Tax Compliance Issues for Circular 230 Practitioners

EAs, CPAs, Attorneys, Enrolled Actuaries, and Appraisers

By Brien T. Downing, Director, OPR

Overview

The Office of Professional Responsibility (OPR) is the IRS organization that interprets and applies Title 31, Code of Federal Regulations Subtitle A, Part 10, "Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, Enrolled Actuaries and Appraisers before the Internal Revenue Service." These regulations are generally known as "Treasury Department Circular 230," or simply "Circular 230." Circular 230 describes expectations, rights, and obligations of those who represent taxpayers before the IRS. Among those expectations is that tax practitioners will comply with their own personal tax obligations.

In the year ending September 30, 2003, the OPR took disciplinary action against 135 attorneys, CPAs, and Enrolled Agents. In 58 cases, the principal violation was failure to comply with personal tax obligations.

This article will review the rules that were violated, some of the reasons offered to explain those violations, the OPR approach to resolving tax compliance cases, and steps tax practitioners can take if they have tax compliance problems.

About the Author:

Brien Downing was appointed Director of the Office of Professional Responsibility in January 2003.

Tax Compliance Obligations of Tax Practitioners

The tax compliance rules for tax practitioners are the same as those that apply to their clients. Like their clients, tax practitioners must timely file and pay the full amount of their federal tax liability. They must pay their estimated taxes on time, and recognize that an extension of the filing deadline is not an extension of the payment deadline. Failure to meet these obligations exposes tax practitioners to the same penalties and interest as may be imposed on their clients—and those penalties and interest can be abated under the same criteria as are applied to their clients.

So where does the idea of a "higher standard" come from? Circular 230 defines "incompetence and disreputable conduct" by practitioners in §10.51. In §10.51(f), the definition includes:

"Willfully failing to make a federal tax return in violation of the revenue laws of the United States, willfully evading, attempting to evade, or participating in any way in evading or attempting to evade any assessment or payment of any federal tax, or knowingly counseling or suggesting to a client or prospective client an illegal plan to evade Federal taxes or payment thereof."

"Willful" is defined as the violation of a known legal duty, and tax practitioners are well versed in federal tax laws and regulations. Thus, it is generally not hard to demonstrate that a tax practitioner who fails to timely file or pay federal taxes has done so "willfully." As a result, a tax practitioner with tax compliance problems is liable for sanctions under Circular 230 in addition to any penalties and interest that may be imposed under the Internal Revenue Code. There isn't a "higher standard," but there is a higher risk—one that can affect the practitioner's business in very significant ways.

At this point, it may be helpful to address the two most common explanations offered by tax practitioners when

OPR contacts them regarding a tax compliance issue. The first is, "I was due a refund, so I knew I had three years to file." This explanation confuses the filing deadline with the statute of limitations on claiming a refund. Returns must be filed by the due date, unless an extension is available and a timely request for extension is filed. The fact that an individual taxpayer's claim for a refund can be made through an original or amended return filed within three years of the original due date of the return does not change the due date of the return.

The second common explanation is, "I put my clients' needs first, and got to my own returns as soon as I could." A variation on this explanation is, "I put my clients' needs first, and my own returns slipped through the cracks." Either way, it sounds like the story of the cobbler's children who had no shoes. The OPR has not been persuaded. We expect tax practitioners to understand their filing obligations and the rules applicable to extensions of time to file. A tax practitioner who cannot arrange his or her personal and business affairs so that returns can be filed timely (including any extensions) might want to consider another line of work.

How OPR Acts on Tax Compliance Matters

The OPR process for considering Circular 230 violations, including those related to tax compliance, is set out in Subpart D of Circular 230. If information comes to our attention that indicates a possible violation, the first step is to determine the relevant facts. In some cases, information available to the OPR is sufficient to permit us to dismiss the matter with no further action. If we can't, we will send a letter to the practitioner outlining the allegation and asking for his or her side of the story. At this stage, there are three possibilities:

- The practitioner's explanation may provide us with information warranting dismissal of the matter;
- The practitioner may admit the violation occurred; or
- The practitioner may raise issues of material fact that must be further explored before we can reach a conclusion about whether a violation occurred.

