Defending Liberty
Pursuing Justice

TAXATION
A Section of the American Bar Association

**Section of Taxation**

10th Floor
740 15th Street, N.W.
Washington, DC 20005-1022
202-662-8670
FAX: 202-662-8682
E-mail: tax@abanet.org



December 7, 2010

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

Re: Comments on Circular 230 Sections 10.2, 10.3, 10.4, 10.5, 10.6, 10.30 and 10.34

Dear Commissioner Shulman:

Enclosed are comments on Circular 230 sections 10.2, 10.3, 10.4, 10.5, 10.6, 10.30 and 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,

Charles H. Egerton
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

# ABA SECTION OF TAXATION COMMENTS ON CIRCULAR 230 SECTIONS 10.2, 10.3, 10.4, 10.5, 10.6, 10.30 and 10.34

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, these Comments should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Charles J. Muller III, Charles J. Muller, IV, and Christopher S. Rizek of the Standards of Tax Practice Committee of the Section of Taxation, and by Scott D. Michel, Committee Chair. Substantive contributions were made by Michael Desmond and Richard Sapinski. The comments were reviewed by Diana L. Erbsen, a Committee Vice-Chair, and by Jeffrey H. Paravano of the Committee on Government Submissions, and were further reviewed by Miriam Fisher, Council Director for the Standards of Tax Practice.

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.


| | | |
|---|---|---|
| Contact: | Charles J. Muller, III | Scott D. Michel |
| | (210) 250-6003 | (202) 862-5030 |
| | chad.muller@strasburger.com | sdm@capdale.com |


Date: December 7, 2010

## EXECUTIVE SUMMARY

The Director of the Office of Professional Responsibility ("OPR") is authorized to regulate practice before the Internal Revenue Service. This includes the power to disbar from practice those representatives determined to be incompetent, disreputable, or who violate regulations prescribed under Section 330 of Title 31 ("Circular 230"). At present, practice before the Service is generally limited to include attorneys, certified public accountants and enrolled agents in all matters connected with a presentation to the Service, including representing taxpayers in the course of an examination of a tax return, appeal of a proposed deficiency determination and matters pertaining to the collection of tax liabilities. In limited contexts, enrolled actuaries and enrolled retirement plan agents are also authorized to practice before the Service.

Under the proposed amendments to Circular 230 the definition of "Practitioner" is expanded to include a new category of "Registered Tax Return Preparers," defined by reference to section 7701(a)(3)[1] and Regulation section 301.7701-15. This new category of practitioners is estimated to include 900,000 to 1.2 million individuals.

We concur in the proposed amendments to sections 10.2, 10.3, 10.4, 10.5 and 10.6 of Circular 230 providing jurisdiction to OPR to determine the competency and suitability of a Registered Tax Return Preparer. We believe regulation of tax return preparers by OPR to be an essential and long overdue component of an effective national tax compliance program. We also strongly support an increased enforcement program which will include increased oversight of paid tax preparers. A core of competent and ethical paid preparers must be a part of any strategy to strengthen the integrity of the tax system.

We concur in the provisions limiting "suitability" checks for Registered Tax Return Preparers as stated in the proposed amendment to section 10.5 of Circular 230. Suitability to practice and suspension of the right to practice should be made by reference to incompetence and disreputable conduct as set forth in sections 10.51 and 10.52 of Circular 230. We concur in the proposition that OPR is the appropriate forum for the determination of suitability. We recommend that OPR continue to provide a restrained interpretation of willful misconduct. We also recommend that consideration be given to providing expedited OPR review where it appears that a paid preparer is engaged in on-going willful misconduct.

These comments also address proposed amendments to section 10.34 of Circular 230, which sets forth standards for tax return preparation. To some extent, the proposed provisions correspond to the return preparer penalty, section 6694. Under the proposed amendment to section 10.34 of Circular 230, a practitioner may not willfully, recklessly or through gross incompetence advise a client to take a position on a tax return or a claim for refund, or prepare a portion of a tax return or claim for refund containing a position that: lacks a "reasonable basis;" or is an unreasonable position as described in section 6694(a)(2); or is a willful attempt by the practitioner to understate the liability for tax or an intentional disregard of rules and regulations.

[1] References to a "section" are to a section of the Internal Revenue Code of 1986, as amended (the "Code"), unless otherwise indicated.

We concur in the proposed amendment to section 10.34 of Circular 230 in so far as it incorporates the disciplinary standard currently set forth in section 10.52 of Circular 230, and to the extent it cites a "pattern" of wrongdoing as a pertinent factor in evaluating whether a practitioner has violated Circular 230. However, we recommend, consistent with ABA Formal Opinion 85-352, that the proposed amendment to section 10.34 of Circular 230 provide that disciplinary sanctions will not be imposed as to undisclosed "non-tax shelter" return positions that meet the "realistic possibility of success on the merits" standard, and as to disclosed positions that meet the "reasonable basis" standard. As to a "tax shelter" type transaction, we recommend that Treasury define more clearly the type of transaction at issue and that it consider adopting a more objective standard for return positions.

## BACKGROUND

On September 26, 2007, the Service and Treasury published final Regulations to modify various provisions of Circular 230.[2] Those final Regulations, however, did not finalize the standards with respect to tax returns under section 10.34(a) of Circular 230 and the definitions under section 10.34(e) of Circular 230 because of recent amendments to the tax return preparer penalty provisions of section 6694 made by the Small Business and Work Opportunity Tax Act of 2007.[3] Instead, the Service and the Treasury reserved sections 10.34(a) and (e) of Circular 230 and issued proposed Regulations that would conform the professional standards under section 10.34 of Circular 230 with the civil penalty standards under section 6694(a) as amended by the 2007 Act.

