Tax Notes Today

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HEADLINE: #1 2015 TNT 111-1 DOES THE IRS HAVE THE POWER TO REGULATE PREPARERS?. (Section 7206 -- Fraud and False Statements) (Release Date: JUNE 09, 2015) (Doc 2015-13519)

CODE: *Section 7206* -- Fraud and False Statements;
Section 7207 -- Fraudulent Returns and Documents;
Section 7212 -- Interfering With Tax Administration;
Section 7213 -- Unauthorized Disclosure;
Section 7216 -- Data Disclosure by Preparers;
Section 7407 -- Return Preparer Injunctions;
Section 7427 -- Preparer Understatement/Burden of Proof;
Section 6694 -- Understatement by Return Preparer;
Section 6695 -- Return Preparer's Penalties

ABSTRACT: At the June 5 New York University Tax Controversy Forum, departing IRS Office of Professional Responsibility Director Karen Hawkins moderated a mock debate on whether the IRS has the legal right to regulate tax return preparers.

SUMMARY: Published by Tax Analysts(R)

At the June 5 New York University Tax Controversy Forum, departing IRS Office of Professional Responsibility Director Karen Hawkins moderated a mock debate on whether the IRS has the legal right to regulate tax return preparers.

The IRS has the power to regulate preparers that are lawyers and CPAs, although it may not impose further qualification requirements on them *(5 U.S.C. section 500).* There are tens of thousands of preparers that are not lawyers or CPAs -- a function of the United States being the only Western democracy in which the tax administrator does not prepare its own citizens' returns.

The question is whether the IRS can impose qualification requirements on these nonprofessional preparers or punish them administratively. The nonadministrative options for sanctioning preparers

are drastic, burdensome for the government, and biased toward keeping preparers in business. When a slap on the wrist will do, the IRS wouldn't be able to do it under recent court decisions.

Michael J. Desmond of the Law Offices of Michael J. Desmond argued that the IRS lacked the power to regulate preparers, while Steve R. Johnson of Florida State University College of Law argued that the IRS should be allowed to continue to do so as a matter of public policy.

Recent court decisions have called the IRS power to promulgate preparer rules into question. In *Loving v. IRS, 742 F.3d 1013 (D.C. Cir. 2014),* the District of Columbia Circuit invalidated the IRS mandatory registered tax return preparer program. That program required that paid preparers register, pass an initial certification exam, pay annual fees, and complete at least 15 hours of continuing education courses each year. Recent statistics showed a 74 percent passing rate on preparer tests administered by the IRS.

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The question is whether the IRS can impose qualification requirements on these nonprofessional preparers or punish them administratively. The nonadministrative options for sanctioning preparers are drastic, burdensome for the government, and biased toward keeping preparers in business. When a slap on the wrist will do, the IRS wouldn't be able to do it under recent court decisions.

The government can always punish the worst preparers by hauling them to court. The Justice Department can criminally prosecute the most egregious cases (*sections 7206*, 7207, 7212, 7213, and 7216). The IRS can impose preparer penalties and enjoin tax return preparers who have been penal-

ized civilly or criminally or who misrepresent themselves, guarantee refunds, or engage in other fraudulent conduct that interferes with the proper administration of the tax laws (*sections 6694*, 6695, and 7407). An injunction requires a trip to district court, where the burden is on the government (*section 7427*).

When a preparer penalty is asserted, there is a mandatory referral to OPR, which examines the underlying conduct for a violation of Circular 230. OPR then sends a letter to the practitioner to discuss the problem. If the latter doesn't respond, the IRS Office of Chief Counsel prepares a complaint, and the parties go before an administrative law judge borrowed from some other agency like the Coast Guard (you read that right). The usual sanction is an 18-month suspension from practice before the IRS.

Michael J. Desmond of the Law Offices of Michael J. Desmond argued that the IRS lacked the power to regulate preparers, while Steve R. Johnson of Florida State University College of Law argued that the IRS should be allowed to continue to do so as a matter of public policy. (For Johnson's special report, see (Doc 2014-27243).)

Recent court decisions have called the IRS power to promulgate preparer rules into question. In *Loving v. IRS, 742 F.3d 1013 (D.C. Cir. 2014)* (Doc 2014-3158), the District of Columbia Circuit invalidated the IRS mandatory registered tax return preparer program. That program required that paid preparers register, pass an initial certification exam, pay annual fees, and complete at least 15 hours of continuing education courses each year. Recent statistics showed a 74 percent passing rate on preparer tests administered by the IRS. (Prior coverage (Doc 2014-20711).)

The statute at issue in *Loving* permits the IRS to regulate practice before the Treasury *(31 U.S.C. section 330*(a)). The D.C. Circuit reasoned that mere return preparation does not constitute practice before the Treasury, and tax return preparers are not representatives.

"Put simply, tax-return preparers are not agents. They do not possess legal authority to act on the taxpayer's behalf. They cannot legally bind the taxpayer by acting on the taxpayer's behalf," Judge Brett M. Kavanagh wrote. "The tax-return preparer certainly *assists* the taxpayer, but the tax-return preparer does not *represent* the taxpayer." (Emphasis in original.)

