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Members in Medium Public Accounting Firms, April 2006

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Members in Medium Public Accounting Firms

April 2006

AICPA

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

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The IRS 2006 Dirty Dozen

Two new schemes appear on the Internal Revenue Service "dirty dozen" list for 2006. The IRS said its personnel in recent months have noted the emergence of scams—"zero wages" and "Form 843 tax abatement"—in which filers use IRS forms to claim that their tax bills have been wrongly inflated. They have been added to this year's dirty dozen, an annual tally of some of the most notorious tax scams, along with an alert to taxpayers this filing season to watch out for schemes that promise to reduce or eliminate taxes.

Also high on the list in 2006 is "phishing," a favorite ploy of identity thieves. Over the past few years, the IRS said it has observed criminals working through the Internet, even posing as IRS representatives, to try to trick unsuspecting taxpayers into revealing private information that can be used to steal from their financial accounts.

Several of the usual suspects from last year remain on the list. The IRS, for example, said it continues to see schemes designed to exploit charitable organizations. Some taxpayers, meanwhile, still use frivolous arguments to claim they do not owe taxes, despite the fact such reasoning has been thrown out of court time and again, the IRS said.

The Service noted that it pursues and shuts down promoters of these and numerous other scams, and that anyone pulled into these schemes can also face repayment of taxes plus interest and penalties.

The List

1. *Zero wages.* In this scam, a taxpayer attaches to his or her return either a Form 4852 (Substitute Form W-2) or a "corrected" Form 1099 that shows zero or little wages or other income. The taxpayer may include a statement saying he or she is rebutting information submitted to the IRS by the payer.

An explanation on the Form 4852 may

cite "statutory language behind IRC 3401 and 3121" or may include some reference to the paying company's refusal to issue a corrected Form W-2 for fear of IRS retaliation. The Form 4852 or 1099 is usually attached to a "zero return" (see number four on page B2).

2. *Form 843 tax abatement.* This scam relies on a faulty interpretation of the Internal Revenue Code in which the filer requests abatement of previously assessed tax using Form 843. Many using this scam have not previously filed tax returns and the tax they are trying to have abated has been assessed by the IRS through the Substitute for Return

Program. The filer uses Form 843 to list reasons for the request. Often, one of the reasons is: "Failed to properly compute and/or calculate IRC Sec 83—Property Transferred in Connection with Performance of Service."

3. *Phishing.* Phishing is used by identity thieves to acquire personal financial data to access the financial accounts of unsuspecting consumers, run up charges on their credit cards or apply for new loans in their names. These Internet-based criminals pose as representatives of a financial institution and send out fictitious e-mails to trick consumers into disclosing private information. In recent months, the Service said, some taxpayers have received e-mails that appear to come from the IRS. A typical e-mail notifies a taxpayer of an outstanding refund and urges the taxpayer to click on a hyperlink and visit an official-looking Web site. The Web site then solicits a Social Security and credit card number. In a variation of this scheme, criminals have used e-mail to announce to unsuspecting taxpayers they are "under audit" and could make things right by divulging selected private financial information. The IRS noted that it does not use e-mail to initiate contact with taxpayers about issues related to their accounts. For

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questions about supposed IRS contacts with clients, call 800/829-1040.

4. *Zero return.* Promoters instruct taxpayers to enter all zeros on their federal income tax filings. In a twist on this scheme, filers enter zero income, report their withholding and then write “nunc pro tunc”—Latin for “now for then”—on the return. They often also do this with amended returns in the hope the IRS will disregard the original return in which they reported wages and other income.

5. *Trust misuse.* The IRS says that for years unscrupulous promoters have urged taxpayers to transfer assets into trusts, promising reduction of income subject to tax, deductions for personal expenses and reduced estate or gift taxes. However, some trusts do not deliver the promised tax benefits, and the IRS said it is actively examining these arrangements. It reports there are more than 200 active investigations under way and three dozen injunctions have been obtained against promoters since 2001.