Once we reach a conclusion that a violation of Circular 230 occurred, based on admissions or our own efforts to develop the case, we will try to reach an agreement with the practitioner on an appropriate sanction. In most cases, we are able to come to an agreement. If we cannot agree, the case may be litigated before an independent Administrative Law Judge in a process that has many elements of a civil trial. If the practitioner or the OPR disagrees with the Administrative Law Judge's decision, the case can be appealed to the Department of the Treasury and then to Federal District Court.

Range of Sanctions Available

Circular 230 provides for a range of formal and informal sanctions. The most serious sanctions are suspension or disbarment from representation of taxpayers before the IRS. Less serious cases can lead to a censure, which becomes part of the public record but does not impose a restriction on representation of taxpayers, or a reprimand, which is not part of the public record.

An OPR decision on sanction is based on consideration of all relevant facts in the case. Some of the questions we ask include:

• What is the non-compliance issue? Generally, we are looking at failure to file, late filing, late payment, and (less frequently) underreporting. Late 941 and late payment of estimated taxes are also common.

• Is there a pattern of non-compliance? Our primary focus is on the most recent five years. A single serious problem can be the basis for sanction. More often, we see a pattern of problems.

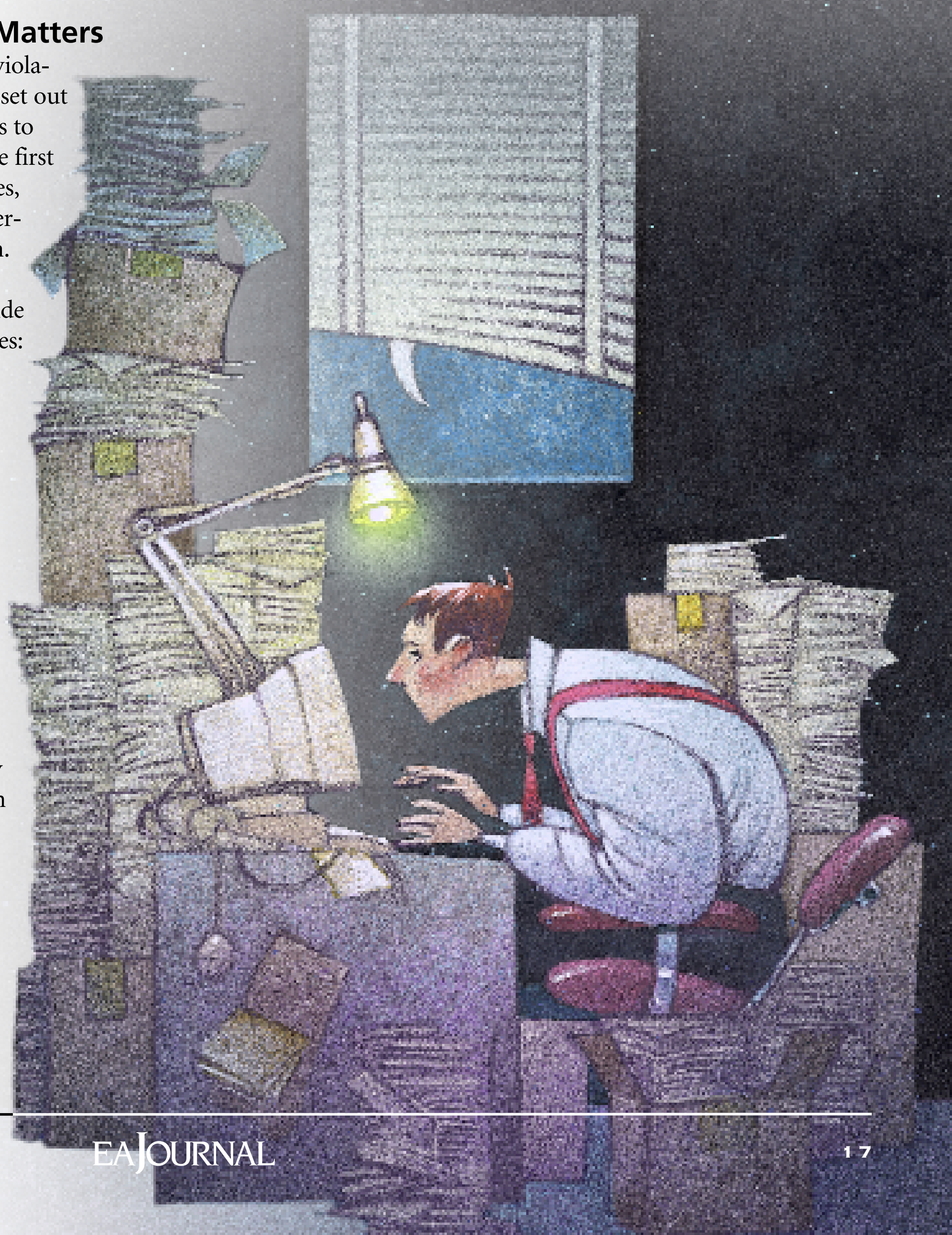

Illustration by Greg Hargreaves

• How significant is the non-compliance? For example, late payment that results in penalties of less than $50 per incident is generally not significant. Similarly, late refund returns may be less significant than late returns with substantial balances due. Failure to pay 941 liabilities is always a serious matter. The extent of delinquency (weeks, months, years), is also a factor.
• Is there evidence of efforts to correct the problem? Two years of late returns followed by three years of compliance suggests a behavior change, as does an installment agreement that is kept current.
• Is there evidence of aggravating or mitigating factors? Aggravating factors include evidence of failure to cooperate in efforts to resolve the tax compliance problem, such as failure to respond to notices or a return secured by a revenue officer. Mitigating factors may include personal circumstances that may help demonstrate that the non-compliance was an unusual event in an otherwise compliant tax record. For example, a family emergency may temporarily distract attention from business and personal tax matters.

Case Examples

The following case summaries illustrate the application of Circular 230 to practitioner tax compliance violations.

Failure to File Individual Income Tax Returns

