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July 15, 2010

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

Re: Comments on Circular 230 Section 10.27

Dear Commissioner Shulman:

Enclosed are comments on Circular 230 section 10.27. 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,

A handwritten signature in black ink, appearing to read "Stuart M. Lewis".

Stuart M. Lewis
Chair, Section of Taxation

Enclosure

cc: Michael Mundaca, Assistant Secretary (Tax Policy), Department of the Treasury
William Wilkins, Chief Counsel, Internal Revenue Service
Jeffrey Van Hove, Acting Tax Legislative Counsel, Department of the Treasury
Karen Hawkins, Director, Office of Professional Responsibility, Internal Revenue Service
Deborah Butler, Associate Chief Counsel, Internal Revenue Service

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**ABA SECTION OF TAXATION
COMMENTS ON CIRCULAR 230 SECTION 10.27**

These comments (“Comments”) are submitted on behalf of the American Bar Association Section of Taxation 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 Ronald M. Wiener of the Standards of Tax Practice Committee of the Section of Taxation. Substantive contributions were made by David B. Casten, Rochelle L. Hodes, and Christopher S. Rizek. The Comments were reviewed by Scott D. Michel, Committee Chair and by Diana L. Erbsen and Linda M. Beale, Committee Vice-Chairs. The Comments were further reviewed by Jeffrey H. Paravano of the Section’s Committee on Government Submissions and by Kathryn Keneally, Council Director, for the Standards of Tax Practice Committee.

Although the members of the Section of Taxation who participated in preparing these Comments have clients who might be affected by the federal tax principles addressed by these Comments, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make 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: July 15, 2010

COMMENTS REGARDING CIRCULAR 230 SECTION 10.27 EXECUTIVE SUMMARY

Section 10.27 of Circular 230 regulates fees charged by tax practitioners concerning matters before the Internal Revenue Service (the “Service”) and restricts the use of unconscionable or contingent fees in tax-related representations. In general, these Comments discuss the provisions in section 10.27 addressing “contingent fees,” defined in section 10.27(c)(1) to include “a fee that is based on a percentage of the refund reported on a return, that is based on a percentage of the taxes saved, or that otherwise depends on the specific result attained.”¹ In 2009, the Service and the Department of the Treasury (“Treasury”) proposed three clarifying changes to section 10.27, all of which we believe would be improvements.²

As a general matter, however, we believe that section 10.27 remains too narrow in identifying circumstances when a tax practitioner may agree with a client to be compensated based on the result obtained in a tax matter. We believe that section 10.27 should permit tax practitioners to charge a result-based fee (in whole or in part) in matters before the Service when the taxpayer’s position will be transparent and subject to direct scrutiny by the Service. These cases would include requests for private letter rulings, claims for refund and the like. Moreover, we believe that one of the proposed changes to section 10.27 may have the unintended consequence of prohibiting a relatively common practice, which is an agreement between a tax practitioner and a client, in determining the final fee in a tax matter, to consider the tax result attained. In addition, because the definition of “contingent fee” in section 10.27(c)(1) significantly differs from the common understanding of that term, we believe the title of section 10.27(b) should be changed to minimize confusion; we recommend that the word “Contingent” in both the title of section 10.27(b)(1) and in the defined term in section 10.27(c)(1) be changed to “Prohibited” and that conforming changes be made in the text of sections 10.27(b) and 10.27(c)(1).

Finally, we urge the Service and Treasury to repeal the “120-day rule,” which currently prohibits a contingent fee in a matter if a claim for refund or amended return is filed more than 120 days following the commencement of an examination or a challenge to an original return.

¹ This is the language prior to the proposed amendments promulgated July 27, 2009, as described later in this Memorandum.

² Fed. Reg. 37,183 (July 28, 2009).

