ETHICS:
ADVISING CLIENTS IN AN AGE OF UNCERTAINTY

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(This outline summarizes some, but not all, of the sources that will be discussed during the Philadelphia Tax Conference Ethics panel.)

I. Circular 230

Under authority granted in 31 U.S.C. § 330, the Secretary of the Treasury ("Treasury") has issued regulations referred to as Circular 230, to regulate the practice of representatives before the Internal Revenue Service ("IRS"). Circular 230 is most easily accessed on the IRS’s website, at https://www.irs.gov/pub/irs-pdf/pcir230.pdf. Violating Circular 230 could result in loss of one’s qualification to represent clients before the IRS on a temporary or permanent basis. In some cases, violations of Circular 230 could result in monetary penalties.

“Practice before the IRS”

Circular 230 regulates “practice before the IRS,” which includes all matters connected with a presentation to the IRS relating to a taxpayer’s rights, privileges or liabilities under laws or regulations administered by the IRS. Until 2011, preparing and filing tax returns were not covered by Circular 230. In that year, Treasury amended Circular 230 to create a new class of Circular 230 practitioners, registered tax return preparers. Members of this group, which included persons who prepared and filed tax returns for compensation but who were not otherwise covered by Circular 230, were required to pass a qualifying examination and to enroll in fifteen hours of continuing education courses annually. Registered tax return preparers were also subjected to all provisions of Circular 230 with respect to their tax practices. This attempt to expand OPR’s jurisdiction was soundly rejected in Loving v. IRS, 742 F.3d 1013 (D.C. Cir. 2014). Treasury has yet to amend Circular 230 to reflect the Loving decision or to convince Congress to provide the IRS with explicit statutory authority to regulate return preparation.¹

The plaintiffs in Loving were tax return preparers who would not have been subject to Circular 230 but for the 2011 amendments. The court construed 31 U.S.C. § 330’s authorization to regulate practice before the IRS not to extend to preparation of tax returns; “tax-return preparers do not practice before the IRS when they simply assist in the preparation of someone else's tax

¹ S. 3278 § 202, introduced on July 26, 2018, would grant Treasury authority regulate “tax return preparers” in “preparing tax returns, claims for refund, or documents in connection with tax returns or claims for refund.”
return.” Of particular interest to persons who unquestionably are Circular 230 practitioners and who otherwise practice before the IRS is whether Loving implies that the IRS Office of Professional Responsibility (“OPR”) has no authority to discipline practitioners under Circular 230 for transgressions that occur only in the context of return preparation. Ridgely v. Lew, 55 F.Supp.3d 89 (D.D.C. 2014), which was decided several months after Loving, supports this notion. In Ridgely, a certified public accountant successfully challenged the IRS’s authority under Circular 230 to regulate contingent fee arrangements. (Mr. Ridgely, a certified public accountant, wished to charge his clients contingent fees for preparing ordinary refund claims.) It remains to be seen how broadly or narrowly the IRS will read the holdings in these cases, or the extent to which regulation of other non-return preparation activities is affected by the rationales of Loving and Ridgely. In one recent case, the court held that OPR has no jurisdiction over individuals who have been suspended from practice before the IRS, stating also that rendering written tax advice to a client does not constitute practice before the IRS for purposes of Circular 230. Sexton v. Hawkins, 119 AFTR 2d 2017-1187 (D. Nev. 2017).

Duties and Restrictions Relating to Practice Before the Internal Revenue Service

Circular 230 contains a series of rules and restrictions pertaining to specific issues arising under Circular 230, including:
1. responding to IRS requests for records or information (section 10.20),
2. advising a client who has made an error or omission on a tax return or other IRS document (section 10.21),
3. diligence as to accuracy (section 10.22),
4. promptly disposing of IRS matters (section 10.23),
5. assisting or accepting assistance from a person under suspension or disbarment from the IRS (section 10.24),
6. practice by former government employees, their partners and associates (section 10.25),
7. notarizing documents in matters in which a practitioner acts as counsel or has an interest (section 10.26),
8. fees (section 10.27),
9. promptly returning records to a client (section 10.28),
10. conflicting interests (section 10.29),
11. solicitation of business (section 10.30),
12. negotiating a client’s government check in respect of a federal tax liability (section 10.31),
13. best practices for tax advisors (section 10.33),
14. standards for advising clients on tax returns and other IRS documents (section 10.34),
15. competence (section 10.35),
16. procedures for ensuring compliance with Circular 230 (section 10.36), and
17. requirements for rendering written tax advice (section 10.37).

