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Recent Changes in Circular 230: Where Are We Now?

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INTRODUCTION

There have been several recent developments in connection with ''Circular 230,''[1] the regulations governing practice before the Internal Revenue Service (''IRS''). In June 2014, the IRS finalized amendments to Circular 230[2] that had been proposed in 2012.[3] Generally, these changes involved eliminating the ''covered opinion'' rules, substituting in their stead a general ''competence'' rule, and clarifying the ''due diligence'' requirements for written advice. There were other changes, including expanding the requirements for a firm's compliance program, clarifying the rules regarding negotiation of taxpayer checks, and some procedural provisions.

A second, and in the long run perhaps more significant, development is the recent *Loving* decisions in the U.S. District Court for the District of Columbia[4] and the U.S. Court of Appeals D.C. Circuit.[5] The *Loving* case has already has resulted in changes to the IRS regulation of return preparers, and it is likely in the long run to have further wide ramifications, including related litigation (notably *Ridgely v. Lew*),[6] the potential for legislation clarifying the meaning of the statute[7] that authorizes Circular 230, and in the meantime, possibly more pressure on the IRS to regulate practitioners using remedies and penalties provided for in the Internal Revenue Code (''Code''), such as injunctive actions under §7408.

The goals of this article are to discuss these recent developments in some depth; consider their possible ramifications; consider some lessons that might be learned from these experiences; and speculate on possible next steps.

AMENDMENTS TO CIRCULAR 230 IN GENERAL

31 U.S.C. §330(a) authorizes the Treasury Department to regulate the practice of representatives of persons before Treasury.[8] The regulations governing practice before the IRS are published in 31 C.F.R. part 10, and reprinted as Treasury Department Circular No. 230 (''Circular 230''). In 2012, Treasury and the IRS proposed amendments to Circular 230 rules regarding written tax advice and other related provisions.[9] Those regulations were finalized in June 2014.[10]

The principal change was the elimination of the ''covered opinion'' rules in Circular 230 §10.35, and the corresponding expansion of the due diligence rules for ''written advice'' in Circular 230 §10.37. Circular 230 §10.36 was also broadened to require firms to have compliance procedures for all of Circular 230, not merely for the ''covered opinion'' and return position rules. There were also changes in a procedural provision (Circular 230 §10.81) regarding expedited disciplinary proceedings, and a revision of Circular 230 §10.31 governing negotiation of client checks. (The rest of the changes are merely conforming amendments.) Each of these is discussed in turn below.

Circular 230 §10.35

The biggest change for practitioners in the new regulations is the elimination of the ''covered opinion'' rules in Circular 230 §10.35 and their replacement with a new Circular 230 §10.35.

Since the early 2000s, former Circular 230 §10.35 had included detailed requirements for written advice regarding certain kinds of transactions. This included written advice not just on ''listed'' transactions and transactions with ''a principal purpose'' of avoidance or evasion of tax, but also certain kinds of written ad-

[1] 31 C.F.R. Part 10 (2014).
[2] 79 Fed. Reg. 33685 (June 12, 2014).
[3] 77 Fed. Reg. 57055 (Sept. 17, 2012).
[4] *Loving v. IRS*, 920 F. Supp. 2d 108 (D.D.C. 2013).
[5] *Loving v. IRS*, 742 F.3d 1013 (D.C. Cir. 2014).
[6] No. 1:12-cv-00565, 2014 BL 196974 (D.D.C. July 16, 2014).
[7] 31 U.S.C. §330.
[8] This statute will be discussed in some depth later in connection with the *Loving* case.
[9] 77 Fed. Reg. 57055 (Sept. 17, 2012).
[10] 79 Fed. Reg. 33685 (June 12, 2014).

vice (''reliance'' opinions, marketed opinions, advice subject to conditions of confidentiality, and contractual protection opinions) regarding transactions ''a significant purpose'' of which is the avoidance or evasion of tax in certain cases.[11] Written advice included (and still does include) emails.[12] The requirements for covered opinions included doing very specific due diligence regarding the facts, assumptions, and legal analysis, discussing ''all'' federal tax issues, and giving a conclusion on each of them.

But there were exceptions. A ''limited scope'' opinion could be limited to specified tax issues, so long as the client agreed and disclaimers to that effect were included.[13] Similarly, the ''reliance opinion'' rules could be avoided by including a disclaimer that the taxpayer could not rely on the advice for penalty purposes.[14] There were other exceptions regarding marketed opinions, ways to avoid contractual confidentiality, etc.

As a practical matter, the net effect of these exceptions is that they came to ''swallow'' the rules. Few practitioners did full-blown ''covered opinions'': clients didn't want to pay for them, and law and accounting firms didn't want to bother with all the process and due diligence paperwork required to do them. Thus, even on controversial issues, only ''limited scope'' opinions tended to be issued. Indeed, because ''a significant purpose'' is such a soft, potentially overbroad standard, practitioners tended to treat every piece of tax advice that left their offices, even emails, as potentially a covered opinion, and as a result put ''no reliance'' disclaimers on them. And for simplicity and ease of administration, the disclaimers were included on everything, whether the text of an email related to a substantive tax issue or a lunch engagement. As a result, the rules were simultaneously burdensome and largely ineffective.

