

NEWS ANALYSIS

Circular 230 and Due Process

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The IRS Office of Professional Responsibility is trying to increase its visibility to tax practitioners while exercising its administrative authority to impose sanctions.

The office's long-established power to police ethical misconduct among those who practice before Treasury and the IRS has increased with the latter's efforts to regulate previously unregistered tax return preparers. Recent amendments to Circular 230 have created an opportunity to more clearly define the role of OPR and the rules applicable to its disciplinary actions.

OPR Director Karen Hawkins has frequently expressed her commitment to ensuring that her office provides due process to practitioners who might be under investigation or subject to sanctions. But practitioners are concerned about some of OPR's past actions on due process matters and wonder whether the IRS as a whole is as committed to due process as OPR. (For prior coverage, see *Tax Notes*, Jan. 30, 2012, p. 532, *Doc 2012-1437*, or *2012 TNT 16-7*.)

Focus on due process has arisen in part because of the growing recognition of the importance of administrative law concepts to the tax system. Courts have recently begun making it clear that tax is just another part of administrative law subject to the legal principles governing that area, such as the Administrative Procedure Act (APA).

"As long as I am director, I will continue to insist on appropriate levels of transparency and due process in the administration of the disciplinary provisions of Circular 230," Hawkins told Tax Analysts. "I am very conscious of the role played by the APA in Circular 230 cases."

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The Supreme Court's analysis in *Mayo* "has made it very clear that a federal agency has substantial authority to define the parameters for those who practice before it," Hawkins said. Circular 230 represents the rules of engagement for those who make their living practicing before Treasury and the IRS, she said, but while the agency must ensure that its

actions are not arbitrary, capricious, or contrary to law, the APA itself doesn't require all the litigation safeguards found in the federal rules of procedure and evidence for matters in federal courts. (For *Mayo Foundation for Medical Education and Research v. United States*, 131 S. Ct. 704 (2011), see *Doc 2011-609* or *2011 TNT 8-10*.)

Oddly enough, the term "due process" does not appear in Circular 230, although specific components of traditional due process are provided for in subpart D. One can assume that the general procedural considerations for due process claims applicable in APA cases are ultimately controlling.

Banister

How much due process is sufficient in a Circular 230 disciplinary hearing? Joseph Banister, a CPA who was disbarred by an administrative law judge adjudicating an OPR complaint (in a decision that was later upheld by the appellate authority and a federal district court), is now arguing to the Ninth Circuit that a hearing consistent with the APA requires sufficient notice, adequate discovery, and presentation of evidence. The district court in the case was unpersuaded, holding that disbarment proceedings do not require a "full hearing on the merits" and that the APA has "no specific provisions for pretrial discovery for administrative proceedings." (For the district court order, see *Doc 2012-8979*.)

Banister may not seem particularly deserving of sympathy given that some of the conduct involved in the complaint was his advice to clients using tax protester arguments. OPR alleged that Banister prepared clearly frivolous federal tax returns, failed to exercise due diligence by taking positions with no factual or legal basis, and engaged in disreputable conduct by providing knowingly false opinions. An ALJ granted OPR's motion for summary judgment. (For the appellate authority's decision in *Director, OPR v. Joseph R. Banister*, No. 2003-02 (2004), see *Doc 2008-21403* or *2008 TNT 195-20*.)

Banister's arguments to the Ninth Circuit for overturning his disbarment focus on the perceived lack of due process in the case. He claims the disbarment was arbitrary and capricious because the ALJ denied his attempts to engage in discovery, provide evidence at the hearing, and to testify on his own behalf. (For Banister's opening brief, see *Doc 2011-24615* or *2011 TNT 227-9*. For the government's brief, see *Doc 2011-24616* or *2011 TNT 227-7*. For Banister's reply brief, see *Doc 2011-24574* or *2011 TNT 227-8*.)

