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# TAX ETHICS IN A CHANGING WORLD

Taxpayers' Federation of Illinois  
SALT Conference

Dave Holets  
Partner – Tax Standards, Quality, and Risk

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The information provided herein is educational in nature and is based on authorities that are subject to change.



# AGENDA

ONE

Tax ethics – a primer

TWO

Professional standards refresher

THREE

The ethics of artificial intelligence in tax

FOUR

Case study – tax strategy vs. tax fraud

FIVE

Q&A



# TAX ETHICS – A PRIMER

# Tax Ethics

- What can tax professionals do to make sure they are maintaining proper ethical standards?
- Consider your personal ethics regarding income taxes
  - Utilitarianism – Taxes should promote the maximum satisfaction across a population, e.g. wealth distribution
  - Deontology – Taxes should only be assessed based on an overall duty, e.g. anyone who uses a public school should pay tax to cover its use
  - Virtue ethics – Taxes should be assessed to encourage specific virtues, like charity and independence
- Do you timely pay and file your personal tax return?
- How do your actions impact yourself? Your employer? Your family? Your community?





# Tax Ethics

- NASBA funded an experiment made up of 132 CPAs from 2 large accounting firms
- CPAs were given an excerpt that either emphasized being an advocate for clients or maintaining integrity
- Participants read a hypothetical land development tax case and asked whether client would be taxed as a dealer or investor. Case facts suggested profit should have been taxed as ordinary income (dealer), but client preferred investor status
- Results demonstrated that judgements were in part based on the original excerpt they read about integrity vs. client advocacy