BACKGROUND

On December 19, 2002, the Service and Treasury issued an Advance Notice of Proposed Rulemaking, requesting comments on amendments to Circular 230 relating to a number of topics, including contingent fees.³ On February 6, 2006, Treasury and the Service published Proposed Amendments to Circular 230, including a prohibition on “contingent fees” in practice before the Service except in limited circumstances.⁴ In response to comments, Treasury and the Service included additional exceptions to the general prohibition of “contingent fees” in the final regulations published in the Federal Register on September 26, 2007, effective for fee arrangements entered into after March 26, 2008.⁵ However, permissible “contingent fees” were limited to certain tax controversy services and certain claims for credit or refund of penalty and interest. As a result, as compared with previous versions of Circular 230, section 10.27(b) and (c) substantially expanded the areas in which such fees are prohibited. In response to additional questions raised about the Final Regulations, on March 26, 2008, the Service issued Notice 2008-43,⁶ providing interim guidance:

- (1) Clarifying for purposes of section 10.27(b)(2)(ii) the circumstances under which a contingent fee may be charged in connection with a challenge by the Service to an amended return or claim for refund or credit “filed within 120 days of the taxpayer receiving a written notice of the examination of, or a written challenge to the original tax return.”
- (2) Clarifying whether section 10.27(b) permits practitioners to charge a contingent fee with respect to whistleblower claims under section 7623 of the Internal Revenue Code of 1986, as amended (the “Code”) by stating that section 10.27(b)(4) would be inserted to permit such contingent fees.

The proposed amendments issued July 27, 2009, would adopt the interim guidance set forth in Notice 2008-43. In addition, the proposed amendments would clarify the definition of “contingent fee” in section 10.27(c)(1) by modifying the second sentence to specify that it is the specific *tax* result that is relevant to the definition of “contingent fee.” As modified, the sentence would state “A contingent fee includes a fee that is based on a percentage of the refund reported on a return, that is based on a percentage of the taxes saved, or that otherwise depends on the specific tax result attained.”

We did not submit comments specific to the amendments proposed on July 27, 2009, because our view was that, of themselves, the amendments were largely clarifying and non-controversial:

- 1) Section 10.27(b)(2)(ii) – 120-Day Rule -- Proposed section 10.27(b)(2)(ii) would clarify the 120-day period within which an amended return or claim for refund or

³ See Announcement 2003-5, 2003-1 C.B. 397, 67 Fed. Reg. 77,724, 77,725 (2002).

⁴ 31 C.F.R. § 10.27(b), 71 Fed. Reg. 6429 (2006).

⁵ T.D. 9359, 72 Fed. Reg. 54,548 (2007).

⁶ 2008-15 I.R.B. 748.

credit must be filed to fall within the current provision's exception for permitted contingent fees in connection with the Service's examination of or challenge to such an amended return or claim for refund.

- 2) Section 10.27(c)(4) – Whistleblower Claims -- Proposed section 10.27(b)(4) would include an additional exception to the general prohibition on “contingent fees” for services rendered in connection with a claim under Code section 7623, dealing with “whistleblower claims.”
- 3) Section 10.27(c)(1) – Tax Matters in Cases Where Fees Are Contingent on a Non-Tax Result -- The amendment would clarify that the current prohibition on “contingent fees” does not prohibit fees for tax services rendered by practitioners as part of an engagement if the overall fee for the matter is contingent on attaining a non-tax result. We welcome the insertion of the word “tax” into this element of the definition of prohibited “contingent fees” under present section 10.27(c)(1), thereby narrowing the current prohibition, which appears to prohibit practitioners from charging any fees for tax services as part of an engagement in which the overall fee is contingent on a non-tax result or event.

These comments do not address the technical contours of these three proposed amendments, but rather suggest principles and specific recommendations that we offer as the basis for a more general review and revision of section 10.27.

