

Federal Tax Practice and Procedures

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By

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TABLE OF CONTENT

Acknowledgements	xiii
List of Acronyms	xiv
List of Figures.....	xv
List of Cited Cases.....	xvi
Chapter 1	1
Organization of the Internal Revenue Service	
1.1 History of the IRS	
1.2 IRS Organization	
• Mission	
• IRS organization	
1.3 IRS Budget and workforce	
1.4 IRS Privacy compliance: Privacy and civil liberty impact assessments (PCLIA)	
1.5 The taxpayer Bill of Rights	
1.6 The Taxpayer advocate service	
Chapter 2	8
Tax Practice and Ethical Standards	
2.1 General	
2.2 Professionals allowed to Practice before the IRS	
2.3 Disciplinary process	
➤ Due Process	
➤ The Appeal before the treasury Appellate Authority	
➤ The US District Court Contest	
2.4 Authorized Sanctions under Circular 230	
2.5 Fate of a discipline practitioner	
2.6 AICPA Statements on Standards for Tax Services	
Chapter 3	17
The Internal Revenue Code and Other IRS Pronouncements	
3.1 General	

3.2 The Internal Revenue Code	
3.1.1 The IRC organization	
3.1.2 The Formal Tax Legislation Process	
3.3 Treasury Regulations	
3.3.1 Legislative regulations	
3.3.2 Interpretative regulations	
3.3.3 Temporary, and final regulations	
3.4 Revenue Rulings and Revenue Procedures, and Notices	
▪ Revenue Ruling	
▪ Revenue Procedure	
▪ A Notice	
3.5 Private Letter Rulings	
3.6 Determination letters	
3.7 Technical Advice memoranda	
Chapter 4	24
Tax Audit Process and Tax Assessment Period	
4.1 General	
4.2 The Audit Process	
4.3 Tax Assessment Period	
➤ An open-end consent	
➤ A restricted consent	
4.4 Taxpayers options	
Chapter 5	31
Federal Tax Court System	
5.1 General	
5.2 The three trier courts	
5.2.1 U.S. Tax Court	
5.2.2 U.S. District Court	
5.2.3 U.S. Court of Federal Claims	
5.3 The Appellate or Circuit Courts	
5.4 The US Supreme Court	
Chapter 6	38
Federal Tax Court: Rules of Practice and Procedure	
6.1 General	
6.2 Collection Due Process Act	
6.3 Tax Courts: Rules of Practice and Procedure	
6.4 U.S. Court of Federal Claims	

Chapter 7	45
Assessment of Tax Deficiencies	
7.1 General	
7.2 The Notice of Deficiency: Purpose and Criteria for issuance	
7.3 Signing and Dating the Notice of Deficiency	
7.4 Notice of Deficiency Reconsideration Cases	
7.5 Fates of the notice of deficiency	
7.6 Rescission the Deficiency note	
7.7 Petition to the US Tax Court	
Chapter 8	51
Tax Civil Penalties	
8.1 General	
8.2 Alternative to Civil fraud penalties	
8.3 Types of civil penalties	
8.3.1 Failure to File Penalty	
8.3.2 Failure to Pay Penalty	
8.3.3 Accuracy-Related Penalty	
8.3.4 Civil Fraud Penalty	
8.3.5 Erroneous Claim for Refund or Credit penalty	
8.3.6 Failure to Deposit Penalty	
8.3.7 Tax Preparer Penalties	
8.3.8 The Dishonoured Check or Other Form of Payment Penalty	
8.3.9 Underpayment of Estimated Tax by Corporations Penalty	
8.3.10 Underpayment of Estimated Tax by Individuals	
8.3.11 International Information Reporting Penalty	
8.4 The reasonable cause	
Chapter 9	61
Criminal Tax Practice and Procedures	
9.1 General	
9.2 The Elements of Section 7206(2) Offense	
9.3 Statute of limitations for Section 7206(2)	
9.4 Civil Injunctions against Fraudulent Tax preparers	
Chapter 10	68
Criminal Tax Statutes	
10.1 General	
10.2 Elements of the Offense	
10.3 Types of criminal tax offenses	
10.3.1 Structuring Transactions to Evade Cash Reporting	

