AICPA®

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1455 Pennsylvania Avenue, NW
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June 24, 2014

The Honorable John A. Koskinen
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: New IRS Regulation of Tax Return Preparers After the *Loving* Decision

Dear Commissioner Koskinen:

The American Institute of Certified Public Accountants ("AICPA") is the world's largest member association representing the accounting profession, with more than 394,000 members in 128 countries and a 125-year heritage of serving the public interest. The AICPA has been a steadfast supporter of the IRS's overall goals of enhancing compliance and elevating ethical conduct. Helping to ensure that tax return preparers are competent and ethical is critical to maintaining taxpayer confidence in our tax system. Indeed, these goals are consistent with the AICPA's own Code of Conduct and enforceable tax ethical standards, the Statements on Standards for Tax Services. We value our longstanding and constructive relationship with the IRS, and we look forward to continuing to work with the IRS to develop workable solutions to important public policy issues, including our shared goal of crafting an improved regulatory approach to tax return preparers.

We have repeatedly expressed to you and your colleagues that our members have very significant concerns regarding a voluntary certification program and urged the IRS to have a formal comment period to obtain and consider the public's views prior to moving forward. Given our discussions with you, the Deputy Commissioner for Services and Enforcement, and the Director of the Return Preparer Office, we had hoped the IRS would pause, reflect, and reconsider any attempt to push out the proposed program. We are encouraged by your statement in your June 6, 2014 letter that a voluntary program is not an ideal solution to the problems related to unregulated tax return preparers. We are also encouraged by your commitment that you will pursue your goals in a "legally allowable manner."

However, it is our understanding that the IRS has no intention of slowing down or considering viable alternatives. Therefore, we feel compelled to consider our next steps, and to raise more formally our legal and policy concerns with the IRS's current path. In particular, we write today to express our strong concern that the IRS's proposed program—in which tax return preparers would receive an IRS certificate for display in return for completing a continuing education program that includes a comprehension assessment (the "proposed program")—would cause significant legal problems that may ultimately frustrate the IRS's goals, confuse the public, and lead to litigation.

As discussed in greater detail below:

First, no statute authorizes the proposed program. The IRS's general authority to administer the tax code under 26 U.S.C. § 7803 does not provide an adequate basis to proceed. Because federal agencies may act only pursuant to a valid delegation of authority by Congress, the IRS may not implement the proposed program. This fatal flaw cannot be overcome by the IRS. That no statutory provision expressly *prohibits* such a program does not legitimize an otherwise illegitimate act.

Second, and relatedly, the proposed program will inevitably be viewed as an end-run around *Loving v. IRS*, which held that the IRS lacks authority to regulate tax return preparers under 31 U.S.C. § 330. To be sure, the regulations invalidated in *Loving* were mandatory, and the proposed program is purportedly voluntary. But in reality tax return preparers would face an overwhelming, compelled incentive to participate in the IRS's credentialing program, meaning that the proposed program will be *de facto* mandatory. In the wake of *Loving*, that is impermissible.

Third, the IRS has evidently concluded, in developing the proposed program, that it need not comply with the notice and comment requirements of the Administrative Procedure Act ("APA"). This is incorrect. Although general statements of policy issued by an agency need not be issued pursuant to notice and comment, because this program would be *de facto* mandatory, it is for practical purposes a binding rule that must be issued pursuant to notice and comment. The IRS must also comply with the Paperwork Reduction Act, which provides that the IRS must seek approval from the Office of Management of Budget ("OMB") before collecting personal information from tax return preparers. And because the proposed program is likely a "significant regulatory action," the IRS will be required to comply with Executive Order 12,866. This will require the IRS to perform a cost-benefit analysis of the proposed program, perform a cost-benefit analysis of reasonably feasible alternatives, and seek approval from the Office of Information and Regulatory Affairs ("OIRA") within OMB before implementing the program. Notably, in adopting the regulations struck down in *Loving*, the IRS provided an opportunity for the public to comment, complied with the Paperwork Reduction Act, and obtained OIRA approval. *See* 76 Fed. Reg. 32,286, 32,286, 32,293 (June 3, 2011).

Finally, the current proposal is arbitrary and capricious because it fails to address the problems presented by unethical tax return preparers who defraud their clients, runs counter to evidence presented to the IRS, and will create market confusion. *See* 5 U.S.C. § 706(2)(A); *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Aut. Ins. Co.*, 463 U.S. 29, 43 (1983).

For all these reasons, we believe the proposed program is unlawful and improper. At the same time, we recognize the public policy benefits that could accrue from additional regulation of tax return preparers. We have sought to work with the IRS to achieve workable solutions to regulate tax return preparers and protect the public, and we stand ready to continue these efforts.