On October 3, 2008, the Tax Extenders and Alternative Minimum Tax Relief Act of 2008[4] again amended the standard of conduct that must be met to avoid imposition of the tax return preparer penalty under section 6694(a). The Service and Treasury published final Regulations in the Federal Register implementing amendments to the tax return preparer penalties on December 22, 2008.[5]

On August 19, 2010, the Service and Treasury released Proposed Regulations that would amend Circular 230 to expand the definition of "Practitioner" under section 10.2(a)(5) of Circular 230 to include "tax return preparers" as defined in section 7701(a)(3) and Regulation section 301.7701-15. The proposed amendments also withdraw the proposed amendment to section 10.34 of Circular 230 published in the Federal Register on September 26, 2007, and make other changes to Circular 230.

The Proposed Regulations also provide new rules governing oversight of tax return preparers. Currently, paid tax return preparers are generally not subject to the provisions of Circular 230 unless they are also an attorney, certified public accountant, enrolled agent or other type of practitioner identified in section 10.2(a)(5) of Circular 230. Under current law, any individual may prepare federal income tax returns and claims for refund without meeting any federally imposed qualifications or competency standards.

---

[2] T.D. 9359.
[3] Pub. L. No. 110-28, § 8247(a), 121 Stat. 190, 204.
[4] Pub. L. No. 110-343, Div. C., 122 Stat. 3765.
[5] T.D. 9436.

These Proposed Regulations establish a new designation, "Registered Tax Return Preparers," as a new class of practitioner subject to sections 10.3 through 10.6 of Circular 230. These provisions describe the process of becoming a Registered Tax Return Preparer and the limitations on a Registered Tax Return Preparer's practice before the Service. In general, practice by a Registered Tax Return Preparer is limited to preparing tax returns, claims for refund and other documents for submission to the Service. Under the Proposed Regulations, a Registered Tax Return Preparer may not provide "tax advice" to a client or another person except as necessary to prepare a tax return, claim for refund, or other document intended to be submitted to the Service. A prior set of Proposed Regulations under section 6109[6] provide that, for returns or claims for refunds filed after December 31, 2010, the identifying number of a tax return preparer is the individual's preparer tax identification number ("PTIN") or such other number prescribed by the Service in forms, instructions or other appropriate guidance.

## INTRODUCTION

The existing provisions of Circular 230 authorize the Director of OPR to act upon applications for enrollment to practice before the Service, to make inquiries with respect to matters under OPR's jurisdiction, to institute proceedings to impose a monetary penalty, and to censure, suspend or disbar a practitioner from practice before the Service.

The existing rules do not apply to paid tax return preparers unless the preparer is an attorney, certified public accountant, enrolled agent or other type of practitioner identified in section 10.2(a)(5) of Circular 230. Thus, under current law, any individual may prepare a Federal income tax return or claim for refund without meeting any qualifications or competency standards. Paid return preparers may also engage in limited practice before the Service.[7]

The Proposed Regulations provide for oversight of all paid return preparers. Specifically, the Proposed Regulations establish "Registered Tax Return Preparers" as a new category of practitioner. Sections 10.3–10.6 of the Proposed Regulations describe the process for becoming a Registered Tax Return Preparer and the limitations on a Registered Tax Return Preparer's practice before the Service.

The Proposed Regulations do not change the existing authority of attorneys, certified public accountants and enrolled agents to practice before the Service under Circular 230. In addition, the Proposed Regulations do not alter or supplant ethical standards that might otherwise be applicable to practitioners. The Commissioner has retained the power to delegate specific duties relating to the administration of certain procedural aspects of the rules to "other IRS functions or third-party vendors."

Proposed Regulation section 10.3(f)(1) provides that a Registered Tax Return Preparer "may practice before the Internal Revenue Service." A Registered Tax Return Preparer's practice is limited to "preparing tax returns, claims for refund and other documents for submission to the Internal Revenue Service" under section 10.3(f)(2) and generally does not include providing tax advice beyond that necessary to prepare a return or other document for submission to the Service.

[6] Prop. Reg. § 1.6109-2, 75 Fed. Reg. 134235 (2010).
[7] Circular 230, section 10.7(c)(1)(viii) and Rev. Proc. 81-38, 1981-2 C.B. 592.

Proposed Regulation section 10.4 provides that the Director of OPR "may designate an individual as a Registered Tax Return Preparer provided an applicant demonstrates competence in Federal tax return preparation matters by written examination administered by, or administered under the oversight of the Internal Revenue Service, possesses a current or otherwise valid PTIN or other prescribed identification number and has not engaged in any conduct that would justify . . . suspension or disbarment."

A Registered Tax Return Preparer is subject to compliance and suitability checks. Tax compliance checks will be limited to an inquiry regarding whether an applicant has filed all required individual or business tax returns and whether the applicant has failed to pay, or make proper arrangements with the Service for payment of, any federal tax debts. The application will be denied only if the results of the compliance or suitability check are sufficient to establish that the practitioner engaged in conduct subject to sanctions under sections 10.51 and 10.52 of Circular 230. The term "suitability" is not defined. An applicant who does not pass the compliance or suitability checks may reapply after an initial denial if the applicant becomes current with respect to the applicant's tax liabilities.

The Proposed Regulations also provide for an appeal from denial of the application to become a Registered Tax Return Preparer. Proposed Regulations section 10.5(f) provides that the Director must inform the applicant in writing as to the reasons for any denial of an application. The applicant may, within 30 days after receipt of the notice of denial of the application, file a written appeal of the denial. The Proposed Regulations state that a decision on the appeal will be rendered by the Secretary, or a delegate, as soon as practicable. The Proposed Regulations do not define the procedure for appealing the denial of an application or an adverse competency or suitability check, nor is the responsible appeal delegate identified.

