RETHINKING TAX RETURN PREPARER PENALTIES AND OTHER WAYS TO INCREASE OVERSIGHT OF TAX PROFESSIONALS  
(IRC §§ 6694, 6695, 6103, 7803)

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¹ The comments contained in this paper are the individual views of the author who prepared them, and do not represent the position of the California Lawyers Association or its Taxation Section.
² Although the participants on this project might have clients affected by the rules and tax forms applicable to the subject matter of this paper and have advised such clients on applicable law, no such participant has been specifically engaged by a client to participate on this project.
EXECUTIVE SUMMARY

Ethical tax return preparers are an integral part of ensuring a properly functioning tax system, and a critical component of overall tax compliance. In that context the process of encouraging the “good” and disincentivizing the “bad” requires a rethinking of return preparer penalties and general oversight of the industry. This paper explores the following topics and makes several recommendations.

First, this paper argues that the IRS needs to realign penalties such that the magnitude of consequences and perception of accountability truly impacts noncompliant preparers. The current statutory penalties under IRC §§ 6694 and 6695 are insufficient to act as an adequate deterrent for the majority of tax return preparers. Moreover, the application of certain provisions, namely IRC § 6695(g), is likely to create unwanted collateral consequences. This paper supports increasing the statutory minimum penalties under IRC §§ 6694(a) and (b) and suggests expanding the statute of limitations for IRC § 6694(a) penalties. Furthermore, this paper suggests expanding the scope of preparer penalties to capture returns and other claims beyond the current limits of income, estate, gift, and excise taxes. Finally, regulations under IRC § 6695(g) must be revised to prevent the otherwise unavoidable consequence of alienating taxpayers from ethical return preparers.

Second, the holdings of Loving, Sexton, Ridgley, and other cases continue to undermine the IRS’s ability to regulate all tax professionals even beyond OPR and Circular 230. The apparent lack of statutory authority under 31 U.S.C. § 330 also undermines the probability of detection – a key element in effectively regulating behavior. Statutory changes to 31 U.S.C. § 330 are desperately needed as are various changes to Circular 230 itself. As an alternative, this paper suggests a new statutory position, with authority to regulate the industry, in IRC § 7803.

Third, experience has shown that OPR is often one of the last participants in any practitioner or preparer misconduct situation, and OPR has admitted that internal referrals within the IRS (other than IRC § 6694(b) penalties) are few and far between. Effectively receiving referrals for conduct-based investigations is the first step in regulating preparers and concurrently disseminating that information to the public. To do so this paper suggests reorganizing OPR directly within the Department of the Treasury, mandating OPR accountability with annual reports, and increasing opportunities for collaboration with the IRS.

Finally, the need to protect taxpayer information under IRC § 6103 is no doubt important, but as applied in the context of tax return preparers, creates several problems. First, unless clearer guidance is given, additional litigation from sanctioned practitioners is possible. Second, resistance to providing OPR with case related information reduces detection of unethical practitioners. Third, redactions in the name of IRC § 6103 undermine the effectiveness of publishing decisions concerning practitioner misconduct. This paper concludes with suggestions to change IRC § 6103 to reduce barriers for OPR to receive critical information while concurrently increasing the effectiveness when publishing decisions of successful disciplinary cases.
DISCUSSION

I. INTRODUCTION

Paid return preparers are not only a significant presence in today’s modern tax system, but they carry a disproportional impact when noncompliant.\(^3\) Rather than one taxpayer acting improperly, a noncompliant tax return preparer’s unethical actions are magnified with each taxpayer whose returns they come in contact with. This paper explores several topics and makes certain recommendations to combat unethical tax professionals while still seeking to avoid unnecessary burdens on others, which if left unaddressed, create an environment for undesired collateral consequences.

1. Realign Penalties Such That The Magnitude of Consequences Punishes The Truly Noncompliant Preparers With Adequate Time to Enforce.

Penalties are an integral part of ensuring a fair and compliant tax system and do so by increasing the cost of noncompliance.\(^4\) But to maximize this role of penalties two features must exist: (1) a high perception of the chances of being caught; and (2) an appropriate magnitude of the punishment if or when detected. Without those two characteristics, i.e., preparers believing the likelihood of either/both detection and punishment is low, the likelihood of noncompliant tax preparers remains high. In balancing these two features this paper addresses several return preparer related penalties.

a. Increase IRC §§ 6694(a) and (b) Minimum Penalty Amounts.

Penalties for a return preparer understating a taxpayer’s liability currently have a $1,000 and $5,000 statutory minimum under IRC §§ 6694(a) and (b), respectively. Although the statutory maximum is equal to 50 and 75 percent of the income derived (or to be derived) by the tax return preparer, respectively, the application of these provisions is unlikely to be an effective tool to address the vast majority of tax return preparers.

The impact of the current penalty structure creates a barbell-type sicario. At one end are low-fee, low-volume return preparers to whom a $1,000 penalty is a significant punishment. Accepting a uniformed expectation of detection, the statutory minimum penalty of $1,000 has a higher magnitude of punishment on low-fee, low-volume return preparers. The proportionality of the penalty to their practice is a regressive model, impacting them more significantly that other return preparer groups. As a result, the current statutory framework is likely to continue to have sufficient deterrence on such low-fee, low-volume preparers. Similarly, high-fee, low-volume return preparers have a high magnitude of punishment associated with the 50 or 75 percent maximum structure because the impact of that penalty across a low-volume practice can be dramatically felt.