Failure to comply with any of the rules enumerated above (except section 10.33, which is aspirational) could give rise to disciplinary action.²

² In light of Loving, Ridgeley and Sexton, it is questionable whether the IRS has authority, under Circular 230, to discipline practitioners for conduct that does not amount to “practice” before the IRS as defined in those cases.
Sanctions for Violation of the Regulations

Violations of Circular 230 may result in one or more of four sanctions: censure (i.e., public reprimand), suspension from practice before the IRS, disbarment from practice before the IRS or monetary penalty. OPR also occasionally issues private reprimands, although this practice is not referred to in Circular 230. Congress gave the IRS authority to impose monetary penalties for Circular 230 violations in 2004. 31 U.S.C. § 330(b). To date, there have been only a few reported instances of monetary penalties having been imposed. Monetary penalties may be imposed on a firm as well as on an individual if the person whose actions violated Circular 230 was acting on behalf of an employer or firm and the employer or firm knew or reasonably should have known of the conduct. A monetary penalty may be up to 100 percent of the gross income derived, or to be derived, from the conduct giving rise to the penalty.

Three categories of act or omissions are sanctionable under Circular 230:
1. incompetent and disreputable conduct,
2. willful violations of Circular 230, and
3. violations of certain provisions of Circular 230 through recklessness or gross incompetence.

Incompetence and disreputable conduct includes any of eighteen specific acts or omissions listed in Circular 230 § 10.51. The level of intent (recklessness, willfulness, etc.) is indicated in each of the items in the list.

Willful violations of any section of Circular 230 (except section 10.33, which sets out aspirational best practices) are sanctionable. Circular 230 § 10.52(a)(1). It has generally been held that willfulness under Circular 230 means the same thing that it does in civil and criminal tax contexts – “the voluntary, intentional violation of a known legal duty.” Consequently, OPR does not have to show that a practitioner acted with malicious intent or bad purposes, only that she purposefully disregarded or was indifferent to her obligations.

Violations of Circular 230 §§ 10.34 (standards with respect to tax returns and other documents), 10.35 (competence), 10.36 (procedures to ensure compliance with Circular 230) and 10.37 (requirements for written advice) are sanctionable only if they result from recklessness or gross incompetence. It is unclear what recklessness or gross incompetence mean in this context, but Circular 230 § 10.51(a)(13) may be helpful. (This section considers as incompetent and disreputable conduct for purposes of Circular 230 § 10.51 the giving of a false opinion, knowingly, recklessly or through gross incompetence, or engaging in a pattern of providing incompetent opinions on questions arising under the federal tax laws.) Section 10.51(a)(13) states in part:

For purposes of this paragraph (a)(13), reckless conduct is a highly unreasonable omission or misrepresentation involving an extreme departure from the standards of ordinary care that a practitioner should observe under the circumstances. A pattern of conduct is a factor that will be taken into account in determining whether a practitioner acted knowingly, recklessly, or through gross incompetence. Gross incompetence includes conduct that reflects gross indifference, preparation which
is grossly inadequate under the circumstances, and a consistent failure to perform obligations to the client.

