Note - Any federal tax advice contained in this transcript is intended to apply to the specific situation described and should not be considered official guidance independent of the presentation. The tax advice and statements contained herein should not be relied upon for retirement planning purposes without first consulting a tax or retirement planning professional. This transcript has been edited for technical accuracy and may differ slightly from the audio recording of the "Ethical Standards for Employee Benefits Practitioners" phone forum. This information is current as of January 29, 2014. Since changes may have occurred, no guarantees are made concerning the technical accuracy after that date.

Colin: I would now like to formally begin today's Phone Forum by introducing John Schmidt.

John: Thank you, Colin. Hello everybody, and thank you for joining us today. I'm John Schmidt, the acting Director of IRS' Employee Plans Customer Education and Outreach. I would like to welcome you to our Phone Forum entitled "Ethical Standards for Employee Benefits Practitioners." Today, we'll be hearing from: Karen Hawkins, Director of IRS' Office of Professional Responsibility; Gabe Minc, Senior Tax Law Specialist from Employee Plans; and, Mary Beth Braitman from the law firm of Ice Miller LLP, who is joining us today as a guest speaker.

Before we start, I'd like to point out a couple of things. We will mail a certification of completion to everyone registered for today's Forum, if you attend the entire presentation. If you are an enrolled agent, retirement plan agent, or actuary, you can receive continuing education credit for this session. Other tax professionals may wish to consult with your licensing organization to see if today's session qualifies for continuing education credit.

Finally, as with all of our presentations, the comments expressed by our speakers should not be construed as formal IRS guidance.

Here at the Internal Revenue Service, we have many retirement plan resources available for you. If you'll take a look at the handout, specifically slide two, you'll see a link to our Retirement Plans webpage. You can also get there by going to the main irs.gov page, where you click on the "Information For" drop-down box in the upper right hand side of the screen and select "Retirement Plans".

If you take a look at slide three, you'll notice a graphic of how you can subscribe to our free electronic newsletters. To subscribe, simply select "Newsletters" in the left navigation bar, choose "Subscribe," and then select "Retirement News for Employers," which is our newsletter for employers sponsoring retirement plans, or, select "Employee Plans," which is our newsletter for retirement plan professionals. Having said all that, it's now my pleasure to turn the microphone over to Gabe Minc.

Gabe: It is absolutely wonderful to be on this panel here today talking about ethical standards for employee benefits practitioners. In particular, today, we would like to focus on the standards of practice applicable to a practitioner's communications with clients and the IRS. We're going to get started by talking about the Office of Professional Responsibility. We're very honored to have Karen Hawkins here today, who's the Director of the Office of Professional Responsibility. She's going to tell us a little bit about the office of Professional Responsibility. We also want to give you a brief overview of Circular 230, and talk about what Circular 230 is. After that, we will analyze some hypothetical fact patterns, which we believe illustrate the application of some key provisions of Circular 230 that apply to a practitioner's offering of tax advice relating to employee benefit plans.

I'd also like to mention that towards the back of the PowerPoint handout that you all received, there's a rundown of some 20, or probably more, provisions of Circular 230. There are also some Internal-Revenue Code and other statutory provisions back there. We will be referring to those, that is, the statutory and regulatory provisions summarized toward the back of the PowerPoint handout, during our presentation today, and hopefully that will be helpful to you.

I think the best place to start right now is by asking Karen if she would help us understand what Circular 230 is.

Karen: Hi everybody. Thanks for joining us this morning (or the afternoon, depending upon which part of the country you're in). We look forward to having a lively discussion about some of the sections of Circular 230, once we've laid a foundation regarding what Circular 230 is. The first thing you need to understand about Circular 230 is that it isn't some whimsical document that the Internal Revenue Service created to make your life miserable. Rather, Circular 230 is a set of regulations that have as their foundation a statute, and all of that is found outside of the Internal Revenue Code.

The statute is at Title 31 of the United States Code. It's been around since 1884. You should immediately notice that that predates the income tax. It predates the Internal Revenue Service, as you know it. It predates everything that we think about as tax, because it wasn't a statute that was passed for tax purposes. It was a statute that was passed specifically to allow the Treasury Department to regulate the conduct and the kinds of people who appeared before the Treasury Department representing the citizens of this country who at the time were seeking reparations for lost property during the Civil War.

We have these regulations providing for ethical standards of conduct that were created at the Treasury Department, which started to be written in 1886, and have been promulgated, revised and further changed over the years. It wasn't until 1921 that these regulations were actually published in a separate document by the Treasury Department that we now refer to as Circular

230. It's best to never lose sight of the fact that these are regulations, just like any other law that a governmental agency would issue.

The regulations, or Circular 230 as we more commonly refer to them, are designed to govern practice before the Internal Revenue Service. That was not exactly the case in1886, but, it was by the time we got to 1921, which is when we actually had something called "Circular 230." It's more formally titled "Regulations Governing Practice before the Internal Revenue Service," or some variation on that. In short, Circular 230 is a set of regulations that govern administrative practice. Or, stated another way, the regulations concern issues relating to how you interact with the administrative agency.

