

Issue Number: 2026-19. Introductory Guidelines for Responsible AI Use in Federal Tax Practice

Artificial intelligence (“AI”) is a rapidly evolving technology that has been adopted by many tax practitioners, some of whom have even developed their own AI platforms. Because AI technology and applications continuously change, there is no decisive definition of AI that describes all its forms and functions. At a basic level, AI can be defined as the use of machines in a way that mimics human cognitive skills, including judgment, perception, and prioritization. Virtually all professional tax firms use some form of AI, whether they are aware of it or not. From document review platforms and advanced legal research products available from providers, such as Thomson Reuters’ Westlaw Edge, Bloomberg Tax, and Lexis-Nexis, AI is ubiquitous in modern law and accounting offices.

As of late, there are open-source programs that use generative artificial intelligence (“GAI”), meaning that they generate original content. These programs have the ability to make discretionary decisions, devoid of any human interaction. This capability is a result of GAI’s use of complex pattern-recognition capabilities that continually interact and evolve, allowing the program to learn from itself. GAI’s transformative potential includes cost savings, rapid data analysis, and, for government tax administrators, in particular the IRS, advanced applications such as fraud detection and audit risk assessment.

Yet, it has limitations—such as fabricated outputs (or, as commonly termed, “hallucinations”), bias, and lack of transparency, and these pose serious ethical and legal risks. As a result, the use of GAI presents concerns involving privacy, confidentiality, and data protection. For example, client privacy can be compromised when data generated for one client is repurposed by the program to respond to an inquiry concerning another client, or data compiled for a particular issue is spilled over into an algorithm and combined with a related tax issue involving a different client. As such, it is incumbent on any tax professional using GAI to carefully review all documents crafted by the technology.

Real-World Consequences of Improper AI Use

Courts have increasingly sanctioned lawyers for improper use of GAI, mainly due to fake citations or other hallucinations contained in legal filings. Typical penalties imposed in these cases have included financial sanctions—often amounting to several thousand dollars; public censure; required completion of legal ethics or professional responsibility courses; default judgments entered against the responsible party; removal from representation of a party to the matter; and disciplinary referrals to state bar authorities.

These sanctions stem from violations of duties of candor and competence, and they often entail reputational harm as attorneys must notify clients and affected judges about the court-ordered

sanctions. The consequences emphasize the need for tax practitioners to act with care and precision when using AI tools, reinforcing the importance of diligent human oversight.

While the legal profession has seen the most public court sanctions, they serve as a warning for other tax professionals. Cases imposing sanctions against other types of tax professionals are slowly emerging. For example, the Australian government published a 230-plus page report on its website in July 2025 that Deloitte Australia had prepared for it. The report contained invented quotes attributable to a judge, references to non-existent reports, and books ascribed to the wrong author, all produced apparently by GAI. Deloitte Australia reportedly resolved the matter directly with the Australian government by agreeing to partially refund a portion of the fee it received from the government.

Regulatory Framework: Circular 230 Provisions

1. **Section (§) 10.22 – Due Diligence:** “A practitioner must exercise due diligence in preparing or assisting in the preparation of, approving, and filing tax returns, documents, affidavits, and other papers relating to Internal Revenue Service matters; in determining the correctness of oral or written representations made by the practitioner to the Department of the Treasury; and in determining the correctness of oral or written representations made by the practitioner to clients with reference to any matter administered by the Internal Revenue Service.”

When using GAI, practitioners must thoroughly review all AI-created documents and language incorporated into writings before delivery to a client or submission to the IRS. Due diligence requires verifying the accuracy of facts, citations, and calculations produced by AI. Practitioners cannot rely solely on AI; human scrutiny and editing are essential to ensure correctness and compliance with IRS expectations.

2. **§ 10.27(a) – Fees:** “A practitioner may not charge an unconscionable fee in connection with any matter before the Internal Revenue Service.”

AI can reduce research and drafting time, such that billing clients for manual labor or time that was not actually spent or double billing for AI-assisted tasks may violate § 10.27, depending on the facts (e.g., a noticeable pattern across clients or the size of the billing differentials). Cost savings should be passed on openly, with billing practices that reflect the efficiencies gained from the use of GAI. Practitioners should not only disclose, in general or specific terms as needed, the AI activities performed, but also fairly credit to the client’s account any cost reductions.

3. **§ 10.35 – Competence:** “A practitioner must possess the necessary competence to engage in practice before the Internal Revenue Service. Competent practice requires the appropriate level of knowledge, skill, thoroughness, and preparation necessary for the matter for which the practitioner is engaged.”

Practitioners must understand both the law and the technology used in their representation of clients before the IRS, including AI systems' operational mechanics, limitations, and risks.

They must understand how AI develops content, recognize the potential for bias or errors, and be able to evaluate whether AI outputs are suitable for use in IRS matters. Lack of technological competence could lead to improper advice or flawed filings.

4. **§ 10.36 – Procedures to Ensure Compliance:** “(a) Any individual subject to the provisions of this part [i.e., Circular 230] who has (or individuals who have or share) principal authority and responsibility for overseeing a firm’s practice governed by this part, including the provision of advice concerning Federal tax matters and preparation of tax returns, claims for refund, or other documents for submission to the . . . [IRS], must take reasonable steps to ensure that the firm has adequate procedures in effect for all members, associates, and employees for purposes of complying with . . . [Circular 230], as applicable. . . .