II. Standards Applicable to Tax Return Preparation and Advice

A. Penalty for Understatement of Taxpayer’s Liability by Tax Return Preparer (IRC § 6694)

IRC § 6694 imposes civil penalties on “tax return preparers.” For tax returns or refund claims that reflect an understatement of a client’s tax liability due to an “unreasonable position,” the penalty is the greater of $1,000 or 50 percent of the income derived, or to be derived, by the tax return preparer from the return or refund claim. IRC § 6694(a). For tax returns or refund claims that reflect an understatement of a client’s tax liability due to willful or reckless conduct by the tax return preparer, or to an intentional disregard of rules or regulations, the penalty is the greater of $5,000 or 70 percent of the income derived, or to be derived, by the tax return preparer from the return or refund claim. IRC § 6694(b). When a penalty is imposed on both an individual preparer and the preparer’s firm, the total amount of the penalties may not exceed 50 percent of the income derived by the firm from the engagement. Treas. Reg. § 1.6694-1(f)(3).

Tax Return Preparer

Penalties under IRC § 6694 can be imposed on any “tax return preparer,” a term that is defined broadly enough to encompass persons who advise with respect to tax returns but who do not physically prepare or sign them. A “tax return preparer” is a person who prepares for compensation a “substantial portion” of a return or refund claim. IRC § 7701(a)(36)(A). IRC § 7701(a)(36)(B) provides exceptions for a person who (1) furnishes typing, reproducing or other mechanical assistance, (2) prepares a return or refund claim for an employer, (3) prepares a return or refund claim as a fiduciary, or (4) prepares a refund claim in response to a notice of deficiency issued to a taxpayer or in response to a waiver of restriction after commencement of an audit of that taxpayer or another taxpayer if a determination in such an audit affects the tax liability of the taxpayer for whom the refund claim is prepared. The list of exceptions is expanded in Treas. Reg. § 301.7701-15(f).

The regulations distinguish between a signing preparer and a nonsigning preparer. Treas. Reg. § 301.7701-15(b)(1) & (2). A signing preparer is the individual who has primary responsibility for the overall substantive accuracy of a return or refund claim. If a tax professional advises with respect to only one or a few individual issues on a return, he would not have primary responsibility for the overall substantive accuracy of the return and would not be a signing preparer with respect to the return. (A signing preparer is required to sign the return. See Treas. Reg. § 1.6695-1(b)(3) (implementing the penalty for failure to sign a return).) A tax return preparer who is not a signing preparer but who prepares a substantial portion of a return or refund claim is a nonsigning preparer and potentially is subject to penalties under IRC § 6694 with respect to the return or portion as to which he provided advice. Subject to some exceptions, tax planners, who

3 If it is determined that there was no understatement on the taxpayer’s return, there can be no penalties under IRC § 6694. Any amounts previously collected will be refunded. IRC § 6694(d).
advise in advance of transactions, generally are not subject to penalties under IRC § 6694, which is meant to apply only to advice with respect to events that have already occurred.

The regulations elaborate on the “substantial portion” concept by providing that a person “who renders tax advice on a position that is directly relevant to the determination of the existence, characterization, or amount of an entry on a return or claim for refund will be regarded as having prepared that entry.” Treas. Reg. § 301.7701-15(b)(3). Determining whether something is a substantial portion depends on whether the person knows or reasonably should know that the tax attributable to the entry or other portion is a substantial portion of the tax required to be shown on the return or refund claim. The size and complexity of the item relative to the taxpayer’s gross income and the size of the understatement attributable to the item compared to the taxpayer’s reported tax liability are among the factors to consider in determining whether the item is a substantial portion. The regulations provide de minimis rules precluding substantial portion treatment where the portion involves less than specified amounts of gross income, deductions, or basis for which credits are determined.

Substantive Standards: IRC § 6694(a) Penalty

The general rule or standard under IRC § 6694(a) is “substantial authority”: a position will not attract a preparer penalty if it is supported by substantial authority. The definition of substantial authority and the process for evaluating whether there is substantial authority for a position is the same as under the accuracy-related penalties. See Treas. Reg. § 1.6694-2(b)(1). Whether a preparer meets the standard is determined based on all facts and circumstances, including the preparer’s diligence.