These Circular 230 rules don't apply in other contexts. They do not apply in any context other than Internal Revenue Service activity. The rules exist strictly for the purpose of laying out Internal Revenue Service administrative expectations. I often refer to them as "rules of engagement," These are rules that apply if you're going to interact with the federal tax administration at any level. The regulations have a rather broad reach. A number of sections, some of which we'll touch on today, actually identify what "practice before the Internal Revenue Service" means, and the scope of the jurisdiction of Circular 230 and the Office of Professional Responsibility.

I'll just touch on a couple of these sections of Circular 230 right now. The term "practice before the Internal Revenue Service" is defined very broadly. It includes all manner of communication with the Internal Revenue Service with respect to the obligations of taxpayers regarding laws and regulations administered by the Internal Revenue Service. Not just tax laws, but also laws that the IRS has been asked to administer outside the tax laws, which, of course, takes into the Service's relationship with the Affordable Care Act rules. It also takes into consideration the Service's administration of the foreign bank account rules. There are a lot of non-tax laws that the IRS has been asked to administer over the years, and interaction with the Service regarding these matters are all covered as practice matters under Circulation 230.

We have a new regulation, which I think is important for you all to be aware of, because it touches on some of the work that you all may do. Section 10.8 of Circular 2030 has two, important, key pieces. The first, is section 10.8(a), which says if you possess a preparer tax identification number ("PTIN"), or you're supposed to possess a PTIN, then you are covered by the regulations regarding conduct and discipline under Circular 230.

The second important, key piece of section 10.8, which may even be more significant than section 10.8(a), is section 10.8(c), which says that <u>anybody</u> who is paid to prepare, or assists in the preparation of, all or a substantial portion of a document for submission to the Internal Revenue Service regarding a taxpayer's liability is subject to Circular 230. Even if you're just

preparing documents that contain statements, or maintain positions, that may impact the taxpayer's tax obligations, or lack of a tax obligation, it is covered under 10.8(c), and jurisdiction under Circular 230 is associated with that conduct.

In terms of jurisdiction under Circular 230, the other place that I think is relevant is found in the statute. The statutory provision is section 330 of Title 31 of the United States Code. The statute was added in 1884 and essentially gives authority to the Treasury Department to impose standards that are applicable to "the practice of representatives of persons before the Department of the Treasury."

If you look at your slide number six now, there's just a reference for future use that will show you how to get to the Office of Professional Responsibility ("OPR") web pages on the irs.gov website. On the OPR web pages, you may look for disciplined tax professionals, if you're inclined to take a look at that.

I guess, moving on to slide seven, I will just very quickly touch on the reference to 31 C.F.R. Part 10. That's the citation to the part of the Code of Federal Regulations which contains the body of regulations that we call Circular 230. As you can see from the slide, and as I said earlier, those regulations started to be written in 1886. In 1921, the regulations were combined together in a small booklet, in pamphlet form, and numbered as Treasury Circular No. 230.

Slide seven further references the subparts of Circular 230. Subpart A of Circular 230 has to do with who has the authority to practice before the Internal Revenue Service. Section 10.2 of subpart A, for example, contains definitions relevant to identifying the categories of persons who may practice before the IRS, such as attorneys and certified public accountants, other practitioners, and tax return preparers. Section 10.2 includes the definition of the term "practice before the Internal Revenue Service," which we talked about earlier. Those of you who are enrolled retirement plan agents, enrolled agents or enrolled actuaries, the eligibility requirements and application process for you to qualify to practice before the IRS are set forth in subpart A of Circular 230.

The Office of Professional Responsibility does not administer the enrolled persons program. That program, since 2011, has been administered by the Return Preparer Office ("RPO"). Otherwise, nothing has changed. We have shifted where the responsibilities are.

Subpart B of Circular 230 contains all the duties and restrictions related to practice before the IRS. We are going to deal with a number of the provisions in subpart B in some considerable depth as we talk through the hypotheticals. I won't say anything more about those now.

Subpart C contains one very big section, which we will cover in this presentation, but which I would strongly urge you to read at some point. The section of Circular 230 that I am referring to is 10.51(a), which is titled "Incompetence and Disreputable Conduct." Section 10.51(a) contains 18 subparagraphs, which list behaviors that the Agency has determined are unacceptable with respect to a practitioner when practicing before the Agency. It's an important section for you to read.

Subpart C of Circular 230 also contains an authorization to the Office of Professional Responsibility to impose sanctions, sets forth the circumstances under which sanctions may be imposed on practitioners, and discusses the levels of sanctions that are available.

Subpart D of Circular 230 is one that I hope you never have to look at. Subpart D outlines all of the disciplinary procedures, including the practitioner's entitlement to notice and an opportunity to be heard whenever there has been an allegation made with respect to a violation of one or more of the standards of practice set forth in Circular 230.

