Office of Chief Counsel
Internal Revenue Service
memorandum

date: August 7, 2017

to: Nina E. Olson
National Taxpayer Advocate

from: Susan L. Hartford
Technical Advisor to the Special Counsel
(National Taxpayer Advocate)

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subject: Advice You Requested from CC:PA

Attached is the advice you asked Michael Baillif to work with me in obtaining from CC:PA regarding the representation arrangements with [redacted]. Please let me know if you have any questions.

cc: Michael Baillif

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:PA:02:MABond
PRENO-117473-17

date: July 19, 2017

to: Susan L. Hartford
Technical Advisor to the Special Counsel
National Taxpayer Advocate

from: Melissa A. Henkel
Senior Technician Reviewer, Branch 2
Procedure & Administration

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subject: Concerns Regarding Tax Return Preparation for the [redacted]

This memorandum responds to your request for assistance dated May 30, 2017. This memorandum may not be used or cited as precedent.

ISSUES

[redacted]

SUMMARY CONCLUSIONS

[redacted]

[redacted]

FACTS

[redacted]

[redacted]

LAW AND ANALYSIS

[redacted]

Section 6061 provides in relevant part that "any return, statement, or other document required to be made under any provision of the internal revenue laws or regulations shall be signed in accordance with forms or regulations prescribed by the Secretary."

Treas. Reg. § 1.6061-1(a) in turn provides that "[e]ach individual (including a fiduciary) shall sign the income tax return required to be made by him, except that the return may be signed for the taxpayer by an agent who is duly authorized in accordance with paragraph (a)(5) or (b) of § 1.6012-1 to make such return." Treas. Reg. § 1.6012-1(a)(5) applies to returns of U.S. citizens and residents and Treas. Reg. § 1.6012-1(b) applies to returns of nonresident alien individuals.

Treas. Reg. § 1.6012-1(a)(5) allows agents to make a return for a U.S. citizen or resident if the taxpayer: (1) is unable to make the return due to disease or injury; (2) is unable to make the return by reason of continuous absence from the United States for a period of at least 60 days before the return is due; or (3) requests permission, in writing, from the area director and the area director determines that there is good cause for permission to be granted. The return must include a power of attorney, such as a Form 2848, specifically authorizing the agent to make, execute, or file the return.

Treas. Reg. § 1.6012-1(b)(3)(ii) allows an agent to make a return for a nonresident alien individual if the agent has a power of attorney, such as a Form 2848, that specifically authorizes the agent to represent the taxpayer in making, executing, and filing the return. The return must include the power of attorney.

[redacted]

[redacted]

Section 6695(f)

Section 6695(f) provides:

> Any person who is a tax return preparer who endorses or otherwise negotiates (directly or through an agent) any check made in respect of the taxes imposed by this title which is issued to a taxpayer (other than the tax return preparer) shall pay a penalty of $500 with respect to each such check. The preceding sentence shall not apply with respect to the deposit by a bank (within the meaning of section 581) of the full amount of the check in the taxpayer's account in such bank for the benefit of the taxpayer.

The $500 amount is subject to inflation under section 6695(h). Treas. Reg. § 1.6695-1(f) clarifies that "check" includes an "electronic version of a check."

Section 6695(f) was added by the Tax Reform Act of 1976 (P.L. 94-455), section 1203(f). The Senate Finance Committee stated that the penalty was to apply to both illegal endorsements and negotiations and legal transactions, such as "where a return preparer endorses or negotiates a check issued to another taxpayer (for example, by reason of a power of attorney or because of a specific or bearer endorsement by the taxpayer)." S. Rep. 94-938, 358, 1976 U.S.C.C.A.N. 3438, 3787.

Section 7701(a)(36) defines "tax return preparer" as "any person who prepares for compensation, or who employs one or more persons to prepare for compensation, any return of tax imposed by this title or any claim for refund of tax imposed by this title." A person is not, however, considered a tax return preparer merely because the person "furnishes typing, reproducing, or other mechanical assistance." I.R.C. § 7701(a)(36)(B)(i).