I. The IRS Must Identify A Statutory Basis For Any Regulatory Approach It Creates.

No statutory authority, including 26 U.S.C. § 7803, authorizes the proposed program. Section 7803 is a general provision that provides the Commissioner of Internal Revenue with "the power to administer, manage, conduct, direct, and supervise the execution and application of the internal revenue laws or related statutes and tax conventions to which the United States is a party." 26 U.S.C. § 7803(a)(2)(A). Read literally, this statutory text is broad; but general language cannot be read in a way that bypasses limitations contained in separate statutory provisions. *See RadLAX Gateway Hotel, LLC v. Amalgamated Bank,* 132 S. Ct. 2065, 2070-71 (2012) ("A well established canon of statutory interpretation succinctly captures the problem: [I]t is a commonplace of statutory construction that the specific governs the general." (internal quotation marks omitted)). This canon was a central premise of *Loving*, which rejected the IRS interpretation of Section 330 partly because it would render superfluous other provisions of the Internal Revenue Code that limit the IRS's authority over tax return preparers. *See Loving v. IRS,* No. 13-5061, slip op. at 14 (D.C. Cir. Feb. 11, 2014) ("Under the IRS's view here, however, all of Congress's statutory amendments [laying out the IRS's authority over tax return preparers] would have been unnecessary. The IRS, by virtue of its heretofore undiscovered carte blanche grant of authority from Section 330, would already have had free rein to impose an array of penalties on any tax-return preparer . . . ."). *Loving* forecloses reliance on an expansive reading of Section 7803. The IRS may not, therefore, bypass the limitations inherent in the Internal Revenue Code by substituting Section 7803 for Section 330 in this context.

If the IRS cannot identify a clear, specific statutory basis for its action, then under the APA it may not act. *See* 5 U.S.C. § 706(2)(C) ("The reviewing court shall hold unlawful and set aside agency action, findings, and conclusions found to be in excess of statutory jurisdiction, authority, or limitations, or short of statutory right."). It is not sufficient for the IRS to claim that no statutory provision *prohibits* the IRS from acting. This would be precisely opposite to how our administrative state functions. "It is axiomatic that administrative agencies may issue regulations only pursuant to authority delegated to them by Congress." *Am. Library Ass'n v. FCC*, 406 F.3d 689, 691 (D.C. Cir. 2005). It is a basic principle of administrative law that an agency may not act absent a grant of statutory authority. The IRS cannot violate that basic principle.

II. A Purportedly "Voluntary" Program Would Be An End-Run Around *Loving*.

The proposed program would contravene the results, reasoning, and judicial concerns underlying the court's opinion in *Loving*. The proposed program is therefore an impermissible end-run around binding precedent and presents litigation risks for the IRS.

A. A "Voluntary" Program Would Be Substantially Indistinguishable From *Loving* And Is Therefore Not Permitted.

In discussing the IRS's scope of authority under Section 330, the court explained that although "[i]t might be that allowing the IRS to regulate tax-return preparers more stringently would be wise as a policy matter," "that is a decision for Congress and the President to make if they wish by enacting new legislation." *Loving*, slip op. at 17. Any attempt to reinstitute a set of regulations similar or identical to those invalidated in *Loving* simply by describing them as "voluntary" would contravene this command by reaching the same result as the regulations struck down in *Loving* without additional legislation.

The IRS may argue that the regulations in *Loving* were mandatory while the proposed program is purportedly voluntary. In reality, tax return preparers will face an overwhelming incentive to participate in the proposed program. Participants will receive a certificate from the IRS touting their competency and also will be listed in an IRS-sponsored database. They will be able to market these signifiers as qualifications to customers and will gain an advantage over tax return preparers who do not participate in the program. As a result, the vast majority of ethical tax return preparers will "choose" to participate, and the end result will be a set of regulations that is substantially indistinguishable from the one invalidated in *Loving*. *Cf. Glenmark Assocs., Inc. v. NLRB*, 147 F.3d 333, 339 n.8 (4th Cir. 1998) ("We are not the first court to wonder whether this new interpretation is an end run around an unfavorable Supreme Court decision in order to promote policies broadening the coverage of the Act . . . ."); *id.* at 334-35 (invalidating the agency's interpretation).