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\(^3\) As used in this paper, “noncompliant” refers to a tax return preparer under IRC § 7701(a)(36) or a tax practitioner who has fallen below the requisite standard of care or otherwise behaves unethically.

\(^4\) See IRS Policy Statement 20-1 (Formerly P-1-18).
On the other end of the barbell are high-fee, high-volume preparers. Remaining constant on any expectation of detection, the current statutory minimums of $1,000 under IRC § 6694(a) and $5,000 under IRC § 6694(b) are unlikely to have a deterrent effect on high-fee, high-volume tax preparers because the higher fees, coupled with a greater volume of returns, is likely enough to overcome the perceived magnitude of punishment. The same holds true for the statutory maximums of 50 or 75 percent of a large client’s fees because the cost to the high-fee, high-volume tax preparer can be offset by the remainder of their high-volume practice. What also remains are low-fee, high-volume and middle-fee, middle-volume tax preparers. In either scenario the magnitude of the statutory minimum is offset by either the increased fees or depth of other clients. To those low-fee, high-volume or middle-fee, middle-volume tax preparers, the risk associated with a $1,000 or $5,000 minimum penalty is disproportionally small and unlikely to have an adequate deterrent effect.

Thus, two solutions exist. First, an increase in the statutory minimum for IRC §§ 6694(a) and (b) should be, and has been, considered. As provided for in the FY2024 Green Book, a proposal exists to increase those penalties to a minimum of $5,000 or $10,000 under IRC §§ 6694(a) and (b), respectively, while also increasing the maximums to 50 and 100 percent of the income derived, respectively. The author supports this change as a necessary step in curbing noncompliant tax return preparers.

Second, either as an alternative to increasing the minimum and maximum amount of the penalties or in conjunction therewith, consideration should be given to expanding the application beyond the singular return which gives rise to the understatement. As the framework currently exits, noncompliant preparers are punished with respect to only the return at issue, meaning that preparers who have larger fees or a greater depth of other clients where no understatement was detected can more easily absorb the cost and risk associated with any IRC §§ 6694(a) or (b) penalty.

Experience has shown that a noncompliant tax preparer’s violation is not typically an isolated act. The exact scope of further noncompliance may be unknown and unknowable because without detection there is no enforcement. An ability to broadly encapsulate the entirety of the tax preparers practice could curb this risk tolerance. Thus, instead of the penalty calculation applying to only the one return in question, preparers who take a position without substantial authority in violation of IRC § 6694(a) would face a penalty equal to the greater of $1,000 for each tax return prepared in a given year or 50 percent of the fees derived or to be derived from the return in question. Similarly, IRC § 6694(b) could be modified to apply a penalty equal to the greater of $5,000 for each tax return prepared in a given year or 100 percent of the income derived or to be derived from the return in question.

\[ b. \quad \text{Extend IRC § 6694(a) Statute of Limitations to Six Years.} \]

In addition to the penalty amount, the statute of limitations has a dramatic impact on a tax preparer’s assessment of the probability of detection and by extension their risk aversion. Because IRC § 6694(b) penalties involve willfulness, there is no statute of limitations for assessment. However, the IRS is limited to three years from the date the return or claim for refund was filed.  

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5 See General Explanations of the Administration’s Fiscal Year 2024 Revenue Proposal, March 9, 2023, at 185.
was filed to assess penalties under IRC § 6694(a). The same holds true for penalties under IRC § 6695, but in particular, IRC § 6694(a) presents a unique challenge in managing return preparer conduct. Because there must first be an understatement of tax due from the underlying taxpayer, paid preparers can mask their noncompliant behavior behind a belief that the probability of being caught within the statute of limitations is low. It can often take years before an underlying return is selected for examination, and even longer before an understatement is determined. This is particularly true of complex audits in large cases requiring extensive factual development and voluminous records. If the taxpayer extends the statute of limitations by executing a Form 872, Consent to Extend the Time to Assess Tax, the same does not extend the statute of limitations for any tax return preparer penalties.

Timing is not in the IRS’s favor. The IRS’s inability to determine that an understatement exists while concurrently pursuing an IRC § 6694(a) penalty likely results in far too many overlooked assessments for conduct that falls below the IRC § 6694(b) willful or reckless standard but is nevertheless noncompliant behavior deserving of a penalty.

Thus, two possible solutions exist. First, a stand-alone increase to the statute of limitations period during which an IRC § 6694(a) penalty may be assessed from three-years to six-years would more fit with the goal of increasing the perceived likelihood of detection. This was also a proposal in the context of IRC § 6695(b) and “ghost” preparers presented in the FY2022, FY2023, and FY2024 Green Books. However, broader considerations should be given to all IRC §§ 6694(a) and 6695 penalties.

Second, any IRC § 6694(a) statute of limitations could be tolled through legislative changes to IRC § 6501 whereby the IRS would maintain an ability to assess the penalty so long as the statute of limitations for the underlying return remained open.

c. Expand Preparer Penalty Scope Beyond “Understatement” Matters.

