

Preparer Penalties & Due Diligence
by

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Preparer Penalties and Due Diligence Objectives

Upon completion of this class you will:

Understand the various preparer penalties

Understand your duties for due diligence in the preparation of returns and other documents submitted to the IRS

Understand the concepts of substantial authority, realistic possibility and reasonable basis.

Table of Contents

Preparer Penalties & Due Diligence

Preparer Penalties & Due Diligence	1
Overview - Abusive Return Preparer	1
Abusive Preparer Prosecutions	1
Audits of 30 Clients.....	2
Promotion of Form to Report Abusive Preparers.....	2
Exhibits.....	5-82

Preparer Penalties & Due Diligence

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Overview - Abusive Return Preparer

1.10 The IRS continues to expand and enhance its abusive preparer program. The program was developed to enhance compliance in the return-preparer community by engaging in enforcement actions and/or asserting appropriate civil penalties against unscrupulous or incompetent return preparers. Bad preparers are a significant problem for both the IRS and taxpayers.

Return preparer fraud involves the preparation and filing of false income tax returns by preparers who claim inflated personal or business expenses, false deductions, unallowable credits or excessive exemptions on returns prepared for their clients. This includes inflated requests for the special one-time refund of the long-distance telephone tax. Preparers may also manipulate income figures to obtain tax credits, such as the Earned Income Tax Credit, fraudulently.

Abusive Preparer Prosecutions

1.20

	FY 2014	FY 2013	FY 2012
Investigations Initiated	305	309	443
Prosecution Recommendations	261	281	276
Indictments/Informations	230	233	202
Convictions	193	207	178
Sentenced	183	186	172
Incarceration Rate*	86.3%	78.0%	84.3%
Average Months to Serve	28	27	29

Audits of 30 Clients

1.30 Another aspect of the IRS preparer program is identifying suspect preparers and audited their clients. If during an examination a revenue agent suspects that some deficiencies on a return were caused by the preparer he/she can refer the matter to an area coordinator. After review the coordinator can initiate a project on the preparer. The preparer is sent a letter notifying her that she has been selected for a project and 30 of her client's returns are audited. If significant deficiencies are found then the IRS may choose one of several courses of action including:

- Referral to Criminal investigation
- Referral to the office of professional liability
- Preparer penalties
- Referral to Department of justice to seek an injunction ordering the preparer to cease filing tax returns.

Promotion of Form to Report Abusive Preparers

1.40 The IRS website now directs taxpayers and others who spot abusive preparers to file Form 3949-A with the Service.

Summary of Preparer Penalties under Title 26

IRC § 6694 – Understatement of taxpayer's liability by tax return preparer.

IRC § 6694(a) – Understatement due to unreasonable positions. The penalty is the greater of \$1,000 or 50% of the income derived by the tax return preparer with respect to the return or claim for refund.

IRC § 6694(b) – Understatement due to willful or reckless conduct. The penalty is the greater of \$5,000 or 50% of the income derived by the tax return preparer with respect to the return or claim for refund.

IRC § 6695 – Other assessable penalties with respect to the preparation of tax returns for other persons.

IRC § 6695(a) – Failure to furnish copy to taxpayer. The penalty is \$50 for each failure to comply with IRC § 6107 regarding furnishing a copy of a return or claim to a taxpayer. The maximum penalty imposed on any tax return preparer shall not exceed \$25,000 in a calendar year.

IRC § 6695(b) – Failure to sign return. The penalty is \$50 for each failure to sign a return or claim for refund as required by regulations. The maximum penalty imposed on any tax return preparer shall not exceed \$25,000 in a calendar year.

IRC § 6695(c) – Failure to furnish identifying number. The penalty is \$50 for each failure to comply with IRC § 6109(a)(4) regarding furnishing an identifying number on a return or claim. The maximum penalty imposed on any tax return preparer shall not exceed \$25,000 in a calendar year.

IRC § 6695(d) – Failure to retain copy or list. The penalty is \$50 for each failure to comply with IRC § 6107(b) regarding retaining a copy or list of a return or claim. The maximum penalty imposed on any tax return preparer shall not exceed \$25,000 in a return period.

IRC § 6695(e) – Failure to file correct information returns. The penalty is \$50 for each failure to comply with IRC § 6060. The maximum penalty imposed on any tax return preparer shall not exceed \$25,000 in a return period.

IRC § 6695(f) – Negotiation of check. The penalty is \$500 for a tax return preparer who endorses or negotiates any check made in respect of taxes imposed by Title 26 which is issued to a taxpayer.

IRC § 6695(g) – Failure to be diligent in determining eligibility for earned income credit. The penalty is \$500 for each failure to comply with the EIC due diligence requirements imposed in regulations.

IRC § 6700 – Promoting abusive tax shelters.

The penalty is for a promoter of an abusive tax shelter and is generally equal to \$1,000 for each organization or sale of an abusive plan or arrangement (or, if lesser, 100 percent of the income derived from the activity).

IRC § 6701 – Penalties for aiding and abetting understatement of tax liability.

The penalty is \$1000 (\$10,000 if the conduct relates to a corporation's tax return) for aiding and abetting in an understatement of a tax liability. Any person subject to the penalty shall be penalized only once for documents relating to the same taxpayer for a single tax period or event.

IRC § 6713 – Disclosure or use of information by preparers of returns.

The penalty is \$250 for each unauthorized disclosure or use of information furnished for, or in connection with, the preparation of a return. The maximum penalty on any person shall not exceed \$10,000 in a calendar year.

IRC § 7206 – Fraud and false statements.

Guilty of a felony and, upon conviction, a fine of not more than \$100,000 (\$500,000 in the case of a corporation), imprisonment of not more than three years, or both (together with the costs of prosecution).

IRC § 7207 – Fraudulent returns, statements, or other documents.

Guilty of a misdemeanor and, upon conviction, a fine of not more than \$10,000 (\$50,000 in the case of a corporation), imprisonment of not more than one year, or both.

IRC § 7216 – Disclosure or use of information by preparers of returns.

Guilty of a misdemeanor for knowingly or recklessly disclosing information furnished in connection with a tax return or using such information for any purpose other than preparing or assisting in the preparation of such return. Upon conviction, a fine of not more than \$1,000, imprisonment for not more than 1 year, or both (together with the costs of prosecution).

IRC § 7407 – Action to enjoin tax return preparers.

A federal district court may enjoin a tax return preparer from engaging in certain proscribed conduct, or in extreme cases, from continuing to act as a tax return preparer altogether.

IRC § 7408 – Action to enjoin specified conduct related to tax shelters and reportable transactions.

A federal district court may enjoin a person from engaging in certain proscribed conduct (including any action, or failure to take action, which is in violation of Circular 230).

Exhibits

IRS Instructions on How to Make a Complaint About a Tax Return Preparer.

Most paid tax return preparers are professional, honest and provide excellent service to their clients. The IRS is committed to investigating those who do not meet these standards. For example:

- Failing to sign tax returns they prepare
- Failing to use a Preparer Tax Identification Number or using an invalid PTIN
- Failing to provide clients a copy of their tax return
- Failing to return a client's records
- Preparing tax returns with a client's last pay stub
- Creating false exemptions or dependents
- Creating false expenses, deductions or credits
- Creating or omitting income
- Using an incorrect filing status
- Altering documents
- Embezzling a client's refund
- Using off-the-shelf software or IRS Free File instead of professional software
- Falsely claiming to be an attorney, certified public accountant, enrolled agent, enrolled retirement plan agent, or enrolled actuary

If you have a complaint, report it on [Form 14157, Complaint: Tax Return Preparer](#). Complete the form and mail it to:

Internal Revenue Service
Attn: Return Preparer Office
401 W. Peachtree Street NW
Mail Stop 421-D
Atlanta, GA 30308

Use this form to file a complaint with the IRS against a tax return preparer or tax preparation business.

CAUTION: READ THE INSTRUCTIONS BEFORE COMPLETING THIS FORM. There may be other more appropriate forms specific to your complaint. (For example, if you believe you are a victim of identity theft, please complete Form 14039, Identity Theft Affidavit).

Section A - Return Preparer Information *(complete all known information)*

1. Preparer's professional status <i>(check all that apply)</i>	
<input type="checkbox"/> Attorney	<input type="checkbox"/> Certified Public Accountant
<input type="checkbox"/> Enrolled Agent	<input type="checkbox"/> Payroll Service Provider
2. Preparer's name and address	3. Preparer's business name and address <i>(if different)</i>
4. Preparer's telephone number(s) <i>(include area code)</i>	5. Preparer's email address
6. Preparer's website	7. Preparer Electronic Filing Identification Number (EFIN)
8. Preparer Tax Identification Number (PTIN)	9. Employer Identification Number (EIN)

Section B - Complaint Information

10. Tax period(s) impacted

11a. Review the complaints below and check all that apply

- Theft of Refund *(Diverted refund to unknown account; return filed does not match taxpayer's copy)*
- E-File *(e-filed returns using pay stub, non-commercial software or Free File without properly securing taxpayer's signature)*
- Preparer Misconduct *(Failed to provide copy of return, return records, sign returns or remit payments for taxes due; misrepresentation of credentials; agreed to file return but did not; filed return without authorization or consent.)*
- PTIN Issues *(Failed to include Preparer Tax Identification Number (PTIN) on tax return; improperly used a PTIN belonging to another individual)*
- False Items/Documents *(False expenses, deductions, credits, exemptions or dependents; false or altered documents; false or overstated Form W-2 or 1099; incorrect filing status)*
- Employment Taxes *(Failed to file forms 940, 941, 943, or 945 or remit Employment Tax payment)*
- Other *(explain below)*

Attach a **copy** of any documents you received from the tax return preparer (e.g. **tax returns**, advertisements, business cards, Form 8879, IRS e-file Signature Authorization, Form 8888, Allocation of Refund (including savings bond purchases), Contract for Service Agreement, and Refund Transfer Agreement). Do not send original returns or payments with this form.

11b. Provide facts and other information related to the complaint (*attach additional sheets if necessary*).

Section C - Taxpayer's Information Are you the taxpayer? Yes No

(We never share this information with the person or business you are reporting)

This information may be necessary to process your complaint. If you are the taxpayer complete section C only. If you are not the taxpayer, complete sections C and D.

12. Name of individual or business

13. Mailing address (*street, city, state, ZIP code*)

14. Telephone number(s) (*include area code*)

15. Email address

16. Taxpayer's signature

17. Date of complaint

Section D - Your Information (*do not complete if you are the taxpayer*)

(We never share this information with the person or business you are reporting)

This information is not required to process your complaint but is helpful if we need to contact you for additional information.

18. Name (*Last, First, MI*)

19. Date of complaint

20. Mailing address (*street, city, state, ZIP code*)

21. Telephone number(s) (*include area code*)

22. Email address

23. Your relationship to Preparer

Client

IRS employee

Return preparer working for a different firm*

Other (*specify*) _____

Return preparer working for the same firm*

* Taxpayers' information and any information relating to another professional are confidential. Please obtain your client's consent before sharing any protected tax information, even with the IRS.

The completed form along with all supporting information can be filed by fax or regular mail.

If mailing Form 14157 send to:

Attn: Return Preparer Office
401 W. Peachtree Street NW
Mail Stop 421-D
Atlanta, GA 30308

If faxing Form 14157 send to:

855-889-7957

Privacy Act and Paperwork Reduction Act Notice

We ask for the information on this form to carry out the Internal Revenue laws of the United States. We need it to ensure that preparers are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by Internal Revenue Code section 6103.

The time required to complete this form will vary depending on individual circumstances. The estimated average time is 15 minutes. The primary purpose of this form is to report potential violations of the Internal Revenue laws by tax return preparers. We are requesting this information under authority of 26 U.S.C. § 7801 and § 7803. Providing this information is voluntary, and failure to provide all or part of the information will not affect you. Providing false or fraudulent information may subject you to penalties. We may disclose this information to the Department of Justice to enforce the tax laws, both civil and criminal, and to cities, states, the District of Columbia, and U.S. commonwealths or possessions to carry out their tax laws. We may also disclose this information to other countries under a tax treaty, to federal and state agencies to enforce federal non-tax criminal laws, and to federal law enforcement and intelligence agencies to combat terrorism.

Instructions for Form 14157, Complaint: Tax Return Preparer

General Instructions

What's New

A check box was added to determine if the form was completed by the impacted taxpayer. Another method to file the form was added.

Purpose of Form

Use Form 14157 to file a complaint against a tax return preparer or tax preparation business.

Individuals who are paid to prepare federal tax returns must follow ethical standards and guidelines as established in Treasury Department Circular 230. For more information on requirements for paid tax return preparers, view Circular 230 at www.irs.gov/taxpros.

Where to Send This Form

The completed form along with all supporting information can be filed by fax or regular mail.

If mailing Form 14157 send to:

Attn: Return Preparer Office
401 W. Peachtree Street NW
Mail Stop 421-D
Atlanta, GA 30308

If faxing Form 14157 send to:

855-889-7957

CAUTION: DO NOT USE Form 14157:

- If you suspect your **identity was stolen**. Use [Form 14039](#). Follow "Instructions for Submitting this Form" on Page 2 of Form 14039.
- If a **tax return preparer** filed a return or altered your return **without your consent** and you are seeking a change to your account, complete [Form 14157-A](#), Tax Return Preparer Fraud or Misconduct Affidavit and this form. Submit both forms along with the documents listed in the Form 14157-A instructions to the address shown on that form.
- To report **alleged tax law** violations by an individual, a business, or both. Use [Form 3949-A](#). Submit to the address on the Form 3949-A.

Specific Instructions

Section A - Return Preparer Information

Preparer's Professional Status - Indicate any professional credentials held, or claimed to be held, by the return preparer. An Attorney is an individual in good standing with a state bar association. A Certified Public Accountant is an individual in good standing with a state board of accountancy. An Enrolled Agent status is granted solely by the IRS upon the individual's demonstration of special competence in tax matters, by written examination, and passing suitability requirements. A Payroll Service Provider is a third party paid by an employer to administer the employer's payroll and tax responsibilities. Select Other/Unknown if you are unsure of the preparer's status.

Information about the Tax Return Preparer - Provide as much information as you know about the paid tax return preparer or business.

Preparer's Identification Numbers(s) - If known, provide the tax preparer's Electronic Filing Identification Number (EFIN), Preparer Tax Identification Number (PTIN), and Employer Identification Number (EIN).

Section B - Complaint Information

Tax Period(s)

Indicate the tax period(s) of the tax return for which the tax preparer misconduct occurred. Most individual's tax returns cover a calendar year of 12 months, January 1 through December 31. For example, you may have a tax return that was prepared in 2013, but the tax year is 2012 because the tax return covered calendar year 2012. A business's tax return can cover a quarter or a full year. For example, you may have a Form 941, Employer's Quarterly Federal Tax Return, prepared for the period ending September 30, 2014.

Review the complaint allegations and check all that apply. Describe in detail the facts of your complaint in 11b. Attach a copy of any documents you received from the tax return preparer. For Employment Tax complaints attach a copy of any Contract for Service Agreement. Also attach additional sheets if necessary. Do not send original returns or payments.

Theft of Refund

A preparer:

- Embezzled or stole all or a portion of a client's federal tax refund.
- Diverted a refund to an account that was not the client's.
- Provided a copy of the return to the client that had direct deposit information that is not theirs.
- Provided a copy of the return to the client that does not match the return that was filed with the IRS.
- Failed to explain that a cash advance, fast refund, or instant refund was actually a refund anticipation loan borrowed against an income tax refund and the related fees and interest charges.

E-File

A preparer:

- Filed a return electronically using a last payroll stub or a leave and earnings statement without waiting for the official Form W-2 from the employer. Return preparers are generally prohibited from filing a return prior to receipt of Forms W-2, W-2G, and 1099-R.
- Used non-commercial software to prepare returns that appear self prepared by the taxpayer and is not including his or her name, PTIN, or firm name. Similarly, the preparer used the "Free File" program to prepare and file tax returns for clients. For more information on Free File, visit www.irs.gov/freefile.
- Filed a return electronically without securing taxpayer's signature on Form 8879 (e-File Signature Authorization).

