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AT COURT

Sexton Opinion Further Restricts What Conduct Can Be Regulated Under "Practice" Before the IRS

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On March 17, 2017, the U.S. District Court for the District of Nevada issued its decision in *Sexton*,[1] becoming the first court outside of the District of Columbia to adopt the D.C. Circuit's holding in *Loving*.[2] As discussed further below, *Loving* (and the later *Ridgeley*[3] case) held that the IRS does not have the authority to regulate mere tax return preparation. While the acceptance of *Loving* outside the District of Columbia is not surprising, *Sexton* potentially extends the reach of *Loving* outside of the tax return preparation context and calls into question the regulation of advice rendered by tax professionals. Specifically, *Sexton* may curtail the ability of the IRS Office of Professional Responsibility (OPR) to regulate tax professionals, lead to limitations on regulatory oversight depending on the service being performed by the professional, and thereby present hazards for tax professionals and taxpayers.

In *Loving*, tax return preparers challenged an IRS regulation that added provisions to Circular 230 requiring paid tax return preparers to meet certain certification and continuing education requirements.[4] The regulation was issued under 31 U.S.C. § 330(a)(1), which authorizes the Treasury Department to "regulate the practice of representatives of persons before the Department of Treasury." The D.C. Circuit held that the regulation was invalid with respect to tax return preparers because the mere preparation and signing of tax returns does not constitute "practice" before the IRS.[5] The court reviewed the history of 31 U.S.C. § 330(a)(1) (among other things), and concluded that the statute regulates tax professionals who represent taxpayers in adversarial proceedings before the Treasury Department and that tax return preparers are not "representatives."[6]

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Five months after the decision in *Loving*, the U.S. District Court for the District of Columbia

1 *Sexton v. Hawkins*, No. 2:13-cv-00893-RFB-VCF (D. Nev. Mar. 17, 2017).
2 *Loving v. IRS*, 742 F.3d 1013 (D.C. Cir. 2014).
3 *Ridgeley v. Lew*, 55 F.Supp.3d 89 (D.D.C. 2014).
4 31 C.F.R. §§ 10.4(c), 10.6(e).
5 *Loving*, 742 F.3d at 1022.
6 *Id.* at 1017-19.

issued its opinion in *Ridgeley*. In *Ridgeley*, another tax practitioner challenged a Circular 230 regulation prohibiting contingent fees for certain tax services, including the filing of ordinary refund claims. Unlike in *Loving*, the plaintiff was a CPA that practiced before the IRS. With *Loving* as controlling precedent in the D.C. Circuit, the district court stated that that section 330 does not grant the IRS authority to "regulate 'practitioners' generally" but rather grants the IRS authority to regulate "a specific kind of activity" that practitioners may undertake.[7] The court held that ordinary refund claims are outside the scope of section 330(a)(1) because refund claims occur prior to the commencement of adversarial proceedings with the IRS and are, therefore, not "practice" before the Treasury.[8]

The decision in *Sexton* involved another subsection of 31 U.S.C. § 330 and resulted in a further limitation on the types of activity that the Treasury Department can regulate. In *Sexton*, the plaintiff, James Sexton, sought a declaratory judgment regarding his status as a "practitioner" under section 330 (Circular 230). Mr. Sexton had been a lawyer who offered various services as a tax professional, including preparation of tax returns, rendering of written advice to taxpayers, and representation of taxpayers during the course of adversarial proceedings with the IRS. Mr. Sexton was disbarred in 2005 and later suspended from practicing before the IRS. Following his disbarment and suspension, Mr. Sexton continued to offer professional tax services.[9]

In 2012, OPR received a complaint from a former client of Mr. Sexton. According to the complaint, Mr. Sexton had prepared the former client's tax returns and "offered to send her a written memorandum analyzing her options regarding her business' tax obligations."[10] The client fired Mr. Sexton shortly thereafter, and Mr. Sexton never provided her with written advice. Based on this complaint, OPR began investigating Mr. Sexton for violating the terms of his suspension by offering written tax advice.[11] Mr. Sexton filed a complaint in the District of Nevada to determine whether the OPR had authority to investigate him.