The legal risk presented by pursuing the proposed program in the wake of *Loving* is underscored by the Supreme Court's decision in *National Cable & Telecommunications Association v. Brand X Internet Services*, 545 U.S. 967 (2005). In that case, the Supreme Court explained that "a judicial precedent holding that [a] statute unambiguously forecloses the agency's interpretation, and therefore contains no gap for the agency to fill, displaces a conflicting agency construction." *Id.* at 982-83. Because *Loving* clearly forbids the IRS from regulating tax return preparers pursuant to Section 330, the IRS is not in a position to repackage its regulations of tax return preparers—even on a purportedly voluntary basis. *See Loving*, slip op. at 17 ("Put in *Chevron* parlance, the IRS's interpretation fails at *Chevron* step 1 because it is foreclosed by the statute.").[1]

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[1] In *Loving*, the plaintiff did not contest that deferential review under *Chevron* applied, and the court was forced to assume that the IRS's interpretation was entitled to deference. But the court's citation to *Brown & Williamson* suggests that, had the issue been raised, the IRS interpretation would not receive *Chevron* deference. *See FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 160 (2000); *MCI Telecomms. Corp. v. AT&T Co.*, 512 U.S. 218, 231 (1994); *SeaWorld of Fla., LLC v. Perez*, No. 12-1375, slip op. at 17 (D.C. Cir. Apr. 11, 2014). If its interpretation is ineligible for *Chevron* deference, the IRS will have to show that its interpretation is the best reading of the statute. For all the reasons identified in *Loving*, that will pose significant challenges.

B. A Voluntary Program Would Undermine Specific Reasons Underlying *Loving*.

The proposed program would also undermine the legal rationale given by the court in striking down the tax return preparer regulations.

First, the court identified two features of the statutory text that foreclosed the IRS's interpretation. Section 330 grants the IRS authority "to regulate the practice of representatives of persons before the Department of the Treasury." 31 U.S.C. § 330(a)(1). The court concluded that the statutory term "representatives" and the phrase "before the Department of the Treasury" both foreclosed the IRS interpretation that tax return preparers are covered by the statute. As to the term "representatives," the court noted that "representative" typically refers to "an agent with authority to bind others" and tax return preparers are not representatives because they do not have that authority. *Loving*, slip op. at 6. Tax return preparers do not sign the returns they prepare on behalf of taxpayers, indicating that tax return preparers do not have authority to bind taxpayers in any way. Moreover, under existing IRS regulations, "representation of a taxpayer before the IRS requires formally obtaining the taxpayer's power of attorney," and tax return preparers do not typically obtain power of attorney when preparing returns. *Id.* at 7.

As to the phrase "practice . . . before the Department of the Treasury," the court concluded that the text refers to participation in an "investigation, adversarial hearing, or other adjudicative proceeding[s]." *Id.* at 9 (internal quotation marks and emphasis omitted). Because "[t]he Federal tax system is basically one of self-assessment, whereby each taxpayer computes the tax due and then files the appropriate form of return along with the requisite payment," the court concluded that tax return preparers do not practice before the Department of the Treasury. *Id.* (internal quotation marks omitted). Additionally, Section 330 grants the Treasury authority to set qualifications for those who seek to practice before the agency. In doing so, the Treasury may require a representative to demonstrate "competency to advise and assist persons in presenting their cases." 31 U.S.C. § 330(a)(2). The court concluded that this language reinforced the conclusion that tax return preparers do not practice before the Department of the Treasury because tax return preparers do not present cases on behalf of their clients. *Loving*, slip op. at 9-10.

If a mandatory regime of regulating tax return preparers is inconsistent with this statutory text, so is the proposed program. The key difference between the proposed program and the regulations invalidated in *Loving* is that the proposed program is purportedly voluntary. As noted above, however, although tax return preparers would not face any legal consequences if they did not participate in the proposed program, they would face an overwhelming competitive incentive to participate. Because the proposed program is substantially indistinguishable from the regulations invalidated in *Loving*, implementation of the proposed program would undermine the limitations contained in the statutory text of Section 330. *Cf. Glenmark Assocs., Inc.*, 147 F.3d at 339 n.8.

Second, in addition to the statutory text, the court explained that the drafting history of Section 330 demonstrates that the IRS lacks authority to regulate tax return preparers under the statute. *Loving*, slip op. at 12-13. In its original form Section 330 allowed those who lost horses and other property during military service to submit claims for reimbursement. *See id.* The court examined that text and concluded that it "plainly would not encompass tax-return preparers." *Id.* at 13. This original statutory text is important because the only revisions to the statute came in 1982, when Congress streamlined and modernized the tax provisions of the U.S. Code. In making those revisions, Congress did not make any substantive changes to the Code. Rather, the goal of those revisions was simply "[t]o revise, codify, and enact" amendments "without substantive change." *Id.* at 13 (quoting Pub. L. No. 97-258, 96 Stat. 877, 877 (1982) (emphasis omitted)).