As to section 10.34 of Circular 230, the Proposed Regulations provide that a practitioner is subject to discipline by OPR only after willful, reckless or grossly incompetent conduct, and that a pattern of conduct is a factor that will be taken into account in determining whether a practitioner's actions meet this standard. These provisions differ somewhat from the preparer penalty regime of section 6694. The reference to a pattern of conduct suggests that the Circular 230 penalty would more often be applied to multiple instances of misconduct rather than to single violations, and — unlike the penalty regime in section 6694 — a practitioner may be subject to discipline under Circular 230 for a position on a return or claim for refund even if there is a final determination that there is no "understatement" on the return (for example, when other positions on the same tax return or claim for refund eliminate the understatement).

Under the proposed amendment, a practitioner whose conduct meets the willfulness standard of section 6694(b)(2) as to any return position may be disciplined under the provisions of Circular 230. As to other violations based on return positions, if OPR establishes that a practitioner has acted willfully, recklessly, or with gross incompetence as to a return position, under the proposed amendments the practitioner may be sanctioned for a position that lacks a reasonable basis or otherwise fails to satisfy the standards set forth in section 6694(a)(2).

## COMMENTS AND RECOMMENDATIONS:

### 1. WE CONCUR IN THE PROPOSED AMENDMENTS TO SECTIONS 10.2 TO 10.6 PROVIDING COMPETENCY TESTING AND ETHICAL SUITABILITY REQUIREMENTS FOR REGISTERED TAX RETURN PREPARERS.

Currently, more than 87 million federal income tax returns are prepared by paid tax return preparers. The precise number of paid preparers is not known, but is estimated to be between 900,000 and 1.2 million. A large share of this group is not licensed by any professional association. These preparers, referred to as "unenrolled preparers," are not required under any existing federal regulatory regime to have a minimum level of education, knowledge, training or skill before preparing a tax return. In short, any person may prepare federal tax return for a fee.[8]

In 2006 and 2008, GAO and the Treasury Inspector General for Tax Administration "shopped" tax return preparation outlets and unenrolled tax preparers.[9] Significant errors were found in both studies. For example, the GAO study found that only two of nineteen tax preparers determined the correct tax liability. Ten of the nineteen preparers failed to report all income. One preparer told the shopper that she did not have to report self-employment income unless it was more than $3,500. Others advised that the shopper had discretion on whether to report this income because the Service would not know about the income unless it was reported.

The Treasury Inspector General shopped twenty-eight unenrolled preparers.[10] Seventeen tax preparers did not report the correct amount of tax owed or refund due on the returns they prepared. If taxpayers had filed the seventeen returns, the net effect would have been $12,828 in understated taxes. Treasury also found that six of the seventeen return preparers willfully or recklessly asserted incorrect positions during the preparation of the shopped returns. These preparers added or increased deductions without permission and, in some situations, did so after the shopper questioned whether the deduction was appropriate. The six individuals prepared more than 950 tax returns during the 2008 filing season.

Thus, while the amount of unpaid taxes on a single return may be relatively small, the cumulative effect is that a single incompetent or unscrupulous preparer may prepare hundreds of erroneous returns in a single filing season. It is enormously inefficient and costly to correct these returns with after-the-fact examinations and deficiency procedures. Incompetent or unscrupulous preparers also undermine taxpayer confidence in the tax system, with broader negative effects on compliance.

The experience of criminal tax litigators confirms these preliminary determinations. In our collective experience, unscrupulous tax preparers are often willing to prepare returns seeking large refunds of withheld taxes. Taxpayers, frequently wage earners, are often reckless or complicit in these schemes. Taxpayers sometimes use the preparer as a scapegoat when the return is examined. These schemes usually involve the preparation of a false Schedule C claiming personal expenses and other false business deductions. For example, from 1997 to 2002, Michael Craig Cooper, president and founder of Renaissance — The Tax People, assisted

[8] *See* I.R.S. Publication 4832, Return Preparer Review 1, 7-8.
[9] *Id.* at 13.
[10] *Id.* at 15-16.

clients to prepare and file false tax returns claiming fraudulent deductions for personal expenses such as children's allowances, comuting expenses, educational expenses and vacation expenses. The alleged proceeds of this fraud were $84 million.[11]

While such misconduct subjects the tax return preparer to civil penalties, injunction, and, criminal prosecution, these remedies are costly and inefficient. Actions to enjoin and criminal prosecution are extremely time consuming and costly. Investigations require examination of a broad spectrum of returns to establish a pattern of misconduct, thereby eliminating defenses asserting that the IRS has selected and challenged a non-representative sample of returns. Taxpayers will usually need to be called as witnesses to rebut defenses asserting that alleged false deductions were based upon information supplied by the taxpayer. Undercover operations are usually required. The pursuit of civil penalties often results in prolonged administrative actions and subsequent collection activities.

These remedies are clearly insufficient to maintain the integrity of the tax system. They are costly after-the-fact remedies, imposed after incompetent or unscrupulous tax preparers have prepared hundreds if not thousands of false returns. In our view, it simply does not make sense to administer a voluntary tax assessment system where anyone, regardless of competency or ethics, can prepare a tax return for a fee. For these reasons, we concur in the proposed amendments to sections 10.2 through 10.6 of Circular 230.

As an additional thought, we note that the proposed amendments to section 10.36 of Circular 230 are intended to expand the compliance related procedures to include tax return preparation activities. The Proposed Regulations provide that "[a]ny practitioner who has (or practitioners who have or share) principal authority and responsibility for overseeing a firm's practice of preparing tax returns, claims for refund, or other documents for submission to the Internal Revenue Service must take reasonable steps to insure that the firm has adequate procedures in effect for all members, associates, and employees for purposes of complying with Circular 230." We note that non-signing preparers will, under the Proposed Regulations, be subject to Circular 230 through the cross-reference to section 7701(a)(36) and Regulation section 301.7701-15 in proposed Circular 230 section 10.2(a)(5). Under that definition, someone who prepares "substantially all" of the return is a preparer subject to Circular 230 registration requirements and sanctions.