I think that's probably enough of an overview for now. We'll get into more depth and detail as we talk specifically about the hypotheticals. I guess, Gabe, you're going to set the stage for us regarding the first hypothetical fact pattern, Hypothetical A, which we will be discussing.

Gabe: Yes. Now that we've had a brief overview of what Circular 230 is, and how it's structured, we will try to practically apply the provisions of Circular 230 to what we think is a somewhat typical type of factual situation a benefits practitioner might encounter. For this first hypothetical fact pattern, we're going to assume that an employee benefits practitioner, and we call her "Practitioner Y," is approached by the Chief Financial Officer (or the "CFO") of a large hospital, which we call" Hospital X." The CFO informs Practitioner Y that the hospital is organized as a tax-exempt entity under Section 501(c)(3) of the Internal Revenue Code, which we just refer to as the "Code."

In this hypothetical, the CFO further assures Practitioner Y that Hospital X is a governmental entity, and that she would like Practitioner Y's assistance in establishing a retirement plan for Hospital X that only covers senior executive employees and provides for a 10-year cliff vesting schedule.

My general question for the panel is, what issues might arise under Circular 230 with respect to this hypothetical. To help the discussion, you'll see that we've got the slides organized into a series of ethical issues. The first ethical issue in the series applicable to this hypothetical fact pattern asks the following question – Under Circular 230, what are Practitioner Y's obligations in terms of establishing the client relationship with Hospital X? Mary Beth, do you have any thoughts on this?

Mary Beth: Yes, I do. I think one of the critical places to start is to clearly document the terms of the engagement and the scope of the work. We think that is important when you begin analyzing the diligence and accuracy requirement in Section 10.22, as well as other aspects of Circular 230. We think that, in this day and age, it is incredibly important to determine the actual client identity. Is it (in this case) Hospital X, is it the plan? Exactly who is the practitioner being asked to represent? That, we think, is a critical starting point.

What we do here is we have an automated process where any time a new file, and that includes either a new client or a new matter for an existing client, is to be opened, that file actually cannot be opened within our accounting system, for purposes of billing, for example, unless an engagement letter or a contract is submitted to the internal electronic system. We think that perhaps these procedures impose an absolute discipline of establishing the terms of engagement, the identity of the client, and the scope of the engagement, at the onset of each representation. Gabe, I'll turn it back to you.

Karen: Allow me to briefly jump in. Slide 9 of the PowerPoint presentation references section 10.33 of Circular 230. I just want to say that section 10.33 is an aspirational section of the regulations. It is not a provision within the Circular that we would ever use to charge a practitioner with misconduct.

I think section 10.33 does inform you about how to conduct yourself in both your relationship with your client and in doing the due diligence. As Mary Beth mentioned, section 10.22 is a section under which you could be charged for violating the Circular. There are a couple of others that I think come into play in this hypothetical as well.

Section 10.33, aside from being aspirational, really feels like a common sense reminder to practitioners. It says stuff like you should communicate clearly with your client about what you're going to do and what the expectations are and how much it's going to cost, and when it's going to happen.

Section 10.33, for me, talks about best practices to be in business, and does list actions that must be taken just to avoid being accused of misconduct under Circular 230. It tells you that you should communicate with the client in some fashion. I know there are state laws for lawyers that would require written engagements, but there other states that don't require writings for engagements. However, you do it, I think, because it's important to lay it all out with your client. You do these things, partly, because you have an obligation outside of the section 10.33 aspirational standards.

Section 10.22 of Circular 230 imposes the obligation to ensure the accuracy of information that you are providing to your client and representations that you're making to the Treasury

Department. That's the start of your due diligence expectation. If you aren't communicating with the client, it's not clear to me how you're going to be able to ensure that you accurately relay relevant facts to them or, how you're going to make accurate representations to the Treasury Department.

There's also a series of subsections under section 10.33 of Circular 230 that address, among other things, the topic of establishing the facts and making sure that they're relevant, that any assumptions that are being made are reasonable, and also that you are advising the client about the importance of the conclusions being reached. All of these, in section 10.33, are aspirational statements. The failure to adhere to these aspirational standards may express itself as a violation of other provisions of Circular 230 that could come into play if something actually does go wrong, either in connection with the practitioner's interactions with his or her client, or an interaction between the practitioner and the IRS. Gabe, is there anything you would like to say?

Gabe: I think we can move along. We've talked about the relationship between Section 10.33 and Section 10.22 of Circular 230. I think the next logical step is to go to slide 11, which is Ethical Issue A3, and ask Mary Beth, as a practical matter, because obviously, for a variety of reasons, the practitioner doesn't want to be accused of not having performed due diligence with respect to the client, how does a firm like yours deal with the issue of demonstrating due diligence in the client relationship?

Mary Beth: In this particular hypothetical, and I think it's an interesting one because it raises a number of possibilities, we would probably start by pulling plan documents, and that would include a review of the State's statutes applicable to Hospital X, and we would more specifically look for a statute which authorized Hospital X as a governmental entity. We would analyze the governing State law, and we would look at State administrative codes of regulations, to see if there are provisions that are devoted to establishing Hospital X or which describe the identity of Hospital X relative to the State.

