How Far Does Circular 230 Exceed Treasury's Statutory Authority?

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In this report, Johnson discusses the future of Circular 230 and argues that if the approach of recent cases is confirmed by litigation and if Congress chooses not to act, significant portions of the circular may be at risk of invalidation.

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Treasury regulations defining the duties of those practicing before the IRS, commonly called Circular 230, are a cornerstone of federal tax practice.[1] Recent judicial decisions, however, raise the genuine possibility that substantial portions of Circular 230 may be invalidated if challenged.

This possibility began to be taken seriously as a result of the 2013 opinion in *Loving v. IRS*, the 2014 affirmance of that judgment, and the government's decision not to seek *en banc* or Supreme Court review.[2] The concerns[3] intensified with the July 2014 decision in *Ridgely v. Lew*.[4] They may intensify further — or be deflated — by pending and future challenges to portions of Circular 230.

I[5] and others[6] have written about *Loving*. Here, I carry the work forward by exploring post-*Loving* developments and their possible effect on the Circular 230 regulations.

I. 31 U.S.C. Section 330

Like all regulations, the Circular 230 rules are valid only if they are grounded in power delegated

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[1]31 C.F.R. subtitle A, pt. 10. For discussion of Circular 230 and related rules, *see, e.g.*, Donald B. Tobin et al., *Problems in Tax Ethics* 16-21 (2009); and Christopher S. Rizek, "Recent Changes in Circular 230: Where Are We Now?" 30 *Tax Man. Real. Est. J.* 299 (2014). For a splendid exploration of the spirit behind the core ethical rules, see George Cooper, "The Tax Avoidance Dynamic: A Tale of Tax Planning, Tax Ethics, and Tax Reform," 80 *Colum. L. Rev.* 1553 (1980).

[2]917 F. Supp.2d 67 (D.D.C. 2013), *aff'd*, 742 F.3d 1013 (D.C. Cir. 2014).

[3]Or hopes, depending on one's view of the merits of the Circular 230 regulations.

[4]2014 U.S. Dist. LEXIS 96447 (D.D.C. 2014).

[5]Steve R. Johnson, "*Loving* and Legitimacy: IRS Regulation of Tax Return Preparation," 59 *Vill. L. Rev.* 515 (2014).

[6]*E.g.*, W. Edward Afield, "A Market for Tax Compliance," 62 *Cleve. St. L. Rev.* 315 (2014); Vincent R. Barrella and Walter Antognini, "*Loving*: A Case of Overreaching?" 91 *Taxes* 33 (July 2013); Bryan T. Camp, "'Loving' Return Preparer Regulation," *Tax Notes*, July 29, 2013, p. 457; Allison Christians, "Regulating Return Preparers: A Global Problem for the IRS," *Tax Notes Int'l*, Aug. 4, 2014, p. 391; Frank G. Colella, "*Loving* Is Affirmed: IRS Lacked Authority to Regulate Preparers," *Tax Notes*, Apr. 21, 2014, p. 371; Lawrence B. Gibbs, "*Loving v. IRS*: Treasury's Authority to Regulate Tax Return Preparers," *Tax Notes*, Oct. 21, 2013, p. 331; Richard M. Lipton, "Loving It: Appellate Court Confirms IRS Overstepped in Regulating Return Preparers," 120 *J. Tax'n* 287 (June 2014); Lipton, "'Tough Loving': District Court Invalidates IRS Regulation of Return Preparers," 118 *J. Tax'n* 200 (Apr. 2013); Nina E. Olson, "More Than a 'Mere' Preparer: *Loving* and Return Preparation," *Tax Notes*, May 13, 2013, p. 767; and Donald T. Williamson and James S. Gale, "*Loving* and the End of RTRPs," *Tax Notes*, Apr. 21, 2014, p. 366.

to the agency by Congress.[7] The statutory foundation of Circular 230 is 31 U.S.C. section 330. The first portion of the statute has been of principal significance in the litigation to date. It allows Treasury to "regulate the practice of representatives of persons before" Treasury and to require, as a condition "before admitting a representative to practice," that the representative demonstrate "(A) good character; (B) good reputation; (C) necessary qualifications to enable the representative to provide persons valuable service; and (D) competence to advise and assist persons in presenting their cases."[8]

The original version of what is now 31 U.S.C. section 330 was enacted in 1884.[9] The need for the 1884 legislation arose from the Civil War and westward expansion, which engendered "claims for damages, pensions, bonuses, back pay, etc. . . . [A] swarm of individuals, recognizing no ethical restraints, solicited representation of claimants and engaged in the buying and selling of the claimants' rights. [This] reached the proportions of a national scandal," necessitating granting authority to departments to regulate the representation.[10]

31 U.S.C. section 330(a) largely took its current form in 1982. Wording changes made in 1982 were stylistic; Congress intended to make no substantive change in the provision.[11] The statute also consists of subsection (b) (setting out the sanctions Treasury may impose for violation of the prescribed rules), subsection (c) (providing rules particular to ethical violations by appraisers permitted to practice before the IRS), and subsection (d) (addressing written advice rendered on potentially abusive transactions). Subsection (d) is discussed in Section V.B.2 below.

II. *Loving*

Although 31 U.S.C. section 330(a) has changed little since its enactment in 1884, relevant IRS policies and the importance of return preparers have both changed.[12] Then, the federal income tax, estate tax, and gift tax had not yet been enacted, so return preparers did not exist as tesserae in the mosaic of American society. Now, "paid return preparers file about 90 million individual income tax returns each year, or 60 percent of all individual [income tax] returns filed."[13] The IRS believes that as a result of incompetence and fraud, returns prepared by unenrolled preparers are especially likely to be materially incorrect.[14]

In 2011 Treasury promulgated regulations to impose various obligations on previously largely unregulated tax return preparers, including testing and continuing education requirements.[15] The *Loving* plaintiffs were among these newly regulated return preparers. They brought suit under the Administrative Procedure Act (APA)[16] and the Declaratory Judgment Act,[17] seeking invalidation of the testing and continuing education requirements and related fees.[18] The district and circuit courts held for the plaintiffs. They concluded that the regulations were beyond the scope of the authority conferred on Treasury by 31 U.S.C. section 330(a) and thus were invalid under *Chevron* step one.[19]

The circuit court set forth six rationales, of which two are principally significant for our discussion.[20] First, the circuit court concluded that tax return

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[7]*See, e.g., City of Arlington v. FCC*, 133 S. Ct. 1863, 1869 (2013); and *Lyng v. Payne*, 476 U.S. 926, 937 (1986) ("an agency's power is no greater than that delegated to it by Congress").

[8]31 U.S.C. section 330(a)(1) and (2).

[9]Act of July 7, 1884, ch. 334.

[10]George Maurice Morris, "Growth and Regulation of the Treasury Bar," 8 *ABA J.* 742 (1922).

[11]H.R. Rep. No. 97-651, at 19 (1982); *see also Poole v. United States*, 1984 U.S. Dist. LEXIS 15351, at *5 (D.D.C. 1984).

[12]*See* Gibbs, *supra* note 6, at 336, n.39.

[13]Preston Benoit, deputy director of the IRS Return Preparer Office, quoted by Matthew R. Madara, "IRS Officials Request Authority to Regulate Preparers," *Tax Notes*, Aug. 25, 2014, p. 921 (adding that paid tax return preparers have a "significant impact on tax administration").

[14]*See, e.g.*, Allison Bennett, "IRS Study Finds High EITC Overclaims by Unenrolled Tax Return Preparers," 33 *Tax Man. Weekly Rep.* 1184 (2014) (reporting that earned income tax credits were overclaimed in 33 to 40 percent of returns prepared by unenrolled preparers, compared with 11 to 13 percent of returns prepared by volunteers in IRS-sponsored programs; adding, however, "it would take further research to determine whether these dollar overclaim percentages were due to the behavior and ability of preparers, or differences in the characteristics of taxpayers seeking assistance").

[15]31 C.F.R. sections 10.3(f), 10.4(d), 10.5, 10.6(d)(2), 10.6(e)(2), and 10.6(f).

[16]5 U.S.C. section 706(2).

[17]28 U.S.C. sections 2201 and 2202.

[18]The plaintiffs did not challenge, and the court did not invalidate, the regulations' requirement that preparers obtain preparer tax identification numbers. *Loving*, 920 F. Supp.2d 108, 109 (D.D.C. 2013).

[19]*E.g., Loving*, 742 F.3d at 1022 ("Put in conventional *Chevron* parlance, the IRS's interpretation fails at *Chevron* step 1 because it is foreclosed by the statute. In any event, the IRS's interpretation would also fail at *Chevron* step 2 because it is unreasonable in light of the statute's text, history, structure, and context."); *see Chevron U.S.A. Inc. v. Natural Res. Def. Council*, 467 U.S. 837, 843 (1984).

[20]The other four, partly interrelated rationales were: "the history of section 330" (it did not originally target tax return preparers), "the broader statutory framework" (the many targeted provisions in the code, which would have been unnecessary if 31 U.S.C. section 330 is as expansive as claimed by the IRS), "the nature and scope of the authority being claimed by the IRS" (inadequate legislative support for "vast expansion of the IRS's authority"), and "the IRS's past approach to this statute" (the uneasy relationship of the IRS's current position to its century and a half of inactivity under the statute). *Loving*, 742 F.3d at 1019-1021.

preparers are not "representatives" as that term should be understood for 31 U.S.C. section 330(a) purposes. The term is "traditionally and commonly defined as [agents] with authority to bind others," but "tax-return preparers are not agents. They do not possess legal authority to act on the taxpayer's behalf."[21]

Second, the circuit court, like the district court below, concluded that return preparation alone does not constitute practice as contemplated by the statute. The circuit court acknowledged that preparing and signing returns "could be considered a 'practice' of sorts,"[22] but it offered that "to 'practice before' a court or agency ordinarily refers to practice during an investigation, adversarial hearing, or other adjudicative proceedings. . . . Not until a return is selected for an audit, or the taxpayer appeals the IRS's proposed liability adjustments" is this threshold crossed.[23] The district court put it this way:

> Filing a tax return would never, in normal usage, be described as "presenting a case." At the time of filing, the taxpayer has no dispute with the IRS; there is no "case to present." This definition makes sense only in connection with those who assist taxpayers in the examination and appeals stages of the process.[24]

Both of those rationales are controversial. I agree with the representatives rationale (although the issue is close). I and others disagree with the practice rationale.[25] But whether *Loving*'s rationales are objectively right or wrong is not the question. The government chose not to seek further review of *Loving*. Moreover, as seen in Section III, several post-*Loving* decisions have adhered to the approach of *Loving*. There are as yet no clearly contrary cases, and plaintiffs have ample incentive to bring future similar cases in the D.C. district court to take advantage of the favorable precedents. Accordingly, the discussion below generally assumes that the *Loving* rationales are correct or, even if incorrect, are likely to remain controlling.

III. *Ridgely* and Other Cases

A. Cases Adhering to *Loving*

In the short time since *Loving*, courts of the D.C. Circuit have continued in *Loving*'s vein. In June 2014 a panel of the circuit quoted *Loving*'s definition of representative in construing the same word for purposes of a different statute: the Freedom of Information Act.[26]

After releasing a March 2013 opinion disposing of some issues,[27] the D.C. district court decided *Ridgely* in July 2014.[28] *Loving* involved provisions of subpart A of Circular 230 dealing with admission and the authority to practice before the IRS. *Ridgely* involved a provision of subpart B governing duties and restrictions regarding practice before the IRS. The plaintiff, a practicing CPA, brought suit under the APA and the Declaratory Judgment Act seeking injunctive and declaratory relief against the enforcement of section 10.27(b) of Circular 230, which prohibits contingent fee arrangements for preparing, giving advice regarding, and filing specified tax returns and refund claims.

The plaintiff maintained that the provisions of section 10.27 exceeded the authority delegated to Treasury under 31 U.S.C. section 330(a). That objection was lodged specifically for so-called ordinary refund claims — that is, "refund claims that practitioners file after a taxpayer has filed his original tax return but before the IRS has initiated an audit of the return."[29]

On cross-motions for summary judgment,[30] the district court held for the plaintiff. It invalidated the

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[21]*Id.* at 1016-1017.

[22]*Id.* at 1017-1018.

[23]*Id.* at 1018.

[24]917 F. Supp.2d at 74.

[25]*See* Johnson, *supra* note 5, at sections IV and V (discussing the rationales and the views of other commentators).

