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Subject: SALT LS: Court invalidates Reg which bans contingency fees

**Court invalidates reg that bans contingent fee arrangements for preparing refund claims**

**Ridgely v. Lew, (DC DC 7/16/2014)** 114 AFTR 2d ¶ 2014-5069

Relying heavily on the decision of the Court of Appeals for the District of Columbia in Loving v. IRS, (CA DC 02/11/2014) 113 AFTR 2d 2014-867, the district court for the District of Columbia has found that Sec. 10.27 of Circular 230, to the extent it prohibits the charging of contingent fees for the preparation of refund claims, exceeds IRS's statutory authority. The court declared the reg invalid for this purpose and issued a permanent injunction against its enforcement.

*Background.* The Secretary of the Treasury has the authority to "regulate the practice of representatives of persons before the Department of the Treasury." 31 USC 330(a)(1). Since IRS is a bureau of the Treasury Department (Reg. § 601.101(a)), the statute also covers practice before IRS. Thus, the statute allows IRS to regulate "representatives" who "practice" before it.

A reg, i.e., 31 CFR 10.27(b) (part of Circular 230—the rules on practice before IRS), provides that, with exceptions not relevant here, a practitioner may not charge a contingent fee for services rendered in connection with any matter before IRS. 31 CFR 10.27 defines "matter before IRS" to include "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 Internal Revenue Service or any of its officers or employees relating to a taxpayer's rights, privileges, or liabilities."

In June of 2011, IRS issued final regs that provided for competency testing, continuing professional education, and ethical standards for tax return preparers (see Weekly Alert ¶ 2 06/02/2011). Several preparers challenged the validity of these regs.

In February, 2014, the DC Circuit, affirming a district court holding, agreed with those preparers. The DC Circuit said that the question in this case was whether IRS's authority under 31 USC 330(a)(1) to "regulate the practice of representatives of persons before the Department of the Treasury" encompasses authority to regulate tax return preparers. In finding that it didn't encompass that authority, the Court noted:

> ... Tax return preparers are not representatives.
>
> ... Tax return preparation does not involve practice before IRS because it does not involve an adversarial proceeding, as envisioned by Congress.
>
> ... The history of 31 USC 330 indicates that the statute contemplates representation in a contested proceeding, not simply assistance in preparing a tax return. (Loving v. IRS, (CA DC 02/11/2014) 113 AFTR 2d 2014-867)

*Facts.* Gerald Ridgely, a certified public accountant (CPA), sought a declaratory judgment that 31 CFR 10.27 is invalid with respect to refund claims and a permanent injunction against its enforcement.

*Court finds the contingency fee reg invalid with respect to refund claims.* The district court found 31 CFR 10.27(b) invalid as it pertains to refund claims and permanently enjoined IRS from enforcing that reg with respect to fees for the preparation of refund claims.

The court began by discussing the nature of preparing and filing a refund claim. A CPA or other person may assist a taxpayer in preparing and filing a refund claim and, in doing so, would not be legally representing the taxpayer until IRS responded to the claim and the CPA submitted a power-of-attorney form to IRS. Thus, what Ridgley challenged was IRS's proclaimed authority to regulate fee arrangements entered into by CPAs for preparing and filing refund claims before the commencement of any adversarial proceedings with IRS or any formal legal representation by the CPA.

The court said that, as to the meaning of the term "representative," *Loving* is clear: a "representative" is traditionally one "with authority to bind others." Tax return preparers neither "possess legal authority to act on the taxpayer's behalf" nor can they "legally bind the taxpayer by acting on the taxpayer's behalf." The *Loving* court defined "tax return preparers" to expressly include those preparing refund claims, but even if *Loving* 's holding fails to directly cover CPAs preparing and filing refund claims, *Loving's* reasoning applies straightforwardly. CPAs preparing and filing such claims before possessing any power of attorney possess no "legal authority to act on behalf of taxpayers." Thus, 31 USC 330's use of the term "representative" excludes refund claim preparers, just as it did tax return preparers in *Loving* .

The process of filing a refund claim—before any back-and-forth with 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. If a tax return preparer does not practice before IRS when he simply assists in the preparation of someone else's tax return (as *Loving* held), then a CPA hardly "practices" before IRS when he simply prepares and files a taxpayer's refund claim, before being designated as the taxpayer's representative and before the commencement of an audit or appeal.

The court then said that, like its plain text, 31 USC 330's broader statutory context led to the conclusion that IRS's regulatory authority does not extend to those preparing and filing refund claims. The Code is full of rules that are specific to return preparers. And, the term "tax return preparer" expressly includes individuals who prepare tax returns or tax refund claims. (Code Sec. 7701(a)(36)) Those many provisions reveal that Congress conceived of tax return preparation and tax refund preparation as similar activities that qualitatively differ from the "practice" of presenting or adjudicating cases. But under IRS's view, these specific provisions would serve no purpose, for 31 USC 330 itself would have given IRS liberal authority to impose various penalties on tax return preparers who behave unethically. The definition of "tax return preparer" and the need to avoid surplusage support the conclusion that Congress differentiated between the preparation and filing of refund claims on the one hand and their subsequent adjudication on the other.

The court rejected IRS's argument that because Ridgely is a CPA, he "is a representative who practices before the Department and is therefore subject to the terms of Circular 230." In other words, according to IRS, it has authority to regulate all actions of CPAs who—at some point—"practice" before it, regardless of "whether they're acting in a representational or non representational capacity." The court said that, according to IRS, it could broadly regulate the actions of CPAs no matter what they were doing—even if their conduct was nowhere close to "practicing" before IRS—simply because, say, the CPAs "practiced" before IRS once a year. Meanwhile, IRS would impose no contingent fee restrictions on the preparation and filing of refund claims by non-CPAs and those who never "practice" before IRS. Nothing in the statutory

text (or, for that matter, the context and history of 31 USC 330) gives IRS this kind of authority over CPAs specifically.

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