If a position is not supported by substantial authority, the preparer may avoid a penalty under IRC § 6694(a) if (1) there is a “reasonable basis” for the position and (2) the position is adequately disclosed.4 “Reasonable basis” carries the same meaning as in Treas. Reg. § 1.6662-3(b)(3) (negligence penalty). Treas. Reg. § 1.6694-2(d)(2). The rules on adequate disclosure in the regulations are inconsistent with, but more generous than, the statute. In easy cases, disclosure of a position is made on Form 8275 or Form 8275-R, or on a return in the manner provided in an annual revenue procedure. E.g., Rev. Proc. 2018-11, 2018-5 I.R.B 335. The regulations consider the disclosure requirement met even where the taxpayer chooses not to disclose the position, so long as the preparer provides a prepared tax return to the taxpayer that includes the required disclosure, or advises the taxpayer of the opportunity to avoid penalties under IRC § 6662 by disclosure and contemporaneously documents that advice in the preparer’s files. Treas. Reg. § 1.6694-2(d)(3).

A penalty under IRC § 6694(a) will not be imposed if it is shown that there was reasonable cause for the understatement and that the tax return preparer acted in good faith. IRC § 6694(a)(3). Factors considered include: the nature of the error causing the understatement, the frequency of errors (the exception does not apply if there is a pattern of errors), materiality of the error, the

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4 A position with respect to a tax shelter (as defined in IRC § 6662(d)(2)(C)(ii)) or a reportable transaction, to which IRC § 6662A applies, is subject to a penalty under IRC § 6694(a) unless it is reasonable to believe that the position would more likely than not be sustained on its merits. IRC § 6694(a)(2)(C). Thus, neither the substantial authority nor the reasonable basis/disclosure standard applies to tax shelters and reportable transactions.
preparer’s normal office practice, reliance on advice of others and reliance on generally accepted administrative or industry practice. Treas. Reg. § 1.6694-2(e).

**Substantive Standards: IRC § 6694(b) Penalty**

A penalty may be imposed under IRC § 6694(b) if an understatement of tax results from “a willful attempt in any manner to understate the liability” or “a reckless or intentional disregard of rules or regulations.” According to the regulations, a preparer is considered to have willfully attempted to understate liability if he disregards information furnished by the taxpayer or other persons in an attempt wrongfully to reduce the tax liability of the taxpayer. Treas. Reg. § 1.6694-3(b).

A preparer is considered to have recklessly or intentionally disregarded a rule or regulation if the preparer takes a position that is contrary to a rule or regulation and the preparer knows of, or is reckless in not knowing of, the rule or regulation in question. A preparer is reckless in not knowing of a rule or regulation if the preparer makes little or no effort to determine whether a rule or regulation exists, under circumstances that demonstrate a substantial deviation from the standard of conduct that a reasonable preparer would observe in the situation. On the other hand, a preparer is not considered to have recklessly or intentionally disregarded a rule or regulation if the position contrary to the rule or regulation has a reasonable basis and is adequately disclosed in accordance with the rules applicable to disclosures under the IRC § 6694(a) penalty. If a position is contrary to a regulation, the position must represent a good faith challenge to the validity of the regulation and, when disclosed, the preparer must identify the regulation being challenged. If a position is contrary to a revenue ruling or IRS notice (other than a notice of proposed rulemaking), a preparer also is not considered to have recklessly or intentionally disregarded the ruling or notice if the position meets the substantial authority standard and is not with respect to a reportable transaction to which IRC § 6662A applies.

The amount of any penalty to which a preparer may be subject under IRC § 6694(b) is reduced by any penalty assessed and collected under IRC § 6694(a) for the same position on a return or refund claim. Treas. Reg. § 1.6694-3(f). There is no reasonable cause or good faith exception to the IRC § 6694(b) penalty.

**B. Circular 230 Standards**

The standards in Circular 230 governing return preparation and advice are similar, but not identical, to those in IRC § 6694. Thus, it is possible for the IRS to collect a preparer penalty under IRC § 6694 without OPR initiating a disciplinary proceeding, and vice versa. Therefore, it is important that practitioners be mindful of both standards.