(b) Any such individual . . . will be subject to discipline for failing to comply with the requirements of this section if—

(1) The individual through willfulness, recklessness, or gross incompetence does not take reasonable steps to ensure that the firm has adequate procedures . . . , and . . . [any firm members] are, or have, engaged in a pattern or practice, in connection with their practice with the firm, of failing to comply . . . ;

(2) The individual through willfulness, recklessness, or gross incompetence does not take reasonable steps to ensure that firm procedures in effect are properly followed, . . . [resulting] in a pattern or practice . . . or;

(3) The individual knows or should know . . . of . . . a pattern or practice . . . , and the individual, through willfulness, recklessness, or gross incompetence fails to take prompt action to correct the noncompliance.”

Firms must deploy internal policies and procedures for compliance with Circular 230 in the AI space, with coverage that includes:

- Staff
 - Comprehensive training on use of AI (the risks – technological and other – and the requirements).
- Rules applicable internally (within the firm)
 - Established protocols for secure data handling, AI accuracy monitoring, etc.
- Contracting with external providers
 - Outsourced or third-party AI tools should be vetted.

And all steps and processes documented to show adherence to section 10.36.

5. **§ 10.37 – Requirements for Written Advice:** “A practitioner may give written advice (including by means of electronic communication) concerning one or more Federal tax matters subject to the requirements . . . of this section. . . . The practitioner must—

- (i) Base the written advice on reasonable factual and legal assumptions (including assumptions as to future events);
- (ii) Reasonably consider all relevant facts and circumstances that the practitioner knows or reasonably should know;
- (iii) Use reasonable efforts to identify and ascertain the facts relevant to written advice on each Federal tax matter;
- (iv) Not rely upon representations, statements, findings, or agreements (including projections, financial forecasts, or appraisals) of the taxpayer or any other person if reliance on them would be unreasonable;
- (v) Relate applicable law and authorities to facts; and
- (vi) Not, in evaluating a Federal tax matter, take into account the possibility that a tax return will not be audited or that a matter will not be raised on audit.”

Because written advice must be based on reasonable factual and legal assumptions, practitioners cannot rely on GAI projections or representations without verification. For legal documents, citations must be checked and cases read. Financial forecasts, inputs, and formulas need to be confirmed. If the system’s logic is opaque, reliance may be unreasonable under section 10.37.

When drafting written advice with GAI, practitioners must independently authenticate all factual and legal information. Blind reliance on what AI yields, especially when the underlying logic or sources are unclear, may constitute unreasonable reliance. Practitioners should treat the advice as a starting point, subject to thorough review before providing it to clients.

6. **IRC sections 6713 and 7216(a):** Civil and criminal preparer penalties apply for unauthorized use or disclosure of tax return information.¹ Section 10.51(a)(15) of Circular 230 also prohibits the willful disclosure or use of tax return information in an unauthorized manner, including in violation of the IRC.

GAI platforms may present risks regarding the unauthorized disclosure of sensitive taxpayer information, especially when data is uploaded to unsecured or public systems. Practitioners must strictly handle all client data using only secure, enterprise-approved AI. AI systems should be utilized with robust confidentiality safeguards firmly in place. Willful mishandling of taxpayer information through AI may lead to disciplinary actions under Circular 230.

¹ Broadly defined in Treasury Regulation § 301.7216-1(b)(3). See subsection (b)(3)(i) (stating, in part, “The term tax return information means any information, including, but not limited to, a taxpayer’s name, address, or identifying number, which is furnished in any form or manner for, or in connection with, the preparation of a tax return of the taxpayer.”).

State Law and Professional Guidance

Several states, including California, Colorado, Illinois, and Utah, have enacted AI governance legislation focusing on transparency, reducing bias, and protecting consumers. In addition, professional organizations such as the American Bar Association have released guidance. For example, the ABA's Standing Committee on Ethics and Professional Responsibility issued Formal Opinion 512, titled, *Generative Artificial Intelligence Tools*, on July 29, 2024. This opinion addresses the growing use of GAI in legal practice and discusses key ABA Model Rules of Professional Conduct that practitioners must consider when leveraging AI.

Best Practices for Responsible AI Use

The items listed below have already been amply discussed, but let's do a quick recap –

- Identify, understand, and stay updated on any relevant federal or state-specific laws, regulations, and guidance that pertain to your professional activities.
- Establish secure AI data handling protocols and access controls.
- Document AI usage and verification processes.
- Foster transparency and accountability in all AI practices.
- Prepare clear procedures for handling breaches or errors.
- Provide necessary staff training.
- Vet third parties' AI offerings when or before purchasing.
- Never upload sensitive data to unsecured sites.
- Treat the written text that AI generates as drafts.
- Review the resulting documents thoroughly for factual and legal accuracy (e.g., always check citations) and any problematic bias.

Conclusion

GAI holds promise to improve efficiency and professional services in tax practice. However, ethical obligations of competence, diligence, and confidentiality remain unchanged. By implementing robust use-management strategies and maintaining human supervision, tax professionals can harness AI's benefits while safeguarding reliability and public trust.

As tax practitioners integrate GAI into their workflows, it is crucial to recognize that technology serves as a powerful tool, not a substitute for professional judgment. AI can streamline routine tasks, enhance research, and provide valuable insights, but final decisions must always rest with qualified professionals who understand the complexities of tax law and ethical standards.

Practitioners must remain vigilant in reviewing what is produced by AI, validating its factual assertions and citations, and handling sensitive client data safely and securely in accordance with both federal and state regulations.

Also important is ongoing self-education and awareness, as directives and guidance from government agencies and professional bodies continue to evolve. Ultimately, responsible adoption of AI policies lies with the profession, to deliver enhanced value while preserving credibility.