Part III - Administrative, Procedural, and Miscellaneous

# Disciplinary Actions under Section 822 of the American Jobs Creation Act of 2004

Notice 2007-39

This Notice provides guidance to practitioners, employers, firms, and other entities that may be subject to monetary penalties under 31 U.S.C. section 330. This Notice also invites comments from the public regarding rules and standards relating to monetary penalties under 31 U.S.C. section 330.

## BACKGROUND

In general, 31 U.S.C. section 330 authorizes the Secretary to regulate attorneys, certified public accountants, enrolled agents, enrolled actuaries, and others who practice before the Service. Regulations under section 330 are promulgated in 31 CFR part 10 and are reprinted as Treasury Department Circular No. 230.

Section 822 of the American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418 (the Act), amended 31 U.S.C. section 330 to expand the sanctions that the Secretary may impose for certain prohibited conduct within the meaning of section 10.52 of Circular 230 to include monetary penalties. As amended by the Act, 31 U.S.C. section 330 authorizes the Secretary to impose sanctions, including monetary penalties, against a practitioner who is incompetent or disreputable, who fails to comply with the regulations prescribed under section 330, or who, with intent to defraud, willfully and knowingly misleads or threatens a client or potential client. The Secretary is also authorized to impose monetary penalties against an employer, firm, or other entity, if the practitioner was acting on its behalf in connection with the prohibited conduct giving rise to the penalties and the employer, firm, or other entity knew, or reasonably should have known, of the prohibited conduct.

Monetary penalties apply only with respect to prohibited conduct that occurs after October 22, 2004, the date of enactment of the Act. Under the Act, the aggregate monetary penalties cannot exceed the gross income derived (or to be derived) from the prohibited conduct giving rise to the penalties.

Monetary penalties may be imposed for a single act of prohibited conduct or for a pattern of misconduct. Monetary penalties may be imposed in addition to, or in lieu of, any suspension, disbarment, or censure of the practitioner. Monetary penalties are not, however, a “bargaining point” that a practitioner may offer to avoid suspension, disbarment, or censure if these sanctions are otherwise appropriate.

## REQUIREMENTS FOR IMPOSITION OF MONETARY PENALTIES

### Amount of the Monetary Penalty

The aggregate amount of the monetary penalty (or penalties) imposed by the Secretary for any prohibited conduct may not exceed the collective gross income derived by the practitioner and the employer, firm, or other entity in connection with such prohibited conduct. If a single act of prohibited conduct giving rise to a monetary penalty is an integral part of a larger engagement, the amount of the penalty will be limited by the “gross income derived (or to be derived)” from the larger engagement. In the event that the larger engagement began on or before October 22, 2004, the "gross income derived (or to be derived)" will be calculated, on a pro rata basis, to exclude amounts attributable to conduct occurring on or before October 22, 2004. In determining the amount of the monetary penalty (or penalties), the Secretary will consider amounts that the practitioner, employer, firm, or other entity could reasonably expect to realize, irrespective of whether the amounts have actually been received.

The Secretary has discretion to impose a monetary penalty in an amount less than the amount allowed by statute. In determining the amount of the penalty (or penalties), the Service will consider the level of culpability of the practitioner, firm, or other entity; whether the practitioner, firm, or other entity violated a duty owed to a client or prospective client; the actual or potential injury caused by the prohibited conduct; and the existence of aggravating or mitigating factors. Mitigating factors may include whether the practitioner, employer, firm, or other entity took prompt action to correct the noncompliance after the prohibited conduct was discovered; promptly ceased engaging in the prohibited conduct; attempted to rectify any harm caused by the prohibited conduct; or undertook measures to ensure that the prohibited conduct would not occur again in the future. In general, the Service will not impose monetary penalties in cases of minor technical violations, when there is little or no injury to a client, the public, or tax administration, and there is little likelihood of repeated similar misconduct.

The Secretary may impose separate penalties against the practitioner and against the employer, firm, or other entity for any prohibited conduct. Each separate penalty may not exceed the gross income derived by the practitioner and the employer, firm, or other entity, respectively.

Imposition of a Separate Monetary Penalty on an Employer, Firm, or Other Entity

If a practitioner acted on behalf of an employer, firm or other entity in connection with prohibited conduct, the Secretary may impose a separate monetary penalty on the employer, firm or other entity if the employer, firm or other entity knew, or reasonably should have known, of the prohibited conduct.

A practitioner is considered to have acted on behalf of an employer, firm, or other entity if –

(1) An agency relationship existed between the practitioner and the employer, firm, or other entity;

(2) The purpose of the agency relationship was to provide services in connection with practice before the Internal Revenue Service (as defined in §10.2(d) of Circular 230), and

(3) The prohibited conduct giving rise to the penalty arose in connection with the agency relationship.

An employer, firm, or other entity knows or reasonably should know of the prohibited conduct if --

(1) One or more members of the principal management (or officers) of the employer, firm, or other entity, or one or more members of the principal management (or officers) of a branch office knows, or has information from which a person with similar experience and background would reasonably know, of the prohibited conduct; or

(2) The employer, firm, or other entity through willfulness, recklessness, or gross

indifference (including ignoring facts that would lead a person of reasonable prudence and competence to investigate or ascertain) did not take reasonable steps to ensure compliance with Circular 230; and one or more individuals associated with the employer, firm, or other entity, in connection with their agency relationship with the employer, firm, or other entity, engages in prohibited conduct within the meaning of section 10.52 of Circular 230 that harms a client, the public, or tax administration, or a pattern or practice of failing to comply with Circular 230.

