for business, but there is uncertainty about whether the home qualifies as the taxpayer's principal place of business. The position is reasonable but not strongly supported. Disclosure may be appropriate.*

2. Positions Contrary to IRS Regulations:

If a taxpayer takes a position that disputes the validity or application of a Treasury regulation, they must disclose using Form 8275-R.

Example: *A taxpayer claims a credit using an interpretation that conflicts with a regulation but is supported by statutory language. Disclosure with Form 8275-R is required.*

3. Positions With No Clear IRS Guidance:

Disclosure is needed when the tax code is silent or unclear and the taxpayer adopts a reasonable interpretation.

Example: *A business receives a large advance payment for multi-year services and chooses to spread the income over the service period. Since authority is limited, disclosure is required.*

4. Large or Complex Deductions With Uncertain Authority:

High-dollar or complex deductions may require disclosure when the legal basis is reasonable but not substantial.

Example: *A company claims a large environmental cleanup deduction where classification of the expense is not clearly defined. Disclosure is required.*

5. Novel or Uncommon Interpretations of Tax Law:

Unique or innovative positions that rely on first-time interpretations should be disclosed.

Example: *A taxpayer claims a research credit for a new type of energy-efficient process where the applicability of the credit is not well established. Disclosure is required.*

6. Any Position the Preparer Knows Does Not Meet Substantial Authority:

If a preparer determines a position has only a reasonable basis, disclosure is necessary.

Example: *A preparer allows a depreciation method supported by limited authority. Disclosure is required to avoid preparer penalties.*

Application: Identify whether substantiation is sufficient given a specific scenario.

Substantiation requires maintaining clear, credible, and timely records to support deductions, credits, or other tax positions. The IRS expects documentation that is consistent, objective, and tied directly to the claimed tax benefit. The following scenarios show when substantiation is sufficient—and when it is not.

Scenario 1 - Home Office Deduction:

- **Facts:** A freelancer claims 30% of housing costs as a home office deduction. Only 15% of the home's square footage is used for business, and the space is occasionally used for personal activities.
- **Assessment:** Substantiation is not sufficient. Home office deductions require exclusive and regular business use, and the deduction must reflect the actual business-use percentage. Floor plans, photos, and records of exclusive use would be needed. Mixed-use space and overstated percentages will be disallowed.

Scenario 2 - Travel Expenses:

- **Facts:** A real estate agent deducts all airfare, hotels, and meals from a trip that included two business meetings and several personal vacation days. Receipts are available, but there is no documentation of the business purpose for each day.
- **Assessment:** Substantiation is insufficient. Travel expenses must be ordinary, necessary, and directly related to business. The taxpayer must document the business

purpose, dates, and activities. Without clear separation of business and personal travel, the deduction will be prorated or denied.

Scenario 3 - Charitable Contribution of Property:

- **Facts:** A taxpayer donates artwork valued at over \$6,000. They claim the deduction using an appraisal conducted by a friend who is not a qualified appraiser.
- **Assessment:** Substantiation is not adequate. Non-cash contributions above certain thresholds require a qualified appraisal prepared by a qualified appraiser and attached documentation. An unqualified valuation will not support the deduction.

Scenario 4 - Business Meals:

- **Facts:** A manager deducts several thousand dollars of business meals. They have credit-card receipts but no notes documenting who attended or the business purpose.
- **Assessment:** Substantiation is insufficient. For business meals, the taxpayer must document the amount, date, place, business purpose, and the business relationship of the attendees. Receipts alone do not meet the substantiation standard.

Scenario 5 - Vehicle Use for Business:

- **Facts:** A consultant claims 80% business use of a personal car but does not maintain a mileage log. They estimate business miles after year-end.
- **Assessment:** Substantiation is not sufficient. Vehicle expenses require a contemporaneous mileage log showing

business miles, total miles, dates, and purpose of each trip. Estimates or reconstructed logs usually fail IRS scrutiny.

Scenario 6 - Cash Expenses for Small Business:

- **Facts:** A contractor pays laborers in cash and deducts the expenses. They keep a handwritten notebook listing dates and amounts but have no receipts, invoices, or proof of payment.
- **Assessment:** Substantiation is weak. The IRS expects objective evidence—receipts, cancelled checks, payment records, or other third-party documentation. A self-created log with no external support is not enough to substantiate the deduction.