10.3.2 Attempt to Evade or Defeat Tax	
10.3.3 Attempt to Evade or Defeat Any Tax or Payment Thereof	
10.3.4 Willful Failure to Collect or Pay Over Tax	
10.3.5 Willful Failure to File Return, Supply Information, or Pay Tax	
10.3.6 Fraudulent withholding	
10.3.7 Tax Money Laundering	
10.4 IRS-CI counts down top 10 cases of 2022	
10.4.1 The Elias Eldabbagh Case	
10.4.2 The King Isaac Umoren case	
10.4.3 The Christopher Burnell Case	
10.4.4 The Michael Dexter Little Case	
10.4.6 The Mehef Bey and Iran Backstrom case	
10.4.7 The David Bunevacz Case	
10.4.8 The Paulette Carpoﬀ Case	
10.4.9 The Michael J. DaCorta Case	
10.4.10 The Michael Avenatti Case	
Chapter 11	88
Overpayments, Refunds, and Refund Litigation	
11.1 General	
11.2 Taxpayer overpayment	
11.2.1 Availability Dates for Overpayments	
11.2.2 Rules for Applying Offsets under Section 6402	
11.3 Taxpayers refunds	
11.4 Refund Litigation	
11.4.1 General rules	
• Extensions of time for refund filing	
• Taxpayer Administrative File	
• Tax Shelter Penalty Refund	
Chapter 12	97
The IRS Summons Enforcement under Section 7604	
12.1 General	
12.2 IRS summons on a third-party record keeper	
12.3 Civil Enforcement of Summons	
12.4 Summons in Criminal Investigation	
12.5 Litigants opposition to summons	
12.5.1 Powell Requirements	
12.5.2 Notice	
12.5.3 Criminal Referral	

12.5.4 Constitutional Arguments	
12.5.5 Privilege and Equitable Estoppel	
12.6 Civil and Criminal Contempt Regarding Summons	
• Civil contempt	
• Criminal contempt	
Chapter 13	109
Liens, Levies, and Collection Procedures	
13.1 General	
13.2 Tax lien	
13.3 A seizure of property	
13.3.1 Seizable Property	
13.3.2 Property Not Seizable	
13.3.3 Appealing a proposed seizure	
13.4 Collection process	
- Extension of Time to Pay	
- Installment Agreement	
- Offer in Compromise	
13.5 Case study	
Chapter 14	118
Tax Forms	
14.1 General	
14.2 Form 1040	
• Schedule 1 (Form 1040) Additional Income and Adjustments to Income	
• Schedule 2 (Form 1040), Additional Taxes	
• Schedule 3 (Form 1040), Additional Credits and Payments	
• Schedule SE for self-employee	
14.3 Form 1065	
• Schedule B-1 (Form 1065), Information on Partners Owning 50% or More of the Partnership	
• Schedule C (Form 1065, Additional Information for Schedule M-3 Filers	
• Schedule D (Form 1065), Capital Gains and Losses	
• Schedule K-1 (Form 1065), Partner's Share of Income, Deductions, Credits, etc.	
• Schedules K-2 (Form 1065) & K-3 (Form 1065)	
▪ Schedule M-2, Analysis of Partner's Capital Accounts	
• Schedule M-3 (Form 1065), Net Income (Loss) Reconciliation for Certain Partnerships	

