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A Smile, a Frown, and a Few New Wrinkles: The Changing Face of Practice before the IRS

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A SMILE, A FROWN, AND A FEW NEW WRINKLES: THE CHANGING FACE OF PRACTICE BEFORE THE IRS

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I. INTRODUCTION

Attorneys who represent clients in federal tax cases must follow the rules of professional responsibility, the Internal Revenue Code [hereinafter I.R.C.], and restrictions imposed by the courts.[1] An additional set of rules also governs their professional conduct: the standards of practice before the Internal Revenue Service set forth in Title 31 of the Code of Federal Regulations [hereinafter C.F.R.].[2] These rules also appear in what the tax bar has come to know with dubious affection as "Circular 230."[3] The attorney who only occasionally represents clients before the Internal Revenue Service [hereinafter Service] may discover the full reach of the rules that govern tax practice by surprise. Moreover, the Treasury Department's recent revisions to Circular 230[4] may come as an even bigger surprise to attorney-practitioners who prepare tax returns or give advice regarding return positions.

The revisions to Circular 230 bind practitioners who prepare returns or give return advice to a standard of accuracy essentially equivalent to the standard currently imposed by the return preparer penalty rules of the I.R.C..[5] The latter provisions impose fines on tax return preparers who advance tax return positions having no realistic possibility of success in litigation on the merits.[6] Violation of the rules in Circular 230 could result in suspension or disbarment from practice before the Service[7] and potentially disciplinary action by the state bar.[8] The

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1. *E.g.*, N.D. PROC. RULES FOR LAWYER DISABILITY AND DISCIPLINE 1.2(A) *reprinted in* N.D. CENT. CODE COURT RULES ANN. 1009, at 1013 (1994) [hereinafter LAWYER DISCIPLINE].

2. *See* 31 C.F.R. pt. 10 (1993); Pope v. United States, 599 F.2d 1383, 1386 (5th Cir. 1979).

3. Treasury Dep't. Circular No. 230, 1985-2 C.B. 742 (codified at 31 C.F.R. pt. 10 (1993)).

4. 59 Fed. Reg. 31,523 (1994) (codified at 31 C.F.R. pt. 10 (1994)) (providing the 1994 revisions to Circular 230).

5. *Compare* 26 U.S.C. § 6694 (Supp. 1993) (providing current penalty rules for return preparers) *with* 59 Fed. Reg. 31,523 (1994). The new standards in Circular 230 also apply to certified public accountants, enrolled agents and enrolled actuaries. *See* 59 Fed Reg. 31,523 (1994).

6. 26 U.S.C. §§ 6694(a)-(b) (Supp. 1993). A return position has a realistic possibility of being sustained on its merits if it has an approximate one in three chance of success if litigated, a standard measured by the existence of substantial legal authority in support of the return position. *See infra* note 25 (discussing the realistic possibility of success standard).

7. *See* 31 C.F.R. §§ 10.50 - .52 (1993).

8. *See generally* LAWYER DISCIPLINE, *supra* note 1, at 1012.

following information is intended to inform attorneys who represent clients before the Service of some of the rules they must follow and what they can expect if they do not, as well as some of the recent changes in those rules.

II. REGULATORY GUIDELINES FOR TAX PRACTICE

Attorneys engaging in the practice of tax law, just like all other attorneys, must abide by the standards of professional responsibility established by the bar of the state in which they are licensed or admitted to practice.[9] North Dakota attorneys adhere to the North Dakota Rules of Professional Conduct.[10] The American Bar Association (ABA) promulgates model rules and issues opinions, both aspirational in nature, and to the extent a state adopts those rules or opinions they become additional rules for the attorney to follow.

Attorneys must also abide by the rules of the courts in which they practice.[11] For example, an attorney who files a refund suit in the United States Claims Court or one who defends a tax evasion case in federal district court must follow the rules of conduct prescribed by those forums. The United States Tax Court, which hears petitions for redetermination of deficiencies assessed by the Service, holds attorneys to the standard of conduct prescribed by the ABA Model Rules of Professional Conduct.[12]

The I.R.C.[13] places further restrictions on the activities of attorneys who fit the legal definition of income tax return preparers.[14] It may come as a surprise to some attorneys to find that they fall into this

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9. *Id.*

10. N.D. RULES OF PROFESSIONAL CONDUCT, *reprinted in* N.D. CENT. CODE COURT RULES ANN. 937 (1994) [hereinafter PROFESSIONAL CONDUCT].

11. *See, e.g.*, N.D. CENT. CODE § 27-13-01 (1991); N.D. RULES OF COURT 11.5, *reprinted in* N.D. CENT. CODE COURT RULES ANN. 773, 791 [hereinafter COURT RULES]; LOCAL RULES UNITED STATES DIST. COURT 2(e)(2) *reprinted in* N.D. CENT. CODE COURT RULES ANN. 1235, 1240 [hereinafter DIST. COURT RULES].

12. RULES OF PRACTICE AND PROCEDURE OF THE UNITED STATES TAX COURT 201(a), reprinted in 26 U.S.C. § 7453 (1989) [hereinafter TAX COURT RULES]. In most cases the various rules achieve the same effect through similar if not identical substantive language. For example, North Dakota Rules of Professional Conduct Rule 3.1 prohibits bringing, defending, asserting or controverting any issue in a proceeding unless the attorney has a non-frivolous basis for doing so, "which includes a good faith argument for an extension, modification or reversal of existing law." In the Tax Court, an attorney must certify by signature on all pleadings that the information in the pleadings is correct and the pleading "is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law . . . ." TAX COURT RULE 33(b). Violation of the standards required by the courts can result in disciplinary action to include suspension or disbarment from practice before the particular court involved. *See, e.g.*, TAX COURT RULE 202.

13. 26 U.S.C. (1994) (containing provisions of the Internal Revenue Code).

14. *See* I.R.C. § 6694 (1994) (providing for return preparer penalties).

category even though they have never attempted to complete a tax return or other IRS form. The I.R.C. defines a return preparer as anyone who, for compensation, prepares or hires one or more employees to prepare any income tax return or income tax refund claim.[15] This includes the preparation of a substantial portion of an income tax return or refund claim.[16] The regulations define the term even more broadly to include one who gives advice or information sufficient to make completion of the return largely a clerical or mechanical matter, even if the person giving the advice did not physically place any information on the form or review it after completion.[17] The advice rendered must have been for compensation, however.[18]

The return preparer penalty provisions call for the assessment of a $250 penalty against a return preparer who prepares a substantial portion of an income tax return in which an understatement of tax liability appears.[19] An understatement for this purpose is any understatement of the net amount of income tax payable or an overstatement of the net amount of an income tax credit or refund claimed.[20] The I.R.C. also proscribes willful or reckless conduct resulting in an understatement of liability[21] and carries a potential penalty of $1,000 for such a violation.[22] In addition, a practitioner who aids a client in filing false information with the Service may face criminal penalties.[23]

The return preparer penalty provisions require return preparers to advance only those return positions having a realistic possibility of success if litigated on the merits.[24] The "realistic possibility" standard is met if a knowledgeable practitioner, after having examined the relevant authorities, would conclude that a return position has an approximate one in three chance of being sustained on its merits.[25]

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15. *Id.* § 7701(a)(36)(A) (1994).

16. *Id.*

17. Treas. Reg. § 301.7701-15(a)(1) (1994).

18. *Id.* § 301.7701-15(a)(4).

19. I.R.C. § 6694(a) (1994). *See, e.g.*, Goulding v. United States, 957 F.2d 1420, 1423 (7th Cir. 1992) (assessing penalties to the preparer under § 6694(a)).

20. I.R.C. § 6694(e) (1994). The net amount payable is not reduced by carrybacks. Treas. Reg. § 1.6694-1(c) (1994). A carryback is a tax attribute, such as a net operating loss deduction, applied to a tax year prior to the year in which it actually accrued. Treas. Reg. § 1.6411-1 (1994).

21. *See, e.g.*, United States v. Venie, 691 F. Supp. 834, 838 (M.D. Pa. 1988).

22. I.R.C. § 6694(b) (1994).

23. *Id.* § 7206(2).

24. *Id.* § 6694(a)(1).

25. The regulations define the realistic possibility of success standard as one which is met "if a reasonable and well-informed analysis by a person knowledgeable in the tax law would lead such a person to conclude that the position has approximately a one in three, or greater, likelihood of being sustained on its merits (realistic possibility standard)." Treas. Reg. § 1.6694-2(b)(1) (1994). To determine whether one has satisfied the realistic possibility standard requires use of the "substantial

The Treasury Department regulates the conduct of practitioners who represent clients in administrative proceedings before agencies of the department.[26] The provisions of Circular 230 regulate practice before the Service.[27] These regulations guide the conduct of practitioners in a number of different ways to include imposing a standard of due diligence as to the accuracy of representations made to the Service and the Department of the Treasury.[28] Stepping over the lines of propriety drawn in Circular 230 could result in disbarment or suspension from practice before the Service.[29]

The standards of practice under the rules of professional responsibility, the rules of the various courts, the return preparer penalty provisions and Circular 230 are cumulative and not mutually exclusive. Consequently, the attorney who practices in the area of federal taxation must wade through an abundant assortment of regulatory restrictions to ensure compliance before advising or representing a client.