[26]*All Party Parliamentary Group on Extraordinary Rendition v. Department of Defense*, 754 F.3d 1047, 1050 (D.C. Cir. 2014). There was no overlap of judges on the *Loving* panel and the *All Party* panel.

Loving also has been cited for principles of interpretation under *Chevron*. *E.g.*, *National Treasury Employees Union v. FLRA*, 754 F.3d 1031, 1042 (D.C. Cir. 2014) (citing *Loving* for the proposition that at *Chevron* step two, an agency's interpretation will be upheld as long as it is reasonable); and *Pharmaceutical Res. & Manufacturers of Am. v. FTC*, 2014 U.S. Dist. LEXIS 73822, at *42 (D.D.C. May 30, 2014) (citing *Loving* for the proposition that the traditional tools of statutory interpretation considered at *Chevron* step one "include evaluation of the plain statutory text at issue, the purpose and structure of the statute as a whole, while giving effect, if possible, to every clause and word of a statute, and — where appropriate — the drafting history").

[27]Originally, there were three *Ridgely* plaintiffs: Ryan LLC, G. Brint Ryan, and Gerald Lee Ridgely. The March 2013 opinion disposed of two of them. Ryan LLC raised a petition clause challenge. The court held that Ryan LLC had standing to do so, but it rejected the challenge of the merits. Mr. Ryan argued both the petition clause and the due process clause. The court rejected the former on the merits and held that Ryan lacked standing to argue the latter. *Ryan LLC v. Lew*, 934 F. Supp.2d 159 (D.D.C. 2013). Thus, only Ridgely and his contention that the "regulation exceeds the scope of the delegation" were left standing to be addressed by the July 2014 opinion.

[28]Three different judges wrote for the D.C. district court in *Loving*, *Ryan*, and *Ridgely*.

[29]*Ridgely*, 2014 U.S. Dist. LEXIS 96447, at *1-*2.

[30]The usual requirements for summary judgment are that the "movant shows that there is no genuine dispute as to any material fact and that the movant is entitled to judgment as a

(Footnote continued on next page.)

challenged provisions based again on *Chevron* step one analysis. The court followed the *Loving* approach, including the representatives and practice rationales: The preparer merely assists the taxpayer and lacks the legal authority to act on the taxpayer's behalf, so he is not a representative;[31] and there is no extant controversy before commencement of the IRS audit or administrative appeal, so assisting on the claims does not involve practice before the IRS.[32]

The *Ridgely* court rejected the government's counterarguments. For instance, the government argued that in addition to authority granted by the statute, agencies have inherent authority to regulate practice before them. The *Ridgely* court, as had the court in *Loving*, rejected this on the ground that a specific statutory delegation displaces any inherent authority.[33]

The government also argued that preparers sometimes engage in activities apart from making ordinary refund claims — services properly subject to Treasury regulation even under the *Loving* conception, bringing them within the ambit of Circular 230. This view appears to reflect government policy rather than an ad hoc litigation position. The director of the IRS Office of Professional Responsibility has been quoted as saying, "After a practitioner submits a Form 2848 'Power of Attorney and Declaration of Representative,' granting them [sic] power of attorney, [OPR] will treat the practitioner as covered by Circular 230."[34] Nonetheless, the *Ridgely* court gave short shrift to this "within Circular 230 in any respect means within Circular 230 in all respects" contention.[35]

matter of law." Fed. R. Civ. P. 56(a); *see, e.g., Anderson v. Liberty Lobby Inc.*, 477 U.S. 242, 247-248 (1986).

However, this usual standard is modified when a court reviews an administrative decision under the APA. In an APA case, the role of the trial court is to ascertain whether "as a matter of law the evidence in the administrative record permitted the agency to make the decision it did." Thus, summary judgment in an APA case is used to determine whether, as a matter of law, "the agency action is supported by the administrative record and otherwise consistent with the APA standard of review." *Sierra Club v. Mainella*, 459 F. Supp.2d 76, 90 (D.D.C. 2006) (citations omitted); *see also Richards v. INS*, 554 F.2d 1173, 1177, and n.28 (D.C. Cir. 1977).

[31]*Ridgely*, 2014 U.S. Dist. LEXIS 96447, at *15.

[32]*Id.* at *16.

[33]*Id.* at *22; *see also Loving*, 742 F.3d at 1014-1016. *See generally* Johnson, "When General Statutes and Specific Statutes Conflict," *State Tax Notes*, July 12, 2010, p. 113.

[34]Karen Hawkins as quoted by William R. Davis, "OPR Will Tell Practitioners to Remove Circular 230 Disclaimers," *Tax Notes*, June 23, 2014, p. 1360.

[35]*See Ridgely*, 2014 U.S. Dist. LEXIS 96447, at *22.

B. Other Cases

1. Forerunners. Although the *Loving* opinions reached the right result, their outcome was striking for at least two reasons. First, the government had stressed the practical importance of the invalidated 2011 regulations,[36] and it is no light matter for "the least dangerous branch"[37] to invalidate what the political branches believe to be an initiative of great public policy significance.[38] The *Loving* courts transcended this reluctance by stressing that in law, the end does not always justify the means,[39] and, in an act of rhetorical jujitsu, by invoking the interpretational principle that the higher the practical stakes of the issue, the clearer must be the evidence that Congress intended to delegate resolution of the issue to an agency rather than reserving that resolution for itself.[40]

The second reason the *Loving* result is striking is more germane for present purposes. Litigation before *Loving* had given little hint that substantial aspects of Circular 230 might be at risk of invalidation. For example, the D.C. district court's 1984 *Poole* decision rejected a challenge to the validity of Circular 230 section 10.50, which defines disreputable conduct — one of the bases for disbarment or other sanctions under Circular 230 section 10.51.[41] The plaintiff was a CPA who had been disbarred from practicing before the IRS because of his willful failure to file his own income tax returns for three consecutive years.

The CPA argued that Treasury's regulatory authority under Circular 230 is limited to those who

[36]*See* Johnson, *supra* note 5, at 520-524.

[37]*See* Alexander Hamilton, *The Federalist*, No. 78, at 4 (Clinton Rossiter, ed. 1961).

[38]As was illustrated by the gymnastics Chief Justice John G. Roberts Jr. performed to avoid invalidating the Affordable Care Act. *See National Federation of Independent Business v. Sebelius* (*NFIB*), 132 S. Ct. 2566, 2593-2600 (2012) (concluding that the shared responsibility payment is not a tax for statutory purposes but is a tax for constitutional purposes).

[39]*Loving*, 742 F.3d at 1022. Quoting two tax cases, the Supreme Court recently observed: "But in the last analysis, these always-fascinating policy discussions are beside the point. The role of this Court is to apply the statute as it is written — even if we think some other approach might accor[d] with good policy." *Burrage v. United States*, 134 S. Ct. 881, 892 (2014) (punctuation omitted) (quoting *Commissioner v. Lundy*, 516 U.S. 235, 252 (1996), quoting *Badaracco v. Commissioner*, 464 U.S. 386, 398 (1984)).

[40]*Loving*, 742 F.3d at 1021 ("courts should not lightly presume congressional intent to implicitly delegate decisions of major economic or political significance to agencies"); *see also Utility Air Regulatory Group v. EPA*, 134 S. Ct. 2427, 2444 (2014), and *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 160 (2000).

[41]*Poole*, 1984 U.S. Dist. LEXIS 15351.

represent claimants before Treasury. The court disagreed, finding that the agency's "disciplinary authority clearly extends to all practitioners before the Treasury Department."[42] The *Poole* court, however, did not attempt to definitively resolve the questions, key to *Loving* and *Ridgely*, of precisely what constitutes practice and who are representatives for purposes of 31 U.S.C. section 330(a).

The spirit of *Poole* seemed congenial to generous construction of 31 U.S.C. section 330(a),[43] but there is nothing definitive in the case for our issues, and there are several distinguishing features.[44] *Poole* was not cited in any of the *Loving* or *Ridgely* opinions.[45] For the above reasons, this omission is readily understandable.

Another pre-*Loving* case is *Wright v. Everson*, decided in 2008.[46] Under section 10.7(c)(1) of Circular 230, unenrolled tax return preparers may represent taxpayers before the IRS in only limited circumstances. The plaintiff, an unenrolled preparer, challenged this restriction. The court found that there were valid reasons for distinguishing among types of advisers and thus that Circular 230 section 10.7(c)(1) was not arbitrary, capricious, or manifestly contrary to the statute. In *Wright*, the plaintiff sought to expand the scope of regulated representation, not to contract it as in *Loving*. Accordingly, *Wright*, too, is of limited utility in this context.

Some recent cases have mentioned *Loving* in not especially helpful contexts.[47] In other cases, parties have distorted *Loving* in futile efforts to deflect tax enforcement directed against them.[48] More interesting are cases involving challenges to fees charged to practitioners by the IRS. Return preparers are charged user fees by the IRS for obtaining and renewing preparer tax identification numbers. In the 2012 case of *Brannen v. United States*, the Eleventh Circuit rejected a constitutional challenge to fees for initially obtaining PTINs.[49] The following year, a district court in the Eleventh Circuit rejected a statutory challenge and held that the renewal fees are not arbitrary and capricious in either design or amount.[50]

Although the plaintiff in that case, *Buckley v. United States*, urged the court to look to *Loving* for guidance, the court was not moved. PTINs are required by statutes other than 31 U.S.C. section 330.[51] Similarly, although user fees are mentioned in Circular 230,[52] there is statutory authorization for them outside 31 U.S.C. section 330.[53] Because the PTIN scheme and the testing/continuing education scheme rested on different statutory authority, the *Buckley* court found that *Loving* had no applicability to the case.[54] Litigation on this score continues. Section III.C.2 describes a pending suit regarding PTIN fees.

2. *AICPA*. Section IV explores how the government may react to *Loving*, *Ridgely*, and possible future decisions of similar ilk. One approach is to substitute the carrot for the stick — that is, to attempt to achieve the same ends through voluntary rather than mandatory means. Arguably, that is how the IRS has responded to *Loving*.

Although, as described in Section IV, the government is urging Congress to legislatively reverse *Loving*, the IRS created an ostensibly voluntary

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[42]*Id.* at *2.

[43]The *Poole* court remarked that courts "must uphold the agency's reasonable interpretation of the statute it administers" and even invoked the inherent authority notion rejected by *Loving*. *Id.* at *5.

[44]Over a half century of consistent judicial and administrative interpretation supported the government's position in *Poole*. *Id.* In contrast, the regulations at issue in *Loving* were promulgated in 2011, over a century and a half after original enactment of the statutory authority. Moreover, before 2011, IRS officials sometimes publicly denied that they had the authority under the statute to enact rules such as those in the 2011 regulations. *See Loving*, 742 F.3d at 1021.

[45]Indeed, *Poole* has been cited in only one judicial decision — a tort case, *Sicignano v. United States*, 127 F. Supp.2d 325, 331 (D. Conn. 2001).

[46]543 F.3d 649 (11th Cir. 2008).

[47]*E.g.*, *Martin v. JTH Tax Inc.*, 2013 U.S. Dist. LEXIS 15512, at *24, n.6 (D.S.C. Feb. 5, 2013) (noting the possible relevance of *Loving* to subsidiary questions on class certification in a tort case).

[48]*E.g.*, *United States v. Elsass*, 978 F. Supp.2d 901, 911-912 (S.D. Ohio 2013) (rejecting the defendants' attempt to use *Loving* to wriggle out of a permanent injunction against their egregious misbehavior as return preparers); and *United States v. Tomlinson*, No. 12-10051-01 (D. Kan. 2013) (mentioning *Loving* in rejecting the argument of the defendant in a criminal tax case that only those subject to regulation under Circular 230 can be subject to criminal prosecution under section 7206(2) for aiding and assisting in preparing and filing false and fraudulent returns).

[49]*Brannen v. United States*, 682 F.3d 1316 (11th Cir. 2012), *aff'g* No. 4:11-CV-0135 (N.D. Ga. 2011).

[50]*Buckley v. United States*, 2013 U.S. Dist. LEXIS 184758 (N.D. Ga. 2013).

[51]"Any return or claim for refund prepared by a tax return preparer shall bear such identifying number" as Treasury will prescribe. Section 6109(a)(4); *see* section 6695(c) (penalty for failure to comply with section 6109(a)(4)), section 6696(e) (defining return and claim for refund), and section 7701(a)(36) (with stated exceptions, defining a tax return preparer as "any person who prepares for compensation . . . any return . . . or claim for refund" or who so prepares "a substantial portion of a return or claim for refund").

