

Proposed regs on Circular 230 standards for return preparers also modify standards for all practitioners

Preamble to Prop Reg 08/19/2010; Prop Reg § 10.0, Prop Reg § 10.2, Prop Reg § 10.3, Prop Reg § 10.4, Prop Reg § 10.5, Prop Reg § 10.6, Prop Reg § 10.7, Prop Reg § 10.8, Prop Reg § 10.9, Prop Reg § 10.30, Prop Reg § 10.34, Prop Reg § 10.36, Prop Reg § 10.51, Prop Reg § 10.90

IRS has issued proposed regs that would modify the general standards of practice before IRS (i.e., Circular 230) to provide for competency testing, continuing professional education (CPE), and ethical standards for a new class of practitioner called a registered tax return preparer (RTRP). The proposed regs also would modify the professional standards for all practitioners in Reg. § 10.34(a) to generally be consistent with the civil penalty standards in Code Sec. 6694 for tax return preparers.

Background. Under current rules, professionals who represent clients before IRS, including attorneys, certified public accountants (CPAs), and enrolled agents (EAs) are subject to IRS (i.e., Circular 230) oversight, but other return preparers are not. Under current law, any individual may prepare tax returns and claims for refund without meeting any qualifications or competency standards. A tax return preparer also may exercise the privilege of limited practice before IRS. (Reg. § 10.7(c)(1)(viii) of Circular 230 and Rev Proc 81-38, 198102 CB 592)

In January, IRS released a study on the U.S. return preparer industry carrying detailed recommendations on new standards for preparers other than attorneys, CPAs, and EAs and what IRS intends to do short- and long-term to raise industry standards. Return preparers who are not attorneys, CPAs or EAs will be subject to new registration requirements, including mandatory use of Preparer Tax Identification Numbers (PTINs), competency testing, continuing professional education (CPE), and ethical standards (see Federal Taxes Weekly Alert 01/07/2010 for more details). All preparers will need to be registered on a new on-line registration system (target date for this system is Sept. 1, 2010) and will need to obtain a Preparer Tax Identification Number (PTIN) before filing any return after Dec. 31, 2010. Testing won't be implemented until after registration and mandatory PTIN usage are in place.

In July, IRS issued proposed regs on tax return preparers' PTIN requirements (see Federal Taxes Weekly Alert 07/29/2010). Now, IRS has issued proposed regs that would amend the Circular 230 rules governing practice before IRS to provide for competency testing, CPE, and ethical standards for a new class of practitioner called a "RTRP." This would be an individual who: (1) demonstrates competence in federal tax return preparation matters by written examination administered by, or administered under the oversight of, IRS; (2) possesses a current or otherwise valid PTIN or other prescribed identifying number; and (3) has not engaged in any conduct that would justify the suspension or disbarment of any practitioner under Circular 230 on the date the application is submitted. (Reg. § 10.4(c)) The proposed regs would not change the existing authority of attorneys, certified public accountants, and enrolled agents to practice before IRS under

Circular 230, or alter or supplant ethical standards that might otherwise be applicable to practitioners. (Preamble to Prop Reg 08/19/2010)

Following is an overview of the proposed regs for RTRPs.

Extent of practice (Prop Reg § 10.3(f)(2)). A RTRP could only prepare, or assist in the preparation of, all or substantially all of a tax return or claim for refund that is commensurate with the level of competence that he has demonstrated by written examination (see below). Registered tax return preparers also would be able to sign tax returns, claims for refund, and other documents as the preparer if the document is commensurate with the level of competence demonstrated, and may represent taxpayers before IRS revenue agents, customer service representatives or similar officers and employees (including the Taxpayer Advocate Service) during an examination if the RTRP signed the tax return or claim for refund for the tax year or period under examination.

Consistent with the limited practice rights currently available to unenrolled return preparers under Prop Reg § 10.7(c)(1)(iii), RTRPs couldn't represent taxpayers, regardless of the circumstances requiring representation, before appeals officers, revenue officers, Counsel or similar officers or employees of IRS or Treasury. A RTRP's authorization to practice under Circular 230 also would not include the authority to provide tax advice to a client or another person except as necessary to prepare a tax return, claim for refund, or other document intended to be submitted to IRS.

The conduct of the RTRP in connection with the preparation of the return, claim for refund, or other document, as well as any representation of the client during an examination, would be subject to the standards of conduct in Circular 230. Inquiries into possible misconduct and disciplinary proceedings relating to RTRP misconduct would be conducted under the provisions in Circular 230.

Eligibility to become a RTRP (Prop Reg § 10.4). An individual would have to pass a minimum competency examination and possess a current or otherwise valid PTIN or other prescribed identifying number to become a RTRP. The examination would be administered by, or administered under the oversight of, IRS, similar to the special enrollment examinations for enrolled agents and enrolled retirement plan agents. There would be no exam exemption based on an individual's past tax return preparation experience.