The task may become both easier and more difficult now that the Treasury Department has revised and amended Circular 230. The new regulations purport to merge standards governing practice before the Service with those already in existence for return preparers under section

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authority" analysis set forth in the regulations pertaining to the accuracy related penalties. *Id.*; *see also id.* §§ 1.6662-4(d)(3)(ii) (nature of analysis), (iii) (types of authority). In other words, sufficient substantial authority must exist to allow the practitioner knowledgeable in tax laws to conclude that the position has a one in three or better chance of success if litigated. *Id.* § 1.6662-4(d)(3)(iii). For this, the practitioner must analyze all of the proper authorities and determine that the weight of the authorities supporting a position is substantial in relation to the weight of the authorities supporting contrary treatment. *Id.* § 1.6662-4(d)(3)(i). The weight to be given an authority depends on the relevance, persuasiveness and type of authority involved in the analysis. *Id.* § 1.6662-4(d)(3)(ii). For example, a court case that merely states a conclusion is less persuasive than one which cogently sets forth the reasoning and the application of the law to the facts. *Id.* The well-reasoned decision would carry greater weight in the analysis. *Id.* Also, a document such as a private letter ruling where information is necessarily deleted to protect the privacy of the taxpayer requesting the ruling carries less weight where the information deleted could affect the decision in the ruling. *Id.* While a practitioner may refer to many different types of authority in reaching a conclusion, certain types of authority are given no weight. These include treatises, legal periodicals, legal opinions and opinions offered by tax professionals. *Id.* § 1.6662-4(d)(3)(iii). The authorities underlying the conclusions reached in the non-authoritative sources may be used as substantial authority if they qualify as such. *Id.* And finally, a well-reasoned construction of the applicable statute may suffice as substantial authority even if no other types of authority support the position. *Id.* § 1.6662-4(d)(3)(ii). Presumably, if little or no authority exists comparable to the facts of the case in question, a well-reasoned construction of the applicable statute should suffice as substantial authority provided the weight of the well-reasoned construction is substantial in relation to any authorities that might support treatment contrary to that proposed by the position advanced. *See id.* §§ 1.6662-4(d)(3)(i), (ii).

26. 31 U.S.C. § 330 (1988).

27. 59 Fed. Reg. 31,523 (1994) (to be codified at 31 C.F.R. pt. 10).

28. 31 C.F.R. § 10.22 (1993).

29. 59 Fed. Reg. 31,528 (1994) (codified at 31 C.F.R. pt. 10 subpart C, §§ 10.50, 10.52 (1994)).

6694 of the I.R.C.[30] One might question the need for new or additional regulations imposing similar or identical standards as those already in existence. Unlike Code section 6694, however, Circular 230 does not merely impose monetary penalties for infractions. Circular 230 governs practice before the Service, and a violation of its rules subjects the violator to potential suspension or disbarment from practice before that agency.[31] Moreover, the Service refers I.R.C. section 6694 violations to the Director of Practice for the Internal Revenue Service for possible additional disciplinary action under the provisions of Circular 230.[32]

III. CIRCULAR 230: THE REGULATIONS

Congress authorized the Treasury Department to issue regulations governing the representation of taxpayers before the Internal Revenue

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30. *See* 59 Fed. Reg. 31,527 (1994) (preamble). Section 10.34 of Circular 230 provides: [Section] 10.34. Standards for advising with respect to tax return positions and for preparing or signing returns.

> (a) *Standard of conduct*—(1) *Realistic possibility standard.* A practitioner may not sign a return as a preparer if the practitioner determines that the return contains a position that does not satisfy the realistic possibility standard, unless the position is not frivolous and is adequately disclosed to the Service. A practitioner may not advise a client to take a position on a return, or prepare the portion of a return on which a position is taken, unless—
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> (i) The practitioner determines that there is a realistic possibility of the position being sustained on its merits (the "realistic possibility standard"); or
>
> (ii) The position is not frivolous and the practitioner advises the client of any opportunity to avoid the accuracy-related penalty in section 6662 of the Internal Revenue Code of 1986 by adequately disclosing the position and of the requirements for adequate disclosure.

Id. Cf. I.R.C. § 6694 (1994). I.R.C. § 6694 provides in pertinent part:

> (a) Understatements Due To Unrealistic Positions. —If—
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> (1) any part of any understatement of liability with respect to any return or claim for refund is due to a position for which there was not a realistic possibility of being sustained on its merits, (2) any person who is an income tax return preparer with respect to such return or claim knew (or reasonably should have known) of such position, and (3) such position was not disclosed as provided in section 6662(d)(2)(B)(ii) or was frivolous, such person shall pay a penalty of $250 with respect to such return or claim unless it is shown that there is reasonable cause for the understatement and such person acted in good faith.
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> (b) Willful Or Reckless Conduct.—If any part of any understatement of liability with respect to any return or claim for refund is due—
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> (1) to a willful attempt in any manner to understate the liability for tax by a person who is an income tax return preparer with respect to such return or claim, or
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> (2) to any reckless or intentional disregard of rules or regulations by any such person, such person shall pay a penalty of $1,000 with respect to such return or claim. With respect to any return or claim, the amount of the penalty payable by any person by reason of this subsection shall be reduced by the amount of the penalty paid by such person by reason of subsection (a).

31. 59 Fed. Reg. 31,528 (1994) (codified at 31 C.F.R. pt. 10 subpart C), § 10.50 (1994)).

32. *I.R.S. Manual: Preparer/Promoter/Protester Penalties Handbook* § (20)(11)22(1)(b) (1993) *reprinted in* 93 TAX NOTES TODAY 206-12 (October 6, 1993).

Service.[33] The Treasury Department's Circular 230 sets forth practitioner qualifications and prescribes a code of conduct for attorneys, certified public accounts, enrolled agents and others who practice before the Service.[34] Over time the rules have undergone the evolutionary process of amendment and now regulate a variety of conduct ranging from solicitation of clients[35] and negotiation of client tax refund checks[36] to standards of accuracy in representations made to the Service.[37]

A. PRACTICE BEFORE THE INTERNAL REVENUE SERVICE

The term "practice" encompasses a fairly broad array of activities. It includes all matters pertaining to representation of clients before the Service such as appearing on behalf of clients at conferences, hearings, and meetings, as well as the preparation and filing of necessary documents and communications with the Service on behalf of clients.[38] Practice involves making a presentation of the type listed above to the Service on behalf of a client that advances in the manner of an advocate the client's interests or in some way relates to the client's rights, privileges or liabilities under the federal tax laws.[39]

Some related activities do not constitute practice. A return preparer may appear as a witness in an I.R.S. proceeding on behalf of a client without engaging in practice as defined by Circular 230.[40] Moreover, anyone can prepare and sign a tax return, election or claim for refund without necessarily engaging in practice before the Service.[41] At one

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33. Pope v. United States, 599 F.2d 1383, 1386 (5th Cir. 1979). The Secretary of the Treasury has specific authority to issue regulations governing practice before the Treasury Department, including practice before the Internal Revenue Service which is a division of the Treasury Department. 31 U.S.C. § 330 (1988).

34. *See* 59 Fed. Reg. 31,523 (1994) (to be codified at 31 C.F.R. pt. 10).

35. *See* 31 C.F.R.§ 10.30 (1993).

36. *See id.* § 10.31.

37. *See id.* § 10.22.

38. 59 Fed. Reg. 31,526 (1994) (codified at 31 C.F.R. pt. 10 § 10.2(e) (1994)).

39. MICHAEL I. SALTZMAN, IRS PRACTICE AND PROCEDURE ¶ 1.08[2] (2d ed 1991). A return preparer not otherwise qualified to practice before the Service may engage in limited practice. 59 Fed. Reg. 31,527 (1994) (codified at 31 C.F.R. pt. 10. § 10.7(c) (1994)).

40. *See* 31 C.F.R. § 10.7(c) (1993) (providing for appearance as a witness), *amended by* 59 Fed. Reg. 31,527 (1994) (codified at 31 C.F.R. § 10.7(e) (1994)); *see also* SALTZMAN, *supra* note 39, at ¶ 1.08[2] (citing the Conference and Practice Requirements of the Internal Revenue Service, Treas. Reg. 601.501(a) (1994)).