3. Taxpayer Penalties

Remembering and Understanding: Recall situations that would result in taxpayer penalties relating to tax returns, and Application: Identify taxpayer penalties given a specific scenario.

Taxpayers may face penalties when they fail to file a return, fail to pay tax, take careless or unsupported positions, or intentionally provide false information. The following summarizes common taxpayer penalties and provides clear examples to illustrate when each applies.

1. Failure-to-File Penalty:

This penalty applies when a taxpayer does not file a required tax return by the due date (including extensions).

- The penalty is based on the amount of unpaid tax.
- Filing even when you cannot pay reduces total penalties.

Example: *Sarah forgets to file her return by April 15 and does not request an extension. She is assessed the monthly failure-to-file penalty until she files.*

2. Failure-to-Pay Penalty:

This penalty applies when a taxpayer files on time but does not pay the tax due by the deadline.

- Interest also accrues on unpaid amounts.

Example: *Mike files his return on time but cannot pay his \$2,000 balance. He is charged the failure-to-pay penalty until the balance is paid.*

3. Insufficient Withholding or Estimated Tax Penalty:

Taxpayers must pay tax throughout the year through withholding or estimated payments.

- If payments are too low or made late, the IRS may assess an underpayment penalty.

Example: *Bob, a freelancer with uneven income, does not make quarterly estimated payments. Because he owes a large amount at year-end, he may be penalized for underpayment.*

4. Earned Income Tax Credit (EITC) Penalty:

The IRS may impose penalties when a taxpayer claims the EITC recklessly, negligently, or fraudulently.

- Taxpayers may be barred from claiming the EITC for 2 to 10 years depending on the severity.

Example: *Jane inflates her income to increase her EITC amount. This is treated as reckless or intentional disregard, and she could lose eligibility for the credit for 10 years.*

5. Negligence or Disregard of Rules:

This penalty applies when an understatement results from careless, inconsistent, or improper reporting.

- Negligence typically includes failing to keep records or not making a reasonable attempt to follow the rules.

Example: *Anna forgets to report a Form 1099 income source and cannot show reasonable cause. The IRS may apply the negligence penalty.*

6. Substantial Understatement of Tax:

This penalty applies when the understatement exceeds the greater of:

- 10% of the correct tax, or
- a specified dollar threshold.

Substantial understatement penalties often apply when a tax position has no substantial authority and lacks proper disclosure.

Example: *John reports \$5,000 of tax, but the IRS determines his actual liability is \$12,000. The large understatement may trigger this penalty.*

7. Substantial Valuation Misstatement:

This penalty applies when a taxpayer significantly overstates the value of property (or understates value for certain taxable transactions).

- Often triggered by inflated charitable contribution valuations.

Example: *Mary donates artwork and claims it is worth \$50,000, but a qualified appraisal later shows it is worth only \$10,000. The IRS may apply the substantial valuation misstatement penalty.*

8. Fraud Penalties (Civil and Criminal):

Fraud penalties apply when a taxpayer intentionally attempts to evade tax.

- Civil fraud penalties are severe.
- Criminal charges may also apply in extreme cases.

Example: *Tom hides income, creates fake deductions, and intentionally files a false return. The IRS may assess civil fraud penalties and pursue criminal prosecution.*

SAMPLE

4. Authoritative Hierarchy

Remembering and Understanding: Recall the appropriate hierarchy of authority for tax purposes.

Tax research relies on a hierarchy of authority—some sources are binding, while others only provide guidance. When authorities conflict, higher-level sources control. The following summarizes the recognized order of authority for federal tax purposes.

1. Internal Revenue Code (IRC):

The IRC is the highest authority short of the Constitution for federal tax matters.

- Enacted by Congress.
- Governs income, estate, gift, employment, and excise taxes.
- Statutory law controls over any administrative or judicial interpretation.

2. Treasury Regulations:

Regulations interpret and explain the IRC.

- Issued by the U.S. Department of the Treasury.
- Come in final, temporary, and proposed forms.
- Final and temporary regulations carry the highest weight of administrative authority.
- Courts generally defer to Treasury regulations unless they conflict with the statute.

3. Judicial Authority (Federal Courts):

Court decisions interpret how tax laws apply in real situations.