[52]*See* 31 C.F.R. section 10.6(d)(6).

[53]*See* 31 C.F.R. section 9701 (authorizing agencies to charge user fees and setting out criteria for determining their amount).

[54]*Buckley*, 2013 U.S. Dist. LEXIS 184758, at *7; *see also Loving*, 920 F. Supp.2d at 109 (clarifying that the *Loving* holding does not extend to the PTIN scheme "except that the IRS may no longer condition PTIN availability on being 'authorized to practice' under 31 U.S.C. section 330").

annual filing season program (AFSP). While the AFSP was being developed, both the American Institute of Certified Public Accountants and the National Association of Enrolled Agents expressed to the IRS their doubts about the wisdom and legality of the initiative.[55] Undeterred, the IRS established the AFSP in June 2014.[56]

The AFSP targets return preparers who are not already enrolled agents[57] — the same target population as the regulations invalidated in *Loving*. Under the AFSP, preparers will receive benefits if they do voluntarily what the invalidated regulations would have compelled them to do: pass an IRS-devised examination and satisfy specified continuing education requirements.[58] The benefits from taking these steps are an IRS-issued record of completion, inclusion of the preparer in a preparer database publicly accessible through the IRS's website, and a limited ability to represent taxpayers before the IRS regarding returns they prepare.[59]

On July 15, 2014, the AICPA filed suit in (can you guess? that's right) the D.C. district court for declaratory and injunctive relief to invalidate the AFSP. The suit alleged that (1) the IRS lacks statutory authority to create such a program; (2) the AFSP was promulgated in violation of the notice and comment rules of the APA;[60] and (3) the AFSP is arbitrary and capricious under the APA[61] because it will confuse consumers and will not effectively address policy issues concerning unethical return preparers. The AICPA maintained that the AFSP is an impermissible attempt to make an end run around *Loving*: Because it would create strong competitive pressures to comply, the nominally voluntary program is de facto mandatory.[62]

Concluding that the AICPA lacked standing, the district court granted the government's motion to dismiss the suit.[63] None of the AICPA's members are unenrolled return preparers. The AICPA contended that although the AFSP does not hurt the organization, it does hurt its members, which thus allows the AICPA to sue under the doctrine of representational or associational standing. This contention failed because the court found the members' alleged injury in fact to be conclusory, speculative, and not fairly traceable to the AFSP.[64]

That may not be the end of the story. The AICPA may appeal. If it doesn't, it (or another organization) likely could find someone who does have sufficient connection and who would be willing to join as a plaintiff in a new suit. Since the same wine may be poured out of different bottles in future litigation, I analyze below the merits of the AICPA's contentions.

The AICPA's suit implicated a significant but somewhat murky vein of administrative law. Generally, the APA requires agencies to publish proposed rules in the *Federal Register*, to give interested persons the opportunity to comment on the proposed rules, and to consider comments seriously in promulgating final rules. Agency "interpretative rules, general statements of policy, [and] rules of agency organization, procedure, or practice" are excepted from these requirements.[65]

Courts have wrestled with the contours of this exception, but generally speaking, rules that create binding obligations are outside it.[66] Nonetheless, scholars and courts have recognized the reality that even formally nonbinding agency pronouncements can, as a practical matter, have powerful, sometimes coercive, effects on regulated persons.[67]

No bright-line rule exists. On one hand, "Congress did not intend that the APA definition of a rule be construed so broadly that every agency action would be subject to judicial review."[68] On the other hand, at some point, an agency's nominally voluntary program can be a binding rule.[69] In making this

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[55] *See, e.g.*, David van den Berg, "Enrolled Agents Ask IRS to Scrap Return Preparer Proposal," *Tax Notes*, June 2, 2014, p. 1017.

[56] FS-2014-8; IR-2014-75.

[57] Enrolled agents are persons who are not attorneys or CPAs but who have passed a competence test administered by or for the IRS. Enrolled agents were subject to Circular 230 even before promulgation of the 2011 regulations that were invalidated in *Loving*. *See* 31 C.F.R. sections 10.3 through 10.6.

[58] *See AICPA v. IRS*, 2014 U.S. Dist. LEXIS 157723, at *6 (D.D.C. Oct. 27, 2014) ("The criteria for participation [in the AFSP] are strikingly similar to the requirements of the 2011 Rule").

[59] *See* Rev. Proc. 2014-42, 2014-29 IRB 192.

[60] 5 U.S.C. section 553.

[61] 5 U.S.C. section 706(2)(A).

[62] *See* William Hoffman, "AICPA Files Suit to Stop IRS Preparer Certification Program," *Tax Notes*, July 21, 2014, p. 240.

[63] Although the district court did not reach the merits, the government might have won if it had. The same judge decided *Loving* and *AICPA*. In *Loving*, the judge had suggested in dictum

(Footnote continued in next column.)

that the IRS try a voluntary program, a fact the judge noted in *AICPA*. *See AICPA*, 2014 U.S. Dist. LEXIS 157723, at *2; and *Loving*, 920 F. Supp.2d at 111.

[64] *AICPA*, 2014 U.S. Dist. LEXIS 157723, at *18-*20.

[65] 5 U.S.C. section 553(b)(3)(A).

[66] *See, e.g.*, *Chrysler v. Brown*, 441 U.S. 281, 315 (1979); *American Mining Corp. & Nat'l Ind. Sand Ass'n v. Mine Safety & Health Admin.*, 995 F.2d 1106, 1112 (D.C. Cir. 1993).

[67] *E.g.*, Mark Seidenfeld, "Substituting Substantive for Procedural Review of Guidance Documents," 90 *Tex. L. Rev.* 331, 343 (2011); *cf. NFIB*, 132 S. Ct. at 2602, and *Steward Machine Co. v. Davis*, 301 U.S. 548, 590 (1937) (both recognizing that at some point, pressure can become so intense that it turns into compulsion).

[68] *Industrial Safety Equip. Ass'n Inc. v. EPA*, 837 F.2d 1115, 1120 (D.C. Cir. 1988).

[69] *E.g.*, *Sugar Cane Growers Co-op of Florida v. Veneman*, 289 F.3d 89, 96 and n.6 (D.C. Cir. 2002).

substance-over-form evaluation, courts have adverted, with varying degrees of favor, to factors such as whether the alleged compulsion is direct or indirect, how substantial the impact is on the regulated person or group, and whether the agency acted with an improper purpose or from an erroneous factual foundation.[70]

Of particular interest in the *AICPA* context, the substance-over-form analysis can include (although not necessarily as decisive considerations) whether the agency "puts a stamp of approval or disapproval on a given type of behavior"[71] and whether the agency has an "intent of penalizing a party through adverse publicity."[72] Given the circumstances of its development, these considerations may be pertinent to the AFSP.

Given the state of the law, one can hardly assert with confidence a view on whether the AICPA's "in substance mandatory" argument would succeed. My conjecture at this stage is that it would be hard for a plaintiff with standing to establish that the AFSP crosses the threshold into de facto mandatory, but that factual development, advocacy skill, and judicial inclination all would have roles to play in the determination.

I harbor serious doubts about the AICPA's arbitrary and capricious contention. It is illegitimate for courts — under the guise of judicial review — to substitute their own policy judgments and preferences for those of agencies with specialized expertise on the subject matter.[73] Accordingly, courts conducting an arbitrary and capricious reviews are deferential to agencies' balancing of competing considerations.[74] I doubt that complaints like the AICPA's regarding customer confusion and the failure to solve all problems would suffice to overcome this deference.

If the foregoing speculations prove accurate, the hope of the plaintiff with standing would hang on the argument that the IRS had no statutory authority to create the AFSP. That is, of course, where *Loving* and *Ridgely* come in. However, assuming the court concludes that the AFSP is indeed voluntary, there may be a difference between the nonbinding agency action in *AICPA* and the binding agency actions in *Loving* and *Ridgely*. Is the no-statutory-basis argument as strong in the former context as in the latter?

If prior Supreme Court pronouncements are taken literally, agency actions of every sort must be traceable to a congressional conferral of power.[75] However, at least two rejoinders might be available to the IRS in an *AICPA*-like suit. First, a generous construction of one of the statutory provisions might cover the AFSP. For instance, Congress has delegated to the Treasury secretary the administration and enforcement of the Internal Revenue Code[76] and has allowed the secretary to subdelegate to the IRS commissioner "such duties and powers as the Secretary may prescribe, including the power to . . . administer, manage, conduct, direct, and supervise the execution of the internal revenue laws."[77] A mandatory registration program might fall outside the ambit of this provision, but a voluntary incentive program might fall within it.

Second, perhaps inherent agency authority — a concept rejected in *Loving* and *Ridgely*[78] but recognized in *Poole*[79] — would cover a voluntary program. *Loving* and *Ridgely* rejected the government's "inherent agency authority" argument on the ground that 31 U.S.C. section 330, a specific statutory provision, controls over general inherent power. But 31 U.S.C. section 330 applies to regulating representatives appearing before Treasury and to admitting them to practice.[80] If the AFSP is held

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[70]*E.g.*, *Industrial Safety Equip.*, 837 F.2d at 1120-1121; and *American Hosp. Ass'n v. Bowen*, 834 F.2d 1037, 1046-1048 (D.C. Cir. 1987).

[71]*American Hosp. Ass'n*, 834 F.2d at 1047.

[72]*Industrial Safety Equip.*, 837 F.2d at 1119.

[73]*E.g.*, *Missouri v. Jenkins*, 515 U.S. 70, 131-133 (1995) (Thomas, J., concurring); *Citizens to Preserve Overton Park v. Volpe*, 401 U.S. 402, 415-416 (1971); *Phelps Dodge Corp. v. NLRB*, 313 U.S. 177, 194 (1941); and Richard J. Pierce Jr., "The Role of Constitutional and Political Theory in Administrative Law," 64 *Tex. L. Rev.* 469, 504-507 (1985).

[74]*E.g.*, *Florida Bankers Ass'n v. Department of Treasury*, 2014 U.S. Dist. LEXIS 3521, at *14 (D.D.C. Jan. 13, 2014). Judge James E. Boasberg wrote both the *Florida Bankers* and *Loving* opinions for the D.C. district court.

An agency "is authorized to make a rational legislative-type judgment. If the [rule] selected by the agency reflects its informed discretion, and is neither patently unreasonable nor a dictate of unbridled whim, then the agency's decision adequately satisfies the [arbitrary and capricious] standard of review." *WJG Telephone Co. v. FCC*, 675 F.2d 386, 388-389 (D.C. Cir. 1982) (citations and punctuation marks omitted); *see also Associated Builders & Contractors Inc. v. Shiu*, 2014 U.S. Dist. LEXIS 37106, at *47-*48 (D.D.C. Mar. 21, 2014) (rejecting an arbitrary and capricious challenge and stating, "Plaintiff may well be correct that more targeted data and modified calculations would lead to a more precise utilization goal, but perfect precision is not what the Administrative Procedure Act demands").

(Footnote continued in next column.)

[75]*E.g.*, *Louisiana Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 374 (1986) ("an agency literally has no power to act . . . unless and until Congress confers power upon it").

[76]Section 7801(a)(1).

[77]Section 7803(a)(2)(A).

[78]*Loving*, 742 F.3d at 1014-1016; *Ridgely*, 2014 U.S. Dist. LEXIS 96447, at *22. *See supra* text accompanying note 24.

[79]*Poole*, 1984 U.S. Dist. LEXIS 15351, at *4-*5. *See supra* note 43. However, *Poole* preceded *Louisiana Public Service*, which emphasized that agencies have no powers except those conferred on them by statute. *See supra* note 75.

[80]31 U.S.C. section 330(a)(1), (2).

to be voluntary, it arguably would be outside the domain of 31 U.S.C. section 330. Then 31 U.S.C. section 330 would not displace inherent agency authority. Even if that were accepted, the government would still have to define the contours of inherent agency authority and show that the AFSP is within them. Far from a slam dunk, this nonetheless is a potential government response to the no-authority argument.