We would look for public financial statements; which could include certified annual financial reports, which Hospital X would be generally required to prepare in many states. We think that would be an important starting point in this matter. In the case of a significant Voluntary Compliance Program (VCP) submission, which we are able to see at the front end sometimes and not at other times, we would review the original materials, financial reports, journal entries, and board actions in order to draft the description of the relevant facts, including how Hospital X and the plan, and their governance, are defined under appropriate State statutes and other applicable law. We would also review the plan documents, any Form 5300, and the summary plan description (SPD).

Ultimately, a description of Hospital X and its proposed retirement plan would start to emerge within the scope of the engagement with the client, which I talked about earlier. We would then have our understanding of the facts, legal analysis and conclusions reviewed by the client in a draft format to allow an open discussion of the status of Hospital X as a municipal or a state governmental entity. We think there tends to usually be quite a lot of collateral information that's available in the facts that you described here that we would want to work our way through that information to make sure we're comfortable with Hospital X's exact legal status, whether it be as a dual entity, as a 501(c)(3) tax-exempt entity, as a municipal corporation, or some other governmental entity.

That's the thing that I think we would start with in this tax situation, Gabe.

Karen: I think what I hear Mary Beth saying somewhat indirectly is a response to the question that gets raised on slide 12. It sounds like, at least from your firm's perspective, which I applaud, you aren't taking the CFO's representation that Hospital X is a governmental employer without satisfying yourself, through external documentation, as well as, I assume, some additional follow-up questioning, or retrieving of documents from the actual hospital, that the hospital indeed qualifies as a governmental employer for the purposes for which they're seeking your assistance.

Mary Beth: Karen, that's exactly right. The other thing that we would then follow-up on is consistency in the treatment of the organization as a governmental entity. We think a question that is important to pursue in this situation is whether Hospital X has historically treated all of its benefit plans as government plans.

We would want to inquire into whether Hospital X participates in a statewide governmental retirement plan or a statewide governmental health plan. We would also want to investigate whether Hospital X is organized pursuant to State statutes specific to it, or pursuant to more general State statutes that Hospital X believes apply to it. We do think that that follow-up is necessary because of the complex area that exists here regarding organizations that often go back many decades and how they fit within the definitions provided under the Internal Revenue Code with respect to governmental entities and governmental plans.

Karen: This may be a good time to reference section 10.34 of Circular 230, which is another very important due diligence regulation under the Circular. Section 10.34 is often only referred to as the due diligence standard applicable to signing tax returns or claims for refunds. That's only partly accurate. Section 10.34(a) contains those provisions. However, there is also section 10.34(b), which deals with the submission of other documents to the Internal Revenue Service.

Section 10.34(b) of Circular 230 specifically states a couple of important things for this audience. It says that you may not advise a client to take a position on a document, affidavit or other paper that is to be submitted to the Internal Revenue Service unless that position is not frivolous. It goes on to say that a practitioner may not advise a client to submit a document that contains or omits information in a manner that demonstrates an intentional disregard of a rule or regulation unless the practitioner also advises the client to submit a document that evidences a good faith challenge to that rule or regulation.

Section 10.34 then goes on to finally get you to section 10.34(d), which states that a practitioner advising a client to take a position on a tax return, document, affidavit or other paper may generally rely in good faith without verification upon information that's provided by the client. But, there is a caveat there. The caveat is that the practitioner can't ignore the implications of the information that's been furnished. The practitioner can't ignore information that's actually known or should be known. So, the practitioner has to make reasonable inquiries of the client if the information appears to be incorrect or inconsistent or incomplete.

In this hypothetical, and I'm not an employee benefits practitioner by training, but, it would seem to me, that the CFO has reached a legal conclusion with respect to his hospital's status as a government employer. I would think the practitioner would have to question the CFO's expertise to reach that legal conclusion and the basis for that legal conclusion. This is what section 10.34(d) of Circular 230 is telling me is required. You've got to ask enough questions to get to the comfort level that you need in order to satisfy this due diligence standard of Circular 230 before you can just take the CFO's word for it.

Of course, by then, you're not just taking his word for it, you've done some additional research.

Gabe: I would like to reflect for a moment on the issue of firm governance with respect to tax practitioners. I'm focusing again specifically on the aspirational standards of Section 10.33 of Circular 230. Section 10.33(b), in particular, says that a tax practitioner's firm must take reasonable steps to ensure the firm's procedures are consistent with the best practices enumerated in section 10.33(a) of Circular 230. I'm wondering what that even means. Mary Beth, what things does your firm do to satisfy the aspirational standards of Section 10.33(b)?

Mary Beth: We've already talked about the engagement letter process, discussions with the CFO, and appropriate research into the governing State statutes and regulations, ethical rules, and so on. Additionally, on significant projects, my firm requires peer review at a group level, that is, within our employee benefits group. This peer review would be required, for example, with respect to IRS submissions for voluntary corrections or closing agreements, or other significant matters. Under the peer review process, more than one professional would go over

the work being performed by the firm. One of the objectives of that peer review process would be to see if there are any unasked questions.

