Ethics, Professional Responsibilities, and Federal Tax Procedures
Ethics and Responsibility in Tax Practice

Regulations Governing Practice before the IRS

After studying this lesson, you should be able to:

1. Recall the regulations governing practice before the IRS.
2. Apply the regulations governing practice before the IRS to a specific scenario.

I. Introduction

A. Circular 230 contains the IRS’s rules of practice governing CPAs and others who practice before the agency. The government may censure, fine, suspend, or disbar tax advisors from practice before the IRS if they violate Circular 230’s standards of conduct. “Practicing” entails primarily preparing and filing documents, and communicating and meeting with IRS representatives on behalf of a taxpayer.

B. Subpart A of Circular 230 sets forth rules governing authority to practice before the IRS. Most importantly, Section 10.3 provides that “[a]ny certified public accountant who is not currently under suspension or disbarment from practice before the Internal Revenue Service may practice before the Internal Revenue Service by filing with the Internal Revenue Service a written declaration that he or she is currently qualified as a certified public accountant and is authorized to represent the party or parties.”

C. Who may practice before the IRS? As long as they are not under suspension or disbarment:

   1. Attorneys
   2. CPAs
   3. Enrolled agents
   4. Enrolled actuaries (enrolled by the Joint Board for the Enrollment of Actuaries), but their practice is generally limited to issues related to qualified retirement plans
   5. Enrolled retirement plan agents, but their practice is limited to issues related to employee plans and to IRS forms in the 5300 and 5500 series

D. Practice before the IRS

   1. Practice before the IRS includes all matters connected with a presentation to the IRS or any of its officers or employees related to a taxpayer’s rights, privileges, or liabilities under laws or regulations administered by the IRS.

   2. These presentations include, but are not limited to:

      a. Preparing documents
      b. Filing documents
      c. Corresponding and communicating with the IRS
      d. Rendering written advice with regard to transactions having a potential for tax avoidance or evasion
      e. Representing a client at conferences, hearings, and meetings

   3. A power of attorney (Form 2848) is required for an individual to represent a taxpayer before the IRS.

E. Subpart B of Circular 230 contains the substantive rules that govern tax practitioners, including CPAs. Our discussion will focus on those rules.

F. Subpart C spells out sanctions for violations. Subpart D contains procedural rules for disciplinary proceedings.
II. Substantive Provisions

A. **Furnishing Information**—A practitioner must *promptly* submit to the IRS any records or information that its agents and officers request properly and lawfully, “unless the practitioner believes in good faith and on reasonable grounds that the records or information are privileged.” In other words, Section 10.20 requires prompt cooperation with all IRS requests for information.

B. **Client’s Omission**—What if you learn that your client has not complied with the laws or made an error or omission on a tax return? Consistent with AICPA ethics guidelines, Section 10.21 requires the practitioner to promptly notify the client of the error and its potential consequences, but the practitioner need not notify the IRS of the error and may not do so without the client’s permission.

C. **Due Diligence and Reliance on Others**—Practitioners must exercise *due diligence* in all aspects of their tax practice, including preparing tax returns and making representations to the IRS. Section 10.22 allows a practitioner to rely on the work product of others, if the practitioner used reasonable care in engaging, supervising, training, and evaluating them, although Sections 10.34 and 10.37 contain a couple of slight limitations on this reliance.

D. **Delays**—Practitioners may not *unreasonably* delay the prompt disposition of any matters before the Service. Stalling tactics are strongly discouraged by Section 10.23.

E. **Assistance from the Disbarred**—What if your former partner violated regulations and has been disbarred by the IRS? She still needs a job and wants to continue to do the same work as before, but have you sign off on everything since you are still in good standing. Section 10.24 provides that a practitioner should not knowingly accept even indirect assistance from any person disbarred or suspended from practice by the IRS.