Could that response be buttressed by asserting a statutory basis for the alleged inherent powers? The so-called housekeeping statute applies to all federal agencies, including Treasury. It provides: "The head of an Executive department . . . may prescribe regulations for the government of his department, the conduct of its employees, and the custody, use, and preservation of its records, papers, and property."[81] The roots of the provision reach back to the founding of the republic.[82]

In the main, courts have read the statute as being narrow. The statute "seems to be simply a grant of authority to [an] agency to regulate its own affairs,"[83] and it confers only administrative, not legislative, power.[84] This would not seem to move the IRS beyond what *Loving* and *Ridgely* already allow. That is, the housekeeping statute might allow the IRS to impose requirements on practitioners directly interacting with the IRS but would seem not to extend to activities preceding an IRS audit or other agency-taxpayer interactive processes.

However, the outer boundaries of the statute have never been precisely defined. Perhaps it's the nature of the beast that only case-by-case decisionmaking is possible. And the courts' generally restrained view of the statute does not stop agencies from trying to make rules. Agencies in need of statutory authority have asserted the housekeeping statute as the basis for many regulatory initiatives. Creative and aggressive agency assertions of authority under the statute have usually been rejected by the courts — but not always.[85]

Finally, to complicate matters further, there is another potential strand of analysis. Above, we considered whether the AFSP is a rule for APA purposes. But the APA also addresses other types of agency actions, one of which is an agency's imposition of sanctions. The APA provides that a "sanction may not be imposed . . . except within jurisdiction delegated to the agency and as authorized by law,"[86] and it allows courts to "hold unlawful and set aside agency action . . . in excess of statutory jurisdiction, authority, or limitations."[87]

If a return preparer does not voluntarily satisfy the requirements of the AFSP, the IRS will withhold from her a certificate of completion, recognition on the IRS website, and representation privileges. Could those consequences be considered sanctions? The APA defines sanction broadly, to encompass deprivation of freedom, imposition of a fine, seizure of property, denial of a license, or "taking other compulsory or restrictive action."[88] Under some circumstances, adverse publicity can constitute a sanction.[89] The AICPA's complaint did not raise the AFSP-as-sanction argument, but that issue may develop later.

3. Pending cases. Two other challenges to Circular 230 provisions have garnered attention.[90] The plaintiff in *Sexton v. Hawkins*[91] is a former lawyer who was disbarred by his state after he pleaded guilty to mail fraud and money laundering. He still has a valid PTIN. OPR has suspended him from practice before the IRS and is pursuing an ongoing investigation of him. Incident to the investigation, OPR sought to compel him to disclose documents and answer interrogatories, with the prospect of sanctions under Circular 230 should he fail to comply. He brought suit, seeking injunctive relief against the ongoing investigation. Citing *Loving*, the plaintiff alleges that he is not a practitioner before the IRS, that mere possession of a PTIN does not make him one, and that he is therefore not subject to regulatory supervision under Circular 230.

The government counters that *Loving* is not germane. OPR is investigating the plaintiff not merely as a return preparer but because of allegations that he offered to give written tax advice despite being suspended from practice before the IRS. In August 2013 the government filed a motion to dismiss. In October 2014 the court denied that motion. The case, presumably, will proceed to trial. During the pendency of the case, the plaintiffs need not produce information requested by the IRS, and the

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[81]5 U.S.C. section 301.

[82]It was enacted in 1789 "to help General Washington get his administration underway by spelling out the authority for executive officials to set up offices and file Government documents." H.R. Rep. No. 85-1461, at 1 (1958).

[83]*Chrysler Corp. v. Brown*, 441 U.S. 281, 309 (1979).

[84]*United States v. George*, 228 U.S. 14, 22 (1913).

[85]*See United States ex rel. O'Keefe v. McDonnell Douglas Corp.*, 132 F.3d 1252, 1254-1256 (8th Cir. 1998) (reviewing cases, including a few agency victories).

[86]5 U.S.C. section 558(a).

[87]5 U.S.C. section 706(2)(c).

[88]5 U.S.C. section 551(10).

[89]*See, e.g., American Tel. & Tel. Co. v. FCC*, 602 F.2d 401, 408 (D.C. Cir. 1979); and H. Rep. No. 7-1980 (1946) (House report on the APA).

[90]*See* Jaime Arora, "2 Cases to Watch in the Wake of *Loving*," *Tax Notes*, Sept. 1, 2014, p. 1029.

[91]No.13-cv-00893 (D. Nev. 2014).

government may not curtail the plaintiffs' ability to electronically file returns for clients for failure to produce information.

In *Davis v. IRS*,[92] the plaintiff had pleaded guilty to aiding the preparation of a false tax return, leading to the loss of his CPA license, termination of his ability to practice before the IRS, and expulsion from participation in the IRS's e-file system. His CPA license and ability to practice before the IRS were later restored. His access to the e-file system was not, however. Because most return preparers are required to use e-filing, this omission essentially prevents him from preparing returns, effectively nullifying his reinstatement.[93] In essence, the plaintiff is arguing that preparing returns is practicing before the IRS. That was the government's rejected position in *Loving*.

The plaintiff filed suit, asking the court to direct the IRS to allow him to again participate in the e-file system. As of this writing, the case was in the discovery stage. If the case goes forward, it will be interesting to see whether and how the government controverts what had been its position in *Loving*.

On September 8, 2014, the plaintiffs filed their complaint in *Steele v. United States*. As noted in Section II.B above, suits against PTIN fees failed in *Brannen* and *Buckley*, that is, in the Eleventh Circuit and one of its district courts. The plaintiffs filed *Steele* (unsurprisingly) in the D.C. district court to capitalize on *Loving* and *Ridgely*.

Interestingly, *Steele* was brought as a class action on behalf of two named CPAs and, according to the caption of the complaint, "A Class of More Than 700,000 Similarly Situated Individuals and Businesses."[94] The class consists of:

> individuals who prepare tax returns for others for compensation and firms (including partnerships) and companies the employees or some or all of the owners of which prepare tax returns for others for compensation, and who: (a) paid the initial PTIN issuance user fee; or (b) paid the initial PTIN issuance user fee and one or more PTIN renewal user fees.[95]

The complaint alleges that both the fee paid to obtain a PTIN initially and fees paid for annual renewals of the PTIN are invalid or excessive. Recognizing that the statutory authority for imposition of user fees is 31 U.S.C. section 9701, the *Steele* plaintiffs maintain that the conditions of a valid user fee are not satisfied. For instance, they allege that a user fee must be justified by a special benefit conferred by the government on the fee payer.[96] Yet "no special benefit is provided to a tax return preparer who obtains or renews a PTIN because, in accordance with the *Loving* case and the U.S. Constitution, a tax return preparer has a right to prepare returns for others for compensation."[97] The *Steele* plaintiffs also allege that the amounts of the initial and renewal fees[98] are greatly excessive because the functions that the fees are supposed to support are impermissible or have not actually been performed by the IRS.[99]

The 14 counts for relief include declaratory judgment that Treasury lacks statutory authority to charge initial and renewal PTIN fees or, alternatively, declaratory judgment that the fees charged are excessive; a refund of fees already paid, with interest; and a permanent injunction prohibiting the charging of future initial or renewal PTIN fees or, alternatively, a permanent injunction prohibiting the charging of excessive future initial or renewal fees.

The *Steele* plaintiffs must, of course, sail into the head winds of *Brannen* and *Buckley*, cases that upheld PTIN fees.[100] Nonetheless, *Steele* raises substantial questions. The plaintiffs may have a better chance of prevailing on their alternative argument (that the fees are excessive in amount) than on their primary argument (that the fees are wholly invalid).

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[92]No. 14-cv-0261 (N.D. Ohio 2014).

[93]The IRS can censure, suspend, disbar, or impose monetary penalties against any practitioner who *inter alia* is incompetent or disreputable. 31 C.F.R. section 10.50(a). Incompetence and disreputable conduct include "willfully failing to file on magnetic or other electronic media a tax return prepared by the practitioner when the practitioner is required to do so by the Federal tax laws unless the failure is due to reasonable cause and not due to willful neglect." 31 C.F.R. section 10.51(a)(16).

[94]Or maybe more. Paragraph 106 of the complaint states: "The number of plaintiffs is believed to be between 700,000 and 1,200,000." *Steele v. United States*, No. 1:cv-14-1523 (D.D.C. filed Sept. 8, 2014).

[95]*Id.* at para. 13. However, the *Buckley* plaintiffs are expressly excluded from the purported class. *Id.*

[96]*Id.* at paras. 90-91 (citing *FPC v. New England Power Co.*, 415 U.S. 345 (1974)).

[97]*Id.* at para. 93.

[98]The fees are $50 initially and another $50 for each annual renewal. To each is added $14.25, a charge paid to a third party to administer the process. T.D. 9501 (Sept. 2010 final regulations).

[99]Steele complaint, *supra* note 94, at paras. 63-72 and 97-101.

[100]The Eleventh Circuit did not find the issue to be close. *Brannen*, 682 F.3d at 1319 ("We readily conclude that, under the plain language of section 6109(a)(4), the PTIN is issued to tax return preparers for a special benefit. And we readily conclude that the benefit — the privilege of preparing tax returns for others for compensation — is the kind of 'special benefit' that qualifies under *New England Power*. The user fee here clearly confers a benefit which is not received by the general public.").

The Eleventh Circuit pointedly observed that what has become the *Steele* alternative argument was not before it in *Brannen*.[101]

Moreover, the landscape is different. The Eleventh Circuit handed down *Brannen* before *Loving* was decided. *Loving*, but not *Ridgely*, had been decided before *Buckley*, but the U.S. District Court for the Northern District of Georgia did not discuss *Loving* at length. It may be in *Steele* that the D.C. district court — the court that decided both *Loving* and *Ridgely* — will find those decisions of greater relevance than the *Buckley* court did.

IV. Possible Threats to Circular 230

A. Evolution of Circular 230

In an excellent concise history, Bryan T. Camp characterized the history of the Treasury ethical rules as "one of ever-expanding regulation."[102] The tax shelter wars have been an important driver of this expansion in recent decades. Treasury ethical rules increasingly were enlisted to combat shelters and other allegedly abusive arrangements.[103]

In its current iteration, Circular 230 has five subparts. Subpart A consists of nine sections setting out rules governing the authority to practice before the IRS. For our purposes, the key provisions involve section 10.3 regarding what kinds of persons may practice before the IRS and what they may do, plus related definitions in section 10.2.

Reflecting the expansion of Circular 230, the definition of practice before the IRS has changed over the years. The 1966 iteration provided: "Neither preparation of a tax return nor the appearance of an individual as a witness for the taxpayer, nor the furnishing of information at the request of the [IRS] is considered practice before the Service."[104] However the June 12, 2014, version states that practice before the IRS:

> comprehends all matters connected with a presentation to the IRS 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 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.[105]

Subpart B sets out 19 sections detailing duties and restrictions regarding practice before the IRS. The sections involve areas such as conduct when dealing with the IRS,[106] fees charged to clients,[107] best practices and arrangements to foster them,[108] standards for tax returns and others documents,[109] competence,[110] and written advice.[111]

Portions of subpart B take the same expansive approach to practice before the IRS that section 10.2 does. Section 10.27 provides: "A practitioner may not charge an unconscionable fee in connection with any matter before the [IRS]."[112] It defines matter before the IRS as including:

> 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 [IRS] . . . 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 and filing documents, corresponding and communicating with the [IRS], rendering written advice with respect to any entity, transaction, plan or arrangement, and representing a client at conferences, hearings, and meetings.[113]

Other parts of subpart B refer to "matter" before the IRS or its equivalent without defining the term. Presumably, in at least some of these parts, the intent is to rely on the section 10.27 definition.[114] In

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[101] 682 F.3d at 1317, n.1 ("We note that Brannen has not challenged the amount or excessiveness of the user fee. Indeed, Brannen expressly disclaimed any such argument in the district court.").

[102] Camp, *supra* note 6, at 457; *see also* Ariel Alvarez, "The Constitutionality of the Inevitable Regulation of All Tax Return Preparers," 14 *J. Accounting, Ethics & Pub. Pol'y* 735 (2013).

[103] *See, e.g.*, Michael J. Desmond, "The Continuing Evolution of Circular 230: Proposed Regulations Repealing the 'Covered Opinion' Standards, Imposing a General Competence Requirement and Expanding Existing Procedures to Ensure Compliance," 15 *J. Tax Prac. & Proc.* 23 (Dec. 2013-Jan. 2014).

[104] 31 F.R. 10773, 10774 (Aug. 13, 1966).

[105] 31 C.F.R. section 10.2(a)(4).

