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June 4, 2009

Hon. Douglas Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Comments on Proposed Amendments to Circular 230 § 10.34

Dear Commissioner Shulman:

Enclosed are comments on proposed amendments to Circular 230 section 10.34. These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association, and should not be construed as representing the policy of the American Bar Association.

Sincerely,

Stuart M. Lewis
Chair - Elect, Section of Taxation

Enclosure

cc: Eric San Juan, Tax Legislative Council (Acting), Department of the Treasury
Karen Hawkins, Director, Office of Professional Responsibility, Internal Revenue Service
Clarissa C. Potter, Acting Chief Counsel, Internal Revenue Service
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**AMERICAN BAR ASSOCIATION SECTION OF TAXATION
COMMENTS ON PROPOSED AMENDMENTS TO
CIRCULAR 230 § 10.34**

The following comments (these “Comments”) are submitted on behalf of the American Bar Association Section of Taxation (the “Section”) and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, the Comments should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Peter S. Wilson, Chair of the Section’s Standards of Tax Practice Committee’s Task Force on Circular 230 section 10.34 Comments. Substantive contributions were made by Linda M. Beale, Michael Lang, Rochelle L. Hodes, and Ronald M. Wiener. These Comments were reviewed by Mona L. Hymel, Chair of the Standards of Tax Practice Committee (the “Committee”) and by Scott D. Michel and Diana L. Erbsen, current and incoming Vice-Chairs of the Committee. These Comments were further reviewed by Charles A. Pulaski, Jr. of the Section’s Committee on Government Submissions and by Kathryn Keneally, the Section’s Council Director for the Committee.

Although members of the Section of Taxation who participated in preparing these Comments have clients who might be affected by the principles addressed by these Comments or may have advised clients in the application of said principles, and all could be affected in their capacity as practitioners, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make, or has a specific individual interest in making, a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

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Date: June 4, 2009

EXECUTIVE SUMMARY

On September 26, 2007, the Treasury Department (“Treasury”) published proposed amendments to section 10.34 of Circular 230¹ in response to changes to section 6694 enacted in May 2007.² There have been a number of important developments since those amendments were initially proposed, including retroactive changes to section 6694 enacted in October 2008 and the issuance of final regulations under sections 6694 and 7701 in December 2008.

We believe that a principles-based approach to the standards of professional conduct for authorized tax practitioners is conducive to achieving the purposes of Circular 230, and we encourage Treasury to employ this approach in any amendment to Circular 230 section 10.34. Consistent with this approach, we believe that Circular 230 section 10.34 should require practitioners to comply with their section 6694 obligations without repeating all the technical requirements set forth in section 6694 and the regulations thereunder.

While we generally support the objective of reconciling certain provisions of Circular 230 section 10.34 with the revised standards in section 6694, there are important differences between Circular 230 and the section 6694 preparer penalty. One critical distinction involves the respective standards for sanction: a section 6694 penalty can be assessed for a single act of negligent tax return preparation resulting in an understatement, while a sanction for an isolated violation of Circular 230 section 10.34 requires a finding of willfulness, recklessness, or gross incompetence. We recommend that Treasury explicitly address this standard for professional discipline and clearly indicate that a practitioner should not be subject to a Circular 230 sanction as a result of a diligent application of uncertain definitions or concepts that affect section 6694 (*e.g.*, the meaning of “significant purpose”).

We support the modification of internal guidance for Internal Revenue Service (“Service”) personnel to eliminate the automatic referral to the Service’s Office of Professional Responsibility (“OPR”) for non-willful, though negligent, tax return preparation under section 6694(a). Because the standard for applying the section 6694(b) penalty (*i.e.*, willfulness or recklessness) parallels the standard in Circular 230 section 10.52, we assume that an assessment of a section 6694(b) penalty will continue to result in an automatic referral to OPR.

In light of the scope and significance of the developments since September 2007, and because of the importance of Circular 230 in regulating practitioners, we believe that the changes to Circular 230 section 10.34 should be repropounded to permit the tax practitioner community to consider these changes in the context of the current state of section 6694 and related guidance, as well as the interaction and the distinctions between Circular 230 section 10.34 and section 6694.