Preparer Misconduct

A preparer:

- Did not provide client with a copy of the return he or she prepared, and refused to provide a copy after a request.
- Did not return some or all of the client's original records.
- Did not sign the federal tax returns that he or she prepared.
- Claimed to be an attorney, certified public accountant, enrolled agent, or registered tax return preparer, but does not actually have the credential claimed or the credential is no longer valid (e.g. expired, suspended or revoked).
- Agreed to file return but did not - The preparer charged for services not performed.
- Did not remit payment for taxes due
- Filed a return or submitted other information for a client without their knowledge, authorization, or consent.
- Failed to explain that a cash advance, fast refund, or instant refund was actually a refund anticipation loan borrowed against an income tax refund and the related fees and interest charges. The return preparer was misleading, or failed to ensure taxpayers understand financial products and related fees.

PTIN Issues

A preparer:

- Improperly used a Preparer Tax Identification Number (PTIN) belonging to another individual.
- Does not have a PTIN or is not including a PTIN on returns prepared.

False Items/Documents

A preparer knowingly:

- Claimed false or fictitious expenses and/or deductions on a tax return.
- Claimed unrelated, non-existent, unknown or additional information on a tax return.
- Made changes to a client's original tax documents or used false or incorrect documents to complete return.
- Claimed false or fictitious income and/or federal withholding on a tax return.
- Claimed an improper filing status on a tax return. The filing status claimed did not accurately reflect the taxpayer's family situation.

Employment Taxes

A preparer:

- Did not remit employment tax funds to the IRS on behalf of a client for Forms 940, 941, 943, 944, or 945 in full or on time.
- Did not prepare employment tax returns (Form 941, 940, 943, 944, 945) on behalf of a client in an accurate and/or timely manner.

Other

- If none of the above describes the nature of the complaint, briefly summarize the complaint. Some examples of other tax preparer misconduct or improper tax preparation practices include, but are not limited to, fee dispute and bad behavior such as threats.

Section C - Taxpayer Information

Indicate if you are the taxpayer impacted by the tax preparer's misconduct or improper tax preparation practices.

Enter the taxpayer's name, street address, city, state, zip code, telephone number(s), and email address where he/she can be contacted.

Taxpayer's Signature – Sign and date.

Section D - Your Contact Information

Enter your name, street address, city, state, zip code, telephone number(s), and e-mail address where you can be contacted. This information is not required to process your complaint but is helpful if we need to contact you for additional information.

Your Relationship to Preparer

Enter your relationship to the return preparer.

Taxpayers' information and any information relating to another professional are confidential. Please obtain your client's consent before sharing any protected tax information, even with the IRS.

Due Diligence Requirements:

Requirement	You must:
1. Complete and Submit Eligibility Checklist	<ul style="list-style-type: none"> • Complete Form 8867, Paid Preparer's Earned Income Credit Checklist, to make sure you consider all EITC eligibility criteria for each return prepared. • Complete checklist based on information provided by your client(s). • For returns or claims for refund filed electronically, submit Form 8867 to IRS electronically with the return. • For returns or claims for refund not filed electronically, attach the completed form to any paper return you prepare and file. • For returns or claims for refund you prepare but do not submit directly to the IRS, provide completed Form 8867 to the taxpayer to send with the filed tax return or claim for refund.
2. Computing the Credit	<ul style="list-style-type: none"> • Complete EITC worksheet from the Form 1040 instructions, or Publication 596, <i>Earned Income Credit</i>, or a document with the same information. The worksheet shows what is included in the computation, that is, self-employment income, total earned income, investment income, and adjusted gross income. Most tax preparation software has the computation worksheet.
3. Knowledge	<ul style="list-style-type: none"> • Know the law and use your knowledge of the law to ensure you are asking your client the right questions to get all relevant facts. • Take into account what your client says and what you know about your client. • Not know or have reason to know any information used to determine your client's eligibility for, or the amount of, EITC is incorrect, inconsistent or incomplete. • Make additional inquiries if a reasonable and well-informed tax return preparer would know the information is incomplete, inconsistent or incorrect. • Document any additional questions you ask and your client's answer at the time of the interview. • The Treasury Regulations give examples of when to apply the knowledge requirement. Find the regulations for tax return preparer due diligence requirements on the Government Printing

	Office site.
4. Keeping Records	<ul style="list-style-type: none"> • Keep a copy of the Form 8867 and EIC worksheet, and a record of any additional questions you asked your client to comply with your due diligence requirements and your client's answers to those questions. • Keep copies of any documents your client gives you that you use to determine eligibility for, or the amount of the EITC. • • Verify the identity of the person giving you the return information and keep a record of who provided the information and when you got it. • Keep your records in either paper or electronic format, but make sure you can produce if IRS asks for them. • Keep these records for 3 years from the latest date of the following that apply: <ul style="list-style-type: none"> ○ The original due date of the tax return (This does not include any extension of time for filing.), or ○ If you electronically file the return or claim for refund and sign it as the return preparer, the date the tax return or claim for refund is filed, or ○ If the return or claim for refund is not filed electronically and you sign it as the return preparer, the date you present the tax return or claim for refund to your client for signature; or ○ If you prepare part of the return or claim for refund and another preparer completes and signs the return or claim for refund, you must keep the part of the return you were responsible to complete for 3 years from the date you submit it to the signing tax return preparer. • Keep your records in either paper or electronic format, but make sure you can produce if IRS asks for them.

Consequences of Filing EITC Returns Incorrectly

People who come to you, a tax return preparer, expect you to know the tax law and prepare an accurate return. Also, if you are paid and prepare EITC claims, you must meet EITC due diligence requirements. Refer to our [EITC Due Diligence Law and Regulation](#) for more information.

Incorrect EITC returns affect your clients, you and your employer.

- If we examine **your client's return** and deny all or a part of EITC, your client:
 - must pay back the amount in error with interest;
 - may need to file the Form 8862, Information to Claim Earned Income Credit after Disallowance;
 - may be banned from claiming EITC for the next two years if we find the error is because of reckless or intentional disregard of the rules; or
 - may be banned from claiming EITC for the next ten years if we find the error is because of fraud.
- If we examine the EITC claims **you prepared** and we find you did not meet all four due diligence requirements, you can get:
 - A \$500 penalty for each failure to comply with EITC due diligence requirements for returns required to be filed after December 31, 2011. The penalty amounts are covered in [IRC section 6695\(g\)](#).
 - A minimum penalty of \$1,000 if you prepare a client return and IRS finds any part of the amount of taxes owed is due to an, unreasonable position. (For reference [see IRC section 6694\(a\)](#))*
 - A minimum penalty of \$5,000 if you prepare a client return and IRS finds any part of the amount of taxes owed is due to your reckless or intentional disregard of rules or regulations. ([For reference see IRC 6694\(b\)](#))*
- IRS can also penalize an **employer or employing firm** if an employee fails to comply with the EITC due diligence requirements. (There are only specific circumstances when an employer is subject to the due diligence penalty. [See our Due Diligence FAQs](#) for the circumstances and ways an employer can prevent penalties).

If you receive a return-related penalty, you can also face:

- Suspension or expulsion of you or your firm from IRS e-file
- Other disciplinary action by the IRS Office of Professional Responsibility
- Injunctions barring you from preparing tax returns or imposing conditions on the tax returns you may prepare

Paid Preparer's Earned Income Credit Checklist

▶ To be completed by preparer and filed with Form 1040, 1040A, or 1040EZ.
▶ Information about Form 8867 and its separate instructions is at www.irs.gov/form8867.

Taxpayer name(s) shown on return

Taxpayer's social security number

For the definitions of **Qualifying Child** and **Earned Income**, see **Pub. 596**.

Part I All Taxpayers

<p>1 Enter preparer's name and PTIN ▶ _____</p>	
<p>2 Is the taxpayer's filing status married filing separately?</p> <p>▶ If you checked "Yes" on line 2, stop; the taxpayer cannot take the EIC. Otherwise, continue.</p>	<p><input type="checkbox"/> Yes <input type="checkbox"/> No</p>
<p>3 Does the taxpayer (and the taxpayer's spouse if filing jointly) have a social security number (SSN) that allows him or her to work and is valid for EIC purposes? See the instructions before answering</p> <p>▶ If you checked "No" on line 3, stop; the taxpayer cannot take the EIC. Otherwise, continue.</p>	<p><input type="checkbox"/> Yes <input type="checkbox"/> No</p>
<p>4 Is the taxpayer (or the taxpayer's spouse if filing jointly) filing Form 2555 or 2555-EZ (relating to the exclusion of foreign earned income)?</p> <p>▶ If you checked "Yes" on line 4, stop; the taxpayer cannot take the EIC. Otherwise, continue.</p>	<p><input type="checkbox"/> Yes <input type="checkbox"/> No</p>
<p>5a Was the taxpayer (or the taxpayer's spouse) a nonresident alien for any part of 2014?</p> <p>▶ If you checked "Yes" on line 5a, go to line 5b. Otherwise, skip line 5b and go to line 6.</p>	<p><input type="checkbox"/> Yes <input type="checkbox"/> No</p>
<p>b Is the taxpayer's filing status married filing jointly?</p> <p>▶ If you checked "Yes" on line 5a and "No" on line 5b, stop; the taxpayer cannot take the EIC. Otherwise, continue.</p>	<p><input type="checkbox"/> Yes <input type="checkbox"/> No</p>
<p>6 Is the taxpayer's investment income more than \$3,350? See the instructions before answering.</p> <p>▶ If you checked "Yes" on line 6, stop; the taxpayer cannot take the EIC. Otherwise, continue.</p>	<p><input type="checkbox"/> Yes <input type="checkbox"/> No</p>
<p>7 Could the taxpayer be a qualifying child of another person for 2014? If the taxpayer's filing status is married filing jointly, check "No." Otherwise, see instructions before answering</p> <p>▶ If you checked "Yes" on line 7, stop; the taxpayer cannot take the EIC. Otherwise, go to Part II or Part III, whichever applies.</p>	<p><input type="checkbox"/> Yes <input type="checkbox"/> No</p>

Part II Taxpayers With a Child

Caution. If there is more than one child, complete lines 8 through 14 for one child before going to the next column.

- 8** Child's name
- 9** Is the child the taxpayer's son, daughter, stepchild, foster child, brother, sister, stepbrother, stepsister, half brother, half sister, or a descendant of any of them?
- 10** Was the child unmarried at the end of 2014?
If the child was married at the end of 2014, see the instructions before answering
- 11** Did the child live with the taxpayer in the United States for over half of 2014?
See the instructions before answering
- 12** Was the child (at the end of 2014)—
- Under age 19 and younger than the taxpayer (or the taxpayer's spouse, if the taxpayer files jointly),
 - Under age 24, a student (defined in the instructions), and younger than the taxpayer (or the taxpayer's spouse, if the taxpayer files jointly), or
 - Any age and permanently and totally disabled?
- ▶ If you checked "Yes" on lines 9, 10, 11, and 12, the child is the taxpayer's qualifying child; go to line 13a. If you checked "No" on line 9, 10, 11, or 12, the child is not the taxpayer's qualifying child; see the instructions for line 12.
- 13a** Do you or the taxpayer know of another person who could check "Yes" on lines 9, 10, 11, and 12 for the child? (If the only other person is the taxpayer's spouse, see the instructions before answering.)
- ▶ If you checked "No" on line 13a, go to line 14. Otherwise, go to line 13b.
- b** Enter the child's relationship to the other person(s)
- c** Under the tiebreaker rules, is the child treated as the taxpayer's qualifying child? See the instructions before answering
- ▶ If you checked "Yes" on line 13c, go to line 14. If you checked "No," the taxpayer **cannot** take the EIC based on this child and cannot take the EIC for taxpayers who do not have a qualifying child. If there is more than one child, see the **Note** at the bottom of this page. If you checked "Don't know," explain to the taxpayer that, under the tiebreaker rules, the taxpayer's EIC and other tax benefits may be disallowed. Then, if the taxpayer wants to take the EIC based on this child, complete lines 14 and 15. If not, and there are no other qualifying children, the taxpayer cannot take the EIC, including the EIC for taxpayers without a qualifying child; do not complete Part III. If there is more than one child, see the **Note** at the bottom of this page.
- 14** Does the qualifying child have an SSN that allows him or her to work and is valid for EIC purposes? See the instructions before answering
- ▶ If you checked "No" on line 14, the taxpayer **cannot** take the EIC based on this child and cannot take the EIC available to taxpayers without a qualifying child. If there is more than one child, see the **Note** at the bottom of this page. If you checked "Yes" on line 14, continue.
- 15** Are the taxpayer's **earned income** and **adjusted gross income** each less than the limit that applies to the taxpayer for 2014? See instructions

	Child 1	Child 2	Child 3
8 Child's name			
9 Is the child the taxpayer's son, daughter, stepchild, foster child, brother, sister, stepbrother, stepsister, half brother, half sister, or a descendant of any of them?	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
10 Was the child unmarried at the end of 2014? If the child was married at the end of 2014, see the instructions before answering	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
11 Did the child live with the taxpayer in the United States for over half of 2014? See the instructions before answering	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
12 Was the child (at the end of 2014)—			
• Under age 19 and younger than the taxpayer (or the taxpayer's spouse, if the taxpayer files jointly),			
• Under age 24, a student (defined in the instructions), and younger than the taxpayer (or the taxpayer's spouse, if the taxpayer files jointly), or			
• Any age and permanently and totally disabled?	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
13a Do you or the taxpayer know of another person who could check "Yes" on lines 9, 10, 11, and 12 for the child? (If the only other person is the taxpayer's spouse, see the instructions before answering.)	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
b Enter the child's relationship to the other person(s)			
c Under the tiebreaker rules, is the child treated as the taxpayer's qualifying child? See the instructions before answering	<input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> Don't know	<input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> Don't know	<input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> Don't know
14 Does the qualifying child have an SSN that allows him or her to work and is valid for EIC purposes? See the instructions before answering	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
15 Are the taxpayer's earned income and adjusted gross income each less than the limit that applies to the taxpayer for 2014? See instructions			<input type="checkbox"/> Yes <input type="checkbox"/> No

▶ If you checked "No" on line 15, **stop**; the taxpayer **cannot** take the EIC. If you checked "Yes" on line 15, the taxpayer can take the EIC. Complete **Schedule EIC** and attach it to the taxpayer's return. If there are two or three qualifying children with valid SSNs, list them on Schedule EIC in the same order as they are listed here. If the taxpayer's EIC was reduced or disallowed for a year after 1996, see Pub. 596 to see if **Form 8862** must be filed. Go to line 20.

Note. If there is more than one child, complete lines 8 through 14 for the other child(ren) (but for no more than three qualifying children).