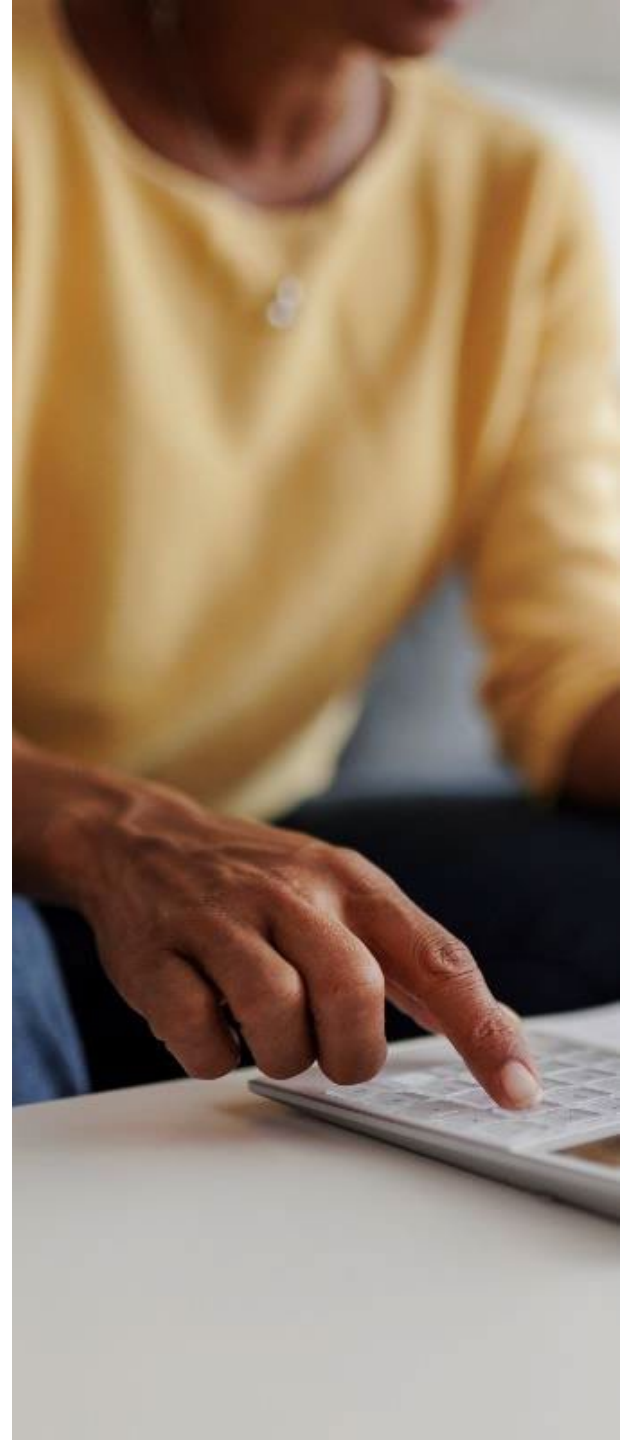


# PROFESSIONAL STANDARDS REFRESHER



# History of Tax Return Preparation

- Federal income tax was enacted in 1913 with the passage of the 16th Amendment
- In 1914, there were only 40 pages of income tax law, but there were already calls for simplification
- By 1916, the Bureau of Internal Revenue was asking for an overhaul of the US tax system
- From 1913 through 1993, there were about 400 federal income tax forms. By 2002, the IRS had added another 120 forms. BNA Forms currently lists over 2,000 federal tax forms and schedules
- During the first part of the 20th century, tax return preparation was an ancillary service to accounting
- Most taxpayers either prepared their own returns or had their returns prepared by their local IRS office





# History of Tax Return Preparation

- As of May 2022, the Bureau of Labor Statistics estimates there are over:
  - 1.4 million accountants and auditors
  - Over 82,000 tax preparers; and
  - Over 50,000 tax examiners and collectors, and revenue agents
- As of Jan. 2, 2024, the IRS reports issuing PTINs for 2024 to 21,069 attorneys; 172,039 CPAs; 138 enrolled actuaries; 57,613 enrolled agents; 423 enrolled retirement plan agents; issuing 60,166 annual filing season program records of completion. A total of 631,377 PTINs have been issued for 2024.
- According to the 2022 National Taxpayer Advocate Report to Congress, 53% of individual returns were prepared by paid return preparers in 2021. The percentage of business and other entity returns prepared by a paid return preparer is likely substantially higher.
- With the number of return preparers in the US, one would expect a highly regulated industry.



# Professional Standards

- Statutory Rules
  - Treasury Circular 230
  - State Codes of Conduct
- Regulatory Authority
  - SEC
  - PCAOB
  - FDICIA
- Professional Rules
  - AICPA Code of Professional Conduct
  - AICPA Statements on Standards for Tax Services
  - ABA Model Tax Rules





# Circular 230 – Applicable Parties

- Applies to tax practitioners representing clients before the IRS (not merely tax preparation). Tax preparation is not representation and thus not covered by Circular No. 230
  - Loving, 742 F.3d 1013 (D.C. Cir. 2014)
- Do you have a Form 2848, Power of Attorney and Declaration of Representative? You are considered “representing before the IRS”
- Most recent version published June 3, 2014 (Rev. 6-2014) and is currently being revised



# Statements on Standards for Tax Services

- Who do the standards apply to?
  - All AICPA members providing tax services, including members in public practice and industry
- How are the standards enforced?
  - Standards are generally enforced by referral to the AICPA
- What punishments apply if non-compliant?
  - Punishments include those available for a breach of the AICPA Code of Professional Conduct, which may include suspension or termination of AICPA membership
  - The AICPA may also refer cases to the relevant state boards of accountancy or similar regulatory authority



# Statements on Standards for Tax Services

- Topics covered:
  - Tax positions
  - Knowledge of errors
  - Data protection
  - Reliance on tools
  - Tax return questions
  - Reliance on others
  - Use of estimates
  - Departure from prior positions
  - Consulting services
  - Taxpayer representation

# THE ETHICS OF ARTIFICIAL INTELLIGENCE IN TAX



## Ethical use of AI in tax practice

- Professional judgement remains with the practitioner
- Verify AI output before using it in advice, returns, or communications
- Data protection
- Proper supervision of AI use by personnel and third parties
- Transparency about AI usage





## Data Protection – AICPA Code of Professional Conduct

- Definition of Client Confidential Information (0.400.09)
  - Any information obtained from the client that is not available to the public
- Confidential Information Obtained from Employment or Volunteer Activities (1.400.070, 2.400.070)
  - Member should maintain the confidentiality of his or her employer's or firm's confidential information and should not use or disclose any confidential employer information obtained as a result of an employment relationship
  - Member should be alert to the possibility of inadvertent disclosure, particularly to a close associate, close relative, or immediate family member
  - Member should take reasonable steps to ensure that staff under his or her control or others within the employing organization and persons from whom advice and assistance are obtained are aware of the confidential nature of the information