The fact that the original statute would not have covered tax return preparers and that the only revisions to the statute were clerical—not substantive—is powerful evidence that the current version of Section 330 does not grant the IRS authority over tax return preparers. That conclusion is strengthened even further by the fact that, "[e]ven after tax-return preparation became a significant industry," Congress did not broaden the language of the provision to cover tax return preparers. *Id.* Thus, clear congressional intent indicates that the IRS lacks authority over tax return preparers pursuant to Section 330, and any effort to expand that authority—including by implementing the proposed program (or by seeking to rely on Section 7803 to do so)—would undermine that clearly expressed intent.

Third, the *Loving* opinion relies on the broader framework of the Internal Revenue Code, which in separate provisions grants the IRS more targeted authority over tax return preparers. *Id.* at 13-15. For example, Section 6694 of the Code imposes civil penalties on tax return preparers who, with the requisite scienter, understate their clients' liability; Section 6695 imposes additional civil penalties on tax return preparers who fail to perform specific administrative tasks related to preparing a tax return for a taxpayer; and Section 6713 imposes civil penalties on tax return preparers who disclose or use any information obtained during the course of preparing a return. *See* 26 U.S.C. §§ 6694, 6695, 6713. These provisions show that, rather than hand the IRS plenary authority over tax return preparers, Congress has opted for a more targeted approach. As the court noted, any attempt to expand Section 330 (and by extension Section 7803) would undermine Congress's preference of a more targeted approach. *Loving*, slip op. at 14. The same is true of a voluntary program.

Fourth, the court explained that, under Supreme Court precedent, "courts should not lightly presume congressional intent to implicitly delegate decisions of major economic or political significance to agencies." *Id.* at 15 (citing *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 133 (2000)). As the Supreme Court has explained, Congress "does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions—it does not, one might say, hide elephants in mouseholes." *Whitman v. Am. Trucking Ass'ns, Inc.*, 531 U.S. 457, 468 (2001). Thus, the court observed that the IRS's interpretation that tax return preparers are covered by Section 330 would "for the first time . . . regulate hundreds of thousands of individuals in the multi-billion dollar tax-preparation industry." *Loving*, slip op. at 15. Because nothing in the statutory text of Section 330 or its accompanying legislative history hints that Congress intended to grant the IRS authority over tax return preparers through Section 330, the court explained that, consistent with Supreme Court precedent, it was unlikely that Congress would have silently expanded IRS jurisdiction so dramatically. *Id.* Reinstituting similar or identical regulations on a purportedly voluntary basis would simply ignore this principle.

Fifth, the court explained that the IRS's previous approach to the statute, while not determinative, also reinforced that Section 330 does not grant the IRS authority over tax return preparers. In 2005, the head of the IRS Criminal Investigation Division testified to Congress that "[t]ax return preparers are not deemed as individuals who represent individuals before the IRS." *Loving*, slip op. at 15-16 (quoting *Fraud in Income Tax Return Preparation: Hearing Before the Subcommittee on Oversight of the House Committee on Ways and Means*, 109th Congress (2005) (testimony of Nancy J. Jardini) (internal quotation marks omitted)). And in 2009, the IRS issued a guidance document explaining that "[j]ust preparing a tax return . . . is not practice before the IRS." *Id.* at 16 (quoting Practice Before the IRS and Power of Attorney, IRS Publication 947, at 2 (April 2009) (internal quotation marks omitted)). The court acknowledged that the IRS is entitled to change its interpretation, assuming that it provides a reasonable explanation for its new interpretation and that its new interpretation is consistent with the statute. *Id.* But it concluded that the IRS's longstanding interpretation that Section 330 did *not* reach tax return preparers was instructive. As the court succinctly summed up, "[i]n light of the text, history, structure, and context of the statute, it becomes apparent that the IRS never before adopted its current interpretation for a reason: It is incorrect." *Id.* This consideration means that the IRS cannot lightly abandon its previous interpretation of Section 330, with respect to the proposed program. Instead, the IRS will have to acknowledge its new interpretation and provide an explanation for it. In light of *Loving*'s persuasive reasoning, that will likely be a difficult task.

A voluntary program would undermine each of the foregoing considerations, which were integral to the court's conclusion that the IRS lacks authority to regulate tax return preparers under Section 330. This, in turn, would create two separate problems for the IRS: It would make the IRS, in adopting the proposed program, appear to disobey *Loving*'s clear commands; and the IRS would likely struggle to formulate persuasive answers to each of these considerations. Both might lead a court to vacate the latest proposal, just as the court did in *Loving*. The IRS should not waste taxpayer money in pursuing a path with so many litigation risks.