The following examples illustrate the above provisions:

Example 1: Attorney A specializes in tax planning and works out of a national accounting firm's headquarters. Attorney A is involved in the development of off-the-shelf tax planning strategies, including Strategy X. Attorney A has wide discretion over his day-to-day work product and rarely supervises other professionals at the firm. Attorney A rarely deals directly with clients as this work is handled by other firm partners or employees. Attorney A works directly with the firm's other attorneys, accountants and support staff across the country to market and fine-tune Strategy X. Clients of the firm are examined by the Service with respect to Strategy X, but Attorney A is not identified on any Form 2848 as a representative.

Attorney A reports to the director of the firm's tax practice. The director of the firm's tax practice provides general oversight as to Attorney A. The director of the firm's tax practice was aware of the strategies that Attorney A developed, including Strategy X, although he was not necessarily familiar with the technical tax details of each strategy. The director of the firm's tax practice also knew that Strategy X generated measurable revenue for the firm.

OPR determines that Attorney A engaged in prohibited conduct in violation of Circular 230 in the creation, promotion and marketing of Strategy X. Attorney A acted on behalf of the firm because an agency relationship existed between Attorney A and the firm, and the misconduct arose in connection with that agency relationship as Attorney A worked on behalf of the firm to promote Strategy X. The firm knew or had reason to know of the prohibited conduct in this situation. The director of the firm's tax practice, who is a member of principal management of the firm, had general knowledge that Attorney A developed the tax-advantaged strategies. Alternatively, in the absence of general knowledge, the director of the firm's tax practice would need to inquire into Strategy X because it added measurably to the firm's revenue. Both Attorney A and the firm are subject to a monetary penalty.

Example 2: Unenrolled Return Preparer B owns and operates her own firm that provides return preparation services to the public and also specializes in preparing Forms 656, Offers In Compromise. B's firm employs 10 attorneys, CPAs and enrolled agents (all practitioners) and 15 unenrolled return preparers. B supervises and directs all of her employees. B's firm is structured in such a manner so that the first and predominant contact for clients coming in from the public is with the unenrolled return preparers. The unenrolled return preparers assist clients with preparing Forms 656 that are later submitted directly to the Service. B does not review individual Forms 656 but has provided specific instructions to her staff regarding how to complete false and misleading Forms 656 in violation of Circular 230. In order to facilitate the submission to the Service of the false or misleading Forms 656, B's procedure is to authorize one of her 10 practitioners to submit a Form 2848 on behalf of a client much later in the process, well after submission of the Forms 656 in violation of Circular 230.

Although B is not a practitioner, the practitioner's actions in submitting the Forms 2848 are done on behalf of the firm pursuant to an agency relationship and occur in connection with prohibited conduct. B's firm is considered to know or have reason to know of the prohibited conduct because B, a member of principal management, instructed her staff regarding completion of the forms in violation of Circular 230. The practitioner's actions subject B's firm to a monetary penalty.

When determining if a monetary penalty should be imposed on an employer, firm or other entity, the Secretary will consider factors in addition to whether the employer, firm, or other entity knew, or reasonably should have known of the prohibited conduct (or whether the employer, firm or other entity did not use reasonable efforts to ensure compliance with Circular 230). For example, the Secretary will consider the gravity of the misconduct, any history of noncompliance by the employer, firm, or other entity, preventative measures in effect prior to the misconduct, and any corrective measures taken by the employer, firm, or other entity after the prohibited conduct was discovered, including measures to ensure that future prohibited conduct does not occur.

Additional Guidance and Request for Comments

The Service may issue additional guidance regarding the application of monetary penalties, including, but not limited to, the factors that the Service should consider when evaluating all the facts and circumstances of a particular case. The Service requests comments with respect to the appropriate factors to be considered when determining whether a monetary penalty is appropriate. Comments also are requested as to factors that the Service should consider in declining to impose a monetary penalty on an employer, firm, or other entity, including the weight given to adequate procedures in place for purposes of complying with Circular 230.

Additionally, in order to develop a penalty system that best encourages compliance with Circular 230, the Service requests comments regarding mitigating circumstances to consider when determining the amount of a monetary penalty. Mitigating circumstances could be considered, for example, in varying the amount of the penalty to correspond to the seriousness of the misconduct or pattern of misconduct. Mitigating circumstances could include, but not be limited to, the immediacy of the misconduct, history of misconduct, the existence of firm procedures, and corrective measures taken after discovery of the misconduct.

Interested parties are invited to submit comments by August 13, 2007. Comments should be submitted to: Internal Revenue Service, CC:PA:LPD:PR (Notice 2007-39), Room 5203, P.O. Box 7604, Ben Franklin Station, Washington, DC 20224. Alternatively, comments may be hand delivered Monday through Friday between the hours of 8:00 a.m. to 4:00 p.m. to: CC:PA:LPD:PR (Notice 2007-39), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC.

Comments may also be submitted electronically via the following e-mail address: Notice.Comments@irscounsel.treas.gov. Please include “Notice 2007-39” in the subject line of any electronic submissions.

DRAFTING INFORMATION

The principal author of this notice is Matthew Cooper of the Office of Associate Chief Counsel (Procedure & Administration), Administrative Provisions and Judicial Practice Division. For further information regarding this notice contact Matthew Cooper at (202) 622-4940 (not a toll-free call).