[redacted]

Treas. Reg. § 301.7701-15(a) further provides that a "tax return preparer is any person who prepares for compensation, or who employs one or more persons to prepare for compensation, all or a substantial portion of any return of tax or any claim for refund of tax under the Internal Revenue Code (Code)."[4]

Neither the Code, the regulations, nor case law provides a precise definition of "employs" under section 7701(a)(36). For federal employment tax purposes, an individual is an employee if the individual has the status of an employee under the usual common law rules applicable in determining the employer-employee relationship.

The question of whether an individual is an employee under the common law rules or an independent contractor is one of fact to be determined upon consideration of the facts and the application of the law in a particular case. Guidance for determining that status is found in three substantially similar sections of the applicable Employment Tax Regulations: Treas. Reg. § 31.3121(d)-1 relating to the Federal Insurance Contributions Act, Treas. Reg. § 31.3306(i)-1 relating to the Federal Unemployment Tax Act, and Treas. Reg. § 31.3401(c)-1 relating to federal income tax withholding.

Treas. Reg. § 31.3121(d)-1(c)(2) of the Employment Tax Regulations provides that, generally, the relationship of employer-employee exists when the person for whom the services are performed has the right to direct and control the individual who performs the services not only as to the result to be accomplished by the work, but also as to the details and means by which that result is accomplished. It is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he or she has the right to do so.

Treas. Reg. § 31.3121(d)-1(a)(3) of the Employment Tax Regulations provides that if the relationship of an employer and employee exists, the designation or description of the relationship by the parties as anything other than that of employer and employee is immaterial. Thus, if an employer-employee relationship exists, it is of no consequence that the employee is designated as partner, co-adventurer, agent, or independent contractor or the like.

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[4] Note that from first publication on November 17, 1977, through December 21, 2008, the regulations included the parenthetical "(or engages)" as follows: "An income tax return preparer is any person who prepares for compensation, or who employs (or engages) one or more persons to prepare for compensation, other than for the person, all or a substantial portion of any return of tax under subtitle A of the Internal Revenue Code of 1954 or of any claim for refund of tax under subtitle A of the Internal Revenue Code of 1954. ..." Consistent with this rule, it was possible for a party to be considered a tax return preparer where that party did not prepare tax returns in the party's own capacity or employ another to do so, but merely used the services of another party in preparing tax returns. For example, in Rev. Rul. 81-246, 1981-2 C.B. 249, the IRS found that where *B* asserted control over the policies, procedures, and standards relating to the operations of *C*'s tax return preparation business, and *B* provided assistance in resolving problems concerning return preparation, *C* was "considered engaged by *B* for the purpose of preparing income tax returns for compensation within the meaning of section 301.7701-15(a)" and *B* was held to be an income tax return preparer with respect to the returns prepared by *C*'s employees, even though the ruling made no finding of employment by *B* of *C*.

In determining whether an individual is an employee or an independent contractor under the common law, all evidence of both control and lack of control or autonomy must be considered. In doing so, one must examine the relationship of the worker and the business. Relevant facts generally fall into three categories: (1) behavioral controls, (2) financial controls, and (3) the relationship of the parties.

Behavioral controls are evidenced by facts which illustrate whether the service recipient has a right to direct or control how the worker performs the specific tasks for which he or she is hired. Facts which illustrate whether there is a right to control how a worker performs a task include the provision of training, the issuance of instruction, or the completion of an evaluation.

Financial controls are evidenced by facts which illustrate whether the service recipient has a right to direct or control the financial aspects of the worker's activities. These factors include the method of payment, the worker's opportunity for profit or loss, and whether a worker has made a significant investment, incurs unreimbursed expenses, or makes services available to the relevant market.

The relationship of the parties is generally evidenced by the parties' agreements and actions with respect to each other, including facts which show not only how they perceive their own relationship but also how they represent their relationship to others. Facts which illustrate how the parties perceive their relationship include the intent of the parties as expressed in written contracts, the provision of or lack of employee benefits, the right of the parties to terminate the relationship, the permanency of the relationship, and whether the services performed are part of the service recipient's regular business activities.

[redacted] First, in United States v. ITS Financial, LLC the Sixth Circuit held that a loan processor and refund transfer processor, which was wholly-owned by the same individual who owned a tax preparation entity but was not involved with the tax returns at issue until after the returns had been filed, was not a tax return preparer and therefore not subject to penalty under section 6695(f). 592 Fed. Appx. 387, 401-402 (6th Cir. 2014) (stating that "An entity that merely processes return payments is not a tax return preparer.").