We are aware that the expansion of Circular 230 has been, and remains, a controversial issue within the tax return preparation community, and we take no position on the issue regarding the scope of the expansion to persons who may not actually be responsible for signing a return. However, we note that some clarification may be useful, as in our view the phrase "substantially all" is still not well defined and there may be a large group of bookkeepers and others who do not sign a tax return but who are, in addition to section 6694 penalties, now potentially subject to Circular 230 regulations and sanctions yet be completely unaware of that. In our view, the standard may ultimately be the same under Circular 230 and section 6694, but by incorporating the non-signing preparer standard into Circular 230, the significance of the issue is greatly magnified. Whatever the outcome of this debate, the expansion of Circular 230

[11] *Promoter Convicted in $70 Million Tax Fraud*, US FED. NEWS, Feb. 28, 2008.

to tax preparation activities will undoubtedly require extensive changes to office practices in firms of all size where any employee is involved in the preparation of tax returns.

## 2. WE STRONGLY SUPPORT AN INCREASED ENFORCEMENT PROGRAM WHICH SHOULD INCLUDE INCREASED IRS OVERSIGHT OF TAX PREPARERS AND INCREASED STAFFING OF THE OFFICE OF PROFESSIONAL RESPONSIBILITY.

The IRS Return Preparer Review, Publication 4832, reflects general agreement by all stakeholders that return preparers and the associated industry play a pivotal role in our system of tax administration. We concur. Competent and ethical paid preparers are an integral part of any strategy to strengthen the integrity of the tax system. More directly, the American public overwhelming supports efforts to increase oversight of paid tax preparers.[12] We also believe that the proposed changes to Circular 230 will support the Commissioner's stated goals of increasing taxpayer compliance and ensuring uniform and high ethical standards of conduct by all preparers.

We therefore support the proposed requirements for competency and suitability checks for Registered Tax Return Preparers. We support the Service's plan to develop a comprehensive, service-wide enforcement strategy that utilizes data gathered through registration and other means to address individuals who fail to comply with the new Regulations. The strategy should include an elevation of the priority of tax return preparer penalties in Collection, the implementation of widespread preparer visits to identify preparer noncompliance, and targeted notices that call on preparers to correct instances of noncompliance. This broad based enforcement strategy should mitigate the harm caused by incompetent and unscrupulous preparers who prepare enormous volumes of tax returns before such misconduct can be effectively addressed through our present enforcement procedures.

We agree that this new strategy must include significant new Examination and Collection resources. The increased level of administrative oversight will require increased staffing at OPR.

Because of the harm that can be caused by the continuing acts of an incompetent or unscrupulous preparer, it is essential that OPR be able to expeditiously review reports of preparer misconduct. As indicated below, we believe that OPR must retain exclusive authority to adjudicate issues of preparer misconduct. Review by OPR is essential to assure tax preparers that allegations of misconduct will be heard in an independent forum.

[12] *Id*. at 32.

**3. WE CONCUR IN THE PROPOSED AMENDMENT TO SECTION 10.5 PROVIDING FOR LIMITED INQUIRY RESPECTING "SUITABILITY" CHECKS. WE CONCUR THAT OPR IS THE FORUM TO DETERMINE SUITABILITY. WE ALSO RECOMMEND THAT OPR CONTINUE TO PROVIDE A RESTRAINED APPROACH TO THE DETERMINATION OF WILLFUL MISCONDUCT.**

The Proposed Regulations provide that, upon receipt of an application to become a Registered Tax Return Preparer, the Service may conduct a federal tax "compliance" and "suitability" check. The compliance check will be limited to an inquiry regarding whether the applicant has filed all required individual or business tax returns, and paid, or made arrangements with the Service to pay, any tax debt. The suitability check will be limited to an inquiry regarding whether the applicant has engaged in any conduct that would justify suspension or disbarment under the provisions of Circular 230.

The Service also contemplates ongoing compliance checks. The Service has announced that it will use data analysis and other means to identify areas of noncompliance. It will more widely utilize preparer visits to identify preparer noncompliance. The Service expects to use targeted notices that call on preparers to correct situations of noncompliance. If the tax return preparer self-corrects, the Service may not pursue penalties. Proposed amendment to section 10.5(d) of Circular 230 states:

> The suitability check will be limited to an inquiry regarding whether an applicant has engaged in any conduct that would justify suspension or disbarment of any practitioner under the provisions of this part on the date the application is submitted, including whether the applicant has engaged in disreputable conduct as defined in Section 10.51. The applicant will be denied only if the results of the compliance or suitability check are sufficient to establish that the practitioner engaged in conduct subject to sanctions under Section 10.51 and Section 10.52.

Sections 10.51 and 10.52 of Circular 230 presently prohibit a range of misconduct that will now apply to Registered Tax Return Preparers. Such misconduct includes the giving of false or misleading information to the Treasury or any officer or employee thereof, willfully evading or attempting to evade the assessment or payment of any tax, assisting, counseling or encouraging a client to violate any Federal tax law, and recklessly, or through gross incompetence, violating section 10.34 of Circular 230. A preparer will be subject to suspension and other sanctions for such violations.

Proposed Regulation section 10.51 provides three new instances of incompetent and disreputable conduct: "[w]illfully failing to file on magnetic or other electronic media a tax return prepared by the practitioner when the practitioner is required to do so by the Federal tax laws unless the failure is due to reasonable cause and not due to willful neglect"; "[w]illfully preparing all or substantially all of, or signing, a tax return or claim for refund when the practitioner does not possess a current or otherwise valid preparer tax identification number or other prescribed identifying number"; and "[w]illfully representing a taxpayer before an officer or employee of the Internal Revenue Service unless the practitioner is authorized to do so pursuant to this part."

