



**Best Practice:** If your clients use firm-supplied tax organizers, verify the client's arithmetic before entering data into a tax software program. Perform spot checks to compare data in completed returns with the information supplied by the client. Regularly check the software manufacturer's web site for notifications regarding software application problems, and for downloads available to update the software. Don't override edit checks built into software programs, but verify that like amounts which appear in more than one place in the return match. Last, maintain a manual quality control system to check returns for completeness and accuracy prior to submission to the client for filing.

### **Election Errors**

Claims involving election errors have been gradually decreasing over the past few years due to changes in the tax code that make it easier to elect and preserve S Corporation status. Nevertheless, between 1994 and 1999, 26% of tax practice claims arose from various election errors.

Election errors generally occur because:

- The tax preparer failed to timely inform the client of the need to make an election;
- The tax preparer failed to investigate whether or not a previously made election was still appropriate for the client;
- Multiple professionals rendered services to the client, and responsibility for following through on preserving a tax election for the client was not assigned to a specific professional.
- The tax preparer failed to "check-the-box" on a tax return to preserve an election.

**Best Practice:** Discuss previously made elections with the client each year prior to preparing their return. If the client makes a decision regarding an election, explain what action needs to be taken. If the client defers a decision, document this as well. Always follow up with a letter to the client recapping the discussion. If the client is also consulting with other professionals regarding either their business or a particular transaction, clearly define your responsibilities in both the engagement letter and follow up correspondence, and alert the client of the need to follow up with other professionals regarding their responsibilities.

### **Estate Tax Return Preparation**

Few CPAs regularly prepare estate tax returns. Nevertheless, when a client dies, family members often ask the CPA to prepare the return and many CPAs agree to do so despite their lack of experience in this specialty practice area. In other cases, the CPA is not asked to prepare the return, but family members assume that the CPA will do so. Delinquent filings are common because of confusion regarding responsibility for preparing the return (especially when attorneys are also rendering services to the estate), or because the CPA fails to docket the engagement to ensure that the return can be filed on time. About half of all estate tax claims result from the CPA's lack of familiarity with estate tax issues and requirements.

Because of the complexities of estate tax law and the large amounts of money involved, simple errors can lead to significant tax liabilities for the estate. In one such claim, a CPA's long time client died, and the surviving family members expected to pay little estate tax on the transfer of ownership of the family farm. Unfortunately, in preparing the estate tax return, the CPA failed to make the qualified terminable interest property election. The error was not discovered in time to make a correction, and \$1,000,000 in additional taxes was incurred on the transfer of ownership.

Surviving family members often have conflicting interests regarding liquidation of the assets of a client's estate. Certain actions to minimize estate taxes may benefit one beneficiary but may not be desirable from another beneficiary's perspective, and the CPA can become embroiled in disputes between the parties. Communications can break down, resulting in errors in structuring or executing transactions. Remember that the client, not the individual beneficiaries of the estate, is the executor or personal representative of the estate.

**Best Practice:** When a client dies, inform the executor or personal representative of the estate in writing of the need to file an estate tax return within nine months of the date of death. Don't prepare estate tax returns unless you have maintained up-to-date training in this practice specialty. If you do prepare estate tax returns, obtain signed engagement letters, subject your work product to an internal quality review, and document all conversations with the client and other professionals being consulted. When in doubt, refer the client to a CPA specializing in estate tax work.

If a team of professionals is working to resolve estate issues, the CPA should define his or her own responsibilities both orally and in writing, document all communications, and verify who each professional is representing prior to discussing estate tax matters with them.

### **"Phantom" Tax Returns**

Business clients typically must collect and remit taxes other than state and federal income taxes. CPAs who fail to sufficiently define the scope of their business tax engagements can face claims alleging that they failed to advise their clients of the need to collect taxes and file returns for payroll, sales, use or occupancy taxes, or for sales, use or income taxes owed on business conducted in another state based on the "nexus" rules.

When faced with a large and unexpected tax liability, some clients seek to hold their tax preparer liable for the amounts owed. In the absence of an engagement letter that clearly defines and limits the scope of tax services being rendered, the average judge or juror will view as irrelevant evidence the fact that the CPA firm received no payment to perform such additional services.

**Best Practice:** Again, issuing annual engagement letters is the best defense to these types of claims. The scope of the engagement should be clearly delineated. If the client has engaged the CPA firm only to prepare certain tax returns, identify the specific tax returns. If tax planning is part of the engagement, be specific in describing what type of advice will be rendered and on what tax topics. The engagement letter should advise the client to contact the firm principal-in-charge of the tax practice if additional services are desired.

Tax season can be both frantic and financially rewarding for many CPA firms. With a little advance preparation, CPA firms can minimize the risk of experiencing client relation problems and tax-related malpractice claims.

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