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August 18, 2011

RE: New IRS Guidelines for Auditing Attorneys

Dear Client:

On July 28, 2011 the IRS issued a new Audit Technique Guideline (ATG) to its examiners auditing an attorney.

In general, the ATG identifies the problem areas that the agents should review, how they should conduct their audit and the documents they should secure in the process of the examination.

The ATG specifically identifies various aspects of the attorney's business which should be reviewed. Specifically, -

1. Unreported Income –  
Fees may be received in the attorney's trust account and not transferred to the operating account as of the year end.  
Fees may be paid by check and deposited directly into personal or investment accounts and not the operating account of the attorney.  
The auditors are requested to give special attention to all checks that are deposited into accounts other than the general operating account or are cashed.
2. Deferral of Income –  
Fees received in the trust account and not released to the operating account until a subsequent tax year.  
The agents are encouraged to analyze the source of funds that remain in trust accounts as of the end of the tax year.
3. Non-cash Payments for Services Rendered –  
The agents are encouraged to verify the manner in which new assets have been acquired, which could reveal non-cash payment for services. Attorneys may receive an interest in a new entity which they assisted in forming.  
The agents are also encouraged to review loans payable to clients to determine if services have reduced the outstanding funds due.  
The agents are encouraged to look for bartering for legal services. The tool they are encouraged to use is a comparison of the attorney's work schedule with his claimed income. If the workload has not decreased but the revenue has, further examination may be warranted.

4. Constructive Receipt –

Income is constructively received when the taxpayer has the right to demand the money and there are no substantial limitations or conditions on his right to receive it. This situation could exist for attorneys working on an hourly basis and not reporting hours worked until a subsequent tax year.

5. Advanced Client Costs –

This issue would generally arise for attorneys who take cases on a contingency fee basis. Client costs are incurred and subsequent receipts reimburse the attorney for the expense. However, the IRS contends that this is a distortion of income if several tax years are involved in a given case. The IRS concludes that the courts have determined that costs paid on behalf of the client in that case are actually loans and are not deductible in the year paid. At the conclusion of the case, if the attorney has not been reimbursed for all of the client costs, a bad debt deduction would be allowed for the un-reimbursed portion.

The ATG states that a cash basis attorney is generally allowed to currently deduct general overhead expenses incurred in the normal operating procedures of the practice.

6. Other Issues –

The attorney misclassifying employees as independent contractors.

Whether the attorney has properly prepared and filed Forms 1099 for independent contractors paid from the attorney's operating or trust funds.

Whether the attorney has filed Form 8300 in cases where the attorney has received more than \$10,000 in one transaction or in two or more related transactions.

We are confident that none of our clients have any reason to be concerned about this new initiative. However, it may be helpful to be up to date on the necessity of maintaining accurate and timely maintained records. Should you have any questions or concerns please do not hesitate contacting me.

**Circular 230 Notice:** In accordance with Treasury Regulations which became applicable to all tax practitioners as of June 20, 2005, please note that any tax advice given herein (and in attachments) is not intended or written to be used, and cannot be used, by any taxpayer for the purpose of avoiding tax penalties.

With kindest personal regards,

Very truly yours,

  
CROWN & COMPANY

/gac