¹ 31 C.F.R. Part 10.

² References to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”), unless otherwise indicated.

DISCUSSION

On May 25, 2007, Congress amended section 6694 to revise the standard for a tax return preparer to prepare all or a substantial portion of a tax return from the former realistic possibility standard to a reasonable belief that a tax return position is more likely than not correct. Revised section 6694 did permit a preparer to prepare a return reporting a position below that standard so long as there was a reasonable basis for the position and the position was adequately disclosed on the return.

On September 26, 2007, Treasury published proposed amendments to Circular 230 section 10.34 in response to the changes to section 6694. In proposing these amendments, Treasury indicated that “the Treasury Department and the IRS have determined that the professional standards under Circular 230 section 10.34 should conform with the civil penalty standards for return preparers.”

On October 3, 2008, President Bush signed the Emergency Economic Stabilization Act of 2008 (the “2008 Act”), which again revised section 6694 to lower the general tax return preparer standard for undisclosed positions to substantial authority, retroactive to May 25, 2007. However, Congress also created a special rule for tax return positions attributable to a tax shelter, as defined in section 6662(d), and for reportable transactions to which section 6662A applies. This special rule requires that the preparer have a reasonable belief that such a tax return position is more likely than not correct, but it does not permit a preparer to employ adequate return disclosure to prepare a return reporting such a position below the more likely than not standard. This special rule applies to positions on returns for tax years ending after October 3, 2008.

On December 15, 2008, Treasury and the Service issued final regulations under section 6694 implementing the changes effected by the 2007 legislation, but those regulations did not address the 2008 Act’s special rule for section 6662(d) tax shelters and for reportable transactions subject to section 6662A. Simultaneously with the issuance of these regulations, the Service issued Notice 2009-5 to provide tax return preparers with interim guidance for applying that special rule.

We generally support the objective of reconciling certain provisions of Circular 230 section 10.34 with the revised standards in section 6694. However, the different purposes of the preparer penalty regime of section 6694(a) and the Circular 230 standards of practice before the Service dictate that the approach to Circular 230 not simply repeat the provisions of the regulations interpreting section 6694.

There are a number of important differences between Circular 230 and the preparer penalty provisions of section 6694:

- Circular 230 establishes standards of professional conduct, including a statement of best practices,³ while section 6694 is a civil penalty provision intended to encourage compliance with existing substantive tax provisions.

³ Circular 230 § 10.33.

- Circular 230 governs the right to practice before the Service by attorneys, certified public accountants, enrolled agents, enrolled actuaries, appraisers, and enrolled retirement plan agents. Section 6694 applies to any paid preparer of a Federal tax return, regardless of whether the preparer is authorized to practice under Circular 230.
- Circular 230 section 10.34 applies to a broader range of conduct than does section 6694. For example, the Circular 230 standards apply to pre-transaction tax planning advice that is not subject to a section 6694 civil penalty.⁴ The final regulations defining a “preparer” subject to the section 6694 penalty contain both a *de minimis* test⁵ and the concept of “substantial portion,”⁶ neither of which is relevant in applying Circular 230.
- The standards for discipline under Circular 230 require either willful or reckless misconduct or a *pattern* of negligent behavior.⁷ The section 6694(a) preparer penalty may be imposed for a single instance of noncompliance with the section 6694 standards in tax return preparation. Because of this difference in standards, we expect that the section 6694 preparer penalty will be imposed more often than sanctions under Circular 230 section 10.34.
- A Circular 230 violation may result in an offending practitioner being censured, suspended, disbarred, or subjected to a monetary penalty.⁸ The consequences of a violation of section 6694 are limited to monetary penalties.
- A practitioner subjected to censure, suspension, disbarment, or a monetary penalty under Circular 230 will be publicly identified by OPR, with resulting damage to the practitioner’s professional reputation. Section 6103 prohibits the Service from publicly identifying preparers subject to the section 6694 penalty.
- OPR has some discretion in the amount of any Circular 230 monetary penalty,⁹ while the amount of a section 6694 penalty is fixed by statute.

⁴ Reg. § 301.7701-15(b)(2) excludes from the definition of “preparer,” and thus excludes from the application of the section 6694 penalty, an individual who provides tax planning advice solely prior to the occurrence of the events that are ultimately reported on the return.