Penalties under IRC § 6694 typically represent the highest visibility penalties applicable to tax return preparers. However, penalties under IRC § 6694 are assessable only for returns or claims for refund that include income tax returns under Subtitle A (e.g., Forms 990T, 1040, 1041, 1120), estate and gift tax returns under Subtitle B (e.g., Forms 706 and 709), employment tax returns under Subtitle C (e.g., Forms 940 and 941), miscellaneous excise tax returns under Subtitle D (e.g., Forms 720, 2290, 5330), and alcohol, tobacco, and other excise taxes under Subtitle E (e.g., Forms 8725 and 8876). These limits on applicability are also true of other penalties. For example, IRC § 6701 penalizes any person (not just a tax return preparer) who aids or abets the preparation or presentation of any return, affidavit, claim, or other document that they know will be used in connection with any material matter. However, an element of IRC § 6701 is still the existence of an understatement of the liability for tax of another person. Thus, largely escaping the current scope of penalties are other “returns” that create no understatement but nevertheless represent a

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6 See General Explanations of the Administration’s Fiscal Year 2023 Revenue Proposal, March 2022, at 84; General Explanations of the Administration’s Fiscal Year 2024 Revenue Proposal, March 9, 2023, at 183.

significant cross section of tax preparer work, *i.e.*, collection or controversy representation and informational disclosures.

Take for example IRS Forms 433-A, *Collection Information Statement for Wage Earners and Self-Employed Individuals*, and 656, *Offer in Compromise*, typically used in the contexts of tax preparers representing taxpayers in collection-related cases. These types of forms require a detailed presentation of a taxpayer’s income, expenses, assets, and liabilities and invite the same types of unscrupulous behavior from noncompliant tax preparers. However, with no room for an “understatement,” current penalties cannot be used as an effective tool to ensure proper and ethical preparation of such forms. Instead, the best existing mechanism to ensure ethical tax professional behavior is OPR enforcement. As discussed elsewhere herein, that enforcement is currently crippled in light of *Loving, Sexton*, and *Rigley*.

Collection related returns are not the only potential area of noncompliant return preparer conduct that escapes current penalties. Certain disclosure forms like 5471, *Information Return of U.S. Persons With Respect to Certain Foreign Corporations*, and 3520, *Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts*, create no understatement of liability even if willfully or recklessly prepared by a noncompliant preparer.

Arguably IRC § 6702 could be used as a mechanism to combat noncompliant preparers outside the scope of returns that create no understatement of tax; however, the threshold for IRC § 6702 is frivolous conduct. Much noncompliant behavior exists between the frivolous and reasonable basis standards. Therefore, consideration should be given to establishing a new penalty structure to capture noncompliant preparers who prepare forms that do not contain an understatement of tax liability. Section 6690 may provide a workable framework for such a new penalty, whereby a tax return preparer who “willfully furnishes a false or fraudulent statement, or who willfully fails to furnish a [complete] statement in the manner, at the time, and showing the information required … shall for each such act, or for each such failure, be subject to a penalty … of [$1,000].”

d. *Create IRC § 6695(g) Protections to Reduce Unwanted Alternatives.*

Refundable credits, namely the Earned Income Tax Credit (“EITC”), the Additional Child Tax Credit (“ACTC”), and the American Opportunity Tax Credit (“AOTC”), provide tax benefits to millions of deserving taxpayers. Given the unique nature of refundable credits, the penalty structure for IRC § 6695(g) exists with the best intentions – to combat unscrupulous preparers who could take advantage of such programs. First enacted in 1997, IRC § 6695(g) began as a $100 penalty on preparers who failed to comply with certain due diligence requirements when preparing return(s) that claim EITC’s under IRC § 32. Since 1997, the IRC § 6695(g) penalty

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11 Taxpayer Relief Act of 1997, PL 105–34, August 5, 1997, 111 Stat 788 (“(2) DUE DILIGENCE REQUIREMENT ON INCOME TAX RETURN PREPARERS. Section 6695 is amended by adding at the end the following new subsection: (g) FAILURE TO BE DILIGENT IN DETERMINING ELIGIBILITY FOR EARNED INCOME CREDIT.—Any person who is an income tax return preparer with respect to any return or claim for
has been increased to $500 per such failure,\textsuperscript{12} indexed to inflation,\textsuperscript{13} and expanded beyond just claimed EITCs.\textsuperscript{14}

Determining eligibility for EITC, ACTC, and AOTC’s can be a cumbersome and complex analysis for tax professionals and taxpayers alike.\textsuperscript{15} In fact, in tax year 2021, it was estimated that a paid return preparer would need to spend an average of 18 minutes learning about the law and another 1 hour, 49 minutes to prepare a Form 8867, \textit{Paid Preparer’s Due Diligence Checklist}.\textsuperscript{16} But paid tax return preparers alone face the entire obligation for filing a Form 8867 and satisfying applicable due diligence requirements. They alone face the entire risk under IRC § 6695(g). Meanwhile, IRC § 6695(g) has other unique characteristics that singularly impact return preparers.

First, IRC § 6695(g) lacks any measure of proportionality to the harm caused. If a taxpayer was undeniably entitled to an EITC, ACTC, AOTC, or Head of Household filing status, yet the paid tax return prepare was somehow deficient in their level of due diligence, the preparer still faces a penalty. Stated otherwise, even if the paid preparer was correct in their determination of eligibility and calculations, they can still be punished. This is in stark contrast to IRC §§ 6694(a) and (b), where if a tax preparer was correct, meaning there was no understatement of a liability, no penalty exits.

