Proposed Regs on Contingent Fees Incorporate Interim Guidance

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Summary by taxanalysts

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After final regulations on contingent fees were adopted in 2007 under Circular 230 section 10.27, practitioners raised questions about application of the rules, including to section 7623 whistle-blower claims. Notice 2008-43 clarified that receipt of a written notice from the agency challenging the original tax return was not a prerequisite to charging contingent fees and that contingent fees could be charged for whistle-blower claims. (For Notice 2008-43, 2008-15 IRB 748, see *Doc 2008-6665* [PDF] or *2008 TNT 60-6* .)

The proposed regs adopt the interim guidance as the standards for contingent fees and would continue to preclude practitioners from charging contingent fees except in matters relating to an original or amended tax return filed within 120 days of receiving an exam notice, as well as in cases involving interest and penalty reviews and for whistle-blower claims. (For the proposed regs (REG-113289-08), see *Doc 2009-16918* [PDF].)

The proposed regs also clarify the definition of what constitutes a contingent fee to exclude nontax contingencies -- such as transaction closings -- on the rationale that they "do not present the same concerns posed by tax-related contingent fees." The new definition "includes, but is not limited to, any fee that depends on the specific tax result obtained in any given transaction." The resulting definition focuses on percentage-based fees from refunds or tax savings, and on all other instances of attaining specific tax results.

Practitioners generally approved of the proposed regs. "Allowing contingent fees for tax whistle-blower cases is completely consistent with the spirit of the overall ban," said Gregory Lynam of the Ferraro Law Firm. "Here, the actions of the taxpayer are fixed, and there is no incentive for a tax practitioner to help a taxpayer take an aggressive position. It was our belief that the old rules would also allow a contingent fee in a whistle-blower case because it was work involving an already filed return."

Bryan Skarlatos of Kostelanetz & Fink LLP said the proposed regulations strike a "proper balance between the need to prohibit taxpayers and practitioners from playing the audit lottery,

and the need to provide taxpayers with access to professional representation in situations where they may not otherwise be able to afford such representation." For example, in whistle-blower cases, he said, the claimant's representative must engage in a substantial amount of work preparing the claim in the uncertain hope of securing a future reward. Absent contingent fees, some whistle-blowers would be unable to make claims because of the substantial professional fees involved, he said.

"Ensuring that taxpayers have access to adequate professional representation in all cases is important -- not only to those taxpayers who could not otherwise afford such representation, but also to the tax system in general," Skarlatos said.

But a potential spoiler to the IRS's contingent fee approach lurks in a proposed bill the Senate is considering, Skarlatos noted. Section 304 of the Stop Tax Haven Abuse Act (S. 506, H.R. 1265) would penalize anyone who charges a contingent fee in tax matters and makes no exception for situations involving IRS challenges to a return, claims for credit or refund of interest or penalties, whistle-blower cases, or judicial proceedings, he said. (For prior coverage, see *Doc 2009-4641* [**PDF**] or *2009 TNT 41-4*. For S. 506, see *Doc 2009-4588* [**PDF**] or *2009 TNT 39-28*. For H.R. 1265, see *Doc 2009-4580* [**PDF**] or *2009 TNT 39-29*.)

"The bill is much more broad and would upset the balance achieved by the proposed regulations," Skarlatos said.

Tax Analysts Information

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