⁵ Reg. § 301.7701-15(b)(2)(i).

⁶ Reg. § 301.7701-15(b)(3).

⁷ Circular 230 §§ 10.51(a)(13), 10.52(a).

⁸ Circular 230 §10.50.

⁹ The statute authorizing the Circular 230 monetary penalty limits the amount of the penalty to “the gross income derived (or to be derived) from the conduct giving rise to the penalty.” 31 U.S.C. § 330(b).

We have considered these differences relevant in the preparation of these Comments, and we strongly encourage Treasury and the Service to evaluate these differences in revising Circular 230 and the related guidance discussed below.

1. Principles-Based Approach to Circular 230 Standards

We strongly support the adoption of a principles-based approach to the standards of professional conduct for authorized tax practitioners under Circular 230. We believe that such a principles-based approach is conducive to achieving the purposes of Circular 230, and we encourage Treasury to employ this approach in any amendment to Circular 230 section 10.34.

2. Practitioner Obligations Under Circular 230 § 10.34(a)

The proposed revision of Circular 230 section 10.34(a) substituted the “more likely than not” and “reasonable basis” standards in revised section 6694 for the former “realistic possibility” and “not frivolous” standards that existed prior to May 2007. The retroactive statutory changes made by the 2008 Act have resulted in the proposed standard for Circular 230 section 10.34(a) being higher than the general standard in section 6694.

The final section 6694 preparer penalty regulations established different disclosure criteria for signing and nonsigning tax return preparers and included detailed rules for meeting the preparer’s disclosure obligations. We believe that Circular 230 section 10.34(a) should recognize the differing obligations of practitioners who sign returns and those who provide advice regarding a position. We also believe that, subject to the differing standards required to establish a violation, the standards and means of adequately disclosing a tax return position under Circular 230 section 10.34 should be consistent with the disclosure obligations and mechanics under section 6694.

To achieve an appropriate degree of conformity between Circular 230 section 10.34 and section 6694, we recommend that Circular 230 section 10.34(a) be revised as follows:

- (a) Tax returns. A practitioner who is a preparer of a tax return shall satisfy the obligations set forth in section 6694 of the Code and the regulations thereunder.

We also recommend that Circular sections 10.34(d) and 10.34(e) either be replaced with a general statement that the terms used and rules regarding practitioner diligence applied under section 10.34 shall be interpreted in a manner consistent with the definitions and rules used in the application of section 6694, or deleted in their entirety.

In keeping with a principles-based approach, and in light of the Circular 230 standards for discipline discussed below, we do not believe that Circular 230 section 10.34 should specifically enumerate all applicable practitioner-favorable provisions of section 6694 (*e.g.*, reasonable cause).

3. **Circular 230 Standard for Discipline**

As noted above, the 2008 Act adopted a separate “reasonable belief of more likely than not” standard for tax return positions attributable to a tax shelter, as defined in section 6662(d), and for reportable transactions to which the section 6662A penalty applies. Both section 6662(d) and section 6662A employ the concept of a “significant purpose” of tax avoidance, but neither these statutory provisions nor any related Regulations provide meaningful guidance as to the meaning of “significant purpose.” The subjective nature of certain other relevant concepts, such as the definition of a “transaction” and the meaning of “substantially similar” under Regulation section 1.6011-4, also result in a high degree of practitioner uncertainty regarding the application of the special rule in section 6694(a)(2)(C) to both tax return preparation and advice to taxpayers. It would be inappropriate to enforce a standard for professional discipline based upon uncertain definitions or concepts that do not have a generally accepted meaning.

We believe that Circular 230 effectively addresses the potential problems posed by this uncertainty in the standards for discipline under Circular 230 section 10.52, which requires a finding that a practitioner’s violation of Circular 230 section 10.34 resulted from willfulness, recklessness, or gross incompetence as a condition to disciplinary sanction for any individual violation.¹⁰ These standards simply do not permit a disciplinary sanction based on a disagreement with a practitioner’s diligent determination as to the scope or meaning of a particular definition or concept.