Second, unlike other preparer-related penalties, IRC § 6695(g) can be assessed against a firm without any apportionment. Under Treas. Reg. § 1.6695-2(c), a firm that employs a tax return preparer can itself be subject to an IRC § 6695(g) penalty in an amount equal to that which the preparer faces. In essence the cost of the penalty is significantly magnified by aggregating the preparer and firm’s combined exposure. This is not true of other return preparer penalties. For example, under Treas. Reg. § 1.6694-1(f)(3), IRC §§ 6694(a) or (b) penalties are allocated to the individual preparer and the firm such that the totality of the punishment does not exceed the statutory maximum penalty.

Third, no deficiency proceeding protections or partial-payment options for refund litigation exists for IRC § 6695(g) penalties. If an IRC § 6695(g) penalty is proposed during an examination, a Letter 1125 and Form 5816, \textit{Report of Tax Return Preparer Penalty Case}, is usually generated by the Revenue Agent and sent to the preparer. Included in that correspondence are instructions that the preparer can appeal the decision within 30-days by filing an administrative protest. At this point the IRC § 6695(g) penalty process is similar to other preparer penalties, including IRC § 6694, because the preparer has the ability challenge the proposed penalty before assessment in front of the IRS Office of Appeals. However, the potential inequities involved with

\textsuperscript{12} PL 112-41, October 21, 2011, 125 Stat 428, § 501(a).
\textsuperscript{13} PL 113-295, December 19, 2014, 128 Stat 4010, § 208(c).
\textsuperscript{14} PL 115-97, 2017 HR 1, PL 115-97, December 22, 2017, 131 Stat 2054, § 11001(b).
\textsuperscript{15} See e.g., \textit{Report Refundable Tax Credits: Comprehensive Compliance Strategy and Expanded Use of Data Could Strengthen IRS’s Efforts to Address Noncompliance}, May 2016 (GAO-16-475).
\textsuperscript{16} Instructions for Form 8867 (Rev. December 2021) (Cat. No. 59407V).
this issue become apparent if an IRC § 6695(g) pre-assessment appeal is unsuccessful in several ways. First, the U.S. Tax Court, a pre-payment forum of strict limited jurisdiction and the preferred location for most tax litigation issues, has not been given the authority to adjudicate IRC § 6695(g) penalties. The ability to protest the IRC § 6695(g) preparer’s innocence then lies in judicial review at a District Court, which is in most cases becomes cost prohibitive. This is especially true because a general rule of federal tax procedure exists in that a taxpayer (or preparer in these circumstances) can maintain a tax refund action in District Court only after paying the assessment in full.\(^{17}\) What has become known as the Flora Rule’s “pay-to-play” regime is not without exception. Over time the “divisibility” exception was created, whereby if a tax or penalty can be divided into separate portions or transactions, a taxpayer can pay only one such divisible portion to serve as a test upon which the entire aggregate assessment can be decided.\(^{18}\) The divisibility exception to the full prepayment Flora Rule has been recognized by the IRS and other courts with respect to penalties imposed by IRC §§ 6695(d),\(^{19}\) 6701,\(^{20}\) 6700,\(^{21}\) 6701,\(^{22}\) 6708,\(^{23}\) 6721,\(^{24}\) and 6722.\(^{25}\) This ability to pay only a portion of the entire penalty before litigating in District Court provides judicial access for an otherwise unattainable and cost-prohibitive remedy. Unfortunately, it has been unsuccessfully argued that IRC § 6695(g) meets the test as a divisible penalty, meaning if a preparer pays the full amount of only one separate IRC § 6695(g) penalty they still do not have the ability to maintain a refund suit over the remaining parts of the entire IRC § 6695(g) assessment.

Finally, IRC § 6695(g) has no upper limits. For example, IRC §§ 6695(a), 6695(b), 6695(c), 6695(d), 6695(e), and 6704(b)(2) all establish limits on the maximum penalty a preparer can face per calendar year. However, IRC § 6695(g) has no such restrictions. This exponential cost is problematic because, given the eligibility criteria for these refundable credits, underlying taxpayers are generally from a lower social-economic statuses. A natural extension of their status is a limit on the price they can afford to pay for tax return preparation services. Therefore, a return

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\(^{18}\) See e.g., Steele v. U.S., 280 F.2d 89, 90 (8th Cir. 1960); Korobkin v. United States, 988 F.2d 975, 976 (9th Cir. 1993) (“taxes or penalties that are assessed as merely the sum of several independent assessments triggered by separate transactions … in such a case, the taxpayer may pay the full amount on one transaction, sue for a refund for that transaction, and have the outcome of this suit determine his liability for all the other, similar transactions.”).

\(^{19}\) Nordbrock v. United States, 173 F.Supp. 2d 959 (D. Ariz. 2000), aff’d 248 F.3d 1172 (9th Cir. 2001).

\(^{20}\) See e.g., Davis v. United States, 961 F.2d 867 (9th Cir. 1992).

\(^{21}\) Hankin v. United States, 891 F.2d 480 (3rd Cir. 1989); accord, Nielsen v. United States, 976 F.2d 951 (5th Cir. 1992).

\(^{22}\) Id.; accord, Gates v. United States, 874 F.2d 584, 587, FN 3 (8th Cir. 1989).