To their credit, Treasury and the IRS recognized this. The preamble of the final regulations states that they ''revisited'' the covered opinion rules ''because their application increased the burden on practitioners and clients, without necessarily increasing the quality of the tax advice that the client received.''[15] Treasury and the IRS also recognized that the disclaimers were too widely used, and expressed the hope that eliminating the covered opinion rules would reduce the use of such disclaimers.[16] Similarly, commentators on the proposed regulations overwhelmingly supported the elimination of the covered opinion rules, because ''[T]he former rules were burdensome and provided minimal benefit to taxpayers'' and ''contributed to overuse, as well as misleading use, of disclaimers on most practitioner communications even when those communications did not constitute tax advice.''[17]

The final regulations thus followed the proposed regulations in completely eliminating the covered opinion rules in former Circular 230 §10.35. New Circular 230 §10.35 is a general competence provision, and all written tax advice is now subject to a single standard, under a revised Circular 230 §10.37. The new general competence provision in Circular 230 §10.35 states:

> 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. A practitioner may become competent for the matter for which the practitioner has been engaged through various methods, such as consulting with experts in the relevant area or studying the relevant law.

The effective date states ''this section is applicable beginning June 12, 2014.'' It appears that the effective date refers to conduct occurring after that date, and not disciplinary proceedings brought after that date.

This new rule has been welcomed by practitioners and in my view should not be controversial. The statute authorizing the regulation of practice before the IRS, 31 U.S.C. §330, clearly permits the IRS to discipline a practitioner (attorney, certified public accountant, or other person authorized to practice before the IRS) who is ''incompetent.''[18] And general competence and due diligence requirements are not new to Circular 230. For instance, former Circular 230 §10.35(d) already included a provision requiring practitioners to be ''knowledgeable'' about the subject of covered advice and to use reasonable diligence in relying on others. Likewise, Circular 230 §10.22 has long required ''due diligence'' in connection with most kinds of tax engagements, and former Circular 230 §10.37 has similar requirements for written advice (which, however, were also the subject of amendment). And while the language of new Circular 230 §10.35 is somewhat vague, there is also sufficient flexibility (e.g., requiring only that level of competence and preparation ''necessary for the matter'') that it will not adversely affect most routine engagements by conscientious practitioners. In short, the only practitioners likely to complain about this new requirement are precisely the ones at whom it is aimed!

Before turning to the other new provisions of Circular 230, it may be appropriate to pause and consider what lessons there are to be learned from the decade-long covered opinions experience. I draw at least two.

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[11] *See* former Circular 230 §10.35(b)(2)(i).

[12] *See* Circular 230 §10.37(a) (both former and current).

[13] *See* former Circular 230 §10.35(c)(v).

[14] *See* former Circular 230 §1035(b)(4)(ii). Note, however, that the rules under Code §6662 were never amended to reflect this. Apparently it was always assumed that a taxpayer could not reasonably rely on advice from a practitioner who had just told the taxpayer not to rely on the advice.

[15] T.D. 9668, 79 Fed. Reg. at 33686.

[16] *Id.*

[17] *Id.*

[18] 31 U.S.C. §330(b)(1).

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First, the history of the covered opinion rules illustrates that using regulation of practitioners to accomplish ends arguably unrelated to the actual practice of taxation — in this case, the fight against abusive tax shelters — may not be particularly productive. In recent years, Congress and the IRS have increasingly blamed practitioners for the faults of the tax system, and have tried to impose more reporting and compliance obligations on practitioners in order to police that system. But extensive litigation over the economic substance and sham transaction doctrines, coupled with disclosure and penalty provisions in the Internal Revenue Code that apply to taxpayers,[19] have probably had substantially more effect on taxpayer reluctance to engage in mass-marketed shelter transactions. Likewise, what has really caught practitioner attention has been the criminal convictions of tax practitioners and firms involved in illegal tax shelters — prosecutions which, one should note, were made under existing tax evasion and conspiracy provisions. The Justice Department has also attacked questionable return preparers using Code §7408, for example. In short, the coordinated attack on tax shelters has largely succeeded due to utilization of other tools.

By contrast, to what extent did the covered opinion rules cause a reduction in mass-marketed tax shelters? I think relatively little. True, one hardly ever sees ''contractual protection'' transactions or ''confidential transactions'' anymore, and far fewer ''marketed'' opinions, but it is not clear that, that is attributable to the covered opinion rules, rather than to the ''reportable transaction'' rules, the government's coordinated attack on shelters, the substantive changes in the law, or even just the economy. As noted, the exceptions in Circular 230 §10.35 came to overwhelm the rules; full-blown covered opinions became vanishingly scarce as practitioners prepared limited scope opinions instead; and the email disclaimers became a subject of ridicule rather than an effective enforcement tool. And there were few (if any) situations in which non-compliance with Circular 230 §10.35 was the main source of disciplinary actions by the Office of Professional Responsibility (''OPR''). In short, I think there is little evidence that §10.35 ''worked'' in any sense of the word — to address whatever problem it was aimed at. Rather, as commentators, Treasury, and the IRS all recognized, it was largely ineffective.

Second, former Circular 230 §10.35 also offers a textbook lesson for draftsmen and practitioners on the consequences and dangers of ''hyperlexis.''[20] All the characteristics of hyperlexis were present: a very detailed, highly prescriptive set of substantive rules; coupled (perhaps necessarily, but not obviously so) with a vague description of the scope to which the substantive rules applied (any transactions with ''a significant purpose'' of avoidance or evasion); and formulaic disclosures and exceptions, the ritual incantation of which became common practice. As frequently occurs in hyperlexis situations, therefore, the result was ineffective or at worst counterproductive. Practitioners found work-arounds in the disclaimers and exceptions — in other contexts these are called ''loopholes'' — which came to swallow the basic rules. And the work-arounds and exceptions were actually counterproductive. Explaining the limited scope or nonreliance disclaimers to clients is nearly impossible: it comes down to ''the IRS makes me do it.''[21] This hardly improves the IRS's image, and arguably damages the credibility of both the agency and practitioners. Finally, the covered opinion rules also added unnecessary costs, and in some instances may have led to avoidance of the rules by not issuing written opinions.[22] Ultimately, the hyperlexis reflected in the covered opinion rules did very little to address the shelter advice problem, and may actually have indirectly damaged voluntary compliance, making the system appear to taxpayers just to be a game.

