Transcript for Ethics Phone Forum for Employee Plans Practitioners

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PRESENTATION

Moderator: Ladies and gentlemen, thank you for standing by and welcome to our Ethics Phone Forum for Employee Plans Practitioners. At this time, all participants are in a listen-only mode. As a reminder, today's conference is being recorded. I would now like to turn the conference over to your host, Mr. Mark O'Donnell. Please go ahead, sir.

M. O'Donnell: Hi, everyone. I'm Mark O'Donnell, Director of Customer Education and Outreach for IRS Employee Plans. Welcome to our Ethics Phone Forum for Employee Plans Practitioners. Today we are fortunate to be hearing from Karen Hawkins, the Director of the Office of Professional Responsibility here at the IRS, and Gabe Minc, a Senior Tax Law Specialist in Employee Plans. Thank you both for speaking to us today.

Note that there is a PowerPoint slide presentation for this phone forum. You should've received a link to this PowerPoint presentation in a reminder e-mail for this phone forum. In any case, you can find it up on our website. Go to www.irs.gov/et if you don't otherwise have the link. It's halfway down the page; a link to Retirement Plans Phone Forums and look for The Ethics Phone Forum Handout.

Before we start, I'd like to point out a couple of things. Everyone registered for this phone forum will receive a certificate of completion by e-mail approximately a week after the phone forum. You must attend the entire live phone forum to receive a certificate. Enrolled agents, enrolled retirement plan agents, and enrolled actuaries are entitled to continuing professional education credit for this session. Other types of tax professionals should consult their licensing organization to see if this session qualifies for continuing professional or educational …. IRS Employee Plans has an array of information regarding retirement plans. Visit our website at irs.gov/et. You can also get there by going to the main IRS web page and clicking on the "retirement plans community" tab along the upper right side.

While visiting our website you might want to subscribe to our free electronic newsletters. The link for the newsletters is on the left-hand navigation bar of our main landing page. We have two newsletters. *The Retirement News for Employers* newsletter, that's for employers sponsoring retirement plans, and *The Employee Plans News for Retirement Plan Professionals.*

So without further ado here are Karen Hawkins and Gabe Minc.

K. Hawkins: Thanks very much, Mark. This is Karen, and I have the pleasure of getting us all started by giving you a bit of an overview of the history of Circular 230, a little bit about OPR, and a little bit about some of the new provisions that will be in place starting next Tuesday. So we're getting very close to all the revisions to Circular 230 becoming operative.

After I finish with my overview, Gabe is going to give you a little more of an overview of some of the Title 26 issues that impact practitioners in this arena, and then we've got a couple of short hypothetical discussions to have where we can try and apply some of what we've talked about.

I would also mention that towards the back of the PowerPoint, if you're looking at it, there is a rundown of a half a dozen or so of what I consider to be the key provisions of Circular 230, most of which will be applicable at some point during our conversation of the hypo.

So with that sort of brief overview of where we're going to start, let me start out by just talking a little bit about Circular 230. It's often a surprise when people hear me give them the history, because most people don't realize that Circular 230 is as old as it is, and even of greater relevance than age, is the enabling statute for Circular 230. The statue is actually found in Title 31 of the U.S. Code, not Title 26. Title 26 being what we all know as the Internal Revenue Code. Title 31 are the general treasury regulations and that's really where the statute is.

It's a very simple statute. It essentially says that The Treasury may regulate the representation of individuals of other persons before The Treasury Department. And the reason that it says Treasury Department instead of Internal Revenue Service is that this statue dates all the way back to 1884, and there was no Internal Revenue Service then, nor was there an Internal Revenue Code. This is immediately following the Civil War, and that's when it was finally enacted as part of something called the Horse Act.

It was in 1886 that the first set of regulations came out with respect to the statue, but it wasn't until 1921 that the regulations were combined together in a small booklet, in pamphlet form, and actually numbered a Treasury Circular No. 230. So that's kind of where the numbering comes from. It was presumably the 230th such pamphlet that Treasury had put together.

So if you notice the date and if you're good at math, which many of you probably are, you'll note that Circular 230 is 90 years old in 2011. So we actually threw it a little birthday party in February to say happy birthday to Circular 230.

The pamphlet itself is a multipart pamphlet, but I would say that the four most important sections for practitioners to pay attention to involve subparts A, B, C, and D.

A being the part that talks about the authority to practice, who may practice, and how that is all defined. And I'm going to talk about that in a little more detail later.

Subpart B is, from my point of view as the Director here, probably the most important section of Circular 230 to because it really describes, in mostly a fairly detailed way, the duties and restrictions that relate to practice before the Internal Revenue Service.