Part III Taxpayers Without a Qualifying Child

<p>16 Was the taxpayer's main home, and the main home of the taxpayer's spouse if filing jointly, in the United States for more than half the year? (Military personnel on extended active duty outside the United States are considered to be living in the United States during that duty period.) See the instructions before answering.</p> <p style="padding-left: 20px;">▶ If you checked "No" on line 16, stop; the taxpayer cannot take the EIC. Otherwise, continue.</p>	<p><input type="checkbox"/> Yes <input type="checkbox"/> No</p>
<p>17 Was the taxpayer, or the taxpayer's spouse if filing jointly, at least age 25 but under age 65 at the end of 2014? See the instructions before answering</p> <p style="padding-left: 20px;">▶ If you checked "No" on line 17, stop; the taxpayer cannot take the EIC. Otherwise, continue.</p>	<p><input type="checkbox"/> Yes <input type="checkbox"/> No</p>
<p>18 Is the taxpayer eligible to be claimed as a dependent on anyone else's federal income tax return for 2014? If the taxpayer's filing status is married filing jointly, check "No".</p> <p style="padding-left: 20px;">▶ If you checked "Yes" on line 18, stop; the taxpayer cannot take the EIC. Otherwise, continue.</p>	<p><input type="checkbox"/> Yes <input type="checkbox"/> No</p>
<p>19 Are the taxpayer's earned income and adjusted gross income each less than the limit that applies to the taxpayer for 2014? See instructions</p> <p style="padding-left: 20px;">▶ If you checked "No" on line 19, stop; the taxpayer cannot take the EIC. If you checked "Yes" on line 19, the taxpayer can take the EIC. If the taxpayer's EIC was reduced or disallowed for a year after 1996, see Pub. 596 to find out if Form 8862 must be filed. Go to line 20.</p>	<p><input type="checkbox"/> Yes <input type="checkbox"/> No</p>

Part IV Due Diligence Requirements

<p>20 Did you complete Form 8867 based on current information provided by the taxpayer or reasonably obtained by you?</p>	<p><input type="checkbox"/> Yes <input type="checkbox"/> No</p>
<p>21 Did you complete the EIC worksheet found in the Form 1040, 1040A, or 1040EZ instructions (or your own worksheet that provides the same information as the 1040, 1040A, or 1040EZ worksheet)?</p>	<p><input type="checkbox"/> Yes <input type="checkbox"/> No</p>
<p>22 If any qualifying child was not the taxpayer's son or daughter, do you know or did you ask why the parents were not claiming the child?</p>	<p><input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> Does not apply</p>
<p>23 If the answer to question 13a is "Yes" (indicating that the child lived for more than half the year with someone else who could claim the child for the EIC), did you explain the tiebreaker rules and possible consequences of another person claiming your client's qualifying child?</p>	<p><input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> Does not apply</p>
<p>24 Did you ask this taxpayer any additional questions that are necessary to meet your knowledge requirement? See the instructions before answering</p> <p>To comply with the EIC knowledge requirement, you must not know or have reason to know that any information you used to determine the taxpayer's eligibility for, and the amount of, the EIC is incorrect. You may not ignore the implications of information furnished to you or known by you, and you must make reasonable inquiries if the information furnished to you appears to be incorrect, inconsistent, or incomplete. At the time you make these inquiries, you must document in your files the inquiries you made and the taxpayer's responses.</p>	<p><input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> Does not apply</p>
<p>25 Did you document (a) the taxpayer's answer to question 22 (if applicable), (b) whether you explained the tiebreaker rules to the taxpayer and any additional information you got from the taxpayer as a result, and (c) any additional questions you asked and the taxpayer's answers?</p> <p style="padding-left: 20px;">▶ You have complied with all the due diligence requirements if you:</p> <ol style="list-style-type: none"> 1. Completed the actions described on lines 20 and 21 and checked "Yes" on those lines, 2. Completed the actions described on lines 22, 23, 24, and 25 (if they apply) and checked "Yes" (or "Does not apply") on those lines, 3. Submit Form 8867 in the manner required, and 4. Keep all five of the following records for 3 years from the latest of the dates specified in the instructions under <i>Document Retention</i>: <ol style="list-style-type: none"> a. Form 8867, b. The EIC worksheet(s) or your own worksheet(s), c. Copies of any taxpayer documents you relied on to determine eligibility for or amount of EIC, d. A record of how, when, and from whom the information used to prepare the form and worksheet(s) was obtained, and e. A record of any additional questions you asked and your client's answers. <p style="padding-left: 20px;">▶ You have not complied with all the due diligence requirements if you checked "No" on line 20, 21, 22, 23, 24, or 25. You may have to pay a \$500 penalty for each failure to comply.</p>	<p><input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> Does not apply</p>

Part V Documents Provided to You

26 Identify below any document that the taxpayer provided to you and that you relied on to determine the taxpayer's EIC eligibility. Check all that apply. **Keep a copy of any documents you relied on.** See the instructions before answering. If there is no qualifying child, check box a. If there is no disabled child, check box o.

Residency of Qualifying Child(ren)

- | | |
|---|---|
| <input type="checkbox"/> a No qualifying child | <input type="checkbox"/> i Place of worship statement |
| <input type="checkbox"/> b School records or statement | <input type="checkbox"/> j Indian tribal official statement |
| <input type="checkbox"/> c Landlord or property management statement | <input type="checkbox"/> k Employer statement |
| <input type="checkbox"/> d Health care provider statement | <input type="checkbox"/> l Other (specify) ▼ |
| <input type="checkbox"/> e Medical records | _____ |
| <input type="checkbox"/> f Child care provider records | _____ |
| <input type="checkbox"/> g Placement agency statement | <input type="checkbox"/> m Did not rely on any documents, but made notes in file |
| <input type="checkbox"/> h Social service records or statement | <input type="checkbox"/> n Did not rely on any documents |

Disability of Qualifying Child(ren)

- | | |
|---|---|
| <input type="checkbox"/> o No disabled child | <input type="checkbox"/> s Other (specify) ▼ |
| <input type="checkbox"/> p Doctor statement | _____ |
| <input type="checkbox"/> q Other health care provider statement | <input type="checkbox"/> t Did not rely on any documents, but made notes in file |
| <input type="checkbox"/> r Social services agency or program statement | <input type="checkbox"/> u Did not rely on any documents |

27 If a Schedule C is included with this return, identify below the information that the taxpayer provided to you and that you relied on to prepare the Schedule C. Check all that apply. **Keep a copy of any documents you relied on.** See the instructions before answering. If there is no Schedule C, check box a.

Documents or Other Information

- | | |
|--|---|
| <input type="checkbox"/> a No Schedule C | <input type="checkbox"/> h Bank statements |
| <input type="checkbox"/> b Business license | <input type="checkbox"/> i Reconstruction of income and expenses |
| <input type="checkbox"/> c Forms 1099 | <input type="checkbox"/> j Other (specify) ▼ |
| <input type="checkbox"/> d Records of gross receipts provided by taxpayer | _____ |
| <input type="checkbox"/> e Taxpayer summary of income | <input type="checkbox"/> k Did not rely on any documents, but made notes in file |
| <input type="checkbox"/> f Records of expenses provided by taxpayer | <input type="checkbox"/> l Did not rely on any documents |
| <input type="checkbox"/> g Taxpayer summary of expenses | |

The Preparer Penalty Statute §6694

Section 6694(a) as amended October 3, 2008

H.R.1424. 110th Congress - Emergency Economic Stabilization Act of 2008, Enrolled, as Signed by the President on October 3, 2008

SEC. 506. MODIFICATION OF PENALTY ON UNDERSTATEMENT OF TAXPAYER'S LIABILITY BY TAX RETURN PREPARER.

(a) IN GENERAL - Subsection (a) of section 6694 is amended to read as follows:

(a) UNDERSTATEMENT DUE TO UNREASONABLE POSITIONS -

(1) IN GENERAL - If a tax return preparer --

(A) prepares any return or claim of refund with respect to which any part of an understatement of liability is due to a position described in paragraph (2), and

(B) knew (or reasonably should have known) of the position,

such tax return preparer shall pay a penalty with respect to each such return or claim in an amount equal to the greater of \$1,000 or 50 percent of the income derived (or to be derived) by the tax return preparer with respect to the return or claim.

(2) UNREASONABLE POSITION

(A) IN GENERAL - Except as otherwise provided in this paragraph, a position is described in this paragraph unless there is or was substantial authority for the position.

(B) DISCLOSED POSITIONS - If the position was disclosed as provided in section 6662(d)(2)(B)(ii)(I) and is not a position to which subparagraph (C) applies, the position is described in this paragraph unless there is a reasonable basis for the position.

(C) TAX SHELTERS AND REPORTABLE TRANSACTIONS - If the position is with respect to a tax shelter (as defined in section 6662(d)(2)(C)(ii)) or a reportable transaction to which section 6662A applies, the position is described in this paragraph unless it is reasonable to believe that the position would more likely than not be sustained on its merits.

(3) REASONABLE CAUSE EXCEPTION - No penalty shall be imposed under this subsection if it is shown that there is reasonable cause for the understatement and the tax return preparer acted in good faith.'

(b) EFFECTIVE DATE - The amendment made by this section shall apply --

(1) in the case of a position other than a position described in subparagraph (C) of section 6694(a)(2) of the Internal Revenue Code of 1986 (as amended by this section), to returns prepared after May 25, 2007, and

(2) in the case of a position described in such subparagraph (C), to returns prepared for taxable years ending after the date of the enactment of this Act.

The §6694 Regulations

26 USC § 6694 - UNDERSTATEMENT OF TAXPAYER'S LIABILITY BY TAX RETURN PREPARER

Current through Pub. L. [113-36](#). (See [Public Laws for the current Congress](#).)

(a) Understatement due to unreasonable positions

(1) In general

If a tax return preparer—

(A) prepares any return or claim of refund with respect to which any part of an understatement of liability is due to a position described in paragraph (2), and

(B) knew (or reasonably should have known) of the position, such tax return preparer shall pay a penalty with respect to each such return or claim in an amount equal to the greater of \$1,000 or 50 percent of the income derived (or to be derived) by the tax return preparer with respect to the return or claim.

(2) Unreasonable position

(A) In general

Except as otherwise provided in this paragraph, a position is described in this paragraph unless there is or was substantial authority for the position.

(B) Disclosed positions

If the position was disclosed as provided in section [6662\(d\)\(2\)\(B\)\(ii\)\(I\)](#) and is not a position to which subparagraph (C) applies, the position is

described in this paragraph unless there is a reasonable basis for the position.

(C) Tax shelters and reportable transactions

If the position is with respect to a tax shelter (as defined in section [6662\(d\)\(2\)\(C\)\(ii\)](#)) or a reportable transaction to which section [6662A](#) applies, the position is described in this paragraph unless it is reasonable to believe that the position would more likely than not be sustained on its merits.

(3) Reasonable cause exception

No penalty shall be imposed under this subsection if it is shown that there is reasonable cause for the understatement and the tax return preparer acted in good faith.

(b) Understatement due to willful or reckless conduct

(1) In general

Any tax return preparer who prepares any return or claim for refund with respect to which any part of an understatement of liability is due to a conduct described in paragraph (2) shall pay a penalty with respect to each such return or claim in an amount equal to the greater of—

(A)\$5,000, or

(B)50 percent of the income derived (or to be derived) by the tax return preparer with respect to the return or claim.

(2) Willful or reckless conduct

Conduct described in this paragraph is conduct by the tax return preparer which is—

(A)a willful attempt in any manner to understate the liability for tax on the return or claim, or

(B)a reckless or intentional disregard of rules or regulations.

(3) Reduction in penalty

The amount of any penalty payable by any person by reason of this subsection for any return or claim for refund shall be reduced by the amount of the penalty paid by such person by reason of subsection (a).

(c) Extension of period of collection where preparer pays 15 percent of penalty

(1) In general

If, within 30 days after the day on which notice and demand of any penalty under subsection (a) or (b) is made against any person who is a tax return preparer, such person pays an amount which is not less than 15 percent of the amount of such penalty and files a claim for refund of the amount so paid, no levy or proceeding in court for the collection of the remainder of such penalty shall be made, begun, or prosecuted until the final resolution of a proceeding begun as provided in paragraph (2). Notwithstanding the provisions of section [7421\(a\)](#), the beginning of such proceeding or levy during the time such prohibition is in force may be enjoined by a proceeding in the proper court. Nothing in this paragraph shall be construed to prohibit any counterclaim for the remainder of such penalty in a proceeding begun as provided in paragraph (2).

(2) Preparer must bring suit in district court to determine his liability for penalty

If, within 30 days after the day on which his claim for refund of any partial payment of any penalty under subsection (a) or (b) is denied (or, if earlier, within 30 days after the expiration of 6 months after the day on which he filed the claim for refund), the tax return preparer fails to begin a proceeding in the appropriate United States district court for the determination of his liability for such penalty, paragraph (1) shall cease to apply with respect to such penalty, effective on the day following the close of the applicable 30-day period referred to in this paragraph.

(3) Suspension of running of period of limitations on collection

The running of the period of limitations provided in section [6502](#) on the collection by levy or by a proceeding in court in respect of any penalty described in paragraph (1) shall be suspended for the period during which the Secretary is prohibited from collecting by levy or a proceeding in court.

(d) Abatement of penalty where taxpayer's liability not understated

If at any time there is a final administrative determination or a final judicial decision that there was no understatement of liability in the case of any return or claim for refund with respect to which a penalty under subsection (a) or (b) has been assessed, such assessment shall be abated, and if any portion of such penalty has been paid the amount so paid shall be refunded to the person who made such payment as an overpayment of tax without regard to any period of limitations which, but for this subsection, would apply to the making of such refund.

(e) Understatement of liability defined

For purposes of this section, the term “understatement of liability” means any understatement of the net amount payable with respect to any tax imposed by this title or any overstatement of the net amount creditable or refundable with respect to any such tax. Except as otherwise provided in subsection (d), the determination of whether or not there is an understatement of liability shall be made without regard to any administrative or judicial action involving the taxpayer.

IRC §6695 Regulations

Internal Revenue Bulletin: 2012-11

March 12, 2012

T.D. 9570

Tax Return Preparer Penalties Under Section 6695

ACTION:

Final regulations.

SUMMARY:

This document contains final regulations that modify existing regulations related to the tax return preparer penalties under section 6695 of the Internal Revenue Code (Code). The final regulations are necessary to monitor and to improve compliance with the tax return preparer due diligence requirements of section 6695(g). The final regulations affect paid tax return preparers.

DATES:

Effective Date: The final regulations are effective on December 20, 2011.

Applicability Date: For date of applicability, see §1.6695-2(e).

FOR FURTHER INFORMATION CONTACT:

Spence Hanemann, (202) 622-4940 (not a toll-free number).

Background

This document contains amendments to the Income Tax Regulations (26 CFR part 1) under section 6695 of the Code.

The Treasury Department and the IRS published a notice of proposed rulemaking (REG-140280-09, 2011-45 I.R.B. 709) in the **Federal Register**, 76 FR 62689, on October 11, 2011 (the NPRM). A public hearing was scheduled for November 7, 2011. The IRS did not receive any requests to testify at the public hearing, and the public hearing was cancelled. Written comments responding to the NPRM were received and are available for public inspection at <http://www.regulations.gov> or upon request. After consideration of all the comments, the proposed regulations are adopted as amended by this Treasury decision. The revisions to the regulations are discussed in this preamble.

Summary of Comments and Explanation of Revisions

The IRS received nine written comments in response to the NPRM, and this section addresses those public comments. This section also describes the significant differences between the rules proposed in the NPRM and those adopted in the final regulations.

1. 2011 Amendment to Section 6695(g)

On October 21, 2011, section 501 of the United States-Korea Free Trade Agreement Implementation Act, Public Law 112-41, 125 Stat 428, amended section 6695(g) of the Code by increasing the amount of the penalty from \$100 to \$500. To account for this change in the law, §1.6695-2(a) of the final regulations has been conformed to the statutory language of section 6695(g), as amended.

2. Necessity of These Regulations

Two commenters stated that the proposed amendments to the due diligence standards in the NPRM were unnecessary in light of recent regulatory changes requiring tax return preparers to register with the IRS and comply with the ethical standards governing practice before the IRS (Circular 230), as well as the tax return preparer penalties under section 6694. They suggested that the IRS can apply these existing provisions to address misconduct by tax return preparers, including improper determination of eligibility for, and amount of, EIC by both individual tax return preparers and firms.

As reflected in section 6695(g), Congress has determined that noncompliance with the EIC rules poses a sufficiently significant problem to merit imposing unique due diligence requirements on tax return preparers involved in determining eligibility for, or amount of, the EIC. By recently quintupling the amount of the penalty for failure to comply with these requirements, Congress reaffirmed the need for specific rules to reduce EIC noncompliance. In order to address noncompliance with the EIC rules, the final regulations modify the due diligence requirements under section 6695(g) that have been in place for over a decade. Treasury and the IRS concluded that these regulations are consistent with section 6695(g), and no modification is made in the final regulations in response to these comments.

3. Submission of Form 8867

Section 1.6695-2(b)(1)(i) of the proposed regulations required that the Form 8867, “*Paid Preparer’s Earned Income Credit Checklist*,” be submitted to the IRS in the manner required by forms, instructions, or other appropriate guidance. One commenter noted, in part, that tax return preparers sometimes provide a paper copy of the completed tax return or claim for refund to the taxpayer for submission by the taxpayer. A tax return preparer’s ability to provide a paper copy, as opposed to filing the tax return

electronically, is subject to the rules and limitations in §301.6011-7 and related guidance. Another commenter stated that the proposed regulations were unclear in how they apply to nonsigning tax return preparers. The due diligence requirements and the penalty for failure to comply with them apply to any tax return preparer, including a nonsigning tax return preparer, who determines eligibility for, or amount of, the EIC.