The new Circular 230 §10.35, and Circular 230 more generally, still rely to some extent on practitioners as police for the system. It remains to be seen whether a more principle-based system (based on somewhat more flexible notions of ''due diligence'' and ''competence'') is any better at obtaining the desired results — whatever they may be.

Circular 230 §10.37

Corresponding to the elimination of Circular 230 §10.35's rules on written advice about tax shelters, Treasury and the IRS enhanced the requirements of Circular 230 §10.37, regarding what used to be called ''other written advice.'' Circular 230 §10.37 is now just captioned ''Requirements for written advice,'' and it now applies to ''all'' such written advice, not just advice ''other'' than tax shelter opinions. The new Circular 230 §10.37 provisions do still draw some language from portions of old Circular 230 §10.35 related to the kinds of factual and legal assumptions and analysis that must be done in rendering written advice. Note, however, that the language is consistently qualified by words like ''reasonable,'' ''reasonably,'' ''unreasonable,'' etc. Indeed, it may fairly be said that the principle of acting reasonably is the overall theme of Circular 230 §10.37. Thus, the changes to Circular 230 §10.37 also correspond to the shift from detailed,

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[19] Provisions like §6707A, §6662, and §6662A of the Code, the reportable transaction regulations in Reg. §1.6011-4, etc.

[20] I am not sure of the origin of this very useful concept. The earliest citation to it that I have located is to an article by Dean Bayless Manning of Stanford Law School, who is said to have coined the term. *See* B. Manning, ''Hyperlexis: Our National Disease,'' 71 *NW L. Rev.* 767 (1977). It was memorably applied to the tax law by Gordon Henderson, see G. Henderson, ''Controlling Hyperlexis — The Most Important 'Law and ...','' 43 *Tax Law.* 177 (1989).

[21] E.g., in the standard email disclosure, which begins ''IRS regulations require.. . .''

[22] Again to their credit, Treasury and the IRS acknowledged these adverse consequences. T.D. 9668, 79 Fed. Reg. at 33686.

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prescriptive rules regarding written advice to a more principle-based system.[23]

What are the new requirements for written advice? Circular 230 §10.37(a)(1) states that ''A practitioner may give written advice (including by means of electronic communication) concerning one or more Federal tax matters,'' only if it meets the six requirements set forth in paragraph (a)(2). Paragraph (a)(2) then states that ''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.''

Most of the language in these items appeared before in slightly different form, either in former Circular 230 §10.37 or in various places in former Circular 230 §10.35. For instance, item (i) is drawn nearly verbatim from former Circular 230 §10.35(c)(1)(ii), item (iv) parallels former Circular 230 §10.35(c)(1)(iii) as well as current Circular 230 §10.34(d); and item (v) is just a rewrite of former Circular 230 §10.35(c)(2)(i). Upon first consideration, these requirements do not appear to be all that onerous; yet as just noted, they largely continue the rules that existed for covered opinions, which generally were viewed by practitioners as being quite severe and burdensome. Perhaps this is attributable to one difference: Circular 230 §10.37, unlike former Circular 230 §10.35, does not require that the practitioner specifically document and describe in the written advice itself all the facts, assumptions, application of law, and conclusions that went into it.

The new rule applies to any written advice (including emails) about a ''Federal tax matter.'' That term is defined[24] as any matter concerning ''the application or interpretation of'' (1) a revenue provision as defined in §6110(i)(1)(B) of the Internal Revenue Code; (2) any provision of law impacting a person's obligations under the internal revenue laws and regulations, including but not limited to the person's liability to pay tax or obligation to file returns; or (3) any other law or regulation administered by the IRS. Note that the last point would encompass, for instance, the rules regarding foreign financial account reporting,[25] which the IRS now administers, even though the statutory requirements are not in the Internal Revenue Code but in Title 31.

Even though a variation of it was in former Circular 230 §10.37, item (vi) strikes me as still being somewhat problematic. Former Circular 230 §10.37(a) did prohibit taking into account ''the possibility that a tax return will not be audited, that an issue will not be raised on audit, or that an issue will be resolved through settlement if raised'' in ''evaluating a federal tax issue.'' The government and commentators focused on whether settlement prospects should be allowed to be considered, and that ultimately was permitted (i.e., the prohibition on doing so eliminated) in both the proposed and final regulations.[26] As revised, however, Circular 230 §10.37 appears to continue to prohibit any written advice about the chances of an examination or of an issue surfacing in an examination — under any circumstances, even for a client who comes in specifically for such advice in a post-return context. While taking the ''audit lottery'' into account has long been prohibited for various kinds of issues, such as covered opinions,[27] accuracy-related penalties,[28] or advice regarding return positions,[29] other provisions often specifically except post-return advice from those prohibitions.[30] And *after* a return is filed, particularly if there is an error or omission, many practitioners have to explain to clients what is likely to happen, including audit and penalty risk. Indeed, §10.21 of Circular 230 (regarding a practitioner's obligations upon becoming aware of an error or omission) arguably might *require* that. Perhaps there is a defense that such advice would not relate to a ''federal tax matter'' as defined in Circular 230 §10.37(d), as it really doesn't involve the ''inter-

[23] The preamble to the final regulations even emphasizes this. T.D. 9668, 79 Fed. Reg. at 33686–87.