[106] 31 C.F.R. section 10.20 (information to be furnished to the IRS), section 10.21 (advising the IRS of client's omissions), section 10.22 (diligence on accuracy), and section 10.23 (prompt disposition of pending matters).

[107] 31 C.F.R. section 10.27. Section 10.27(b) regarding contingent fees was at issue in *Ridgely*.

[108] 31 C.F.R. sections 10.33 and 10.36-10.38.

[109] 31 C.F.R. section 10.34.

[110] 31 C.F.R. section 10.35.

[111] 31 C.F.R. section 10.37.

[112] 31 C.F.R. section 10.27(a).

[113] 31 C.F.R. section 10.27(c)(2).

[114] *E.g.*, 31 C.F.R. section 10.30(a)(1) (restrictions on advertising and solicitation) and section 10.30(d) (prohibiting a practitioner "in matters related to the" IRS from assisting, or accepting assistance from, "any person or entity who, to the knowledge of the practitioner, obtains clients or otherwise practices in a manner forbidden under this section").

other situations, however, matter before the IRS is limited by context to a later phase in the process.[115]

Subpart C contains four sections addressing sanctions for violation of the regulations. Possible sanctions include censure, suspension, disbarment, and monetary penalties.[116] Sanctions may be imposed under any of these circumstances: "if the practitioner is shown to be incompetent or disreputable (within the meaning of section 10.51),[117] fails to comply with any regulation in this part (under the prohibited conduct standards of section 10.52), or with intent to defraud, willfully and knowingly misleads or threatens a client or prospective client."[118]

"Part" means part 10 of title 31 of the Code of Federal Regulations, in other words, the whole of Circular 230. However, section 10.52 somewhat mitigates this broad sweep. First, section 10.33 lays out best practices for tax advisers. Because those best practices are primarily aspirational, failing to conform to them is not sanctionable.[119] Second, violations of Circular 230 rules generally are sanctionable only if they are committed willfully.[120] However, recklessness or gross incompetence suffices when the rules violated are section 10.34 (standards regarding tax returns and documents), section 10.35 (competence), section 10.36 (procedures to ensure compliance), or section 10.37 (requirements for written advice).[121]

Subpart D contains 23 sections setting out rules applicable to disciplinary proceedings, and subpart E has four general provisions.

B. Sting in the Recent Cases

Two aspects of *Loving* and *Ridgely* pose dangers to aspects of Circular 230 beyond the particular regulations at issue in, and invalidated by, those decisions. They are (1) the threshold the cases offer for the commencement of practice before the IRS, and (2) the spirit in which, or the level of rigor with which, the court performs the *Chevron* step one inquiry. These are described below.

1. Commencement of practice before the IRS. Both *Ridgely* and *Loving* held that the plaintiff's activities were outside the permissible scope of regulation because they preceded the point at which there was a representative engaged in practice before the IRS. But it is unclear precisely where the courts located that point. Within and between themselves, the cases are in tension.

Loving addressed the preparation and filing of tax returns. The circuit court's opinion endorsed as "succinct and cogently explained" the following passage from the *Loving* district court opinion:

> Filing a tax return would never, in normal usage, be described as "presenting a case." At the time of filing, the taxpayer has no dispute with the IRS; there is no "case" to present. This definition makes sense only in connection with those who assist taxpayers in the examination and appeals stage of the process.[122]

The circuit court added that "the statute contemplates representation in a contested proceeding"[123] and that practice before an agency or court "ordinarily refers to practice during an investigation, adversarial hearing, or other adjudicative proceeding."[124]

Ridgely addressed the preparation and filing of what it called ordinary refund claims — that is, claims the taxpayer filed after she filed her return or that she filed during the course of an IRS audit, but in either case filed before she commenced a refund suit. The court endorsed the plaintiff's position that the taxpayer's adviser "would not be legally representing the taxpayer until the IRS responds to the claim and the CPA submits a power of attorney."[125] In other words, the adviser is not a representative engaged in practice "*before* the commencement of any adversarial proceedings with the IRS or any formal legal representation by the CPA."[126]

The *Ridgely* court returned to that theme later in its opinion. After quoting the portions of *Loving* discussed above, the *Ridgely* court likened the situation before it to that in *Loving*: "The process of

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[115]For instance, section 10.20(a)(1) requires the practitioner to "promptly submit records and information in any matter before" the IRS, absent a reasonable, good-faith belief that the material is privileged. This duty operates once there has been "a proper and lawful request by a duly authorized officer or employee" of the IRS, which presupposes that an audit or other IRS-taxpayer interactive process already has begun.

[116]31 C.F.R. section 10.50(a) and (c).

[117]Section 10.51(a) identifies 18 categories of incompetence and disreputable conduct, and this enumeration is illustrative, not exhaustive.

[118]31 C.F.R. section 10.50(a).

[119]31 C.F.R. section 10.52(a)(1).

[120]*Id.*

[121]31 C.F.R. section 10.52(a)(2).

[122]742 F.3d at 1018 (quoting 917 F. Supp.2d at 74).

[123]742 F.3d at 1020.

[124]*Id.* at 1018.

[125]2014 U.S. Dist. LEXIS 96447, at *4.

[126]*Id.* (emphasis in the original). This formulation is slightly reworked in the order the *Ridgely* court entered on the same day it handed down its opinion. The order provided in part as follows:

> ORDERED that [Treasury and the IRS] lack statutory authority to promulgate or enforce the restrictions on contingent fee arrangements, as delineated in 31 C.F.R. section 10.27, with respect to the preparation and filing of Ordinary Refund Claims, where "preparation and filing" precedes the inception of any examination or adjudication of the refund claim by the IRS and any formal legal representation on the part of the practitioner.

Ridgely, 2014 U.S. Dist. LEXIS 96447 (D.D.C. July 16, 2014).

filing an Ordinary Refund Claim — again, before any back-and-forth with the IRS — is similar to the process of filing a tax return in that both take place prior to any type of adversarial assessment of the taxpayer's liability."[127]

There are several discordancies in these *Loving* and *Ridgely* formulations. A chief one is that they sometimes emphasize the element of conflict (the IRS must have actually disagreed with the taxpayer about the return or the claim), while at other times they emphasize a formal event or stage in the process (such as commencement of an audit or Appeals Office hearing, or the filing of a power of attorney form with the IRS).

These divergent formulations could point to different moments for when the Rubicon has been crossed. For instance, *Ridgely* identified the filing of the power of attorney form as a possible crossover point, but neither *Loving* opinion did so. Moreover, an IRS audit certainly involves back-and-forth, but it need not be contested or adversarial. The IRS's goal in examining a return is to determine true tax liability, not to skin the taxpayer out of every dollar possible.[128] Many audits are closed on a no-change basis or even with the determination of an overpayment.

In a detailed and insightful article, Camp has argued that IRS audits are best understood as inquisitorial rather than adversarial.[129] Some Tax Court judges took this theme even further, maintaining that we should "view a tax trial as being investigatory in nature rather than a simple adversary proceeding."[130] Whether one goes that far regarding tax trials, there is much to commend the view that — at least from the IRS's standpoint — the taxpayer should not at the audit stage be perceived as an adversary.[131]

Other ambiguities exist as well. The *Loving* circuit court referred to an "adjudicative proceeding" but did not define that concept. We often associate it with cases tried in court or trial-type hearings before administrative law judges, but the APA uses the term more broadly. Under the APA, adjudication is an "agency process for the formulation of an order,"[132] and an order is "the whole or a part of a final disposition, whether affirmative, negative, injunctive, or declaratory in form, of an agency in a matter other than rule making but including licensing."[133] Tax lawyers are not accustomed to thinking of the IRS as an adjudicatory body, but within this framework of the APA, many kinds of IRS actions and decisions constitute adjudications.[134] Did the D.C. Circuit mean adjudicative proceeding to be understood from an everyday perspective or an APA perspective?

Even if the latter, we still are not out of the woods. The above APA definition refers to a "final disposition." Typically, finality requires two elements. First, the action must be the consummation of the agency's deliberative process, not merely a tentative view. Second, the action must determine rights and obligations; legal consequences must flow from it.[135] The notion of finality shoves to later in the process the point at which the IRS can properly be said to have adjudicated. Issuance of a statutory notice of deficiency (90-day letter) by the IRS is a final order in APA terms. Issuance of a revenue agent's report (30-day letter) by the IRS is not a final order.[136]

Similar ambiguity exists in *Ridgely*. *Ridgely*'s reference to "adversarial assessment" evokes the deficiency process under which the IRS often cannot assess additional income, estate, or gift taxes without first issuing a notice of deficiency and allowing an opportunity for prepayment review of the merits by the Tax Court.[137] But the issuance of a notice of deficiency comes after audit and often after IRS Appeals Office consideration. Did the court intend to push the decisive moment so late in the process?

"Assessment" has an understood term of art meaning in tax parlance.[138] Generalist judges often use the term imprecisely, but does mere sloppiness explain the *Ridgely* court's use of it? That explanation would be undercut by the fact that the *Loving*

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[127] 2014 U.S. Dist. LEXIS 96447, at *16.

[128] *E.g.*, Rev. Proc. 64-22, 1964-1 C.B. 689.

[129] Camp, "Tax Administration as Inquisitorial Process and the Partial Paradigm Shift in the Internal Revenue Service Restructuring and Reform Act of 1998," 56 *Fla. Tax Rev.* 1, 17-78 (2004).

[130] Theodore Tannenwald Jr., "Tax Trials: A View From the Bench," 59 *ABA J.* 295, 295 (1973); *see also* Meade Whitaker, "Some Thoughts on Current Practice," 7 *Va. Tax Rev.* 421, 437-438 (1988), and Tannenwald, "The Ervin N. Griswold Lecture," 15 *Am. J. Tax Pol'y* 1, 7-8 (1998).

[131] *See, e.g., Loving*, 742 F.3d at 1018 ("the IRS conducts its own . . . non-adversarial assessment of the taxpayer's liability").

[132] 5 U.S.C. section 551(7).

[133] 5 U.S.C. section 551(6); *see* Alan B. Morrison, "Administrative Agencies Are Just Like Legislatures and Courts — Except When They're Not," 59 *Admin. L. Rev.* 79, 98 (2007) ("under the APA, any agency action that is not a rulemaking is an adjudication").

[134] *See* Johnson, "Reasoned Explanation and IRS Adjudication," 63 *Duke L. J.* 1771, 1792-1800 (2014).

[135] *E.g., Bennett v. Spear*, 520 U.S. 154, 177-178 (1997).

[136] A 90-day letter is the official determination of the IRS. A 30-day letter is not. *E.g.*, section 6212(a).

[137] *See* sections 6211 through 6213.

[138] *See* sections 6201 through 6204; *United States v. Galletti*, 541 U.S. 114, 122 (2004).

district court began its analysis by defining assessment,[139] as did the *Ridgely* court.[140] If that was not a result of sloppiness, then was *Ridgely* intentionally pushing until late in the process the commencement of "practice before the IRS"?

In short, both *Loving* and *Ridgely* tell us, in their respective contexts, that the Circular 230 provisions there at issue misconstrued when practice before the IRS starts. However, the cases do not leave us with a settled understanding of the point, moment, phase, or event that marks the commencement of practice. Precision in this regard was not needed to decide the particular questions in *Loving* and *Ridgely*. Future cases may well require greater clarity.

2. Rigor of *Chevron* step one analysis. Along with the Supreme Court, the D.C. Circuit and its district court are at the center of the great battles of administrative law.[141] *Loving* and *Ridgely* were decided as they were because of, and reflecting shifts in, the dominant judicial approach to *Chevron* in administrative law, especially in the D.C. Circuit.

It once was thought that *Chevron* was a "super-deferential approach,"[142] and that may once have been so.[143] But fashion, the prevalence of 3-D movies, and judicial styles of interpretation change over time. Many cases would have been decided differently had they reached the courts at a different time, when a different interpretational approach held sway. As relevant here, in recent years, there has been a turn in administrative law back toward congressional primacy. Judicial deference to agencies has weakened as a result.[144]

A subtle but important shift has occurred in how judges frame the question — a shift from "I'll uphold the agency action unless Congress prohibited the agency from wielding this power" to "I'll uphold the agency action only if Congress gave the agency this power." As a practical matter, a judge laboring under the former approach is predisposed to hold for the agency. Less so is the judge operating under the latter approach.