And in the court's view, the words "regulate the practice of representatives of persons before the Treasury" connote some sort of appearance on behalf of the taxpayer and advocacy. "Filing a tax return would never, in normal usage, be described as 'presenting a case,'" Kavanagh wrote, focusing on the wording of *section 330(a)(2)(D)*. Thus the IRS program was invalid because it is not expressly permitted by the statute under the newly fashionable restrictive view of agency authority (*City of Arlington v. FCC, 133 S. Ct. 1863 (2013),* and *Chevron U.S.A. Inc. v. Natural Res. Def. Council, 467 U.S. 837 (1984)).*

That means that preparers cannot be required to exercise due diligence in their preparation of returns and cannot be tested for fitness to practice, Desmond argued. He explained that lawyers, CPAs, and enrolled agents were not affected by this decision. The affected class is registered tax return preparers, like the *Loving* plaintiffs -- a category created by the IRS for the purpose of getting

a handle on paid return preparation. That thousands of mom-and-pop return preparers could be sanctioned was a factor in the D.C. Circuit's decision.

What's left for the IRS to do about preparers if *Loving* remains the law? The court didn't care, according to Desmond. Moreover, the court noted that the government has civil and criminal sanctions for preparers who get out of hand, which would have been redundant if the IRS had the claimed authority to regulate under *section 330(a)*.

There are bills before Congress to reverse the *Loving* decision. Two Senate Finance Committee members introduced the Taxpayer Protection and Preparer Proficiency Act of 2015 (S. 137 (Doc 2015-495)). It would clarify *section 330(a)* to add preparation of tax returns to the acts that can be regulated and a definition of preparer linked to *section 7701(a)(36)*.

The Obama administration did not appeal *Loving*. It requested authority to regulate preparers in its budget submission. (For the Treasury green book, see (Doc 2015-2512).) Meanwhile, the IRS had to scramble to replace the requirements with a voluntary educational program *(Rev. Proc. 2014-42, 2014-29 IRB 192,* (Doc 2014-16235)). The American Institute of Certified Public Accountants sued to invalidate the voluntary program on the view that it was an end run around *Loving*. (Prior coverage (Doc 2014-17533).) The government's motion to dismiss succeeded (*AICPA v. IRS*, Dkt. No. 1:14-cv-01190 (D.D.C. Oct. 27, 2014) (Doc 2014-25805)).

Johnson pointed out that other courts see the law differently and another section of the same statute was not before the court in *Loving (31 U.S.C. section 330*(b)). *Section 330(b),* which details the possible sanctions, grants independent authority to regulate preparers, Johnson argued. It says that the IRS can disbar or suspend a representative who is disreputable, violates *section 330(a)* regulations, or misleads the client.

Section 330(d), which is directed to tax shelters, says that nothing shall prevent the IRS from acting against written advice with a potential for tax avoidance or evasion. Weirdly, Congress seems to have inserted this subsection in anticipation of court challenges to IRS authority to stop practitioners from pushing tax shelters.

But if, according to *Loving*, a return preparer is not a representative, what room is there for assertion of *section 330(b)*? In *Legel v. IRS*, No. 11-60914 (D. Fla. 2011) (Doc 2011-24894), the court relied on *section 330(b)* to grant summary judgment to the IRS on a CPA's challenge to his temporary suspension from practice after his conviction for assisting a client in failure to pay tax (*section 7203*). Johnson cited *Legel* for the independent power of section 330(b), because the CPA argued that he was not acting in a representative capacity. The court relied on Circular 230 to reject that argument.

Loving is just wrong, in Johnson's view, and is contradicted by *Poole v. United States, 1984 U.S. Dist. LEXIS 15351 (D.D.C. 1984),* which concerned a CPA disbarred from practice before the IRS on the ground of disreputable conduct. The court held that IRS disciplinary authority extends to all practitioners before Treasury under *section 330(a)*. The court believed that the IRS had made a reasonable interpretation of the statute.

In *Ridgely v. Lew*, No. 1:12-cv-00565 (D.D.C. 2014) (Doc 2014-17725), the district court for the District of Columbia followed *Loving* with a decision, on cross motions for summary judgment, that permanently enjoined the portion of Circular 230 covering contingent fees for ordinary refund claims. Like *Loving*, this case was decided under *section 330(a)*, but the court indicated that getting a power of attorney to represent the taxpayer might bring a practitioner into its ambit.

There are other cases in the wings. *Sexton v. Hawkins*, Dkt. No. 2:13-cv-00893 (D. Nev. 2014) (Doc 2014-26136), survived a government motion to dismiss. *Davis v. IRS et al.*, No. 1:14-cv-00261 (N.D. Ohio) (Doc 2014-20501), is still pending, and asserts a violation of due process in addition to lack of statutory authority. (Prior analysis, (Doc 2014-20456).)

Hawkins warned her audience that complacency about preparer regulation in the wake of *Loving* would be misplaced. "We can weave our way into having jurisdiction over you," she said.