14.4 Form 1120	
• Schedule M 1	
• Schedule M-2	
• Schedule M-3	
14.5 Form 1120s	
• Schedule B-1 (Form 1120-S), Information on Certain Shareholders of an S	
• Schedule D (Form 1120-S), Capital Gains and Losses and Built-in Gains	
• Schedule K-2 (Form 1120-S), Shareholders' Pro Rata Share Items—International	
• Schedule M-3 (Form 1120-S), Net Income (Loss) Reconciliation for S	
14.6 Form 8832- The Entity Classification	
14.7 Form 2553- Election by a Small Business Corporation	
Chapter 15	219
The U.S. Competent Authority	
15.1 General	
15.2 The Pre-Filing Conference	
15.3 Content and Form of Competent Authority Request	
15.4 Competent Authority Process	
15.5 Competent Authority Outcomes	
Bibliography	226
Glossary of Terms	227

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LIST OF ACRONYMS

- AGI: Adjusted Gross Income
- AMT: Alternative Minimum Tax
- AV: Assessed Valuation
- CT: Corporation Tax
- BOE: Board of Equalization
- DOJ: Justice Department
- FTB: Franchise Tax Board
- IRA: Individual Retirement Account
- IRB: Internal Revenue Bulletin
- IRC: Internal Revenue Code
- IRS: Internal Revenue Service
- LB&I: Large Business & International
- NOL: Net Operating Loss
- PIT: Personal Income Tax
- PTIN: Preparer Tax Identification Number
- R&D: Research and Development Credit
- SSN: Social Security Number
- TI: Taxable Income
- TIN: Taxpayer Identification Number
- TY: Taxable Year
- UBI: Unrelated Business Income

LIST OF FIGURES

- Figure 1.1: IRS operating costs
- Figure 10.1: Money laundering cycle
- Figure 15.1: Competent authority procedure

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CHAPTER 1

ORGANIZATION OF THE INTERNAL REVENUE SERVICE

Abstract

Congress established the Office of the Commissioner of Internal Revenue under the Department of the Treasury. The IRS reorganized itself in 2000 to closely resemble the private sector, creating four major business divisions, each aligned to a group of taxpayers with similar needs. The IRS is organized into two primary organizations—the Deputy Commissioner for Services and Enforcement (DCSE) and the Deputy Commissioner for Operations Support (DCOS). Each and every taxpayer has a set of fundamental rights they should be aware of when dealing with the IRS.

1.1 History of the IRS

On February 21, 1787, Congress approved a Constitutional Convention to revise the Articles of Confederation: “... the Congress shall have the power to lay and collect taxes, duties, imposts, and excesses, to pay the debts and provide for the common defense and general welfare of the United States.”

On September 2, 1789, Congress established the Department of the Treasury and appointed Alexander Hamilton as the first Secretary¹. On July 1, 1862, President Lincoln signed the second revenue measure of the Civil War into law. This law levied internal taxes and established a permanent internal tax system.

Congress established the Office of the Commissioner of Internal Revenue under the Department of the Treasury. On July 17, 1862, George S. Boutwell became its first Commissioner². The Revenue Act of June 30, 1864, authorized the Commissioner of Internal Revenue to compromise all

¹ IRS (2019): IRS History Timeline, pp. 1-48, https://www.irs.gov/pub/irs-utl/irs-history-timeline_march-2019.pdf.

² Idem.

suits “relating to internal revenue,” to abate outstanding assessments and to refund taxes subject to current regulations³.