[24] Circular 230 §10.37(d).

[25] FinCEN Form 114, *Report of Foreign Bank and Financial Accounts*, which superseded Form TD F 90-22.1 (the so-called ''FBAR'' form that was used in prior years).

[26] *See* T.D. 9668, 79 Fed. Reg. at 33688.

[27] *See* former Circular 230 §10.35(c)(3)(iii).

[28] *See* Reg. §1.6662-4(d)(2) (''The possibility that a return will not be audited or, if audited, that an item will not be raised on audit, is not relevant in determining whether the substantial authority standard (or the reasonable basis standard) is satisfied.'').

[29] *See* Reg. §1.6694-2(b)(1) (the out-of-date return preparer penalty regulations).

[30] *See, e.g.,* former §10.35(b)(2)(ii)(C) (excepting post-return advice from the covered opinion rules); Reg. §301.6111-3(b)(2)(iii)(B) (similar carve-out for the ''tax statement'' rules applicable to ''material advisors'').

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pretation or application'' of a legal provision. Alternatively, this may simply be a drafting issue; I don't think that the IRS intended to prohibit all such written advice in a post-return context, but the rule is still there.

Circular 230 §10.37 also contains somewhat overlapping ''reliance'' rules, which again continue the overarching rule of reasonableness. First, as noted, item (iv) in §10.37(a)(2), above, permits reliance on ''representations, statements, findings or agreements'' by ''the taxpayer or any other person'' unless such reliance would be ''unreasonable.'' This appears to be partially duplicative of Circular 230 §10.34(d), regarding ''Relying on information furnished by clients'' in the context of return preparation (as well as former Circular 230 §10.35(c)(1)(iii), which was eliminated). Somewhat oddly, however, Circular 230 §10.37 contains two other reliance provisions, which also do not appear to have been fully synchronized in drafting. Paragraph (a)(3) states that ''Reliance on representations, statements, findings, or agreements is unreasonable if the practitioner knows or reasonably should know that one or more representations or assumptions on which any representation is based are incorrect, incomplete, or inconsistent.'' This statement is not in paragraph (a)(2), which paragraph (a)(1) says sets the standards for written advice; it appears instead to be an elaboration of the requirement in item (a)(2)(iv) regarding no unreasonable reliance. (And again, it appears to have been drawn from the old covered opinion rules, former Circular 230 §10.35(c)(1)(iii).)

Circular 230 §10.37(b), however, discusses ''reliance on the *advice* of another person,'' indicating again that a practitioner can rely on such advice only if the advice was ''reasonable and the reliance is in good faith considering all the facts and circumstances.'' It is not clear how this provision relates to paragraphs (a)(1) and (a)(2), however. The ''another person'' in (b) appears to be the same as the ''any other person'' described in item (iv) — i.e., any person who is not the taxpayer. But, ''advice'' appears to be something different from ''representations, statements, findings, or agreements'' in (a)(2) item (iv); otherwise, the provision would appear to be duplicative. As (a)(1) states that a practitioner may give advice *only* ''subject to the requirements of'' (a)(2), query, can a practitioner rely on third-party advice (as discussed in paragraph (b)) at all?

Paragraph (b) continues by providing that reliance on third-party advice ''is not reasonable when:

(1) The practitioner knows or reasonably should know that the opinion of the other person should not be relied on;

(2) The practitioner knows or reasonably should know that the other person is not competent or lacks the necessary qualifications to provide the advice; or

(3) The practitioner knows or reasonably should know that the other person has a conflict of interest in violation of the rules described in this part.''

These rules also appear to be drawn from former Circular 230 §10.35(d)(1), and there are conceptual parallels to this provision in the Treasury regulations describing when a return preparer may rely on information furnished by a taxpayer or another advisor,[31] although the language does not fully match. Of the three enumerated requirements, the third factor may be problematic. First, there certainly are going to be differences over what a conflict of interest is. The IRS has taken the position in litigation that representing a client in multiple contexts — e.g., in structuring the transaction, giving tax advice regarding return positions, or defending it in an examination — can be a conflict.[32] On the other hand, this factor requires a violation of Circular 230's own conflict rules (set forth in Circular 230 §10.29), which rarely are enforced as stand-alone violations.[33] It is difficult to envision a situation in which the third factor could be the focus of disciplinary action if OPR has not first plead and shown a violation of Circular 230 §10.29 — by the *other* practitioner on whom reliance is being placed. It is thus unclear how this provision will be applied in practice.

Circular 230 §10.37(c)(1) states, in language similar to former Circular 230 §10.37's, the ''standard of review'' applied in evaluating whether a practitioner has complied with the written advice requirements:

> In evaluating whether a practitioner giving written advice concerning one or more Federal tax matters complied with the requirements of this section, the Commissioner, or delegate, will apply a reasonable practitioner standard, considering all facts and circumstances, including, but not limited to, the scope of the engagement and the type and specificity of the advice sought by the client.

This facts and circumstances evaluation is flexible, for instance allowing for the possibility of lower due diligence expectations in more limited engagements, as Treasury specifically noted in the preamble.[34]

Circular 230 §10.37(c)(2) contains a different standard for a specific kind of advice, however:

> In the case of an opinion the practitioner knows or has reason to know will be used or referred to by a person other than the practitioner (or a person who is a member of, associated with, or employed by the practitioner's firm) in promoting, marketing, or recommending to one or more taxpayers a

[31] *See, e.g.,* Reg. §1.6694-1(e), §1.6694-2(e)(5).

[32] *See, e.g., Canal Corp. v. Commissioner*, 135 T.C. 199 (2010).