41. 31 C.F.R. § 10.7(c) *amended by* 59 Fed. Reg. 31,527 (1994) (to be codified at 31 C.F.R. § 10.7(e) (1994)); *see also* SALTZMAN, *supra* note 39, at ¶ 1.08[2] (citing Treas. Reg. 601.501(a) (1993)). *But see* BERNARD WOLFMAN AND JAMES P. HOLDEN, ETHICAL PROBLEMS IN FEDERAL TAX PRACTICE 46 n.4. (2d ed. 1985) (stating that the preparation of a tax return is presumably a form of practice but not one which requires qualification as attorney, CPA, or enrolled agent).

time the regulations specifically excluded tax return preparation as a form of practice, but the Treasury Department amended that exclusion in 1984.[42] Now, apparently, when a "practitioner" as defined under Circular 230 prepares and signs a return, claim or election, the practitioner is engaging in practice before the Service and must adhere to the regulations.[43]

If any confusion existed as to whether Circular 230 applied to the attorney-practitioner with regard to the preparation of tax returns, it should disappear now that the Treasury Department has revised Circular 230. The return preparation and related disciplinary standards of the new Circular 230 apply without question to practitioners who represent taxpayers before the Service and to those "who sign or otherwise prepare returns."[44]

B. WHO MAY PRACTICE

Circular 230 regulates practitioner qualification as well as conduct. The term "practitioners," meaning persons authorized to practice before the IRS, includes attorneys,[45] certified public accountants,[46] enrolled agents,[47] enrolled actuaries,[48] and applicants for enrolled agent status granted temporary authority to practice.[49]

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42. 49 Fed. Reg. 6,722 (1984) (amending 31 C.F.R. pt. 10).

43. 31 C.F.R. § 10.22 (requiring the due diligence standard for attorneys, certified public accountants and enrolled agents who prepare, approve or file any documents with the Service, or assist in any of those activities).

44. 57 Fed. Reg. 46, 356 (1992). *See also* 59 Fed. Reg. 31,523 (1994).

45. 31 C.F.R. § 10.3(a) (1993).

46. *Id.* § 10.3(b).

47. *Id.* § 10.3(c). These regulations do not contain the earlier restriction that prohibited an attorney or a certified public accountant from becoming or maintaing status as enroled agent. *See also* 31 C.F.R. §§ 10.3(a), (b) (1993), *reprinted in* 1985-2 C.B. 743.

48. 31 C.F.R. § 10.3(d) (1993).

49. *Id.* § 10.5(c). The regulations allow for some persons not otherwise qualified to engage in limited practice before the Service. *Id.* For instance, one who signs a return as a preparer, and who appears on behalf of the taxpayer at an audit or other procedure at a level below that of District Conference with respect to issues arising out of the taxable year for which the person prepared or signed the return is considered a practitioner for purposes of Circular 230. *Id.* § 10.7(a)(7). Of course, the return preparer must have proper authorization from the taxpayer to act in a representative capacity. *Id.*; 59 Fed. Reg. 31,527 (1994) (codified at 31 C.F.R. pt. 10, § 10.7(c)(1) (1994)). The return preparer who wishes to represent the taxpayer may not be currently disbarred or suspended from practice before the Service or other practice of his profession by any other authority. 31 C.F.R. § 10.7(a)(7) (1993); 59 Fed. Reg. 31,527 (1994) (codified at 31 C.F.R. pt. 10, § 10.7(c)(2)(1) (1994)). Others who may engage in limited practice include a regular full-time employee representing her employer; a partner representing his partnership; a person representing without compensation a member of the person's own family; an individual appearing on her own behalf; a bona fide officer or regular full-time employee appearing on behalf of his corporate employer; and a trustee on behalf of a trust. 31 C.F.R. §§ 10.7(a)(1)-(3) (1993); 59 Fed. Reg. 31,527 (1994) (codified at 31 C.F.R. pt. 10, § 10.7(c)(1)(i)-(v) (1994)).

Any member in good standing of the bar of the highest court of any state, commonwealth, the District of Columbia, or any territory or possession of the United States,[50] may represent taxpayer clients in matters before the Service as long as that attorney is not presently disbarred or suspended from doing so.[51] Circular 230 expands this restriction to prohibit knowingly and directly or indirectly employing or accepting assistance from any person presently disbarred or suspended from practice before the Service.[52] Nor may a practitioner share fees with or accept employment as an associate, subagent or correspondent from one under such disbarment or suspension.[53] Furthermore, knowingly aiding and abetting an ineligible person in practicing before the Service constitutes disreputable conduct which in turn justifies suspension or disbarment.[54] The Director of Practice may presume a violation of this rule if the practitioner appearing before the Service maintains a law partnership with an attorney disbarred under Circular 230.[55] Former government employees face additional restrictions,[56] and Circular 230 prohibits a practitioner from accepting assistance from any former government employee in violation of those restrictions.[57]

C. TAX RETURN ADVICE

Section 10.22 of Circular 230 imposes a due diligence standard of accuracy on practitioners who file returns or prepare or assist in filing returns. This provision expressly takes attorneys out of the mere non-practitioner return preparer category of former section 10.7(c) by enumerating the types of practitioners bound by the due diligence standard for accuracy. Section 10.22 provides: "Each *attorney*, certified public accountant, enrolled agent . . . *shall exercise due diligence*: (a) *In preparing or assisting in the preparation of, approving, and filing returns*, documents, affidavits, and other papers relating to Internal Revenue Service matters . . . ."[58] The Secretary of the Treasury may disbar or suspend any attorney for, among other things, refusal to comply with the rules and regulations set forth in Circular 230.[59]

50. 31 C.F.R. § 10.2(b) (1993) (defining "attorney").
51. *Id.* § 10.3(a).
52. *Id.* § 10.24(a).
53. *Id.* § 10.24(b).
54. *Id.* § 10.51(h).
55. 31 C.F.R. § 10.51(h) (1993).
56. *Id.* § 10.26.
57. *Id.* § 10.24(c).
58. *Id.* § 10.22 (emphasis added).
59. *Id.* §§ 10.50, 10.52(a). *See* Pope v. United States, 599 F.2d 1383, 1386 (5th Cir. 1979).

Consequently, an attorney authorized to practice before the Service who fails to comply with the due diligence standard in the preparation of a return faces potential suspension or disbarment from practice before the Service.[60] Knowingly or recklessly giving a false opinion, or giving an opinion as a result of gross incompetence constitutes disreputable conduct[61] and similarly subjects a practitioner to sanctions.[62] This includes establishing a pattern of providing incompetent opinions on federal tax law issues.[63]

Under the old regulations, it appeared as though the Service would forgive an occasional mistake, and that the practitioner would escape sanctions if the advice she gave was only negligently erroneous and not part of a pattern of bad advice. Perhaps the Service was willing to allow every attorney one slip-up, much like the old common law rule that entitled every dog to one bite. However, the Service does not require a pattern of offending conduct before seeking disciplinary action. The introduction to the new regulations explains that Circular 230 will not "countenance improper conduct" and that a practitioner will not be allowed to violate Circular 230 once with impunity.[64]

D. STANDARDS OF CONDUCT

Subparts B and C of Circular 230 set forth standards of conduct required of practitioners. Some of the more common rules of conduct require a practitioner to provide information to the Service when lawfully and properly requested to do so as long as the information requested is not privileged or the request of doubtful legality.[65] A practitioner must promptly advise a client of the fact of any errors in or omissions from any return, affidavit or other document the law requires the client to file or execute.[66] The due diligence requirement discussed above also applies to the determination of the correctness of oral and written representations to the Service[67] and to the client.[68] A practitioner

60. 31 C.F.R. §§ 10.50, 10.52 (1993).
61. *Id.* § 10.51(j).
62. *Id.* §§ 10.50, 10.52(a).
63. *Id.* § 10.51(j).
64. 59 Fed. Reg. 31,527 (1994).
65. 31 C.F.R. § 10.20(a) (1993).
66. *Id.* § 10.21.
67. *Id.* § 10.22(c).
68. *Id.* § 10.22 (c). Harary v. Blumenthal, 555 F.2d 1113, 1117 (2d Cir. 1977) (discussing 31 C.F.R. § 10.22(c)).

must not unreasonably delay the disposition of any matters pending before the Service.[69]

Most of the rules set forth in Circular 230 create little controversy and essentially follow other rules of professional conduct, such as the model rules promulgated by the American Bar Association. The additional rules address the peculiarities of tax practice, and the practitioner engaging in such matters must become familiar with them to avoid the potential sanctions that result from violations, however inadvertent they may be.[70]

E. SUSPENSION OR DISBARMENT

The Secretary of the Treasury has the authority to suspend or disbar practitioners under certain circumstances.[71] For example, the Secretary may suspend or disbar an attorney for incompetence, for refusal to comply with the rules of Circular 230, or for disreputable conduct.[72]

Section 10.51 of Circular 230 cites numerous examples of disreputable conduct, to include giving false or misleading opinions either "knowingly, recklessly, or through gross incompetence, or establishing a pattern of providing incompetent opinions" on tax issues.[73] The definition of false opinions includes those opinions reflecting or resulting from (1) a knowing misstatement of law or fact; (2) asserting a position known to be unwarranted under existing law; (3)

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69. 31 C.F.R. § 10.23 (1993). *Cf.* Tax Court Rule 33(b) (pleadings may not be interposed for any improper purpose such as unnecessary delay) (codified at 26 C.F.R. ch. 76, § 301.6673-1 (1994)). Other rules govern various activities of a practitioner such as: serving as a notary public in matters before the Service in which the practitioner is interested, 31 C.F.R. § 10.27 (1993); representing conflicting interests, except as allowed after disclosure and consent, *id.* § 10.29; and providing tax shelter opinions and offering materials. *Id.* § 10.33. The regulations also proscribe engaging in disreputable conduct. Such conduct includes, by way of example, violations of criminal laws under the tax code or other laws involving dishonesty or breach of trust. 31 C.F.R. § 10.51(a) (1993). *Blumenthal*, 555 F.2d at 1116. It also includes the submission of false or misleading information to the Treasury Department in connection with tax matters pending before it, *id.* § 10.51(b); evasion of tax or failure to file tax returns, *id.* § 10.51(d); knowingly, recklessly, or through gross incompetence, giving a false opinion on questions arising under the federal tax law. *Id.* § 10.51(j).