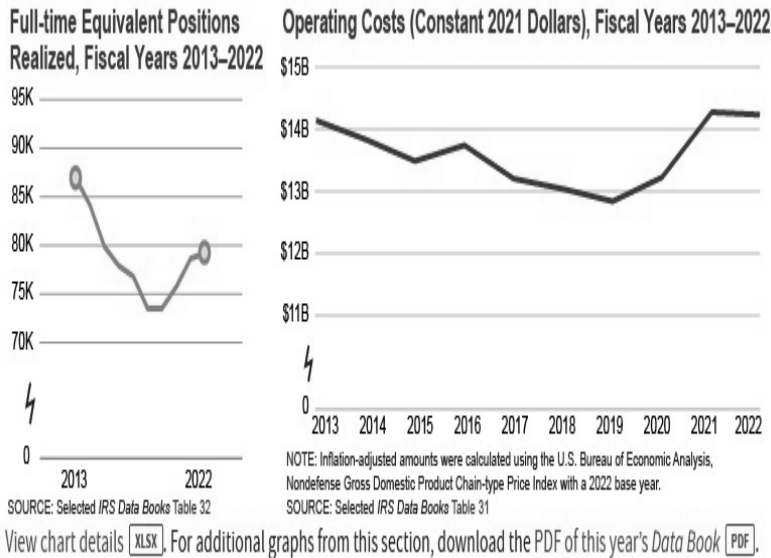
On February 25, 1913, the 16th Amendment officially became part of the Constitution, granting Congress constitutional authority to levy taxes on corporate and individual income. The Bureau of Internal Revenue established a Personal Income Tax Division and Correspondence Unit to answer a flood of questions about its enforcement, and a special division within General Counsel to prepare opinions interpreting internal revenue laws. On June 1, 1930, the main section of the new Internal Revenue building opened. On August 14, 1935, Franklin D. Roosevelt signed the Social Security Act. Employees originally paid one percent of the first \$3,000 of their salaries to finance the benefits. The law required a new system of tax withholding, which the Bureau of Internal Revenue had to collect and turn over to the Social Security Trust Fund. In 1952, President Harry S. Truman called for a comprehensive reorganization of the Bureau of Internal Revenue. The agency officially became the Internal Revenue Service on July 9, 1953. In 1959, Congress and the Secretary of the Treasury approved IRS plans to install a nationwide automatic data processing system. On January 1, 1967, the IRS launched a nationwide, automated federal tax system. That same year, the IRS established a long-range study to determine automated data processing requirements through 1970 and beyond. Under the Tax Reform Act, U.S. Congress passed the Tax Reform Act to “simplify the income tax code.” The Service marked a pivotal change in the way it interacted with taxpayers by beginning the progression from paper-based filing to electronic filing. In 1991, the IRS started electronic filing to lower operating costs and paper use. The Service anticipated over 90% of 150 million individual returns would be filed electronically for the 2019 tax-filing season. The IRS Restructuring and Reform Act of 1998 prompted the most comprehensive reorganization and modernization of the IRS in nearly half a century. The IRS reorganized itself in 2000 to closely resemble the private sector, creating four major business divisions, each aligned to a group of taxpayers with similar needs.

In 2014, Commissioner John Koskinen and Taxpayer Advocate Nina E. Olson released an enhanced Taxpayer Bill of Rights. Written to be clear, understandable and accessible for both taxpayers and IRS employees, the updated document grouped the dozens of existing rights in the tax code into ten fundamental rights. The Taxpayer Bill of Rights is displayed in IRS

³ Idem.

offices across the country as a reminder that “respecting taxpayer rights continue to be a top priority for IRS employees.

Figure 1.1: IRS operating costs



1.2 IRS Organization

- Mission and organization

The IRS is a bureau of the Department of the Treasury and one of the world's most efficient tax administrator. The IRS was created to provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all. The IRS is organized to carry out the responsibilities of the Secretary of the Treasury under Internal Revenue Code 7801. The Secretary has full authority to administer and enforce the internal revenue laws and the power to create an agency to enforce these laws. The IRS was created based on this legislative grant. IRC Section 7803 provides for the appointment of a Commissioner of Internal Revenue to administer and supervise the execution and application of the internal revenue laws. The IRS is organized to carry out the responsibilities of the US Secretary of the Treasury under Internal Revenue Code Section 7801. The Secretary has the authority to

administer and enforce the internal revenue laws and the power to create an agency to enforce said laws.

- IRS organization

The IRS is organized into two primary organizations—the Deputy Commissioner for Services and Enforcement (DCSE) and the Deputy Commissioner for Operations Support (DCOS).

