OUTER LIMITS

OF TAX REPRESENTATION PRACTICE

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One of the primary reasons people become enrolled agents is to be able to help their clients with tax problems. EAs (as well as attorneys and CPAs) can represent taxpayers before all administrative levels of the IRS. In order to effectively represent taxpayers, however, EAs need to be aware of just how far a practitioner can go, both ethically and professionally, without exceeding the limits of authority granted by the EA designation. In the classic movie *Dirty Harry*, Clint Eastwood's character states that "a man's got to know his limitations." This article will explore those limitations in tax practice.

31 C.F.R., Subtitle A, Part 10 (also known as Circular 230) is the primary authority regulating an EA's ability to represent taxpayers before the IRS. Every EA should know these rules inside and out.

Competence

Circular 230 Sec. 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."

Think back to school when a fellow student would ask the teacher "Can I go to the bathroom?" The teacher would respond "I hope you can, but what I think you want to ask is 'may you go to the bathroom." That day, everyone learned the difference between can and may. May implies permission, but can implies ability.

Similarly, just because the EA designation says that an EA may represent a taxpayer, the proper question is "can I represent the taxpayer?" That is the essence of Sec. 10.35—ensuring that a practitioner is competent for the engagement. Not having competency in a matter—and thus providing inadequate representation—can have severe financial and legal consequences to a taxpayer.

The National Association of Enrolled Agents has one of the best methods for gaining that competency in the National Tax Practice Institute®. Another way of gaining competence includes partnering with more experienced EAs when working on a case with issues that are unfamiliar.

Competency is not gained by relying on a software program to come up with a solution for the taxpayer. While software tools exist to make your job representing taxpayers easier and certainly makes the forms legible, it is ultimately an EA's responsibility to understand all the potential options and solutions and to help guide the taxpayer to the solution most appropriate for his or her unique situation. In short, tax software is no substitute for a good enrolled agent.

Potentially Criminal Tax Matters

Circular 230 Sec. 10.20 states, in part,

> "A practitioner must, on a proper and lawful request by a duly authorized officer or employee of the Internal Revenue Service, promptly submit records or information in any matter before the Internal Revenue Service unless the practitioner believes in good faith and on grounds that the records or information are privileged."

IRC Sec. 7525 deals with confidentiality privileges relating to taxpayer communications. We call this "accountant-client privilege".

Sec. 7525 (a) Uniform application to taxpayer communications with federally authorized practitioners.

> (1) General rule
> With respect to tax advice, the same common law protections of confidentiality which apply to a communication between a taxpayer and an attorney shall also apply to a communication between a taxpayer and any federally authorized tax practitioner to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney.
>
> (2) Limitations Paragraph (1) may only be asserted in—
> (A) any noncriminal tax matter before the Internal Revenue Service; and
> (B) any noncriminal tax proceeding in Federal court brought by or against the United States.
> (3) Definitions
> For purposes of this subsection—
> (A) Federally authorized tax practitioner The term "federally authorized tax practitioner" means any individual who is authorized under Federal law to practice before the Internal Revenue Service if such practice is subject to Federal regulation under Section 330 of Title 31, United States Code.
> (B) Tax advice
> The term "tax advice" means advice given by an individual with respect to a matter which is within the scope of the individual's authority to practice described in subparagraph (A).
>
> (b) Section not to apply to communications regarding tax shelters The privilege under subsection (a) shall not apply to any written communication which is—
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> (1) between a federally authorized tax practitioner and—
> (A) any person,
> (B) any director, officer, employee, agent, or representative of the person, or
> (C) any other person holding a capital or profits interest in the person, and
>
> (2) in connection with the promotion of the direct or indirect participation of the person in any tax shelter (as defined in Section 6662(d)(2)(C)(ii)).

It is important to recognize that the "accountant-client privilege" only applies to tax advice, which includes representation, and not to tax preparation or the information gathered in anticipation of tax return preparation. Those not subject to Circular 230, such as most unenrolled preparers, have no privilege. The privilege covers only non-criminal matters. State law and tax shelters are beyond the scope of this article.

Therefore, in any potentially criminal tax matter, a non-attorney tax practitioner may be compelled to disclose to the IRS the past communication between the practitioner and the taxpayer. This could be very damaging evidence to the taxpayer's case. Attorneys-at-law have a

stronger attorney-client privilege that includes communication about criminal matters. No one (not even attorneys) has privilege regarding the preparation of tax returns.