Subpart C is the shortest piece of Circular 230, and it talks about the available sanctions. Essentially what choices, if you will, I have as Director to sanction someone who has violated Circular 20, and I'll talk about those a little bit later as well.

And subpart D is the procedural section that really explains how the entire disciplinary process functions, how it moves through the system, who's involved, what the timing is, and that sort of thing.

One of the things that I like to point out to people; everybody refers to Circular 230 as the ethical rules of practicing before the Internal Revenue Service, but I tend to look at it a little more broadly than that. I see Circular 230 more as a hybrid document. There are, of course, ethical statements in there. Statements relating to negotiating a taxpayer's refund check, avoiding conflicts of interest. Those are what I would consider to be ethical standards.

On the other hand there are a lot of other things in Circular 230: like the most recent one being an addition that will be affective as of August 2nd, the need to e-file if you prepare, at least this year, 100 or more returns. Next year it will be 10 or more returns. I don't see that as an ethical violation if someone doesn't e-file, but the Internal Revenue Service is, essentially in Circular 230, presenting you with what its "rules of engagement" are and that's how I refer to them.

This is the agency's perspective on what it needs practitioners to do, the rules that it needs practitioners to adhere to. in order to ensure the integrity of the tax system. So I'm finally—I'll call it ethics, but I do like to remind people that there are things in Circular 230 that aren't necessarily ethical constraints. It doesn't make you a bad person on a moral level if you don't do certain things in Circular 230, but it does give the agency the right to tell you that you may not practice until you improve in a particular area.

So what does it mean to practice? There's a slide on this. If you want it it's about four in. I think three or four in, and much of the slide comes right from the definition that's contained in the Circular. Practice is essentially all matters that are connected with a presentation to the Internal Revenue Service that relate to a taxpayers rights, privileges, or liabilities under laws or regulations administered by the Internal Revenue Service. And we've bolded the "Administered by" for a reason. It's mostly to call your attention to the fact that Circular 230 has jurisdiction

over people who are practicing somewhat outside of the Internal Revenue Code, but with respect to matters that are still being administered by the IRS.

So from my point of view that involves things like ERISA. It involves things like Child Care Credit, First-Time Home Buyer Credit. If the healthcare process ever really gets into full play, the IRS will be administering pieces of that. Foreign bank account reporting is another good example. Those are all pieces of legislation that are found elsewhere in The United States Code, but for whatever reason, mostly I think one of best competence, the Internal Revenue Service has been asked to administer them. So when people are functioning in those areas as practitioners, they would still be subject to OPRs jurisdiction.

And by way of example for what it means in a little more nitty-gritty level to practice, it's any time you prepare or file a document, any time you correspond or communicate with the IRS, any time you give written advice, and certainly every time that you represent a client at a conference, at a hearing, or in meetings you are practicing before the Internal Revenue Service.

And the other thing that we're making a little bit of a big deal about, although for this crowd it probably isn't as important, is that until the second of August the preparation of income tax returns or tax returns generally has not been considered to be practice. After next Tuesday for all purposes the preparation of tax returns will be treated as practice and anybody who does that for compensation is subject to Circular 230 and OPRs jurisdiction.

So who is it that can practice? Well there's a fairly long list comprised of attorneys, certified public accountants, and then we have the enrolled groups, some of which you're probably familiar with, enrolled agents, enrolled actuaries, and enrolled retirement plan agents. And starting towards the end of this year, we will have registered tax return preparers.

I'm not going to spend a lot of time talking about what's been going on in that area. I think you all have probably read everything about PTINs being issued and if you have to prepare a return or you do prepare returns for compensation you have to get a PTIN. There are some exceptions to that. Most notably the entire ERPA group has been excluded from that, but most people will have to get PTINs.

They will also have to test sometime between September of 2010 when we started issuing PTINs and December of 2013. People who are not otherwise the types that I named, attorneys, CPAs, and the enrolled types, will have to take a test, and once they pass that test and they have their PTINs they will be called Registered Return Preparers. At the moment we're expecting about a half a million new people who will be called Registered Return Preparers.

So there are a couple of sections that I wanted to bring to your attention and one of them flows from this discussion of practice, and that has to do with a brand new provision that was added in 10.8. It happens to be subparagraph C, and it's essentially a provision that encompasses individuals who prepare or assist in preparing all or a substantial portion of a document that pertains to a taxpayer's liabilities that are then intended to be submitted to the Internal Revenue Service. So the key words are, "All or a substantial portion of a document pertaining to a taxpayers liabilities intended for submission to the Internal Revenue Service." Those people, whether they have a license to practice as an attorney or CPA, whether they are enrolled or whether they have a PTIN is irrelevant. This will encompass people who have no other status, if you will, with the Internal Revenue Service. They will be subject to subpart D, which I just mentioned to you as the duties and restrictions of practitioners, and subpart C, which are the sanctions that can be imposed.

