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discussion immediately? Failure to properly report and receive clearance from ...

Dec. 12, 2016



As Tax Season looms closer, it's worth having a quick discussion with the partner group on your firm's policy for paying client's tax penalties. Why should you have this discussion immediately? Failure to properly report and receive clearance from your insurer can void your policy on that issue! Tax penalties tend to make unhappy clients and unhappy clients tend to bring claims. Claims also make unhappy partners, but having a **claim with no insurance coverage will be exceedingly painful**. Tax claims are the most frequent type of claim, so it's worth being savvy in this area.

Why Firms Do This:

“Time is Money...” – Benjamin Franklin

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Paying Tax Penalties:

“I’m a big crier in general. The right life insurance commercial will take me out for a couple of days.” -Isaac “Ike” Barinholtz

VII. POLICY CONDITIONS – C. Cooperation and Assistance of the *Insured*:

3. The *Insureds* shall not, except at the *Named Insured*'s own cost and expense, **admit any liability**, assume any *Damages*, **voluntarily make any payments**, or incur any *Claim Expenses* **without the prior written consent of the Company**.

Referencing the language above, we can see that paying tax penalties is problematic on two fronts. First, you can't make voluntary payments. Second, these voluntary payments could insinuate your admission of liability for that penalty. The above was taken directly from a CAMICO policy, but regardless of who your insurer is, you likely have very similar policy language.

The larger the client, the larger penalty a firm would consider paying to keep them happy. It is also more likely that there is a significant underlying issue that brought about that penalty. This of course means there is a much higher probability for a claim to occur. Do not be caught without coverage.

What if I Waive My Fees Instead?

This could easily be construed as falling under the same exclusions as those raised when you pay penalties for your client. By waiving your fees, you are likely admitting some level of liability on the matter, and settling without insurer consent. The same considerations we raised for tax penalties should apply to waiving fees.

Speak with your Insurance Company First:

We recommend that you first consider speaking with your insurer concerning the

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your firm on how to proceed with the penalty, what to tell your client, and recommendations on how to prevent the issue in the future. With a quality insurer, all pre-claim expenses are *paid by your insurer and not subject to your deductible*.

3. After speaking with your insurer, the most likely outcome is that you'll receive permission to use their penalty waiver form. This should:
4. Avoid the exclusion barring coverage we discussed earlier.
5. Keep your client happy.
6. Provide your firm another opportunity to create good-will with your client.
7. Release you from most follow-on claims against your firm related to the penalty.

Will This Annoy My Clients?

"Those people who think they know everything are a great annoyance to those of us who do."
-Isaac Asimov

At first, many firms are hesitant to use their insurer provided release form because they believe that it may scare clients away or damage their accountant-client relationship. However, this practice has been in place for many years. They're usually quite happy to avoid additional payments, and it imparts additional good will on behalf of your firm. Think of it as another opportunity to interact with clients and demonstrate your ability to solve their problems.

When Should I Report?

"There are no secrets that time does not reveal." -Jean Racine

While we always want to keep you compliant with your policy, there is a risk/reward calculus present in all activities. In this instance, most of the firms we work with have developed a penalty threshold before reporting the issue to their insurer. After

all, going through the motions for every \$100 tax penalty is likely not worth the time,

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How Do I Report?

“We do all of our own stunts” – Dan & Joe

Within your professional liability policy, there should be a line that specifies how you are supposed to report any claims or potential claims. Proactive brokers that specialize in this area should be able to field the issue for you, and best position your case to the insurer.

Partner Action Items

☐ Send this article to relevant partners so you can have a basis for discussion. They need to understand the policy implications of paying penalties without insurer consent. They'll be involved with the following action items as well.

☐ Determine what threshold of penalty your firm will pay before you want it reported to your insurer. If your firm is going to pay tax penalties, or waive fees, on behalf of clients, discuss what special circumstances, regardless of penalty amount, would warrant reporting. Remember, this policy needs to remain internal. Don't promise your clients, contractually, or otherwise, that your firm will pay for all tax penalties.

☐ Consider who will be the central point of contact that will authorize payment of tax penalties. This is typically the CFO/Controller, advised by the leading tax partner. We often see the CFO/Controller speak with the Managing Partner before issuing large payments as a secondary check on compliance.

☐ Train your staff. This cannot be emphasized enough. Your staff should never promise a client your firm will pay a tax penalty without first being advised by management. They should also have a clear understanding of how, and to whom, they should report tax penalties and other client related problems.

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roughly the same exclusion we discussed, consider sending them this article.

Please direct further questions to:

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