6. *Frivolous arguments.* The IRS cited these baseless claims made by promoters:

- The Sixteenth Amendment concerning congressional power to lay and collect income taxes was never ratified.
- Wages are not income.
- Filing a return and paying taxes are merely voluntary.
- Being required to file Form 1040 violates the Fifth Amendment right against self-incrimination or the Fourth Amendment right to privacy.

7. *Return preparer fraud.* The IRS says some dishonest return preparers skim a portion of their clients’ refunds and charge inflated fees for return preparation services, attracting new clients by promising large refunds. During fiscal year 2005, the IRS said, more than 110 tax return preparers were convicted of tax crimes.

8. *Credit counseling agencies.* The IRS urged caution in dealing with organizations that claim they can fix credit ratings, push debt payment plans or impose high set-up fees or monthly service charges that may add to existing debt. The IRS Tax Exempt and Government Entities Division is revoking the tax-exempt status of numerous credit counseling organizations that it says operated under the guise of educating financially distressed consumers with debt problems while charging debtors large fees and providing little or no counseling.

9. *Abuse of charitable organizations and deductions.* The IRS said it has seen more use of tax-exempt organizations to improperly shield income or assets from taxation. This can occur, for example, when a taxpayer moves assets or income to a tax-exempt supporting organization or donor-advised fund but maintains control over the assets or income, thereby obtaining a tax deduction without transferring a commensurate benefit to charity. A “contribution” of a historic facade easement to a tax-exempt conservation organization is another example, according to the IRS. In many cases, local historic preservation laws already prohibit alteration of the home’s facade, making the contributed easement superfluous. Even if the facade could be altered, the deduction claimed for the easement contribution may far exceed the easement’s impact on the value of the property.

10. *Offshore transactions.* Despite a crackdown by the IRS and state tax agencies, the Service said people still illegally hide income

How to Report Suspected Tax Fraud

Suspected tax fraud can be reported to the IRS using IRS Form 3949-A, Information Referral, which can be downloaded from the IRS Web site or ordered by phone:



www.irs.gov



800/829-3676

in offshore bank and brokerage accounts or use offshore credit cards, wire transfers, foreign trusts, employee leasing schemes, private annuities or life insurance. The IRS said that during fiscal 2005, 68 people were convicted on charges of promotion and use of abusive tax schemes designed to evade taxes.

11. *Employment tax evasion.* The IRS said it has seen a number of illegal schemes that instruct employers not to withhold federal income tax or other employment taxes from wages paid to their employees, based on an incorrect interpretation of Section 861 and other parts of the tax law that has been refuted in court. Lately, the IRS said it has seen an increase in “double-dip” parking and medical reimbursement issues. In recent years, the courts have ordered more than a dozen people to stop promoting the scheme. During fiscal 2005, more than 50 people were sentenced to an average of 30 months in prison for employment tax evasion, it said. Employers can also be held responsible for back payments of employment taxes, plus penalties and interest. Employees who have nothing withheld from their wages are still responsible for payment of their personal taxes.

12. *“No gain” deduction.* Filers attempt to eliminate their entire adjusted gross income (AGI) by deducting it on Schedule A. The filer lists the AGI under the Schedule A section labeled “Other Miscellaneous Deductions” and attaches a statement to the return that refers to court documents and includes the words “No Gain Realized.”

Two Fall Off the List

The IRS said two noteworthy scams have dropped off the “Dirty Dozen” this year: “claim of right” and “corporation sole.” IRS personnel have noticed less activity in these scams over the past year following court cases against a number of promoters.

Write CPA Letter Articles, Receive CPE Credit

The CPA Letter medium firm supplement encourages readers to share information and experiences through bylined articles on subjects of interest to your fellow CPAs in public practice. If the topic fits our editorial calendar and your article is featured, you may claim continuing professional education credits for the time you spent preparing the article (in accordance with the Joint AICPA/NASBA Statement on Standards for Continuing Professional Education, revised as of Jan. 1, 2002). The first step is to submit article topics for approval to:



adennis@aicpa.org

Survey Confirms CPAs' Salary Advantage

According to a recent SmartPros Salary Survey, accounting and finance professionals who are CPAs earn substantially more than those without a certification.