Chevron spoke not just of explicit congressional conferrals of power on agencies. It also ventured that statutory gaps can constitute implicit delegations.[145] That formulation is favorable ground for the agency. Implicit delegation, however, was deemphasized in later cases.[146] Those cases, including recent Supreme Court tax decisions, continue to define delegation as a key aspect of *Chevron*, and their main focus is explicit, not implicit, delegation.[147]

A key case in the current delegation-oriented approach to *Chevron* is the Supreme Court's 2013 decision in *City of Arlington v. FCC*.[148] The agency prevailed in that case, with the majority holding that *Chevron* applies to an agency's determination of the scope of its jurisdiction. This might seem pro-agency. It is not. The majority, in an opinion written by Justice Antonin Scalia, stressed that *Chevron* review — in jurisdiction cases as in all cases — is to be exacting, not indulgent. Near the beginning, the majority opinion stated: "No matter how it is framed, the question a court faces when confronted with an agency's interpretation of a statute it administers is always, simply, *whether the agency has stayed within the bounds of its statutory authority*" (emphasis in the original).[149]

At the end of its opinion, the *City of Arlington* majority reemphasized: "The fox-in-the-henhouse syndrome is to be avoided . . . by taking seriously, and applying rigorously, in all cases, statutory limits on agencies' authority. Where Congress has established an ambiguous line, the agency can go no further than the ambiguity will fairly allow."[150] None of the nine justices — whether in the majority,

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[139]917 F. Supp.2d at 69-70.

[140]2014 U.S. Dist. LEXIS 96447, at *2.

[141]*See, e.g.*, Jim Rossi, "Does the Solicitor General Advantage Thwart the Rule of Law in the Administrative State?" 28 *Fla. St. U. L. Rev.* 459, 460-461 (2000).

[142]*E.g.*, William D. Popkin, *Materials on Legislation: Political Language and the Political Process* 611 (2009).

[143]*But see* Richard J. Pierce Jr., "What Do the Studies of Judicial Review of Agency Action Mean?" 63 *Admin. L. Rev.* 77 (2011) (finding that federal courts uphold agency actions about 70 percent of the time, regardless of whether *Chevron* or alternative standards of review are applied).

[144]*See, e.g.*, Jack M. Beerman, "The Turn Toward Congress in Administrative Law," 89 *B.U. L. Rev.* 727 (2009); Johnson, *supra* note 5, at 113-114.

[145]*Chevron*, 467 U.S. at 843; *see also Morton v. Ruiz*, 415 U.S. 199, 231 (1974).

[146]*E.g.*, *United States v. Mead Corp.*, 533 U.S. 218, 226-227 (2001) ("We hold that administrative implementation of a particular statutory provision qualifies for *Chevron* deference when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in the exercise of that authority"); *see* Stephen M. Johnson, "Bringing Deference Back (But for How Long?)," 57 *Cath. L. Rev.* 1 (2007).

[147]*E.g.*, *United States v. Home Concrete & Supply LLC*, 132 S. Ct. 1836, 1843-1844 (2012); and *Mayo Foundation for Medical Education and Research v. United States*, 131 S. Ct. 704, 713-714 (2011). For discussion of *Home Concrete*, see Johnson, "Reflections on *Home Concrete*: Writing Tax Regulations and Interpreting Tax Statutes," 13 *Fla. St. U. Bus. Rev.* 77 (2014). For discussion of *Mayo*, see Johnson, "Preserving Fairness in Tax Administration in the *Mayo* Era," 32 *Va. Tax Rev.* 269 (2012); and Johnson, "*Mayo* and the Future of Tax Regulations," *Tax Notes*, Mar. 28, 2011, p. 1547.

[148]*City of Arlington*, 133 S. Ct. 1863.

[149]*Id.* at 1868.

[150]*Id.* at 1874.

in concurrence, or in dissent — disputed the proposition that *Chevron* step one review should be rigorous.

The Supreme Court handed down *City of Arlington* between the district court's and circuit court's opinions in *Loving*. Despite preceding *City of Arlington*, the district court opinion applied a rigorous, nondeferential style of analysis at *Chevron* step one.[151] The *Loving* circuit court's opinion was unmistakably influenced by *City of Arlington*. The opinion quoted *City of Arlington* in both the first and last paragraphs of its analytical portion.[152] Unsurprisingly, early in its opinion, the *Ridgely* court also quoted *City of Arlington*.[153]

The "construe the delegation rigorously" approach of *City of Arlington* continues to be the dominant conception of *Chevron*. A June 2014 Supreme Court decision quoted *City of Arlington* in support of this proposition: "Even under *Chevron* . . . agencies must operate within the bounds of reasonable interpretation."[154] And a September 2014 circuit court case remarked: "An administrative agency's authority is necessarily derived from the statute it administers and may not be exercised in a manner . . . inconsistent with" what Congress ordained.[155]

Nonetheless, pendulums swing. The fact that rigorous step one analysis is in vogue now guarantees nothing for the future. *Chevron* cases are litigated every day the courts are open. The equities of these cases will always influence doctrine, as will the ever-shifting perceived necessities of the time.

A significant current area of controversy involves *Chevron* and tax aspects of the Affordable Care Act. On July 22, 2014, panels of the D.C. Circuit and the Fourth Circuit issued conflicting opinions in this controversy. Sections 1311(b)(1) and 1321(c) of the ACA encourage states to establish exchanges through which individuals can buy medical insurance. Thirty-four states have chosen not to do so, however. Accordingly, under section 1321(c)(1) of the act, the Department of Health and Human Services has set up federal exchanges in those states.

Section 36B, added to the tax code by the ACA, authorizes a tax credit for persons buying insurance through an exchange "established by the State under section 1311."[156] Taken literally, this language would not make the credit available to those who buy insurance through the federal exchange established in the state in lieu of the state establishing its own exchange. However, by regulation, Treasury has interpreted section 36B broadly and made the credit available as well to customers of those federal "in lieu of" exchanges.[157] The validity of that regulation has been challenged.

In *Halbig v. Burwell*, over a dissent and reversing the trial court, a panel of the D.C. Circuit concluded that the statute unambiguously restricts the section 36B credit to insurance purchased on state-established exchanges and so invalidated the regulation at *Chevron* step one.[158] On the same day, in *King v. Burwell*, a panel of the Fourth Circuit, unanimously and affirming the trial court, upheld the same regulation under *Chevron*.[159]

Since then, a district court has agreed with the *Halbig* decision;[160] the D.C. Circuit, vacating the panel decision, has granted *en banc* review of *Halbig*;[161] and the Supreme Court has granted certiorari in *King*.[162] Even if the regulation at issue is ultimately upheld, that would not undermine the conclusion that *Chevron* step one inquiries are conducted in a rigorous manner. It is settled that the step one analysis looks at the statutory language in context, not in isolation.[163] The role of the section 36B credit in the total scheme of the ACA's operation provides significant (though not necessarily decisive) contextual support for the interpretation enshrined in the regulation.[164]

Moreover, a pro-government result in the section 36B controversy would not necessarily have spillover utility to the government in Circular 230 cases. The Supreme Court has cautioned against courts placing too much weight in interpretation on apparent anomalies within statutes.[165] That principle may excuse anomalies within the ACA, which consists of 10 titles stretching to more than 900

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[151]*See* Johnson, *supra* note 5, at 113-120.

[152]742 F.3d at 1016, 1022.

[153]2014 U.S. Dist. LEXIS 96447, at *13.

[154]*Utility Air Regulatory Group v. EPA*, 134 S. Ct. 2427, 2442 (2014). The Court particularly warned against deference that "would bring about an enormous and transformative expansion in [the agency's] regulatory authority without clear congressional authorization." *Id.* at 2444. That is just what the regulation invalidated in *Loving* did.

[155]*United States v. Transocean Deepwater Drilling Inc.*, 767 F.3d 485, 489 (5th Cir. 2014).

[156]Section 36B(b)(2)(A).

[157]Reg. section 1.36B-2(a)(1).

[158]758 F.3d 390 (D.C. Cir. 2014).

[159]759 F.3d 358 (4th Cir. 2014).

[160]*Oklahoma v. Burwell*, 2014 U.S. Dist. LEXIS 139501 (E.D. Okla. Sept. 30, 2014).

[161]2014 U.S. App. LEXIS 17099 (D.C. Cir. Sept. 4, 2014).

[162]S. Ct. Dkt. No. 14-114 (*cert. granted* Nov. 7, 2014).

[163]*E.g.*, *Nat'l Ass'n of Home Builders v. Defenders of Wildlife*, 551 U.S. 644, 666 (2007); *Robinson v. Shell Oil Co.*, 519 U.S. 337, 341 (1997).

[164]*See King*, 759 F.3d at 374.

[165]*E.g.*, *Michigan v. Bay Mills Indian Community*, 134 S. Ct. 2024, 2033-2034 (2014).

pages.[166] Less interpretational indulgence would be appropriate for the short 31 U.S.C. section 330.

C. Potentially Vulnerable Circular 230 Provisions

We have seen that *Loving* and *Ridgely* (1) reflect the dominant approach of rigorous, nondeferential review of agency authority and statutory clarity at *Chevron* step one; (2) identify 31 U.S.C. section 330(a) as the foundation of Treasury's ability to impose professional responsibility rules through Circular 230; (3) allow those rules only to the extent they bear on representatives engaged in practice before the IRS; (4) limit "representatives" to persons who act as agents of taxpayers in dealing with the IRS and who possess the legal authority to act on the behalf of their taxpayers; and (5) define practice as commencing only at some not yet precisely marked time or event involving (a) presentation to the IRS of a power of attorney, (b) the existence of an actual dispute between the taxpayer and the IRS, or (c) the start of an audit, a similar IRS action, or an adjudicatory process.

Unless further litigation causes the courts to retreat from these positions, many portions of Circular 230, not just those specifically at issue in *Loving* or *Ridgely*, could be in peril of invalidation if challenged. I will not attempt below to develop this thought exhaustively. Instead, the focus will be on some of the more important portions that may be in jeopardy.

1. Section 10.22. Section 10.22 of Circular 230 requires that a practitioner exercise due diligence regarding accuracy in three situations:

> 1. in preparing or assisting in the preparation of, approving, and filing tax returns, documents, and other papers relating to [IRS] matters;
>
> 2. in determining the correctness of oral or written representations made by the practitioner to the Department of the Treasury; and
>
> 3. in determining the correctness of oral and written representations made by the practitioner to clients with respect to any matter administered by the [IRS].[167]

This regulation is not facially invalid, but under recent cases, it may be invalid as applied in some situations. If the referenced activities take place in interactions with IRS personnel after the start of an audit, their regulation under Circular 230 section 10.22 likely would be upheld under *Loving* and *Ridgely*. If they occur earlier than that, regulation, and the imposition of sanctions for violation, would seem to be in peril.

2. Section 10.27. Section 10.27 addresses fees that practitioners charge their clients. This section's limitation on contingent fees[168] was at issue in, and was partially invalidated by, *Ridgely*. However, the section also contains a more general prohibition: "A practitioner may not charge an unconscionable fee in connection with any matter before" the IRS.[169] As seen in Part IV.A above, the section defines a matter before the IRS broadly.[170]

The *Ridgely* plaintiff did not ask the court to invalidate the general unconscionability provision, and the case did not, as a formal matter, affect it. However, the logic of the case applies to the general unconscionable fees rule as fully as it does to the specific contingent fees rule.

3. Section 10.29. Largely tracking general ethical rules,[171] section 10.29 provides, with stated exceptions, that "a practitioner shall not represent a client before the [IRS] if the representation involves a conflict of interest," which the section then defines.[172]

The key to the validity of this provision in a *Loving/Ridgely* environment is, of course, the scope of "before the IRS." In that context, this rule would be enforceable only after the practitioner has become a "representative" and the process has matured into "practice" as those terms are defined in the cases.

4. Section 10.34. Section 10.34 sets out standards for tax returns and documents, affidavits, and other papers. It (1) prohibits practitioners from advising clients to take unreasonable positions on returns or refund claims,[173] and (2) requires practitioners to apprise clients of potential penalties for returns and other documents submitted to the IRS.[174] To the extent these and other rules apply to return preparation and other pre-audit advice, they are at risk under *Loving* and *Ridgely*.

5. Section 10.36. Section 10.36 establishes procedures to ensure compliance. It provides in part as follows:

> Any individual subject to [Circular 230] who has . . . principal authority and responsibility for overseeing a firm's practice governed by

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[166] *NFIB*, 132 S. Ct. at 2580.

[167] 31 C.F.R. section 10.22(a).