So there are a number of people who are going to fall into this category either because we have excluded them from getting PTINs or because they are the kind of people who don't necessarily have anything to do with tax returns at all. The most obvious one that comes to mind for us here are the people who do tax debt resolution service, many of whom are often not eligible to practice otherwise before the IRS. So that's a very broad reaching provision that is just becoming affective on the second of August.

The second one that I wanted to mention to you, because I think it's probably even more relevant to you all, is there has been a new addition to 10.36 of Circular 230, and it's 10.36(b). Those of you who are familiar with 10.36(a) know that it was placed in Circular 230 at the same time as the covered opinion rules of 10.35 were placed.

10.36(b) essentially is a provision that says that if you have a firm or some kind of business with employees, and you have the primary responsibility for the tax preparation process and procedures in your office, you may incur personal liability under Circular 230 if you fail to ensure that the people who are preparing the returns and who are advising clients and working with clients—you have to ensure that they are adhering to Circular 230.

You have to have procedures in place. It doesn't say written procedures, but I will say just as an aside that that's probably the best way to keep track of them, and you must ensure that everybody knows what those procedures are and that everyone is following them. This is true already for covered opinions. It will become true for tax returns and other documents as of August 2nd.

If you discover, as the principal person or primarily responsible person, that some people in your office have not been adhering to Circular 230 or in fact have violated Circular 230, you are further obligated to take steps to ensure that they make corrections to that behavior and that it doesn't happen in the future.

So there are some serious liability issues for owners of businesses in Circular 230 at 10.36. If you're not familiar with it and you're an owner of either a business that writes opinions or a business that does tax form preparation or other kinds of document preparation that are submitted to the Internal Revenue Service, I would encourage you to read that provision.

The last piece that I will mention before I hand it over to Gabe to talk about Title 26 is what the options are for discipline. First of all what I want to mention is we always talk about discipline and it always feels a bit in terrorem for me. We have a lot of cases that come through and are referred to OPR from all areas and places, both internal and external. I would say the vast majority of those never see the light of day because we conclude that there is nothing that we should pursue, or there's no violation of Circular 230, or we don't' have any jurisdiction over the conduct.

And when we do finally identify someone who it does appear has violated Circular 230, there are a ton of due process protections and provisions in the Circular that provide for notice, opportunities to be heard, opportunities to explain yourself, opportunities to submit documentation, opportunities to have a conference here with one of the lawyers in the office, an opportunity even, if you feel strongly that we're wrong about something, to go to an administrative hearing and tell your story to an administrative judge. If you don't like the administrative law judge's decision, you also have the opportunity to appeal. So there are tremendous protections all focused on due process in Circular 230.

So when I talk about what the discipline options are these are not things that are either lightly or arbitrarily imposed on someone. It is a fairly lengthy and very thoughtful process. Although I'm sure for any practitioner involved with it it's also an anxiety provoking one.

So with that being said, I will say the available options to OPR are reprimand, which is really a private letter from me that says you didn't do this right, or you did a bad thing: it looks like it's your only transgression to date and so we just want to remind you to be mindful of the provisions in 230 and try to adhere to them.

The second option I have is a censure. That cannot be done without the practitioner's concurrence, and it's essentially a one-time public reprimand. I can also suspend or disbar someone. Suspensions can last anywhere from six months to 59 months. Disbarments are 5 five years or more. Neither of those can be imposed arbitrarily. The practitioner has to either agree to the suspension or the disbarment, or we have to have gone before an administrative law judge and/or an appeal and have the proposed suspension or disbarment upheld by those administrative decision makers.

The last disciplinary option that is available to OPR is to impose a monetary sanction. The interesting thing about the monetary sanction is that it is available to be imposed on both individuals and firms. And, I will tell you the focus here in OPR is that we would prefer to use the monetary sanction against a firm. We have plenty of other opportunities to do things with respect to individuals.

To date, we have not imposed a monetary sanction. It was only placed in Circular 230 in 2007. So we are only able to look at conduct after that date that would warrant such a sanction, and we just haven't seen anything that we think justifies taking that kind of a step. I think it will be a big step when we take it. It'll probably get a lot of attention, and I want to make sure that we do it properly and we do it in the right context so that it provides a good lesson going forward for all of us.

So those are the kinds of sanctions that are available, but none of them until, and after, and all of the due process opportunities have been afforded to the practitioners.

So on that note, I will turn it over to Gabe who is going to tell us a little bit about some of the Title 26 issues associated with the return preparer.

