

The New York Chapter of Tax Executives Institute

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Standards of Tax Practice – An Update

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Topic: Contingent Fees

Newly amended (and finalized) § 10.27(b) of Circular 230:

Contingent fees--(1) Except as provided in paragraphs (b)(2), (3), and (4) of this section, a practitioner may not charge a contingent fee for services rendered in connection with any matter before the Internal Revenue Service.

Contingent Fee: “Matter” Defined Very Broadly

- §10.27(c)(2):

Matter before the Internal Revenue Service includes tax planning and advice, preparing or filing or assisting in preparing or filing returns or claims for refund or credit, and all matters connected with a presentation to the Internal Revenue Service or any of its officers or employees relating to a taxpayer's rights, privileges, or liabilities under laws or regulations administered by the Internal Revenue Service. Such presentations include, but are not limited to, preparing and filing documents, corresponding and communicating with the Internal Revenue Service, rendering written advice with respect to any entity, transaction, plan or arrangement, and representing a client at conferences, hearings, and meetings.

“Contingent Fee” Also Defined Broadly

§10.27(c)(1):

Contingent fee is any fee that is based, in whole or in part, on whether or not a position taken on a tax return or other filing avoids challenge by the Internal Revenue Service or is sustained either by the Internal Revenue Service or in litigation. A contingent fee includes a fee that is based on a percentage of the refund reported on a return, that is based on a percentage of the taxes saved, or that otherwise depends on the specific result attained. A contingent fee also includes any fee arrangement in which the practitioner will reimburse the client for all or a portion of the client's fee in the event that a position taken on a tax return or other filing is challenged by the Internal Revenue Service or is not sustained, whether pursuant to an indemnity agreement, a guarantee, rescission rights, or any other arrangement with a similar effect.

Exceptions, While Broadened, Still Very Narrow

§10.27(b):

- (2): A practitioner may charge a contingent fee for services rendered in connection with the Service's examination of, or challenge to--
 - (i) An original tax return; or
 - (ii) An amended return or claim for refund or credit where the amended return or claim for refund or credit was filed within 120 days of the taxpayer receiving a written notice of the examination of, or a written challenge to the original tax return.
- (3) A practitioner may charge a contingent fee for services rendered in connection with a claim for credit or refund filed solely in connection with the determination of statutory interest or penalties assessed by the Internal Revenue Service.
- (4) A practitioner may charge a contingent fee for services rendered in connection with any judicial proceeding arising under the Internal Revenue Code.

Bottom Line

- A lawyer, CPA or enrolled agent cannot charge a contingent fee, performance-based fee, or refundable fee for tax planning services – period.
- There has been some faulty news reporting on this point, and perhaps some erroneous folklore.

Now, the Brouhaha Over “Return Preparation” Standards

- Historically, it generally has been thought that a representative’s professional responsibility should be coextensive with that of the client.
- Although in some cases taxpayers can be subject to penalty if they do not “disclose” and do not meet “more likely than not” or “substantial authority” standard, general threshold for penalty for position without disclosure is “realistic possibility of success.”

Similarly, Until this Year, “Return Preparer” Penalty Standard Reflected RPOS

Section 6694(a), prior to amendment in 2007:

If --

- (1)** any part of any understatement of liability with respect to any return or claim for refund is due to a position for which there was not a realistic possibility of being sustained on its merits,
- (2)** any person who is an income tax return preparer with respect to such return or claim knew (or reasonably should have known) of such position, and
- (3)** such position was not disclosed as provided in section 6662(d)(2)(B)(ii) or was frivolous,

such person shall pay a penalty of \$250 with respect to such return or claim unless it is shown that there is reasonable cause for the understatement and such person acted in good faith.

Section 6694(a) as Amended:

(1) IN GENERAL. --Any tax return preparer who prepares any return or claim for refund with respect to which any part of an understatement of liability is due to a position described in paragraph (2) shall pay a penalty with respect to each such return or claim in an amount equal to the greater of --

(A) \$1,000, or

(B) 50 percent of the income derived (or to be derived) by the tax return preparer with respect to the return or claim.

(2) UNREASONABLE POSITION. --A position is described in this paragraph if --

(A) the tax return preparer knew (or reasonably should have known) of the position,

(B) there was not a reasonable belief that the position would more likely than not be sustained on its merits, and

(C)

(i) the position was not disclosed as provided in section 6662(d)(2)(B)(ii), or

(ii) there was no reasonable basis for the position.

(3) REASONABLE CAUSE EXCEPTION. --No penalty shall be imposed under this subsection if it is shown that there is reasonable cause for the understatement and the tax return preparer acted in good faith.

Wide Scope of “Return Preparation” under § 6694

§ 7701(a)(36)(A) has long provided that generally

—

[t]he term "income tax return preparer" means any person who prepares for compensation, or who employs one or more persons to prepare for compensation, any return of tax imposed by subtitle A or any claim for refund of tax imposed by subtitle A. For purposes of the preceding sentence, the preparation of a substantial portion of a return or claim for refund shall be treated as if it were the preparation of such return or claim for refund.

Initial IRS Administrative Response

- Notice 2007-54 (June 11): New preparer rules were to apply to returns filed after 12/31/07.

Proposed Amendment to § 10.34 of Circular 230

- (a) *Tax returns.* A practitioner may not sign a tax return as a preparer unless the practitioner has a reasonable belief that the tax treatment of each position on the return would more likely than not be sustained on its merits (the more likely than not standard), or there is a reasonable basis for each position and each position is adequately disclosed to the Internal Revenue Service. A practitioner may not advise a client to take a position on a tax return, or prepare the portion of a tax return on which a position is taken, unless--
- (1) The practitioner has a reasonable belief that the position satisfies the more likely than not standard; or
 - (2) The position has a reasonable basis and is adequately disclosed to the Internal Revenue Service.

Proposed Amendment to Circ. 230 (cont'd)

- In keeping with Announcement 2007-54, proposed amendment would be effective with respect to returns filed no earlier than 1/1/08, even if reg. is finalized sooner.
- Although Circ. 230 standard is labeled a return-preparation standard, it is in fact an “advice” standard.

Practical Questions

- Will practitioner potentially be subject to discipline whenever taxpayer is penalized?
- How will MLTN standard be interpreted with respect to “measurement” issues – e.g., transfer pricing or determination of R&D credits: Must one believe that at least half the benefits will be sustained, or (more natural reading) that there is more than a 50% likelihood that reporting position will be sustained in full?
- Tax community hasn’t even begun to digest implications of the new standard.