After consideration of these comments, Treasury and the IRS have concluded that the rules in the regulations should be clarified to provide how tax return preparers who prepare a tax return or claim for refund but do not submit it directly to the IRS can satisfy the requirement under proposed §1.6695-2(b)(1)(i) to submit the completed Form 8867 to the IRS. In response to these comments, §1.6695-2(b)(1)(i) of the final regulations provides that tax return preparers who prepare a tax return or claim for refund but do not submit it directly to the IRS may satisfy this aspect of their due diligence obligation by providing the form to the taxpayer or the signing tax return preparer, as appropriate, for submission with the tax return or claim for refund.

One commenter suggested that the Form 8867 be a stand-alone form that the taxpayer signs and submits as an affidavit of EIC eligibility. After consideration of this comment, Treasury and the IRS have concluded that imposing such an obligation on taxpayers, rather than on tax return preparers, would be contrary to the purpose of section 6695(g), which is to discourage tax return preparers from preparing EIC tax returns or claims for refund without performing basic due diligence. No modification is made in the final regulations in response to this comment.

4. Requirement to Verify Taxpayer Information

Section 1.6695-2(b)(1)(i) of the proposed regulations required submission of Form 8867 to the IRS, and §1.6695-2(b)(4)(i)(C) of the proposed regulations required retention of a copy of any document that was provided by the taxpayer and on which the tax return preparer relied to complete Form 8867 or the Earned Income Credit Worksheet. Two commenters suggested that these additional requirements increased a tax return preparer's burden under the knowledge requirement of existing §1.6695-2(b)(3) because a tax return preparer would now be obligated to verify taxpayers' responses to the eligibility questions and also to verify nonsigning tax return preparers' (if any) completion of the Form 8867. The proposed regulations, however, do not expand tax return preparers' obligation to verify information provided by taxpayers and other tax return preparers under existing §1.6695-2(b)(3).

Under §1.6695-2(b)(3) of the current regulations, tax return preparers are already required to complete Form 8867, prohibited from ignoring the implications of information provided, obligated to make reasonable inquiries if the information provided appears incorrect, inconsistent, or incomplete, and required to contemporaneously document their reasonable inquiries and the taxpayer's responses. For purposes of §1.6695-2(b)(3), tax return preparers would not be held to a higher standard under the proposed regulations than they are under the existing regulations. A tax return preparer can

generally rely on the information furnished by a taxpayer (or other tax return preparer who determines eligibility for, or amount of, the EIC) as long as the tax return preparer does not know, or have reason to know, that the information is incorrect, inconsistent, or incomplete. A signing tax return preparer who satisfies the knowledge requirement in §1.6695-2(b)(3), therefore, will ordinarily be able to rely on the information furnished to the signing tax return preparer by a taxpayer or nonsigning tax return preparer regarding the EIC. The additional requirements in proposed §1.6695-2(b)(1)(i) and (b)(4)(i)(C) are not unduly burdensome and will improve the IRS' ability to determine whether a tax return preparer has complied with the EIC due diligence requirements that already exist. No modification is made in the final regulations in response to these comments.

5. Nonsigning Tax Return Preparers

Two commenters expressed concern that expanding the due diligence requirements and penalty to nonsigning tax return preparers would subject individuals to the section 6695(g) penalty who are beyond the intended scope of these rules. The commenters provided the example of individuals hired by tax preparation software companies to answer discrete questions for taxpayers who are using tax preparation software to prepare their own tax return or claim for refund. These individuals provide general resource information for the taxpayers who are preparing their own tax return or claim for refund, and they do not know all of the specific facts relating to the taxpayer's tax return or claim for refund. The commenters reasoned that these individuals might be nonsigning tax return preparers and would arguably be subject to these due diligence requirements and related penalty.

The term "nonsigning tax return preparer" is specifically defined in §301.7701-15(b)(2) and is limited to those who prepare all or a substantial portion of a tax return or claim for refund within the meaning of §301.7701-15(b)(3). Under §301.7701-15(b)(3), a person who renders tax advice on a position that is directly relevant to the existence or amount of an entry on a tax return or claim for refund is regarded as having prepared that entry. Section 301.7701-15(b)(3) further provides that whether a schedule, entry, or other portion of a tax return or claim for refund is a substantial portion is determined based upon whether the person knows or reasonably should know that the tax attributable to the schedule, entry, or other portion of a tax return or claim for refund is a substantial portion of the tax required to be shown on the tax return or claim for refund. Also, §301.7701-15(f)(1)(viii) provides an exception from the definition of tax return preparer for any individual providing only typing, reproduction, or other mechanical assistance in the preparation of a tax return or claim for refund.

Treasury and the IRS have concluded that, in the routine situation described by these commenters, the individuals employed at the tax preparation software companies as described in the comments are not nonsigning tax return preparers as long as they either (i) fall within the mechanical exception because they are not exercising

independent judgment on the taxpayer's underlying tax positions, or (ii) do not know (and reasonably should not know) that any generic advice provided relating to the EIC is a substantial portion of the tax required to be shown. On the other hand, in rare instances when any such individual is both exercising independent judgment and knows or reasonably should know that specific advice provided to a taxpayer relating to EIC is a substantial portion of the tax return or claim for refund within the meaning of §301.7701-15(b)(3), the individual is a nonsigning tax return preparer subject to the due diligence rules. No modification is made to the final regulations in response to this comment.

6. Penalizing Firms

By replacing "signing tax return preparer" with "tax return preparer," §1.6695-2(a) of the proposed regulations effectively provided that a firm that employs a person to prepare for compensation a tax return or claim for refund may be subject to the penalty for its employee's failure to comply with the due diligence requirements. Two commenters questioned the proposed application of the due diligence requirements and penalty to firms. Section 6695(g) imposes a penalty on "[a]ny person who is a tax return preparer" that fails to comply with the due diligence requirements "with respect to determining eligibility for, or the amount of, the credit allowable by section 32." Under section 7701(a)(36), a "tax return preparer" is "any person who prepares for compensation, or who employs one or more persons to prepare for compensation, any return of tax imposed by title or any claim for refund of tax imposed by this title." After consideration of these comments, Treasury and the IRS have concluded that it is appropriate to apply the due diligence requirements to firms as provided in the proposed regulations. This position is consistent with the long-standing application of the section 6694 tax return preparer penalties to firms under the rules provided in §§1.6694-2(a)(2) and 1.6694-3(a)(2). No modification is made to the final regulations in response to these comments.

7. Conditions Required for Imposing a Penalty on a Firm

Proposed §1.6695-2(c) provided generally that a firm cannot be subject to a penalty under section 6695(g) unless one of the following three conditions is satisfied: (1) a member of the principal management of the firm knew of the failure to comply with the due diligence requirements; (2) the firm failed to establish reasonable and appropriate procedures to ensure compliance with the due diligence requirements; or (3) the firm failed to comply with its reasonable and appropriate compliance procedures through willfulness, recklessness, or gross indifference. Two commenters expressed concern with the conditions required for application of the penalty to a firm, as set forth in proposed §1.6695-2(c).

One of these commenters noted that, if management became aware through the firm's reasonable and appropriate compliance procedures that an employee failed to comply

with the due diligence requirements, then the firm would be subject to a penalty under proposed §1.6695-2(c)(1) because management knew of the failure. The commenter suggested that the final regulations provide that the penalty not apply to the firm if management knew and took reasonable action to resolve the problem before the penalty is assessed. After consideration of this comment, Treasury and the IRS have concluded that, if management knows of the failure to comply prior to the date the tax return or claim for refund is filed, the only acceptable remedial action would be to satisfy the due diligence requirements prior to filing, in which case there would be no penalty. If, on the other hand, management does not know of the failure to comply until after the tax return or claim for refund is filed, the appropriate analysis is whether the firm had reasonable and appropriate compliance procedures and disregarded those procedures through willfulness, recklessness, or gross indifference, as described in §1.6695-2(c)(3), and management's knowledge is relevant only insofar as it is a factor in that analysis. In response to this comment, the final regulations provide that a firm is only subject to a penalty under §1.6695-2(c)(1) if the manager knew of an employee's failure to comply with the due diligence requirements prior to the date the tax return or claim for refund was filed.

The other commenter suggested that the IRS might determine under proposed §1.6695-2(c)(3) that a single failure to submit Form 8867 with a tax return by an otherwise compliant firm qualifies as disregard of reasonable and appropriate compliance procedures through gross indifference. Section 1.6695-2(c)(3) of the proposed regulations established a heightened standard, in part, by imposing liability for the penalty against a firm that disregarded its reasonable and appropriate compliance procedures through willfulness, recklessness, or gross indifference. A single, accidental failure to submit Form 8867 with a tax return by an otherwise compliant firm would not constitute disregard of compliance procedures through willfulness, recklessness, or gross indifference, and the firm would not be subject to the penalty in that situation. After consideration of this comment, Treasury and the IRS have concluded that the heightened standards in proposed §1.6695-2(c)(3) would adequately protect firms against isolated and inadvertent instances of disregard of their compliance procedures. No modification is made to the final regulations in response to this comment.

8. Retention of Records

Proposed §1.6695-2(b)(4)(ii) required that a tax return preparer must retain the records described in §1.6695-2(b)(4)(i) for the period ending three years after the later of the date the tax return or claim for refund was due or the date it was filed. One commenter stated that the record retention date should not be tied to the date the tax return or claim for refund was filed because, if the tax return preparer who prepares the tax return or claim for refund is not the individual who files it, that tax return preparer might not know when it is filed and when the retention period expires. In response to the comment, the final regulations require a tax return preparer to retain the records described in §1.6695-2(b)(4)(i) for the period ending three years after the later of the date the tax return or claim for refund was due or the date it was transferred in final form by the tax return

preparer to the next person in the course of the filing process. In the case of a signing tax return preparer who electronically files the tax return or claim for refund, the next step in the filing process will be to electronically file the tax return or claim for refund, so the relevant date is the date the tax return or claim for refund is filed. In the case of a signing tax return preparer who does not electronically file the tax return or claim for refund, the next person in the course of the filing process will be the taxpayer, so the relevant date is the date the tax return or claim for refund is presented to the taxpayer for signature. In the case of a nonsigning tax return preparer, the next person in the course of the filing process will be the signing tax return preparer, so the relevant date is the date the nonsigning tax return preparer submitted to the signing tax return preparer that portion of the tax return or claim for refund for which the nonsigning tax return preparer was responsible.

The record retention date under the final regulations will be the same for nonsigning tax return preparers supervised by a signing tax return preparer in the same firm and nonsigning tax return preparers who are employed by a different firm than the signing tax return preparer. In both cases, the records must be retained until three years from the later of the due date of the tax return or the date the tax return or claim for refund is submitted in final form to the signing tax return preparer. As a practical matter, however, a supervised nonsigning tax return preparer and the supervising signing tax return preparer can satisfy both of their record retention obligations under the final regulations by retaining a single paper or electronic copy of the records described in §1.6695-2(b)(4)(i). The supervised nonsigning tax return preparer's record retention period may, nevertheless, expire before the signing tax return preparer's record retention period. In such cases, the supervising signing tax return preparer is required to retain the records until the expiration of his or her record retention period under §1.6695-2(b)(4)(ii), regardless of when the supervised nonsigning tax return preparer's record retention period expires.

IRS Letters to Suspect Preparers of EITC Returns

Reaching Out to Preparers

Outreach and education is the first step of in our strategy to improve the accuracy of EITC claims. It is our most important tool to help you prepare high quality EITC claims. Our focus is letting you know about available resources and helping you understand your due diligence responsibilities.

Pre-Filing Season Letters to Preparers

The last step in our outreach and educational part of our tiered EITC Preparer Compliance program is letters directed to specific preparers. We look at the number of returns with a high likelihood of EITC errors completed by the same preparer. And, we send letters to preparers who have a high number of these returns. The letters:

- Acknowledge that we believe the preparer submitted inaccurate returns
- Pinpoint the primary issues identified as questionable on the returns
- Highlight the consequences of filing inaccurate EITC claims
- Outline EITC due diligence responsibilities
- Provide tips on preparing accurate returns and points to online EITC tools, information and other resources
- Inform preparer that we are monitoring their future returns

Return Preparers who file returns with EITC errors or questionable claims may receive one or more of the following letters: (all are in pdf format):

- Letter 4833, a large number of 2012 tax returns you prepared with Earned Income Tax Credit (EITC) may have errors. We will monitor returns prepared during 2014. If those returns don't improve significantly in quality, you may be subject to special follow-up procedures mentioned below in "Additional Steps During the Filing Season," including the possibility of an on-site audit.
- [Letter 5025](#), You may have violated tax law by submitting inaccurate returns. Primary issues identified are qualifying children who don't meet the relations or residency requirements and questionable income and expenses on Schedule C
- [Letter 5025-C](#), You may have violated tax law by submitting inaccurate returns. Primary issue identified is questionable income and expenses on Schedule C
- Letter 5025-D, You may have violated tax law by submitting inaccurate returns. The Primary issue identified is questionable qualifying children with disabilities.
- [Letter 5025-Q](#), You may have violated tax law by submitting inaccurate returns. Primary issue identified is questionable qualifying children who don't meet the relations or residency requirements

Additional Steps

We send the letters to help preparers file accurate EITC claims in the future. We do not assess penalties against preparers because of the letters, but monitor returns filed by these preparers to ensure accuracy improves. If there is no improvement, we may follow-up with phone calls, additional letters or due diligence visits.

Return Preparer Penalties Under IRC 6694
Questions and Answers from the January 21, and January 28, 2009
National Phone Forums

Internal Revenue Manual on Preparer Penalties

Section 3. Return Preparer Penalty Cases

8.11.3 Return Preparer Penalty Cases

- 8.11.3.1 Return Preparer Penalty Overview
- 8.11.3.2 Origin of Return Preparer Penalty Cases
- 8.11.3.3 Receipt of Preparer Penalty Cases
- 8.11.3.4 Return Preparer Penalties as Appeals Coordinated Issues (ACI)
- 8.11.3.5 Closing Procedures for Return Preparer Penalty Cases

Manual Transmittal

September 24, 2013

Purpose

(1) This transmits revised IRM 8.11.3, Appeals Penalties, Return Preparer Penalty Cases.

Effect on Other Documents

This supersedes IRM 8.11.3 dated September 14, 2012.

Effective Date

(09-24-2013)

8.11.3.1 (10-01-2012) Return Preparer Penalty Overview

1. This section addresses the procedures for return preparer penalties considered by Appeals. Return preparer penalties are imposed against the person or business that prepared a return.
2. The penalties discussed in this section are penalties proposed under:
 - IRC 6694, Understatement of Taxpayer's Liability by a Tax Return Preparer, and
 -
 - IRC 6695, Other Assessable Penalties with Respect to the Preparation of Tax Returns for Other Persons, and
 -
 - IRC 6713, Disclosure or Use of Information by Preparers of Returns.

8.11.3.1.1 (09-24-2013)

Return Preparer Penalties Under IRC Section 6694

1. The definition of a tax return preparer for purposes of Sections 6694 and 6695 is provided in IRC 7701(a)(36) and Treasury Regulation 301.7701-15.
2. IRC 6694 penalties can only apply if there is an understatement of tax liability.
3. The IRC 6694(a) penalty is the greater of \$1,000 or 50% of the income derived (or to be derived) by the tax return preparer with respect to each return, amended return or claim for refund prepared if there is an understatement on the return or claim due to an unreasonable position taken on the return or claim that the preparer knew or reasonably should have known about. A position is unreasonable if:
 - A. There was not substantial authority for the position and the position was not disclosed.
 - B. The position was disclosed but there was not reasonable basis for the position.
 - C. The position is with respect to a tax shelter or reportable transaction under IRC 6662A and it is not reasonable to believe the position will be more

likely than not sustained on the merits. See Notice 2009-5. Refer to IRM 20.1.6.4.10 for tax shelters and reportable transactions to which IRC 6662A applies.