INTRODUCTION

We acknowledge the propriety of including in Circular 230 certain limitations on the fees permitted to be charged by practitioners in practice before the Service. We also recognize that several types of fee arrangements prohibited by the current version of section 10.27(b) were a contributing factor in the creation and marketing of certain overly aggressive tax reduction “products” commonly referred to as “abusive tax shelters.” In our comments before issuance of the amendments to section 10.27 adopted in September 2007, we set forth the following as one principle that we believe should guide regulation of practitioners under Circular 230:

[T]he Secretary and [the Office of Professional Responsibility (“OPR” or the “Office”)] may regulate practitioner conduct that is not “practice before the Internal Revenue Service” only if the conduct in question bears some demonstrable relationship to the practitioner’s activities as a practitioner before the IRS and the regulation intrudes only to the extent necessary into the practitioner-client relationship. Thus, for example, in connection with proposed section 10.27, relating to the use of contingent fees, we do not object to restrictions that reasonably serve to minimize any incentive to exploit the audit selection process. However, absent such a connection, we do not believe the regulation of contingent fees by OPR is appropriate.⁷

⁷ ABA Section of Taxation, Comments Concerning Proposed Regulations Governing Practice Before the Internal Revenue Service (Circular 230) (June 6, 2006), p. 4, *available at* http://www.abanet.org/tax/pubpolicy/2006/proposedamendments_circular230.pdf.

We continue to believe that this principle should guide the provisions included in section 10.27 and their interpretation and application by OPR. Because restrictions imposed on permissible fee arrangements may have a significant adverse effect on a taxpayer's ability to assert legitimate rights not to overpay taxes, we believe such restrictions should balance taxpayer rights and interests against the Service's legitimate interest in discouraging improper conduct by taxpayer representatives. Moreover, we believe it undesirable to establish rules that might encourage revenue agents, revenue officers, and other Service personnel to initiate inquiries into fee arrangements in the absence of evidence of impropriety unless warranted by some overriding Government interest.

We believe that the current regulation does not accord with this important principle and that adoption of the proposed amendments would not materially improve the current provisions. We do not believe that a fee arrangement between a taxpayer and his or her practitioner representative should of itself constitute "practice before the Internal Revenue Service." Because of the complexities of our tax laws and the procedural hurdles faced by taxpayers in pursuing their recognized right to pay no more tax than required by law, we believe unnecessary or unreasonable restrictions should not be imposed on the ability of taxpayers and their advisors to agree on flexible fee arrangements – including fees that are wholly or partly contingent upon, or otherwise influenced by, the tax result attained by the taxpayer – in representations before the Service.

In this connection, we note that the restrictions set forth in sections 10.27(b) and (c) on the fees permitted to be charged in matters before the Service are in addition to the limitation in section 10.27(a) on charging "an unconscionable fee" and limitations on fees that may otherwise be applicable to practitioners. For example, Rule 1.5 of the American Bar Association's Model Rules of Professional Conduct ("Model Rule 1.5")⁸ sets forth conditions under which lawyers are permitted to charge a fee that is "contingent on the outcome of the matter for which the service is rendered." Rule 1.5(c) provides, however, that a contingent fee is not permitted if it is otherwise "prohibited by paragraph [1.5](d) or other law." Comment [4] to Model Rule 1.5 expressly references "government regulations regarding fees in certain tax matters" as an example of applicable law that may impose such restrictions on fees that are contingent on the outcome of a matter.⁹ Certified Public Accountants ("CPAs") also are subject to certain fee restrictions under codes of conduct adopted by their practitioner organizations and under the laws of the various states. If a lawyer or a CPA were to be sanctioned by a state regulatory body for violating a fee-related restriction, this could result in the practitioner becoming subject to expedited suspension proceedings by OPR under section 10.82(a) and (b)(1).