[33] The IRS does often insist on obtaining ''waiver'' or ''consent'' for alleged ''material limitation'' conflicts, however. *See* Circular 230 §10.29(b)(3) and §10.29(c).

[34] T.D. 9668, 79 Fed. Reg. at 33687.

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partnership or other entity, investment plan or arrangement a significant purpose of which is the avoidance or evasion of any tax imposed by the Internal Revenue Code, the Commissioner, or delegate, will apply a reasonable practitioner standard, considering all facts and circumstances, with emphasis given to the additional risk caused by the practitioner's lack of knowledge of the taxpayer's particular circumstances, when determining whether a practitioner has failed to comply with this section.

This appears to apply to what were previously referred to as ''marketed'' opinions in the covered opinion rules.[35] But there are puzzling things about it: after repeating the facts and circumstances test, it then says ''with emphasis give to the additional risk caused by the practitioner's lack of knowledge of the taxpayer's particular circumstances.'' I confess to not completely understanding what this even means. Risk to whom — the practitioner or the recipient of the advice? Is ''lack of knowledge of the taxpayer's particular circumstances'' a positive factor (i.e., less due diligence is required, because the practitioner is opining only on the transaction in the abstract and not about consequences to particular taxpayer) or a negative factor (i.e., the practitioner must do more precisely because of the lack of knowledge of any specific taxpayer)? It is even a bit disconcerting that the general rule in Circular 230 §10.37(c)(1) uses the phrase ''evaluating whether a practitioner . . . complied,'' whereas this provision asks ''whether a practitioner has *failed* to comply.''[36] Perhaps failure is presumed for this kind of marketed opinion advice — in which case practitioners should be very cautious.

Circular 230 §10.36

The principal change in Circular 230 §10.36, ''Procedures to Ensure Compliance,'' is that it now requires procedures to ensure compliance with all of Circular 230, whereas it previously required such procedures for two kinds of tax work, covered opinions (under former Circular 230 §10.36(a)), and preparing tax returns, claims for refund, or other submissions to the IRS (former Circular 230 §10.36(b)). There are a number of cosmetic and editorial changes in this provision, but most of them flow from this primary change. Thus, the citations to §10.35 are replaced by ''this part,'' i.e. Circular 230, and ''practitioner'' is replaced throughout by ''individual'' or ''individuals'' who are ''subject to this part.''

It is explicitly recognized that there may be more than one individual who has ''principal authority and responsibility for overseeing a firm's practice governed by this part.'' In the absence of such a person, the IRS ''may identify one or more individuals'' who will be deemed ''responsible for compliance with'' Circular 230 §10.36. The preamble makes it clear that OPR would look to find a ''practitioner'' who has such overall responsibility, not firm management in general.

The new provision identifies three potential failures to comply in paragraph (b), all of which are adapted from prior provisions:

(1) The individual through ''willfulness, recklessness or gross incompetence'' fails to have adequate procedures to comply with Circular 230 (and there exists a pattern or practice of non-compliance);

(2) The individual through ''willfulness, recklessness or gross incompetence'' fails to ensure the procedures to comply with Circular 230 are followed (and a pattern or practice of non-compliance);

(3) The individual knows or should know of a pattern of non-compliance and fails to take ''prompt action to correct the noncompliance.''

As a practical matter, most tax practices have already instituted procedures to ensure compliance with parts of Circular 230 beyond just the covered opinions and return position rules. So I expect that this should not be a major undertaking for most firms. Still, it is probably a ''best practice'' for firms to formalize their compliance program and to document that.[37] Further, the high standards of proof necessary (''willfulness, recklessness or gross incompetence'' *and* a ''pattern or practice of non-compliance'') make sanctions under the first two provisions quite unlikely except in egregious cases. Recall, however, that the flush language at the end of 31 U.S.C. §330(b) permits OPR to sanction firms, not just individual practitioners, if the firm itself ''knew or reasonably should have known'' of the non-compliant conduct. (And compare that to the third potential failure described above in Circular 230 §10.37(b)(3).) Firm-level sanctions can extend even to very personal non-compliance, such as practitioners' failure to file their own tax returns (sanctionable under Circular 230 §10.51(6)).[38] Firm-wide sanctions typically should not be imposed, however, except possibly in a negotiated settlement, and again, one hopes that OPR will seek them only in truly egregious cases.

[35] Former Circular 230 §10.35(b)(5).

[36] But note that, at one point, even the preamble describes the general reliance rule in terms of whether the practitioner ''failed to comply.'' T.D. 9668, 79 Fed. Reg. at 33687.

[37] *Cf.* Circular 230 §10.33(b) (''best practices,'' which is still extant, albeit aspirational).

[38] *See* T.D. 9668, 79 Fed. Reg. at 33689–90.

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OTHER CHANGES TO CIRCULAR 230

Circular 230 §10.31, regarding "Negotiation of Taxpayer Checks," was modified in two respects.[39] First, the persons covered were expanded from "a practitioner who prepares tax returns" to *any* practitioner. Second, it was clarified to state that negotiation of a taxpayer check includes accepting or directing payment in any way, including electronically.

Negotiating taxpayer checks has long been prohibited for practitioners who prepare tax returns.[40] The preamble claims that new Circular 230 §10.31 does not prohibit any arrangement that is allowed under the Code §6695 regulations "or any arrangement that is not subject to penalty" under Code §6695(f),[41] but it nevertheless appears to do so. A practitioner who does not prepare returns (e.g., someone who represents taxpayers *only* during examination or collection or appeals) would not be subject either to penalty under Circular 230 §6695(f) (which applies only to return preparers) or to discipline under former Circular 230 §10.31 (which was similarly restricted), and thus, theoretically would have been permitted to negotiate a taxpayer refund check. That appears no longer to be allowed for *any* practitioner under the revised Circular 230 §10.31. Note finally that, pursuant to *Loving* (discussed below), many return preparers are not subject to Circular 230, so this change will have no effect on them. Only Code §6695(f) will continue to apply to such persons.