Allegations like those at issue in *Banister* are unlikely to arise in the future. *Banister* was based on a complaint filed by a previous OPR director nearly a decade ago, but Hawkins has been diligent in

stressing the need for affording practitioners proper due process in any complaints or hearings initiated by OPR.

The referral to OPR in *Banister* came from a revenue agent. But Hawkins has said that OPR is now carefully scrutinizing field referrals before acting on them. (For prior coverage, see *Tax Notes*, Nov. 14, 2011, p. 804, *Doc 2011-23359*, or *2011 TNT 216-1*.)

APA Challenges

There is little case law to rely on in examining how APA requirements affect the due process rights of practitioners challenging disbarment under Circular 230. The oldest published case dates back several decades, when a district court affirmed an accountant's disbarment stemming from a criminal conviction for filing a fraudulent tax return under section 7206 (*Washburn v. Shapiro*, 409 F. Supp. 3 (S.D. Fla. 1976)). Noting that Circular 230 requires only "due notice and an opportunity for a hearing," the judge determined that a disbarment hearing need only offer "the requisites of elementary fairness — due notice and the opportunity to be heard."

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By those standards, there is little that OPR must do to comply in terms of supplying adequate notice and the chance to respond in a hearing. In *Washburn*, the court was satisfied by the OPR complaint setting out allegations it said were "certainly specific enough to inform the respondent of the nature of the charges against him." Circular 230 section 10.62 states:

A complaint must name the respondent, provide a clear and concise description of the facts and law that constitute the basis for the proceeding, and be signed by an authorized representative of the Internal Revenue Service under §10.69(a)(1). A complaint is sufficient if it fairly informs the respondent of the charges brought so that the respondent is able to prepare a defense.

The Circular 230 notice procedures were deemed sufficient by another district court when a practitioner received written notice of the alleged violations of Circular 230, was given an ALJ hearing, and

appealed the ALJ determination to the appellate authority (*Hubbard v. United States*, 496 F. Supp. 2d 194 (D.D.C. 2007)).

Another recent judicial discussion of attendant due process rights in Circular 230 hearings arose in a CPA's challenge of his suspension. Larry Legel faced an expedited suspension under Circular 230 section 10.82 as a result of his prior criminal conviction for aiding and abetting in his client's failure to pay income tax. The ALJ who heard the complaint agreed with OPR that Legel's conviction counted as evidence of disreputable conduct under Circular 230 section 10.51 and imposed a two-year suspension after conducting a factors test to analyze the severity of the misconduct. The appellate authority upheld the suspension, deeming the conviction evidence of willful blindness, but increased it to three years because of Legel's lack of remorse. (For the ALJ decision in *Acting Director, OPR v. Larry Legel, CPA*, Complaint No. 2009-16, see *Doc 2011-8270* or *2011 TNT 74-46*. For the appellate authority's decision, see *Doc 2011-8271* or *2011 TNT 74-47*. For prior coverage, see *Tax Notes*, May 9, 2011, p. 539, *Doc 2011-9561*, or *2011 TNT 87-4*.)

Legel appealed his sanction to a federal district court. The presiding judge reviewed the sanction but noted that the standard of review under the APA is a "deferential standard presum[ing] the validity of the agency action" that should ignore administrative decisions "only for substantial procedural or substantive reasons." The district court determined that the appellate authority's decision was not arbitrary, capricious, or an abuse of discretion, and that all of the hearing proceedings "conformed to the procedures and regulations outlined in Circular 230." (For *Legel v. IRS*, No. 11-60914 (S.D. Florida 2011), see *Doc 2011-24894* or *2011 TNT 230-13*.)

Evidence and Review Standards

The rules of evidence for Circular 230 disciplinary proceedings provide ALJs with a lot of latitude. Circular 230 section 10.73 states that general evidentiary rules are not controlling in an ALJ hearing, leaving it up to the ALJ to determine what will be allowed. In *Lopez v. United States*, 129 F. Supp. 2d 1284 (D.N.M. 2000), the district court affirmed that "there is no general constitutional right to discovery in an administrative proceeding." While there may be judicial concern about due process violations when "a complete denial of discovery can be shown to have caused clear prejudice," as the court said in *Lopez*, courts don't seem bothered if an ALJ doesn't provide all the discovery that a practitioner might ask for in a Circular 230 hearing.