[168] 31 C.F.R. section 10.27(b).

[169] 31 C.F.R. section 10.27(a).

[170] 31 C.F.R. section 10.27(c).

[171] *See* American Bar Association Model Rule 1.7; and *Developments in the Law — Conflicts of Interest in the Legal Profession*, 94 *Harv. L. Rev.* 1244 (1981).

[172] 31 C.F.R. section 10.29(a), (b).

[173] 31 C.F.R. section 10.34(a), (b).

[174] 31 C.F.R. section 10.34(c).

this part, including the provision of advice concerning Federal tax matters and preparation of tax returns, claims for refund, or other documents for submission to the [IRS], must take reasonable steps to ensure that the firm has adequate procedures in effect for all members, associates, and employees for purposes of complying with [Circular 230]. In the absence of a person or persons identified by the firm as having the principal authority and responsibility described in this paragraph, the [IRS] may identify one or more individuals . . . responsible for compliance with the requirements.[175]

The IRS has not often attempted to enforce Circular 230 section 10.36. Overseers are unlikely to be held sanctionable when the overseen themselves are not. If the above observations about Circular 230 have force regarding the duties of line practitioners, they also would seem to apply to the duties of their supervisors.

6. Section 10.37. Section 10.37 is potentially among the more important of the sections not formally at issue in recent cases but perhaps imperiled by them. At the stages of its development, adoption, and amendment, this section and its predecessors have received more attention from tax practitioners than most other prescriptions and proscriptions in Circular 230.[176]

Treasury reworked the rules now in section 10.37 several times over the last three decades as part of the war against tax shelters. Key rules formerly were lodged in section 10.35. They migrated into section 10.37 via Circular 230 amendments proposed in 2012 and finalized in 2014.[177]

Subject to various implementing rules, section 10.37 requires that a practitioner:

i. base the written advice on reasonable factual and legal assumptions . . .;

ii. reasonably consider all relevant facts and circumstances that the practitioner knows or reasonably should know;

iii. use reasonable efforts to identify and ascertain the facts relevant to written advice on each Federal tax matter;

iv. not rely upon representations, statements, findings, or agreements . . . of the taxpayer or any other person if reliance on them would be unreasonable;

v. relate applicable law and authorities to facts; and

vi. not, in evaluating a Federal tax matter, take into account the possibility that a tax return will not be audited or that a matter will not be raised on audit.[178]

The section defines a federal tax matter as "any matter concerning the application or interpretation of [*inter alia* any] law or regulation administered by" the IRS.[179]

Clearly, this is directed at written advice rendered before a return has been selected for audit, before the commencement of an adjudicatory process, and before the occurrence of any other taxpayer-IRS or adviser-IRS interactions. If the approach of *Loving* and *Ridgely* stands, one foot of section 10.37 is on the gallows and the other foot is on a banana peel.[180]

7. Some possible rejoinders. The *Ridgely* court stressed that apart from the challenge to the section 10.27(b) contingent fee rules, "the parties have not raised, and the Court expresses no view on, the IRS's authority to issue and enforce standards of practice by representatives under other subsections" of Circular 230.[181] That observation may ring differently to different ears. To the government, it might be a sweet invitation to develop better vehicles than section 330(a), which broke down in *Loving* and *Ridgely*. To potential future plaintiffs, it might be a sonorous tattoo of future troubles; they may have to meet arguments stronger than section 330(a). From whichever perspective, it would be surprising indeed if the decided and pending cases described in Section III above were the last *Chevron* challenges to aspects of Circular 230.

In future cases, the IRS may attempt to distinguish *Loving* and *Ridgely*, ideally to cabin them to their facts, by adverting to factual differences. The government's effort along that line fell flat in *Ridgely*. The government noted that *Loving* and *Ridgely* involved different types of plaintiffs — non-CPA preparers in the former but a CPA in the latter — and different provisions of Circular 230 — sections 10.3 to 10.6 in the former but section 10.27 in the latter.[182] Those were distinctions, to be sure, but without meaningful difference.[183]

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[175]31 C.F.R. section 10.36(a).

[176]*See, e.g.*, Tobin et al., *supra* note 1, at 204 (noting that rules ancestral to the current section 10.37 "have received a lot of focus from the tax bar, and there have been a lot of complaints that [they go] too far").

[177]*See* Desmond, *supra* note 103, at 23-24.

[178]31 C.F.R. section 10.37(a)(2).

[179]31 C.F.R. section 10.37(d).

[180]*See, e.g.*, Madara, "Court Relies on *Loving* in Striking Down Contingent Fee Rules," *Tax Notes*, July 21, 2014, p. 242 (describing the views of Stuart Bassin, counsel for the plaintiffs in *Steele*, discussed in Section III.C.2).

[181]*Ridgely*, 2014 U.S. Dist. LEXIS 96447, at *12, n.3.

[182]*Id.* at *14.

[183]*Id.*

Alternatively, the government might attempt to cast a thread of connection over the divide identified by the recent cases — the divide between what is potentially controversial (thus constituting practice and thereby subject to regulation under 31 U.S.C. section 330(a)) and what is merely preparatory (thus non-practice and not subject to regulation). The government tried to do so in *Ridgely*, justifying the challenged Circular 230 rules as means to prevent the "exploit[ation of] the audit selection process" by overreaching preparers.[184] But this was *Palsgrafian*.[185] Chaos theory tells us that a chain of "but for" connections may link a butterfly flapping its wings in Brazil to a tornado in Texas.[186] Whatever degree of truth that may possess in the abstract, in the eyes of the law, the thread of connection at some point becomes so attenuated that it snaps under its own weight.[187] As in *Ridgely*, metaphysical possibilities do not trump statutory text and context.

V. How the Tax System Might Respond

Assume that the train of litigation outcomes continues to roll down the tracks laid in *Loving* and *Ridgely* and, thus, that the portions of Circular 230 identified above in Section IV.C as being at risk are in fact invalidated. This is far from a certainty, but it is a possibility. Should that future dawn, what would the ethical dimension of federal tax practice look like?

The answer to that question depends on what, if any, direct or collateral corrections are made. That action could involve one or more of the following: (1) federal legislation to strengthen 31 U.S.C. section 330(a); (2) non-legislative federal responses, such as greater emphasis on civil or criminal penalties, 31 U.S.C. section 330(d), 31 U.S.C. section 330(b), other federal statutes, or "voluntary" programs emphasizing incentives instead of commands; or (3) nonfederal responses, such as state regulation and malpractice actions brought by aggrieved taxpayers.

[184]*Id.* at *1.

[185]*Cf. Palsgraf v. Long Island R. Co.*, 162 N.E. 99 (N.Y. 1928) (holding that acts that are the "but for" cause of injury still are not actionable in tort if the connection between the acts and the injuries is too indirect or remote in probability).

[186]*See, e.g.*, Robert C. Hilborn, "Sea Gulls, Butterflies, and Grasshoppers: A Brief History of the Butterfly Effect in Nonlinear Dynamics," 72 *Am. J. Physics* 425 (2004).

[187]*See, e.g.*, *Smith v. Commissioner*, 40 B.T.A. 1038 (1939) (rejecting a but-for test for determining whether costs are deductible as ordinary and necessary business expenses), *aff'd per curiam*, 113 F.2d 114 (2d Cir. 1940).

A. Federal Legislation

Loving and *Ridgely*, and future cases that may follow their lead, are or will be statutory, not constitutional, decisions. As such, they always can be reversed legislatively. Congress can amend 31 U.S.C. section 330 anytime it wishes to shore up the delegation of rulemaking power on which Circular 230 rests.

Some efforts are being made to do just that for the issue in *Loving*: regulation of return preparers. Treasury, the IRS, and some others believe that greater regulation of preparers is critically important to the viability of the tax system and the protection of American taxpayers.[188] They also believe that the ultimate solution to the problem is legislation to provide the statutory basis found lacking in *Loving*.[189]

Bills have been introduced, and some hearings have been held. Some bills take the direction one would expect — that is, they would, if enacted, expand Treasury's statutory authority to prescribe professional responsibility rules for practice before the IRS.[190] But those proposals sail into stiff head winds of political opposition, in no small part because of remarkably maladroit navigation by the IRS in recent years. The IRS's inappropriate processing of applications for tax exemption by conservative-leaning groups, its inept handling of resultant congressional inquiries, waste and irresponsibility in some IRS training programs, and isolated acts of partisanship and illegality by individual IRS employees all have created a hostile climate for the IRS on Capitol Hill.[191] As a result, the IRS's budget is taking big hits,[192] and the appetite for legislation of any kind to help the IRS is small. Add in the gridlock now prevailing in Washington, and even the IRS acknowledges that it does not expect Congress to act anytime soon on legislation to reverse *Loving* and *Ridgely*.[193]

[188]*See* Johnson, *supra* note 5, at 520-524 (describing arguments and evidence on both sides of the policy debate).

[189]Madara, *supra* note 13 (quoting John Dalrymple, IRS Deputy Commissioner for Services and Enforcement); *see also* Katherine M. Hetherington, "Regulation of Paid Tax-Reform Preparers: A Foregone Conclusion Regardless of the Result in the *Loving* Case," 1 *Suffolk U. L. Rev. Online* 105 (2013).

[190]*E.g.*, H.R. 4470, Tax Return Preparer Accountability Act of 2014; and H.R. 1570, Taxpayer Protection and Preparer Fraud Prevention Act of 2013.

[191]*E.g.*, Joseph J. Thorndike, "Stop Blaming the IRS for Problems It Didn't Create," *Tax Notes*, July 14, 2014, p. 115 (appropriately noting the shortcomings of Congress in tax legislation and oversight, but saying that "the IRS deserves a hard time from Congress. In recent years, its list of failures and transgressions is long and serious.").

[192]*E.g.*, IRS Oversight Board, "Annual Report to Congress 2013," at 11-23 (Mar. 2014).

[193]Madara, *supra* note 13 (citing Benoit).

Another bill might offer a way around that obstacle but would raise concerns of its own. If enacted, the Tax Refund Protection Act of 2014 would vest authority to regulate tax return preparers not in Treasury and the IRS, but in the Consumer Financial Protection Bureau (CFPB), an independent agency within the Federal Reserve System.[194] Styling the measure as a consumer protection matter rather than a tax administration matter and vesting authority outside the IRS might facilitate passage.

But we should think long and hard before expediency drives us in this direction. The CFPB is less expert in the area than Treasury and the IRS. It also has vast responsibilities under the Dodd-Frank Act, which created it, and might pay less attention to this interloper than to matters within its core responsibilities. Moreover, the CFPB is itself controversial. It was designed to have extraordinary independence — far too much, critics allege. The CFPB's broad empowerment and its relative independence from congressional, presidential, and judicial oversight have led to suggestions that the CFPB is dangerous,[195] perhaps unconstitutional.[196]

B. Possible Non-Legislative Federal Actions

1. Civil and criminal penalties. Even if Circular 230 were invalidated in toto (which no one suggests is a possibility), the government could still punish (and hopefully deter) egregious wrongdoing and incompetence by tax advisers and return preparers. An imposing array of potentially applicable civil and criminal provisions exists in the tax code.

Civilly, the code sets forth penalties (of varying amounts, with different elements and subject to various defenses) for advisers or preparers who (1) give unreasonable advice, leading to a tax understatement,[197] (2) fail to give the taxpayer a copy of the return,[198] (3) fail to sign the return,[199] (4) fail to supply an identifying number,[200] (5) fail to retain copies or a list of returns,[201] (6) endorse or negotiate a check issued to a taxpayer,[202] (7) fail to comply with due diligence regulations concerning the earned income tax credit,[203] (8) promote abusive tax shelters,[204] (9) aid and abet the understatement of tax liabilities,[205] and (10) improperly disclose tax return information.[206] Moreover, violation of some of these provisions allows the government to seek an injunction against the adviser or preparer prohibiting future conduct, including return preparation.[207]

Criminally, tax advisers and return preparers can be incarcerated under the tax code for (1) attempting to evade or defeat the assessment or collection of a tax,[208] (2) aiding and assisting in the understatement of tax liability,[209] (3) delivering to the IRS a false return or other document,[210] (4) interfering with tax administration,[211] and (5) unauthorized use or disclosure of tax return information.[212] These prohibitions are reinforced by criminal statutes in other titles of the U.S. Code, including prohibitions on lying to federal officials,[213] conspiracy,[214] aiding and abetting violation of the law,[215] and mail and wire fraud.[216]

The *Loving* and *Ridgely* courts adverted to those sections in giving Circular 230 a restricted scope. They concluded that Congress could not have intended 31 U.S.C. section 330(a) to be read so broadly that it would render superfluous this imposing array of targeted sanctions[217] or allow the IRS to circumvent procedural safeguards written into them by basing sanctions instead on Circular 230.[218]

Should future litigation invalidate vulnerable portions of Circular 230, the IRS would still have the above civil and criminal sanctions with which to punish, and by which to deter, fraudulent or incompetent behavior by tax advisers and preparers. Many arrows would remain in the government's quiver. One must acknowledge the practical reality that Circular 230 remedies might in some instances

[194]H.R. 4463.