Another change was made to the expedited suspension procedures of Circular 230 §10.82. That provision authorizes the immediate suspension of a practitioner who has engaged in certain conduct. The regulations extend the expedited disciplinary procedures to disciplinary proceedings against practitioners who have willfully failed to comply with their own personal federal tax filing obligations. Amended Circular 230 §10.82 permits the use of expedited procedures only in a couple new circumstances, however, when a practitioner demonstrates a pattern of willful conduct by: (i) failing to make an annual federal tax return during four of five tax years immediately before the institution of an expedited suspension proceeding; or (ii) failing to make a return required more frequently than annually during five of seven tax periods immediately before the institution of an expedited suspension proceeding. The preamble makes it very clear that this is not limited to a practitioner's federal income tax returns. So it would apply to employment tax returns, for instance — and the second rule (5 failures in 7 tax periods) would apply, not the first (4 failures in 5 years).

Finally, there were a number of related, minor changes to correspond to these changes in Circular 230 §10.82. The period under Circular 230 §10.81 before which a sanctioned practitioner is eligible to reapply to practice was set at the same five years for both disbarred and suspended practitioners. Certain terminology was changed ("show cause order" substituted for "complaint," "response" for "answer," etc.). And the time period for the IRS to change from the expedited suspension process to the regular process, in response to a practitioner's request, was extended to 60 days. These changes will be of limited application — only to practitioners who are already in OPR's gunsights. As to which, Circular 230 §10.1 was tweaked to clarify that OPR is responsible for practitioner disciplinary matters.

[39] *See* T.D. 9668, 79 Fed. Reg. at 33690–91.

[40] Former Circular 230 §10.31. *Cf.* Code §6695(f) (penalty for return preparer who negotiates taxpayer check).

[41] T.D. 9668, 79 Fed. Reg. at 33691.

THE *LOVING* DECISION

Beyond the changes to Circular 230 that were promulgated by Treasury and the IRS, litigation in the courts has had, and is having, a profound impact on the regulation of certain practitioner activities under Circular 230. Chief among these are the *Loving* decisions and their aftermath.

The background to *Loving* is as follows. In 2011, final Treasury Regulations were issued[42] to provide for regulation of tax return preparers under Circular 230. The authority cited for the statute was 31 U.S.C. §330(a), which states in pertinent part, "Subject to section 500 of title 5, the Secretary of the Treasury may — (1) regulate the practice of representatives of persons before the Department of the Treasury." Among other things, the regulations required a testing and admissions process, and continuing professional education ("CPE"), for return preparers, even if they were not otherwise practitioners (i.e., not attorneys, certified public accountants, or enrolled agents). On March 13, 2012, three tax return preparers filed a complaint in U.S. District Court for the District of Columbia seeking a declaratory judgment that the IRS did not possess statutory authority to issue the regulations and seeking to permanently enjoin them. Their argument was, in essence, that return preparation was not "practice . . . before the Department [IRS]" under 31 U.S.C. §330(a). Cross-motions for summary judgment on this issue were filed, and the court decided them on January 18, 2013, with an opinion and order granting the plaintiffs' motion for summary judgment.[43]

The district court held that the statute does not provide Treasury and the IRS with the authority to issue the regulations, and it issued a permanent injunction against the challenged portions (relating to testing and continuing professional education). The IRS filed a notice of appeal, and both the district court and the court of appeals (i.e., the D.C. Circuit) denied motions for a stay pending appeal, although the district court did clarify that the IRS PTIN, testing and continuing education centers could remain in operation, although tax return preparers were no longer required to participate.

[42] T.D. 9527, 76 Fed. Reg. 32286 (June 3, 2011).

[43] *Loving v. IRS*, 920 F. Supp. 2d 108 (D.D.C. 2013).

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On February 11, 2014, the D.C. Circuit issued a decision affirming the district court's decision and invalidating the regulations.[44] The D.C. Circuit provided six reasons why the regulations failed to satisfy step 1 (and step 2) of the "*Chevron*" test[45] for deference to regulations. In order, they are:

1. Tax return preparers are not "representatives" of persons before the Treasury, under the applicable statute (31 U.S.C. §330). Representatives have authority to bind their principals, as an "agent" does.

2. Preparing tax returns does not constitute "practice" before the Treasury Department. The statute suggests that Congress intended "practice" to mean adversarial proceedings, not merely submission of documents.

3. The history of the statute indicates that Congress intended it to cover representation in contested proceedings.

4. The broader statutory framework likewise suggests that the statute should be read narrowly. Congress has adopted a number of statutory provisions covering the conduct of tax return preparers.

5. It should not be presumed that Congress intended a broad delegation of authority to regulate tax return preparers. The regulations would have affected hundreds of thousands of preparers in a multi-billion dollar industry.

6. The IRS had not previously interpreted the statute as authority to regulate tax return preparers. In fact, several IRS representatives had previously stated that the IRS did not possess such authority.

The government did not file a petition seeking a writ of certiorari, and the time to do so passed in May 2014.

AFTERMATH OF *LOVING*

Although it was decided just months ago, *Loving* is already having ripple effects in various areas, including other litigation, the IRS's continuing attempts to regulate return preparation, and potential legislation. Many practitioners are considering its potential impact on the regulation of other activities (e.g., opinion-writing) as well, as under the *Loving* rationale those activities may not be "practice before the IRS" subject to regulation.