70. For example, those who practice before the Service must provide information or testimony to the Director of Practice regarding another person practicing before the Service in violation of the rules of Circular 230 unless the information is privileged or the request of doubtful legality. 31 C.F.R. § 10.20(b) (1993). Any refusal to provide information or testimony under the exceptions must be based on reasonable grounds and good faith. *Id.* § 10.20. Another example is the rule in section 10.31 that prohibits a practitioner from negotiating a client's tax refund check. *Id.* § 10.31. *See also supra* note 69 (discussing various rules governing practitioner conduct).

71. 31 C.F.R. §§ 10.50 - .52 (1993).

72. *Id.* § 10.50. *See* Washburn v. Shapiro, 409 F. Supp. 3 (S.D.Fla. 1976) (disbarring accountant-practitioner after conviction for willfully preparing a false or fraudulent income tax return).

73. 31 C.F.R. § 10.51(j) (1993).

counseling or assisting in conduct known to be illegal or fraudulent; (4) concealment of information legally required to be disclosed; or (5) conscious disregard of information that would indicate that the material facts expressed in a tax opinion or offering material are false or misleading.[74]

The term "reckless" connotes an extreme departure from ordinary care and not just simple or even inexcusable neglect.[75] "Reckless conduct" involves a "highly unreasonable omission or misrepresentation[.]"[76] This departure from the standards of ordinary care must have been known or so obvious that a "competent practitioner either must or should have been aware of it."[77] "Gross incompetence" reflects "gross indifference, grossly inadequate preparation under the circumstances and a consistent failure to fulfill the obligations to the client."[78] New section 10.52(a), like the current regulation, applies the willful violation standard to all of the regulations in Circular 230.[79]

The former rules provided for disbarment or suspension of practitioners who violated the tax shelter rules in Circular 230 if the violation was willful, reckless or a result of gross incompetence as defined in Section 10.51(j).[80] Section 10.52(b), as revised, maintains the reckless and gross incompetence standard for tax shelter opinions but also extends that standard to the new section 10.34 which establishes a higher standard of accuracy for practitioners who prepare returns or give advice regarding return positions.[81] The price of a violation of these standards could be suspension or disbarment from practice before the Service.[82]

F. THE PROCEDURE FOR DISCIPLINARY ACTION

Subpart C of Circular 230 provides the disciplinary mechanism for enforcement of the standards of practice. Section 10.50[83] grants the Secretary of the Treasury authority to suspend or disbar a practitioner

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74. *Id.*

75. *Id.* The new regulations changed some of the language in section 51(j), but the Service assures practitioners that the changes are not substantive. *See* 59 Fed. Reg. 31,528 (1994).

76. 31 C.F.R. § 10.51(j) (1993).

77. *Id.*

78. *Id.*

79. 57 Fed. Reg. 31,528 (1994) (codified at 31 C.F.R. § 10.52(a) (1994)).

80. 31 C.F.R. § 10.52(b) (1993).

81. 59 Fed. Reg. 31,528 (1994).

82. *Id.*

83. The Treasury Department modified the language of section 10.50 in the 1994 revisions, but this modification does not appear to constitute a substantive change in the provision. *See* 59 Fed. Reg. 31,528 (1994) (codified at 31 C.F.R. § 10.50 (1994)).

for any of the reasons listed therein, including refusal to comply with the regulations set forth in Circular 230.[84] When an officer or employee of the Service learns or has reason to believe that a practitioner has violated a provision of Circular 230, that person may file a written complaint to the Director of Practice.[85] Any other person with information pertaining to a potential violation may also make such a report to the Director of Practice or to any employee of the Service.[86]

The Director of Practice institutes proceedings against a practitioner by naming the practitioner as respondent on a complaint filed in the Director's office.[87] The Director may grant the suspected violator a conference, and they may agree upon stipulations to be entered into the record.[88] The rules allow a practitioner an opportunity to submit an offer of voluntary suspension.[89] Otherwise, the attorney has the right to a hearing presided over by an administrative law judge.[90] If the administrative law judge orders a period of suspension, the attorney may not practice before the Service during that period.[91] If the complaint results in disbarment the practitioner may petition for reinstatement after a period of five years.[92]

A practitioner may administratively appeal an adverse decision to the Secretary of the Treasury[93] who will make the final decision of the agency.[94] If the Secretary affirms the decision of the administrative law judge, the affected practitioner may appeal the agency decision to the United States district court and through the federal appellate system if necessary.[95]

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84. Section 10.52 of Title 31 of the Code of Federal Regulations grants additional authority for the suspension of a practitioner who willfully violates any of those regulations. As a practical matter, one might encounter difficulty in distinguishing between a refusal to comply as opposed to a willful failure to comply, but the regulations address both instances if a real distinction exists between the two.

85. 31 C.F.R. § 10.53 (1993). *See supra* note 31 and accompanying text (discussing Circular 230 complaints and the effect on practitioners).

86. 31 C.F.R. § 10.53 (1993).

87. *Id.* § 10.54. Sections 10.54 through 10.72 of Circular 230 set forth the procedure for initiating and conducting the proceedings necessary for investigation and disposition of a complaint against practitioners. *See id.* §§ 10.54 - .72.

88. *Id.* § 10.55(a).

89. *Id.* § 10.55(b).

90. *Id.* § 10.65(a).

91. 31 C.F.R. § 10.73 (1993).

92. *Id.* § 10.75.

93. *Id.* § 10.71.

94. *Id.* § 10.72.

95. *See* Harary v. Blumenthal, 555 F.2d 1113, 1116 (2d Cir. 1977) (providing a good description of the disciplinary process from the administrative level through subsequent appellate proceedings).

IV. REVISIONS TO CIRCULAR 230

A. DUE DILIGENCE

1. *The Old Standard: A Toothy Grin*

The old regulations imposed on practitioners a requirement of due diligence in preparing or assisting in the preparation of income tax returns and other documents relating to matters involving the Service.[96] This standard required advancing only those return positions that had a reasonable basis in the law.[97] The reasonable basis standard eroded over time to mean that a practitioner could advise practically any return position as long as it was supported by some colorable claim to legality.[98] Some commentators described the due diligence standard as involving a laughter test: if the practitioner could advance the return position with a straight face, then the position was supported by a reasonable basis in the law.[99] Thus, advancing return positions that did not actually fall within the bounds of the law became perfectly acceptable as long as the practitioner could make some kind of a legal argument in its favor.

The Service does not perform a complete audit of every tax return.[100] Instead, tax returns are selected for audit in part based on

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96. 31 C.F.R. § 10.22 (1993). *See also* 57 Fed Reg 31,523 (1994) (to be codified at 31 C.F.R. pt. 10 (1994)).

97. AMERICAN BAR ASSOCIATION COMMITTEE ON PROFESSIONAL ETHICS, OPINION 314 (1965) *reprinted in* 51 A.B.A. J. 671 (1965). For example, consider the tennis player who sought to deduct the cost of his tennis clothing as a business expense. Mella v. Commissioner, 52 T.C.M. (CCH) 1216 (1986) (deduction denied). If Ozzie and Harriet could deduct the cost of the casual, every-day clothes they wore while filming their television show, Nelson v. Commissioner, 25 T.C.M. (CCH) 1142 (1966) (deduction allowed), surely the tennis professional would have a reasonable basis to deduct the cost of his work clothes, in spite of the fact that work clothes suitable for off-duty wear are not generally deductible. Pevsner v. Commissioner, 628 F.2d 467, 469 (5th Cir. 1980).