If a taxpayer's situation may have potential criminal exposure (items like a substantial understatement of income, completely fabricated tax-related events, a substantial overstatement of deductions, or other non-tax illegal activities), a non-attorney practitioner should cease the discussion with the taxpayer immediately and refer the taxpayer to an attorney with experience in criminal tax matters. The attorney could decide to engage the practitioner to assist under a *Kovel* [1] letter, which will state that all of the work performed is the work product of the attorney, and thus is subject to the attorney-client privilege. However, the attorney may determine that the client has disclosed too much that would not be deemed confidential, and, therefore, the attorney cannot use the practitioner for that particular client. This is to protect the taxpayer's rights and limit further damage from potential disclosure of information.

The confidentiality privilege belongs to the taxpayer and not the practitioner. The taxpayer can choose to divulge any information to the IRS himself or herself at any time; however, proper representation would limit the IRS's contact with the taxpayer to prevent the taxpayer from doing that. If a communication has been divulged to any third parties, then it is no longer confidential. The practitioner's privilege also covers the staff of the Circular 230 practitioner.

It is important to take steps to protect that confidentiality by keeping a separate file folder labeled "Confidential" or marking the tax advice and representation work papers confidential. Do not mingle the tax planning and representation documents with the tax return preparation documents, since the privilege does not protect tax return preparation documents.

Conflict of Interest

It is tempting for a practitioner to want to engage a client for representation in an examination if the practitioner prepared the return. However, the potential for a conflict of interest exists, so the EA must determine if he or she can ethically do so.

In an examination, the IRS can assert accuracy-related penalties for negligence or disregard of a rule or regulation, or for a substantial understatement of tax[2]. However, the penalty will not be asserted if reasonable cause can be established for the understatement[3]. One basis for reasonable cause is reliance on the opinion of an adviser for the position taken[4].

The Tax Court has promulgated a three-prong test by which the taxpayer can negate an accuracy-related penalty due to reliance on an adviser. First, the professional was competent with sufficient expertise to advise on the matter. Second, the taxpayer provided the advisor accurate and necessary information. Third, the taxpayer actually relied in good faith on the adviser's judgment[5].

Thus, if the taxpayer is liable for understatements, and the return in question was prepared by and represented by the same adviser, there is a conflict of interest. The taxpayer may be able to successfully argue reliance on a tax professional to avoid accuracy-related penalties; however, the adviser would be admitting that he or she took an incorrect positivon on the return, which could potentially lead to preparer penalties under IRC Section 6694. IRS staff are directed to consider assertion of IRC 6694 penalties when there is a substantial understatement of tax during an examination [6].

If the practitioner is unaware of unsupported positions on the return, and believes the return is materially correct, then there is likely no conflict of interest in the representation. However, if the practitioner later learns there is an unsupported position, or realizes it upon the inquiry for engagement, it is best for the practitioner to withdraw and refer the case as to avoid the conflict of interest.

United States Tax Court

While most IRS disputes can be resolved at the administrative level, sometimes litigation in court is an effective means of resolution. The United States Tax Court is the most common avenue for challenging proposed deficiencies resulting from an examination because the taxpayer does not have to pay the deficiency prior to filing the petition and the Tax Court will review the case de novo to determine the correct tax liability.

After an examination, the IRS will issue a notice of deficiency if additional tax is owed. The taxpayer or taxpayer's counsel has ninety days to file the petition (150 days if the taxpayer is outside of the United States on the date the notice of deficiency is mailed)[7]. During this period, the practitioner can actively try to continue to contest the examination findings; however, the notice of deficiency sets a fixed deadline for protecting an important right of the taxpayer. A petition is considered timely filed if timely mailed pursuant to the rules in IRC Section 7502.

A simplified petition form (T.C. Form 2) is available from the Tax Court's website at www.ustaxcourt.gov. While this may look like a simple fill-in-the-blank form, it is important to avoid the temptation to give advice to the taxpayer about how to properly fill out a petition to U.S. Tax Court.

"IN AN EXAMINATION, THE IRS CAN ASSERT ACCURACY-RELATED PENALTIES FOR NEGLIGENCE OR DISREGARD OF A RULE OR REGULATION OR FOR A SUBSTANTIAL UNDERSTATEMENT OF TAX."