That's a very important component of the peer review process, especially with respect to non-covered opinion letters. We have a committee process within the firm. At a firm level, a committee acts like a review board that looks through the draft materials prepared by the firm, including the statement of the facts, research, legal analysis and conclusions, and then questions what they see. Much of this process is directed at determining whether the firm's due diligence standards, such as those set forth in section 10.34 of Circular 230, have been satisfied.

We also try to have benefit group meetings where we talk about how these ethical rules apply to the employee benefits area specifically. We do think there are some special concerns in the employee benefits context, such as the exact identity of the client. For example, in the hypothetical we're analyzing, is the client Hospital X, or is it the new plan Hospital X seeks to establish, a committee created by Hospital X, or some other entity? This is a highly complex area of the law that requires special attention in terms of applying the ethical standards of practice set forth in Circular 230.

Karen: Can I just jump in for a second here? I think everything that Mary Beth is saying is just right on with respect to what we'd like to see in terms of the due diligence standards of Circular 230. I would just like to add that we just might have some folks on the phone who don't have the luxury of being in a giant firm where there are committees, boards and panels providing multiple levels or tiers of checking and oversight.

I've not practiced in the employee benefits area, but I did practice for a few years in a very small, two-person firm in California. I just want to remind people in small practices, that you don't have to have big committees, and you don't have to have all of these multiple layers of review, but you do have to have checks and balances in place. You can do that, even in a small firm setting.

Even as a solo practitioner, you can do some peer review by making sure that you affiliate yourself with, or somehow have relationships with, others, that you can do reality checks with, that you can bounce ideas off of. In a small firm you can set something up so that if you've done the work someone else can check it for you. My partner and I were constantly critiquing and responding to one another's thought processes either orally or writing. It doesn't have to be a big event in order for you to pay attention.

You should have some working knowledge and access to Circular230 so that you periodically check to make sure that you're not running afoul of your ethical obligations vis-à-vis the tax

administration process. It's not a bad idea, and you simply can do that on your own, and you can consult with others if you don't quite understand what a provision of Circular 230 is saying to you. I don't want the smaller practitioner firms to think that it has to be a huge event for you to adhere to the practice standards and best practices set forth in Circular230. I think that that can be done with a lot less fanfare and still be quite adequate.

Gabe: I think we're ready to move on to Hypothetical B. We're going to change the facts of Hypothetical A just a little bit. For purposes of Hypothetical B, let's assume the tax practitioner is actively seeking clients for a product that she has named the "qualified executive governmental pension plan." Practitioner Y identified a number of teaching hospitals associated with large public universities.

Using a variety of research tools and assumptions, Practitioner Y has created a model of the tax benefits that would be made available to Hospital X and its senior executives if Hospital X establishes a qualified executive governmental pension plan. Based on these analyses, Practitioner Y proposes a value billing arrangement pursuant to which Practitioner Y will charge Hospital X a flat fee of $50,000 to produce the plan document, a legal opinion letter concluding that the plan is a valid governmental pension plan under Section 414(d) of the Code, and for submitting the plan to the IRS for a determination letter that the plan is qualified under Section 401(a) of the Code.

Practitioner Y acknowledges that there is some economic risk to Hospital X in establishing the arrangement. To minimize that risk, Practitioner Y offers to enter into a contractual arrangement with Hospital X pursuant to which Practitioner Y will refund $40,000 of her fee to Hospital X if the IRS does not actually issue a favorable determination letter with respect to the plan.

However, because Practitioner Y considers the qualified executive governmental plan product to be proprietary, Practitioner Y insists that, as part of the arrangement, Hospital X enter into a confidentiality agreement with practitioner Y regarding the products and services being provided by Practitioner Y in connection with the qualified executive governmental plan.

The first question I have in connection with Hypothetical B has to do with the fee. In particular, my question relates to section 10.27 of Circular230, which says that a practitioner must generally not charge an unconscionable fee or, subject to certain exceptions, a contingency fee. I'm wondering whether the fee arrangement in Hypothetical B satisfies the standards of practice of Circular 230. Karen or Mary Beth, would either of you like to comment?

Karen: I'll jump in first and perhaps Mary Beth can say something additionally. The notion that a practitioner shouldn't charge an unconscionable fee should almost be one of our aspirational

standards because unconscionable fees are in the eye of the beholder. There are some factors that will come into play, the geography of those clients and the practitioner, what the market will pay or whatever people are charging for the same thing.

As a practical matter, I have seen situations, even since I have been Director of OPR for the past five years, where I've been able to look at something and say - "That's an unconscionable fee." But, in most instances, it's because the practitioner ended up before me without having performed any services at all. So, the practitioner was taking money and not doing any of the promised work. It's very troubling for me to second guess a professional about how much he or she thinks should be charged for something.