DCSE oversees the following operating divisions:

- Wage and Investment (W&I)
- Small Business/Self-Employed (SB/SE)
- Large Business and International (LB&I)
- Tax Exempt and Government Entities (TE/GE)
- Criminal Investigation (CI)
- Office of Professional Responsibility (OPR)
- Whistle-blower Office
- Return Preparer Office (RPO)
- Online Services

DCOS oversees the following integrated support functions:

- Information Technology (IT)
- Chief Financial Officer (CFO)
- Facilities Management and Security Services (FMSS)
- Human Capital Office (HCO)
- Private, Government Liaison and Disclosure (PGLD)
- Equity, Diversity and Inclusion (EDI)
- Office of the Chief Risk Office (CRO)
- Procurement
- Research Applied Analytics and Statistics (RAAS)

1.3 IRS Budget and workforce

Section 6 of the IRS Data Book provides an overview of IRS budget activities, including taxpayer services, enforcement, operations support, and business systems modernization. The section also includes information on the size and composition of the IRS workforce. IRS's actual expenditures were almost \$14.3 billion for overall operations in Fiscal Year (FY) 2022, including supplemental funding to support the IRS's COVID-19 pandemic-related activities. In FY 2022, the IRS used 79,070 full-time equivalent (FTE) positions in conducting its work, a decrease of 9.1 percent since FY

2013. Ethnic minority employees made up 53.7 percent of the IRS and Chief Counsel workforce, compared to a 39.2 percent share of the overall federal civilian labor force. Women represented 65.0 percent of IRS and Chief Counsel personnel, compared to 45.0 percent of the overall federal civilian labour force, and veterans comprised 9.4 percent of the IRS and Chief Counsel work-force.

1.4 IRS Privacy compliance: Privacy and civil liberty impact assessments (PCLIA)

A PCLIA is a decision-making tool used to identify and mitigate privacy risks at the beginning of and throughout the development life cycle of a program or system. PCLIA's help the public understand what PII the agency is collecting, why it is being collected, and how it will be used, shared, accessed, secured and stored. The PCLIA uses the Fair Information Practice Principles (FIPPs) to assess and mitigate any impact on an individual's privacy. Generally, a PCLIA is required before a program or system containing PII becomes operational. Generally, a PCLIA accomplishes these goals:

- Ensure conformance with applicable legal, regulatory, and policy requirements for privacy.
- Determine the risks and effects.
- Evaluate protections and alternative processes to mitigate potential privacy risks.
- Provide assurance to the public about the protection of privacy and constitutional rights

1.5 The taxpayer Bill of Rights

Some countries have provided charters or declarations of taxpayer rights. The main effect of these charters is to prohibit arbitrary practices by the tax administration against taxpayers⁴. The Taxpayer Bill of Rights is a cornerstone document that highlights the 10 fundamental rights taxpayers have when dealing with the Internal Revenue Service. The IRS wants every taxpayer to be aware of these rights in the event they need to work with the IRS on a personal tax matter. Each and every taxpayer has a set of

⁴ Frans Vanistendael (1996): Legal Framework for Taxation, IMF, Tax Law Design and Drafting, volume 1; pp. 1-56,
<https://www.imf.org/external/pubs/nft/1998/tlaw/eng/ch2.pdf>.

fundamental rights they should be aware of when dealing with the IRS. These include:

➤ The Right to Be Informed.

Taxpayers have the right to know what they need to do to comply with the tax laws. They are entitled to clear explanations of the laws and IRS procedures in all tax forms, instructions, publications, notices and correspondence. They have the right to be informed of IRS decisions about their tax accounts and to receive clear explanations of the outcomes.

➤ The Right to Quality Service.

Taxpayers have the right to receive prompt, courteous, and professional assistance in their dealings with the IRS, to be spoken to in a way they can easily understand, to receive clear and easily understandable communications from the IRS, and to speak to a supervisor about inadequate service.