98. AMERICAN BAR ASSOCIATION COMMITTEE ON STANDARDS OF TAX PRACTICE, REPORT OF THE SPECIAL TASK FORCE ON FORMAL OPINION 85-352, *reprinted in* 39 TAX LAW. 635, 639-40 (1986) [hereinafter TASK FORCE REPORT].

99. *See* Arthur A. Guthrie, *IRS' Shapiro Describes Centerpiece Proposal, Hopes to Complete Circular 230 Project*, 59 TAX NOTES 1225 (1993) (quoting Internal Revenue Service Director of Practice Leslie S. Shapiro); Gwen Thayer Handelman, *Law and Order Comes to "Dodge City": Treasury's New Return Preparer and IRS Practice Standards*, 60 TAX NOTES 1623, 1625 (1993).

For an example of the reasonable basis standard, see United States v. Yorke, unpublished opinion (D. Md. July 19, 1976) *reprinted in* MARVIN J. GARBIS ET AL., TAX PROCEDURE AND TAX FRAUD 17 (3d ed. 1992). In *Yorke*, the government prosecuted the taxpayer for failing to report income in the amount of $400 per week. *Id.* The taxpayer's attorney had prepared documents which characterized the payments as loans subject to forgiveness if the taxpayer realized insufficient income to repay the debt from capital gains of certain speculative stock purchases. *Id.* at 18. Although the scheme was aggressive, to say the least, the court found that the position had a reasonable basis in the law. *Id.*

100. Saltzman, *supra* note 39, ¶ 8.03[1].

information that suggests the presence of tax deficiencies and in part through a random selection process sometimes known as the audit lottery.[101] Practitioners exploited the audit lottery process by submitting the arguably colorable claims, knowing the chances of an audit were small and the claim would probably escape detection.[102] Even if the Service discovered and rejected the dubious return position the practitioner could still avoid the sanctions of Circular 230 as long as the position advanced had a "reasonable basis."

2. *New Standards*

When the ABA recognized the ineffectiveness of the reasonable basis standard, it proposed a heightened standard for tax practitioners in Opinion 85-352.[103] The ABA's recommendation admonished practitioners to advise only those return positions having "some realistic possibility of success if the matter is litigated."[104] To meet the ABA's recommended standard, a return position needed approximately a one-third chance of success if litigated on the merits,[105] a standard practically identical to the approximate one in three quantification of the realistic possibility standard in the I.R.C.'s return preparer penalty provisions that followed in 1989.[106]

The erosion of the reasonable basis standard and exploitation of the audit lottery process led the Treasury Department, like the ABA, to propose new regulations in 1986 which would have held practitioners to a higher standard in administrative practice before the Service.[107] The new regulations never became final, however. In 1989 Congress revised I.R.C. section 6694 to require higher standards of accuracy for income tax return preparers.[108] Under the revised I.R.C. section, an income tax return preparer faces a penalty of $250.00 for advancing a return or refund claim position which results in an understatement of tax liability and for which no realistic possibility exists for the position to be

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101. *Id.* ¶ 8.03[1][b]; GARBIS, ET AL., *supra* note 99, at 121 ("In practical terms, a taxpayer wins the audit lottery when his ticket is not pulled from the barrel.").

102. TASK FORCE REPORT, *supra* note 98, at 639-40.

103. AMERICAN BAR ASSOCIATION STANDING COMMITTEE ON ETHICS AND PROFESSIONAL RESPONSIBILITY, FORMAL OPINION 352 (1985) *reprinted in* 39 TAX LAW. 631 (1986) [hereinafter OPINION 85-352].

104. *Id.*; TASK FORCE REPORT, *supra* note 98, at 638.

105. TASK FORCE REPORT, *supra* note 98, at 638-39.

106. Treas. Reg. § 1.6694-3(a)(1) (1994).

107. 51 Fed. Reg. 29,113 (1986).

108. Omnibus Budget Reconciliation Act of 1989, Pub. L. No. 101-239, § 7732(a), 103 Stat. 2106, 2402 (1989).

sustained on its merits.[109] Congress recognized that not every taxpayer's situation will fall neatly within existing legal guidelines. Consequently, a return preparer may still advance a position that fails to meet the realistic possibility standard provided the position is not frivolous and is disclosed to the Service.[110] The penalty increases to $1,000 for understatements of liability due to willful attempts to understate liability or a reckless or intentional disregard of rules or regulations.[111]

The new statutory standard for return preparers differed from the Circular 230 revisions proposed in 1986, so in 1992 the Treasury Department withdrew the proposed regulations and substituted new ones.[112] The Treasury Department intended to supplement the existing due diligence standard of section 10.22 with the standard set out under new section 10.34, which holds practitioners to the same standard of accuracy required by the return preparer penalty regulations under I.R.C. section 6694.[113] The standard in Section 6694 of the I.R.C. limits return preparers to advancing only those return positions having a realistic possibility of being sustained on the merits if litigated, referred to in the regulations as the "realistic possibility" standard.[114] Section 10.34 of the new practice regulations does the same.[115] To meet the realistic possibility standard under section 10.34, a return position must have an approximate one in three or greater chance of success in litigation on the merits.[116] Just like the corresponding standard under I.R.C. section 6694, under section 10.34 a return position has the requisite one in three chance if it is supported by substantial authority.[117]

3. *More Changes to Come?*

While the Treasury Department narrowed the gap between the standards for return preparers under the I.R.C. and those for practitioners under Circular 230, other disparate standards still exist in tax practice. For example, in Tax Court litigation a practitioner needs only a

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109. I.R.C. § 6694(a) (1994). *See supra* note 25 (discussing the "realistic possibility" standard).

110. I.R.C. § 6694(a)(3) (1994); Treas. Reg. § 1.6694-2(c)(1) (1994).

111. I.R.C. § 6694(b) (1994); Treas. Reg. § 1.6694-3(a)(1) (1994).

112. 57 Fed. Reg. 46,359 (1992) (amending 26 C.F.R. § 10.34 (1991)).

113. *Id.*; 59 Fed. Reg. 31,523 (1994).

114. Treas. Reg. § 1.6694-2(b)(1); *see supra* note 25 (discussing the "realistic possibility" standard).

115. 59 Fed. Reg. 31,523 (1994) (to be codified at 31 C.F.R. pt. 10 (1994)) (providing the 1994 revisions to Circular 230).

116. 59 Fed. Reg. 31,523 (1994) (to be codified at 31 C.F.R. pt. 10 (1994)) (providing the 1994 revisions to Circular 230).

117. *Id.*; *see* Treas. Reg. § 1.6662-4(d)(3)(ii) (1994). *See also* TASK FORCE REPORT, *supra* note 98, at 638-39.

good faith argument for the application, extension, modification or reversal of existing law.[118] The "not frivolous" standard required by the Tax Court seems more subjective and more closely resembles the due diligence requirement for accuracy in section 10.22.[119] The term "good faith" injects an element of subjectivity into the Tax Court standard while the realistic possibility standard purports to be more objective.

The Tax Court standard for litigation differs significantly from the new regulatory standard for administrative practice before the Service. Section 10.34 would govern return positions advanced and returns prepared by practitioners.[120] Existing section 10.22 relates to duties and restrictions pertaining not only to return preparation by a practitioner but also to matters involving the representation of a taxpayer in proceedings before the Service based on a return position already advanced.[121] The due diligence standard of section 10.22 will still apply in "practice" before the Service, such as filing non-return documents and making oral or written representations to Service personnel.[122] One would assume that a practitioner should still be able to argue for a certain application of the law under the reasonable basis standard as long as it has some basis in the law. Yet that seems to be precisely the problem the Service intended to alleviate. Section 10.34 purports to eliminate the effects of a vague and abused standard of accuracy, the reasonable basis standard, but the new regulations leave the reasonable basis standard intact while adding the realistic possibility standard in the narrower context of return preparation.

The rules governing the presentation of a case to the Tax Court still require only a good faith argument for reversal or modification of existing law.[123] Administrative practice rules should require at least that much. Perhaps the Treasury Department's regulations should specifically define the due diligence standard for accuracy in such a way as to mandate good faith and a truly reasonable basis in much the same way as the court rules do. Administrative practice requires a considerable

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118. TAX COURT RULES, *supra* note 12, Rule 33.

119. *See* F. Nagle, *Practitioners Complain to IRS's Shapiro Over Circular 230 Rules*, 93 TAX NOTES TODAY 30-6 (Feb. 8, 1993). Tax Court Rule 33(b) requires counsel or the party signing the pleadings to certify that the signer read the pleading, that, to the best of the signer's knowledge, information, and belief formed after reasonable inquiry, it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation. TAX COURT RULES, *supra* note 12, Rule 33 (b).

120. 59 Fed. Reg. 31,527 (1994).

121. 31 C.F.R. § 10.22; 57 Fed. Reg. 46,356 . *See* SALTZMAN, *supra* note 39, at ¶ 1.08[2].