4. The IRC 6694(b) penalty is the greater of \$5,000 or 50% of the income derived (or to be derived) by the tax return preparer with respect to returns, amended returns, and claims for refund prepared after May 25, 2007. The penalty may be imposed against a tax preparer if:
 - A. There is an understatement of liability, on a return or claim for refund prepared by the preparer, which is due to a willful attempt in any manner to understate the tax liability by the preparer, or
 - B. The preparer has recklessly or intentionally disregarded rules or regulations.
5. Reduce the IRC 6694(b) penalty by the amount of the IRC 6694(a) penalty if both the IRC 6694(a) and (b) penalties are asserted against the preparer on the same return or claim.
6. Because the IRC 6694(b) penalty involves willfulness, there is no statutory period for assessment of this penalty. On tax return preparer penalties asserted under section 6694(a) and 6695, the three year statute of limitations for assessment begins to run on the statutory due date of the return or, if filed late, the filing date of the return. The statute of limitations on assessment for the section 6694(a) and 6695 penalties may be extended using a Form 872-D, *Consent to Extend the Time on Assessment of Tax Return Preparer Penalty*. IRC 6696(d) addresses periods of limitation.
7. Refer to IRM 20.1.6.4, *IRC 6694 Understatement of Taxpayer's Liability by Tax Return Preparer*, for additional information.
8. These penalties are generally processed under the pre-assessment penalty procedures.

8.11.3.1.2 (09-24-2013)

Preparer Penalties Under IRC Section 6695

1. The return preparer penalties under IRC 6695 are assessed against preparers who:
 - A. Fail to provide the taxpayer with a copy of the return, \$50 per failure, up to a maximum of \$25,000 for each calendar year; per IRC 6695(a),
 - B. Fail to sign the return, \$50 per failure, up to a maximum of \$25,000 for each calendar year, per IRC 6695(b),
 - C. Fail to provide an identifying number, \$50 per failure, up to a maximum of \$25,000 for each calendar year; per IRC 6695(c),
 - D. Fail to retain a copy of the return or a list of returns prepared, \$50 per failure, up to a maximum of \$25,000 for each return period, per IRC 6695(d),
 - E. Fail to file a tax return preparer information return or set forth an item in the return as required under IRC 6060, \$50 for each failure, up to a maximum of \$25,000 for each return period, per IRC 6695(e),
 - F. Negotiate a refund check or misappropriate a refund via electronic means, \$500 per failure per IRC 6695(f), or
 - G. Fail to be diligent in determining eligibility for the Earned Income Tax Credit, \$500 per failure per IRC 6695(g).
2. These penalties are generally processed under the pre-assessment penalty procedures.
3. Refer to IRM 20.1.6.5, *IRC 6695 Penalties That May Apply to a Tax Return Preparer*, for additional information.

8.11.3.1.3 (09-24-2013)

Return Preparer Penalties Under IRC Section 6713

1. The penalty under IRC 6713 is assessed against preparers who:

- A. receive compensation for preparing a tax return, or engage in the business of preparing or providing services in connection with the preparation of tax returns; and
 - B. disclose any information furnished to him or her in connection with the preparation of any return; or
 - C. use any information furnished to him or her for any purpose other than to prepare or assist in preparing the taxpayer's return. The same exceptions set forth in IRC 7216(b) apply to IRC 6713.
2. The penalty is \$250 for each disclosure or use, up to a maximum of \$10,000 for each calendar year.
 3. These penalties are generally processed under the pre-assessment penalty procedures.
 4. Refer to IRM 20.1.6.7, *Penalty for Unauthorized Preparer Disclosure or Use - IRC 6713*, for additional information.

8.11.3.2 (09-24-2013)

Origin of Return Preparer Penalty Cases

1. Examinations under Small Business/Self Employed (SB/SE) Campus and Area, Large Business and International (LB&I) and Tax Exempt and Government Entities (TE/GE) Divisions are responsible for identifying tax returns to which return preparer penalties apply. See IRM 20.1.6.4, *IRC 6694 Understatement of Taxpayer's Liability by Tax Return Preparer*, for detailed procedures.
2. Some penalties are related to positions taken or items reported on underlying tax returns (the related tax return). In general, an unagreed penalty case will not be sent to Appeals before the related tax return is submitted to Appeals. Examination will include in the preparer case file information on the current status and location of the related return.

- A. IRC 6694, IRC 6695, and IRC 6713 penalties generally have pre-assessment appeal rights. Refer to IRM 20.1.6.19.1, *Pre-Assessment Appeals IRC 6694, IRC 6695, IRC 6707A, and IRC 6713*.
 - B. A preparer conduct penalty may not be submitted to Appeals if there is less than 180 days remaining on the statute of limitations.
 - C. If the statutory period for assessment of the IRC 6694(a) penalty is about to expire and the taxpayer will not agree to an extension, Compliance assesses the penalty.
 - D. Examination sends the preparer Letter 1125, which provides the preparer with information on appeals rights.
 - E. If there is no response to the letter, the penalty is assessed.
3. Provide the preparer, upon request, the same appeal rights post-assessment as would have been provided if the appeal was received in a pre-assessment status.

8.11.3.3 (09-24-2013)

Receipt of Preparer Penalty Cases

1. Refer to IRM 8.20.5.29.2, *Return Preparer Penalty (RPP) Cases Carding*, for APS carding procedures.
2. All return preparer penalty work units are controlled on ACDS (Appeals Centralized Database System).
3. Appeals Technical Employees (ATEs) should review the case summary card for accuracy. Preparer penalties are established on ACDS the same way as other penalty appeal cases except for the following:
 - **TYPE** = 6694A, 6694B or 6695 (These are code sections and will be identified on the Form 8278 under column (a).) 6713 will be "OTHPEN."

- **MFT** = 55 for individual, 13 for business (also found on Form 8278)
- **FEATRCOD** (Feature Code) = **AI** Appeals Coordinated Issue except 6713
- **STATDATE** (statute date) or **STATCODE** (statute code) = If the penalty is assessed enter the statute code ASES. If the penalty is not assessed, see the table below.

Type	STATDATE (statute date)	CODE (statute code)
6694A	3 years from the statutory due date of the underlying return or, if filed late, 3 years from the filing of the return. Use the earliest ASED if there is more than one statute date.	Blank
6694B	Blank	6694B – Penalties under IRC 6694B do not have a statute of limitations for assessment.
6695	3 years from the statutory due date of the underlying return or, if filed late, 3 years from the filing of the return. Use the earliest ASED if there is more than one statute date.	Blank
OTHPEN for 6713	Blank	6713 – Penalties under IRC 6713 do not have a statute of limitations for assessment.

4. Treat the case as one work unit when multiple returns are involved in a preparer penalty case.

Example:

IRC 6694(a) is proposed against a preparer on 10 returns that were prepared. The case will appear as one work unit number under the preparer's TIN.

8.11.3.4 (09-24-2013)

Return Preparer Penalties as Appeals Coordinated Issues (ACI)

1. Return preparer penalty issues were re-designated as Appeals Coordinated Issues, Category of Case (ACICC) on August 28, 2011. Review and concurrence is no longer required before finalizing any resolution for a return preparer penalty.
2. Appeals employees having a work unit with a return preparer penalty issue must make a referral to Domestic Operations through their manager upon assignment or preliminary review using Form 13381, *Appeals Technical Guidance Referral*.

Note:

Return preparer penalties under IRC 6713 are not coordinated and a referral should not be made.

3. Refer to the "Domestic Ops" tab on the Appeals Website <http://appeals.web.irs.gov/lbsp/default.htm> for list of Technical Specialists.

8.11.3.4.1 (09-24-2013)

Consideration of Return Preparer Cases

1. Differences in preparer penalty cases.
 - A. Penalties under sections 6694, 6695, and 6713 are not subject to deficiency procedures.
 - B. We use Closing Codes 14, 15, or 16 which refer to whether penalties have been sustained or abated rather than cases closed "agreed" or "unagreed."
 - C. We use Closing Code 20 for all premature referral cases.
 - D. There is no required "agreement form" for return preparer penalties, nor is one required to assess the penalty and close the case. The only way to enter into a binding agreement would be a Form 906, *Closing Agreement*.
 - E. When Appeals sustains or partially sustains a pre-assessment return preparer penalty, the return preparer can still file a claim, and if disallowed, can come to Appeals again in post-assessment status.

2. Upon receipt of the case, the Appeals Technical Employee (ATE) must follow the procedures outlined in IRM 8.11.1.1.6, *New Receipt Procedures for Appeals Technical Employees*. This includes, but is not limited to:
 - Determining the statute of limitations and validating the statute-related fields on ACDS within five (5) business days of receipt of the case in accordance with IRM 8.11.1.1.6 (1) and IRM 8.21.3, *Appeals Technical Employees Statute Responsibility*.
 - Validating the Case Summary Card (CSC) information and making updates, if necessary, in accordance with IRM 8.11.1.1.6 (2). Refer to *IRM 8.11.3.3* for fields pertaining to return preparer penalty cases.
 - Ensuring that the ACDS Uniform Acknowledgment Letter 4141 was issued in accordance with IRM 1.4.28.3.1, *Assignment of Work Units and Issuance of Letter 4141(CG)*, *Uniform Acknowledgment Letter (UAL)* and IRM 1.4.28-6, *Pre-Selected Enclosures for the UAL Based Upon the Category and Type of Case*.
3. Consideration of the penalty case will include an analysis of the litigating hazards. See IRM 8.11.1.1.7.2, *Hazards of Litigation*.
4. Process return preparer penalties as follows:
 - Use Form 8278, *Computation and Assessment of Miscellaneous Penalties*, to process the request for Assessment/Adjustment/Abatement.,
 - A. Use the customized Form 5402, *Appeals Transmittal and Case Memo*, as the transmittal document for all preparer penalty cases.
 - B. Use closing Letter 1342 with addendum, for cases where a penalty is sustained or partially abated. This letter describes the procedures for filing suit with district or claims court.
 - C. Use closing Letter 5011 for cases where the penalty is conceded in full.
5. Refer all IRC 6694(b) preparer penalties **asserted** by Appeals against an attorney, certified public accountant, registered tax return preparer, enrolled

agent or enrolled actuary, to the Office of Professional Responsibility (OPR). See IRM 8.10.2.1.2.2, *Reports to Outside Officials*, for procedures on reports to the Office of Professional Responsibility and IRM 20.1.6.12.3, *Referral to the Office of Professional Responsibility*.

6. ATEs should exercise discretion in making referrals to OPR for other return preparer penalties. Referrals of asserted IRC 6694(a) and/or IRC 6695(a) through (g) penalties to OPR should be based on a pattern of behavior or penalties across multiple taxpayers, tax issues or tax years.

8.11.3.5 (09-24-2013)

Closing Procedures for Return Preparer Penalty Cases

1. Refer to IRM 8.20.7.8.4, *Return Preparer Penalty Closing Procedures*, for APS closing procedures.
2. Preparer penalties are closed the same as other penalty appeals with the following additions:
 - A. Form 5402, *Appeals Transmittal and Case Memo*, will be included in the closing package. It should include information on the revised penalty amounts needed to update ACDS.
 - B. Form 8278 will be included and will require processing.
3. The following closing codes apply:

Determination Made	CLOSINGCD
Sustained (penalties are not removed)	14
Abated (penalties are fully removed)	15
Partially Abated (only part of penalties are removed)	16
Premature Referral (case returned to Examination)	20

Determination Made

CLOSINGCD

4. APS will assess or abate penalty per the ATE prepared Forms 5402 and 8278 instructions.

A. Penalties are assessed using TC 240 and the applicable reference code.

5. If closing a case as a premature referral that contains an IRC 6695(g) penalty, the ATE will advise APS to return the case to the appropriate EITC coordinator by notating this in the other remarks section of the Form 5402. The list of EITC coordinators can be found at

<http://mysbse.web.irs.gov/exam/tip/rp/contacts/12536.aspx>.

2011 Circular 230 Revisions

Standards With Respect to Tax Returns and Documents, §6694 & §10.34(a)

After consideration, the IRS and the Treasury Department continue to conclude that the professional standards in §10.34(a) generally should be consistent with the civil penalty standards in §6694 for tax return preparers. As discussed in this preamble, the limited differences between the standards in §10.34 and §6694 arise from the different purposes served by those provisions and the different manner in which the two standards will be administered.

The standards with respect to tax returns in §10.34(a) in the final regulations provide broader guidelines that are more appropriate for professional ethics standards. Under §10.34(a)(1)(i) of the regulations, a practitioner may not willfully, recklessly, or through gross incompetence, sign a tax return or claim for refund that the practitioner knows or reasonably should know contains a position that: (A) lacks a reasonable basis; (B) is an unreasonable position as described in §6694(a)(2) (including the related regulations and other published guidance); or (C) is a willful attempt by the practitioner to understate the liability for tax or a reckless or intentional disregard of rules or regulations by the practitioner as described in §6694(b)(2) (including the related regulations and other published guidance).

Under §10.34(a)(1)(ii) of the regulations, a practitioner may not willfully, recklessly, or through gross incompetence, advise a client to take a position on a tax return or claim for refund, or prepare a portion of a tax return or claim for refund containing a position, that: (A) lacks a reasonable basis; (B) is an unreasonable position as described in §6694(a)(2) (including the related regulations and other published guidance); or (C) is a willful attempt by the practitioner to understate the liability for tax or a reckless or intentional disregard of rules or regulations by the practitioner as described in §6694(b)(2) (including the related regulations and other published guidance).

Independent Determination

Some commentators were concerned that a violation of §6694 would translate to a *per se* violation of §10.34. If the IRS, however, assesses a penalty against a practitioner under §6694 and also refers the practitioner for possible discipline under Circular 230, an independent determination as to whether the practitioner engaged in willful, reckless, or grossly incompetent conduct subject to discipline under §10.34(a) will be made before any disciplinary proceedings are instituted or any sanctions are imposed. Thus, a practitioner liable for a penalty under §6694 is not automatically subject to discipline under §10.34(a) of the regulations.

The Treasury Department and the IRS continue to believe that a practitioner also acts

unethically in violating the civil penalty standards under §6694(a) (including when there is a reasonable basis for a position on a return or claim for refund but the practitioner does not adequately disclose the position within the meaning of §1.6694-2(d)(3)) through willful, reckless, or grossly incompetent conduct. Accordingly, final §10.34(a)(1)(i) and (a)(1)(ii) provide three independent standards of practitioner conduct and a practitioner who fails to satisfy any one of the three standards is subject to discipline under §10.34(a).

Procedures to Ensure Compliance-§10.36

§10.36(b) of the regulations provides that firm management with principal authority and responsibility for overseeing a firm's practice of preparing tax returns, claims for refunds and other documents filed with the IRS must take reasonable steps to ensure that the firm has adequate procedures in effect for purposes of complying with Circular 230. The Treasury Department and the IRS continue to believe that expansion of §10.36 to require firm procedures for tax return preparation practice, in addition to the pre-existing application to covered opinions, will help ensure compliance and encourage firms to self-regulate. Firm responsibility is a critical factor in ensuring high quality advice and representation for taxpayers.

20.1.6.3 (05-16-2012)

Overview—Preparer, Promoter, Material Advisor, and Failure to Disclose Reportable Transaction Penalties

1. There are four categories of penalties addressed in this IRM subsection. They are as follows:
 1. Preparer penalties and actions to pursue injunction
 2. Promoter penalties and action to pursue injunction
 3. Material advisor penalties
 4. Failure to disclose reportable transaction penalties

20.1.6.3.1 (05-16-2012)

Preparer Penalties and Action to Pursue Injunction

1. Preparer penalties and actions to enjoin are as follows:
 - IRC 6694, Understatement of Taxpayer's Liability by Tax Return Preparer
 - IRC 6695, Other Assessable Penalties With Respect to the Preparation of Tax Returns for Other Persons
 - IRC 6701, Penalties for Aiding and Abetting Understatement of Tax Liability
 - IRC 6713, Disclosure or Use of Information by Preparers of Returns
 - IRC 7407, Action to Enjoin Tax Return Preparers

20.1.6.3.2 (09-17-2010)

Promoter Penalties and Action to Pursue Injunction

1. Promoter penalties and actions to enjoin are as follows:
 - IRC 6700, Promoting Abusive Tax Shelters, Etc.
 - IRC 6701, Penalties for Aiding and Abetting Understatement of Tax Liability
 - IRC 7408, Actions to Enjoin Specified Conduct Related to Tax Shelters and Reportable Transactions

20.1.6.3.3 (09-17-2010)

Material Advisor Penalties

Material advisor penalties are IRC 6707, Failure to Furnish Information Regarding Reportable Transactions, and IRC 6708, Failure to Maintain Lists of Advisees With Respect to Reportable Transactions.

20.1.6.3.4 (05-16-2012)

Failure to Disclose Reportable Transaction

The failure to disclose reportable transaction penalty is IRC 6707A, Penalty for Failure to Include Reportable Transaction Information With Return.