For instance, accounting and finance survey respondents with no certifications

earned an average salary of \$50,845, while CPAs earned an average of \$84,051—or 65% more than non-accredited accountants. Professionals with both a CPA and MBA reported an average salary of \$87,525.

Overall, the survey looked at accounting and finance professionals with a wide variety of titles, areas of practice, certifications and years of experience. As a group,

they reported an average annual salary of \$70,497, according to SmartPros.

The survey provides a great deal of data broken down by area of practice, professional title, certification and years of experience. It can be found at:



accounting.smartpros.com/standard/download/smartpros_salarysurvey05.pdf

The Latest on Audit Quality: Governmental, Not-for-Profit and Certain For-Profit Organization Audits

For firms that perform audits under *Government Auditing Standards* (“Yellow Book” audits), there are several developments on the audit quality front of which to be aware. This article outlines these developments, the importance of audit quality and several audit quality resources, including the AICPA’s Governmental Audit Quality Center.

Pervasiveness of Yellow Book Audits

Each year more than 6,300 CPA firms perform thousands of governmental, not-for-profit (NPO) and certain for-profit organization audits under the Yellow Book. The organizations involved receive billions of dollars in governmental financial assistance each year and, as a result, are subject to myriad unique and complex audit requirements. The Yellow Book audits performed include single audits of governments and NPOs; audits performed under the Department of Housing and Urban Development Audit Guide and various Department of Education Guides; and numerous other grant and assistance program audits. For an idea of the pervasiveness of these audits nationwide, in single audits alone, there were over 30,000 audits submitted to the federal government for 2003 (the most recent year with complete submission information), which represented over \$500 billion of federal dollars expended.

Audit Quality Is a Concern

Based on information received from the AICPA peer review process and ethics investigations, improvements are still needed in these audits. The quality indications are further supported by results of quality control reviews performed by federal agencies. Audit deficiencies noted in reviews of these engagements relate to almost every aspect of the audits, including planning, fieldwork and reporting. A few of the more common deficiencies are:

- Audit documentation does not evidence the work performed. Particular problems have been noted with documentation relating to the auditor’s responsibilities for internal control.
- Errors are being made with regard to major program determination in single audits, particularly regarding application of the “two-year lookback” rule, clustering and percentage of coverage.

- Audit findings do not include the required detail or are contained in a management letter instead of the required Schedule of Findings and Questioned Costs.
- Mistakes are made in completing the required Data Collection Form.
- The auditor’s report is not supported by the work that was performed.

Based on the federal government’s concern about audit quality, an interagency, interdisciplinary task force led by the Department of Education was established to provide an overall assessment of single audit quality. The task force selected a statistical sample of 208 single audits for review. At this time, the majority of those reviews have been completed. The task force is in the process of evaluating and accumulating the results of their work and expects to issue a final summary report sometime during the second half of this year.

What Can You Do To Help Ensure Your Firm’s Quality?

Because of the complexity of these audits and the concerns about audit quality, practitioners should ensure that their firms are doing everything they can to deliver the highest quality services. To help CPA firms meet the challenges of performing quality Yellow Book audits of governments, NPOs and certain for-profits, the AICPA launched its Governmental Audit Quality Center (GAQC) in Sept. 2004. Almost 500 firms of all sizes have joined the center to date. Feedback from member firms—performing anywhere from just a few of these audits to hundreds of them—has been very positive.

The center keeps member firms informed about the latest developments and provides tools and information to help them better manage their audit practice. Firms that join demonstrate their commitment to audit quality by agreeing to adhere to certain membership requirements. The center’s focus is to promote the highest quality audits and to save firms time by providing a centralized place to find information they need, when they need it, to maximize quality and practice success. Center resources include:

- *E-mail news alerts* on current audit and regulatory developments keep member firms informed about the latest developments.
- *A dedicated Center Web site* at www.aicpa.org/GAQC with sections for Resources, Community, Events and Products, and a complete listing of GAQC members in each state.
- *Online member discussion forums* for sharing best practices and discussing issues firms are facing.
- *Webcasts, Web seminars and teleconferences* updating members

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on a variety of technical, legislative, regulatory and practice management subjects.