C. The "Voluntary" Program Would Undermine Important Concerns Underlying *Loving*.

In addition, the IRS proposal would undermine two important concerns that animate the court's opinion in *Loving*. Although these concerns did not provide independent grounds for invalidating the regulations, the text of the opinion indicates that they were nonetheless important in shaping the court's decision.

First, the court noted that the IRS regulations unduly prevent taxpayers from choosing who prepares their taxes. For example, the court began its opinion by explaining that "[t]he federal income tax code is massive and complicated. So it is not surprising that many taxpayers hire someone else to help prepare their tax returns." *Id.* at 2. The court also noted that, if it accepted the IRS's interpretation, it would be approving a significant expansion of IRS jurisdiction over "hundreds of thousands of individuals in a multi-billion dollar tax-preparation industry" and explained that courts "should not lightly presume congressional intent to implicitly delegate decisions of major economic or political significance to agencies." *Id.* at 15. Together, these statements reflect an understanding that tax return preparers will incur additional costs to comply with the proposed program. Increased costs for tax return preparers will, in turn, inevitably result in increased prices for consumers who rely on tax return preparers to prepare their tax returns and will make it more difficult for taxpayers to find competent assistance in complying with a "massive and complicated" tax code.

A voluntary program would have similar effects because, as noted above, it would yield virtually indistinguishable results from the regulations invalidated by *Loving*. Given the importance of this issue to ordinary taxpayers and the likely effects of the IRS's proposed program, the IRS would have to confront this concern in any challenge to its purportedly voluntary program.

Second, in several places, the court emphasized the novelty of the IRS's approach toward Section 330. For example, in laying out the factual background of the case, the court noted that Section 330 was "[o]riginally passed by Congress and signed by President Chester A. Arthur." *Id.* at 3. It further explained that "[i]n the first 125 years after [Section 330's] enactment, the Executive Branch never interpreted the statute to authorize regulation of tax-return preparers." *Id.* at 2. Finally, the court explained that the IRS had likely never interpreted Section 330 to cover tax return preparers because the statute does not support that interpretation. *Id.* at 16.

The court's language underscores that a dramatically novel statutory interpretation is, all things being equal, more likely to be unlawful than a longstanding interpretation. *Cf. Talk Am. Inc. v. Mich. Bell Tel. Co.*, 131 S. Ct. 2254, 2263 (2011) ("And although the FCC concedes that it is advancing a novel interpretation of its longstanding interconnection regulations, novelty *alone* is not a reason to refuse deference." (emphasis added)). That inference is even stronger where, as is the case for Section 330, there are clear pronouncements from a federal agency foreswearing the very interpretation the agency now offers. *See Loving*, slip op. at 15-16. If the IRS reinstitutes similar or identical regulations to those invalidated in *Loving*, it will likely have to explain why, since the advent of the tax return preparer industry, it has never before offered the interpretation it offers now. Just as in *Loving*, that would prove challenging for the agency.

Any court reviewing the proposed program would also likely find these concerns to be significant. Together, they undercut the policy and legal foundations of the IRS's proposed program.

III. The IRS Must Comply With Procedural Requirements.

The IRS takes the view that it can implement its proposal without complying with the APA's notice and comment requirements. But the proposed program is a *de facto* rule that must be issued subject to notice and comment. In addition, the IRS also must comply with the Paperwork Reduction Act. Finally, the proposal almost certainly qualifies as a "significant regulatory action" that requires the IRS to perform a cost-benefit analysis of the proposed program and a cost-benefit analysis of reasonably feasible alternatives, and to obtain approval for the proposed program from OIRA.[2]

A. The IRS Must Comply With The APA's Notice And Comment Procedures.

Pursuant to 5 U.S.C. § 553(b), there are several exceptions to the APA's standard notice and comment requirements. As relevant here, an agency is not required to provide for notice and comment when issuing: (1) procedural rules; (2) interpretive rules; or (3) general statements of policy. *See* 5 U.S.C. § 553(b). Because the IRS proposal does not fit in any of these categories, the IRS must allow for notice and comment before implementing any voluntary program.

First, it is clear that the IRS proposal is not a procedural rule. In general, "a procedural rule does not itself alter the rights or interests of parties" but instead alters "the manner in which . . . parties present themselves or their viewpoints to the agency." *See Elec. Privacy Info. Ctr. v. Dep't of Homeland Sec.*, 653 F.3d 1, 5 (D.C. Cir. 2011) (internal quotation marks and citation omitted). The IRS's proposed program does not fit this description. The proposed program has no effect on the "manner in which . . . parties present themselves or their viewpoints to the agency." In addition, the IRS deliberations on the scope of the program have focused on the substantive policy merits of various approaches, which the D.C. Circuit has explained is a hallmark of a substantive rule. *Id.* at 6.