[195]*E.g.*, Todd Zywicki, "The Consumer Financial Protection Bureau: Savior or Menace?" 81 *Geo. Wash. L. Rev.* 856 (2013); and Brenden D. Soucy, "The Consumer Financial Protection Bureau: The Solution or the Problem?" 40 *Fla. St. U. L. Rev.* 691 (2013).

[196]Eric Pearson, "A Brief Essay on the Constitutionality of the Consumer Financial Protection Bureau," 47 *Creighton L. Rev.* 99 (2013).

[197]Section 6694(a), (b).

[198]Section 6695(a).

[199]Section 6695(b).

[200]Section 6695(c).

[201]Section 6695(d).

[202]Section 6695(f).

[203]Section 6695(g).

[204]Section 6700.

[205]Section 6701.

[206]Section 6713.

[207]Sections 7407 and 7408.

[208]Section 7201.

[209]Section 7206(2).

[210]Section 7207.

[211]Section 7212.

[212]Sections 7213(a)(3) and 7216.

[213]18 U.S.C. section 1001.

[214]18 U.S.C. section 371.

[215]18 U.S.C. sections 286 and 287.

[216]18 U.S.C. sections 1341 and 1343. For discussion of the tax and related criminal statutes, see John A. Townsend et al., *Tax Crimes*, chs. 2A, 2B, and 3 (2008); and Scott A. Schumacher, "Magnifying Deterrence by Prosecuting Professionals," 89 *Ind. L.J.* 511 (2014).

[217]*Loving*, 742 F.2d at 1020; *Ridgely*, 2014 U.S. Dist. LEXIS 96447, at *17-*18.

[218]*Loving*, 917 F. Supp.2d at 72-79.

be faster or easier to apply than alternative targeted remedies under the civil and criminal sections described above. There could be an efficiency loss. But after all, Congress wrote procedural safeguards into civil and criminal penalties for a reason. Procedural protections should not be brushed aside lightly just to make the IRS's job easier.[219]

2. 31 U.S.C. section 330(d). Our focus thus far has been on subsection (a) of 31 U.S.C. section 330. It now is time to bring subsection (d) into the discussion. Congress added subsection (d) in 1984 as part of the tax shelter wars. Subsection (d) provides: "Nothing in this section or in any other provision of law shall be construed to limit the authority of . . . the Treasury to impose standards applicable to the rendering of written advice with respect to any entity, transaction plan or arrangement, or other plan or arrangement, which is of a type which [Treasury] determines as having a potential for tax avoidance or evasion."

If courts continue to limit 31 U.S.C. section 330(a), the IRS would be strongly tempted to ground Circular 230 rules, as much as possible, in 31 U.S.C. section 330(d) as an alternative delegation of rulemaking power. Doing so would raise three concerns, however.

First, 31 U.S.C. section 330(d) isn't a clear, affirmative conferral of power. It does not say that Treasury has the power. It says only that no law prevents it from having the power. But where is the positive delegation from Congress to the agency? I suspect the courts would get past this objection, though. The oddly worded section probably would be seen as a delegation by negative inference.[220] Otherwise, what is the provision for? The courts presume that Congress means its enactments to have effect, and interpretations that create statutory nullities usually are avoided.[221]

Second, 31 U.S.C. section 330(d) could not support all of the vulnerable Circular 230 rules. By its terms, 31 U.S.C. section 330(d) allows regulation of written advice only. Oral advice or other conduct would not be covered.

Third, some courts would feel uneasy about aggressive application of 31 U.S.C. section 330(d). The language having to do with "any plan or arrangement Treasury thinks has a potential for tax avoidance" is vague and potentially sweeping. Obviously, Congress was trying to get at tax shelters, but neither this nor other statutes have been notably successful in defining them.[222]

Tax avoidance usually is understood as reducing one's tax liability by legal means. Buying a house rather than renting, buying tax-exempt state or local bonds, and forming a business as a limited liability company or S corporation rather than a C corporation all are transactions with potential for tax avoidance. Could Congress really have meant 31 U.S.C. section 330(d) to sweep so broadly?

Hesitation regarding that question would inspire some courts to disfavor an aggressive Treasury interpretation of 31 U.S.C. section 330(d). Indeed, that happened in *Ridgely*. The government asserted 31 U.S.C. section 330(d) late, raising it for the first time in oral argument, and the court was disinclined to read the provision broadly. Finding that the text, context, and history of 31 U.S.C. section 330 paint a clear picture, the court remarked: "That clarity cannot be eclipsed by brief, thinly supported references to ambiguous statutory language [in 31 U.S.C. section 330(d)], the relevance of which the IRS never really explains."[223]

Continued restrictive interpretation of 31 U.S.C. section 330(a) would give the government an incentive to do a better job of explanation in future cases. For the reasons discussed above, 31 U.S.C. section 330(d) could not completely substitute for a broad view of 31 U.S.C. section 330(a), but it would be part of the package of government responses.

3. 31 U.S.C. section 330(b). Could the government in future cases make more substantial use of another portion of the statute: subsection (b)? In relevant part, 31 U.S.C. section 330(b) provides that the IRS "may suspend or disbar from practice . . . or censure, a representative who . . . is incompetent; . . . is disreputable; . . . violates regulations prescribed under [section 330]; or . . . with intent to defraud, willfully and knowingly misleads or threatens the person being represented."

We will need a great deal more judicial guidance before we can form a clear idea of the extent to

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[219] Statutory procedural protections are not the only barrier to effective enforcement; bureaucratic failures play a role as well. A recent study found that the IRS often (almost half the time) fails to timely process complaints it receives about return preparers. Treasury Inspector General for Tax Administration, "Processes Do Not Ensure That Complaints Against Tax Return Preparers Are Timely, Accurately, and Consistently Processed," No. 2014-40-056 (Aug. 8, 2014).

[220] Probably but not certainly. *See, e.g., Chamber of Commerce of the United States v. NLRB*, 721 F.3d 152, 160 (4th Cir. 2013) ("we do not presume a delegation of power [to an agency] simply from the absence of an express withholding of power"); and *National Rifle Ass'n of America Inc. v. Reno*, 216 F.3d 122, 136 (D.C. Cir. 2000). *Cf. Wozniak v. Dolgencorp LLC*, 2009 U.S. Dist. LEXIS 113437, at *7 (M.D. Fla. 2009) (a plaintiff "may not establish federal [court] jurisdiction through negative inferences").

[221] *E.g., Babbitt v. Sweet Home Chapter of Communities for a Great Oregon*, 515 U.S. 687, 697-698 (1995); and Johnson, "The 'No Surplusage' Canon in State and Local Tax Cases," *State Tax Notes*, Sept. 17, 2012, p. 793.

[222] *E.g.*, sections 6707A(c) and 6662(d)(2)(c)(ii).

[223] *Ridgely*, 2014 U.S. Dist. LEXIS 96447, at *22.

which subsection (b) can occupy ground from which *Loving* and *Ridgely* ousted subsection (a). One question, of course, is whether practice and representative have the same meaning in the two subsections, rendering (b) as limited as (a). The consistent meaning canon of construction would, if applied, push a court toward the same meaning in both places.[224] However, that canon is ignored or declined about as often as it is applied.[225]

Moreover, the component "violates regulations prescribed under [section 330]" presumably does not give Treasury carte blanche to promulgate any regulations it wishes and thus bootstrap itself into an opportunity, previously unavailable, to sanction practitioners. Violation of a regulation that is procedurally or substantially invalid should not reasonably provide the predicate for imposition of Circular 230 sanctions.[226]

4. 'Voluntary' initiatives. As seen in Section III.C.1, as a stopgap pending legislative change, the IRS created an ostensibly voluntary program to achieve as fully as possible what the mandatory program invalidated in *Loving* would have done. The "voluntary" program survived its first challenge when the district court decided *AICPA*. Will it avoid or survive other challenges as well? If so, one would expect the government to consider similar more or less voluntary expedients, whenever possible, should other parts of Circular 230 be invalidated.

C. Possible Nonfederal Responses

1. State regulation. Extensive bodies of law already exist in the states on the professional responsibilities of lawyers, CPAs, and some other professionals.[227] No one thinks that state regulation and professional self-policing are complete answers to the problems, but some states may prove more aggressive in regulation than others. For example, four states regulate return preparers in ways that would take up some of the slack created by *Loving*.[228]

2. Malpractice suits. Taxpayers given bad advice or otherwise abused by their tax advisers and preparers often can sue in state or federal court on a variety of theories. Again, this cannot be a complete remedy. Many taxpayer-clients lack the resources to successfully prosecute malpractice suits, and a tangle of legal doctrines often renders those suits unsuccessful.[229] Nonetheless, this private remedy is part of the mix. Malpractice suits are now fairly common in failed high-end tax shelters and have had at least some impact in curbing bad practices.[230]

VI. Conclusion

We may be at the start of a sea change in professional responsibility in tax. For decades, Treasury has been increasingly aggressive in regulating tax practice through Circular 230. Recent cases suggest that Treasury's zeal sometimes outstrips its statutory authority.

If the approach of recent cases is confirmed by future litigation and Congress chooses not to act, significant portions of Circular 230 may be at risk of invalidation.[231] The fine art of rendering sound tax advice — always difficult[232] — may for a time become even harder as once-accepted norms become unsettled.

The sky, of course, is not falling and will not fall. Organisms and systems often display impressive capacity to adapt to changed conditions. Moreover, there are features of our federal tax system that even with the loss of important parts of Circular 230 would prevent the degeneration of tax practice into an anything goes Wild West free-for-all. We will survive in any case, but the ways in which tax law is practiced in the United States may have to find a new equilibrium.

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[224] *See, e.g.*, *Atlantic Cleaners & Dryers Inc. v. United States*, 286 U.S. 427, 433 (1932).

[225] *See generally* Antonin Scalia and Bryan A. Garner, *Reading Law: The Interpretation of Legal Texts* 170-173 (2012).

[226] For discussion of the ways in which Treasury tax regulations may be challenged, see Johnson, "Preserving Fairness in Tax Administration in the *Mayo* Era," 32 *Va. Tax Rev.* 269, 300-323 (2012).

[227] The state rules often are heavily influenced by ethical pronouncements by professional organizations. *See, e.g.*, ABA Formal Op. 85-352 (July 7, 1985); and "Report of the Special Task Force on Formal Opinion 85-352," 39 *Tax Law.* 635 (1985).

[228] *See* Cal. Code Ann. section 22250; Md. Code Ann. section 10-824; N.Y. CLS Tax section 32; and Or. Rev. Stat. section 673.457.

[229] There is another possible concern. For many causes of malpractice action, the plaintiff must identify a standard of care or duty and then show that the adviser's conduct fell below that standard. The Circular 230 rules are a convenient source for those standards. If important Circular 230 rules are invalidated by the courts, plaintiffs in malpractice cases may find it more difficult to establish that their advisers' conduct fell below a recognized level of care or duty.

[230] *See, e.g.*, Jay A. Soled, "Tax Shelter Malpractice Cases and Their Implications for Tax Compliance," 58 *Am. U. L. Rev.* 267, 268-269 (2008).

[231] I am not alone in harboring this suspicion. "The outcomes of *Loving* and *Ridgely* will spawn additional cases challenging other sections of Treasury Circular 230 and possibly, or perhaps probably, limiting some of the ethical rules of practice applicable to even attorneys, CPAs, and enrolled agents." Internal Revenue Service Advisory Council, 2014 *Pub. Rep.* 23 (Nov. 19, 2014).

[232] *See, e.g.*, Charles A. Rose, "The Tax Lawyer's Dilemma: Recent Developments Heighten Tax Lawyer Responsibilities and Liabilities," 2011 *Colum. Bus. L. Rev.* 258, 259.