TAX COURT CASE UPDATE

Citation:

Gerald Lee Ridgely, Jr. v. Jacob J. Lew, Civil Action No. 1:12-cv-00565 (District of Columbia District Court), July 16, 2014.

Overview:

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

The Facts:

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

Discussion:

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 the IRS responded to the claim and the CPA submitted a power-of-attorney form to the IRS. Therefore, what Ridgley challenged was the 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 the 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 the 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 the IRS when he simply assists in the preparation of someone else's tax return (as *Loving* held), then a CPA hardly practices before the 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 the 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. 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 the IRS's view, these specific provisions would serve no purpose because 31 USC 330 itself would have given the IRS liberal authority to impose various penalties on tax return preparers who behave unethically. The definition of tax return preparer supports 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 the 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 the 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 the 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 the IRS, simply because, say, the CPAs "practiced" before the IRS once a year. Meanwhile, the IRS would impose no contingent fee restrictions on the preparation and filing of refund claims by non-CPAs and those who never "practice" before the IRS. Nothing in the statutory text (or, for that matter, the context and history of 31 USC 330) gives the IRS this kind of authority over CPAs specifically.

Conclusion:

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