- U.S. Supreme Court: Highest authority; decisions are binding nationwide.
- U.S. Court of Appeals: Binding in the applicable circuit unless the Supreme Court rules otherwise.
- U.S. Tax Court, U.S. District Courts, and U.S. Court of Federal Claims: Provide precedent but carry less weight than appellate or Supreme Court decisions.

4. IRS Administrative Guidance:


These sources show the IRS's interpretation of tax law but rank lower than statutes, regulations, and court decisions.

- Revenue Rulings: IRS positions on specific fact patterns; authoritative but not binding on courts.
- Revenue Procedures: Provide procedural guidance (elections, accounting methods, filing steps).
- Notices and Announcements: Provide temporary or immediate IRS guidance, often used before regulations are issued.
- Private Letter Rulings (PLRs): Apply only to the requesting taxpayer and are not precedent, but they show how the IRS views an issue.

5. Non-Authoritative Guidance:

These materials help with understanding but do not constitute authority.

- IRS publications, instructions, and FAQs.
- Tax treatises, textbooks, articles, and commercial research tools.
- Professional commentary or tax journals.

 **Key Tip:** When resolving a tax issue, rely first on the IRC and Treasury regulations, then judicial authority, and only afterward on IRS administrative guidance or non-authoritative materials.

SAMPLE

D. Legal Duties and Responsibilities

1. Common Law Duties and Liabilities to Clients and Third Parties

Remembering and Understanding: Summarize the tax return preparer's common law duties and liabilities to clients and third parties; Application: Identify situations which result in violations of the tax return preparer's common law duties and liabilities to clients and third parties.

Tax return preparers owe certain duties to their clients under common law, and they may also be liable to third parties in limited situations. These duties arise from professional standards of care and general legal principles governing service providers.

1. Duty of Reasonable Care:

Preparers must perform their work with the skill and diligence expected of a reasonably competent tax professional.

- This includes gathering necessary information, asking questions when facts appear incomplete or inconsistent, and applying tax rules correctly.
- If a preparer fails to meet this standard and the client suffers financial harm, the preparer may be liable for negligence.

Example: *A preparer overlooks a client's Form 1099 that was included in the client's documents. The omission leads to additional tax, penalties, and interest. Because the preparer had the information and failed to use reasonable care, they may be liable for the client's losses.*

2. Duty to Follow the Engagement (Contract Obligations):

An engagement letter forms a contract. Preparers must do what the engagement promises and complete the work within a reasonable timeframe.

- If a preparer fails to meet these obligations and the client incurs avoidable costs, the preparer may be liable for breach of contract.

Example: *A preparer agrees to file a return before the deadline but misses it without reasonable cause. The resulting late-filing penalty may be recoverable as damages.*

3. Duty of Confidentiality:

Preparers must protect client information and may not disclose or use it improperly.

- Unauthorized disclosure can result in civil liability in addition to statutory penalties.
- Confidentiality applies to both tax data and non-tax personal information shared during the engagement.

4. Duty of Loyalty and Avoidance of Conflicts:

Preparers must avoid conflicts of interest unless both clients give informed consent.

- A conflict exists when the preparer's ability to serve one client is limited by obligations to another.
- If a conflict harms a client, liability may arise.

Example: *A preparer advises two business partners on matters where their tax interests diverge without obtaining consent. If one partner suffers harm because the preparer could not serve both impartially, liability may result.*

5. Liability to Third Parties (Limited):

A preparer's primary duty is to the client, but in some situations a third party may rely on the preparer's work.

- Courts differ on how far this duty extends, but liability generally arises only if the preparer knew the third party would rely on the information.
- Foreseeable reliance is the key factor.


Example: *A preparer knows the client's tax return will be provided to a bank to secure a loan. If the preparer negligently misstates income and the bank suffers a loss, liability may be possible in some jurisdictions.*

6. Liability for Fraud or Intentional Misconduct:

If a preparer knowingly makes false statements, intentionally falsifies return information, or engages in deceptive conduct, they may face civil or criminal liability.

- Fraud requires intent—it is not the result of simple errors.
- Fraud eliminates many defenses and significantly increases potential damages.