The Preamble to the proposed amendments states "[t]he primary rationales behind the prohibition on contingent fees is to preclude any fee arrangement that is related to or requires a favorable ruling by the Service and that has the potential to exploit the audit selection process or compromise a practitioner's duty of independent judgment."¹⁰ We believe these rationales do not provide adequate policy justification for certain of the restrictions presently set forth in

⁸ Model Rules of Prof'l Conduct R. 1.5 (2009), available at http://www.abanet.org/cpr/mrpc/rule_1_5.html.

⁹ Model Rules of Prof'l Conduct R. 1.5 and cmt. 4 (2009).

¹⁰ REG-113289-08 (Jul. 28, 2009).

section 10.27, either in their present form or as proposed to be modified by the proposed amendments. We thus submit three recommendations, in order of breadth, for consideration.

RECOMMENDATIONS

1. WE URGE THAT CIRCULAR 230 BE REVISED TO EXPAND THE SCOPE OF REPRESENTATIONS AS TO WHICH A TAX PRACTITIONER MAY CHARGE A CONTINGENT FEE.

We agree with the expansion of section 10.27(b) to permit practitioners to charge contingent fees for services rendered in connection with whistleblower claims under Code section 7623. Claims under Code section 7623 are likely to receive careful substantive scrutiny by the Service, thereby minimizing the risk that permitting practitioners to charge contingent fees for their services relating to such claims will lead to a meaningful incidence of improper conduct by such practitioners.

For the same reason, we believe that additional exceptions should be included to the general prohibition on contingent fees for a practitioner's services in connection with other submissions to the Service when the Service routinely gives close scrutiny to the legal and factual issues involved, and thus when the risk of improper conduct is comparably small. We believe there is no meaningful distinction that would justify permitting such fees for services relating to whistleblower claims and for challenges to the Service's assessments of interest and penalties, as under present section 10.27(b)(3), while at the same time prohibiting such fees for services in other areas in which there is a similar expectation of close scrutiny of the legal and factual issues involved in a taxpayer's submission to the Service. Therefore, we recommend that section 10.27(b) be amended to permit contingent fees for services in matters in which the taxpayer's position is particularly transparent within the Service, such as requests for private letter rulings, requests for relief under Regulation section 301.9100, applications for prefilling agreements, requests for advance pricing agreements, applications for exempt organization status, applications for changes in accounting methods requiring advance consent, and applications for relief under other provisions of the Code, Regulations, Revenue Procedures, or other guidance that require submissions to the Service for approval.

An expansion of section 10.27(b) in the manner we recommend would be unlikely to lead to abusive conduct. Other measures already in Circular 230 (such as the "due diligence" requirements of section 10.22, the document submission standards of section 10.34, the prohibition on submitting false or misleading information of section 10.51(a)(4), and the prohibition on willfully assisting a client in violating Federal tax laws of section 10.51(a)(7)) directly regulate practitioner conduct and are sufficient to deter frivolous or unscrupulous claims. Moreover, OPR is now a vigorous force in the tax community and Circular 230 has an almost ubiquitous presence in the lives of nearly all tax professionals. In addition, there are several penalty provisions in the Code that are directly aimed at practitioner misconduct in submissions to, or practice before, the Service, and these penalties have significantly increased the Service's power to deter and punish improper practitioner conduct. Examples include section 6694 (which imposes penalties that were recently increased substantially), section 6700, and section 6701, as well as the provisions imposing criminal sanctions for certain types of particularly egregious

misconduct. Furthermore, the current initiative by the Service to enhance its oversight of tax return preparers (certain aspects of which will not apply to attorneys, CPAs, or enrolled agents) has further increased the awareness in the practitioner community of the seriousness with which the Service views any form of practitioner misconduct.¹¹ We see little risk that practitioners, merely because they are given the opportunity to charge contingent fees in a wider array of matters, will suddenly increase to a meaningful degree their participation in frivolous or even illegal positions in filings that are certain to be scrutinized by Service personnel.