We note that the term "willfully" is interpreted differently under some provisions of the Code. For example, under the responsible officer penalty, section 6672, the term is applied to knowing conduct, without any determination of knowledge of the law. Under other provisions, such as section 7206(2), which makes it a crime to willfully prepare or assist in the preparing a false tax return, the term "willfully" requires evidence of an intentional violation of "a known legal duty." Thus, the Service is required in the latter situation to establish that the preparer knew he or she was violating the law. Competent preparers might occasionally fail to identify obscure Regulations contrary to their position. Occasional, unintentional violations might be considered "disreputable conduct" if a liberal definition of "willfulness" is applied.

For these reasons, we believe that willfulness should be subject to a retrained interpretation, ordinarily requiring notice of a violation, failure to self-correct and a continuing pattern of misconduct.

Finally, we agree that it would be disreputable conduct for a preparer to ignore the regulatory regime and proceed with tax preparation without registering or having a valid PTIN, and similarly, that preparers who falsely hold themselves out as authorized practitioners should be sanctioned. We note that there may be reasons an accurate PTIN is not provided, *e.g.*, by mistake, or because it has been applied for, and we hope that enforcement in this area is limited to cases of obvious willfulness or a pattern of misconduct. However, we urge that the example in Proposed Regulation section 10.51(a)(16) defining the willful failure to file a return electronically as "disreputable conduct" be dropped. At present there is no specific monetary penalty for such failure. Moreover, there may be situations where the preparer believes it is necessary to file a paper form, for instance when making a large payment with a return, or when making a significant election. While those situations may be unusual, it seems improper to deem such actions (which may be taken intentionally and in the best interests of the taxpayer), as incompetent and disreputable.

## 4. WE RECOMMEND A REFERRAL OF ONGOING PREPARER MISCONDUCT BE SUBJECT TO EXPEDITED REVIEW PROCEDURES SUCH AS THOSE SET FORTH IN SECTION 10.82 OF CIRCULAR 230.

At present, section 10.82 of Circular 230 permits expedited suspensions only for practitioners who have had their license suspended or revoked for cause, or for practitioners who have been convicted of a crime under the Code or a crime involving dishonesty. Expedited suspensions therefore apply to situations where the offending conduct has been subject to a review in another court or forum.

A Registered Tax Return Preparer engaged in alleged misconduct will be subjected to limited review before suspension; however, we believe Registered Tax Return Preparers have the potential to do great harm, and do not have an inherent right to practice before the Service. We believe that an expedited suspension procedure is in accord with due process and in the public interest.

It is imperative that OPR be able to quickly suspend an offending preparer when the Service has developed evidence of ongoing noncompliance or misconduct in the preparation and filing of returns. Accordingly, we believe consideration should be given to amending section

10.82 of Circular 230 so that it addresses defined situations where a Registered Tax Return Preparer is apparently engaged or assisting in the willful preparation of false tax returns.

## 5. WE SUGGEST THAT GUIDANCE BE CONSIDERED REGARDING THE INTERACTION BETWEEN THE PROPOSED AMENDMENTS AND SECTION 7525 OF THE INTERNAL REVENUE CODE.

Section 7525 sets forth in certain contexts a privilege for advice given by "federally authorized tax practitioners." In general, communications between such persons and their clients, when not arising in the context of tax shelters or criminal tax cases, are protected as confidential in the context of federal tax matters.

By redefining "practitioner" to include nearly one million Registered Tax Return Preparers, these proposed amendments appear to dramatically expand the potential pool of "federally authorized tax practitioners" whose advice may be subject to assertions of privilege. To be sure, all of these individuals are engaged only in the preparation of tax returns, which is, by longstanding precedent, not covered under section 7525. Moreover, Proposed Regulation section 10.3(f)(2) provides that these new practitioners may not provide tax advice beyond the preparation of tax returns and related documents. But both practitioners and clients may need to be reminded of the rules and limitations regarding privilege under section 7525.

We suggest that the Treasury Department, when it promulgates the final amendments to Circular 230, consider providing guidance on the relationship between the new definition of "practitioner" and the privilege afforded clients under section 7525. We believe it would be inappropriate for clients of these newly designated practitioners to develop unreasonable expectations of confidentiality in connection with their communications with their return preparers, and it would avoid administrative problems for OPR and the Service in administering the new regime if the privilege issue were addressed up front.

## 6. WE RECOMMEND A MODIFICATION TO THE PROPOSED AMENDMENT TO SECTION 10.34 BECAUSE WE BELIEVE THAT "REALISTIC POSSIBILITY OF SUCCESS ON THE MERITS" IS THE APPROPRIATE ETHICAL STANDARD FOR UNDISCLOSED POSITIONS IN CONNECTION WITH THE PREPARATION OF TAX RETURNS.

As noted above, the proposed amendments propose a change to section 10.34(a) of Circular 230 regarding standards for practitioner's advice with respect to tax return and other documents. As the preamble to these Proposed Regulations notes, Congress amended section 6694 twice, in 2007 and 2008.[13] Section 10.34(a) has therefore been "reserved" since 2007, and the statutory revisions to section 6694 provide the stated reason for amending section 10.34 at this time.

[13] In section 8246 of the Small Business and Work Opportunity Tax Act of 1997, Pub. L. No. 110-28, 121 Stat. 190, 200, and section 506 of the Tax Extenders and Alternative Minimum Tax Relief Act of 2008, Pub. L. No. 343, 122 Stat. 3765, 3880.