The practitioner will probably get by an unconscionable fee analysis, at least preliminarily. I think the thing that surprises a lot of people is the contingency provision in Circular 230, which is unlike any other that you would see in the law elsewhere. Section 10.27(c) of Circular 230 essentially says that a contingent fee is a fee that's based, in whole or in part, on whether the position taken in the document, return, or other filing avoids challenge by the IRS, or is sustained but after challenge.

Under section 10.27(c), a contingent fee also includes a fee that is based on a percentage of the refund, or that otherwise depends on a specific result attained. The theory behind the definition of "contingent fee" in section 10.27(c) is an important one. The Agency doesn't like contingencies because the contingent fee arrangement between a practitioner and his or her client is really gambling with somebody else's money. The practitioner and the client are playing a lottery. They're playing "catch me if you can" in some instances. The fee arrangement in Hypothetical B falls pretty squarely into the definition that I just recited to you in section 10.27.

The concern would be that this is just shy of the equivalent of saying let's throw it up against the wall and see if it sticks. If it doesn't, I'll give you your money back. The victim of this kind of lottery process is the Agency itself. It's incumbent upon the Agency to figure out that this an inappropriate submission because the taxpayer doesn't qualify for whatever it is that is being requested from the Agency, a determination letter in Hypothetical B. The Agency is over-worked, under-staffed, whatever the case may be, or the tax issue is just well hidden in the documentation that has been submitted to the Agency.

It may not be caught and so, in a sense, this kind of a fee is being charged for not getting caught, not for the actual amount of work that's being perfumed. I would say that if this came to OPR's attention, and we had enough other supporting documentation, particularly if the Agency had determined that Hospital X's pension plan did not qualify for a favorable determination letter, and Hospital X was unhappy with Practitioner Y, we might take

disciplinary action with respect to Practitioner Y. We do get referrals from clients, and not just our own people. We would take a look at this and probably not be happy about how Practitioner Y has charged Hospital X.

It also appears that Practitioner Y may have an established pattern of engaging in these types of contingency fee arrangements. Gabe, I think you said Practitioner Y was a promoter of this particular type of pension arrangement with respect to employers in Hospital X's industry. It's more likely than not that there will be multiple examples of Practitioner Y having entered into a contingency fee arrangement with other hospitals or other kinds of tax-exempt entities. Such a pattern of behavior, which is prohibited under Circular 230, would more likely prompt OPR to open a case on Practitioner Y, and possibly take it to the next level, involving disciplinary proceedings.

Gabe: Karen, going on now to slide 16, what about the way Practitioner Y solicited Hospital X. The rules under Circular 230 talk about solicitation. Do you think there are any problems in terms of the way Practitioner Y solicited Hospital X?

Karen: It's a little hard to talk about this just based on the facts provided in Hypothetical B. Section 10.30 of Circular 230 essentially says that you shouldn't be soliciting either in a public or a private way if the solicitation includes communications containing false, fraudulent, or coercive statements or claims. There's no prohibition on this promoter going directly to Hospital X, provided her solicitation of Hospital X does not include false, misleading, fraudulent, coercive, or deceptive statements. I can't tell from the facts provided in Hypothetical B exactly what the promoter may have represented to the client, but certainly if the promoter is representing that getting a favorable determination letter is a slam dunk in a context where the promoter should know better, then her solicitation of Hospital X would be a problem under section 10.30 of Circular 230.

If the promoter knows that she must cut some corners, or tinker with the application for a determination letter, in order to avoid the representation of any of the unfavorable facts that the IRS might use to deny a favorable determination letter, then I would say that there has been a violation of section 10.30 of Circular 230. I'll offer that it's a little difficult to tell whether this type of activity is going on under the facts of Hypothetical B. There are a couple of additional things I'd like to say about this topic of solicitation within the context of section 10.30 of Circular 230.

As regards solicitation, there is a provision at section 10.30(d) of Circular 230 that essentially says that you may not get business or accept business from any person or entity that obtains clients or otherwise practices in a manner that violates section 10.30 of Circular 230, even if that other person or entity is not subject to Circular 230. If the promoter, for instance, was

using “front men,” that is, people who are soliciting or screening potential clients and then referring those potential clients to the promoter, and the front men made false, fraudulent, or coercive statements or claims to the potential clients, then the promoter will be deemed to have violated section 10.30, regardless of whether the promoter made any such statements or claims herself.

A practitioner is not permitted to take advantage of, or gain a benefit from, someone else’s violation of the Circular. Section 1030(d) is one provision of Circular 230 that people are usually unaware of.

The other thing I wanted to do is just make a disclaimer about the section 10.27 provisions of Circular 230 relating to contingent fee arrangements. There is litigation pending in the District of Colombia, called “Ryan, LLC versus Lew.” Jacob Lew was sued in his official capacity as the U.S. Secretary of the Treasury. The case might have been captioned “Ryan, LLC versus IRS.” In this case, the plaintiffs challenged section 10.27 as it relates to ordinary refund claims (that is, claims for refund filed after taxpayers have filed their original tax return, but before the IRS initiates an audit of the return), saying that the Agency overstepped its authority in promulgating that regulation. There are some exceptions to the limitation on contingent fees arrangements. For example, there is a relatively narrow exception that permits contingent fee arrangements for services rendered in connection with the Service’s examination of, or challenge to, an amended return or claim for refund or credit where the amended return or claim for refund or credit was filed within 120 days of the taxpayer receiving a written notice of examination of, or written challenge to, the original tax return.