We believe that the benefits to the tax system of adopting our recommendation would be significant. We also believe very few taxpayers would be able to make effective submissions to the Service in the kinds of matters subject to our recommendations without substantial assistance from practitioners. This is particularly true for most individuals and small business taxpayers, who are much less likely than high net worth individuals and large businesses to be able or willing to incur the significant fees for professional assistance that submissions of this kind often entail, particularly when specialized expertise is required. The problem is especially acute for taxpayers with very limited financial resources, but it is not limited to those taxpayers. Permitting taxpayers to negotiate practitioner fees that are wholly or partly contingent upon a successful outcome would likely have the practical effect of significantly increasing the number of such taxpayers who would pursue their right to petition the Service for the same kinds of benefits that more affluent taxpayers routinely apply for and obtain.

Thus, in balancing the Government's interest in discouraging improper practitioner conduct (which we share) with taxpayers' interests in having flexibility in the terms on which they secure representation in connection with their rights to petition the Service, we believe that contingent fees should be permitted under some circumstances. This result may be effected by adding a subparagraph to section 10.27(b), after section 10.27(b)(5), describing the additional types of matters for which practitioners are permitted to charge contingent fees. We suggest the following language as both descriptive of the types of matters for which such fees should be permitted and not so specific that further amendments to Circular 230 would be required for each new type of similar submission that is adopted as a result of additional Service guidance or statutory changes:

A practitioner may charge a contingent fee for services rendered in connection with a submission to the Internal Revenue Service for approval of any of the following matters: applications for a private letter ruling; applications for relief under Treasury Regulation section 301.9100; requests for approval of advance pricing agreements; requests for advance pricing agreements; applications for exempt organization status; applications for changes in accounting methods requiring advance consent; and applications for relief under such other provisions of the Code, Regulations, Revenue Procedures, or other guidance that require submissions to the Service for approval as may be identified in guidance issued from time to time by the Office of Professional Responsibility.

¹¹ Prop. Reg. § 1.6109-2(a)(2), (d)-(i), 75 Fed. Reg. 14,539 (2010); *see* Internal Revenue Service, Return Preparer Review (Dec. 2009).

2. WE URGE THAT CIRCULAR 230 BE REVISED TO CLARIFY THAT THE “TAX RESULT” IS AN APPROPRIATE FACTOR TO BE CONSIDERED IN SETTING A PRACTITIONER’S FEE.

As noted above, we agree with the insertion of the word “tax” into the definition of prohibited “contingent fees” under present section 10.27(c)(1). This would narrow the current prohibition, which appears to prohibit fees for tax services as part of an engagement in which the overall fee is contingent on a non-tax result or event. However, we believe that the resulting restriction may be construed to be excessively broad, because it might be interpreted to ban, without justification, the use of an accepted and ethically proper consideration commonly used by practitioners and their clients to arrive at mutually agreeable fees in tax matters.

Section 10.27(c)(1) defines “contingent fee” for purposes of section 10.27. The second sentence, if the Proposed Amendment were to be adopted without change, would state that a “contingent fee includes a fee that is based on a percentage of the refund reported, that is based on a percentage of the taxes saved, *or that otherwise depends on the specific tax result attained.*” (Emphasis added.)

As background, similar language was added to the 1994 version of the Circular 230 fee limitations.¹² The previous (1984) version made no reference to contingent fees, but included in section 10.28 only the prohibition on charging “an unconscionable fee.”¹³ The 1994 revisions added to section 10.28 a prohibition on charging contingent fees for preparing an original return but permitted contingent fees for amended returns or refund claims if “substantive review by the Service” was reasonably anticipated. The last sentence of section 10.28 provided, “A contingent fee includes a fee that is based on a percentage of the refund shown on a return or a percentage of the taxes saved, *or that otherwise depends on the specific result attained.*”¹⁴

When Circular 230 was next amended in 2002, the above-quoted sentence was omitted entirely, and “contingent fee” was defined in section 10.27(b)(1) in a manner similar to present section 10.27(c)(1), but without the above-quoted sentence.¹⁵ Although Announcement 2003-5¹⁶ had requested comments on a number of matters related to possible changes to Circular 230, including several matters related to contingent fees, no reference was made to possible changes to the definition of “contingent fee.” Because the change to the definition was not explained in the Preamble to either the February 3, 2006, Proposed Regulations or the September 26, 2007, final Regulations,¹⁷ it is unclear why the change was made.