G. Minc: Okay, for those of you who are following along we're now on slide number nine. And what I wanted to talk about first was who is a tax return preparer for PTIN purposes. As Karen just mentioned, tax return preparers are now generally required to have a PTIN. And for purposes of the PTIN requirements, a tax return preparer is any individual who is compensated for preparing or assisting in the preparation of all or substantially all of a tax return or a claim for a refund of tax. The IRS may specify an appropriate guidance, the returns schedule and other forms that qualify as tax returns or claims for refund for purposes of the PTIN regulations.

Generally all tax returns, claims for refund, or other tax forms submitted to the IRS are considered tax returns or claims for refund unless otherwise provided by the IRS.

In applying these rules, the term tax form is interpreted broadly. In IRS notice 2011-6 certain forms were specifically exempted for the PTIN requirements. We will talk about some of the forms that are exempted from the PTIN requirements in just a minute, but first I'd like to talk about how the term, "Tax return preparer for PTIN Purposes," differs from how the term is used for tax return preparer penalty purposes.

So we're now on slide number ten, and slide number ten has to do with who is a tax return preparer for section 6694 purposes. Now section 6694 of the Internal Revenue Code imposes penalties on tax return preparers for conduct given rise to certain understatements of liability on a return or a claim for refund.

For positions other than those with respect to tax shelters and reportable transactions the section 6694 penalty is imposed on a tax return preparer for an understatement of tax liability that is due to an undisclosed position for which there is no substantial authority. A penalty may also be imposed due to do a disclosed position for which there is no reasonable basis.

For positions with respect to tax shelters or reportable transactions as defined in Internal Revenue Code section 6662. The 6694 penalty is imposed on tax return preparers for an understatement of tax liability for which it is not reasonable to believe that the position would more likely than not be sustained on it's merits. For purposes of these preparer penalties, a tax return preparer is an individual that is primarily responsible for the position of the return or a claim for refund giving rise to the understatement.

If there is a signing tax return preparer, the signing tax return preparer generally will be considered the person who is primarily responsible for all of the position on the return or claim for refund. A non-signing tax return preparer within the signing tax return preparer's firm maybe consider the tax return preparer who is primarily responsible for the position under appropriate circumstances.

So we're now on slide number 11, and these are some of the forms where PTINs are not required. IRS notice 2011-6 lists a number of forms that are not subject to the PTIN requirements, including many that are familiar to employee benefits practitioners, and these include form 5500 series returns, forms 5300 and 5307, form 5310, form 1099, form SS4, form 2848, and form 8717. There are a number of other exempted forms listed in notice 2011-6 as well.

K. Hawkins: Gabe, can I just interject here for one minute because I know that there has been some confusion, and so I guess I can give a State of the Union address here in terms of the forms 5300. Right now the only three 5300 forms that are exempt from the PTIN requirement are 5300, 07, and 10, as you mentioned a minute ago.

The IRS has received some written correspondence expressing some concerns from actuarial professional groups that there are other forms in the 5300 series that perhaps should be considered for exemption. What I can tell you is that the correspondence is being taken into account and taken very seriously. It's being looked at. Consideration is being given to the concerns being raised, and if you read the Notice 2011-6, it does reserve the right for the Internal Revenue Service to add or delete forms from the list that it has put out.

So if there is to be a change there would be a new rev. prop that would come out or a new notice that would come out that would add those forms, and I do believe at this point in time that fairly serious consideration is being given to exempting the entire section 5300 level forms, but at the moment it's only the three that Gabe mentioned.

G. Minc: Okay. Well as Karen mentioned, we have some case studies, which we hope will help show how the rules of Circular 230 are applied. We're now on slide number 12, if you're following along, and this is case study number one part one.

And in this case study you're asked to suppose that a plan sponsor wants to set up a defined benefit pension plan for the owner of a management company and provide no benefits for rank and file employees in a related company. The plan sponsor intends to disregard the related entity, and as we all know under the coverage rules, the qualified plan under section 401(a), this would be inappropriate. So the first question would be if a tax practitioner is asked to accept this engagement, who is the client?

K. Hawkins: Are you asking me that question or are you just letting people mull it over?

G. Minc: I'm letting them mulling it over but I'm really asking you specifically.

K. Hawkins: Well I think the point here is that you have got to decide who your client is, and that really isn't a Circular 230 issue except maybe down the road, but it certainly is a best practices issue. You've got to decide whether it's just the plan, whether it's the company that is funding the plan, whether it is individual owners of the plan who want things a certain way, whether it's the plan sponsor, and depending upon the decisions that you make about how many of these people, or entities, that you can represent you may have issues in terms of explaining to each of them if there happens to arise a conflict of interest, if they have a dispute about something, you're going to have to know who's side your supposed to be on right from the get go.