F. **Practice by Former IRS Agents**—The IRS is concerned about abuses by former IRS agents who might try to exploit their former position when they leave the Service. Therefore, Section 10.25 contains extensive rules meant to prevent conflicts of interest, such as IRS employees going into private practice and working on cases they had knowledge of when they worked for the government. For example, if IRS agent Fred worked on a matter involving taxpayer Stan within one year before he left the IRS, he could not join an accounting firm and represent Stan in that matter within two years of leaving the Service. Fred should not use his knowledge or influence in assisting or representing Stan in IRS proceedings during that two-year period.

G. **Notaries**—A practitioner must not act as a notary public with respect to matters before the IRS in which he or she is involved or interested (Section 10.26).

H. **Fees**

1. **Unconscionable fees**—No practitioner may charge an *unconscionable fee* for representing a client before the IRS.

2. **Contingent fees**—The rest of Section 10.27 relates to contingent fees, providing that a practitioner *may not* charge a contingent fee for providing services before the IRS, with three exceptions. A contingent fee may be charged:

   a. For services rendered in connection with an IRS *examination or challenge* to either (i) an original tax return or (ii) an amended return or claim for refund when they were filed within 120 days of receiving a written notice of examination or written challenge to the original exam

   b. Where a claim for refund is filed solely in connection with determination of statutory interest or penalties

   c. When the accountant is representing the client in judicial proceedings

   In these three situations, the threat that the tax practitioner and client will play the “audit lottery” (taking an aggressive position because it is unlikely that the Service will substantively examine it) is small.

3. **PCAOB**—Remember that the PCAOB believes that a public company auditor is not independent from an audit client if it offers that client any services on a contingent fee basis.
I. **Return of Client Records**—What if you have fired the client, or the client has fired you? You still have the client’s tax records, but perhaps the client has not paid you. You don’t want to give the client’s records back until you are paid. Section 10.28 instructs the practitioner to promptly return any and all records needed for the client to comply with federal tax obligations. The practitioner may keep a copy. The rule specifies that the existence of a fee dispute does not change this obligation but recognizes that if applicable state law permits retention in the case of a fee dispute, the practitioner need return only those records that must be attached to the taxpayer’s return. However, the rule further provides that the practitioner “must provide the client with reasonable access to review and copy any additional records of the client retained by the practitioner under state law that are necessary for the client to comply with his or her Federal tax obligations.” The rule broadly defines “records of the client,” but states that “[t]he term does not include any return, claim for refund, schedule, affidavit, appraisal or other document prepared by the practitioner ... if the practitioner is withholding such documents pending the client’s performance of its contractual obligation to pay fees with respect to such document.”

J. **Conflicts of Interest**—Section 10.29 provides that practitioners should not represent a client before the IRS if to do so would create a conflict of interest.

1. Such a conflict exists if the representation of one client would be adverse to that of another, or if there is a significant risk that the representation of one client would be materially limited by the practitioner’s responsibilities to another client.

2. Notwithstanding the existence of a conflict of interest, however, practitioners may represent a client if they:
   a. Reasonably believe that they can provide competent and diligent representation to the client;
   b. The representation is not prohibited by law; and
   c. The affected client gives informed consent in writing. Practitioners should keep the consents on file for at least three years.

K. **Solicitation**—Section 10.30 contains several limitations on solicitation of clients. Among others, false advertising is, of course, prohibited. But practitioners may publish accurate written schedules of fees and hourly rates.

L. **Check Negotiation**—A practitioner who prepares tax returns may not endorse or otherwise negotiate any check issued to a client by the IRS, according to Section 10.31.

M. **Practicing Law**—Tax accountants, typically, learn quite a bit of tax law, but nothing in Circular 230 is meant to authorize persons who are not members of the bar to practice law (Section 10.32).