When federal courts have discussed the burden of proof necessary to sanction a practitioner under Circular 230, the applicable standard sometimes has

been lower than practitioners would like. In *Lopez*, the court approved of the use of a preponderance of the evidence standard for Circular 230 ALJ hearings, although practitioners are certain to prefer the higher clear and convincing evidence standard given that disbarment results in the loss of occupation.

Kevin E. Thorn of the Thorn Law Group said ALJs should adopt a permissive attitude regarding evidence at a hearing. “I believe it’s good to let everything potentially relevant in, because after all, it’s someone’s license at stake,” he said. Because a tax practitioner must jump through so many hoops to get a license — whether an attorney, CPA, or enrolled agent — the process “should provide more deference to allow individuals who are the subject of a complaint to submit whatever evidence they believe could help,” he said.

The current version of Circular 230 creates an odd bifurcation, applying the stricter clear and convincing standard for a monetary penalty, disbarment, or suspension of six months or longer, while censure or a suspension of less than six months must meet only a preponderance threshold. An obvious question is why there is a distinction. A sanction of any kind can have serious consequences for a practitioner’s livelihood, so it seems imprudent to allow for a lower standard of proof in any disciplinary case.

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Thorn said he viewed the distinction in standards as minor but agreed that having a uniform standard might make sense. “Handing out a six-month sanction is not going to put anyone out of business, especially if it occurs after filing season,” he said, adding, “I’ve never seen a disciplinary case with a sanction less than six months.”

Substantively, practitioners face a high hurdle in showing that an ALJ decision imposing a Circular 230 sanction is arbitrary or capricious. The district court in *Hubbard* said that review of an ALJ determination need only articulate “an explanation establishing a ‘rational connection between the facts found and the choice made.’”

Professor Michael B. Lang of Chapman University School of Law said he had few concerns with the level of due process offered in Circular 230. “On the whole, the Circular 230 hearing process is pretty parallel to what happens in state bar disciplinary proceedings,” he said. “Practitioners are allowed to

defend themselves after being given notice of what the charges are, which really is the essence of due process.”

Administrative hearings are meant to be more informal, Lang said, noting that complex, strictly applied rules of evidence and procedures for discovery would be problematic in the long run, reducing the discretion of both the OPR director and ALJs and causing delays. “The process works best when good people are making the decision and able to exercise sound judgment,” he said. Although some practitioners may fear arbitrariness in how sanctions are applied, “I see more consistency now that the appellate authorities have been around long enough to guide the ALJs on various issues” such as willfulness and statutes of limitations, he said.

“I don’t see due process as a real looming issue under Circular 230, because it doesn’t seem to be a problem,” Lang said. “You have to show either that there is a serious risk of harm from the process or that someone has been harmed, and I think that’s missing here.”

One advisory group has recommended the IRS produce a publication for tax practitioners that “describes in reasonable detail the practitioner’s due process and appeal rights, as well as potential sanctions if the practitioner is ultimately found to have violated Circular 230.” In its 2011 public report, the Internal Revenue Service Advisory Council said that the IRS provides a similar explanation of the rights available to taxpayers in the administrative process. A document outlining the OPR process for practitioners, “including the right to notice, time periods for responding to allegations, the right to representation, the right to submit evidence relevant to the proceeding, administrative hearings, administrative appeals, appeal rights to U.S. District Court, and the potential sanctions if the practitioner is ultimately found to have violated Circular 230,” would clarify applicable due process rights, the council said. (For the report, see *Doc 2011-23766* or *2011 TNT 219-76*.)