122. The new regulations do not affect existing section 10.22 of Title 31 of the Code of Federal Regulations. *See* 57 Fed. Reg. 46,356 (1994) .

123. TAX COURT RULES, *supra* note 12, Rule 33(b).

amount of give and take to resolve cases at the administrative level. Good faith along with a realistic and reasonable basis should not be too much to ask for. Eventually, perhaps the Service and the tax bar will equate practice under section 10.22 with practice in the Tax Court, just as the regulations now require practitioners to equate the return preparer standards under Circular 230 with those under I.R.C. section 6694. The standard for preparing tax returns is higher than the standard for defending a challenged return position in Tax Court. This seems proper since the tax return and court litigation serve two different purposes.

One could argue that the good faith standard for Tax Court pleadings already applies at the administrative practice level since the administrative record essentially lays the basic foundation for the proceedings in Tax Court.[124] Nevertheless, from a policy standpoint, supplementing the due diligence requirement with a higher standard for return positions at the administrative level seems to hold promise of ensuring greater compliance, an essential element of our voluntary assessment system.

B. A NEW STANDARD FOR ACCURACY

The substance of section 10.34(a) closely tracks I.R.C. section 6694 and applies to practitioners who advise clients to take return positions or who sign or otherwise prepare returns.[125] Under section 10.34(a), when a return position fails to satisfy the realistic possibility standard a practitioner may not sign the return as a preparer, prepare that portion of the return, or advise the client to take the position.[126]

An exception exists if the position is not frivolous, that is, not patently improper,[127] and the practitioner advised the taxpayer to adequately disclose[128] the position to the Service.[129] The language of the new regulation suggests that a nonsigning return preparer may advise a client to take a noncomplying return position as long as the position is not frivolous and the preparer advises the client "of any opportunity to avoid the accuracy-related penalty of section 6662 of the the [I.R.C.]" through adequate disclosure.[130] Although this appears to present an opportunity to circumvent the preparer standards of Circular 230, the

124. *See* TAX COURT RULES, *supra* note 12, Rules 34(b)(3)-(5).
125. 59 Fed. Reg. 31,523-24 (1994).
126. 59 Fed. Reg. 31,527 (1994) (codified at 31 C.F.R. § 10.34(a)(1) (1994)).
127. 59 Fed. Reg. 31,528 (1994) (codified at 31 C.F.R. § 10.34(a)(4)(ii) (1994)).
128. Disclosure is accomplished by completing and submitting IRS Forms 8275 and 8275-R.
129. 59 Fed. Reg. 31,527 (1994) (codified at 31 C.F.R. § 10.34(a)(1)(ii) (1994)).
130. 59 Fed. Reg. 31,527 (1994) (codified at 31 C.F.R. § 10.34(a)(1)(ii) (1994)).

preparer must still comply with I.R.C. section 6694, just as the taxpayer remains liable for his mistakes under the accuracy related penalty provisions of I.R.C. section 6662.

The new regulations subject a practitioner to suspension or disbarment from practice before the Service only if the violation of the realistic possibility standard was "willful, reckless or a result of gross incompetence. . . ."[131] The preamble to the proposed rules explained that if a practitioner acted in good faith and with reasonable cause she would not be considered to have acted willfully, recklessly or through gross incompetence.[132] The Service has already taken the position that it will not seek to impose the I.R.C. section 6694(a) penalty as long as the understatement by the preparer was "due to reasonable cause and the preparer acted in good faith."[133] From all indications the same "reasonable cause, good faith" exception will apply to the practice regulations as it applies to the return preparer penalty provisions.[134] Although one commentator had recommended that the new rules expressly incorporate the "reasonable cause and good faith exception," the Service declined to do so.[135] The preamble to the final regulations suggests that the existing standard of discipline necessarily includes a reasonable cause and good faith exception because reasonable cause and good faith are inconsistent with willful, reckless, or grossly incompetent violations of Circular 230.[136]

Circular 230 does not enumerate factors for the Service to consider when trying to determine whether good faith and reasonable cause exist. The return preparer penalty regulations, however, set forth five basic categories of factors relevant to a good faith reasonable cause analysis: (1) the nature of the error causing the understatement, (2) the frequency of errors, (3) the materiality of the errors, (4) the preparer's normal office practice, and (5) whether the preparer relied on the advice of another preparer.[137] Given the similarity between the return preparer penalty provisions and section 10.34, and in light of the Service's attempt to bring uniformity to the standards of tax practice, these factors should also apply to a good faith reasonable cause analysis under Circular 230.

In his remarks to members of the Washington, D.C. bar, the Director of Practice of the Internal Revenue Service, Leslie S. Shapiro, said that a

131. 59 Fed. Reg. 31,528 (1994) (codified at 31 C.F.R. § 10.34(b) (1994)).
132. *See* 59 Fed. Reg. 31,524 (1994).
133. Treas. Reg. § 1.6694-2(d) (1994).
134. 59 Fed. Reg. § 31,524 (1994).
135. *Id.*
136. *Id.*
137. Treas. Reg. § 1.6694-2(d)(1) - (5) (1994).

practitioner's conduct would have to be "egregious" before the Service would consider it a violation of the Circular 230 return preparer standards.[138] He also commented that in the case of a "close call" the Service would have to take the position that the proposed realistic possibility standard had not been met.[139] Presumably, at that point the Service would analyze the facts and circumstances[140] to determine whether the reasonable cause and good faith exception would apply to absolve the practitioner.[141] If the Service found the exception inapplicable, the Director of Practice would most likely institute disciplinary proceedings.

Some practitioners applauded the Treasury Department's attempt to bring uniformity to the standards for preparers and practitioners and to make them more objective, but at the same time they lamented the Treasury Department's attempt to establish a precise mathematical standard.[142] While determining precise odds seems impossible, it also seems unnecessary. The realistic possibility standard does not require that a return position be a clear cut winner.[143] It merely requires an approximate one in three chance of success. And in the event of a close call at which point the Service would deny the existence of a realistic possibility of success, the new regulations will allow the practitioner to rely on good faith and reasonable cause to avoid suspension or disbarment. Practitioners should and no doubt will hold the Service to its express culpability standard of failure to comply due to willful or reckless conduct or gross incompetence.[144]

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138. B. Kirchheimer, *Service Official Offers Insight on Amendments to Circular 230*, 57 TAX NOTES 984 (1992).

139. *Id.* at 984.

140. *Id.*

141. 57 Fed. Reg. 46,356 (1992).

142. *Unofficial Transcript of IRS Hearing on Proposed Standards of Practice Rules*, 92 Tax Notes 252-23 (Dec. 16, 1992) (providing remarks of Harvey Coustan, Chairman, American Institute of Certified Public Accountants). The thought of trying to establish a precise mathematical standard calls to mind an observation the late Justice Thurgood Marshall made in a different context, although his comments seem to apply in this instance as well: "Condemned to the use of words, we can never expect mathematical certainty from our language." Grayned v. City of Rockford, 408 U.S. 104, 110 (1972) (addressing void for vagueness arguments in a constitutional challenge to a municipal noise ordinance).

143. A higher standard exists for return positions on tax shelter items. 26 C.F.R. §§ 1.6662-4(g)(1), (4) (1993). A position advanced with regard to a tax shelter requires substantial authority and a reasonable belief by the taxpayer that at the time the return was filed the position taken was more likely than not the proper treatment. *Id.*

144. 59 Fed. Reg. 31,528 (1994) (codified at 31 C.F.R. § 10.34(b) (1994)).

C. REPORTING ERRONEOUS INFORMATION AND MISTAKES TO CLIENTS

Section 10.34(a)(2) requires a practitioner who advises a client to take a position on a return, prepares a return, or signs a return as a preparer to tell the client about any penalties reasonably likely to apply because of the position.[145] The practitioner must also advise the client of the opportunity to avoid penalties by disclosing the position.[146] The new regulation applies only to penalties "reasonably likely to apply," so it appears the practitioner need not educate the client on all potential penalties, however remotely possible, but merely those that appear reasonably likely.[147]

As with other proposed rules, section 10.34(a) drew criticism when it was initially proposed. The American Institute of Certified Public Accountants suggested amending the proposed revision to require practitioners to advise clients of penalties reasonably likely to be asserted instead of those reasonably likely to apply.[148] One commentator complained that if adopted the regulation would force practitioners to "play cops" for the Service.[149]

In one respect, the Director of Practice may have offered an appropriate response to such concerns when he commented, "A sound tax practice would require a practitioner to advise his client of the risk and possible results."[150] Without question, attorneys have a duty to advise their clients of the possible results of their actions, especially if the actions could lead to penalties, fines or criminal sanctions.[151]

But what becomes of the attorney-client privilege and the duty of confidentiality? If one of the Service's revenue agents asks a taxpayer whether the taxpayer's adviser informed her of the penalties reasonably likely to apply and about disclosure, the taxpayer might be put in the

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145. *Id.* § 10.34(a)(2).