A practitioner failed to file federal individual income tax returns for four tax years; failed to pay federal individual income taxes for one tax year; was assessed a failure to pay penalty for failure to adhere to an installment agreement; and owed amounts for a civil penalty assessment.

The practitioner's attorney stated that the practitioner, upon receipt of the allegation letter, had filed all required returns and paid all outstanding balances. The attorney also stated that the practitioner had not been aware of the civil penalty assessment but would pay it.

Negotiations resulted in the practitioner's offering to consent to an indefinite suspension with the right to petition for reinstatement after 12 months. The petition would be granted provided: the practitioner has timely filed all federal tax returns for which he or she is responsible; timely paid all outstanding federal tax balances or entered into an installment agreement; is in good standing with state licensing authorities; is not the subject of further allegations of misconduct; and is otherwise in compliance with the regulations contained in Circular 230.

Failure to File Forms 941 and to Remit Payroll Trust Funds

A practitioner was charged with multiple instances of failure to file Forms 941, Employer's Quarterly Federal Tax Return, and multiple failures to timely remit payroll trust funds to the IRS. The practitioner's only asserted defense was economic hardship. After the practitioner declined to consent to suspension, the director issued an administrative complaint and scheduled a hearing before an administrative law judge. Prior to the hearing, the practitioner consented to a 3-year suspension, which the director accepted.

What You Can Do If You Have Tax Compliance Problems

A practitioner who has tax compliance problems can reduce his or her risk of a significant sanction under Circular 230 by taking some common sense steps. First, resolve the non-compliance as soon as possible. File any delinquent returns, pay applicable penalties and interest, and take steps to ensure future compliance. If full payment is not possible, consider an installment agreement and *stay current with payments called for in the agreement.* If there is a possible basis for seeking abatement of penalties and/or interest, do so. Factors that may warrant abatement may also be relevant as mitigating factors in the OPR case. Finally, adopt a cooperative attitude. The OPR will not consider insistence on your rights as a taxpayer as an indication of failure to cooperate, but failure to respond to notices, "substitute for return," enforced collection action, and "secured returns" do not reflect cooperation and efforts to comply. Of course, each case will be considered based on the facts presented.

If you have questions or comments about this or any other matter related to Circular 230, contact OPR at opr@irs.gov. EA