We recommend that the Treasury Decision adopting any final amendments to Circular 230 section 10.34 and any internal guidance to Service personnel explicitly discuss the standards for discipline under Circular 230 section 10.51 and section 10.52 and clearly state that these standards effectively prevent the imposition of a sanction for an alleged violation attributable to a practitioner’s diligent application of uncertain definitions or concepts. We also recommend that the Treasury Decision specifically address the current state of uncertainty surrounding “significant purpose” in the special rule governing section 6662(d) tax shelters and reportable transactions subject to section 6662A. We believe that these statements will help to avoid confusion among practitioners concerning the application of Circular 230 section 10.34 and further the purposes of Circular 230.

Of course, the future publication of regulations or other guidance addressing areas of uncertainty surrounding section 6694 will prospectively affect the application of Circular 230 section 10.34 to practitioner conduct. We are aware that Treasury is considering regulatory guidance concerning the “significant purpose” issue discussed above. The principles based approach that we have advocated, with appropriate emphasis on the standards for discipline in Circular 230 section 10.51 and section 10.52, will readily accommodate such future guidance. We will, of course, consider the impact of

¹⁰ A pattern of violations resulting from multiple instances of negligent advice may result in discipline under Circular 230 § 10.51(a)(13).

future regulations or other guidance upon practitioners under Circular 230, and we will provide additional comments to Treasury and to the Service as warranted.

4. Referrals to the Office of Professional Responsibility

In its Notice of Proposed Rulemaking for the regulations implementing the changes to sections 6694 and 7701, Treasury stated that the Service intends to modify its internal guidance to eliminate the requirement that an assessment of the section 6694(a) penalty for negligent tax return preparation result in an automatic referral to OPR.¹¹ We support this approach, consistent with our belief that the limited resources of OPR should not be expended on reviewing referrals for isolated, non-willful violations of section 6694. While we agree that the assessment of a section 6694(a) penalty should not trigger an automatic referral to OPR, it is clearly important that Treasury establish a process for collecting information relating to the imposition of these penalties so that (i) a practitioner with a history of negligence may be referred to OPR and (ii) OPR has access to appropriate information relevant to any referrals.

We recommend that any revisions to the Service's internal guidance provide that referrals to OPR in connection with a section 6694(a) penalty be made only in those cases where OPR action is expected to promote the purposes of Circular 230. We also recommend that this internal guidance enumerate relevant considerations for determining whether an OPR referral is warranted, which should at a minimum include the considerations enumerated in the reasonable cause defense in Regulation section 1.6694-2(e). If the Service elects to employ a numeric standard in considering the propriety of an OPR referral (*e.g.*, X section 6694(a) penalties within Y years), this standard should be in writing and publicly available to all authorized tax practitioners.

Inasmuch as the standard for applying the section 6694(b) penalty (*i.e.*, willfulness or recklessness) parallels the standard in Circular 230 section 10.52, it is our expectation that the assessment of a section 6694(b) penalty will continue to result in an automatic referral to OPR.

5. Reproposal of Amendments to Circular 230 § 10.34

The proposed amendments to Circular 230 section 10.34 were issued in September 2007. A number of significant developments have occurred since that time, most importantly the retroactive revision of section 6694 by the 2008 Act. Treasury has issued proposed and final regulations under section 6694 and section 7701, and additional regulations are expected in light of certain changes made by the 2008 Act. The final regulations include important modifications to the regulatory regime in effect before September 2007, which could not have been considered when the revisions to Circular 230 section 10.34 were proposed.

¹¹ IRM 20.1.6.2.1 currently mandates a referral when an assessment of any section 6694 penalty is “closed agreed by the examiner or sustained in Appeals, or closed unagreed without Appeals contact.”

Because of the scope and significance of the developments since September 2007, and because of the importance of Circular 230 in regulating and sanctioning tax practitioners, we believe that the changes to Circular 230 section 10.34 should be repropose to permit the tax practitioner community to consider these changes in the context of the current state of section 6694 and related guidance, as well as the interaction and the distinctions between Circular 230 section 10.34 and section 6694. Reproposal would also provide an opportunity for Treasury to receive additional comments concerning the operation of the special rule in section 6694(a)(2)(C) and its impact on Circular 230 section 10.34.