I think this is—and again, this is sort of off the Circular 230 issues, but it's more associated with my 30 years with a private practice. The more confusion there is about who your client is at the front end, the deeper you dig the hole for yourself going forward and almost ensuring that at the end of the day one or more of those clients is not going to be happy with you anymore. So you do have to decide right at the beginning, and for the purposes of this hypo, Gabe, I guess we're assuming the plan sponsor will be our client.

G. Minc: Yes, we're assuming the plan sponsor is the client, but that also raises a number of other issues, because we know that attorney/client relationships can be set up intentionally but they can also occur inadvertently. So if a tax practitioner is talking to a fiduciary, the fiduciary might end up believing that they are the client and there's also an issue here as to what responsibility the tax practitioner has to the participants and beneficiaries even though they might not even know that the tax practitioner is providing advice on issues relating to the plan.

Now Karen, you mentioned conflicts of interest. Do you see any potential conflicts of interest here or what rules might apply in determining whether there's a conflict of interest?

K. Hawkins: Well I don't have enough facts yet to know whether I would see one, but certainly anybody who's going into this engagement would have to think about whether there was one. And if they were making a determination that there might be, then they would want to—depending of course on if they're attorneys they've got their own state bar rules in all instances that are going to say something to them about what they're supposed to do about conflicts of interests in the legal arena. And from my point of view in almost every instance that I can think of State Bar Rules are going to trump anything that Circular 230 has as an expectation. But for those of you who are not attorneys section 10.29 of Circular 230 contains the rules with respect to conflicts of interest, and I think we've got that in the materials. Gabe, none of the pages are numbered so you can probably—

G. Minc: They're actually in order of their number.

K. Hawkins: They're about five more pages in, but I can very quickly just tell you that under Circular 230, if that's your governing instrument for dealing with conflicts, you, being the practitioner, have to make a determination as to whether your commitments and your loyalty to one client are going to be materially impacted by your commitments and responsibilities to a second client.

Have I been lost?

G. Minc: No, I can still hear you.

K. Hawkins: Oh, okay. Somebody just cut in on my phone and said something so I thought maybe I had been dropped and I didn't want to talk away here and not know that. So you do have to. at that point in time, if you determine that there is a likelihood that a conflict could arise, you have to provide the client with informed consent, which means a careful explanation of what the nature of the conflict would be and what might result from the nature of that conflict, and then you have to get the client to sign a waiver allowing you to continue—each client—allowing you to continue to represent them both in that particular matter.

G. Minc: Right. In connection with the waiver, presumably the person has to sincerely believe that they can do the representation without a material limitation or without direct adversity, or at least—

K. Hawkins: It has to be the practitioner's judgment call. That is not something—too many practitioners, I think, make the mistake that what it means to get a client waiver is to sit there in the office and say, "So going on down the road we might have a conflict so I need to have you waive it right now," and you stick something in front of them that says, "I'm waiving the conflict." That is not informed consent. That is not the practitioner's subjective determination that they can continue in the representation, and it certainly isn't a fully enough explained potential for conflict that the client really knows that they're signing away or waiving.

But it is the practitioner who has to make the ultimate determination that they can continue to represent both, or more than two depending upon what the situation is, clients without being impacted in their representations of one or the other.

G. Minc: Okay. Well, Karen, I know this fact pattern is pretty open ended, but what would you say are the duties of the practitioner to the plan sponsor in this fact pattern under Circular 230?

K. Hawkins: Well I guess I would phrase it a little differently. I'm looking at our, I guess the second page of our hypo that says, "The plan sponsor wants you to participate in setting up the plan," and what do I see as the issues that you're going to have to be concerned about? And I guess being the "cop" on the phone, I look at it in terms of how many violations can you commit by participating and doing what this plan sponsor has just asked you to do?

So the first thing that you have an absolute duty and obligation to this plan sponsor to provide them with a correct and accurate and complete discussion of what the law is. Even though you may suspect that they're planning on skirting it anyway, you have an obligation to make sure that you correctly tell them what the rules of the game are, and you have an obligation to tell them where they might be exposing themselves, vis-a-vis the Internal Revenue Service, and ways that perhaps they might not want to do. And your obligation about ensuring the correctness of your statements to your client is found at 10.22 of Circular 230.

You also have an obligation to avoid, you personally, to avoid providing false or misleading information or assisting or participating in the providing of false or misleading information to The Treasury Department. That's a direct violation of Circular 230, and that's found at 10.51(a)(4).

You also have to be concerned about the prohibition in Circular 230 about assisting or encouraging a violation of Federal Tax Law, or an illegal plan to evade tax. That's at 10.57(a)(7). I would think that would come into play when you're considering whether you want to do this "favor" for your client or not.

If you're asked for an oral opinion or I guess comfort, if that's what the plan sponsor wanted from me, and that it's okay to do, orally you could possibly be violating 10.51(a)(13) that affectively requires that you ensure yourself that you know all of the facts and all of the appropriate laws and that you not ignore any relevant fact when you are giving advice.