## Data Protection – Other Standards and Laws

- AICPA Statements on Standards for Tax Services (SSTS) Sec. 1.3 – Data Privacy
  - Members must take “reasonable efforts” to safeguard client data
  - Reasonable efforts may include use of VPN, encryption, and other security measures
- IRC Sec. 7216
  - Tax return preparers are subject to a fine of up to \$1,000 and/or 1 year imprisonment for the knowing or reckless disclosure of tax return authorization without authorization
  - Treasury Regs. Section 301.7216-2 and -3 define permissible disclosures without taxpayer consent and the form of consent needed to authorize certain disclosures
- Treasury Circular 230 – prohibits willful disclosure or other unauthorized use of taxpayer data
- FTC Safeguards rule – 16 CFR part 314 – requires financial institutions, including tax return preparers specifically, to develop, implement, and maintain a written information security program (WISP)
- ABA Model Rule 1.6 – requires informed consent for disclosure



## Privilege

- United States v. Heppner
  - Defendant entered attorney-provided information into consumer Claude
  - Court found no attorney-client relationship with the AI tool
  - Sharing privileged information with Claude/Anthropic waived privilege
  - Work product did not apply – counsel did not direct AI use
- Consider policies regarding recording meetings and use of AI notetakers



## Practical Controls

- Use only approved AI tools with suitable confidentiality and retention terms
- Prohibit client data, legal advice, and investigation material in public AI tools
- Separate legal advice from business, technical, and tax preparation discussions
- Train personnel on AI and include AI controls in engagement and vendor procedures

# CASE STUDY – TAX STRATEGY VS. TAX FRAUD

## Tax Strategy vs. Tax Fraud

Background:

- Micro-Captive Insurance – strategy identified in final regulations published in Treasury Decision 10029
- Regulations identify both listed and reportable transaction types
- Elements of a listed transaction:
  - Taxpayer sets up captive insurance company in which there is a 20% or greater direct or indirect ownership by the insured, owner, or another related party
  - Captive insurance company elects under 831(b) to exclude underwriting income from tax (requires premiums under \$2.9 million in 2026)
  - Taxpayer is in existence for at least 10 years
  - Taxpayer has an average loss ratio of less than 30% over 10-year testing window
  - Financing factor – captive provides loans or guarantees to related parties



## Tax Strategy vs. Tax Fraud

- Components of the strategy:
  - Insured entities get current insurance premium deduction
  - Captive entity pays tax only on investment earnings
  - Insured is able to develop customized insurance plan
  - Risks otherwise deemed uninsurable by the market can be covered, e.g. hurricane or flood insurance in a coastal area
  - Allows purchase of high-deductible insurance by insured to limit third party insurance expense





## Tax Strategy vs. Tax Fraud

Basic scenario for discussion – Family-owned restaurant sets up captive

- Issue 1 – Proper interpretation of existing law
  - Is there proper risk shifting?
    - Number of entities – 1 vs. multiple
    - Coverage of third-party risk
    - Use of reinsurance
- Is tax law regarding reserves followed?



## Tax Strategy vs. Tax Fraud

Basic scenario for discussion – Family-owned restaurant sets up captive

- Issue 2 – Economic substance
  - Is there a demonstrated reason for the captive beyond tax savings?
    - Captive is part of documented overall insurance plan
  - Is the captive financed appropriately?
    - Maintains at least minimum capital to meet state requirements
    - Not operated as “personal bank account”
    - Owner has real interest in business activity



## Tax Strategy vs. Tax Fraud

Basic scenario for discussion – Family-owned restaurant sets up captive

- Issue 3 – Form of transaction
  - Is there proper documentation?
    - Actuary involvement
    - Insurance manager
    - State licensing
  - Is the captive being run as a business?
    - Are claims submitted and paid consistently?
    - Are claims covered legitimate and/or priced appropriately? For example, flood insurance in Nevada should have low cost if covered at all

## Tax Strategy vs. Tax Fraud

Points to consider in analysis

- Does the strategy follow existing law and/or guidance?
- Is there economic substance to the strategy?
- Does the form of the strategy support a valid business purpose?
- Is there any guidance, formal or informal, about the strategy from tax officials or the general tax community?
- Gut check: does the strategy feel too good to be true?





## Tax Strategy vs. Tax Fraud

Recent Micro-Captive case law

- Patel v. Commissioner, 165 T.C. No. 10 (2025)
- CFM Insurance Inc. v. Commissioner, T.C. Memo 2025-83 (2025)



# Q&A



# THANK YOU

Dave Holets – Partner  
Tax Standards, Quality, and Risk  
317-706-2683  
david.holets@crowe.com



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