20.1.6.4 (05-16-2012)

IRC 6694 Understatement of Taxpayer's Liability by Tax Return Preparer

1. Review *IRM 20.1.6.22, Third Party Contacts—IRC 7602(c)*.
2. Estate and gift tax attorneys and LB&I, SB/SE, and TE/GE examiners should determine if tax return preparer penalties are warranted. The determination is based on all the facts and circumstances of the case including both oral testimony and written evidence developed during the examination process of the tax return prepared by the tax return preparer for his or her client.
3. Campus examination operations return preparer scheme referral procedures are in *IRM 4.19.10.6, Return Preparer Scheme Identification*.
4. Determining whether or not to proceed with a preparer penalty investigation is documented on the penalty lead sheet of the examination return preparer's client case file. The penalty lead sheet for SB/SE Examination is *300—Penalty Approval Form*. Estate and gift tax examiners should use the penalty lead sheet in the Notebook Job Aid. Other BUs may use a functional equivalent. This lead sheet documents whether a return preparer penalty was considered. Disclosure guidelines preclude reference to an examination of another taxpayer in the return preparer's client case file. When the determination is made that the return preparer may be responsible for the understatement of tax the response in lead sheet *300—Penalty Approval Form*, or its functional equivalent under the preparer section is to check "yes" in the box "Consider Penalty." Examiners must discuss their recommendations with their manager and secure managerial approval before initiating a return preparer penalty investigation. See *IRM 20.1.6.1.1.2* for additional information regarding the documentation of approval by managers for penalties.
5. Note:
6. Campus examination employees will document their return preparer penalty determination on Form 4700, *Examination Workpapers*.
7. If the manager approves the penalty investigation, the separate penalty examination case will be controlled and established on ERCS. Form 5809, *Preparer Penalty Case Control Card*, for operating divisions using ERCS. Form 5809 is signed by the manager and retained in the preparer penalty case file.
8. Note:

9. TE/GE penalty investigations will be controlled and established on RCCMS. Visit the TE/GE's RCCMS website at <http://tege.web.irs.gov/templates/TEGEHOME.asp> for preparer penalty investigation procedures.

20.1.6.4.1 (05-16-2012)

IRC 6694 Penalties That May Apply to a Tax Return Preparer

1. This section includes the following:

- IRC 6694(a), *Understatement Due to Unreasonable Positions*
- IRC 6694(b), *Understatement Due to Willful or Reckless Conduct*

Note:

See Training Publication 26809-001, *Return Preparer Penalties—IRC 6694 and IRC 6695 (Student Guide)*, Catalog Number 20189I, at <http://core.publish.no.irs.gov/trngpubs/pdf/20189f09.pdf>

20.1.6.4.2 (05-16-2012)

Tax Return Preparer Defined

1. Section 8246 of The Small Business Work Opportunity Tax Act of 2007 (SBWOTA) amended IRC 7701(a)(36), Tax Return Preparer, expanding the definition of tax return preparer for periods after May 25, 2007, to any person (including a partnership or corporation) who prepares for compensation, or who employs one or more persons to prepare for compensation, all or a substantial portion of a tax return or claim for refund
2. For periods prior to May 26, 2007, the definition of a tax return preparer is limited to income tax return preparers.
3. Treas. Reg. 301.7701-15(a) and various revenue rulings provide information on the definition of a tax return preparer, including nonsigning preparers.
4. Treas. Reg. 301.7701-15(f) provides guidance on persons who are not tax return preparers.
5. See Lesson 1 of Training Publication 26809-001, *Return Preparer Penalties—IRC 6694 and IRC 6695*, Catalog Number 20189I at <http://publish.no.irs.gov/cat12.cgi?request=CAT1&=20189f> for additional information.
6. A nonsigning preparer who prepares a schedule or entry or portion that constitutes a substantial portion of the return may be considered a tax return preparer. In making the decision as to what constitutes a "substantial portion," examiners should compare the

length, complexity, and tax liability or refund of the entity, schedule, or portion of the return or claim of refund prepared by the nonsigning preparer to the length, complexity, and tax liability or refund of the return or claim for refund as a whole. To determine whether an individual is a nonsigning tax return preparer, see Treas. Reg. 301.7701-15(b)(2) and (3).

7. See IRC 7701(a)(36)(B), Tax Return Preparer, for exceptions to the general definition.

20.1.6.4.3 (05-16-2012)

Firm Liability

1. Prior to January 1, 2009, regulations encompassed a "one preparer per firm" rule that treated the signing preparer as the preparer subject to the IRC 6694 penalty. Under the prior regulations, if there is no signer in a firm, the individual with overall supervisory responsibility for the advice given by the firm with respect to the return or claim is the nonsigner subject to penalty.
2. After December 31, 2008, Treas. Reg. 1.6694-1(b) changed the rule under previous regulations. In the course of identifying the individual who is primarily responsible for the position, the IRS may advise multiple individuals within the firm that it may be concluded that they are the individual within the firm who is primarily responsible for the position. A penalty, however, may only be assessed against the individual in the firm who is the primarily responsible tax return preparer. See Treas. Reg. 301.7701-15(b)(3).

20.1.6.4.4 (09-17-2010)

Employers Subject to IRC 6694 Penalty

1. For years after December 31, 2008, Treas. Reg. 1.6694-2(a)(2) provides that corporations, partnerships, and other firms that employ a tax return preparer may be subject to a penalty under IRC 6694(a).
2. A firm that employs a tax return preparer subject to the penalty under IRC 6694 (or a firm in which the individual tax return preparer is a partner, member, shareholder, or other equity holder) is also subject to the penalty if, and only if the following:
 - A. One or more members of the principal management (or principal officers) of the firm or a branch office participated in or knew of the conduct proscribed by IRC 6694(a);
 - B. The corporation, partnership, or other firm entity failed to provide reasonable and appropriate procedures for review of the position for which the penalty is imposed; or
 - C. The corporation, partnership, or other firm entity disregarded its reasonable and appropriate review procedures through willfulness, recklessness, or gross indifference (including ignoring facts that would lead a person of reasonable prudence and competence to investigate or ascertain) in the formulation of the advice, or the preparation of the return or claim for refund, that included the position for which the penalty is imposed.

20.1.6.4.5 (05-16-2012)
Rev. Proc. 2009-11 Section 3

1. Rev. Proc. 2009-11, Section 3, Returns and Claims for Refund Subject to the Section 6694 Penalty, identifies categories of returns to which the penalties under IRC 6694 apply. The categories are as follows:
 - A. Income Tax Returns—Subtitle A (e.g., Form 1040, U.S. Individual Income Tax Return, Form 1041, U.S. Income Tax Return for Estates and Trusts, Form 1120, U.S. Corporation Income Tax Return)
 - B. Estate and Gift Tax Returns—Subtitle B (e.g., Form 706, U.S. Estate (and Generation-Skipping Transfer) Tax Return and Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return)
 - C. Employment Tax Returns—Subtitle C (e.g., Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return, Form 941, Employer's Quarterly Federal Tax Return, Form 943, Employer's Annual Tax Return for Agricultural Employees)
 - D. Miscellaneous Excise Tax Returns—Subtitle D (e.g., Form 720, Quarterly Federal Excise Tax Return, Form 2290, Heavy Highway Vehicle Use Tax Return)
 - E. Alcohol, Tobacco, and Certain Other Excise Taxes—Subtitle E (e.g., Form 8725, Excise Tax on Greenmail)

Note:

Rev. Proc. 2009–11 obsoletes Notice 2008–12, IRB 2008-3 280, and , Notice 2008–46, IRB 2008-18 868. Rev. Proc. 2009–11 modifies and supersedes the list of forms in Notice 2008–13, IRB 2008–3 282

20.1.6.4.6 (05-16-2012)
IRC 6694(a) Standards of Conduct Required

1. Pre-SBWOTA, Prior to May 26, 2007: For income tax returns and claims for refund filed under the following:
 - A. Any part of an understatement of liability with respect to an income tax return or claim for refund was due to a position for which there was not a realistic possibility of being sustained on its merits, and
 - B. A person who is an income tax return preparer with respect to that return or claim for refund knew (or reasonably should have known) of the position, and

- C. The position was not disclosed as provided in IRC 6662(d)(2)(B)(ii), or was frivolous,
 - D. Then the penalty was \$250 for such person with respect to such return or claim unless it is shown that there was a reasonable cause for the understatement and such person acted in good faith.
2. Post-SBWOTA, After May 25, 2007: SBWOTA both increased the penalty amount under IRC 6694(a) and made it applicable with respect to all tax returns, amended returns and claims for refund, including estate tax returns and gift tax returns, generation-skipping transfer tax returns, employment tax returns, and excise tax returns. SBWOTA and Tax Extenders and Alternative Minimum Tax Relief Act (TEAMTRA) also changed the standards of conduct that return preparers must meet in order to avoid imposition of the IRC 6694(a) penalty. The preparer penalty under IRC 6694(a) applies to tax returns and claims for refund filed after May 25, 2007, if there is an understatement of taxpayer's liability due to an unreasonable position; and either of the following:
- A. The position was properly disclosed, but there was no reasonable basis for the position, or
 - B. The position was not properly disclosed and there was not substantial authority for the position.

SBWOTA increased the penalty applicable to IRC 6694(a), Understatement Due to Unreasonable Positions, to the greater of \$1,000 or 50 percent of the income derived (or to be derived) by the tax return preparer with respect to returns, amended returns and claims for refund prepared after May 25, 2007.

20.1.6.4.7 (09-17-2010)

IRC 6694(a)—Understatement Due to Unreasonable Positions

1. The standard for disclosed position is reasonable basis.
2. The standard for positions that are not disclosed is substantial authority if the position is not a tax shelter (as defined in IRC 6662(d)(2)(C)(ii)(I)) or a reportable transaction to which IRC 6662A, Imposition of Accuracy-related Penalty on Understatements With Respect to Reportable Transactions, applies.

20.1.6.4.7.1 (09-17-2010)

Reasonable Basis—Standard for Disclosed Position

1. "Reasonable basis" has the same meaning as in Treas. Reg. 1.6662-3(b)(3) or any successor provision of the accuracy-related penalty regulations.

2. Treas. Reg. 1.6662-3(b)(3) states, "Reasonable basis is a relatively high standard of tax reporting, that is, significantly higher than not frivolous or not patently improper. The reasonable basis standard is not satisfied by a return position that is merely arguable or that is merely a colorable claim. A return position is reasonable when using one or more of the authorities set forth in Treas. Reg. 1.6662-4(d)(3)(iii) (taking into account the relevance and persuasiveness of the authorities, and subsequent developments)."

Note:

Lesson 2 of Training Publication 26809-001 provides further guidance on this issue. The website address is <http://core.publish.no.irs.gov.trngpubs/pdf/20189f09.pdf>

20.1.6.4.7.2 (09-17-2010)

Substantial Authority Standard for Positions Not Disclosed

1. The substantial authority standard is less stringent than the more likely than not standard (the standard that is met when there is a greater than 50 percent likelihood of the position being upheld), but more stringent than the reasonable basis standard as defined in Treas. Reg. 1.6662-3(b)(3). See Treas. Reg. 1.6662-4(d)(2).
2. For tax shelters and reportable transactions to which IRC 6662A, Imposition of Accuracy-related Penalty on Understatements With Respect to Reportable Transactions, applies see IRM 20.1.6.4.10, Tax Shelters and Reportable Transactions.

20.1.6.4.8 (09-17-2010)

Notices 2007-54 and Notice 2008-11

1. Notice 2007-54, IRB 2007-27 12, and Notice 2008-11, IRB 2008-3 279, provided transitional relief for all returns, amended returns, and refund claims due on or before December 31, 2007, to advice given before December 31, 2007, and 2007 employment and excise tax returns due on or before January 31, 2008 that are filed after May 25, 2007. Also, see Notice 2009-5, IRB 2009-3 309, for further information.

Note:

Treasury Decision (T.D.) 9436 effective December 22, 2008, obsoletes Notice 2007-54 and Notice 2008-11. The T.D. is the final regulation implementing changes to return preparer legislation in 2007 and 2008. Announcement 2009-15 contains corrections to T.D. 9436.

20.1.6.4.9 (09-17-2010)

Adequate Disclosure Defined

1. The criteria for adequate disclosure is defined as follows:
 - A. See IRM 20.1.6.4.9.1, Signing Tax Return Preparer Adequate Disclosure.
 - B. See IRM 20.1.6.4.9.2, Nonsigning Tax Return Preparer Adequate Disclosure.
2. See Treas. Reg. 301.7701-15(b)(2) for definition of nonsigning tax return preparer.

20.1.6.4.9.1 (09-10-2013)

Signing Tax Return Preparer Adequate Disclosure

1. Disclosure of a position for which there is a reasonable basis but for which there is not substantial authority is adequate if the signing tax return preparer meets the standard outlined in paragraphs 2, 3, or 4 below.
2. The position is disclosed in accordance with Treas. Reg. 1.6662-4(f) on the following:
 - A. A properly completed and filed Form 8275, Disclosure Statement, or Form 8275-R, Regulation Disclosure Statement, as appropriate; or
 - B. On the tax return in accordance with the annual revenue procedure described in Treas. Reg. 1.6662-4(f)(2).
3. The tax return preparer provides the taxpayer with the prepared tax return that includes the disclosure in accordance with Treas. Reg. 1.6662-4(f).
4. For returns or claims for refund that are subject to penalties pursuant to IRC 6662, Imposition of Accuracy-related Penalty on Underpayments, other than the accuracy-related penalty attributable to a substantial understatement of income tax under IRC 6662(b)(2) and IRC 6662(d):
 - A. The tax return preparer advises the taxpayer of the penalty standards applicable to the taxpayer under IRC 6662, and
 - B. The tax return preparer also contemporaneously documents the advice in the tax return preparer's files.

20.1.6.4.9.2 (09-10-2013)

Nonsigning Tax Return Preparer Adequate Disclosure

1. Disclosure of a position for which there is a reasonable basis standard but does not satisfy the substantial authority standard is adequate if the nonsigning tax return preparer meets either of the following standards:
2. The position is disclosed in accordance with Treas. Reg. 1.6662-4(f) on a properly completed and filed Form 8275, Disclosure Statement, or Form 8275-R, Regulation Disclosure Statement, as applicable; or
 - A. The position is disclosed on the return in accordance with an annual revenue procedure described in Treas. Reg. 1.6662-4(f)(2).
3. If a nonsigning tax return preparer provides advice to a taxpayer with respect to a position which there is a reasonable basis standard but does not satisfy the substantial authority standard, disclosure of that position is adequate based on the following:

- A. The tax return preparer advises the taxpayer of any opportunity to avoid penalties under IRC 6662A, Imposition of Accuracy-related Penalty on Understatements With Respect to Reportable Transactions, that could apply to the position, if relevant, and of the standards for disclosure to the extent applicable.
 - B. The tax return preparer also contemporaneously documents the advice in the tax return preparer's files. The contemporaneous documentation should reflect that the affected taxpayer has been advised by a tax return preparer in the firm of the potential penalties and the opportunity to avoid penalty through disclosure.
4. If a nonsigning tax return preparer provides advice to another tax return preparer with respect to a position which there is a reasonable basis standard but does not satisfy the substantial authority standard, disclosure of that position is adequate based on the following:
- A. The tax return preparer advises the other tax return preparer that disclosure under IRC 6694(a) may be required.
 - B. The tax return preparer also contemporaneously documents the advice in the tax return preparer's files. The contemporaneous documentation should reflect that the tax return preparer outside the firm has been advised that disclosure under IRC 6694(a) may be required.

20.1.6.4.10 (09-17-2010)

Tax Shelters and Reportable Transactions

1. Notice 2009-5, IRB 2009-3 309, provides that TEAMTRA's standard of more likely than not for tax shelters and reportable transactions applies for taxable years ending after October 3, 2008.
- A. It is reasonable to believe that positions have a "more likely than not" chance of being upheld on their merits if a preparer has analyzed the pertinent facts and authorities and concluded, in good faith, that there is greater than 50 percent likelihood that the tax treatment will be upheld if the IRS challenges it.
 - B. The analysis prescribed by Treas. Reg. 1.6662-4(d)(3)(ii) (or any successor provision) for purposes of determining whether substantial authority is present applies for purposes of determining whether the more likely than not standard is satisfied. Whether a tax return preparer meets this standard will be determined based upon all facts and circumstances, including the tax return preparer's due diligence.
 - C. Notice 2009-5, IRB 2009-3 309, also provides an interim compliance rule for tax shelter transactions that are not listed or otherwise reportable under IRC 6662A, Imposition of Accuracy-related Penalty on Understatements With Respect to Reportable Transactions. A position will not be deemed an "unreasonable position" if there is substantial authority for the position and the tax return preparer advises the taxpayer of the penalty standards applicable to the taxpayer.