N. **Best Practices**—Section 10.33 sets forth best practices for tax advisers, including:

1. Communicating clearly with the client regarding the terms of the engagement, including the purpose, use, scope, and form of the advice

2. Establishing the facts, determining which facts are relevant, evaluating the reasonableness of assumptions or representations, relating the applicable law to the relevant facts, and arriving at a conclusion supported by the law and the facts

3. Advising the client regarding the import of the conclusions reached, including whether taxpayers may avoid accuracy-related penalties if they rely on the advice;

4. Acting fairly and with integrity when practicing before the IRS

5. Exercising any firm supervisory powers to ensure that firm employees act in accordance with best practices

O. **Tax Return Standards**—Section 10.34 instructs practitioners not to willfully, recklessly, or through gross incompetence sign a tax return or claim for refund that the practitioner knows or reasonably should know contains a position that: (1) lacks a reasonable basis; (2) is an unreasonable position as defined by the Internal Revenue Code (Section 6694(a)(2)); or (3) is a
willful attempt to understate the tax liability or a reckless or intentional disregard of IRC rules. Nor
should a practitioner advise a client to take such unreasonable positions.

1. Additionally, practitioners should not advise clients to take “frivolous” positions on documents
filed with the IRS.

2. Practitioners must inform clients of penalties reasonably likely to be imposed with respect to
positions taken.

3. Practitioners may generally rely in good faith on information provided by their clients but may
not ignore inconsistent information in their personal knowledge or other red flags that might
appear.

P. Competence—Practitioners must be competent, meaning that they possess “the appropriate
level of knowledge, skill, thoroughness, and preparation necessary.” Section 10.35 indicates that
they may acquire competence by studying the relevant law or consulting with experts.

1. Compliance procedures—Section 10.36 provides that practitioners who have or share
principal authority and responsibility for overseeing a firm’s tax practice may be sanctioned
if they either (a) willfully, recklessly, or through gross incompetence fail to take reasonable
steps to assure that the firm has adequate procedures in place to ensure that all members
and employees are complying with Circular 230 or (b) know or should know that a member
or employee is not complying with Circular 230, but through willfulness, recklessness, or
gross incompetence fail to take prompt corrective action. The obvious purpose of this
provision is to prevent those officials at the top of an accounting firm from placing all the
blame for inappropriate tax shelter or other activity on lower-ranking members of the firm.
The provision is an exception to Section 10.22’s provision that allows a practitioner to rely on
the work product of others if the practitioner used reasonable care in engaging, supervising,
training, and evaluating them.

2. Other written advice—Section 10.37 provides that tax practitioners may give written advice
if the practitioners:
   a. Base the advice on reasonable factual and legal assumptions;
   b. Reasonably consider all relevant facts and circumstances that the practitioners know or
reasonably should know;
   c. Use reasonable efforts to identify and ascertain relevant facts;
   d. Do not rely on others’ representations if to do so would be unreasonable;
   e. Relate applicable law and authorities to facts; and
   f. Do not take 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 settled.

III. Penalties and Procedures
   A. Subpart C of Circular 230 sets forth the rules and penalties for disciplinary proceedings.
      1. As a general notion, Circular 230 authorizes the IRS to punish any tax professional who is
incompetent, disreputable, violates the Treasury Department’s rules of practice or with intent
to defraud willfully and knowingly misleads or threatens the person being represented.
      2. Section 10.50 empowers the IRS to impose a monetary penalty on practitioners who have
violated practice rules. The maximum penalty equals 100% of the gross income derived from
the conduct and may be added to other penalties, such as suspensions and censures. It may
also be added to the 50% penalty of gross income authorized by 26 U.S.C. Section 6694,
meaning that the penalty could theoretically be up to 150% of the income derived from an
engagement.
3. Section 10.51 lists numerous acts of incompetence or disreputable conduct that are sanctionable under Section 10.50, including:
   a. Conviction of any crime under federal tax laws
   b. Conviction of any crime involving dishonesty or breach of trust
   c. Conviction of any state or federal felony that would render one unfit to practice before the IRS
   d. Giving false or misleading information to tax officials
   e. Soliciting employment in violation of Section 10.30
   f. Willfully evading taxes
   g. Being disbarred or suspended from practice as a CPA or an attorney;
   h. Contemptuous conduct before the IRS

B. The remainder of Subpart C, as well as Subchapter D, contains sections setting forth the procedures governing the process when the IRS takes disciplinary action against tax practitioners.