➤ The Right to Pay No More Than the Correct Amount of Tax.

Taxpayers have the right to pay only the amount of tax legally due, including interest and penalties, and to have the IRS apply all tax payments properly.

➤ The Right to Challenge the IRS's Position and Be Heard.

Taxpayers have the right to raise objections and provide additional documentation in response to formal IRS actions or proposed actions, to expect that the IRS will consider their timely objections and documentation promptly and fairly, and to receive a response if the IRS does not agree with their position.

➤ The Right to Appeal an IRS Decision in an Independent Forum.

Taxpayers are entitled to a fair and impartial administrative appeal of most IRS decisions, including many penalties, and have the right to receive a written response regarding the Office of Appeals' decision. Taxpayers generally have the right to take their cases to court.

➤ The Right to Finality.

Taxpayers have the right to know the maximum amount of time they have to challenge the IRS's position as well as the maximum amount of time the

IRS has to audit a particular tax year or collect a tax debt. Taxpayers have the right to know when the IRS has finished an audit.

➤ The Right to Privacy.

Taxpayers have the right to expect that any IRS inquiry, examination, or enforcement action will comply with the law and be no more intrusive than necessary, and will respect all due process rights, including search and seizure protections and will provide, where applicable, a collection due process hearing.

➤ The Right to Confidentiality.

Taxpayers have the right to expect that any information they provide to the IRS will not be disclosed unless authorized by the taxpayer or by law. Taxpayers have the right to expect appropriate action will be taken against employees, return preparers, and others who wrongfully use or disclose taxpayer return information.

➤ The Right to Retain Representation.

Taxpayers have the right to retain an authorized representative of their choice to represent them in their dealings with the IRS. Taxpayers have the right to seek assistance from a Low Income Taxpayer Clinic if they cannot afford representation.

➤ The Right to a Fair and Just Tax System.

Taxpayers have the right to expect the tax system to consider facts and circumstances that might affect their underlying liabilities, ability to pay, or ability to provide information timely. Taxpayers have the right to receive assistance from the Taxpayer Advocate Service if they are experiencing financial difficulty or if the IRS has not resolved their tax issues properly and timely through its normal channels.

1.6 The Taxpayer advocate service

The Taxpayer Advocate Service is an independent organization within the IRS. The TAS mandate is to ensure that every taxpayer is treated fairly, and that you know and understand your rights as a taxpayer. It helps to guide taxpayer through the often-confusing process of resolving tax problems that he/she may not be able to solve on his own.

CHAPTER 2

TAX PRACTICE AND ETHICAL STANDARDS

Abstract

Circular 230 defines “practice” and who may practice before the IRS; describes a tax professional’s duties and obligations while practicing before the IRS; authorizes specific sanctions for violations of the duties and obligations; and, describes the procedures that apply to administrative proceedings for discipline. The OPR’s oversight of the conduct of tax practice extends to all individuals who make a presentation to the IRS relating to a taxpayer’s rights, privileges, or liabilities under laws or regulations administered by the IRS. More, the AICPA has developed professional ethics standards for CPAs.

2.1 General

The Office of Professional Responsibility (OPR) supports the IRS’s strategy to enhance enforcement of the tax law by ensuring that tax professionals adhere to tax practice standards and follow the law. The OPR is the governing body responsible for interpreting and applying the Regulations Governing Practice before the Internal Revenue Service. The OPR has exclusive responsibility for practitioner conduct and discipline, including instituting disciplinary proceedings and pursuing sanctions. It functions independently of the Title 26 enforcement components of the IRS. Circular 230 defines “practice” and who may practice before the IRS; describes a tax professional’s duties and obligations while practicing before the IRS; authorizes specific sanctions for violations of the duties and obligations; and, describes the procedures that apply to administrative proceedings for discipline. Practice before the IRS comprehends all matters connected with a presentation to the IRS, or any of its officers or employees, relating to a taxpayer’s rights, privileges, or liabilities under laws or regulations administered by the IRS. Such presentations include, but are not limited to, preparing documents; filing documents; corresponding and communicating with the IRS; rendering oral and written advice with respect to any entity, transaction, plan or arrangement, or other plan or arrangement having a

potential for tax avoidance or evasion; and representing a client at conferences, hearings and meetings.