\(^{23}\) IRS CCA 200646016 (Nov. 17, 2006) (“As shown by both of the failure to file examples cited above, each possess a maximum penalty that can be assessed against the taxpayer. Thus, the taxpayer has a calculable ceiling to which he or she can be subjected. This is true of practically every other penalty contained in the Internal Revenue Code. ... Because Congress enacted a penalty that has the potential for extremely high, unlimited and continuously accruing penalties, it is reasonable to interpret the statute in a manner that provides a reasonable means of obtaining potential relief by an affected material advisor. If the penalty was not considered divisible, difficulty in implementing the full pay rule would result because it would be hard for the material advisor to ascertain and pay the full amount due’”).

\(^{24}\) IRS CCA 201315017 (Apr. 12, 2013).

\(^{25}\) Id.; but see contra, IRS CCA 201150029 (Dec. 16, 2011) (finding IRC § 6677 was not a “dividable tax” for purposes of the full prepayment Flora Rule).
preparer who services a lower social-economic client base can face an IRC § 6695(g) penalty well in excess of the fees charged to prepare the returns.

At one point return preparers could escape all IRC § 6695(g) risk by avoiding returns that claimed EITCs. But that choice has been significantly eroded with the expansion of IRC § 6695(g) to include other tax attributes, including Head of Household filing status. These one-sided structural problems combined with growing penalty amount (especially considering the most recent proposal to increase the amount to $1,500 per such failure) and scope of applicability will in all likelihood create one of three undesirable scenarios, all of which center on pushing taxpayers out of the hands of otherwise competent tax preparers given the perceived costs and compliance burden that cannot be passed through to the taxpayers:

(1) More Self-Prepared Returns. Taxpayers will elect to self-prepared their returns to avoid higher fees from burdened preparers who continue to ask for more and more substantiation. On balance a self-prepared return is likely to have more noncompliant elements than a professionally prepared return.

(2) More Non-Compliant Taxpayers. Taxpayer will fall out of compliance all together to avoid higher fees and nuisance questions. Given the status of many refundable credit recipients and cash-intensive activities, this may be an easy transition.

(3) Increase in “Ghost Preparers.” Taxpayers will fall into the hands of unscrupulous and “ghost” preparers who are not burdened by the risk of IRC § 6695(g) and have no interest or desire in fully satisfying the knowledge or other due diligence requirements of Treas. Reg. § 1.6695-2.

Acknowledging the important deterrent effect IRC § 6695(g) serves, which should not be abandoned, Congress and the IRS should nevertheless consider some additional relief provisions to reduce the chances of the aforementioned consequences.

First, a “safe harbor” for correctly claimed EITC, ACTC, AOTC, or Head of Household filing status should be created. As addressed above, unlike IRC § 6694 penalties, a tax return preparer can face an IRC § 6695(g) penalty even if it is determined that the underlying taxpayer was fully entitled to the credit and/or filing status. Many tax return preparers struggle with this penalty-without-harm framework, and frequently cite their client’s full legal entitlement to the credit as justification for relief. Unfortunately, as IRC § 6695(g) currently exists, no such relief is available. To do so, Congress and the IRS could look to IRC § 6694(d). Under IRC § 6694(d), a return preparer can seek to abate an IRC §§ 6694(a) or (b) penalty if there is a final administrative or judicial determination that there was no understatement of liability.²⁶ A similar remedy should be considered for IRC § 6695(g), whereby a penalized tax preparer would have the

²⁶ IRC § 6694(d) (“If at any time there is a final administrative determination or a final judicial decision that there was no understatement of liability in the case of any return or claim for refund with respect to which a penalty under subsection (a) or (b) has been assessed, such assessment shall be abated, and if any portion of such penalty has been paid the amount so paid shall be refunded to the person who made such payment as an overpayment of tax without regard to any period of limitations which, but for this subsection, would apply to the making of such refund.”).
ability to file an abatement request if either: (1) a final administrative determination or final judicial decision exists that their client was entitled to the refundable credit or filing status; or (2) present evidence of their client’s rightful eligibility for any refundable credit or filing status.

Second, the IRS should modify Treas. Reg. § 1.6695-2(c) to clarify that the vicarious liability for IRC § 6695(g) is pro-rated amongst the individual preparer and any firm. The exact method of distributing the cost of the IRC § 6695(g) penalty could be in some relationship to the acts of the individual versus the firm, but importantly, confirm that the combined amount would not exceed the statutory maximum for each such failure.

Third, to alleviate the burdens on any IRC § 6695(g) penalty appeal, Congress and the IRS should look to IRC §§ 6694(c) and 6703 for guidance. Under these two provisions, if a tax return preparer is assessed the applicable penalty, they have 30-days to pay 15% of the penalty and use that partial-payment to satisfy the prepayment Flora Rule. This exception is also made clear to preparers in the instructions to Form 6118, Claim for Refund of Tax Return Preparer and Promoter Penalties, which states that: “If you were assessed a penalty under section 6700, 6701, or 6694, you may file a claim for refund upon paying 15% of the penalty if you do so within 30 days from the date of notice and demand.”27 By extending to IRC § 6695(g) the same kind of refund litigation relief, like that found in IRC § 6694(c), Congress and the IRS could help alleviate possible inequities currently pricing return preparers out of the judicial review necessary to vindicate themselves. The deterrent effect of the penalty would not be compromised as the whole assessment could later be made, and the 15% is not so de minimis as to reduce all barriers to judicial challenge. Nonetheless, offering the ability to pay only 15% of an otherwise limitless penalty strikes a balance between affording tax preparers the opportunity to further dispute IRS conclusions and the overall objectives of IRC § 6695(g).

