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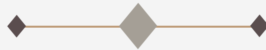

Addressing the Complexity of Tax Practice Rules

By Marshall J. Heap, EA

Action Required:

Addressing the Complexity of Tax Practice Rules

Historically, Circular 230 has embodied the regulation of tax practice before the IRS, including the ethical standards that tax practitioners must follow. Originally, 31 USC Sec. 330, which originated in the Horse Act of 1884, granted the secretary of the Treasury the authority to regulate agents representing claimants before the Treasury Department. Treasury used circulars to provide guidance to these agents. In 1921, these circulars were combined into a single governing document, and Circular 230 was born.[1]

The current edition of Circular 230 (*Regulations Governing Practice before the Internal Revenue Service*) was published in June 2014. However, it is not the only source of ethical regulations and guidance for tax professionals. In addition to reviewing relevant court cases (such as *Loving v. IRS*, *Ridgely v. Lew*, *Sexton v. Hawkins*, and *Steele v. United States*), tax professionals should also be aware of the official pronouncements shown in the table below.

This article discusses public laws regulating tax professionals' behavior, court cases affecting Treasury's ability to oversee tax preparers, the work of the Office of Professional Responsibility (OPR), and recent legislative initiatives in this area. It also looks candidly at several actions that could be undertaken to unravel the complexity of tax practice rules.

Increasing Regulation of Tax Preparer Behavior by Fiat

Several statutory provisions include penalties for tax return preparer violations.[3] These range from relatively minor violations, such as failure to sign a tax return or provide a client with a copy of the same, to serious acts such as fraud and false statements. (Kathy Morgan, EA, USTCP, offers a detailed discussion of these penalties in her article "Due Diligence: It's Not Just about EITC Anymore!" on pages 10–14 of this issue.)

Most tax return preparers, and certainly those among our readership, do not run afoul of these violations. Therefore, this article focuses on those provisions shown in the table that even scrupulous preparers should be careful to heed.

The Revenue Act of 1971 (PL 92-178) counts among its many provisions IRC Sec. 7216. Effective beginning January 1, 1972, tax return preparers who knowingly or recklessly disclose or use clients' tax return information for purposes other than tax preparation are subject to sanctions. Treasury Reg Sec. 301.7216-1(b)(5) clarifies:

> "The term disclosure means the act of making tax return information known to any person in any manner whatever. To the extent that a taxpayer's use of a hyperlink results in the transmission of tax return information, this transmission of tax return information is a disclosure by the tax return preparer subject to penalty under section 7216 if not authorized by regulation."

A violation of these rules can result in a misdemeanor conviction punishable by up to one year in prison and/or a maximum fine of $1,000, together with prosecution costs. These sanctions emphasize how careful preparers must be in safeguarding client information to prevent unauthorized use or disclosure, even before consideration of the Gramm-Leach-Bliley Act (GLBA) provisions.

The Safeguards Rule of the 1999 GLBA specifically lists tax return preparers as

Table 1. Other Ethical Regulations and Guidance for Tax Professionals beyond Circular 230

Pronouncement	Description	Effective Date(s)
IRC Sec. 7216 and associated Treasury regulations	Prohibits improper disclosure or use of information by preparers of returns	January 1, 1972
The Gramm-Leach-Bliley Act (GLBA)[2] Safeguards Rule	Requires secure storage of confidential client information (both paper and digital)	November 12, 1999
IRC Sec. 6695(g)	Establishes a $510 preparer penalty for failure to exercise due diligence in claiming refundable tax credits or head-of-household filing status	January 1, 1997: Earned Income Credit January 1, 2016: Child Tax Credit, Additional Child Tax Credit, and American Opportunity Tax Credit January 1, 2018: Head of Household

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one of the businesses required to safeguard client data.[4] These businesses are required to have a written plan that details how it will keep customer information secure, according to the Federal Trade Commission (FTC). The Safeguards Rule provides detailed guidelines regarding the structure and implementation of a suitable plan for the secure storage of confidential client information, regardless of whether such information is in paper or digital form. For example, the guidelines recommend that digital client information be kept in encrypted files.