2.2 Professionals allowed to Practice before the IRS

The below professionals are admitted to practice before the IRS:

- State-licensed Attorneys and Certified Public Accountants (CPAs) authorized and in good standing with their state licensing authority who interact with tax administration at any level.
- Individuals enrolled to practice before the IRS: Enrolled Agents, Enrolled Retirement Plan Agents, and Enrolled Actuaries.
- Individuals providing appraisals used in connection with federal tax matters (e.g., charitable contributions; estate and gift assets; fair market value for sales gain, etc.).
- Individuals who are unenrolled and unlicensed (as attorneys or CPAs) and who represent taxpayers before IRS examination, customer service, and similar personnel, including the Taxpayer Advocate Service, in connection with returns they prepared and signed. For more information, go to [IRS.gov/tax-professionals/annual-filing-season-program](https://www.irs.gov/tax-professionals/annual-filing-season-program).
- Licensed and unlicensed individuals who give written advice with respect to any entity, transaction, plan or arrangement, or other plan or arrangement, which is of a type the IRS determines as having a potential for tax avoidance or evasion. For this purpose, “written advice” means all forms of written material, including the content of an email, given in connection with any law or regulation administered by the IRS.
- Any individual submitting a power of attorney in connection with limited representation of a taxpayer before the IRS with respect to a specific matter before the Agency.

2.3 Disciplinary process

The OPR’s authority and case determinations are independent of the enforcement functions performed by the general IRS population. Referrals to the OPR alleging violations of Circular 230 are received from a variety of sources both internal and external. Only rarely does the OPR initiate its own projects to identify specific matters for investigation. When a referral is received, the OPR independently determines, based on all available pertinent facts and circumstances, whether the alleged violation is one

which calls into question a practitioner's fitness to continue to practice. If the OPR determines that an alleged violation warrants investigation, the OPR provides the practitioner with information regarding the conduct alleged, and the fact that the OPR has initiated a disciplinary investigation. The letter informing the practitioner of the allegations gives the practitioner an opportunity to provide any evidence or documentation s/he believes is relevant to the OPR's determination. The practitioner may also have a conference with the OPR. After a thorough investigation of the facts and an analysis/consideration of aggravating and mitigating circumstances, the OPR decides whether it will seek corrective action, including possible discipline.

➤ Due Process

Due process protections are incorporated throughout the disciplinary process. During the investigation, the practitioner may propose a resolution of the matter, which may include discipline or other corrective action. If the OPR and the practitioner cannot agree on a resolution of the matter and the OPR believes discipline is appropriate, a formal "complaint" is drafted and the case is referred to the Office of Chief Counsel, General Legal Services (GLS). GLS sends a letter to the practitioner offering a final opportunity to resolve the matter without a proceeding. If settlement is not reached, GLS files the complaint to commence a civil proceeding before an Administrative Law Judge (ALJ). The ALJ presides over the proceeding and decides the merits of the case against the practitioner (the "respondent"). The proceeding is generally governed by the Administrative Procedures Act (5 USC § 500 et seq.). The ALJ may order a hearing to be held, during which the government and respondent present their evidence and arguments. The case may be settled by concurrence of both parties at any time prior to a decision.

If a hearing is conducted, and after post-hearing briefs are submitted, the ALJ issues an Initial Decision and Order. The ALJ may find the OPR has proven the allegations of the complaint and conclude the respondent committed violations of Circular 230 for which the respondent should be sanctioned. The ALJ may then go on to impose the sanction which the OPR proposed. Alternatively, the ALJ may rule in the OPR's favor on the facts and law but increase or reduce the recommended sanction. Or the ALJ may reject both the OPR's version of events and its recommendation of a sanction, and thus dismiss the case.