After completing competency testing, RTRPs would be subject to suitability checks to determine whether they have engaged in disreputable conduct which, at the time the application is filed with the Office of Professional Responsibility (OPR), could result in suspension or disbarment under Circular 230. An individual who has engaged in disreputable conduct could not become a RTRP.

One examination would cover wage and nonbusiness income Form 1040 series returns, while another examination will cover wage and small business income Form 1040 series

returns. An exam would have to be successfully completed before one becomes a RTRP and gets a PTIN. IRS will prescribe by forms, instructions, or other appropriate guidance the tax returns and claims for refund, including the schedules and forms, that a RTRP may prepare based upon the written examination successfully completed under Prop Reg § 10.4(c). A RTRP who passes the wage and small business income Form 1040 series examination, however, would be able to prepare any Form 1040 series returns. (Preamble to Prop Reg 08/19/2010)

IRS requests comments on whether a tax return preparer who solely prepares tax returns other than Form 1040 series returns (e.g., Form 941, Employer's Quarterly Federal Tax Return, or Form 706, U.S. Estate Tax Return) should be permitted to prepare these other tax returns without successfully completing any examination. (Preamble to Prop Reg 08/19/2010)

When will exams will be available. Exams to become a RTRP will not be available until after the effective date of the proposed regs. IRS says it will provide published guidance establishing transition rules that explain the steps individuals must take to prepare all or substantially all of a tax return or claim for refund while awaiting full implementation of the examination process. (Preamble to Prop Reg 08/19/2010)

Application procedures (Prop Reg § 10.5). The procedures for applying to become a RTRP would be generally be consistent with the procedures currently uses for EAs and enrolled retirement plan agents. As a condition for consideration of an application, IRS could conduct a federal tax compliance check and suitability check. The tax compliance check would be limited to whether an applicant has filed all required individual or business tax returns (e.g., employment tax returns) and whether he has failed to pay, or make proper arrangement with IRS for payment of, any federal tax debts. The suitability check would be limited to whether an applicant has engaged in any conduct that would justify suspension or disbarment of any practitioner under Circular 230, including whether the applicant has engaged in disreputable conduct.

Once an application to become a RTRP is approved, IRS would issue a registration card or certificate valid for a stated period.

Renewal procedures (Prop Reg § 10.6). Completion of continuing education requirements would be a condition of renewal. A RTRP would have to complete 15 hours of continuing education during each registration year (at least 3 hours of federal tax law updates, 2 on tax-related ethics and 10 on federal tax law topics). The registration year would be defined as each 12-month period that the RTRP is authorized to practice before IRS. Registered tax return preparers would have to maintain records with respect to the completion of the continuing education credit hours and to self-certify the completion of the continuing education credit at the time of renewal.

A qualifying continuing education course would have to enhance professional knowledge in federal taxation or Federal tax related matters and be consistent with the Code and effective tax administration.

The current regs on continuing education credit for work as an instructor, discussion leader, or speaker at an education program would be modified to limit maximum credit for instruction and preparation to 4 hours annually. There would be no hours for authoring articles, books, or other publications.

Standards for tax returns and documents, affidavits and other papers (Prop Reg § 10.34(a)). IRS has determined that the professional standards in Reg. § 10.34(a) generally should be consistent with the civil penalty standards in Code Sec. 6694 for tax return preparers. To that end, the standards for tax returns are being repropoed to provide broader guidelines that are more appropriate for professional ethics standards.

Under the proposed regs, a practitioner could not willfully, recklessly, or through gross incompetence, sign a tax return or claim for refund, that he knows or reasonably should know contains a position that: (A) lacks a reasonable basis; (B) is an unreasonable position as described in Code Sec. 6694(a)(2) (including related regs and other published guidance); or (C) is a willful attempt by the practitioner to understate the liability for tax or a reckless or intentional disregard of rules or regulations by the practitioner as described in section Code Sec. 6694(b)(2) (including related regs and other published guidance).

Similarly, a practitioner could not willfully, recklessly, or through gross incompetence, advise a client to take a position on a tax return or claim for refund, or prepare a portion of a tax return or claim for refund containing a position, that is described in (A), (B), or (C), above, for signing a return or claim for refund.

These proposed ethical guidelines would loosely mirror the civil penalty standards in Code Sec. 6694 with only a few minor differences:

1. A position on a return or claim for refund would always have to meet the minimum threshold standard of reasonable basis. There would be no exception merely because there is a final determination that no understatement of liability for tax exists. By contrast, under Code Sec. 6694(d), IRS must abate (or refund) a preparer penalty any time there is a final administrative determination or a final judicial decision that there was no understatement of liability by the taxpayer. As a result, a practitioner could still be subject to Circular 230 discipline for a position on a tax return or claim for refund even if other positions on the same tax return or claim for refund eliminate the understatement of liability.
2. A practitioner would be subject to discipline only after willful, reckless, or grossly incompetent conduct. Under Code Sec. 6694, a single, unintentional error that is not willful, reckless, or grossly incompetent may result in a Code Sec. 6694(a) penalty. Similarly, a return preparer may claim a reasonable cause defense to the imposition of Code Sec. 6694 penalties, while Circular 230 does not provide such a defense but rather relies on the requirement that a practitioner must have acted willfully, recklessly, or through gross incompetence to ensure that sanctions are not imposed on a practitioner who acts reasonably and in good faith.