Prior to 2007, both section 6694 and section 10.34 of Circular 230 set forth a standard for non-disclosed return positions of "a realistic possibility of success on the merits" ("RPSM"). This standard was derived from pronouncements of the ABA (in Formal Opinion 85-352) and the AICPA (in Statement of Tax Standards No. 1 (2000)) and was described in those authorities as approximately a one-in-three chance of prevailing if an issue were litigated. The former Regulations under section 6694 reflected this assessment of what the RPSM standard meant.[14] For a disclosed position, the standard was a relatively low "not frivolous" for both section 6694 and section 10.34 of Circular 230. This regime harmonized ethical pronouncements from professional societies, the disciplinary rules under Circular 230, and the penalty provisions of section 6694.

The net effect of the Congressional changes to section 6694 has been to raise the standard for a non-disclosed return position to "substantial authority," which is grounded on the presence or absence of precedent, but generally considered to require more authority than the one-in-three RPSM standard and less than the 51% chance of prevailing inherent in the concept of a "more likely than not" return position. Similarly, for positions disclosed in accordance with section 6694, the standard has been raised from "not frivolous" to "reasonable basis."

The proposed amendment to section 10.34 of Circular 230 tracks Congress's actions, but only in part. It provides that a practitioner "may not willfully, recklessly, or through gross incompetence (i) Sign a tax return or claim for refund that the practitioner knows or reasonably should know contains a position that (A) Lacks a reasonable basis; (B) Is an unreasonable position as described in section 6694(a)(2) of the Internal Revenue Code (including the related regulations and other published guidance); or (C) Is a willful attempt by the practitioner to understate the liability for tax or a reckless or intentional disregard of rules or regulations by the practitioner as described in section 6694(b)(2) of the Code (including the related regulations and other published guidance)." Similar restrictions are provided with respect to advising a client or preparing a portion of a tax return or claim for refund. Proposed Regulation section 10.34(a)(2) provides that "A pattern of conduct is a factor that will be taken into account in determining whether a practitioner acted willfully, recklessly, or through gross incompetence."

We concur with the portion of the proposed amendment that incorporates the behavior standards from section 10.52 of Circular 230, and the objective requirement that the practitioner "know or have reason" to know that the return contains a proscribed return position. We believe that this is the appropriate framework for application of a series of ethical rules, although we question why the standard requires repetition of section 10.52 of Circular 230, rather than merely a cross-reference. Moreover, we agree with the concept that OPR should take into account a "pattern of conduct" in deciding whether to pursue sanctions under Circular 230. This seems only appropriate in the context of a set of rules that regulate professional practice, as opposed to a set of statutory provisions that may warrant imposition of a civil penalty in a particular case. We further agree that Circular 230 should reach multiple practitioners in the same firm, unlike the penalty regime of section 6694. And we also, of course, agree that Circular 230 should proscribe any willful attempt by a practitioner to understate the liability for tax or a reckless or intentional disregard of rules or regulations by the practitioner as described in section 6694(b)(2).

[14] Reg. § 1.6694-2(b).

We are concerned, however, about the first and second clauses regarding return positions as a basis for finding a violation. Under the first clause, Proposed Regulation section 10.34(a)(1)(i)(A), the practitioner who fails to satisfy the "reasonable basis" standard – irrespective of whether the return position is disclosed – may be punished. Under the second clause, the practitioner whose return position has a reasonable basis may nonetheless be sanctioned if the position is "unreasonable" as defined in section 6694(a)(2). Section 6694(a)(2) imposes a preparer penalty on practitioners who take return positions unrelated to tax shelters that, if not disclosed, fail to meet the "substantial authority" test or, if disclosed, lack a reasonable basis. The two clauses are in the disjunctive, so the failure to meet either standard can be the basis for sanction. The result is that Proposed Regulation section 10.34(a)(1)(i)(A)'s reasonable basis standard would ultimately apply only in the circumstance where a position has a reasonable basis but has not been disclosed on a Form 8275 or otherwise.

We believe that the combination of the "reasonable basis" standard in Proposed Regulation section 10.34(a)(1)(i)(A) and, by incorporation, the standard set forth in section 6694(a)(2) is unnecessarily complex. The former is a minimum standard, prior to evaluating whether a position constitutes an "unreasonable position" as described in section 6694(a)(2). The latter proscribes reasonable basis positions only if not disclosed. In other words, one clause under the proposed amendment would proscribe a position that lacks a "reasonable basis," irrespective of disclosure, and the other would punish a position that has a "reasonable basis" position only if it is not disclosed. We believe that the standards contained in a regime based in ethics should be clearer.

We concur with the proposition that disclosed return positions that satisfy the reasonable basis standard should not be subject to disciplinary action. We believe this is entirely appropriate. However, the incorporation of the "substantial authority" standard for undisclosed positions conflicts with the longstanding position of the ABA. In Formal Opinion 85-352, the ABA endorsed a standard requiring that tax return positions have a reasonable possibility of success on the merits ("RPSM"). This opinion is an interpretation of the Model Rules of Professional Responsibility adopted by most states and incorporated into many court rules (including the Tax Court). It was based on the view that "reasonable basis" is an inappropriately low standard for ethical behavior by tax practitioners (at least with respect to undisclosed positions). RPSM, generally thought to represent a one in three chances of prevailing,[15] was settled upon precisely because "reasonable basis" was perceived to be subject to abusive behavior, such as positions that were just barely "not frivolous" or "not patently improper."[16] Meanwhile, the "substantial authority" test imported into the proposed amendments from section 6694 would ground the reporting standard for disciplinary purposes in the presence or absence of authority, which may or may not correspond to the underlying merits of the position.

Following the standard set forth in the ABA's Opinion 85-352, we urge that the disciplinary provisions of Circular 230 match its conclusion as to undisclosed positions. Therefore, following the provisions of Formal Opinion 85-352, we urge that Proposed Regulation section 10.34(a)(1) be revised, in part, to say:

---

[15] Reg. §1.6694-2(b) (2007).