If it's a written opinion that he's seeking, you would have to worry about 10.37, which again requires that you know all of your facts and all of the appropriate law and you reach the proper conclusion based on the application of the facts to the law.

10.34(b) would come into play. That section essentially is the obligations of the practitioner relating to submission to The Internal Revenue Service. So you may not advise or participate in making submissions that contain frivolous positions or that are done with the intention to disregard rules and regulations.

You also, I think, would have an obligation under 10.34(c), which essentially is if you are advising a position or you are signing a document that contains a position that is less than black and white- maybe you thought of some argument why this plan sponsor can get away with what they want to do- you must advise on the potential for penalty, and you must advise on the opportunity, if there is one, to avoid the penalties by making a disclosure in the appropriate way depending upon what kind of form you're talking about. So kind of off the top of my head, those are all of the ways that a practitioner could get themselves sideways with OPR by assisting this plan sponsor and going forward with what he wants to do.

G. Minc: Okay. And I supposed that would include let's say the plan sponsor. All the plan sponsor really wants the tax practitioner to do is prepare the plan documents and not do anything else. Do you still feel that all of those … would be implicated or do you think that that's something the practitioner could do without getting too sideways with OPR?

K. Hawkins: Well my first disclaimer is I'm not—in my private practice, I was never a benefits person, and so I don't know the nuances or the subtleties about where you can draw the lines. I do know that many of these plan documents contain a lot of very proforma language that on its own conceivably could be written in such a way that would not suggest to anybody that the underlying administration of the plan ended up discriminating against this other entity's employees.

So if the only thing that the practitioner is doing is blindly drafting a plan that someone else is going to implement and oversee and so they've just been in many respects a mere scrivener , I would say it's highly unlikely that there would be anything in Circular 230 that would arise as long as there is nothing in the plan that attempts to condone what the plan sponsor has asked too, which I understand to be a violation of the provision. And there is no other involvement by the practitioner. I question whether it's good business practice for a practitioner to conduct themselves that way, but that would be outside the scope of Circular 230.

G. Minc: Okay. Well let's move to part three of the case study. For those of you following along it's slide number 14. And in slide number 14, the plan sponsor asks for advice regarding the administration of the plan in a manner that does not take the existence of the employees of the related company into account. And the question I have with respect to that part of the case study is are any of the communications between the plan sponsor and the practitioner privileged? And I'll actually attempt, at least initially, to answer that.

Section 7525 of the Internal Revenue Code provides that, with respect to tax advice, the same common law protections of confidentially that apply to a communication between a taxpayer and an attorney will also apply to a communication between a taxpayer and any Federally authorized tax practitioner. However, this privilege applies to a communication between a tax practitioner and his or her client only to the extent that communication would be considered privileged if it were between a taxpayer and an attorney.

There are lots of limitation and exceptions to this section 7525 privilege. For example, the section 7525 privilege applies only to non-criminal tax cases brought before the IRS or in Federal Court by or against the United States. The privilege only applies to tax advice; therefore it does not apply to business advice, accounting advice, or tax preparation advice. The section 7525 privilege also does not apply to communications regarding tax shelters or communications in furtherance of a crime or fraud. Under a fiduciary exception to the privilege, many courts have held that the privilege does not protect communications between council and a party being advised in a fiduciary capacity regarding planned administration from being disclosed to plan beneficiaries.

In addition, the section 7525 privilege may be inadvertently waived such as if purported confidential information is disclosed to non-client third parties by the client or by the attorney acting on behalf of the client. So there's a good chance that these communications regarding the plan administration will not be privileged under IRC Section 7525, and probably not under the other ethical codes that will apply.

K. Hawkins: Yes, I would just add to that this sort of an arrangement it's highly likely—you think immediately that the criminal investigation it's highly unlikely that something like this is going to catch the attention of the Criminal Investigation Division of the Internal Revenue Service, but the reference to the crime/fraud exception to privilege, which is a doctrine that is deeply buried in the law of every state, doesn't require something rising to the level of a crime to qualify. That's why it's really the crime/fraud exception.

And if you recall, I recited a number of provisions from the competence and disreputable conduct section of Circular 230, which is 10.51, that all address some layers of fraud, false and misleading information being provided to The Treasury is technically fraudulent conduct. Assisting and encouraging violations of Federal Tax Law or advising an illegal plan to evade tax are all degrees of fraud. Providing a false opinion is a degree of fraud.

So there are ways of identifying fraud that will essentially break the attorney/client privilege relatively simply, and I think most lawyers who practice in areas where there may be an issue, know pretty well by now it's almost been obliterated to the point of being non-existent. I think it'd be quite dangerous to ever rely on a privilege to protect your communications with any of your tax clients almost for any purpose.