Example: *A preparer knowingly inflates deductions to increase a client's refund, keeping a portion of the refund for themselves. This constitutes intentional misconduct and may result in both civil and criminal consequences.*

 **Key Tip:** Negligence involves a lack of reasonable care. Fraud involves intent. Liability increases sharply when intent is present.

SAMPLE

2. Privileged Communications, Confidentiality and Privacy Acts

Remembering and Understanding: Summarize the rules regarding privileged communications as they relate to tax practice.

Privilege limits when the IRS or a court can compel disclosure of communications between a taxpayer and a professional. In tax practice, privilege is narrow, and candidates should understand what is covered—and what is not.

1. Attorney–Client Privilege:

Communications with an attorney for the purpose of obtaining legal advice are generally protected.

- Applies in civil and criminal matters.
- Protects the communication, not the underlying facts.
- Privilege is waived if shared with a third party.

2. Federally Authorized Tax Practitioner (FATP) Privilege (IRC § 7525):


This privilege extends attorney–client–style protection to CPAs, enrolled agents, and enrolled actuaries, but in limited circumstances.

- Applies only to noncriminal federal tax matters before the IRS and noncriminal federal tax proceedings in federal court.
- Covers confidential communications that relate to tax advice.
- Does not apply to state tax matters unless a state adopts similar laws.

3. Important Limits on Privilege:

Privilege does not apply to:

- Return preparation communications—the information used to prepare a return is never privileged, even if discussed with an attorney.
- Criminal matters when the practitioner is not an attorney (FATP privilege does not apply).
- Communications used to commit fraud or evade tax (crime-fraud exception).
- Communications shared with third parties, which typically waives privilege.
- Required records, such as bank statements or source documents, even if discussed in a privileged conversation.

 **Key Tip:** Confidentiality is not the same as privilege. A CPA must keep client information confidential, but that information can still be subpoenaed unless a legal privilege applies.

4. Work Product Doctrine:

Documents prepared in anticipation of litigation may be protected from disclosure.

- Applies mainly to attorneys and those working under their direction.
- Does not protect documents created in the ordinary course of preparing a tax return.

5. Kovel Arrangements (Concept Only):

If an attorney hires a CPA to assist in providing legal advice, communications with the CPA may remain privileged.

- Only applies when the CPA is acting under the attorney's direction to help provide legal advice.
- This is still subject to all the usual limitations above.

SAMPLE

Application: Identify situations in which communications regarding tax practice are considered privileged.

Privilege applies only in specific circumstances. The following examples illustrate when communications would be privileged.

1. Attorney–Client Privilege (Always Civil or Criminal):

- Scenario: A taxpayer meets with a tax attorney to discuss whether unreported income from prior years could expose them to criminal charges.
 - Why Privileged: The communication is for the purpose of obtaining legal advice from an attorney.
- Scenario: An attorney drafts a memo analyzing whether a client should litigate an IRS notice of deficiency.
 - Why Privileged: Litigation strategy between attorney and client is fully protected.

2. Federally Authorized Tax Practitioner (FATP) Privilege (Only Noncriminal Federal Tax Matters):

- Scenario: A taxpayer consults a CPA about whether a complex position on their return has substantial authority.
 - Why Privileged: Confidential tax advice in a noncriminal federal tax matters.
- Scenario: An enrolled agent explains to a client how to structure a legitimate business deduction and the taxpayer asks questions about supporting documentation.
 - Why Privileged: The discussion is confidential tax advice—not return preparation.

3. Privilege Under Kovel (CPA Assisting an Attorney):

- Scenario: A tax attorney hires a CPA to assist with reviewing financial records so the attorney can provide legal advice. The client, attorney, and CPA meet to review the documents together.
 - Why Privileged: The CPA's involvement supports the attorney's legal advice, so the communication is treated as attorney–client privileged.

4. Work Product Doctrine (Prepared for Litigation):

- Scenario: An attorney directs a CPA to prepare an analysis estimating exposure if a specific tax position is litigated.
 - Why Privileged: The document is created in anticipation of litigation, so it is protected work product.

The following would not be privileged (and should not appear in examples of privileged communication):

- Conversations about return preparation
- Communications with a CPA about criminal matters
- Communications shared with a third party
- Tax advice used to further fraud or evasion
- Communications with a CPA about ordinary business transactions (unless under Kovel)