Finally, the exception to the IRC § 6695(g) penalty gives little to no guidance to tax return preparers. Since Notice 97-65, the IRS has allowed a return preparer to avoid an IRC § 6695(g) penalty if they can, to the satisfaction of the IRS, demonstrate that their “normal office procedures are reasonably designed and routinely followed to ensure compliance,” and the breach of the due diligence standard was “isolated and inadvertent.”28 Unfortunately, the terms “isolated” and “inadvertent” are not defined terms, nor are they frequently used in the tax lexicon. Does “isolated” mean the breach of the due diligence standards happened just once, or was it more than once, but not a constant or regular failure and part of a larger pattern? Similarly, does “inadvertent” refer to accidental, negligent, or willful conduct? Without further guidance these questions plague preparers and may invite costly, and potentially disparate, answers.29 At their core “isolated” and “inadvertent” address concerns over frequency and mens rea. These concerns are also addressed in IRC § 6694. Importantly, IRC § 6694(a) penalties may be abated if “it is shown that there is

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27 Form 6118 (Rev. April 2017), Cat. No. 24415J.
reasonable cause for the understatement and the tax return preparer acted in good faith.”

30 By comparing the knowledge element of Treas. Reg. § 1.6695-2(b)(3), the isolated and inadvertent exception of Treas. Reg. § 1.6695-2(d), and IRC §§ 6694(a) and (b), greater similarities regarding culpability exist with IRC § 6694(a). This is important, because unlike Treas. Reg. § 1.6695-2(d), the regulations associated with IRC § 6694(a)(3) list and detail six factors for consideration to determine whether a tax preparer is entitled to the “reasonable cause” or “good faith” defense: (1) the nature of the error; (2) the frequency of the errors; (3) the materiality of the errors; (4) the preparer's normal office practice; (5) reliance on the advice of another preparer, and (6) reliance on administrative or industry practices. Adapting a “reasonable cause and good faith” exception in Treas. Reg. § 1.6694-2 and moving away from the current “isolated” and “inadvertent” standard is desirable because it would enhance preparers in knowing their rights and responsibilities, lending to less risk aversion in the context of preparing returns with refundable credits.

2. 

Increase Statutory Authority to Regulate Tax Advisors.

The impacts of Loving, Sexton, Rigley, and similar cases continue to undermine IRS’s ability to effectively regulate the practice of tax preparers and other tax advisors who pose a risk of harm to taxpayers through the filing of inaccurate return, erroneous refunds and credits, their own personal tax return noncompliance, and more. As observed in the FY2024 Green Book:

The current lack of authority to provide Federal oversight on paid tax return preparers results in greater non-compliance when taxpayers who use incompetent preparers or preparers who engage in unscrupulous conduct become subject to penalties, interest, or avoidable costs of litigation due to the poor-quality advice they receive. The lack of authority affects revenues to the IRS when the resulting noncompliance is not mitigated during return processing. Regulation of paid tax return preparers, in conjunction with diligent enforcement, will help promote high quality services from paid tax return preparers, will improve voluntary compliance, and will foster taxpayer confidence in the fairness of the tax system.

Thus, the author strongly supports any proposal to amend 31 U.S.C. § 330 to provide the IRS with explicit authority to regulate all paid preparers of Federal tax returns, including establishing mandatory minimum competency standards. In fact, such proposals have been made which could easily be modified to address the current problem. For example, on September 27, 2013, Loving v. IRS, 917 F.Supp. 2d 67 (D.D.C. 2013), aff’d 742 F.3d 1013 (D.C. Cir. 2014).

30 IRC § 6694(a)(3).
31 Treas. Reg. § 1.6694-2(e).
33 Treas. Reg. § 1.6694-2(e)(2).
34 Treas. Reg. § 1.6694-2(e)(3).
36 Treas. Reg. § 1.6694-2(e)(5).
37 Treas. Reg. § 1.6694-2(e)(6).
41 General Explanations of the Administration’s Fiscal Year 2024 Revenue Proposal, March 9, 2023, at 183.
2021, Representative Ms. Suzanne Bonamici (D-OR) introduced H.R. 5375 – 117th Congress (2021-2022) to authorize the Department of the Treasury to regulate the practice of tax return preparers. The proposed legislation made only moderate changes to 31 U.S.C. § 330, but which would nevertheless be more than sufficient to create the type of near universally desired authority over tax return preparers.

Even as shocking as the Sexton\(^{42}\) case was, the need to amend 31 U.S.C. § 330 to provide oversight of practitioners may be even broader than currently contemplated. For example, a requirement for a non-cash charitable contribution’s supporting “qualified appraisal” are declarations and the identity of the appraiser.\(^{43}\) In at least one case the requirements for the appraisal summary to have declarations by the qualified appraiser were directly linked to the IRS’s statutory authority under 31 U.S.C. § 330.\(^{44}\) The concern exists that if the “qualified appraiser” is not in fact “practicing” before the IRS, such requirements on their qualified appraisal report may be unenforceable in a post-Loving, post-Sexton, and post-Ridgley world. The argument that someone performing valuation services that are merely a part of an overall tax return is not representing a taxpayer is not difficult to make – appraisers are not agents of a taxpayer nor in the preparation of the qualified appraisal are they advocating for their clients during an investigation or adversarial hearing.