146. *Id.*

147. *Id.*

148. H. Coustan, *Comments on Proposed Regulations Regarding Circular 230* submitted to the Service on November 18. 1992 *reprinted in AICPA Supports Expanded Use of Contingent Fees*, 92 TAX NOTES TODAY 236-13 (November 18, 1992). Mr. Coustan authored and submitted the comments in his capacity as Chariman of the Executive Committee of the Tax Division of the American Institute of Certified Public Accountants. *Id.*

149. R. Zeidner, *Treasury Proposal Would Prohibit Preparers From Advising Clients to Take Risks*, 92 TAX NOTES TODAY 210-13 (October 19, 1992) (quoting Gerald Portney, Director of Tax Practice at KPMG Peat Marwick, Washington, D.C.).

150. Leslie S. Shapiro, Director of Practice, *quoted in* Zeidner, *supra* note 149.

151. *See* PROFESSIONAL CONDUCT, *supra note* 10, Rule 1.4 (providing that a lawyer has a duty to inform the client of all information and explain all matters necessary for the client to make informed decisions); *see also id.* Rule 2.1 (providing for the lawyer's duty to render candid advice to the client).

position of either incriminating herself or incriminating her tax adviser with her response.[152] Commentators suggested amending the proposed regulations or taking other measures to preclude this type of unfair questioning by revenue agents.[153]

D. REASONABLE INQUIRY REQUIREMENT

Section 10.34(a)(3) generally allows a practitioner giving tax return advice to a client to rely on information provided by the client without substantiating the information as long as the practitioner does so in good faith.[154] To be sure, this provision applies to the practitioner who prepares a return or signs a return as a preparer. If a practitioner knows or has reason to suspect the information may not be correct, or if it appears incomplete or inconsistent with other information the practitioner knows of, the regulation imposes a duty on the practitioner to make a reasonable inquiry into the validity of the information furnished by the client.[155] This provision seems to require the practitioner to "play cops" much more than the rule in Section 10.34(a)(2).[156]

Although it may seem like a reasonable requirement, what of the practitioner in a small community who represents a farmer who purchases land from another client pursuant to an installment contract? If the buyer reports a certain amount of interest paid and the seller reports a different amount of interest received in the same transaction, the practitioner faces the choice of either violating rules regarding disclosure and confidentiality or violating the regulations.[157] The practical answer appears to be that the practitioner would simply withdraw from the representation altogether, but in a rural state such as North Dakota that alternative is not as practical as it sounds. An attorney in a rural community may be the only available lawyer within a considerable distance. Furthermore, in rural areas attorneys may find it

152. Comments on proposed amendments to Part 10 of Title 31, Code of Federal Regulations were submitted to the Internal Revenue Service on December 22, 1992 by P. Lewis, C. Roady, R. DeArment, and W. Wilkins *reprinted in D.C. Bar Tax Section Responds to Circular 230 Proposal*, 92 TAX NOTES TODAY 259-21 (December 30, 1992). Mr. DeArment and Mr. Wilkins, chairs of the tax section's Tax Policy Task Force, and Ms. Lewis and Ms. Roady, members of that task force, co-authored and submitted their comments in their respective capacities. *Id.*

153. *Id.*

154. 59 Fed. Reg. 31,527 (1994) (to be codified at 31 C.F.R. § 10.34 (a)(3) (1994)).

155. *Id.*

156. *See supra* text accompanying notes 148-49 (discussing comments of accountants about section 10.34(a)).

157. *See Unofficial Transcript of IRS Hearing on Proposed Standards of Practice Rules*, 92 TAX NOTES TODAY 252-23 (December 16, 1992) (providing the comments of Claudia Hill, National Association of Enrolled Agents).

difficult to turn away established clients where clients, like members of the general population, are few and far between.

Other examples also suggest potential problems. What of the client who once asked the practitioner in a different matter if he should falsify his court testimony to strengthen his position? Does this suggest the practitioner should cast a wary glance at all information provided by the client? Or what if the client had taken some improper deductions in earlier tax years prior to the practitioner's representation or involvement in the preparation of the client's return? Must the practitioner substantiate all similar deductions the client currently claims? The language of the regulation sweeps quite broadly by saying that a "practitioner may not ignore the *implications* of information furnished to, or actually known by, the practitioner, and must make reasonable inquiries if the information as furnished *appears* to be incorrect, inconsistent, or incomplete."[158]

The latter phrase regarding the appearance of the validity of the information arguably limits these restrictions to information currently under consideration and relieves the practitioner of considering the client's past performance or circumstances. But what of the client who is occasionally less than completely accurate? If the information that the client submits appears similar to false or erroneous information submitted in the past, the regulation would seem to impose a duty on the practitioner to substantiate the current claims. If so, a practitioner who prepares returns or gives advice on return positions may face a significantly increased burden and may risk either alienating the client or violating the substantiation requirements.

E. EXPEDITED SUSPENSION OR DISBARMENT

A new section 10.76 added to Circular 230 gives the Director of Practice authority to expedite the suspension of a practitioner when an independent authority, such as a state bar board or a court, has already found that the practitioner engaged in serious misconduct.[159] The procedures for disbarment or suspension of a practitioner discussed above[160] continue to apply under Circular 230. The new regulation, section 10.76, allows for expedited suspension of a practitioner whose

158. 59 Fed. Reg. 31,527 (1994) (codified 31 C.F.R. § 10.34(a)(3) (1994)) (emphasis added).

159. 57 Fed. Reg. 46,356, 46,357 (1992). The 1994 revisions redesignated former section 10.76 as paragraph (d) of section 10.33. 59 Fed. Reg. 31,523 (1994). The new section 10.76, governing expedited suspensions, was originally proposed as section 10.53A. 57 Fed. Reg. 46,357 (1992).

160. *See supra* notes 87-95 and accompanying text.

license to practice law has been suspended or revoked for cause or who has been convicted of any crime under the Internal Revenue Code, such as willful failure to file an income tax return,[161] or of any felony under Title 18 of the United States Code involving dishonesty or a breach of trust.[162] Loss of a professional license for failure to pay a professional licensing fee does not constitute cause for expedited suspension.[163]

The pre-existing regulations already allow for the suspension or disbarment of a practitioner for a conviction of a tax crime or any other offense involving dishonesty or a breach of trust.[164] Those provisions do not, however, provide for an expedited suspension based on a criminal conviction. The new regulations allow the Director, upon learning of the suspension, disbarment or conviction of a practitioner, to file a complaint against the practitioner, giving the practitioner a stated period of time to file an answer.[165] The Director currently has the authority to suspend a practitioner served with a complaint if the practitioner fails to answer the complaint within the allotted time period, or immediately following the conference if the practitioner named in the complaint requests one.[166]

The new rules regarding expedited suspension of disqualified practitioners may seem redundant given the fact that a practitioner who loses her license to practice in her profession no longer satisfies the requirements for authorization to practice before the Service.[167] Section 10.3(a) authorizes a member in good standing of a state bar to practice before the Service as long as the attorney is not suspended or disbarred from such practice.[168] A strong point of the new rule, however, seems to lie in the fact that many attorneys belong to the bars of more than one

161. 59 Fed. Reg. 31,528 (1994) (codified at 31 C.F.R. § 10.76(b) (1994)).

162. 59 Fed. Reg. 31,528 (1994) (codified at 31 C.F.R. § 10.76(b) (1994)).

163. 59 Fed. Reg. 31,528 (1994) (codified at 31 C.F.R. § 10.76(b)(1) (1994)).

164. 31 C.F.R. § 10.51(a) (1993). *See, e.g.*, Washburn v. Shapiro, 409 F. Supp. 3 (1976) (disbarring practitioner from practice before the Service after his conviction for willfully preparing a false or fraudulent income tax return). The preexisting Circular 230 section 10.51(a) does not limit suspension or disbarment to convictions under Titles 18 and 26 of the United States Code as the new regulation does. *See* 31 C.F.R. § 10.76(b)(2) (1994).

165. 59 Fed. Reg. 31,528 (1994) (codified at 31 C.F.R. § 10.76(c)(1) (1994)). The final regulation allows a practitioner 30 days to answer the Director's complaint. 59 Fed. Reg. 31,528 (1994) (codified at 31 C.F.R. § 10.76(d) (1994)).

166. 31 C.F.R. § 10.58(c) (1993).