In any event, the additional sentence prohibiting a fee that “depends on the specific result attained” appears directed primarily at fee arrangements (whether or not “contingent” in the traditional meaning of that term¹⁸) associated with the development, promotion, and marketing

¹² 31 C.F.R. § 10.28, 59 Fed. Reg. 31,527 (1994).

¹³ 31 C.F.R. § 10.28, 51 Fed. Reg. 2875 (1986).

¹⁴ 31 C.F.R. § 10.28(b), 59 Fed. Reg. 31,527 (1994) (emphasis added).

¹⁵ 31 C.F.R. § 10.27(b)(1), T.D. 9011, 67 Fed. Reg. 48,760, 48,772-73 (2002).

¹⁶ 2003-1 C.B. 397.

¹⁷ See 31 C.F.R. § 10.27(b), 71 Fed. Reg. 6429 (2006); T.D. 9359, 72 Fed. Reg. 54,548 (2007).

¹⁸ Model Rule 1.5(b) requires that before or within a reasonable time after commencing a representation, a lawyer must communicate to the client, preferably in writing, the basis or rate of the fee and expenses for which the client

of certain “tax products,” a number of which were determined to have been “abusive tax shelters.” Because fees for such transactions, like traditional contingent fees, were typically agreed upon in explicit terms at the beginning of a representation, we believe that this element of the definition is not intended to prohibit taxpayers and practitioners, at the conclusion of a representation, from taking “tax results” into account along with other relevant factors in agreeing upon the fee to be charged to the taxpayer.

Model Rule 1.5(a) sets forth the general rule that a lawyer is not permitted to charge or collect “an unreasonable fee.” Model Rule 1.5(a) then lists eight non-exclusive factors to be considered in determining the reasonableness of a fee.

Rule 1.5: Fees

- (a) A lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for expenses. The factors to be considered in determining the reasonableness of a fee include the following:
- (1) the time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;
 - (2) the likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the lawyer;
 - (3) the fee customarily charged in the locality for similar legal services;
 - (4) the amount involved *and the results obtained*;
 - (5) the time limitations imposed by the client or by the circumstances;
 - (6) the nature and length of the professional relationship with the client;
 - (7) the experience, reputation, and ability of the lawyer or lawyers performing the services; and
 - (8) whether the fee is fixed or contingent.

(Emphasis added.)

When the tax savings, tax refunds claimed, or other tax results do not form the sole or primary basis on which fees are charged, but instead are just one factor taken into account in the fee-setting process, we believe the general prohibition in Circular 230 on “contingent fees” should not apply. In routine matters, it is common practice for the practitioner and the client to look back at the conclusion of the representation and agree on the final fee to be charged for the services rendered, taking all relevant factors into account. We believe section 10.27(b) should

will be responsible. Model Rule 1.5(c) requires that, when permitted, a fee that is “contingent on the outcome of the matter for which the service is rendered” must be set forth in a written contingent fee agreement signed by the client. When read together, these rules require that a contingent fee agreement be entered into by the client at or near the beginning of the representation.

not be interpreted to prohibit the parties from considering the tax results of the representation as a factor in determining the final fee in such matters.