[16] *Cf.* Reg. §1.6662-3(b)(3) (addressing that concern by noting that "reasonable basis is a relatively high standard of reporting, that is significantly higher than not frivolous or not patently improper).

(1) A practitioner may not willfully, recklessly, or through gross incompetence –
(i) Sign a tax return or claim for refund that the practitioner knows or reasonably should know contains a position that –
(A) does not have at least a realistic possibility of success on the merits if litigated, or
(B) if the position is disclosed, does not have a reasonable basis…

We believe this would be a simpler and more straightforward guidepost for an ethical rule that will now cover hundreds of thousands of Registered Tax Return Preparers as well as the class of tax practitioners already regulated under Circular 230.[17]

While RPSM has been the professional standard for asserting positions in a tax return for twenty-five years, Congress has amended section 6694 twice in recent years. The fluidity of the legislatively adopted return preparation standards can create uncertainty and the possibility or perception of uneven enforcement. Since Circular 230 is a statement of ethics rules, we believe it should not be subject to legislative shifts. Adopting a delinked standard creates a uniform and potentially permanent rule, and when the Service is about to regulate hundreds of thousands of tax return preparers nationwide, these objectives strike us as worthy of incorporation into the amendment of Circular 230.

We would also note that section 10.34 applies to a broader range of cases than section 6694. Section 6694 applies only if the practitioner advises as to a position that constitutes at least a substantial portion of the taxpayer's tax return. In contrast, section 10.34 applies to advice regarding any position taken on a tax return, without regard to whether the position represents a substantial portion of the return. Second, a violation of section 6694 will not result in a penalty if there is no understatement on the return. Again, section 10.34 applies without regard to the existence of any understatement on a return. Given the broader scope of section 10.34, we do not believe there is a compelling argument that the standard in section 10.34 needs to track the standard in section 6694.

Having said all of this, reasonable basis, one way or the other, will likely be a component of revised 10.34 of Circular 230. We therefore urge that more guidance be provided respecting the definition of the concept. Currently, the Regulations state only that:

> Reasonable basis is a relatively high standard of tax reporting, that is significantly higher than not frivolous or not patently improper. The reasonable basis standard is not satisfied by a return position that is merely arguable or that is merely a colorable claim.[18]

[17] Indeed, because claims for refund by definition entail disclosure, the rule might also be stated as follows:
(1) A practitioner may not willfully, recklessly, or through gross incompetence –
(i) Sign a tax return that the practitioner knows or reasonably should know contains a position that –
(A) does not have at least a realistic possibility of success on the merits if litigated, or
(B) if the position is disclosed, does not have a reasonable basis…, or
(ii) Sign a claim for refund that does not have at least a realistic possibility of success on the merits if litigated.

[18] Reg. § 1.6662(b)(3).

The Regulations also state that a taxpayer may take a reasonable basis position based upon specified legal authorities, even though the position does not meet the substantial authority standard.[19] Implicit in our recommendation, of course, is our view that RPSM is a higher standard than "reasonable basis."

Given the scope of the regulation of Registered Return Preparers under the Circular 230 regime, it would behoove Treasury to consider providing a more detailed definition of the concept of "reasonable basis."

## 7. WE RECOMMEND THAT SECTION 10.34 OF CIRCULAR 230 MORE CLEARLY DEFINE THE TRANSACTIONS ADDRESSED BY THE INTENDED INCORPORATION OF SECTION 6694(a)(2)(C) AND THAT A HIGHER REPORTING STANDARD BE IMPOSED ON SUCH TRANSACTIONS.

Even for disclosed positions, under section 6694(a)(2)(C) the reasonable basis standard does not apply to "tax shelters" or "reportable avoidance transactions." Rather, the Code imposes a penalty on a preparer who does not reasonably believe that such transactions would more likely than not be sustained on the merits. Under interim guidance provided in Notice 2009-5,[20] the substantial authority standard continues to apply to these positions but only if the preparer has properly informed the taxpayer of the penalty risk. This is the so-called "substantial authority plus speech" standard.

As a threshold matter, to the extent the amendments proposed to section 10.34 of Circular 230 incorporate the definition of an unreasonable position in section 6694(a)(2)(C), we recommend that Treasury specifically address the current state of uncertainty surrounding the definition of a "tax shelter." Section 6694(a)(2)(C) incorporates by reference the special rule governing section 6662(d) tax shelters and the reportable transactions subject to section 6662A, which in turn use the phrase "a significant purpose of tax avoidance or evasion."[21] To some extent, nearly all bona fide tax planning has a significant purpose of lawful tax avoidance hence might, arguably, fall under a section 10.34(a) regime that incorporates section 6694(a)(2)(C). Such breadth in a definition would be grossly overbroad. As OPR is set to embark on regulating tax return preparers, we believe that further clarification in this area will help to avoid both uncertainty and confusion concerning the application of section 10.34 and further the purposes of Circular 230.

Further, we believe that the proposed amendment's incorporation of the standard described in section 6694(a)(2)(C) presents additional complexity and may result in a standard for "shelter" type transactions that is too low. Section 6694(a)(2)(C) provides that such a transaction may not be the basis for a preparer penalty if "it is reasonable to believe that the position would more likely than not be sustained on its merits." Note that this statutory standard is not a simple, objective "more likely than not" standard. One can have a "reasonable belief" that a position satisfies the "more likely than not" standard when in fact it would not. Put

[19] *Id.*
[20] 2009-3 I.R.B. 309.
[21] Notice 2009-5 states specifically that it provides only interim guidance "while the Treasury Department and IRS consider further guidance for tax return preparers and taxpayers on the definition of tax shelter for purposes of sections 6694 and 6662(d)(2)(C)."

another way, in practical terms, if a practitioner facing sanction under section 6694(a)(2)(C) can find a qualified expert who would opine that one could have a reasonable belief that a position satisfies the "more likely than not" standard, then a penalty might not be imposed. The result would be that no discipline could be imposed despite a course of conduct involving positions that do not in fact have a more likely than not chance of succeeding on the merits.