Several other suits to which *Loving* may be relevant are already pending in various federal courts, and one has been decided. Most notably, in *Ridgely v. Lew*,[46] the U.S. District Court for the District of Columbia ruled that *Loving* compels the conclusion that a certified public accountant — admittedly a practitioner before the IRS in some other contexts — is not engaged in such "practice before the IRS" when he prepares "ordinary" refund claims (refund claims prepared after an initial return is filed, but before the IRS has commenced an examination). The court thus held invalid Circular 230 §10.27, which purports to restrict a practitioner's ability to charge a contingent fee for such refund claims, and it enjoined enforcement of it in that situation. As of this writing, the government has not appealed that ruling — and it would have to do so to the same court of appeals that just issued *Loving* a few months earlier.[47]

Other cases are raising similar issues with respect to other activities that practitioners engage in. For instance, *Davis v. IRS*[48] involves a CPA who lost his license but then was reinstated, and was suspended and then reinstated by OPR as well, but who is being denied the ability to use the IRS's e-filing system. Even though the e-filing system is not administered by OPR, the plaintiff argues that preparing and filing returns, which he is authorized to do, is part of practice before the agency, and denying him e-file access interferes with that. *Loving*'s holding that return preparation is not practice may undercut this argument, so it will be interesting to see whether the government in *Davis* chooses to follow that rule, contests it, or distinguishes it. Conversely, the plaintiff in *Sexton v. Hawkins*[49] claims that he engages solely in return preparation, which under *Loving* is not subject to OPR's jurisdiction. Mr. Sexton was formerly suspended from practice permanently by OPR, and he now seeks to enjoin an OPR investigation into whether he is complying with the terms of his permanent suspension. It is presently unclear what effect, if any, *Loving* — and now *Ridgely* — will have on these or similar cases, but it is certain that more will be coming.

One potential outcome of overturning the IRS's authority to regulate return preparers through Circular 230 may be more utilization by the IRS of the penalty and other procedural provisions of the Code related to return preparation.[50] One of the six reasons given by the Court of Appeals in *Loving* for invalidating the return preparer regulations in Circular 230 is the overlap between them and those Code provisions. "Under the IRS's view," the Court commented, "all of Congress's statutory amendments [in the Internal Revenue Code] would have been unnecessary. . . . [W]e find at least some significance in the fact that multiple Con-

[44] *Loving v. IRS*, 742 F.3d 1013 (D.C. Cir. 2014).

[45] *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984).

[46] No. 1:12-cv-00565, 2014 BL 196974 (D.D.C. July 16, 2014).

[47] I am counsel of record in *Ridgely*, and accordingly (until the time for appeal has run) somewhat constrained in what I can say about it.

[48] No. 1:14-cv-00261-SO (N.D. Ohio Feb. 7, 2014).

[49] 2:13-cv-00893-RFB-VCF (D. Nev. 2014).

[50] *E.g.*, Code §6694, §6695, §6700, §6701, §7206(2), §7207, §7213, §7408, etc.

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gresses have acted as if [U.S.C.] Section 330 did not extend so broadly as to cover tax-return preparers.''[51] As the IRS can no longer utilize Circular 230 to weed out unsavory return preparers, it may now be compelled to rely more on the Code provision and penalties to do so.

However, the IRS has not given up on regulating tax return preparers directly. After *Loving* held invalid the mandatory admissions, testing, and CPE requirements in Circular 230, the IRS took a different approach and commenced a voluntary certification effort, the ''Annual Filing Season Program'' for return preparers.[52] Participants in this program must complete an annual refresher course in tax preparation and consent to regulation under Circular 230. In exchange, those return preparers who complete the program will be permitted to represent taxpayers with respect to returns they prepared and signed, and will be identified in a publicly accessible IRS database.

Reaction to the voluntary certification program was swift. Even before it was announced, both the National Association of Enrolled Agents and the American Institute of Certified Public Accountants had submitted comment letters to the Commissioner of Internal Revenue.[53] And shortly after it was formally announced, the AICPA filed suit to enjoin the program, arguing that it is beyond the IRS's statutory authority and violates the Administrative Procedure Act.[54] Although the case has yet to be decided, there does appear to be a legitimate question whether the voluntary program is authorized under 31 U.S.C. §330, particularly in the wake of the holdings in *Loving* and *Ridgely* that ''practice before the IRS'' does not extend to the preparation of returns or certain refund claims.

Legislation to authorize the regulation of return preparers is also pending in Congress. The Senate Finance Committee held a hearing earlier this year on the topic,[55] and former Senator Baucus's 2013 tax reform ''discussion draft'' contained a provision to clarify the law.[56] Several bills have also been introduced in the House of Representatives to accomplish the same thing.[57] Finally, some states (California, Maryland, Oregon, and New York) already regulate return preparers, and more states may fill the gap if Congress doesn't act.

Loving, and now *Ridgely* as well, call into question the scope of the IRS's authority under 31 U.S.C. §330 to regulate other activities through Circular 230 that do not involve the active representation of a specific taxpayer in an examination, collection, or appeals matter before the IRS. For instance, if, as *Ridgely* held, the IRS lacks authority to prohibit contingent fees under Circular 230 §10.27 in connection with the preparation of ''ordinary refund claims,'' then what authority is there for prohibiting contingent fees in connection with the preparation of original returns? Similarly, after *Loving*, what authority is there for regulating opinions or other written advice that is communicated only to a client and not to the IRS? True, 31 U.S.C. §330(d) implicitly recognizes that the IRS may regulate opinions regarding tax shelters[58] — and yet the IRS just repealed the covered opinion rules in Circular 230 §10.35, the promulgation of which prompted this 2004 clarification in the statute in the first place.[59] It is unclear what other authority might exist for regulating other written advice in Circular 230 §10.37, at least with respect to matters not ''of a type which the Secretary determines as having a potential for tax avoidance or evasion.'' And finally, to stick with just the most recent changes, what provision of 31 U.S.C. §330 authorizes the prohibition on negotiating taxpayer checks in Circular 230 §10.31?