Under Circular 230 § 10.34, a practitioner may not willfully, recklessly or through gross incompetence sign, prepare a portion of, or advise a client to take a position on, a tax return or refund claim containing a position that the practitioner knows or reasonably should know contains a position that:

1. lacks a reasonable basis,

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5 But see Loving, Ridgley and Sexton, supra.
2. is an unreasonable position as described in IRC § 6694(a)(2), or
3. 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 IRC § 6694(b)(2).

In determining whether to pursue discipline, OPR will take into account whether there is or has been a pattern of conduct. A single violation of IRC § 6694 will not result in a mandatory violation of Circular 230 § 10.34(a). Unlike IRC § 6694, however, whether the taxpayer owes additional tax, or not, as a result of the position at issue, is irrelevant.

C. Ethical Standards

The American Institute of Certified Public Accountants has updated its professional standards to conform to IRC § 6694 and Circular 230 § 10.34. Under Statement on Standards for Tax Services No. 1, Tax Return Positions (“SSTS No. 1”), certified public accounts (“CPAs”) should comply with standards imposed by the applicable taxing authority when recommending a tax return position. Thus, if advice is given with respect to a federal tax return, CPAs should comply with IRC § 6694 and Circular 230 § 10.34. If the applicable taxing authority has no written standards with respect to recommending a tax return position, or if those standards are lower than the standard set forth in SSTS No. 1, then a CPA may not recommend a tax return position or prepare or sign a tax return unless the CPA has a good faith belief that the position has at least a realistic possibility of being sustained administratively or judicially on its merits if challenged. (This has been described as a one in three likelihood of success.) Notwithstanding the preceding rule, a CPA may recommend a tax return position if the CPA concludes that there is a reasonable basis for the position and advises the taxpayer to disclose the position. See also Interpretation No. 1-1 of SSTS No. 1, “Reporting and Disclosure Standards.”

In Formal Op. 85-352 (July 7, 1985), the American Bar Association adopted the realistic possibility of success (one in three likelihood of success) as the standard under which a lawyer may ethically recommend a return position. The ABA has not updated its professional standards to conform to revisions in IRC § 6694 or Circular 230 § 10.34. Thus, an attorney is ethically permitted to recommend a position that could subject her to a preparer penalty or to discipline under Circular 230 (an odd result).

III. Conflicts of Interest

A. Ethics Rules

The basic principle embodied in the Model Rules’ conflict provisions is that a lawyer may not represent anyone where the interests of another person — a current or former client, perhaps, or the lawyer’s own interests — could impair the lawyer’s ability to zealously and impartially act on a client’s behalf. Resolution of a conflict might entail declining to undertake representation, withdrawing from an existing representation, or obtaining a client or clients’ written consent to proceed despite a conflict.
The basic rules governing conflicts of interest are contained in Model Rule 1.7. This rule sets out the general conflicts of interest principles on which all other conflicts rules rely. Model Rule 1.7(a) provides that a lawyer must not represent a client if the representation involves a concurrent conflict, meaning that either:

1. the representation of one client will be directly adverse to another client, or
2. there is a significant risk that representation of one or more clients will be materially limited by the lawyer's responsibility to another client, a former client, or a third person, or by the lawyer's own personal interest.

Notwithstanding a concurrent conflict, however, Model Rule 1.7(b) permits a lawyer to represent a client if:

1. the lawyer reasonably believes that she will be able to competently and diligently represent each affected client,
2. the representation is not prohibited by law,
3. the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding, and
4. each affected client gives informed consent, confirmed in writing.

Louisiana has adopted Model Rule 1.7.

The Model and Louisiana Rules immediately following Rule 1.7 set forth conflicts rules that apply in particular. While not formally a conflicts rule, Rule 1.13 often must be considered in the context of conflicts analyses; that rule provides that a lawyer employed or retained by an organization (such as a corporation) represents the organization and not its constituents (such as officers or shareholders). Rule 1.13 is deceptively simple, however, as will be exemplified by a hypothetical fact pattern discussed during the ethics panel.