We recognize that Treasury could simply amend section 10.34 of Circular 230 to apply directly, rather than by incorporation, the standard now in place – "reasonable belief in more likely than not." Such an approach would have the advantage of continuing a system most recently in place. But it would again present the possibility, if not the likelihood, that Circular 230's standard would once again conflict with subsequent Congressional action or further Treasury or Service guidance. It would also incorporate into Circular 230 the ambiguity presented by Congress's grafting of a "reasonable belief" component onto the "more likely than not" standard.

Thus, it may be that for "tax shelter" type transaction, Treasury should consider adopting a purely objective standard in the return position language of section 10.34 of Circular 230, leaving out the question whether one could "reasonably believe" that a standard has been satisfied. Indeed, the requirement in section 10.34 of Circular 230 that OPR demonstrate willfulness, recklessness or gross incompetence, in our view, ensures that a practitioner should not face professional sanction if the practitioner has a reasonable belief that a reporting position has been satisfied.

We see three potential options for a purely objective reporting position standard for "tax shelter" type transactions, i) a "more likely than not" standard, ii) a "substantial authority" standard, and iii) RPSM.

For the reasons stated above, an objective "more likely than not" standard could be considered a stricter standard than what is now imposed by the combination of section 6694(a)(2)(C) and Notice 2009-5. But in the context of OPR's need to establish willfulness, recklessness or gross incompetence, especially given the reference in section 10.34 of Circular 230 to a "pattern" of misconduct, we believe that it would be a simpler approach.[22] It would essentially subject to potential discipline any practitioner who endorses a return position that is likely, by objective measure, to lose in court. As to the practitioner's mental state, whether a reasonable person could believe that the position would succeed would be irrelevant – what would matter would be whether the practitioner at issue acted willfully, recklessly, or with gross incompetence.

Alternatively, an objective "substantial authority" standard for "tax shelter" type transactions would set a lower bar than a "more likely than not" test . It would center the analysis under the disciplinary regime of Circular 230 as to the merits of a given return position on the question whether the transaction can be supported by authority, rather than on an attempt to speculate retrospectively whether a given position might win or lose in court. Such a standard might, in fact, be simpler for OPR to enforce. There is an extensive and time tested body of law

[22] Indeed, because 10.34 would require proof that a practitioner acted willfully, recklessly or with gross incompetence, the incorporation of a standard that contains a "reasonable belief" element just adds to the complexity in terms of the evidence required to sustain a sanction.

on what constitutes "substantial authority."[23] Having said that, as we note above, "substantial authority" grounds the rule in the presence of decisional and other authority, and not on the merits of the position at issue which should be the touchstone for determining the propriety of a tax position.

Finally, there is the ABA's longstanding position of RPSM, stated in Formal Opinion 85-352, which is applicable without regard to whether a transaction is a "shelter" or not. RPSM, while recently removed from section 6694's preparer penalty regime, has remained a component of the ethical landscape for many years. It is a standard practitioners can easily comprehend – "does this position have at least a one in three chance of prevailing?" It is, of course, a lower standard than more likely than not, and OPR would in our judgment be reasonable in concluding that a higher standard should apply for a defined – we hope more narrowly defined than now – category of "shelter" type arrangements. But if adopted for such transactions, it would permit OPR to have a relatively straightforward and consistent disciplinary regime for enforcing Circular 230 among hundreds of thousands of return preparers, irrespective of the type of transaction at issue, because the same standard would apply to all undisclosed tax return positions.

Whatever standard is adopted, we do not believe the proposed amendment strikes quite the right chord concerning the standard for "tax shelter" transactions, and we urge Treasury to adopt for Circular 230 its own clear and objective standard, one not dependent on transitory administrative guidance or legislative standards and one that, as to the relevant, subjective mental state of the practitioner, relies on the standard set forth in section 10.52 of Circular 230 as incorporated into section 10.34 of Circular 230.

Finally, we also see problems arising from simply incorporating the current regime under section 6694(a)(2)(C) in light of the interpretation provided by Notice 2009-5. As noted, under that regime a "tax shelter" type transaction is not subject to penalty if the practitioner reasonably believes that it meets the more likely than not test; nor is a practitioner penalized if the transaction meets the substantial authority test so long as the practitioner has informed the taxpayer of the penalty risk. By its own terms, however, Notice 2009-5 is transitory, and we expect Treasury and the Service to revise the rules therein in the future – indeed, in our above comments we urge that this be done. Just as with a simple incorporation of section 6694, which has been revised twice in recent years by Congress, we see problems in the future if Circular 230 simply incorporates a potentially transitory regime based on a Code section plus an IRS notice.

Irrespective of the issue of permanence, it is simply unclear from the proposed amendment whether the standard in Notice 2009-5 would apply in a Circular 230 context. We have urged the issuance of more permanent guidance than is now set forth in Notice 2009-5, but in any event, the proposed amendments, whether directly or in the preamble, should address whether a practitioner may be disciplined under Circular 230 even though Notice 2009-5's process has been satisfied.

[23] *See, e.g.*, Reg. § 1.6662-4.

## CONCLUSION

We believe that the proposed regulation of tax return preparers by OPR is an essential and long overdue component of an effective national tax compliance program. We strongly support the proposed enforcement program which will include increased oversight of paid tax preparers. We recommend, however, that Treasury reconsider the return preparation standards in Proposed Regulation section 10.34 along the lines we suggest.