By contrast, some others of the most recent amendments to Circular 230 appear to be well-grounded in the statute and should be unaffected by *Loving*. 31 U.S.C. §330(b) provides that the Secretary may impose discipline for incompetence, disreputable conduct, fraud on a client, or violating (authorized) regulations under Circular 230, and the flush language at the end of that section authorizes firm-wide sanctions. Thus, the new general competence rule in Circular 230 §10.35 and the expanded rules regarding firm-wide compliance in Circular 230 §10.37 should be defensible. Likewise, it appears that discipline can be imposed for other non-representational, non-practice activities (even after *Loving* and *Ridgely*) if the actions demonstrate incompetence or disreputable character — perhaps including things such as the commis-

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[51] 742 F.3d at 1020.

[52] *See* Rev. Proc. 2014-42, 2014-29 I.R.B. 192; IR 2014-75 (June 26, 2014).

[53] Letter from NAEA dated May 23, 2014, reprinted at http://services.taxanalysts.com/taxbase/eps_pdf2014.nsf/DocNoLookup/13170/$FILE/2014-13170-1.pdf; Letter from AICPA dated May 21, 2014, reprinted at http://services.taxanalysts.com/taxbase/eps_pdf2014.nsf/DocNoLookup/12691/$FILE/2014-12691-1.pdf.

[54] *Am. Inst. of CPAs v. IRS*, No. 1:14-cv-01190 (D.D.C. July 15, 2014).

[55] *Protecting Taxpayers from Incompetent and Unethical Return Preparers*, United States Senate Committee on Finance, Tuesday, April 8, 2014, available at http://www.finance.senate.gov/hearings/hearing/?id=331dea1b-5056-a032-5215-1df389f40a67.

[56] http://www.finance.senate.gov/newsroom/chairman/download/?id=13b89986-efe4-4be5-95a1-c1f14ab8fbf0.

[57] H.R. 4470, ''Tax Return Preparer Accountability Act of 2014'' (to allow IRS to regulate any preparers not regulated under 31 U.S.C. §330); H.R. 4463, ''Tax Refund Protection Act of 2014'' (to require Consumer Financial Protection Bureau to regulate preparers not regulated under 31 U.S.C. §330).

[58] It awkwardly states, ''Nothing in this section or in any other provision of law shall be construed to limit the authority of the Secretary of the Treasury to impose standards applicable to the rendering of written advice with respect to any entity, transaction plan or arrangement, or other plan or arrangement, which is of a type which the Secretary determines as having a potential for tax avoidance or evasion.''

[59] *See* H. Conf. Rep. 108-755 (Oct. 7, 2004) at 616.

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sion of certain crimes, nonpayment of taxes, etc.[60] But this area is sure to be the subject of future discussion and litigation.

LESSONS TO BE LEARNED FROM *LOVING*

In anticipation of that, let me conclude by offering some observations regarding the aftermath of *Loving* (and now *Ridgely* too). The first is the obvious lesson familiar to all law students that ''bad cases make bad law.'' *Loving* arose in the first place because of a perfect storm of unclear statutory drafting by Congress and regulatory overreach by Treasury and the IRS to address an ill-defined objective (improving compliance by return preparers). Even assuming that significant compliance problems exist in the practitioner and return preparer communities, the government itself is at least partly to blame for the fix it finds itself in now. More attention to detail at every stage of the process may have forestalled this result.

Second, and following from the first observation, 31 U.S.C. §330 clearly needs a dramatic overhaul. The IRS should not be relying on a 130-year-old statute for a new regulatory program, and the Courts of Appeals should not be called on to interpret such a statute's applicability to such a program. And Congress (and the Treasury Department) should not be timid about rewriting the entire statute. The last couple of efforts to amend 31 U.S.C. §330 (the addition of the firm-wide sanctions provision, the shelter opinion provision, etc.) have, in my view, not gone particularly well. This is at least partly because the IRS was concerned that a more complete overhaul could lead to adverse inferences regarding prior enforcement activities, while many in Congress were not enthusiastic about giving the agency more power. Until a drastic rewrite occurs, however, we are going to continue to see a proliferation of litigation and inadequate half-step responses by the IRS. A thorough house-cleaning is in order.

And that brings me to my last point, which is that we are all Administrative Procedure Act lawyers now. The Supreme Court has waded into tax regulatory issues with surprising gusto in recent years,[61] and the Tax Court and other courts have struggled with the same issues. In particular, clarification of the application of *Chevron* has unsettled long-held notions regarding the IRS's authority under various statutes and the deference to be given to Treasury regulations, especially interpretative regulations under Code §7805. In the wake of those cases, tax controversy lawyers have new tools to challenge agency actions under the Administrative Procedure Act. As I tell my students, you have to know more than just tax law to be a good tax controversy lawyer these days.

[60] *See* Circular 230 §10.51.

[61] I refer to cases such as *Mayo Found. for Med. Educ. & Research v. United States*, 131 S. Ct. 704 (2011), and *United States v. Home Concrete & Supply LLC*, 132 S. Ct. 1836 (2012).

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