AICPA conflicts of interest rules are set forth at AICPA Code of Professional Conduct ET Section 102.031.100.001 and Interpretation 102–21.110. Conflicts of interest for accountants are defined in terms of relationships that could be viewed by a client, employer, or another party as impairing a CPA's objectivity. If a CPA believes that a professional service can be performed with objectivity, however, and the relationship is disclosed to and consent is obtained from the client, employer, or other appropriate party, then the CPA is permitted to perform the professional service. Conflicts cannot be waived with respect to engagements that require independence, e.g., audits, reviews and other attest services.

B. Circular 230 Rules

Circular 230 includes conflicts of interest rules in section 10.29. While it follows from Loving, Ridgely and Sexton, discussed supra, that OPR does not have authority to apply these rules to tax return preparation activity, the conflicts rules may apply in other contexts.

The conflicts of interest rules in Circular 230 § 10.29 are very similar to those in Model Rule 1.7. Circular 230 § 10.29, however, imposes three additional requirements.
1. While both the Model Rules and Circular 230 require that conflict waivers be confirmed in writing, Circular 230 mandates that confirmation be obtained within a reasonable period of time, but in no event later than 30 days after the client has consented to the representation. The AICPA standards do not require written consent.

2. Unlike Model Rule 1.7, which permits affected clients to provide informed consent verbally if the consent is contemporaneously documented by the practitioner in writing, a verbal consent followed by a confirmatory letter authored by the practitioner will not satisfy Circular 230 § 10.29 unless the confirmatory letter is countersigned by the client.

3. Under Circular 230, practitioners are required to retain copies of written consents for at least 36 months from the date on which representation of the client concludes. While AICPA standards do not require written consent, they do state that members should abide by Circular 230’s more restrictive requirements concerning written consent when practicing before the IRS. AICPA Code of Prof’l Conduct Interpretation 1.110.010.18.

Practitioners must provide copies of written consents to IRS officers or employees, including those from OPR, upon request. Although the requirement to turn over copies of written consents is explicitly stated in Circular 230 § 10.29(c), it is consistent with the practitioner’s duty, as a general matter under Circular 230 § 10.20, to provide documents and information to the IRS upon proper and lawful request. Unlike Circular 230 § 10.29(c), however, Circular 230 § 10.20 explicitly provides that information and documents need not be turned over if the practitioner believes in good faith and on reasonable grounds that the records or information are privileged.

**C. Tax Court Rules**

Practitioners representing clients in Tax Court proceedings must comply with the Tax Court’s own rule on conflicts of interest. Tax Court Rule 24(g) provides that if any counsel of record “represents more than one person with differing interests with respect to any issue in the case,” she must secure the clients’ informed consent to the representation, withdraw from the case, or take whatever other steps are necessary to obviate the conflict of interest. Tax Court Rule 24(g) imposes the same obligations on any counsel who “was involved in planning or promoting a transaction or operating an entity that is connected to any issue in a case.” Counsel who is a potential witness in a case must withdraw or take other steps necessary to obviate a conflict; obtaining the client’s informed consent is not an option in this situation.

**IV. Social Media and Ethics**

As lawyers continue to increasingly turn to social media for both business and personal reasons, bar associations have sought to identify and address the ethical issues that can arise when operating on these new platforms. Pennsylvania Bar Association Formal Opinion 2014-300, available at https://www.pabar.org/members/catalogs/Ethics%20Opinions/formal/F2014-300.pdf, provides ethical guidance on a number of questions including (but not limited to): (1) advising clients about the content of social media sites, (2) connecting with clients and former clients via social networking sites, (3) contacting persons represented by counsel via a site, (4) contacting
unrepresented persons via a social media site, (4) using information gathered through a social networking site in a client matter, (5) endorsing other attorneys through a site, (6) viewing a juror's social media presence, and (7) connecting with judges via social media. Relatedly, the ABA has addressed the ethical obligations of lawyers surrounding use of the internet to transmit and communicate client information. ABA Formal Opinion 477 (May 11, 2017). Previously, in August 2012, the ABA revised the Comment to Model Rule 1.1 (Duty of Competence) to specify that areas of competence required for lawyers include keeping up-to-date on "the benefits and risks associated with relevant technologies."