Michael J. Desmond of the Law Offices of Michael J. Desmond said the risk to a practitioner’s livelihood and reputation requires having “a robust system in place for practitioner involvement in, and independent review of, Circular 230 disciplinary proceedings.” With the increased transparency of final decisions under recent revisions to Circular 230 section 10.72(d) and new — and largely untested — provisions under section 10.36 that can result in liability for supervisors, the procedural aspects of the disciplinary process are more important than ever, he said. And the need for strong procedural rules will only become greater as OPR focuses on increasingly complex cases involving,

for example, opinion writing practices, in which the issues may be far more nuanced than they were in many of the recently publicized OPR disciplinary cases, he said.

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Desmond said that while Circular 230 may not use the phrase "due process," subpart D contains a fairly comprehensive set of procedural rules designed to ensure that the practitioner's rights are taken into consideration. "An ALJ has considerable discretion in how a hearing is conducted, including the evidence allowed in," he said. Although that discretion suggests the possibility of a practitioner being unable to offer all the evidence he would like to, "I don't think that is so unusual under administrative law," he said.

With the current rules more focused on flexibility, it is "incumbent upon practitioners to make their record" in a hearing for future appeals, Desmond said. OPR should encourage ALJs to let more evidence in, he said, adding that that would increase the likelihood of an ALJ determination being sustained on appeal.

Perception of Independence

Also included in the notion of proper due process is OPR's independence from the IRS. Tax practitioners objected when the proposed Circular 230 rules removed references to OPR as the sole initiator and overseer of disciplinary complaints. That concern went unaddressed in finalizing the rules, but practitioners continued to warn the IRS that disciplinary authority should not be shifted to the new Return Preparer Office or any other office within the Service. (For prior coverage, see *Tax Notes*, June 13, 2011, p. 1133, *Doc 2011-12291*, or *2011 TNT 110-3*.)

The general perception of fairness of Circular 230 is an important consideration. Despite specific provisions for the rights practitioners have in contesting an allegation of misconduct under Circular 230, the continued placement of OPR as an independent agency with reporting duties to the IRS commissioner raises concerns. The delegation of appellate authority in Circular 230 matters to the IRS chief counsel, who has traditionally re-delegated the role to a chief counsel employee, seems to create tension between regulating the practice of individuals before the IRS and acting as part of the tax system

administrative function committed to revenue integrity. As a result, "practitioners have been concerned historically with the perception of fairness in certain aspects of [disciplinary] proceedings," Desmond said.

The district court in *Legel* showed no concern about the appellate authority having divided loyalties given his status as an IRS employee in addition to his part-time work hearing appeals of ALJ determinations. "Nothing in the Decision on Appeal demonstrates that the appellate authority was anything other than fair and impartial," the court wrote.

Although discussions about establishing a special group of ALJs within Treasury to hear OPR cases have never borne fruit, the idea deserves serious consideration. OPR subcontracts with other federal agencies that have their own ALJs, including the Department of the Interior, the Environmental Protection Agency, and the Coast Guard.

One of the most frequent arguments against Treasury having its own ALJs is the lack of need for them because of the small number of Circular 230 complaints that proceed to a formal hearing stage. But that should not impede Treasury from pursuing the option. Even if the current caseload doesn't merit hiring a full-time ALJ, creating a part-time or contractual position would strongly enforce the notion that a disciplinary hearing is being decided by someone more sensitive to the difficulty and nuances of tax practice, rather than, say, an environmental or labor specialist.

"I've always supported the idea of Treasury having its own ALJs to hear OPR cases," said Thorn, arguing that "practitioners would feel the process is more fair."

Hawkins said that what makes the IRS unique as an agency is its licensing of individuals, other than attorneys and CPAs, to represent taxpayers in matters administered by the IRS. While attorneys and accountants can continue to perform legal and accounting services outside their relationship with Treasury, most enrolled and registered individuals must remain in good standing under Circular 230 in order to earn a living, she said. "That makes the due process protections contained in Circular 230 particularly important to these professionals. The staff in OPR is very aware of, and sensitive to, the authority they have," she said. ■