Second, it is clear that the IRS proposal is not an interpretive rule. Interpretive rules "advis[e] the public of [an agency's] current understanding" of its statutory mandate. *Id.* But the proposed program has never been presented as the IRS's effort to clarify its existing statutory authority. Rather, the proposed program has been cast as creating additional regulatory criteria applicable to tax return preparers.

Third, the IRS proposal is not a general statement of policy but rather a *de facto* rule that must be issued pursuant to notice and comment. *See Ctr. for Auto Safety v. Nat'l Highway Traffic Safety Admin.*, 452 F.3d 798, 806 (D.C. Cir. 2006). As the D.C. Circuit has acknowledged, the distinction between policy statements and *de facto* rules is not always clear. *See id.* at 807 (noting that "it is not always easy to distinguish" policy statements from *de facto*

[2] Separately, the IRS will inevitably incur costs in administering the proposed program. Those costs must be recouped, and it is unclear how the IRS will fund the proposed program. And for example, it may be that accepting payment from regulated parties in exchange for issuing a certificate is an impermissible conflict of interest. *See, e.g.*, Treasury Directive 61-09 (May 3, 2001).

rules). Under D.C. Circuit precedent, two lines of inquiry guide the analysis of whether an agency pronouncement is a policy statement or *de facto* rule.

The court must "consider[] the effects of an agency's action, inquiring whether the agency has (1) imposed any rights and obligations, or (2) genuinely left the agency and its decision makers free to exercise discretion." *Id.* at 806 (internal quotation marks, citation, and alteration omitted). The court also "looks to the agency's expressed intentions" as to whether a rule is voluntary or mandatory. *Id.* at 807. For guidance on this question, courts look to "(1) the agency's own characterization of the action; (2) whether the action was published in the Federal Register or the Code of Federal Regulations; and (3) whether the action has binding effects on private parties or on the agency." *Id.* (internal quotation marks, citation, and alterations omitted); *see also McLouth Steel Prods. Corp. v. Thomas*, 838 F.2d 1317, 1320 (D.C. Cir. 1988) (agency proposal is a general statement of policy if it is nonbinding and does not constrain the agency's discretion in approaching a problem).

Because the IRS must cast the proposed program as "voluntary" to avoid a direct conflict with *Loving*, the question is whether the proposal would for practical purposes impose binding obligations on tax return preparers. A purportedly nonbinding agency pronouncement is nonetheless a *de facto* rule that must be issued pursuant to notice and comment if it is "binding *as a practical matter*." *Gen. Elec. Co. v. EPA*, 290 F.3d 377, 383 (D.C. Cir. 2002) (emphasis added); *see Nat'l Ass'n of Home* Builders *v. Norton*, 415 F.3d 8, 15 (D.C. Cir. 2005).

To be sure, references in a single D.C. Circuit decision—*Center for Auto Safety v. National Highway Traffic Safety Administration*—suggest an agency pronouncement may not be a *de facto* rule simply because it provides an incentive for regulated parties to act in a certain way. *See Ctr. for Auto Safety*, 452 F.3d at 811. But the agency pronouncement in that case was quite different from the proposed program here. *Center for Auto Safety* did not deal with an agency pronouncement that created an overwhelming market incentive for regulated parties to comply. Instead, the policy statement in that case simply announced the agency's *likely* approach toward a particular issue. As the court explained, the policy statement did "not command[], require[], order[], or dictate[]" regulated parties to take any particular course of action. *Id.* at 809.

Further, the policy statement at issue in *Center for Auto Safety* did not bind the agency to the approach explained in the statement and as a result, regulated parties could not rely on the statement "as a norm or safe harbor by which to shape their actions." *Id.* (internal quotation marks omitted). Here, by contrast, the proposed program would impose hard-and-fast requirements on tax return preparers and would create two separate reliance interests: Tax return preparers who successfully complete the proposed program would be entitled to a certificate from the IRS and to special recognition in an IRS-sponsored database; and taxpayers searching for a competent tax return preparer would be entitled to rely on the IRS's representation that tax return preparers who complete the IRS's program are minimally qualified. In addition, the IRS will be required to award certificates to tax return preparers who successfully complete the proposed program. The proposed program thus limits the IRS's discretion, which also indicates that the proposed program is a binding rule. *See McLouth Steel Prods. Corp.*, 838 F.2d at 1320.