Second, in United States v. Elsass, the District Court for the Southern District of Ohio addressed whether an individual (Elsass), Elsass' wholly-owned entity (FRG), and FRG's wholly-owned entity (STS) were tax return preparers within the meaning of section 7701(a)(36). 978 F. Supp. 2d 901 (S.D. Ohio 2013), aff'd, 769 F.3d 390 (6th Cir. 2014). Elsass, FRG, and STS operated a business assisting taxpayers claim tax refunds through tax deductions for questionable theft losses under section 165, and the United States brought suit to enjoin the defendants from providing certain services based on frequent violations of the tax laws. Id. at 906. In determining whether Elsass,

FRG, and STS were tax return preparers, the court first determined that returns were signed by Elsass or listed FRG or STS as the firm of the tax return preparer. Id. at 910. The court did not, however, stop there in its section 7701(a)(36) analysis.[5] The court described both Elsass and FRG as "the moving force" behind prepared returns, and pointed to instructions provided by them for how to complete amended returns. Id. Additionally, it noted that as claimed on FRG's website, "one of the services provided to customers was '[a]ssistance in preparation and submission of all necessary forms and supporting documentation.'" Id. at 911. The court noted Elsass' overseeing of the individuals employed by STS as well as of outside tax preparers. Id. Significantly, the court noted that

> [T]he statutory definition of tax return preparer is broadly written to include those who "employ" others to prepare tax returns. Elsass and FRG accordingly can be considered tax return preparers by virtue of the fact that they currently hire entities to complete amended tax returns for FRG's customers for a fee. Aside from the actual direction as to how tax forms should be completed and the retention of others to process forms, the Court also looks to the "upfront" research work done by FRG and Elsass identifying scams that may qualify for theft-loss treatment. ... As the information gathered through that research is ultimately used in supporting the customers' individual theft-loss deductions, the Court considers this a significant factor in concluding that FRG and Elsass are tax return preparers.

Id. Finally, the court noted the import of revenue to FRG through customers' tax refunds and FRG's ability to make material decisions regarding the tax returns as being relevant to the determination of whether FRG was a tax return preparer. Citing a Seventh Circuit opinion, the court stated that Congress intended the definition of tax return preparer to include those parties contributing to material decisions regarding tax returns. Id.

Section 601.504(a)(5) of the Conference and Practice Requirements, *Check drawn on the United States Treasury*, provides in relevant part:

> The authority to receive (but not endorse or collect) a check drawn on the United States Treasury must be specifically granted in a power of attorney. (The endorsement and payment of a check drawn on the United States Treasury are governed by Treasury Department Circular No. 21, as amended, 31 Part [sic] CFR [Part] 240.) Endorsement of such check by any person other than the payee must be made under one of the special types of powers of attorney prescribed by Circular No. 21, as amended, (31 CFR Part 240).

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[5] The court's analysis regarding whether Elsass, FRG, and STS are return preparers is arguably dictum after it determined that each had signed returns or been listed as the firm employing the signer.

Appendix A to Part 240, Subchapter A, Chapter II, Subtitle B, Title 31, of the Code of Federal Regulations, *Optional Forms for Powers of Attorney and Their Application*, describes a "Fiscal Service Form 231—General Power of Attorney (Individual)." The appendix provides that "[t]his general power of attorney form may be executed by an individual, unincorporated partnership, or sole owner, for checks drawn on the United States Treasury, in payment: (1) For redemption of currencies or for principal or interest on U.S. securities; (2) for tax refunds; and (3) for goods and services." (Emphasis added.)