To enroll or learn more about the GAQC, visit the site or e-mail GAQC staff at:

 www.aicpa.org/GAQC

 GAQC@aicpa.org

To speak with someone about GAQC membership, call Cynthia Dillon at:

 202/434-9207

You should also be aware that there are a number of other resources available from the AICPA to assist in performing these audits, including technical guidance, practice aids, educational

courses and industry conferences. To view a summary of events and products that relate to this area, go to:

 www.aicpa.org/GAQC/Events and
 www.aicpa.org/GAQC/Products

Quality Is Critical

There is no question that these audits have a strong public interest component. The independent audits of governmental, NPO and certain for-profit organizations provide assurance to the recipients of governmental financial assistance, regulators and taxpayers that the laws and regulations associated with the assistance or programs are being complied with. Therefore, the quality of such audits is of utmost importance. CPA firms that perform these audits should make it a high priority to ensure that they are meeting all of the standards and requirements.

IRS Tax Forums

The Internal Revenue Service will host a series of six tax forums across the nation this summer for tax professionals. The forums present the latest news and information from the IRS over three days of seminars. Representatives of the IRS, the AICPA and other organizations will lead seminars and be available for discussion.

In a survey of last year's attendees, 98% were satisfied with the Nationwide Tax Forums, according to the IRS. Attendees have also said that as a result of



their participation they are able to respond to their clients' needs in a more professional manner and can offer more technical expertise.

In addition to the seminars, the forums also feature a two-day expo with representatives from the IRS and tax, financial and business communities offering their products, services and expertise.

Locations and Dates, CPE Credits, Registration

The locations and dates of the 2006 tax forums are:

- Anaheim, Calif.—June 27–29
- Chicago, Ill.—July 11–13

- Atlanta, Ga.—July 25–27
- Orlando, Fla.—Aug. 1–3
- Las Vegas, Nev.—Aug. 22–24
- New York, N.Y.—Aug. 29–31

CPAs can earn up to 18 continuing education credits at each forum. The fees for the 2006 forums are \$159 per person per city for pre-registration and \$299 for late or on-site registration. The pre-registration period will end two weeks before the start of each forum.

For additional information and registration updates, visit:

 www.taxforuminfo.com

Proposed Circular 230 Amendments

The Treasury Department and the Internal Revenue Service issued a notice proposing amendments to Treasury Department Circular 230, which governs tax professionals who practice before the IRS.

The IRS said that ensuring that tax professionals adhere to professional standards and follow the law is one of its top four enforcement goals, and the proposed revision of Circular 230 plays a critical part in achieving this goal.

The proposed revisions would modify:


- The definition of practice.
- Eligibility for enrollment.
- Unenrolled practice.
- The rules concerning contingent fees, conflicts of interest, standards with respect to tax returns and documents, affidavits and other papers, sanctions, discovery, publicity and appeals.

The proposed regulations also would replace certain terminology to conform to the terminology used in 18 U.S.C. 207, and 5 C.F.R. parts 2637 and 2641 (or superseding regulations). The proposed regulations do not address the standards for written tax advice that were the subject of final amendments to the regulations issued in Dec. 2004 and modified in May 2005.

The proposal, according to the IRS, follows a thorough review

of extensive public comments to a Dec. 2002 advance notice of proposed rulemaking relating to the Office of Professional Responsibility, unenrolled practice, eligibility for enrollment, sanctions and disciplinary proceedings, contingent fees and confidentiality agreements.

A hearing on the proposed regulations is scheduled for June 21 at 10 a.m., in the IRS auditorium. The Treasury Department and the IRS are requesting comments on the proposed regulations by Apr. 7, 2006. Comments may be submitted to: CC:PA:LPD:PR (REG-122380-02), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, D.C. 20044, or hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG-122380-02), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. Alternatively, taxpayers may submit comments electronically to the IRS Internet site at:

 www.irs.gov/app/scripts/ct.jsp?regTitle=Regulations%20Governing%20Practice%20Before%20the%20Internal%20Revenue%20Service%20

The proposed regulations themselves can be found at:

 www.irs.gov/pub/irs-reg/122380002.pdf