Moreover, *Center for Auto Safety* itself also recognized that a purportedly nonbinding pronouncement is nonetheless a *de facto* rule if an agency pronouncement is "binding as a practical matter." 452 F.3d at 809.[3]

Finally, the entire concept of a *de facto* rule would be void if a court could not consider practical effects when considering if a purportedly nonbinding agency pronouncement is in fact binding. If an agency could manipulate market incentives such that it did not have to issue legally binding rules, agencies would easily be able to avoid the notice and comment procedures fundamental to the APA.

For all these reasons, the IRS will confront significant hurdles in seeking to argue that its proposal is merely a policy statement. As a result, the IRS cannot avoid the APA's notice and comment requirements and any attempt to do so could lead to challenges that would further delay implementation of the proposed program. Notably, even if the IRS (incorrectly) believes it has legal authority to act, the IRS would benefit from the public comment process.

B. The IRS Must Comply With The Paperwork Reduction Act And With Executive Order 12,866.

The IRS must comply with the Paperwork Reduction Act, which requires the IRS to obtain approval from the Director of OMB before collecting information such as that needed to verify a tax return preparer's qualifications. *See* 44 U.S.C. §§ 3501(1), 3507(a)(2). The Act requires the Director of OMB to provide for a 30-day comment period so that interested parties may submit comments regarding whether it is appropriate for the IRS to seek information from tax return preparers. Failure to comply with the Act might lead a court to remand the proposal, which would further delay implementation of any program.

In addition, it is likely that the IRS must obtain OIRA approval before issuing the proposed program. Under Executive Order 12,866, federal agencies must obtain OIRA approval before issuing "a significant regulatory action"—a rule that has "an annual effect on the economy of $100 million or more." Exec. Order No. 12,866, § 3(f)(1) (Sept. 30, 1993). As part of that process, agencies must provide OIRA with a cost-benefit analysis of the proposed action, including a cost-benefit analysis of reasonably feasible alternatives. *See id.* § 6(a)(3)(B)-(C).

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[3] The Transportation Committee of the House of Representatives has recently expressed skepticism about a National Highway Traffic Safety Administration ("NHTSA") program in which motorists are asked to provide breath and saliva samples to agency officials on a voluntary and anonymous basis in order to determine the number of people who are impaired while driving. Members expressed concerns that although motorists have a right to refuse to provide these samples they would nonetheless feel compelled to participate. *See House Panel To Investigate Roadside Surveys*, ASSOCIATED PRESS (Mar. 6, 2014), *available at* http://bigstory.ap.org/article/us-house-committee-looking-roadside-survey. The substantive issues involved in the IRS's proposed program are different from those implicated by the NHTSA program, but the idea of the IRS promulgating a "voluntary" program in this context will also prompt skepticism.

The tax return preparer industry generates more than $9 billion per year. *See* Patrick Temple-West, *Appeals Court Quashes IRS Tax-Return Preparer Crackdown*, REUTERS (Feb. 11, 2014), http://www.reuters.com/article/2014/02/11/us-usa-tax-preparers-idUSBREA1A1CT20140211; *see also* U.S. Internal Revenue Serv., Internal Revenue Service Return Preparer Review, at 7 (2009) (noting that the tax return preparer industry "is a multibillion dollar industry"), *available at* http://www.irs.gov/pub/irs-utl/54419l09.pdf. Because the proposed program would have a profound effect on a multibillion dollar industry, it would likely have an annual economic effect of greater than $100 million and would require the IRS to comply with each element of the OIRA process.

The IRS appears not to have considered these requirements, although it did so in connection with the original rulemaking. *See* 76 Fed. Reg. 32,286, 32,293 (June 3, 2011) ("This rule has been designated a 'significant regulatory action' under section 3(f) of Executive Order 12866, inasmuch as it may adversely affect in a material way the economy, a sector of the economy, productivity, competition, or jobs. Accordingly, the rule has been reviewed by the Office of Management and Budget."); *id.* at 32,286 ("The collection of information contained in these regulations was previously reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995.").

IV. The Proposal Is Arbitrary And Capricious.

Regardless of whether the IRS is required to issue its proposal through notice and comment, the IRS must comply with the APA's substantive requirements. *See Ctr. for Auto Safety*, 452 F.3d at 807 ("[I]f the NHTSA applies the 1998 policy guidelines in a particular situation, it must be prepared to support the policy. An agency cannot escape its responsibility to present evidence and reasoning supporting its substantive rules by announcing binding precedent in the form of a general statement of policy." (internal quotation marks and citation omitted)). The proposed program, as currently formulated, is arbitrary and capricious because it "entirely fail[s] to consider an important aspect of the problem[s]" related to tax return preparers and "runs counter to the evidence before the agency." *State Farm*, 463 U.S. at 43. Further, the IRS has not sufficiently considered "reasonably obvious alternative rules." *Walter O. Boswell Mem'l Hosp. v. Heckler*, 749 F.2d 788, 797 (D.C. Cir. 1984); *see also Int'l Ladies' Garment Workers' Union v. Donovan*, 722 F.2d 795, 815, 817 (D.C. Cir. 1983) ("It is absolutely clear from decisions by the Supreme Court and this court that . . . an artificial narrowing of options is antithetical to reasoned decision making and cannot be upheld." (internal quotation marks and citation omitted)).