[redacted]

[redacted]

[redacted]

Circular 230

[redacted]

[redacted]

Receipt vs. Negotiation

It is well established that a taxpayer may legitimately designate a representative or other third party to receive (for the taxpayer) a tax-refund check payable to the taxpayer. See 26 C.F.R. § 601.506(c)(1) ("A check drawn on the United States Treasury (e.g., a check in payment of refund of internal revenue taxes, penalties, or interest, . . .) will be mailed to the recognized representative of a taxpayer provided that a power of attorney is filed containing specific authorization for this to be done."); accord Treas. Reg. § 301.6402-2(f)(1) ("Checks in payment of claims allowed will be drawn in the names of the persons entitled to the money and . . . the checks may be sent direct to the claimant or to such person in care of an attorney or agent who has filed a power of attorney specifically authorizing him to receive such checks."). But see Rev. Proc. 81-38 § 5.02 (specifying that "the following acts on behalf of the taxpayer are beyond the scope of authority permitted an unenrolled preparer: . . . (b) Receiving checks in payment of any refund of Internal Revenue taxes, penalties, or interest"), superseded by Rev. Proc. 2014-42 (supersession effective for tax returns and claims for refund prepared and signed after Dec. 31, 2015).

While it is or may be common for a tax professional who assisted a taxpayer in obtaining an income or other tax refund to act as essentially a temporary custodian of a refund check on behalf of the client, the act of negotiation or endorsement is out of bounds, as is electronic payment (direct deposit) of the refund into the representative's account, regardless of the taxpayer's consent or agreement.

Circular 230 Rule

Section 10.31(a) of Circular 230 prohibits a Circular 230 practitioner from engaging in such conduct:

> A practitioner may not endorse or otherwise negotiate any check (including directing or accepting payment by any means, electronic or otherwise, into an account owned or controlled by the practitioner or any firm or other entity with whom the practitioner is associated) issued to a client by the government in respect of a Federal tax liability.

The provision was broadened in 2014, beyond tax return preparation and to explicitly include electronic payments. The prior version, adopted in 2002, read: "A practitioner who prepares tax returns may not endorse or otherwise negotiate any check issued to a client by the government in respect of a Federal tax liability."

For what it may be worth, the Service and Treasury characterized the 2014 changes as being in the nature of a clarification, at least as to electronic payments, possibly

suggesting that the section already applied to these payments (consistent with the section 6695(f) regulations, which have referred to a "check" as "including an electronic version of a check," since 2008). According to the explanation of provisions in the preamble to the NPRM:

> Treasury and the IRS are proposing to revise § 10.31 to clarify that the prohibition on practitioner negotiation of taxpayer refunds applies in the modern-day electronic environment in which the IRS and practitioners operate today. The proposed regulations also expand § 10.31 to apply to all individuals who practice before the IRS, not just those practitioners who are tax return preparers. Treasury and the IRS continue to encounter a small number of unscrupulous preparers and practitioners who attempt to manipulate the electronic refund process with the intent to defraud their clients and the IRS. The proposed regulations clarify that it constitutes disreputable conduct for a practitioner to direct the payment (or accept payment) of any monies issued to a client by the government in respect of a Federal tax liability to the practitioner or any firm or entity with which the practitioner is associated and that such conduct is subject to sanction.

77 Fed. Reg. 57055, 57059 (Sep. 17, 2012).

The "Summary of Comments and Explanation of Revisions" to the final regulations was similar in tone:

> This prohibition on practitioner negotiation of taxpayer refunds is intended to provide guidance in the modern-day electronic environment in which practitioners, taxpayers, and the IRS operate. Proposed and final § 10.31 also amend former § 10.31 to apply to all individuals who practice as representatives of persons before the IRS, not just those practitioners who are tax return preparers.

T.D. 9668, 79 Fed. Reg. 33685, 33690-91 (Jun. 12, 2014) (section titled, "IV. Electronic Negotiation of Taxpayer Refunds"). Further, the drafters found in their review of the public comments, "Most commenters on the proposed regulations agreed with Treasury and the IRS that these revisions to § 10.31 are an appropriate standard for all practitioners as well as a necessary step in protecting taxpayers in today's electronic commerce environment." Id. at 33691.