Consumers can file complaints with the FTC regarding businesses that engage in fraudulent, deceptive, or unfair business practices. The FTC then enters these consumer complaints into a secure online database that is accessible by civil and criminal law enforcement agencies.[5]

Another statutory provision that affects tax return preparers is the due diligence requirements for claiming refundable tax credits under IRC Sec. 6695(g). Initially, these requirements applied only to the Earned Income Credit, until the Child Tax Credit, Additional Child Tax Credit, and the American Opportunity Tax Credit were added in 2016. The latest expansion to these preparer due diligence requirements came with the Tax Cuts and Jobs Act of 2017 (TCJA), which added the determination of head of household filing status eligibility. Preparers are subject to a $510 penalty for each failure to exercise due diligence under IRC Sec. 6695(g).

Preparer incompetence and disreputable conduct are punishable under subpart C of Circular 230 (discussed later in the OPR section of this article). However, none of the statutory preparer penalty provisions previously discussed are mentioned in Circular 230, which, it is worth remembering, is titled *Regulations Governing Practice before the Internal Revenue Service*.

Circular 230 also fails to express the responsibilities of a tax preparer with respect to his/her clients. It includes comprehensive rules for disclosure of taxpayer information to the IRS and the courts, yet it is silent on the general need to maintain the confidentiality of client information. Both IRC Sec. 7216 and the GLBA Safeguards Rule, however, shed light on these requirements. Further, some IRS oversight responsibilities under Circular 230 are increasingly under question, as several recent court cases have shown.

Recent Significant Court Decisions Regarding Tax Practitioners

Several recent court cases have dealt with tax practices. In *Loving*,[6] the U.S. Court of Appeals for the District of Columbia upheld the district court's previous decision that the IRS lacks the statutory authority to enforce its 2011 regulatory program for registered tax return preparers (RTRPs).[7] Moreover, the court also issued a permanent injunction barring the IRS from enforcing registration requirements for tax return preparers. Although this decision did not specifically address Circular 230 practitioners, such as lawyers, CPAs, and enrolled agents, it strongly influenced subsequent court decisions. The IRS decided not to further appeal the ruling.[8]

In *Ridgely*,[9] the U.S. District Court for the District of Columbia was asked to rule whether the IRS has statutory authority to regulate a tax preparer's contingent fee arrangement used in the preparation of an ordinary refund claim. As in *Loving*, the court reviewed the Horse Act of 1884, which the IRS cited as its source of regulatory authority, and noted that this Act provides the IRS with authority to regulate only "representatives," not tax return preparers. After citing the *Loving* case as precedent, the court concluded that IRS's attempted regulation of *Ridgely*'s contingent fee arrangement was beyond the scope of its statutory authority and was therefore unlawful.

Steve Johnson, a Florida State University College of Law professor, argued that the *Loving* and *Ridgely* district court decisions indicate that IRS may be exceeding its authority in regulating the practice of *any* tax return preparer under Circular 230. Johnson concludes that "if the approach of recent cases is confirmed by future litigation and Congress chooses not to act, significant portions of Circular 230 may be at risk of invalidation."[10]

Post *Ridgely*, there have been two noteworthy cases. *Sexton*[11] concerns an OPR (headed by the defendant, Karen Hawkins) investigation stemming from a client complaint concerning the plaintiff's tax practice activity. The plaintiff, an attorney with a master's degree in taxation, was suspended (indefinitely) from practice before IRS by OPR in 2008. The court ruled in 2017 that OPR had no jurisdiction to conduct an investigation of the plaintiff. Specifically, the court concluded that OPR lacked "statutory authority to enact, promulgate or enforce demands or authority" over Sexton pertaining to his tax preparation and tax consulting activities. In referring to *Loving*, the court stated that practice before a court or agency "ordinarily refers to practice during an investigation, adversarial hearing, or other adjudicative proceeding before the IRS and that this does not encompass the work of tax preparers."