EAs and CPAs are allowed to practice before all administrative levels of the IRS. However, going to Tax Court is a judicial procedure before a court, not an administrative level of the IRS. As such, practitioners must not conduct the unauthorized practice of law without a license.

The Tax Court has many rules and procedures to ensure efficient equal and just treatment of taxpayers. For example, rules for the petition itself are found in Tax Court Rule 34. The misinterpretation of a part of a rule or procedure, or the omission of certain required information may unfairly prejudice a taxpayer and harm his or her case. Not properly following the rules and procedures could result in either the Tax Court not having jurisdiction to hear the taxpayer's case, or in having certain of the items of the notice of deficiency deemed admitted as true and, therefore, not contestable in court.

A practitioner who is not properly licensed and admitted to Tax Court may find that his or her professional liability insurance will not cover acts for which he or she is not authorized or properly licensed. In addition, the practitioner's state Bar Association may have an issue with the practitioner practicing law without a license. A conviction for a violation of this law may be reportable to the Office of Professional Responsibility for further sanctions under Circular 230.

If a non-attorney practitioner wants to assist taxpayers with Tax Court litigation, then there is a proper procedure for that — pass the exam given to non-attorneys by the Tax Court for admission to practice before the Tax Court. This exam is held every other year at the Tax Court in Washington D.C., and the next exam will be held in November 2016. Non-attorneys admitted to practice before the United States Tax Court are called United States Tax Court Practitioners (USTCPs).

Admittance to practice to the United States Tax Court still limits the practitioner to litigation in Tax Court. Appeals of Tax Court decisions, which go to the circuit court of appeals, or suits for refund in federal district court, which is another way of contesting a tax liability, all require an attorney.

Docketed Tax Court Cases

Once a Tax Court case has been docketed (the court proceeding has been entered into), the normal procedure is for cases which previously have not been sent to the IRS Appeals Office to be sent to Appeals for settlement negotiations. Appeals is an administrative level of the IRS, and an EA or CPA may represent a taxpayer before Appeals.

Therefore, once a petition is filed by the taxpayer, attorney, or USTCP, the non-admitted EA or CPA may represent the client under the supervision of or in conjunction with the attorney or USTCP. Generally, if a power of attorney has been previously filed, the IRS will first contact the petitioner's counsel regarding the case, and not the power of attorney. This is not the IRS bypassing the power of attorney: the power of attorney is for administrative matters, and the case, once docketed, is a judicial matter. Thus, if an EA or CPA refers a taxpayer to an attorney or USTCP, make sure that all parties are clear about who is handling which responsibilities.

Bankruptcy

Most practitioners are familiar with the most common ways of resolving an unpaid IRS tax balance: an installment agreement, an offer in compromise, or "currently not collectible" status. However, bankruptcy is an option as well, especially for taxpayers who have other debts. Tax debts can be potentially discharged in a bankruptcy proceeding if the debts meet certain tests, which are beyond the scope of this article to discuss in-depth.

However, a practitioner who does collection work must be aware of two key things related to bankruptcy. First, he or she must know the general rules for when a tax debt is dischargeable and when a client may potentially benefit from a bankruptcy filing. Second, bankruptcy is the practice of law. Therefore, while a practitioner can be aware of the issues and when bankruptcy might be beneficial, advising the client about bankruptcy and the filing of the bankruptcy petition should be left to an attorney who specializes in bankruptcy law (and, ideally, tax law).

Conclusion

Circular 230 practitioners are often said to have unlimited representation rights before the IRS – and this is generally true. However, there are ethical and legal issues that commonly occur that can derail a practitioner from successfully representing the taxpayer. Be sensitive and aware of these issues, recognize conflicts of interest, know one's limits of knowledge, and acknowledge the limits of one's license to practice, and the practitioner will not only be successful in his or her career, but will also be acting in the best interests of his or her clients at all times. EA

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To learn more about this topic, visit the NAEA Forums.

ENDNOTES

1. United States v. Kovel, 296 F.2d 918 (2d Cir. 1961)
2. IRC 6662(b)(1) and 6662(b)(2)
3. Treas. Reg. 1.6664-1(a)
4. Treas. Reg. 1.6664-1(c)
5. Neonatology Associates, P.A. et. al. v. Commissioner, 115 T.C. 43 (2000)
6. IRM 20.1.5.8.2, para. 7
7. IRC 6213(a)