The Ryan, LLC v. Lew case is live litigation. I can’t really comment any further, except to say that the complaint initially contained three counts. Two of them have been disposed of in the Government’s favor on the basis of motions to dismiss. The third count argues that the IRS exceeded its statutory authority in promulgating Circular 230. The parties have written summary judgment motions with respect to the remaining count of plaintiffs’ complaint. There was an oral argument that was supposed to have occurred last month, but there was some shifting of judicial duties and so for administrative reasons, the hearing was continued.

The case has been put on hold until further notice and a new judge can be assigned. That case is out there. If you’re really interested in contingency fee arrangements, you might just want to be aware of it. You may wish to watch for the court’s decision as it comes down. My guess is that it’s highly likely that no matter which party loses at the district court level, there will be an appeal. This could go on for the next couple of years, but it is out there and I do want people to know about it.

Gabe: I'd like to wander away from Circular 230 for just a minute and talk about preparer penalties under Section 6694 of the Code. Under Section 6694, if the tax return preparer prepares any return or claim for refund with respect to which any part of an understatement of liability is due to an "unreasonable position," and the preparer knew (or reasonably should have known) of the position, then the preparer is subject to a penalty with respect to each such tax return or claim for refund in an amount equal to the greater of $1,000 or 50% of the income derived by the preparer with respect to the return or claim.

The term "unreasonable position," for purposes of the preparer penalty, is defined in section 6694(a)(2) of the Code as either: (1) an undisclosed position for which there is no substantial authority; (2) a disclosed position for which there is not a reasonable basis; or (3) in the case of a tax shelter (or a "reportable transaction"), if it is unreasonable to believe that the position would more likely than not be sustained on the merits.

Moving along to slide number 18, Ethical Issue B.4, I was wondering if there are any circumstances under which Practitioner Y could violate the standards of conduct under Circular 230 if she somehow transgresses the standards set forth in Section 6694 of the Code?

Mary Beth: That sounds like it's probably a Karen question.

Karen: My answer is, you've got it. The reason is that in section 10.34(a) and (b) of Circular 230, which relate to the standards of practice with respect to tax returns and documents, affidavits and other papers, there are specific references to the same key words. For example, section 10.34(a) says that a practitioner may not willfully, recklessly, or through gross negligence advise a client to take a position on a tax return or claim for refund, or prepare a portion of a tax return or claim for refund containing a position, that lacks a reasonable basis, or is an unreasonable position as described in section 6694(a)(2) of the Code. The definitional factors in section 6694 of the Code and section 10.34 are interrelated.

What I would say, with respect to section 6694 of the Code and section 10.34 of Circular 230 is that there are both similarities and differences in terms of how and when sanctions are imposed. Was there substantial authority for an undisclosed position? Was there a reasonable basis for a disclosed position? Was it reasonable to believe a position would more likely than not be sustained on the merits in the case of a tax shelter or reportable transaction? If the answer to any of these questions is "no," then a preparer penalty may be imposed under section 6694(a) of the Code.

Section 6694(b) of the Code says that a preparer penalty may also be imposed on any tax return preparer who prepares any return or claim for refund with respect to which any part of an

understatement of liability is due to willful conduct or a reckless or intentional disregard of rules and regulations.

In the case of Circular 230, there are discretionary referrals from the field to OPR and mandatory referrals from the field to OPR. In the case of a section 6694(a) penalty, the field is instructed that when there appears to be a pattern of misconduct by a preparer across clients, years, or issues involving the section 6694(a) penalty, which involves negligent or intentional disregard of tax rules and regulations, a referral to OPR is discretionary, but should be seriously considered. The field is further instructed that isolated instances in which a section 6694(a) penalty is assessed should not, in and of itself, require a referral, unless willful conduct is involved. However, a referral to OPR is mandatory when the section 6694(b) penalty, involving a willful attempt to understate the liability for tax, is asserted.

When it comes to OPR, the mere fact of the proposal of the preparer penalty is not what triggers our investigation. We go behind the penalty to look at the conduct that the Agency thought warranted a penalty, and we make our own independent determination as to whether the conduct that underlies the penalty is in fact a statement of the practitioner's lack of fitness to continue to practice before the Agency.

Keep in mind that we're making determinations about whether someone should continue to be able to represent and advise taxpayers in the tax administration system. What we do to a practitioner is far more significant to them and causes far more harm than the imposition of a monetary penalty. The imposition of a monetary penalty, which can be paid, is just a one-time event. The removal of someone's license for some period of time for practicing before the Agency is obviously a very serious decision to make.

