Chapter 5: Ethics

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Please note. Corrections for all of the chapters are available at www.TaxSchool.illinois.edu. For clarification about acronyms used throughout this chapter, see the Acronym Glossary at the end of the Index.

REGULATION OF TAX PRACTITIONERS: UPCOMING CHANGES

Circular 230 defines “practice” before the IRS as encompassing all matters connected with a presentation to the IRS or its officers or employees relating to a taxpayer’s rights, privileges, or liabilities under laws or regulations administered by the IRS.1 This includes preparing and filing documents, corresponding, and communicating with the IRS. It also includes providing written advice regarding any entity, transaction, plan or arrangement, or any plan or arrangement having a potential for tax avoidance or evasion, and representing clients at conferences, hearings, and meetings. Circular 230 specifically states that none of its provisions may be construed as authorizing nonlawyers to practice law.2

All practitioners must comply with the requirements of Circular 230 when practicing before the IRS. Any individual who prepares or assists with the preparation of a tax return or claim for refund for compensation must have a preparer tax identification number (PTIN).3 The Office of Professional Responsibility (OPR) may discipline practitioners who violate the rules of the circular. Disciplinary measures include public censure, suspension or disbarment from practice before the IRS, and monetary fines.4 Other ethical standards also may apply to practitioners, such as rules of professional conduct governing lawyers and CPAs. Clients also may institute civil actions against practitioners for substandard work done on tax matters.

Note. Circular 230 provides that a person who is a tax return preparer under IRC §7701(a)(36) also is a tax return preparer subject to the rules of Circular 230.5 The scope of this provision is unclear. For example, an accountant who advises a client about the tax treatment of a transaction on a tax return may be considered a return preparer under IRC §7701 if the issue involves a substantial tax liability. It is questionable, however, whether the accountant is a return preparer subject to the requirements of Circular 230 if they do not prepare other returns or otherwise practice before the IRS.

2. Circular 230, §10.32.
5. Circular 230, §10.2.
On September 17, 2012, the Department of the Treasury published proposed regulatory changes to Circular 230.\(^6\) In the preamble to the proposed regulations, the Department of the Treasury stated that several changes were necessary, including the following.

- Eliminate the complex covered opinion rules
- Expand the requirements for written tax advice
- Broaden the rules to which firm managers must adhere to ensure Circular 230 compliance by their employees and associates
- Provide a definition of competence

This chapter addresses the proposed changes to Circular 230 as well as other key sections of Circular 230.

Note. Although the discussion period for these proposed changes closed November 16, 2012, no action has yet been taken on these proposed changes at the time this chapter went to press.

REGISTERED TAX RETURN PREPARERS (RTRP) STATUS

A recent decision by the U.S. District Court for the District of Columbia invalidated the provisions of Circular 230 regulating tax return preparers, holding that the statute allowing the Treasury to regulate representatives who practice before the IRS does not apply to tax return preparers.\(^7\) The decision applies to the regulations issued in 2011 that require certain tax return preparers to pass a qualifying examination, pay an annual application fee, and take a specified number of continuing education courses each year.\(^8\) The court issued a declaratory judgment that the IRS lacks the statutory authority to promulgate or enforce its new regulatory scheme for RTRPs. The court also issued a permanent injunction barring the IRS from enforcing its registration requirements for tax return preparers. The decision does not affect the provisions of Circular 230 relating to practitioners such as lawyers, CPAs, and enrolled agents.

The IRS appealed the decision to the U.S. Court of Appeals for the District of Columbia, maintaining that the regulations are a valid interpretation of an ambiguous statute authorizing the agency to regulate tax practice. In its reply brief, the plaintiff tax return preparers argued that the district court correctly determined that the statute is unambiguous in its description of “practice” as advising and assisting persons in presenting their cases — a definition that excludes tax return preparation.\(^9\) The tax return preparers’ brief describes the RTRP regulations as an “unprecedented federal licensing scheme” that exceeds the boundaries of the statute the IRS relies upon.

Note. If the district court’s decision is affirmed on appeal, a new law from Congress will be required for the IRS to regulate tax return preparers. In that situation, a new statute may authorize the IRS to impose more complex, burdensome, and expensive requirements on tax return preparers.

Observation. At the time this book went to press, oral arguments in connection with the injunction that now precludes the IRS from enforcing the RTRP rules were scheduled in the D.C. Court of Appeals for September 24, 2013.

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\(^7\) Loving et al. v. IRS et al., No. 1:12-cv-00385-JEB, D.C. Cir. (Jan. 18, 2013).
\(^9\) Loving et al. v. IRS et al., No. 13-05061, D.C. Cir. (May 17, 2013).
PTIN REGISTRATION

Although the court injunction precludes the IRS from enforcing the RTRP-related program and regulations, the PTIN requirements remain intact and the PTIN registration process continues to be administered by the IRS.

A PTIN may be applied for or renewed through the IRS website or using Form W-12, IRS Paid Preparer Tax Identification Number (PTIN) Application and Renewal. Both alternatives ask the applicant about past felony convictions, federal tax compliance, and professional credentials without any further background information being requested from the applicant. The IRS has indicated that proposals are still being considered to bolster the level of background and suitability checks through the PTIN registry, including fingerprinting.10

**Observation.** Because the PTIN process must be used by all tax return preparers (including CPAs, attorneys, and enrolled agents), a PTIN suitability and background check covers all preparers.

USE OF CLIENT INFORMATION

A practitioner must promptly submit information or records properly requested by the IRS unless the practitioner has a good faith, reasonable belief that the information is privileged.11 If the practitioner or client does not possess or control the requested records or information, the practitioner must promptly notify the IRS and provide information about the identity of anyone the practitioner believes may have possession or control of such materials.12 Consequently, a practitioner may not simply ignore an IRS request for documents or information.

A practitioner must make a “reasonable inquiry” of a client about the possession or control of the records or information, but need not question any other person or independently verify information a client provides regarding the identity of such persons.13 A practitioner may not interfere with a proper and lawful IRS effort to obtain records or information unless the practitioner has a good faith, reasonable belief that the record or information is privileged.14 Upon a proper and lawful request by an IRS officer or employee regarding an alleged violation of Circular 230, a practitioner must provide information concerning the alleged violation and testify about this information in any proceeding, unless the practitioner has a good faith and reasonable belief that the information is privileged.15

A practitioner who knows that a client has not complied with the U.S. tax laws or has made an error or omission with respect to any return, document, affidavit, or other paper submitted or executed under such laws must promptly advise the client about the noncompliance, error, or omission.16 This duty to advise the client of the error or omission does not require further advice regarding corrections, additional tax payments, or refund requests. In many situations, however, further advice may be appropriate.

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13. Ibid.