First, a voluntary program would not address the problem of unethical or fraudulent tax return preparers. As members of an established profession with a tradition of effective self-regulation and that is subject to extensive external regulation—by the IRS, states, and others—AICPA members appreciate the value of regulatory oversight, and are concerned by the policy problems related to unregulated tax return preparers under current regulations. These unethical tax return preparers misrepresent their credentials. If they do a poor job completing a return, it is ultimately the taxpayer who must repay the IRS with interest for any outstanding taxes. But tax return preparers who might deceive the public in order to win business are likely the only group of tax return preparers who will resist the competitive pressure to participate in the proposed program because they alone have a countervailing incentive: to avoid increased IRS scrutiny. Thus, the proposed program will fail to solve the most egregious abuses occurring within the tax return preparation industry. Moreover, the fact that these unethical tax return preparers do not participate will put increased pressure on honest tax return preparers to participate, as a way of distinguishing themselves from unethical tax return preparers. The IRS cannot simply ignore this issue and its decision to do so is grounds for vacating the program. *See State Farm*, 463 U.S. at 43 (noting that agency action is arbitrary and capricious if it "entirely fail[s] to consider an important aspect of the problem").

Second, as you acknowledge in your June 6 letter, a voluntary program could give rise to confusion among consumers. Consumers will likely be unable to distinguish the precise differences between tax return preparers' qualifications if the IRS adopts the proposed "certification" requirement; confusion between the different types of preparers will become pronounced. There will be a tremendous challenge in explaining to taxpayers, as consumers, the difference between individuals with a preparer tax identification number ("PTIN"), those preparers who are authorized ("enrolled") to prepare returns and represent clients before the IRS, and individuals who have availed themselves of the voluntary regime. This marketplace confusion will be even more pronounced because the IRS has been referring to the proposed program as an "annual filing season certification" and public statements by high ranking IRS officials have made reference to the term "certification" and variations of the term. Indeed, Circular 230 prohibits the use of "a misleading or deceptive statement or claim" and prohibits the use of the term "certified." Moreover, most consumers will likely conclude that the IRS has endorsed tax return preparers who have participated in the proposed program. Not only is it wholly inappropriate for the IRS to endorse particular tax return preparers—a group they are charged with regulating—consumers will become frustrated if there are problems with their tax returns prepared by someone they thought was endorsed by the IRS. The IRS should not affect consumer choice in this way.

Third, the IRS has not sufficiently considered alternative methods of ensuring that tax return preparers are qualified and competent. We have sought to work with the IRS to achieve workable solutions and we stand ready to continue an effort to identify alternatives that fit within the IRS's authority. The IRS has an array of penalties it can levy against such tax return preparers, including civil penalties for understatements due to reckless or willful conduct, *see* 26 U.S.C. § 6694; civil penalties for failure to sign a return or place a PTIN number on a return, *see id.* § 6695; civil penalties for aiding or abetting understatements, *see id.* § 6701; civil penalties for disclosing or using taxpayer information obtained by preparing a return, *see id.* § 6713; criminal penalties for willfully aiding or abetting preparation of a fraudulent return, *see id.* § 7206; and obtaining an injunction prohibiting certain individuals from serving as tax return preparers, *see id.* § 7407.

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In sum, it is essential that any regulatory approach instituted by the IRS to address this issue has a firm legal basis and reflects sound policy. For the reasons outlined above, we believe that the proposed program is unlawful and improper. We continue to believe that additional regulation of tax return preparers might yield significant benefits and that the IRS can achieve these objectives while remaining consistent with *Loving* and other statutory limitations on the IRS's authority.

Sincerely,

William E. Balhoff, CPA, CGMA, CFF
AICPA, Chairman of the Board of Directors

Barry C. Melancon, CPA, CGMA
AICPA, President & CEO

cc: The House Committee on Ways and Means
The Senate Committee on Finance
Christopher J. Meade, General Counsel, Department of the Treasury
Brian Deese, Acting Director, OMB
Howard Shelanski, Director, OIRA