Thus, Congress must act to provide the IRS with clearer authority in this area. As discussed elsewhere herein, an alternative to amending 31 U.S.C. § 330 may be in creating a new IRC § 7803(f) whereby a designated position and statutory authority for the Director of OPR is established.

3. **Change Organization, Accountability, and Collaboration with OPR.**

OPR’s role in ensuring ethical tax professionals is unmatched and should stand as a clear supplement to return preparer penalties rather than the latter acting as a substitute. However, there are several areas where OPR’s organizational structure, accountability, and internal collaborations could be changed such that its goal of investigating, analyzing, enforcing, and litigating Circular 230 cases is enhanced, and by extension, decrease the risk of noncompliant tax professionals.

   a. **Reorganize OPR Directly Within the Treasury Department.**

       OPR currently exists within the IRS under the theory that therein OPR could be a part of a larger IRS-wide solution of stopping problem practitioners. This was not the historical organization of OPR. While internal collaboration may be a byproduct of organization within the IRS, moving OPR directly within the Treasury Department should be considered. Doing so is likely to have several key benefits. One benefit to OPR’s presence directly within the Treasury Department will increase its profile and visibility. This position will likely translate into an aura of authority and responsibility currently lacking.

   b. **Mandate OPR Accountability and Statutory Position for Director of OPR.**

\(^{43}\) Treas. Reg. § 1.170A-13(c)(4)(ii).
Until FY2018, OPR had a history of releasing publicly available annual reports. Such reports contained extremely useful information in enhancing OPR’s profile and disseminating information to the public and tax practitioners. For example, the last report provided the public with useful information about the structure and operations of OPR.45 Such publications provide useful tools to both tax professionals and taxpayers at large.

However, OPR has yet to issue any newer reports unlike other parts of the IRS, namely the Taxpayer Advocate Office. Section 7803(c)(2)(B)(ii) requires the National Taxpayer Advocate to submit an annual report to the House Committee on Ways and Means and the Senate Committee on Finance that, among other things, includes a summary of the ten most serious problems encountered by taxpayers and recommendations to mitigate them. A similar statutory requirement, including the statutory establishment of a Director of OPR, would go far in increasing the profile of the office and ensuring accountability that in turn creates an extremely useful tool in combating noncompliant practitioners.46

Consideration should also be given to creating a new designated provision in IRC § 7803 at (f), statutorily creating the Director of the OPR and outlining the scope of authority (another possible cure to the 31 U.S.C. § 330 problem). A template for a statutory framework can be borrowed from state-level Boards of Accountancy or State Bar Associations.47 This change would similarly increase the profile, visibility, and effectiveness of OPR and its ability to combat noncompliant tax professionals.

c. **Increase Collaboration Between IRS Office (e.g., OPR, TAS, Whistleblower, RPO)**

IRS personnel are instructed to refer all IRC § 6694(b) penalties to OPR but exercise discretion for other return preparer-related penalties unless they see a pattern of behavior.48 OPR itself has acknowledged this barrier and observed that referrals concerning other tax preparer-related penalties are often not made.49 The byproduct of these policies impairs the frequency of enforcement, which may be even more important that the severity of punishment to reduce violation behaviors.

The solution for increasing collaboration should be multi-faceted. First, applicable provisions of the Internal Revenue Manual should be revised to reduce reluctance in making referrals. Second, internal education (rather than external events focused on tax professionals)

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45 Office of Professional Responsibility’s Annual Report, Publication 5638 (3-2009), Catalog No. 92984F.
46 See e.g., Cal. B&P Code § 5008 (requiring the California State Board of Accountancy “from time to time, but not less than twice each year, prepare and distribute to all licensees, a report of the activities of the board, including amendments to this chapter and regulations adopted by the board, and may likewise distribute reports of other matters of interest to the public and to practitioners.”).
47 See e.g., Cal. B&P Code §§ 5000.1, 5018. (giving statutory authority to create a Board of Accountancy tasked with “exercising its licensing, regulatory, and disciplinary functions” in the name of protection of the public.).
48 I.R.M. § 8.11.3.5.1(5) (4-24-2019).
should be a priority for the IRS. Informing other IRS personnel of the role and function of OPR will likely bring about increased referrals and the opportunity to enforce noncompliant behavior at an appropriate level. This goal should also be supplemented by changes to IRS Form 8484, Report of Suspected Practitioner Misconduct and Reporting of Appraiser Penalty to the Office of Professional Responsibility (OPR). For example, the current version of Form 8484 only allows reporting individuals to select from attorneys, CPA’s, Enrolled Agents, Enrolled Actuaries, or appraisers. This was one of the potential problems, notwithstanding the ongoing 31 U.S.C. § 330 authority, in Bowman v. Iddon.50 The IRS should take from this case the need to streamline the intake process for OPR referrals both internally and externally. Finally, OPR and the IRS should establish a liaison program between themselves whereby employees from various IRS jobs are given exposure to OPR, and vice versa. This increased communication and cooperation within the IRS will further assist in raising OPR’s profile and the necessary referrals to target noncompliant tax professionals.