Note:

These interim compliance rules do not apply to a position, described in IRC 6662A, that is a reportable transaction with a significant purpose of federal tax avoidance or evasion or a listed transaction.

20.1.6.4.11 (05-16-2012)
Reasonable Cause Exception

1. The penalty under IRC 6694(a) will not be imposed if, considering all the facts and circumstances, it is determined that the understatement was due to reasonable cause and the tax return preparer acted in good faith. See Treas. Reg. 1.6694-2(e). A tax return preparer will be found to have acted in good faith when the tax return preparer relied on the advice of a third party who is not in the same firm as the tax return preparer and who the tax return preparer had reason to believe was competent to render the advice. The advice may be written or oral, but in either case the burden of establishing that the advice was received is on the tax return preparer. A tax return preparer is not considered to have relied in good faith if—
 - A. The advice is unreasonable on its face;
 - B. The tax return preparer knew or should have known that the third party advisor was not aware of all relevant facts; or
 - C. The tax return preparer knew or should have known (given the nature of the tax return preparer's practice), at the time the tax return or claim for refund was prepared, that the advice was no longer reliable due to developments in the law since the time the advice was given.
2. The other factors to consider include the following:
 - A. Nature of the error causing the understatement: Whether the error resulted from a provision that was so complex, uncommon, or highly technical that a competent preparer of returns or claims of the type at issue reasonably could have made the error. The reasonable cause and good faith exception does not apply to an error that would have been apparent from a general review of the return or claim for refund by the preparer.
 - B. Frequency of errors: Whether the understatement was the result of an isolated error (such as an inadvertent mathematical or clerical error) rather than a number of errors. Although the reasonable cause and good faith exception generally applies to an isolated error, it does not apply if the isolated error is so obvious, flagrant or material that it should have been discovered during a review of the return or claim. Furthermore, the reasonable cause and good faith exception does not apply if there is a pattern of errors on a return or claim for refund even though any one error, in isolation, would have qualified for the reasonable cause and good faith exception.
 - C. Materiality of errors: Whether the understatement was material in relation to the correct tax liability. The reasonable cause and good faith exception generally applies if the understatement is of a relatively immaterial amount. Nevertheless, even an immaterial understatement may not qualify for the reasonable cause and good faith exception if the error or errors creating the understatement are sufficiently obvious or numerous.
 - D. Preparer's normal office practice: Whether the preparer's normal office practice, when considered together with other facts and circumstances, such as the knowledge of the preparer, indicates that the error in question would rarely occur and the normal office practice was followed in preparing the return or claim in question. Such a normal office practice must be a system for promoting accuracy and consistency in the preparation of returns or claims and generally would

include, in the case of a signing preparer, checklists, methods for obtaining necessary information from the taxpayer, a review of the prior year's return, and review procedures. Notwithstanding the above, the reasonable cause and good faith exception does not apply if there is a flagrant error on a return or claim for refund, a pattern of errors on a return or claim for refund, or a repetition of the same or similar errors on numerous returns or claims.

20.1.6.4.12 (09-17-2010)
Penalty Computation

1. SBWOTA increased the IRC 6694(a) penalty for understatements due to unreasonable positions from \$250 to the greater of \$1,000 or 50% of the income derived (or to be derived) by the tax return preparer from the preparation of a return or claim with respect to which the penalty was imposed. Examiners calculating the penalty using 50% of the income derived (or to be derived) by the tax return preparer from the preparation of a return or claim must elevate the calculation determination through his or her manager to the function RPC. For SB/SE Examination, the area RPC is used in lieu of the functional RPC. The RPC will then consult with the appropriate local Counsel contact person.

20.1.6.4.13 (09-10-2013)
Understatement Due to Willful or Reckless Conduct—IRC 6694(b)

1. Standard of conduct for IRC 6694(b) remains the same for both prior and post SBWOTA.
2. There must be an understatement of liability for the penalty under IRC 6694(b) to be considered. It should be imposed when the following conditions are met:
 - A. Any part of the understatement was due to a willful attempt by a tax return preparer; or
 - B. Reckless or intentional disregard of rules or regulations by a tax return preparer.
3. Prior to SBWOTA, IRC 6694(b) was applied only to income tax return preparers.

20.1.6.4.13.1 (05-16-2012)
IRC 6694(b)—Burden of Proof

1. Under IRC 7491(c) the IRS bears the burden of production in any court proceeding with respect to the liability of any individual for a penalty. Under IRC 7427, Tax Return Preparers, the IRS bears the burden of proof on the issue of whether the preparer willfully attempted to understate the tax liability.
2. Reckless conduct is a highly unreasonable omission or misrepresentation involving an extreme departure from the standards of ordinary care that a practitioner should observe under the circumstances.
3. Following are examples of willful or reckless conduct from Treas. Reg. 1.6694-3(d):
 - A. A taxpayer provided a preparer with detailed check registers reflecting personal and business expenses. One of the expenses was for domestic help, and this expense was identified as personal on the check register. The preparer knowingly deducted the expenses of the taxpayer's domestic help as wages paid

in the taxpayer's business. The preparer is subject to the penalty under IRC 6694(b).

- B. A taxpayer provided a preparer with detailed check registers to compute the taxpayer's expenses. However, the preparer knowingly overstated the expenses on the return. After adjustments by the examiner, the tax liability increased significantly. Because the preparer disregarded information provided in the check registers, the preparer is subject to the penalty under IRC 6694(b).

20.1.6.4.13.2 (09-17-2010)

Penalty Computation—IRC 6694(b)

1. SBWOTA increased the IRC 6694(b) penalty to the greater of \$5,000 or 50 percent of the income derived (or to be derived) by the tax return preparer with respect to returns, amended returns, and claims for refund prepared on or after May 26, 2007.
2. If both IRC 6694(a) and IRC 6694(b) penalties apply to a tax return preparer, the IRC 6694(b) penalty amount must be reduced by the IRC 6694(a) penalty amount per IRC 6694(b)(3), Reduction in Penalty.
3. Examiners should ensure that the combined assessment of IRC 6694(a) and IRC 6694(b) penalties against a preparer do not exceed the greater of \$ 5,000 or 50 percent of the income derived (or to be derived) by the tax return preparer with respect to returns, amended returns, and claims for refund prepared on or after May 26, 2007.
4. Examiners calculating the IRC 6694(b) penalty using 50 percent of the income derived (or to be derived) by the tax return preparer from the preparation of a return or claim must elevate the calculation determination through his or her manager to the functional RPC. The RPC will then consult with the appropriate local Counsel contact person.

20.1.6.4.14 (09-17-2010)

Referrals to Office of Professional Responsibility—IRC 6694

1. See IRM 20.1.6.12, Office of Professional Responsibility (OPR).

20.1.6.4.15 (09-17-2010)

Statute of Limitations—IRC 6694

1. See IRM 20.1.6.21, Statute Of Limitations.

20.1.6.4.16 (09-17-2010)

Appeals Procedures

1. See IRM 20.1.6.19, Appeal Rights.

20.1.6.5 (05-16-2012)

IRC 6695 Penalties That May Apply to a Tax Return Preparer

1. Review IRM 20.1.6.22, Third Party Contacts-IRC 7602(c).
2. The IRC 6695 penalties only apply to tax return preparers. See IRM 20.1.6.4.2, Tax Return Preparer Defined. The following is a list of penalties found in IRC 6695:

- A. IRC 6695(a), Failure to Furnish Copy to Taxpayer, a \$50 penalty will be asserted for each failure, with a maximum of \$25,000 per preparer per calendar year;
- B. IRC 6695(b), Failure to Sign Return, a \$50 penalty will be asserted for each failure, with a maximum of \$25,000 per preparer, per calendar year;
- C. IRC 6695(c), Failure to Furnish Identifying Number, no more than one penalty may be imposed with respect to a single return or claim for refund. A \$50 penalty will be asserted for each failure, with a maximum of \$25,000 per preparer, per calendar year;
- D. IRC 6695(d), Failure to Return Copy or List, a \$50 penalty will be asserted for each failure, with a maximum of \$25,000 to any return period;
- E. IRC 6695(e), Failure to File Correct Information Returns, the penalty is \$50 for each failure to file a return as required by IRC 6060, Information Returns of Tax Return Preparers, and \$50 for each failure to include a required item in the return. The maximum amount for any return period is \$25,000;
- F. IRC 6695(f), Negotiation of Check, the penalty is \$500 for each negotiated check. There is no maximum amount; and
- G. IRC 6695(g), Failure to Be Diligent in Determining Eligibility for Earned Income Credit, any return preparer who fails to comply with the EITC due diligence requirements of IRC 6695(g) will be charged a penalty for each failure. For any tax returns or claims for refund for tax years ending before December 31, 2011 the penalty is \$100 per failure. There is no maximum amount. For any tax returns or claims for refund for tax years ending on or after December 31, 2011 the penalty is \$500 per failure. There is no maximum amount.

20.1.6.5.1 (09-10-2013)

Failure to Furnish Copy to Taxpayer-IRC 6695(a)

1. The IRC 6695(a) penalty applies if the preparer fails to comply with IRC 6107(a), Furnishing Copy to Taxpayer. Under IRC 6107(a) a preparer is required to furnish a completed copy of the return or claim for refund to the taxpayer before (or at the same time) the return or claim for refund is presented to the taxpayer for signature.
 - A. This copy may be given to the taxpayer in any media, including electronic media, that is acceptable to both the taxpayer and the tax return preparer.
 - B. In the case of an electronically filed return, a complete copy of a taxpayer's return or claim for refund consists of the electronic portion of the return or claim for refund, including all schedules, forms, attachments, and jurats, which were filed with the IRS. The copy provided to the taxpayer must include all information submitted to the IRS to enable the taxpayer to determine what schedules, forms, electronic files, and other supporting materials have been filed with the return.
 - C. The copy, however, need not contain the identification number of the paid tax return preparer. The electronic portion of the return or claim for refund may be contained on a replica of an official form or on an unofficial form. On an

unofficial form, however, data entries must reference the line numbers or descriptions on an official form. See Treas. Reg. 1.6107-1(a)(2).

2. If there is an employment arrangement between two or more preparers, the requirement to furnish a copy only applies to the person who employs (or engages) one or more other preparers. Similarly, if there is a partnership arrangement, the requirement to furnish a copy only applies to the partnership. See Treas. Reg. 1.6107-1(c).
3. The IRC 6695(a) penalty does not apply if the failure is due to reasonable cause and not due to willful neglect. Thus, the penalty for failure to furnish a copy to the taxpayer will not be imposed solely because of the following:
 - A. A person is a nonsigning preparer under Treas. Reg. 301.7701-15(b)(2), or
 - B. A person is a preparer under Treas. Reg. 301.7701-15(b)(3) on account of having prepared another return (e.g., the partnership return) which affects the amounts reported on the return in question (e.g., the partner's return).
4. The IRC 6695(a) penalty will also not be imposed where a preparer deletes certain information from the copy furnished to the taxpayer if the taxpayer holds an elected or politically appointed position with the government of the United States or a state or political subdivision thereof and who in order to carry out his or her official duties, has arranged his or her affairs so that he or she has less than full knowledge of the property he or she holds or of the debts for which he or she is responsible. See Treas. Reg. 1.6695-1(a)(2).

20.1.6.5.2 (09-17-2010)

Failure to Sign Return or Claim for Refund—IRC 6695(b)

1. The IRC 6695(b) penalty applies if the preparer, who is required by regulations to sign the taxpayer's return or claim for refund, fails to sign the return or claim for refund. Preparers must sign the return or claim for refund that are not signed electronically using the appropriate method prescribed by the Secretary after it is completed and before it is presented to the taxpayer for signature.
 - A. In the case of electronically signed tax returns, the signing tax return preparer need not sign the return prior to presenting a completed copy of the return to the taxpayer. The signing tax return preparer, however, must furnish all of the information that will be transmitted as the electronically signed tax return to the taxpayer contemporaneously with furnishing the Form 8879, IRS e-file Signature Authorization. The information may be furnished on a replica of an official form. The signing tax return preparer shall electronically sign the return in the manner prescribed by the Commissioner in forms, instructions, or other appropriate guidance. See Treas. Reg. 1.6695-1(b)(2). Also see IRM 3.42.5.16.1.3 (5), IRS e-File Signature Authorization Forms, for signatures on electronically filed returns.
 - B. If the preparer required to sign the return or claim for refund is unavailable to sign, another preparer must review the return or claim for refund and then sign the return or claim for refund. If more than one preparer is involved in the preparation of the return or claim for refund, the preparer with primary responsibility for the overall substantive accuracy of the return or claim for refund

is the preparer who must sign the return or claim for refund. See Treas. Reg. 1.6695-1(b)(1).

2. A signing tax return preparer must provide a signature on returns or claims for refund that are filed on or after January 1, 2009. Rev. Proc. 2009-11, IRB 2009-3 313, section 4.02, identifies categories of returns and claims for refund required to be signed by a tax return preparer in order to avoid a penalty under IRC 6695(b).
3. For a list of tax returns filed during the 2008 calendar year that must be signed to avoid a penalty under IRC 6695(b), see Notice 2008-12, IRB 2008-3 280.
4. IRC 6695(b) no longer requires a manual signature. The IRS will permit tax return preparers to sign original returns, amended returns, or requests for filing extensions by rubber stamp, mechanical device, or computer software program. These alternative methods of signing must include either a facsimile of the individual preparer's signature or the individual preparer's printed name. Tax return preparers utilizing one of these alternative means are personally responsible for affixing their signatures to returns or requests for extension. See Notice 2004-54, IRB 2004-33 209. The signature requirement may also be satisfied if the preparer signs the completed return, makes a photocopy of the return, and the taxpayer signs and files the photocopy. See Rev. Rul. 78-370, 1978-2 C.B. 336.
5. If a preparer is physically unable to sign a return because of a temporary or permanent disability, the IRC 6695(b) penalty should not be imposed if the words "Unable to Sign" are printed, typed, or stamped on the preparer signature line. Also, the preparer's name should be printed, typed, or stamped under the signature line after the return is completed, and before it is presented to the taxpayer for signature. See Rev. Proc. 79-7, 1979-1 C.B. 486.
6. A preparer is not required to affix an identification number to the taxpayer's copy of the return. See preamble to T.D. 9436, IRB 2009-3 268.
7. The IRC 6695(b) penalty does not apply if the failure was due to reasonable cause and not due to willful neglect. If a preparer asserts reasonable cause, the preparer should provide a written statement to substantiate the preparer's claim of reasonable cause. The penalty for failure to sign will not be imposed solely because of the following:
 - A. A person is a nonsigning preparer under Treas. Reg. 1.301.7701-15(b)(2), or
 - B. A person is a preparer under Treas. Reg. 1.301.7701-15(b)(3) on account of having prepared another return (e.g., the partnership return) which affects the amounts reported on the return in question (e.g., the partner's return).