Thus, we request that Circular 230 specifically clarify that it is permissible for a practitioner and a taxpayer, in agreeing upon the final fee following the conclusion of a tax matter, to take into account in some fashion whether the outcome of the matter was favorable or unfavorable to the taxpayer, provided that there was not an advance agreement or express or implied understanding that all or a major part of the fee ultimately charged was to be contingent upon the tax results attained. For example, we believe a reduction in the fees to be charged to an unhappy taxpayer because of an unsuccessful effort, or a “bonus” to be paid by a satisfied taxpayer for a “best-case” result, should not be prohibited. Similarly, in the common situation in which the practitioner and the taxpayer have agreed in advance that the practitioner’s fee will be based on a stated hourly rate times the number of hours spent working on the matter, we believe the parties should not be prohibited from taking into account all of the applicable factors listed in Model Rule 1.5 – including the extent to which the outcome of the matter was favorable to the taxpayer – in determining the practitioner’s fee for the matter. This very common approach to setting fees is not generally considered to result in “contingent fees.” And because a practitioner always has an incentive to obtain the best possible result for his or her client, we believe that a clarification of the general contingent fee prohibition of section 10.27(b) to expressly permit this practice would not result in a significant increase in unprofessional conduct by practitioners.

To accomplish this, we recommend that the following sentence be inserted immediately after the second sentence in section 10.27(c)(1):

However, a fee shall not be treated as a contingent fee merely because the practitioner and the taxpayer agree, in setting the final fee at the conclusion of a matter, to take the tax result attained in the representation into account along with such other factors as the time spent by the practitioner, the practitioner’s normal hourly rates, the difficulty of the matter, amount of tax at stake, and the taxpayer’s ability and willingness to pay; provided, however, that the foregoing clause shall not apply when the representation consists of the preparation of an original return or a claim for refund (including a claim for refund included on an amended return).

As noted in the prior section, we see a material distinction between such cases and those in which a taxpayer’s position will be directly reviewed by Service personnel. In the latter group of cases, we believe that it would be appropriate to clarify that negotiation of a bonus or premium fee or a fee reduction based upon the tax result attained would be permissible, even at the beginning of the representation and even when the tax result attained constitutes the primary factor or a major consideration in determining the amount of a bonus or premium paid to a practitioner when there has been a successful outcome or in determining the amount of a reduction in a fee following an unsuccessful outcome.

The definition of “contingent fee” as set forth in section 10.27(c)(1) differs from the commonly understood meaning of that term. For example, the American Bar Association’s Model Rule 1.5(c) refers to a fee that is “contingent on the outcome of the matter for which the

service is rendered.”¹⁹ The “outcome” is normally understood to mean the *final* outcome, after applicable appeals. However, sections 10.27(b)(1) and 10.27(c)(1) prohibit a practitioner from charging “a fee based on a percentage of the refund reported on a return” even if the fee is not refundable to the taxpayer following denial of the refund by the Service and the courts. In order to minimize misunderstanding of the rule, we recommend that the word “Contingent” in the titles of sections 10.27(b) and 10.27(c)(1) be changed to “Prohibited,” with conforming changes to be made in the text of sections 10.27(b) and (c)(1).

3. WE URGE REVISION OF CIRCULAR 230 TO ELIMINATE THE “120 DAY RULE,” WITH THE SERVICE REGULATING “LATE FILED REFUND CLAIMS” THROUGH OTHER PROCEDURES.

The proposed amendment to section 10.27(b)(2)(ii) would clarify the ambiguity in the present regulation concerning the 120-day period within which an amended return or claim for refund or credit must be filed to fall within the current provision’s exception for permitted contingent fees in connection with the examination of or challenge to such an amended return or claim for refund. We remain concerned, however, that the 120-day period would be too restrictive and would constitute an arbitrary and unfair limitation on the circumstances under which a contingent fee may be charged in connection with a challenge by the Service.