Regarding tax advice, the court reasoned that the authority provided the secretary of the Treasury by 31 USC Sec. 330(e) "allows the secretary to impose standards to the rendering of such advice—but does not provide a mechanism to sanction such advice, nor the offering of such advice."

In *Steele*,[12] the most recent case, the U.S. District Court for the District of Columbia confirmed IRS's authority to require tax return preparers to obtain preparer tax identification numbers (PTINs), yet it ruled that the IRS may not charge fees for issuing those PTINs. The core reasoning behind the court's June 1, 2017, decision was that the RTRP regulations regarding testing and eligibility requirements (struck down by the *Loving* case) and the PTIN regulations are interrelated. In basing its ruling on *Loving*, the court stated:

> "Although the IRS may require the use of PTINs, it may not charge fees for PTINs because this would be equivalent to imposing a regulatory licensing scheme and the IRS does not have such regulatory authority."

At the time of writing, IRS is appealing this decision. However, the January 5, 2018, issue of NAEA's *E@lert* reported that the U.S. District Court for the District of Columbia denied IRS's motion to stay the injunction prohibiting it from collecting PTIN fees during appeal.[13] Interestingly, the court stated that the government's "rehashed arguments" did not present any "serious, substantial, difficult and doubtful" issues since the last memorandum opinion. The court also noted that the government had not presented any new information since the last ruling. These court observations do not bode well for the eventual success of IRS's appeal.

The recurring theme in all these cases is that the secretary of the Treasury has authority under 31 USC Sec. 330 to regulate representation during an investigation, adversarial hearing, or other adjudicative proceeding before the IRS. Beyond that, the secretary can impose standards for the rendering of tax advice, but it cannot sanction such advice, nor can it sanction the offering of such advice. Most importantly, the secretary does not have the authority to regulate tax preparation. Clearly, these rulings severely limit the jurisdiction of OPR.

The Office of Professional Responsibility

OPR ultimately derives its authority from 31 USC 330. It is responsible for applying the rules, regulations, ethical/conduct provisions, and disciplinary procedures to those who practice before the IRS. This includes rules and regulations embodied in Circular 230, as well as the statute and associated regulations.[14]

In 2016, OPR had 32 staff members, including attorneys, paralegals, management, and administrative personnel, who closed 889 cases of alleged practitioner misconduct. Although disciplinary or corrective actions applied in 42 percent (369) of these cases, they consisted of reprimands and "soft" (no further action) notices 83 percent of the time. There were 64 cases with more serious sanctions. OPR's *FY 2016 Accomplishment Report* specifically cites lack of practitioner due diligence and competence as the cause of many conduct violations.[15]

As of September 1, 2017, there were 722,262 persons who held valid PTINs, but only 351,680 (49 percent) were Circular 230 tax practitioners authorized to practice before the IRS and subject to OPR oversight.[16] Consequently, total practitioner violations and serious practitioner violations constituted roughly 0.1 percent (369 ÷ 351,680) and 0.02 percent (64 ÷ 351,680), respectively, of active qualified practitioners. We could draw several conclusions: Circular 230 practitioners exhibit exemplary behavior, OPR does not have the manpower to properly investigate all potential violations, or misconduct violations are underreported. Speaking of reporting, the *FY 2016 Accomplishment Report* is vague on the sources of misconduct reporting. However, it appears that most misconduct referrals come from either the Return Preparer Office (RPO) or IRS field personnel. Going forward, OPR will increase coordination with the RPO to identify recipients of preparer penalties that constitute mandatory referrals to OPR.[17]

Until recently, members of the public relied on the *Internal Revenue Bulletin* for information on sanctioned tax practitioners. In 2016, OPR compiled this list into an Excel spreadsheet, which is now available on IRS's website.[18] Information on how to make a formal complaint regarding a tax preparer is also available on IRS's website.[19]

Legislative Proposals to Regulate Tax Preparation

For the last three years, the IRS Advisory Council has recommended that Congress

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enact legislation granting Treasury the authority to regulate practice by all paid return preparers.[20] Members of this OPR-appointed subgroup are credentialed tax practitioners.

