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IRS Lacks Authority to Issue and Enforce Tax Return Preparer Regulations

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On February 11, 2014, the U.S. Court of Appeals for the District of Columbia upheld the decision of the District Court for the District of Columbia, affirming that the Internal Revenue Service (IRS) lacked the authority to issue and enforce tax return preparer regulations it issued in 2011, and permanently enjoined the IRS from enforcing the regulations.

Loving v. Internal Revenue Service, No. 13-5061, decided on February 11, 2014, by the U.S. Court of Appeals for the District of Columbia Circuit (Circuit Court), upheld the decision of the District Court for the District of Columbia (District Court), affirming that the Internal Revenue Service (IRS) lacked the authority to issue and enforce the final Treasury Department Circular 230 (Circular 230) tax return preparer regulations that were issued in 2011.

Background

For a more detailed background and discussion of the District Court's decision in *Loving*, see "District Court Holds IRS Lacks Authority to Issue and Enforce Tax Return Preparer Regulations," by Robin Greenhouse and Gale Chan.

In short, in June 2011, the IRS created a new category of tax return preparers, "registered tax return preparers," which are subject to the ethical standards of conduct and rules in Circular 230. Under the new regulations, registered tax return preparers can prepare and sign tax returns, claims for refunds and other documents for submission to the IRS. A registered tax return preparer who signs the return may represent taxpayers before revenue agents during examination, but cannot represent the taxpayer before IRS appeals officers, revenue officers, counsel or similar officers or employees for the IRS.

In *Loving*, three individual paid tax return preparers filed suit against the IRS, the Commissioner of Internal Revenue and the United States (collectively, Government), arguing that the IRS cannot regulate tax return preparers whose only "appearance" before the IRS is the preparation of tax returns and requesting the court to permanently enjoin the IRS from enforcing the regulations. To support its authority to regulate tax return preparers, the IRS relied on 31 U.S.C. § 330, a statute originally enacted in 1884, which provides the Department of the Treasury (Treasury) with the authority to regulate the people who practice before it.

The District Court, applying the regulatory deference framework of *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc*., 467 U.S. 837 (1984), concluded that the text and context of 31 U.S.C. § 330 unambiguously foreclosed the IRS' interpretation of the statute. The District Court found that: (i) 31 U.S.C. § 330(a)(2)(D) defines the phrase "practice of representatives" in a manner that does not cover return preparers; (ii) the IRS' interpretation of 31 U.S.C. § 330 would undermine other statutory penalties and regulations from the Internal Revenue Code (Code) that are specifically applicable to tax return preparers, which would essentially "relegate to oblivion" those provisions; and (iii) that the IRS' interpretation of 31 U.S.C. § 330 would read Section 7407 (the IRS' authority to seek an injunction against a tax return preparer to enjoin the preparer from further preparing returns for specific unlawful conduct) out of the Code as duplicative.

The Circuit Court's Six Considerations

The Circuit Court, applying a de novo standard of review to the District Court's statutory interpretation, upheld the District Court's determination for six different reasons:

First, the Circuit Court, like the District Court, determined that the term "representative" found in 31 U.S.C. § 330 does not include return preparers. The Circuit Court discussed a number of dictionary definitions for the statutory term "representative" finding that it "is traditionally and commonly defined as an agent with authority to bind others, a description that does not fit tax-return preparers." Because return preparers are not agents and do not possess the legal authority to act on the taxpayer's behalf, they are not representatives under 31 U.S.C. § 330.

Second, the Circuit Court explained that the 31 U.S.C. § 330 phrase "practice…before the Department of the Treasury" also does not include tax return preparers. "Practice before" the Treasury only occurs during an investigation, adversarial hearing or adjudicative proceeding. The District and the Circuit Courts each found that 31 U.S.C. § 330(a)(2)(D) helped to define what practice before the Treasury actually means, and the statute explicitly provides that "practice" is advising and assisting a taxpayer "in presenting their case." The Government did not "contend that preparing a tax return constitutes 'presenting' a 'case'," but that the requirements of 31 U.S.C. § 330(a)(2) are disjunctive. The Circuit Court found the Government's argument unpersuasive. The statute itself used the conjunctive "and" when it provided that it applied to persons possessing "necessary qualifications to enable the representative to provide to persons valuable service" *and* "competency to advise and assist persons in presenting their cases." Moreover, the Circuit Court concluded that changing the "and" to "or" was not supported in that the original statute as of 1884 which specified that the requirements were conjunctive and that, when Congress reenacted the statute in 1982, it intended to do so "without substantive change."

Third, the Circuit Court again referred to the original 1884 statute, which authorized the Secretary of Treasury to prescribe rules and regulations governing "the recognition of *agents, attorneys, or other persons representing claimants before his Department*" and who were "otherwise competent to advise and assist such claimants *in the presentation of their cases*," and held that the "original plain language would not encompass tax return preparers."

Fourth, the Circuit Court explained that 31 U.S.C. § 330 must be read within the broad statutory framework, and the IRS' interpretation would "effectively gut" Congress' "carefully articulated existing system for regulating tax-return preparers." Like the District Court, the Circuit Court found that Congress has already enacted various statutory provisions specifically applicable to tax return preparers and the IRS' interpretation of 31 U.S.C. § 330 would turn it into a "carte blanche" to re-regulate conduct that Congress has already seen fit to regulate.

Fifth, the Circuit Court found that the IRS' interpretation of 31 U.S.C. § 330 vastly exceeds the nature and scope of the authority granted to it; Congress did not intend to "grow such a large elephant in such a small mousehole."

Finally, the Circuit Court pointed to the IRS' interpretation of the statute and its predecessor. The IRS has never, until now, taken the position that it had the authority to regulate tax return preparers, and the Circuit Court quotes a few of the IRS' officials who state that the IRS has no such authority.

Conclusion

The Circuit Court concludes that the IRS' interpretation of 31 U.S.C. § 330 fails both steps under *Chevron* because (i) the IRS' interpretation is foreclosed by the statute itself and (ii) such interpretation is unreasonable in light of the statute's text, history, structure and context. The Circuit Court's decision will greatly impact tax return preparers and the clients they serve. Although the decision is a blow to the IRS and Treasury, tax return preparer fraud is a real problem that harms innocent taxpayers. As a result, it is possible the IRS and Treasury will continue to address this issue by working with Congress in an attempt to reduce the harm caused by fraudulent tax return preparers.

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