We believe the 120-day rule is inconsistent with the purposes of Circular 230, either in its present form or as clarified by the Proposed Amendments. In light of its stated purpose - to discourage the tactical preparation of a refund claim or amended return filed late in the examination process – we believe the rule should not apply through Circular 230 only to taxpayers represented by “practitioners” and even then only if contingent fees are charged. If the filing of refund claims late in the examination process creates a serious burden for the Service, we believe it would be more effective for the Service to adopt an administrative rule that applies to all taxpayers in all examinations, whether or not the taxpayer is represented and, if represented, whether or not the practitioner’s fee is “contingent” or non-contingent. The Service might administratively determine, for example, that claims received late in the examination process would not be processed, would be summarily denied, or both, eliminating the tactical advantage of late submission. We believe this would be a more straightforward way to address the perceived problem of late-filed refund claims than to restrict the late-filed claims only to when the claims were done on a contingent-fee basis or only to when the taxpayer is represented by a “practitioner.” We suggest that the Service not affect the practitioner-client relationship when the Service’s interest arises only from the administrative difficulty of handling a refund claim or administrative review process, and when the Service has other effective alternative means of addressing its concerns. Moreover, we believe adoption of such substantive rules would have the additional benefit of “leveling the playing field” for all taxpayers, whether represented or not.²⁰

¹⁹ Model Rules of Prof’l Conduct R. 1.5(c) (2009).

²⁰ Moreover, the 120-day period appears to be arbitrary and we believe it often would provide too little time for a taxpayer to make an informed decision whether or not to contest the Service’s challenge to the return or claim in question. Any taxpayer who receives a notice of an examination may easily consume the entire 120 days in the course of reviewing its records and trying to determine whether there is even a need for representation. In some cases, the taxpayer may not know which issues are likely to be raised by the Service or the amount of tax likely to be put in controversy. By the time the taxpayer contacts a practitioner about representation, the practitioner reviews the

To implement our recommendation as to this issue, we suggest that a period be inserted after the phrase “An amended return or claim for refund or credit” in proposed section 10.27(b)(2)(ii). This would permit a contingent fee to be charged in connection with the Service’s challenge, regardless of when the taxpayer files a claim for refund or credit and regardless of when the taxpayer receives notice of the challenge. As revised, section 10.27(b)(2) would read as follows:

- (2) A practitioner may charge a contingent fee for services rendered in connection with the Internal Revenue Service’s examination of, or challenge to -
 - (i) An original tax return; or
 - (ii) An amended return or claim for refund or credit.

CONCLUSION

We recognize that Circular 230 has a place in the regulation of contingent fee arrangements to prevent abuse. We believe, however, that the current regulatory scheme cuts too deeply, reaching instances in which a client and a tax practitioner may ethically and fairly agree upon a contingent fee arrangement in a tax matter without leading to a material increase in practitioner misconduct. We respectfully request that OPR consider a broad review of section 10.27 consistent with the principles outlined above. We would be pleased to provide our assistance in or respond to any inquiries that may develop during such a review. We thank you for considering our views.

issues, and the parties agree upon appropriate fee arrangements for the engagement, the 120 days may well have expired. We believe that, if there is no imminent expiration of the statute of limitations, the interests of the Service in prompt disposition of its examinations of returns and refund claims would be properly served by a more flexible limitation. This is particularly true in light of the rationale for the 120-day rule as stated in the Preamble to the 2009 Proposed Regulations: “to discourage the tactical preparation of a refund claim or amended return filed late in the examination process.” 74 Fed. Reg. 37,183, 37,184 (July 28, 2009). Except in relatively simple cases, we believe 120 days would rarely be “late in the examination process.”

Even if the 120-day period were to be lengthened, the restriction now contained in section 10.27(b)(2)(ii) is unfair to taxpayers, who sometimes cannot obtain competent representation with respect to entirely legitimate refund claims or other tax issues unless the representative will agree to be paid pursuant to a fee arrangement that is wholly or materially contingent on the outcome. We are not aware of any reason for creating a two-tier system, whereby taxpayers with the financial resources to engage representation on a non-contingent fee basis have the privilege of contesting the Service’s challenges to their tax return positions but those who lack adequate resources are precluded from representation completely.