➤ The Appeal before the treasury Appellate Authority

Following the ALJ's Decision and Order, either party may appeal the case to the Treasury Appellate Authority. If neither party appeals within 30 days, the ALJ's Initial Decision and Order becomes the Final Agency Decision. If either party appeals, the Treasury Appellate Authority will, after receiving briefs from both parties and reviewing the record, render the Final Agency Decision. For the OPR, a decision by the Appellate Authority is a final determination in the case.

➤ The US District Court Contest

A practitioner who is not satisfied with the Treasury Appellate Authority's Final Agency Decision may file a complaint in U.S. District Court to contest it. This proceeding is also conducted according to the Administrative Procedures Act, under which the Federal district judge will review findings of facts based only on the administrative record and will set aside agency action only if arbitrary or capricious, contrary to law, or an abuse of discretion. The proceeding is not a trial de novo.

Examples of misconduct

- Inaccurate or unreasonable entries/omissions on tax returns, financial statements and other documents.
- A lack of due diligence exercised by the practitioner.
- A wilful attempt by the practitioner to evade the payment or assessment of any Federal tax.
- Cashing, diverting or splitting a taxpayer's refund by any means, electronic or otherwise.
- "Patterns" of misconduct under Circular 230 involving multiple years, multiple clients or unprofessional conduct demonstrated to multiple IRS employees.
- Potential conflict-of-interest situations, such as representation of both spouses who have a joint income tax liability or when representation is affected by competing interests of the practitioner.
- Any wilful violation of Circular 230 provisions.

2.4 Authorized Sanctions under Circular 230

Circular 230 discipline includes Censure (essentially a public reprimand), Suspension of practice privileges and Disbarment. A suspension can be for

a fixed term or may be indefinite, and a practitioner must request and be granted reinstatement by the OPR before practice privileges are restored. When a practitioner is suspended for a fixed term, the individual may not petition to be reinstated to practice before the end of the term. When a practitioner is disbarred, s/he may not petition for reinstatement for five years. The OPR also may propose a monetary penalty on any practitioner who engages in conduct subject to sanction. The monetary penalty may be proposed against the individual or a firm, or both, and can be in addition to any Censure, Suspension or Disbarment. The amount of the penalty may be up to the amount of gross income derived or to be derived from the conduct giving rise to the penalty.

Before any of the above sanctions is imposed, the practitioner (or firm) is provided with notice and an opportunity for a conference and an opportunity for a formal proceeding.

If formal discipline is not appropriate, the OPR may issue a private reprimand or a cautionary “soft letter.” The “soft letter” typically advises a practitioner of allegations and warns against noncompliance with obligations under Circular 230, but does not reach a conclusion as to whether a violation was actually committed.

The OPR may also disqualify an appraiser from further submissions in connection with tax matters. A taxpayer may not rely for a federal tax purpose on an appraisal from a disqualified appraiser that was rendered after the disqualification.

2.5 Fate of a discipline practitioner

A practitioner who has been suspended or disbarred may not represent clients before the IRS, unless and until s/he petitions the OPR for reinstatement and the OPR grants that petition. If a suspension or disbarment is based in whole or in part on action by a State licensing authority (typically a State Board of Accountancy or lawyer disciplinary authority), reinstatement by the State is NOT sufficient to permit practice before the IRS. The same rule applies when a suspension is based in whole or in part on a criminal conviction. Satisfaction of sentencing provisions, such as a term of incarceration or probation, still requires a petition for reinstatement to be made to and approved by the OPR. The OPR will grant reinstatement only when the OPR determines that the petitioner is not likely to engage again in conduct in violation of the rules of practice and that reinstatement would not harm the public interest.