For purposes of analyzing the highly particular situation you have asked about, it is worth taking careful note of the precise terms of the whole parenthetical addition that was adopted in 2014 (emphasis added), i.e.: "including directing or accepting payment by any means, electronic or otherwise, into an account owned or controlled by the practitioner or any firm or other entity with whom the practitioner is associated . . . ." An employer-employee relationship is not a necessary element to the provision or a

violation thereof.[8]

Application to the [redacted]

[redacted]

[redacted]

[8] On the other hand, the 2014 final regulations briefly addressed one commentator's concern that section 10.31 as revised prohibited "certain arrangements" allowable under the section 6695(f) regulations when entered into "between a 'tax return preparer-bank' and a taxpayer." 77 Fed. Reg. at 33691. The comment was resolved with this response: "Treasury and the IRS do not believe that the rule in proposed § 10.31 prohibits the arrangements described in the section 6695 regulations or any arrangement that is not subject to the penalty under the [sic] section 6695(f), and therefore no change to finalized § 10.31 was made in this regard." Id.

[9] Notwithstanding the Loving decision's invalidation of the RTRP provisions in Circular 230, the court's decision did not undo the treatment of a paid unenrolled return preparer as a category of "recognized representative" in the Conference and Practice Requirements (Subpart E) of the Statement of Procedural Rules (26 C.F.R. §§ 601.501(b)(12), 601.502(b)(5)(iii)). See Loving v. IRS, 742 F.3d 1013 (D.C. Cir. 2014). By signing Part II of Form 2848, the Declaration of Representative, an unenrolled return preparer necessarily declares that the representative is "aware of the regulations contained in Treasury Department Circular No. 230 (31 C.F.R., part 10), concerning the practice of attorneys, certified public accountants, enrolled agents, enrolled actuaries, and others)" (§ 601.502(c)(2)).

[redacted]

[redacted]

Two of the fundamental components of the prohibition in section 10.31 are (1) that a payment is "issued to a client" of a practitioner and (2) the practitioner's actions constitute "directing or accepting payment . . . into an account owned or controlled by the practitioner or any firm or other entity with whom the practitioner is associated." [redacted]

[redacted]

To be sanctionable, however, a violation of section 10.31 must be willful (see sections 10.50(a), 10.52(a)(1)). [redacted]

[redacted]

[redacted]

[redacted]

[redacted] Line 5a of the Form 2848 provides a check box whereby a taxpayer may authorize a representative to sign a return, which would include an original income tax return that contained a claim for refund. The Service, however, will make any refund check (or electronic funds transfer) payable only [redacted]. Treas. Reg. § 301.6402-2(f) provides that checks in payment of allowed claims will be drawn in the names of the persons entitled to the money; and, except for checks in payment of claims that have either been reduced to judgment or settled in the course or as a result of litigation, the checks may be sent either directly to the claimant or to such person in care of an attorney or agent who has filed a power of attorney specifically authorizing him to receive such checks. The Service will mail the refund check to the authorized representative if the Form 2848 specifically authorizes the representative to receive refund checks (but not to endorse or cash it) as provided on Line 5a of Form 2848. See also 26 C.F.R. § 601.504(a)(5) (Conference and Practice Requirements). [redacted]

[redacted] Treas. Reg. § 301.6402-2(f)(3) points out the restriction on the assignment of claims and references section 3477 of the Revised Statutes (31 U.S.C. § 203) (which is now at 31 U.S.C. § 3727), otherwise known as the Anti-Assignment Act. Under the Anti-Assignment Act, in order for an assignment of a claim against the United States to be valid, at the time of assignment: (1) the claim must be allowed, (2) the amount of the claim decided, and (3) a warrant for payment must have issued. 31 U.S.C. § 3727(b). An "assignment" for purposes of the Anti-Assignment Act means—

> (1) a transfer or assignment of any part of a claim against the U.S. Government or of an interest in the claim; or
> (2) the authorization to receive payment for any part of the claim.

31 U.S.C. § 3727(a). See IRM 4.4.3.2 (09-16-2011) *Transferring Payments and Credits*

Between Related Taxpayers, for an example of a valid assignment. See also IRC § 6422 which lists cross references for Chapter 65, *Abatements, Credits, and Refunds*, and provides at (8): "For restrictions on transfers and assignments of claims against the United States, see section 3727 of Title 31, United States Code." See Atlas Hotels, Inc. v. U.S., 140 F.3d 1245, 1247 (9th Cir. 1998) (The purported assignment of the right to the refund was void as against the United States because it did not comply with the requirements of the Assignment of Claims Act); Rev. Rul. 86-55 at Issue 3. [redacted]

[redacted]