31 U.S.C. § 330(e) provides that "Nothing in this section or in any other provision of law shall be construed to limit the authority of the [Treasury Department] to impose standards applicable to the rendering of written advice with respect to any entity, transaction plan or arrangement…having a potential for tax avoidance or evasion." Under IRS regulations promulgated pursuant to Circular 230, "practice before the [IRS]" includes "rendering written advice with respect to any…arrangement having a potential for tax avoidance or evasion."[12] In *Sexton*, the U.S. Department of Justice (DOJ) argued that the statute extends to tax professionals who offer written tax advice regardless of whether they represent taxpayers in an adversarial proceeding with the IRS.[13] Thus, DOJ sought a narrow interpretation of *Loving* that would limit its holding to tax professionals who are mere tax return preparers. Such an interpretation would permit IRS regulation of tax professionals who provide services other than tax return preparation even if those services fall short of representation in an adversarial proceeding.[14] The *Sexton* court rejected DOJ's argument, and held that

7 *Ridgeley*, 55 F.Supp.3d at 97.
8 *Id.*
9 *Sexton* at 2.
10 *Id.*
11 *Id.* at 2-3.
12 31 C.F.R. §10.2(a)(4).
13 *Sexton* at 6.
14 OPR also argued that § 330 grants the IRS inherent authority over tax professionals who have been suspended from practice before the IRS as a result of misconduct. OPR reasoned that such authority is common for professional licensing bodies in order to investigate alleged violations of the suspension. The court rejected this argument, stating that "an individual or entity does not subject himself to infinite and undefined oversight by the IRS based upon suspension." *Id.* at 6-9.

section 330(e) does not extend to tax professionals offering written advice outside of the context of an adversarial proceeding before the IRS.[15]

The holding in *Sexton* raises significant concerns. First, the limitation on regulation of advice in *Sexton* is potentially detrimental to taxpayers and the administration of tax generally. The IRS should have tools at its disposal to regulate professionals who are providing advice, as it appears Congress intended.

Second, the decision raises the question of whether a tax professional who represents taxpayers in adversarial proceedings before the IRS is *always* subject to IRS regulation under section 330. The court's assertion that a tax professional "does not subject himself to infinite and undefined oversight by the IRS,"[16] though made with respect to suspended professionals, could suggest that the IRS's authority over a tax professional should be evaluated on the nature of services being performed or on a taxpayer-by-taxpayer basis. As a result, *Sexton* could be interpreted broadly, such that a professional is "representing taxpayers before the IRS" only with respect to the particular taxpayer or matters identified on the Form 2848, Power of Attorney and Declaration of Representative (POA).[17] Thus, a tax professional may be "practicing" before the IRS and subject to regulation with respect to one taxpayer (for whom the professional submitted a power of attorney during the course of typical tax controversy), but not with respect to another taxpayer (for whom the professional has merely offered to render written advice). Such an interpretation could have significant ramifications for tax professionals who provide a range of services to taxpayers. It would also increase the costs of administering Circular 230 and create potential pitfalls for taxpayers seeking to hire tax professionals.

While it is clear that *Sexton* could be viewed as further restricting OPR's ability to use Circular 230 to regulate tax professionals, the breath of the decision is unclear. The government could argue in subsequent cases that *Sexton* was a relatively limited opinion about Mr. Sexton himself who was ultimately only involved in tax return preparation and advice relating to tax return preparation. ■

15 *Sexton* at 10-13.

16 *Id.* at 9.

17 Part II of the POA was recently revised to require tax professionals to certify that they are "subject to regulations contained in Circular 230 (31 CFR, Subtitle A, Part 10), as amended, governing practice before the [IRS]."