



## TAX LITIGATION ISSUES

## Expert Analysis

# New IRS Focus Is on the Conduct Of Taxpayers' Representatives

The Internal Revenue Service (IRS) is authorized to regulate tax professionals to ensure that attorneys, accountants and other tax practitioners adhere to professional standards and follow the law.

This responsibility falls to the IRS' Office of Professional Responsibility (OPR). Specifically, Circular 230, which sets forth the regulations governing the practice of professionals before the IRS, provides that the OPR "establishes and enforces consistent standards of competence, integrity and conduct for tax professionals."<sup>1</sup>

In recent years, the Department of Justice has undertaken several high-profile prosecutions of tax practitioners, especially in the tax shelter area. Simultaneously, the OPR has increased its focus on tax professionals and their efforts on behalf of their clients. New initiatives announced by the OPR, in addition to a recent case out of the U.S. Court of Appeals for the Seventh Circuit, reflect the increased exposure of tax professionals to examination of their own conduct.

### Efforts of the OPR

At a Tax Executives Institute conference held in Boston last October, Michael Chesman, the director of the OPR, announced a number of initiatives with respect to the practice of tax professionals. First, Mr. Chesman announced that the IRS will begin to check the personal tax compliance history of any tax professional filing a Power of Attorney and Declaration of Representative, or Form 2848.<sup>2</sup> While the OPR has long performed tax compliance checks on individuals seeking licensure as "enrolled agents"—a tax professional who



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has met specific requirements to represent clients before the IRS, the new policy will mean that attorneys and accountants appearing on behalf of clients in connection with investigations and audits will have their own filing and payment compliance scrutinized.

This extraordinary step—subjecting professional representatives to investigation simply for plying their trade—may create practical problems. Taxpayers generally retain tax professionals to assist them in connection with audits or other investigations and are required to sign a Form 2848 to authorize the practitioner to communicate with the IRS on their behalf. Because there is often an exigency associated with the retention of a tax professional, there is some concern that the taxpayer might suffer delay while the IRS checks the practitioner's personal compliance. Indeed, one professional suggested that it makes more sense to have the numbers assigned to each practitioner who deals with the IRS become renewable and "have a process for checking us out before they renew them—perhaps even having us sign a statement that we will notify [the] IRS if we are out of compliance."<sup>3</sup>

The second initiative announced by Mr. Chesman was the revision of the consent agreement a tax professional signs at the conclusion of an investigation of violations of Circular 230. Previously, adverse actions taken by the OPR were not made public. Now, however, as part of the sanction and settlement process, the practitioner will have to admit to having

violated a specific section of Circular 230 and agree to have that information published by the IRS. Associated with this enhanced transparency in the resolution of Circular 230 investigations is an increased willingness to use the threat of sanctions to deter professionals from disputing allegations of misconduct. According to Mr. Chesman, practitioners who pursue litigation and are unable to reach an agreement with the IRS may face stricter sanctions. "In no situation do we suggest a lower sanction during that period of time, and unless new facts are found, the sanction generally is heavier."<sup>4</sup>

Finally, Mr. Chesman noted the OPR's information-sharing relationship with state authorities, stating that his office is in the process of finalizing and executing memoranda of understanding with all 50 states, the District of Columbia, and Puerto Rico to establish formal procedures to exchange information. This is significant since the OPR will bar a professional from practice before the IRS if it learns that the professional has been convicted of a state felony. Although Mr. Chesman said that the OPR's system of accepting referrals from states has been successful, he stated that the OPR does not intend to expand its focus to tax professionals who knowingly violate foreign laws "unless and until the state bar or board dealt with that issue."<sup>5</sup>

As addressed by Mr. Chesman, it is clear that the OPR aims to hold tax professionals practicing before the IRS to high standards in their personal and professional lives. The expansion of tax compliance checks, the broadening of settlement and sanction agreements for those who have violated Circular 230, and the growth of the OPR's relationship with the states, all point to closer scrutiny of tax professionals and greater sanctions for those who are perceived to have fallen short of their obligations.

### 'Khan v. United States'

A recent decision by the Seventh Circuit may foretell even broader scrutiny of tax professionals. In *Khan v. United States*,<sup>6</sup>

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an IRS agent conducting an audit of two taxpayers (the Khans) issued several summonses seeking the testimony of an accountant (Greisman) who had advised the Khans with respect to several tax shelter transactions. In response to a petition to quash the summonses, the agent asserted that his examination sought to determine the Khans' tax liability, but neglected to state whether the IRS had referred Mr. Greisman to the Department of Justice for criminal investigation. Section 7602(d)(1) of the Internal Revenue Code (IRC) provides that "[n]o summons may be issued...with respect to any person if a Justice Department referral is in effect with respect to such person." Based on this statute, the district court quashed the summonses because the IRS would not reveal whether it had made a criminal referral with respect to Mr. Greisman as a result of his involvement in the Khans' matters.