We are not just taking the Agency's word that someone has acted in a negligent way, which is the standard for imposing the section 6694(a) penalty, or even whether a professional acted in a willful manner or with reckless or intentional disregard under the section 6694(b) penalty. We reexamine all the facts associated with the imposition of a section 6694 preparer penalty before we decide that discipline is appropriate. However, certainly, there is significant overlay and interaction between the section 6694 preparer penalty and the provisions in Circular 230.

Gabe: I'd like to jump ahead. I'd like to skip over Hypothetical C for the moment, and jump to Hypothetical D, which is at slide 22. In Hypothetical D, which is yet another variation on the facts of Hypothetical A, Practitioner Y prepares a pension plan document and submits it to the Service for a determination regarding the form of the plan. The IRS responds by stating that additional information is required in order to complete the application.

Responding to the IRS' additional information requests drives up the fees for the project. Also, the IRS' determination is not forthcoming. Two years go by since the application was first submitted, and no ruling has been issued by the Service. The CFO of Hospital X is losing all patience and refuses to pay Practitioner Y's most recent invoice, and additionally asks Practitioner Y to send all of her files regarding Hospital X and Plan Z to Hospital X.

My first question is - What are practitioner Y's obligations under Circular 230 regarding the IRS' information request in Hypothetical D?

Mary Beth: This is Mary Beth. I would start by looking at section 10.20 of Circular 230 and my obligation to promptly submit information to the Service, unless I believed in good faith and on reasonable grounds that the records or information requested by the Service are privileged. Also, a basic principle, which I think is very helpful when dealing with the IRS, is to keep the agent apprised of my progress. It's not clear from Hypothetical D what the IRS' specific requests were or the amount of time permitted to submit the additional information. Certainly, we find that there are times when a response to such requests for additional information can take longer than anticipated to file with the Service.

We've always found the agents quite reasonable in terms of extension requests, if we explain why additional time is needed, such as the need to consult with the client, actuary or accountant regarding a specific question. My first point, then, is that it is critical for Practitioner Y to communicate with the IRS so that it's clear to the Service what is happening or not happening in terms of the information the Service has requested.

My second point is that communication between Practitioner Y and her client is very important. If those communications haven't occurred they should occur. The client should be aware of what the IRS is asking for including the effect of the question. Communication regarding the effect of the question can include some discussion about what the Service is looking at broadly with respect to a requested document or requested piece of information. Practitioner Y should make sure the client understands what generally is being looked for so that there's complete disclosure at the end of the day with respect to that question.

The third point that I think is critical here, which is the privilege that may exist between attorney and client, and that certainly has its own special considerations, which I won't take the time to go through now, but must be attended to. Gabe, I'll turn it back to you.

Colin: Just a reminder we are approaching the top of the hour.

Karen: Let me just supplement some of what Mary Beth said so that we've got the Circular covered. I would also turn your attention to section 10.28 of Circular 230. In Hypothetical D,

the client has asked for their records back because they're ticked off and they're not paying the bill. So there's this little tension between the two. Section10.28 says that if a client requests their records because the records are necessary for the clients to comply with their federal tax obligations, the practitioner must promptly return them. The practitioner can keep copies. However, if the practitioner has originals of client records, and the practitioner would interfere with the client's ability to be compliant if the records were not returned, then the practitioner would be in trouble under section 10.28 of Circular 230 if the records were not returned.

However, I would like to make a distinction for you all. When I'm talking about, and the way I interpret, section 10.28, I'm talking about a client's original records. If you've got copies of things, and you know the client has retained the originals, there is no obligation for the practitioner to give the copies to the client. You're entitled to retain the copies. The other thing that you are entitled to retain, and particularly if there's a big dispute, is your work product.

If the firm has spent time, or the individual has spent time, creating a schedule, an affidavit, or any other kind of document from the raw material that was given to them by the client, that material belongs to the practitioner and they are entitled to keep that material pending whatever negotiation they want to go through with the client to get payment for their work product. You just need to save any original client data and background material, and be able to separate that from anything that you have created. If you're in that situation, you might want to take a closer look at section 10.28 of Circular 230.

With respect to section 10.20 of Circular 230, which relates to information that must be furnished to the IRS, there is an expectation that the practitioner, who is, of course, working under a power of attorney, will make an inquiry of the client about the whereabouts of the material and information that's being requested by the Internal Revenue Service.

If the client doesn't know where the requested records or information are, and the practitioner doesn't know where they are either, they must promptly advise the Internal Revenue Service of that. If they think certain material is privileged, they must present a privilege log which makes it clear why they think the material is privileged, and it needs to be a reasonable good faith interpretation if they think it is privileged. As long as that is done, I think you also stay on the right side of section 10.20 of Circular 230. I think I have probably hit the hour. I also think we agreed that the last Mohican standing was going to thank the audience for listening.

We hope that we have shed some light and not caused any more confusion than you may have had before you listened to this program about how some of your duties and obligations interact with the expectations of Circular 230 as regards your clients and the Internal Revenue Service. With that, I guess we all say goodbye.