167. *See* 31 C.F.R. § 10.3(a) (1993). Recall that one who simply prepares income tax returns does not need a license to practice law or accounting. *See supra* note 42. A suspended or disbarred attorney may not, however, prepare income tax returns as she did before her suspension or disbarment if a substantial portion of the attorney's practice had consisted of tax work. *In re* Larson, 485 N.W.2d 345, 350 (N.D. 1992). The preparation of tax returns under those circumstances would constitute the unauthorized practice of law. *Id.*

168. 31 C.F.R. § 10.3(a) (1993).

state. An attorney practitioner could be disbarred from practice for cause in one state and still be a member in good standing (although probably not for long) of another state's bar.[169] While the attorney disciplinary board in the second state considers and acts upon the attorney's disbarment in the first state, the attorney remains free to practice before the Service by virtue of her license to practice in the second state. To the extent this may pose a problem, the new rule providing for expedited suspension reduces the time period during which the attorney could practice before the Service after having been disbarred in the first state but while awaiting disciplinary action in the second.[170]

The pre-existing regulations allow a practitioner charged with misconduct an opportunity to present her case to an administrative law judge in a hearing[171] before being suspended or disbarred, whereas the new expedited suspension procedure merely allows the practitioner an opportunity for a conference with the Director of Practice prior to suspension.[172] The new rules allow the Director to suspend a practitioner within forty-four days of service of the complaint upon the respondent rather than waiting for depositions, a hearing and the decision of the administrative law judge.[173] The practitioner suspended under the expedited suspension proceedings may still avail herself of the opportunity for a hearing by an administrative law judge by asking the Director to issue a complaint pursuant to the procedures under section 10.54.[174] The expedited suspension would nevertheless remain in effect until lifted by the Director of Practice or an administrative law judge.[175]

The new rules for expedited suspension of a practitioner give the Director of Practice greater power to regulate who may practice before the Service, whereas the pre-existing regulations temper the Director's authority with immediate application of due process safeguards required by statute.[176] The expedited suspension rules retain the due process

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169. *See* LAWYER DISCIPLINE, *supra* note 1, Rule 4.4 (reciprocal discipline).

170. *Cf.* Silverton v. Dep't. of the Treasury, 644 F.2d 1341, 1343 (9th Cir. 1981) (disbarring attorney from practice in California but not disbarring from practice before the Service until after the hearing and decision of the administrative law judge).

171. 31 C.F.R. § 10.65 (1993).

172. 59 Fed. Reg. 31,523, 525 (1994) (codified at 31 C.F.R. § 10.76(e) (1994)).

173. The respondent has 30 days to respond to the complaint from the date it is served. 59 Fed. Reg. 31,528 (1994) (codified at 31 C.F.R. § 10.76(d) (1994)). The respondent may request a conference with the Director, and if so, it must be held within 14 days after the deadline for filing the answer. 59 Fed. Reg. 31,528 (1994) (codified at 31 C.F.R. § 10.76(e) (1994)). The Director may suspend the respondent immediately after the hearing if he finds suspension is warranted. *Id.*

174. 59 Fed. Reg. 31,528; 31,529 (1994) (codified at 31 C.F.R. § 10.76(g) (1994)).

175. *Id.* at 31,529 (codified at 31 C.F.R. § 10.76(f) (1994)).

176. 31 U.S.C. § 330(b) (1988). *See* Washburn v. Shapiro, 409 F. Supp. 3, 10 (1976) (finding that

safeguards for the protection of the practitioner, while allowing the Director of Practice to get offenders "off the streets" much more quickly.[177]

V. DIFFERENT STANDARDS FOR TAXPAYERS AND RETURN PREPARERS

Although the new regulations bring return preparer-practitioners closer to a single standard, another disparity in tax return preparation exists. The law holds taxpayers to one standard of accuracy while return preparers must abide by a different, higher standard. Section 6662 of the Internal Revenue Code imposes a twenty per cent penalty on the underpayment of any tax required to be shown on a return when the underpayment results from any of the following: negligence; careless, reckless or intentional disregard of rules and regulations; substantial understatement of income tax; substantial overstatement of pension liabilities; or any substantial estate or gift tax valuation understatement.[178] The penalty applicable to substantial valuation misstatements increases to forty per cent in the case of a "gross" valuation misstatement as defined in the I.R.C..[179] The accuracy-related penalties for substantial understatement of income tax do not apply when substantial authority supports the taxpayer's position[180] or when the taxpayer adequately discloses the position that results in the understatement and had a reasonable basis for taking the position.[181] Additionally, a general exception shields the taxpayer from accuracy related penalties when the taxpayer acts in good faith and with reasonable cause.[182]

In 1993, Congress slightly upgraded the standard of accuracy for taxpayers.[183] The amendments to section 6662 still left a gap between the standard of accuracy for a preparer and those an uncounseled

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statutory due process requirements were adequate).

177. The Service referred to title 31, section 330(b) of the United States Code for authority that the final regulation satisfies due process requirements in that it gives the practitioner notice of the grounds for suspension and an opportunity for a hearing before the Director of Practice before being suspended. 59 Fed. Reg. 31,523 (1994) (codified at 31 C.F.R. § 10.50 (1994)).

178. I.R.C. § 6662(b) (1994).

179. *Id.* § 6662(h).

180. *Id.* § 6662(d)(2)(B)(i).

181. *Id.* § 6662(d)(2)(B)(ii).

182. *Id.* § 6664(c)(1).

183. Omnibus Budget Reconciliation Act of 1993, P.L. No. 103-66, 107 Stat. 312, 531, § 13251(a) (codified at 26 U.S.C. § 6662 (1993)). Prior to the Act, the Code allowed for a reduction in an understatement of tax equal to the amount attributable to the tax treatment of an item where the taxpayer adquately disclosed the relevant facts affecting the tax treatment. I.R.C. § 6662 (a)(2)(B)(ii)(I) (1988). The 1993 amendments created the requirement for disclosed positions to be supported by a reasonable basis. Omnibus Budget Reconciliation Act of 1993, P.L. No. 103-66, 107 (stat. 312, 531, § 13251 (a) (codified at 26 U.S.C. § 6662 (1993)).

taxpayer must meet. In effect, counseled taxpayers will have a greater legal obligation than those who do not seek professional advice.

Some practitioners compared the negligence standard of the accuracy related penalties for taxpayers with the reasonable basis standard.[184] The recent amendments to Circular 230 constrain practitioners who prepare returns to the more stringent "realistic possibility" standard.[185] One commentator suggested that the disparity in the standards may lead to conflicts between the practioner and the client in which the client insists on measuring the validity of a return position by the reasonable basis standard while the practitioner must abide by the one-in-three test of the "reasonable possibility" standard.[186] The client willing to risk negligence penalties has less to lose than the practioner who would risk imposition of sanctions under Circular 230. If the client insists on a return position supported merely by reasonable basis but not by a realistic possibility of success, the practitioner would have to counsel against it, refuse to prepare that portion of the return containing the controversial position, and refuse to sign the return as a preparer.[187] Conflicts of this nature may even require the practitioner to withdraw as counsel.[188] The client would be within his rights to assert a position supported by mere reasonable basis, but the practitioner, held to a higher standard, would not be allowed to assist the client in asserting those rights. It is difficult to imagine another instance in which the client would be deprived of counsel in such a manner.

One might suggest that the lower standard for taxpayers is justified by the fact that professional tax advisers are trained in the subject matter and should be held to a higher standard because of their "expertise." Nevertheless, our voluntary self-assessment income tax system should strive to accurately and efficiently collect the correct amount of taxes due and owing to the government no matter who prepares the return. If the disparate standards encourage some taxpayers to calculate their tax liabilities less accurately in their favor, then the voluntary self assessment system fails. It cannot be administered fairly and impartially because the conscientious taxpayers who retain the services of professional tax advisers to calculate their tax liability stand a greater chance of paying

184. F.R. Nagle, *Practitioners Complain to IRS's Shapiro Over Circular 230 Rules*, 93 TAX NOTES TODAY 30-6 (February 8, 1993).

185. *Id.*

186. *Id.*

187. *Id.*

188. *Id.*

the correct (and in many cases probably higher) amount of taxes while taxpayers who prepare their own returns have more incentive to be less accurate in their attempts to pay less taxes.

A fair and impartial tax assessment and collection system should encourage accuracy by all taxpayers and not just by those who pay a professional to determine their tax liability. A fair and efficient system would apply a uniform standard of accuracy to all taxpayers, either directly or indirectly, by requiring the same degree of accuracy in all tax returns regardless of who prepares the returns. Until that happens, the debate will likely continue.

VI. CONCLUSION

Few areas of the law change as much and as often as federal taxation. The standards of tax practice change more slowly but just as profoundly. Tax practitioners must keep abreast of the rules governing their practice, not only on the local level but at the federal level as well.

While recent modifications certainly affect the way practitioners represent clients before the Service, the new revisions to the practice regulations will bring even greater changes to the relationship between the practitioner and his client and between the practitioner and the Service. The changes purport to eliminate one set of problems but threaten to create new difficulties in the process. To the extent the revisions in the rules governing tax practice enhance accuracy, fairness and professionalism they are desirable. To the extent that they create new problems or aggravate old ones, they are unwelcome wrinkles on the everchanging face of tax law.