3. Multiple practitioners from the same firm could be disciplined if their conduct in connection with the same act(s) does not comply with the standard of conduct required under Reg. § 10.34. By contrast, only one person within a firm is subject to the Code Sec. 6694 penalty.

4. A pattern of conduct would be a factor taken into account in determining whether a practitioner acted willfully, recklessly, or through gross incompetence for Reg. § 10.34 purposes. By contrast, under Code Sec. 6694, a penalty is imposed based on a single act in violation of the applicable provisions.

Other changes. Other changes that would be made by the proposed regs include:

Expanding procedures to ensure compliance to include practice involving tax return preparation activities. (Prop Reg § 10.36)

Providing that disreputable conduct includes willfully failing to file on magnetic or other electronic media a tax return prepared by the practitioner when he is required to do so by the federal tax laws (unless the failure is due to reasonable cause and not due to willful neglect). (Prop Reg § 10.51(a)(16))

Providing that disreputable conduct also includes willfully preparing all or substantially all of, or signing as a compensated tax return preparer, a tax return or claim for refund when the practitioner does not possess a current or otherwise valid PTIN or other prescribed identifying number. (Prop Reg § 10.51(a)(17))

Proposed effective date. The proposed regs are generally proposed to apply 60 days after the date that final regs are published.

New return preparer application system with user fee to go live in mid-September

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In a news release, IRS has announced that a new online application system for compensated tax return preparers is expected to go live in mid-September. Such return preparers will need to obtain, or reapply for, a Preparer Tax Identification Numbers (PTINs) and pay a user fee using this new comprehensive system. The launch of this new system and the proposed user fees are dependent on the publication of final regs on the PTIN requirement.

Background. In January of this year, IRS released a study on the U.S. return preparer industry carrying detailed recommendations on new standards for preparers other than attorneys, CPAs, and enrolled agents (EAs) and what IRS intends to do short- and long-

term to raise industry standards. Return preparers who are not attorneys, CPAs or EAs will be subject to new registration requirements, including mandatory use of PTINs, competency testing, continuing professional education (CPE), and ethical standards (see Federal Taxes Weekly Alert 01/07/2010 for more details). All preparers will need to be registered on a new on-line registration system and will need to obtain a PTIN before filing any return after Dec. 31, 2010. Testing won't be implemented until after registration and mandatory PTIN usage are in place.

In July of this year, IRS issued proposed regs that would establish a new annual user fee for individuals who apply for or renew a tax return preparer tax identification number (see Federal Taxes Weekly Alert 07/29/2010).

New application system and new fee. IRS has proposed requiring that all individuals who receive compensation for preparing all or substantially all of a federal tax return or claim for refund after Dec. 31, 2010 must have a PTIN. Under proposed regs, compensated tax return preparers would need to obtain, or reapply for, a PTIN and pay a user fee using this new comprehensive system, which is part of a series of steps planned to increase oversight of federal tax return preparation. Tax return preparers would create PTIN accounts with IRS when they use the new system.

Under the proposed regs, the requirement to sign up on the new system would apply to all compensated tax return preparers of federal tax returns regardless of whether they currently possess a PTIN. Return preparers who already have a PTIN generally would be reassigned the same number. Individuals who plan to prepare all or substantially all of a tax return for compensation would have to obtain a PTIN even if they were not subject to the testing and continuing education requirements that would be required under Circular 230. Access to the online application system would be through the Tax Professionals page at <http://www.irs.gov/taxpros/index.html?navmenu=menu1>.

To prepare for the launch of the comprehensive new PTIN system, IRS will cease issuing PTINs effective Aug. 22 using Form W-7P, Application for Preparer Tax Identification Number, and through e-services—Online Tools for Tax Professionals. If preparers apply for a PTIN before Aug. 22, 2010, they will have to reapply once the new online PTIN application system begins.

Under the proposed regs, compensated tax return preparers would be required to renew their PTINs annually and pay the associated user fee. The \$64.25 user fee the first year for a PTIN would be based on two underlying costs: \$50 per user to pay for outreach, technology, and compliance efforts associated with the new program; and the third-party vendor would receive \$14.25 per user to operate the online system and provide customer support. The amount of the fee might change in future years as the actual program costs are periodically re-evaluated.

For proposed regs that would generally extend current regs that apply to attorneys, certified public accountants and other specified tax professionals to all tax return preparers, including currently unenrolled tax return preparers.