G. Minc: Okay, well let's move on to part four of our case study. That would be slide number 15. And in slide number 15, the plan sponsor also wants the tax practitioner's assistance in asserting the plan as qualified under section 401(a) of the code. So that would now presumably involve filing of form 5300 for a determination letter or action to that affect.

So assuming that's what's required, do you think the plan sponsor can submit documents to the IRS that omit critical information, for example that the employee of this related entity are being omitted from the coverage testing that required under section 401(a)?

K. Hawkins: Well I think the plan sponsor can try and get away with anything the plan sponsor wants to get away with, but the practitioner better not be involved because in all instances I would certainly hope that my colleagues over at TEGE would be sending that practitioner's name over to me pretty quick.

And again, I've pretty much given you the litany. Here I would immediately look to 10.51(a)(4), which is assisting and providing false and misleading information to The Treasury Department, and 10.51(a)(7), which is either assisting or encouraging the violation of Federal Tax Law or an illegal plan to evade tax. The practitioner's assistance with making these assertions, and I'm assuming for this purpose that we know what's being done is not correct.

If there's gray area, then certainly a practitioner's always permitted to argue the gray area and to make their point. But if we're just going in there and obfuscating, trying to distract the IRS's attention from the real issues to get the plan approved, and we know that there's a problem, then I would say that the 10.51(a)(4) and,(7) are going to kick in and as soon as TEGE gets through disqualifying the plan and the plan sponsor, I would hope they'd send that practitioner's name over to OPR so that we could do our work.

G. Minc: Okay. Let's try case study number two now. That's slide number 16, and we're going to do case study number two, part one, and bear with me, this part of the fact pattern's a little longer.

In this part of the fact pattern a plan sponsor comes to the tax practitioner after another advisor has already set up a defined benefit pension plan for the owner of a management company, and in setting up the plan the prior adviser disregarded a related entity in a way that's inappropriate under section 401(a) of the code, and the plan provides no benefits for rank and file employees of the related company.

If the plan has already requested and received a favorable determination letter; in other words, all the submissions have already been made to the IRS regarding whether the plan is qualified under section 401(a) or not. And then under this fact pattern, Karen, would your answer to who is the client be any different as to the last fact pattern?

K. Hawkins: I think that you still have to ask yourself the same question. Whether you conclude that it's just going to be the plan sponsor or not is probably part of the conversation that you have with the plan sponsor, but anytime, for me, a new client comes in and there's potentially more than one thing associated with it, the fiduciary, the plan sponsor, the beneficiaries, I think you have to go through the exercise of determining who your client is in order to then give the right kind of advice only to that client.

G. Minc: And then presumably the same conflict of interest potentials exist.

K. Hawkins: Exactly. Yes.

G. Minc: So what about the duties that the tax practitioners owe to the plan sponsor? Is there anything about this fact pattern that's different from the earlier fact pattern?

K. Hawkins: Well sure. You've got a practitioner. You're the practitioner. You haven't had any other additional information. You didn't have the sponsor coming and asking you essentially to be complicit in what they were doing. You're only seeing it after the fact, and I will mention that we did have a question that came in that anticipated this fact pattern. So hopefully we can respond to most of those questions as we talk through it.

In this particular instance, you've noticed all of these things after the fact. So you're first responsibility, if you look at Circular 230, is really identified under 10.21 of Circular 230. And even though it's titled, "Knowledge of Client's Omission," what it really says is that if you've been retained by someone with respect to an IRS matter and you know that the client hasn't complied with revenue laws, not that they just made an omission, but they haven't complied with the revenue laws or they've made an error in or an omission from any return document affidavit or other paper that the client has submitted to the Internal Revenue Service, you're obligation, as sort of the new person on the scene, is to advise the client promptly of that non-compliance, that error, that omission, and advise the client of the consequences, as they would occur under the Internal Revenue Code or its regulations, of that non-compliance, error or omission.

So the way I usually describe that is once you know that a mistake has been made in some fashion, deliberately or not, your only obligation as the new practitioner is to advise the taxpayer as to what the consequences are if they fix it or if they don't fix it. So you really have to cover both sides of the fence. In some instances fixing it is more painful than not fixing it, at least some advisors believe that.

So that would be your obligation. You do not have an obligation to force the fixing. You do not have an obligation to report the mistake or the error to anybody in the Internal Revenue Service, and you probably have an obligation to yourself to decide where your lines are going to be drawn. Can you in good conscience continue to represent this client if they say, "No, I'm not going to fix it?"