Focusing on the statute's reference to "any person," the district court held that the preclusion on the issuance of summonses was not limited specifically to the taxpayer being investigated. Rather, "[t]he court found that [Mr.] Greisman's potential liability was 'directly related' to resolution of an issue in this action, which it identified as the use of potentially abusive tax shelters. Because the government refused to disclose whether a referral was in effect, the court determined that the summonses must be quashed."<sup>7</sup>

On appeal, the Seventh Circuit framed the issue as "whether §7602(d)(1) only bars the IRS from summoning taxpayers whose liabilities are at issue and who have been referred to the Justice Department, or whether it also bars the IRS from summoning a third-party witness referred to Justice." As they had below, the taxpayers argued that the summonses in question violated the statute because the government had failed to affirmatively state that Mr. Greisman was not the subject of a referral. The government responded that §7602(d)(1) only bars the IRS from summoning the person whose tax liability is being examined where a referral is in effect with respect to that person. Thus, even if there had been a referral with respect to Mr. Greisman, there would be no prohibition to summoning him in connection with an examination of the Khans' tax liabilities.

The Seventh Circuit noted that the IRS had issued a regulation interpreting §7602(d)(1) as only barring a summons issued to a person (a) whose tax liability is at issue and (b) who is the subject of a criminal referral. The court then noted that under *Chevron U.S.A. Inc. v. Natural Resources Defense Council Inc.*, a reviewing court first looks to the language of the pertinent statutory provision to determine if the plain meaning of the text either

supports or opposes the regulation. Where the statutory language is either silent or unclear on the point, the reviewing court then assesses the reasonableness of the applicable regulation.

#### Government Arguments

With respect to the first step of the inquiry, the government argued that the district court incorrectly construed the statute to mean that "no summons may be issued...with respect to any person" to mean that "no summons may be issued...to any person." Thus, the government argued that although the summonses had been issued to the taxpayers' accountant, they were issued with respect to the tax liabilities of the taxpayers and their entities.

The taxpayers disagreed, arguing that the phrase "with respect to" "carries the flexibility to encompass both the summoned witness and the taxpayer under audit within the 'any person' universe."<sup>8</sup> In addition, the taxpayers noted that while Congress included the phrase "any person" in both §7602(d)(1) and §7602(d)(2), which defines a Justice Department referral, it used different language in subsection (a)(2) of the statute, which gives the IRS the authority to summons "the person liable for tax." Accordingly, the taxpayers argued that "Congress consciously drew a distinction"

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in referring to the individual liable for tax and the individual summoned. If the Legislature had intended that subsection (d)(1) be limited to the person whose tax liability was under investigation, it would specifically have noted so as it did in subsection (a)(2).

Finding that the taxpayers' argument had some "persuasive value" and that the government's reading of the statute was plausible, the Seventh Circuit held that, "[d]espite each side's best efforts to demonstrate that the statute has a plain meaning that supports its argument, we conclude that while both interpretations have some merit, there is no clear winner." Accordingly, the court moved on to the second step of the *Chevron* analysis.

Under this step, the court noted it was required to defer to the IRS commissioner's interpretation where it was reasonable. In conducting this analysis, the court is permitted to consider extrinsic sources such as legislative history and the language, origin and purpose of the statute. Noting

that the Senate Finance Committee's report specifically noted that §7602(d)(1) prevented the issuance of a summons "if a Justice Department referral is in effect with respect to the person whose tax liability is in issue," the court found there was no evidence that Congress intended to expand the statute to a summoned third party, such as Mr. Greisman. Concluding that the regulation's interpretation was reasonable and in harmony with the statute and the legislative history, the court deferred to the regulation, holding that the IRS was permitted to summon Mr. Greisman even if it had referred him to the Justice Department for criminal investigation.

Combined with the OPR's recent initiatives, the Seventh Circuit's decision in *Khan v. United States* suggests that practitioners representing taxpayers before the IRS should be prepared to have their own conduct examined. While it is reasonable to expect that such practitioners will comply with their filing and payment obligations, the IRS' willingness to utilize its authority to investigate taxpayer representatives creates a risk of chilling the advocacy of lawyers and accountants representing clients. To the extent the IRS abuses its power in this area, it will fall on Congress and the courts to reset the balance of power.



1. Internal Revenue Service Web site, "The Office of Professional Responsibility (OPR) At-a-Glance," (last viewed Dec. 31, 2008) (available at <http://www.irs.gov/irs/article/0,,id=175512,00.html>).

2. Tax Analysts, "Practitioners Who File Power of Attorney to Undergo Tax Check" (Oct. 21, 2008).

3. The Connecticut Society of Certified Public Accountants, "IRS Will Check Personal Tax Compliance of Practitioners Filing POAs" (Nov. 3, 2008) (available at <http://www.cscpa.org/Content/23495.aspx>).

4. Tax Analysts, "Practitioners Who File Power of Attorney to Undergo Tax Check."

5. Id.

6. 548 F.3d 549 (7th Cir. 2008).

7. Id. at 553.

8. Id. at 555.