However, not everyone agrees that Treasury is the only candidate to oversee tax preparers. For example, on April 10, 2014, Rep. Suzanne Bonamici (D-OR) proposed the Tax Refund Protection Act of 2014,[21] which would vest the authority to regulate uncredentialed tax return preparers in the Consumer Financial Protection Bureau.

More recently, Reps. Diane Black (R-TN) and Patrick Meehan (R-PA) introduced the Tax Return Preparer Competency Act of 2015,[22] which would have required all tax return preparers to meet minimum competency standards, attend continuing education classes, and submit to a background check.

Both bills died.

Conclusion

Contributing to the complexity of tax practice rules is the fact that they originate from several sources, which requires tax practitioners to be familiar not only with Circular 230, but also with statutory provisions in the Internal Revenue Code, the GLBA, and relevant court cases. Moreover, tax practitioners must keep up with new developments in real time (the latest being the new head of household due diligence requirements in the TCJA). OPR could help reduce this complexity by preparing a tax preparer/representative code of conduct that summarizes and regularly updates all these requirements. This code of conduct could easily be communicated to tax practitioners through their IRS PTIN accounts.

Current confusion stems from the need for clarification of IRS's role in tax preparer oversight. A legislative solution to the question of tax preparer regulation would be preferable. Interestingly, Republican leaders in Congress have already indicated that a technical corrections bill may be required to fix drafting mistakes in the TCJA.[23] This could represent an opportunity to tack on legislation for regulation of all tax preparers, assuming the rules permit this. The two recent legislative proposals coming from opposite sides of the aisle suggest that tax preparer regulation is an area where bipartisan support is possible. However, regardless of the feasibility of legislation in this regard, other actions can be undertaken.

Perhaps the most pressing action required is a revision of Circular 230 in light of recent court decisions, particularly concerning tax preparation and consulting. Tax practitioners, OPR, and taxpayers all stand to benefit from this. Taxpayers should benefit, too, because they will know what tax preparer complaints are actionable by OPR, unlike the client in *Sexton*. In fact, there is a need to raise public awareness regarding the role of OPR in tax preparer oversight.

OPR is part of the IRS, so, unsurprisingly, it has relied heavily on IRS resources to identify alleged tax preparer/representative misconduct. We would all benefit from a higher-profile RPO so that taxpayers are better informed regarding disciplined preparers, complaint procedures, actionable complaints, and annual misconduct statistics. After all, the vast majority of tax practitioners are scrupulous individuals who take pride in carrying out their work to the highest standards. Improving the visibility of RPO's role is ultimately in the best interests of both these practitioners and the taxpayers.

As the leading professional society representing enrolled agents, NAEA plays an important role here. For instance, NAEA was part of a coalition of organizations that have pushed for IRS reform, which would include a strengthened practitioner organization within IRS. Moreover, NAEA has for many years advocated for minimum standards for paid preparers, long before it became popular to do so. **EA**

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Disclaimer

The views and opinions expressed in this article belong to the author and do not necessarily reflect the views and opinions of NAEA.

About the Author

Marshall J. Heap, EA, is a tax content development and instruction specialist at the University of Illinois Tax School. An EA since 1984, Marshall was a senior manager at PricewaterhouseCoopers and has seven years' experience as an approved IRS continuing education provider. Marshall's academic background is in computing and associated fields, with degrees from the following UK universities: The Open University (BSc), University of London, Birkbeck College (MSc), and University of Reading (PhD).

ENDNOTES

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23. Tax Cuts and Jobs Act, Public Law 115-97 (Dec. 22, 2017).

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