G. Minc: Okay. So that takes us to part number two of case study number two. That's slide number 17. And in slide number 17, the plan sponsor asks the practitioner to make relatively routine amendments to the plan to reflect changes in the applicable law and not having anything to do with the omitted related company and so on. These are just sort of some other part of the applicable law has changed.

Under those circumstances, if the plan sponsor insists on going forward without taking the employees of the related company into account, can the practitioner prepare these relatively routine plan amendments without violating any of the standards of practice under Circular 230?

K. Hawkins: Yes, this is kind of an interesting one because it's sort of like saying a client comes to you and they've been using the wrong basis for depreciation for years and years, and they just want you to prepare this year's return, and just take into account everything that's on the prior year's return without fixing anything. I think this gets a little dicey.

First of all you've still got the 10.21 obligation. You've got to tell them that they have, essentially had—there's been an error of some sort made in connection with the Internal Revenue laws that they should really fix and here's what's going to happen if they don't. But I query, and I guess it would depend on how many amendments we're talking about. You've tried to box me in by calling them relatively routine, but I'd still want to look at them when I saw them.

Do you suddenly become the owner of that document if you make too many amendments to it so that it starts to look more like your drafting than someone else's drafting? Does it matter whether you make only one amendment, or multiple amendments, to be its drafting owner? I don't know that there are any legal decisions I can point to that would say one way or the other, but that certainly is where I, as the Director, would focus if someone from TEGE chose to refer that practitioner in here. And at that point it would be, what did you know, and at what point in time, and is the fact that you agreed to do the amendment at all encouraging the client to continue to perpetuate their fraudulent conduct on the service with, now, your assistance?

It's not as clear-cut and black and white, I think, as some of the other things we've talked about. And again, I think some of the best practices considerations would be: does somebody who really wants to be in legitimate practice want to put themselves in this particular exposure part for just one client?

G. Minc: Well, Karen, we have a few minutes left. I was wondering if you would be willing to comment on what kinds of interactions or relationships OPR has with other agencies like Criminal Investigation, The Department of Labor, or even The Operating Functions at the IRS. I mean how does OPR interact with the rest of government, basically?

K. Hawkins: Well as you might imagine, because you haven't seen us out there with our little uniforms on, we aren't "cops on the street. " We don't go out and beat the bushes. We don't go out and deliberately look for errant practitioner behavior. We are dependant on those who are interacting on a more regular basis with practitioners to tell us what they're seeing. So as you can probably guess, the largest source of referrals for us is the field personnel, the people who are in examination, the people who are in collection, the people who are in appeals; are the folks that would see the practitioner behavior that would bring to mind provisions and 230s that might be being violated.

We have a very close working relationship with The Criminal Investigation Division and with The Treasury Inspector General for Tax Administration, that's TIGTA, because when they pursue, in a criminal context, an individual who happens to also be a practitioner in conjunction with whatever they've done. When those cases are closed, whether they are closed through ultimate prosecution and conviction or whether they are dropped for lack of sufficient amounts evidence, all of those cases are referred over to OPR to take a look at whether there are Circular 230 violations and if there are whether they rise to the level determining that the practitioner's fitness is being called into question so that maybe they shouldn't continue to practice in quite the way that they have been.

More recently, we have become fairly heavily involved with The Department of Justice, particularly the civil injunctions area. They're the ones who are enjoining practitioners now who are not under OPR's jurisdiction, the unlicensed preparers, who get themselves sideways with the law, unfortunately too often, and we're sort of teaching DOJ what to look for as we go forward with this new group of tax return preparers that we're going to be registering.

We have been working with The Federal Trade Commission, and at least a couple of the state's attorney general's offices on tax/debt resolution issues. We assisted the FTC in a fairly major injunctive action that they brought in Southern California against what is essentially known as an offer and compromise mill. We provided some assistance to the California Attorney General recently in a fairly high profile action against a nation-wide advertiser for tax controversy services. And we assisted The Texas Attorney General in their actions against another tax debt resolution company.

So it's sort of interesting. OPR is kind of out there in little quiet ways that you don't see necessarily in the papers just trying to assist other agencies in their understandings of the machinations of the Internal Revenue Code, and some of the ways that practitioners can get themselves sideways with the agency's "rules of engagement".

So that's probably all I should say because my watch says that we're right absolutely down to the wire.

G. Minc: Yes, I agree. I think we're all out of time. I really just want to thank you so much for spending all this time with us.

K. Hawkins: It's my pleasure. I hope that the audience learned something from all of this, and that they go away wiser and less apt to violate—as I like to say when I'm in live speaking situations, I'd be delighted to meet you some time at a cocktail party, but I hope you never have to come in to my office.

G. Minc: Well thank you very much, Karen.

K. Hawkins: You're welcome.

Moderator: And that does conclude our conference for today. Thank you for your participation and for using AT&T TeleConference service. You may now disconnect.