Disseminating the facts of disciplinary cases is an exceptional learning tool to understand preparer noncompliance. Just as one reads and reviews case law to better understand the facts behind an issue, OPR Decisions on Appeal help guide the tax return preparer community. Although such opinions are now, once again, available after a brief hiatus, the meaningful substance is all but unintelligible given IRC § 6103 and related redactions.51

Similar to the deterrent impact preparer penalties have, OPR’s ability to enforce ethical standards is directly impacted by the probability of detection and the magnitude of punishment. Outreach and communications go only so far towards increasing the profile of OPR. Direct action with successful dispositions augment this visibility, but only when readily available and understood. Section 6103 rightly exists to assure taxpayers of the privacy and confidentiality of their tax return information, comforting them that information will not become public knowledge, by restricting access to such information to persons who are deemed to have a material interest in them.52 But IRC § 6103 hampers OPR in its ability to effectively combat unethical practitioners in two ways.

First, published decisions are so heavily redacted that they are of little useful value as shown with the attached exhibit.

Second, IRC § 6103 as it exists may inhibit OPR’s ability to obtain meaningful internal referrals, and by extension, act on otherwise deserving cases of alleged practitioner misconduct. Pursuant to IRC § 6103(a)(1), an officer or employee of the United States must keep returns and return information confidential unless disclosure is authorized under Title 26. As discussed, this is an important taxpayer privacy provision, but when applied to OPR matters, may limit access to information helpful in investigating alleged practitioner misconduct.

50 848 F.3d 1034 (D.C. Cir. 2017).
Under IRC § 6103(b)(2)(A), “return information” includes a taxpayer’s identity as well as whether the taxpayer’s return was, is being, or will be examined. It also includes “any other data received by, recorded by, prepared by, furnished to, or collected by the Secretary with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person under this title for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense.” Both Revenue Agent Reports (“RAR”) and unagreed case packages reflect the examination of a taxpayer. The RAR is generally prepared by a Revenue Agent at the conclusion of an audit. The case package, whether or not agreed, may include the taxpayer’s tax returns and normally contains data received by, recorded by, prepared by, furnished to, and/or collected by an IRS employee concerning the taxpayer’s tax liability. Therefore, the IRS has concluded that the RAR and contents of the unagreed case package are “returns and return information” within the meaning of IRC § 6103(b). As a result, IRS employees are otherwise prohibited from disclosing the RAR and unagreed case package to OPR unless an exception to IRC § 6103(a)(1) applies.

To that, IRC § 6103(h)(1) permits disclosure of returns and return information to officers and employees of the Department of Treasury, without written request, where the recipient needs to know the information to perform tax administration duties. OPR is a part of the IRS, which is in turn a bureau of the Department of Treasury. Tax administration is broadly defined under IRC § 6103(b)(4)(A)(i) and includes “the administration, management, conduct, direction, and supervision of the execution and application of internal revenue laws and related statutes (or the equivalent laws and statutes of a state).”

Circular 230 provides OPR with the authority to conduct investigations, to commence disciplinary proceedings, and to pursue sanctions, when appropriate against practitioners, notwithstanding the limits created by the Loving, Sexton, and Ridgley cases discussed herein. The IRS has previously concluded that when OPR employees investigate the federal tax compliance of those who are subject to Circular 230, they are performing their official tax administration duties within the permissible disclosure exception of IRC § 6103(h)(1). However, the IRS’s prior conclusion was largely based on the case of Kenny v. United States, 489 Fed. Appx. 628 (3d Cir. 2012). In Kenny the practitioner came to the attention of OPR from an internal IRS referral, and once OPR opened the investigation, OPR examined the practitioner’s tax returns and discovered he had filed his personal tax returns late in two tax years without an extension. In response thereto, the practitioner brought suit against the IRS seeking monetary and injunctive relief for violations of IRC §§ 7804, 7433, and 7431, among others. The Court of Appeals for the Third Circuit concluded that because OPR was acting within their official tax administration duties under IRC § 6103(h) and had the authority to conduct such investigation under IRC § 6103(j)(4)(B) due

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53 IRS CCA 201403006 (IRS CCA Jan. 17, 2014); see also IRS CCN CC-2020-008, Subject: Examples Relating to Disclosure of Third Party Tax Info. in Syndicated Conservation Easement Matters, Q&A 3 (IRS CCN Sept. 8, 2020).
54 IRS CCA 201403006 (IRS CCA Jan. 17, 2014); see also IRS CCN CC-2020-008, Subject: Examples Relating to Disclosure of Third Party Tax Info. in Syndicated Conservation Easement Matters, Q&A 3 (IRS CCN Sept. 8, 2020); but see, IRS CCA 201001019 (IRS CCA Jan. 8, 2010).
56 Id.
to 31 U.S.C. § 330(b), no violation of IRC § 6103 occurred.57 However, Kenny was decided on July 19, 2012 in the pre-Loving, pre-Sexton, and pre-Ridgley landscape of OPR’s authority under 31 U.S.C. § 330. Although one can make some assumptions that the practitioner in Kenny was in fact practicing before the IRS (i.e., the origin of his complaint was interference from a Revenue Officer, lending itself to his involvement in representing taxpayers before the IRS in collection matters), future cases may result in disparate outcomes unless clearer statutory authority is given to the IRS and OPR. Moreover, even if the exception under IRC § 6103(h) survives a post-Loving, post-Sexton, and post-Ridgley challenge, it only serves to reduce the internal resistance for a referral.

Thus, IRC § 6103(h)(4)(B) should be amended to make clear (or regulations adopted making understood) that certain tax return information (perhaps excluding taxpayer names and identifying information) is related to the resolution of an issue in an OPR proceeding, even though the taxpayer is not a direct party to that case.

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57 Id. at 631.