20.1.6.5.3 (05-16-2012)

Failure to Furnish Identifying Number—IRC 6695(c)

1. The IRC 6695(c) penalty applies if the preparer fails to comply with IRC 6109(a)(4), Furnishing Identifying Number of Tax Return Preparer. Under IRC 6109(a)(4) and the regulations thereunder, the return or claim for refund must contain the following:

- A. The identifying number of the preparer required to sign the return or claim for refund under IRC 6695(b), and
 - B. The identifying number of the partnership or employer (if there is a partnership or employment arrangement between two or more preparers).
2. A self-employed preparer can use either his or her social security number (SSN) or preparer tax identification number (PTIN) for tax returns or refund claims prepared through December 31, 2010. If there is an employment arrangement or association, the employer's identification number (EIN) and the individual preparer's SSN or PTIN must be on the return. The preparer is not required to provide his or her SSN, PTIN, or EIN on the copy furnished to the client.
 3. Effective January 1, 2011, tax return preparers must have a PTIN to prepare returns. The PTIN is to be used as of January 1, 2011, as the preparer identifying number. See PTIN Requirements for Tax Return Preparers at <http://www.irs.gov/taxpros/article/0,,id=210909,00.html?banner=PTIN> and Treas. Reg 1.6109-2(d). If there is an employment arrangement or association the related EIN must also be on the tax return.
 4. The IRC 6695(c) penalty does not apply if the failure was due to reasonable cause and not due to willful neglect. Thus, the penalty will not be imposed solely because of the following:
 - A. A person is a nonsigning preparer under Treas. Reg. 1.301.7701-15(b)(2) or
 - B. A person is a preparer under Treas. Reg. 1.301.7701-15(b)(3) on account of preparing another return (e.g., the partnership return) which affects the amounts reported on the return in question (e.g., the partner's return).
 5. IRC 6695(c) penalties will not be imposed against the following:
 - A. A preparer who is employed or engaged by a person who is also a preparer of the return or claim for refund, or
 - B. A preparer who is a partner in a partnership which is also a preparer of the return or claim for refund.

20.1.6.5.4 (09-17-2010)

Failure to Retain Copy or List—IRC 6695(d)

1. The IRC 6695(d) penalty applies if the preparer fails to comply with IRC 6107(b), Copy or List to Be Retained by Tax Return Preparer. Under IRC 6107(b) and the regulations thereunder, a preparer must do the following:
 - A. Retain a completed copy of the return or claim for refund, or alternatively retain a record (by list, card file, electronically, or otherwise) of all the taxpayers, their taxpayer identification numbers, the taxable years, and the type of returns or claims for refund prepared.
 - B. Retain a record (by copy of the return or claim for refund or by a list, card file, electronically, or otherwise) of the name of the preparer required to sign the return or claim for refund under IRC 6695(b) for each return or claim for refund presented to the taxpayer.

- C. Make such copy or list available for inspection upon request by the IRS for a three year period following the close of the return period. See IRC 6060(c), Return Period Defined.
2. If there is an employment arrangement between two or more preparers, the requirement to retain a copy or list only applies to the person who employs (or engages) one or more tax return preparers. Similarly, if there is a partnership arrangement, the requirement to retain a copy or list only applies to the partnership. See Treas. Reg. 1.6107-1(c).
3. The IRC 6695(d) penalty does not apply if the failure was due to reasonable cause and not due to willful neglect. Thus, the penalty for failure to retain a copy or list will not be imposed solely because of the following:
 - A. A person is a nonsigning preparer under Treas. Reg. 301.7701-15(b)(2), or
 - B. A person is a preparer under Treas. Reg. 301.7701-15(b)(3) on account of having prepared another return (e.g., the partnership return) which affects the amounts reported on the return in question (e.g., the partner's return).

20.1.6.5.5 (09-17-2010)

Failure of Preparer Employer to File Information Returns—IRC 6695(e)

1. The IRC 6695(e) penalty applies if the preparer fails to comply with IRC 6060, Information Returns of Tax Return Preparers. Under IRC 6060(a), General Rule, and Treas. Reg. 1.6060-1(a)(1), each person who employs (or engages) one or more signing tax return preparers must retain a record of the name, taxpayer identification number, and place of work of each tax return preparer employed (or engaged) by him. For purposes of IRC 6060, a partnership is treated as the employer of the partners.

Note:

Employers satisfy the filing requirement of IRC 6060 by retaining a record of the information described above and by making that record available for inspection upon request by the IRS. See Treas. Reg. 1.6060-1(a)(1).

2. The record may be in any form of documentation so long as it discloses on its face which individuals were employed (or engaged) as tax return preparers during that period.
3. The record must be retained and made available for inspection for a three-year period following the close of the return period to which it relates. The term "return period" means the twelve month period beginning on July 1st of each year.
4. If a tax return preparer is not employed by another preparer, such preparer is treated as his or her own employer for purposes of this penalty. Therefore, if a preparer is a sole proprietor, he or she must retain and make available a record.
5. The IRC 6695(e) penalty does not apply if the failure was due to reasonable cause and not due to willful neglect.
6. The IRC 6695(e) penalty must be assessed within three years after the return or claim for refund was filed.

20.1.6.5.6 (09-10-2013)

Negotiation of a Taxpayer's Refund Check—IRC 6695(f)

1. The IRC 6695(f) penalty of \$500 applies if the preparer endorses or otherwise negotiates (directly or through an agent) a refund check (including an electronic version of a check) issued to a taxpayer (other than the preparer).
2. The penalty applies to a tax return preparer who directs (either on Form 8888 or on the direct deposit line of the form series returns) the IRS to deposit a taxpayer's refund into a bank account in the preparer's name or into a bank account under the preparer's control.
3. Taxpayers sometimes request that their refunds be direct deposited into a bank account in the preparer's name or into a bank account under the preparer's control when taxpayers do not have their own bank account. Even if a taxpayer has requested the direct deposit to be made in this manner, the preparer is still subject to the IRC 6695(f) penalty for complying with the request.
4. The preparer may not endorse or negotiate a check for a taxpayer even though the preparer was designated as the taxpayer's representative on a Form 2848, Power of Attorney. See Rev. Rul. 80-35.
5. The penalty is imposed at a rate of \$500 per refund check or direct deposit of a refund. It does not vary based on how much compensation the preparer receives from the taxpayer, the amount of the refund check, or the direct deposit.
6. A person in a business other than tax return preparation who fills out or reviews returns for his or her customers may be a preparer and, thus, subject to the IRC 6695(f) penalty if such person endorses or otherwise negotiates the customer's refund check. See Rev. Rul. 86-55, 19861 C.B. 373.

20.1.6.5.6.1 (09-10-2013)

Exceptions to IRC 6695(f)

1. A tax return preparer will not be considered to have endorsed or otherwise negotiated a check as a result of having affixed the taxpayer's name to a refund check for the purpose of depositing the check into an account in the name of the taxpayer or in the joint names of the taxpayer and one or more other persons (excluding the tax return preparer). See Treas. Reg. 1.6695-1(f)(1).
2. In certain circumstances, a preparer-bank may cash a refund check and remit the cash to the taxpayer or may accept a refund check for deposit to the taxpayer's account. A preparer-bank may do the following:
 - A. Cash a refund check and remit all the cash to the taxpayer.
 - B. Accept a refund check for deposit in full to the taxpayer's account, provided the bank does not initially endorse or negotiate the check (unless the bank has made a loan to a taxpayer on the basis of the anticipated refund).
 - C. Endorse a refund check for deposit in full to the taxpayer's account pursuant to a written authorization of the taxpayer (unless the bank has made a loan to the taxpayer on the basis of the anticipated refund).

- D. Endorse or negotiate a refund check as part of the check clearing process after initial endorsement or negotiation by the taxpayer. See Treas. Reg. 1.6695-1(f)(2).
3. There is no reasonable cause exception to this penalty.

20.1.6.5.7 (05-16-2012)

Failure to Be Diligent in Determining Eligibility for Earned Income Tax Credit—IRC 6695(g) for Tax Returns or Claims for Refund for Tax Years Ending Before December 31, 2011

1. The IRC 6695(g) penalty applies if tax return preparer fails to comply with due diligence requirements with respect to determining eligibility for, or the amount of, the earned income tax credit (EIC).
2. Compliance visits with preparers to determine the due diligence requirement for the earned income credit are not third party contacts.
3. Under Treas. Reg. 1.6695-2(b), preparers must comply with the following due diligence requirements for tax returns or claims for refund for tax years ending before December 31, 2011:
 - A. Complete an eligibility checklist. Preparers may use Form 8867, Paid Preparers Earned Income Credit Checklist, or their own form as long as it provides the same information.
 - B. Compute the credit using either the EIC worksheet in the Form 1040, Form 1040A, U.S. Individual Income Tax Return, Form 1040EZ, Income Tax Return for Single and Joint Filers With No Dependents, instructions, or Pub 596, Earned Income Credit, or their own worksheet that contains the same information.
 - C. Retain copies of Form 8867, Paid Preparers Earned Income Credit Checksheet, (or its successor), computation worksheet, and record of how and when the information used to determine eligibility and compute the EIC was obtained by the preparer. The items must be retained for three years from June 30th following the date the return or claim was given to the taxpayer for signature. The items may be retained either on paper or electronically.
 - D. The tax return preparer must not know, or have reason to know, that any information used by the tax return preparer in determining the taxpayer's eligibility for, or the amount of, the EIC is incorrect.
 - E. The tax return preparer may not ignore the implications of information furnished to, or known by, the tax return preparer, and must make reasonable inquiries if the information furnished to the tax return preparer appears to be incorrect, inconsistent, or incomplete.
 - F. A tax return preparer must make reasonable inquiries if a reasonable and well-informed tax return preparer knowledgeable in the law would conclude that the information furnished to the tax return preparer appears to be incorrect, inconsistent, or incomplete.
 - G. The tax return preparer must also contemporaneously document in the files the reasonable inquiries made and the responses to these inquiries. See Treas. Reg. 1.6695-2(b)(3)(i).

4. Treas. Reg. 1.6695-2(b)(3)(ii) provides the following examples.

Example 1: A 22 year-old taxpayer wants to claim two sons, ages 10 and 11, as qualifying children for purposes of the EIC. Preparer A must make additional reasonable inquiries regarding the relationship between the taxpayer and the children as the age of the taxpayer appears inconsistent with the ages of the children claimed as sons.

Example 2: An 18 year-old female taxpayer with an infant has \$3,000 in earned income and states that she lives with her parents. Taxpayer wants to claim the infant as a qualifying child for the EIC. This information appears incomplete and inconsistent because the taxpayer lives with her parents and earns very little income. Preparer B must make additional reasonable inquiries to determine if the taxpayer is the qualifying child of her parents and, therefore, ineligible to claim the EIC.

Example 3: Taxpayer asks Preparer C to prepare his tax return and wants to claim his niece and nephew as qualifying children for the EIC. Preparer C should make reasonable inquiries to determine whether the children meet EIC qualifying child requirements and ensure possible duplicate claim situations involving the parents or other relatives are properly considered.

Example 4: Taxpayer asks Preparer D to prepare her tax return and tells D that she has a Schedule C business, that she has two qualifying children, and that she wants to claim the EIC. Taxpayer indicates that she earned \$10,000 from her Schedule C business, but that she has no expenses. This information appears incomplete because it is very unlikely that someone who is self-employed has no business expenses. D must make additional reasonable inquiries regarding taxpayer's business to determine whether the information regarding both income and expenses is correct.

20.1.6.5.7.1 (05-16-2012)

Failure to Be Diligent in Determining Eligibility for Earned Income Tax Credit—IRC 6695(g) for Tax Returns or Claims for Refund for Tax Years Ending on or After December 31, 2011

1. The IRC 6695(g) penalty applies if tax return preparer fails to comply with due diligence requirements with respect to determining eligibility for, or the amount of, the EIC.
2. Compliance visits with preparers to determine the due diligence requirement for the earned income credit are not third party contacts.
3. Under Treas. Reg. 1.6695-2(b), the preparer must comply with the following due diligence requirements for tax returns or claims for refund for tax years ending on or after December 31, 2011.
 - A. The tax return preparer must complete Form 8867 or such other form and such other information as may be required by the IRS to be submitted in the manner required by forms, instructions, or other appropriate guidance.
 - B. The tax return preparer's completion of Form 8867 (or successor form) must be based on information provided to the tax return preparer or otherwise reasonably obtained by the tax return preparer.

- C. The tax return preparer must either complete the earned income credit worksheet in the Form 1040 instructions or such other form and such other information as may be prescribed by the IRS or otherwise record in one or more documents in the tax preparer's paper or electronic files the EIC computation, including the method and information used to make the computation.
- D. The completion of the earned income credit worksheet or other permitted record must be based on information provided by the taxpayer to the tax return preparer or otherwise reasonably obtained by the tax return preparer.
- E. The tax return preparer must not know, or have reason to know, that any information used by the tax return preparer in determining the taxpayer's eligibility for, or the amount of, the EIC is incorrect. The tax return preparer may not ignore the implications of information furnished to, or known by, the tax return preparer, and must make reasonable inquiries if the information furnished to the tax return preparer appears to be incorrect, inconsistent, or incomplete. A tax return preparer must make reasonable inquiries if a reasonable and well-informed tax return preparer knowledgeable in the law would conclude that the information furnished to the tax return preparer appears to be incorrect, inconsistent, or incomplete. The tax return preparer must also contemporaneously document in the files the reasonable inquiries made and the responses to these inquiries.

These responses are provided within the context of the information presented during the National Phone Forum and are intended to clarify points discussed in the presentation.

The responses below should not be considered official guidance independent of the presentation and are based upon the law as of the above event dates.

Substantial Authority/Thresholds

Q1. As a result of the phone forum today I have a question regarding Substantial Authority greater than 35-40% or Realistic Possibility greater than 33%. I'm not sure which one is used for undisclosed positions. Please clarify.

A. For undisclosed positions that are not tax shelters, as defined in section 6662(d)(2)(C)(ii) or reportable transactions to which section 6662A applies, the standard is Substantial Authority, which is considered to be a 35% - 40% standard.

Q2. During the presentation, reference was made on several occasions to penalties based on the likelihood of a position succeeding. The thresholds varied from 33% to over 50%. How are these percentages determined?

A. The standards are as follows:

- For Disclosed Positions which are not tax shelters or reportable transactions: The standard is Reasonable Basis
- For Undisclosed Positions which are not tax shelters or reportable transactions: The standard is Substantial Authority
- For Positions regarding a Tax Shelter or Reportable Transaction: The standard is More Likely Than Not

Q3. Page 8, third paragraph, says penalty is THE LARGER OF \$1,000 OR 50% OF THE INCOME DERIVED....On page 15, last paragraph, says THE AMOUNT OF PENALTY ASSESSED AGAINST THE INDIVIDUAL AND THE FIRM SHALL NOT EXCEED 50% OF THE INCOME DERIVED...

The statements look contradictory. Which is correct?

A. The statement on page 15 should say "The amount of the penalties assessed against the individual and the firm shall not exceed 50 percent of the income derived (or to be derived) by the firm from the relevant engagement(s) relating to the position(s) giving rise to an understatement or \$1000, whichever is larger."

Q4. Are IRS publications considered substantial authority?

A. Notice 2009-5 provides the definition of Substantial Authority. This Notice provides that for Section 6694 purposes, Substantial Authority for a position has the same meaning as in Treas. Reg. § 1.6662-4(d)(2). The authorities listed in Treas. Reg. 1.6662-4(d)(3)(iii) are considered authority for purposes of Substantial Authority. However, "an authority does not continue to be an authority to the extent it is overruled or modified, implicitly or explicitly, by a body with the power to overrule or modify the earlier authority." Furthermore, in accordance with Treas. Reg. § 1.6662-4(d)(3)(ii), the weight accorded an authority depends on its relevance and persuasiveness, and the type of document providing the authority.

Q5. What is the IRS position on using a combination of official and unofficial sources in determining whether a position has "substantial authority" or is "more likely than not" to be sustained by a court if challenged in preparing tax returns for taxpayers?

A. See Answer 4.

Q6. Slide #9 and again on Slide # 22, the speaker stated that the transitional relief provided by Notice 2007-54 and Notice 2008-11 are still able to be used. For example, a return prepared by 12/31/07, would the old rules apply meaning:

For Undisclosed Position the standard would be Realistic Possibility of Success apply?

- a) **For Disclosed Position the standard would the Not Frivolous Standard apply?**
- b) **For 6694(a) penalty would it be \$250?**
- c) **For 6694(b) penalty would it be \$1000?**

A. Yes. For positions other than those involving a tax shelter or a listed transaction, the new regulations are effective for advice given and returns and claims filed after 12/31/2008.

Adequate Disclosure

Q7. An S corporation deliberately does not provide its bank statements. The corporate owner prepares the company's numbers corresponding to sales, costs and expenses in order to have the corporate tax return done. Should the preparer disclose this fact on Form 8275?

A. The regulations provide that the tax return preparer generally may rely in good faith without verification upon information furnished by the taxpayer. The tax return preparer is not required to audit, examine or review books and records, business operations, documents or other evidence to verify independently information provided by the taxpayer. The tax return preparer, however, may not ignore the implications of information furnished to the tax return preparer or actually known by the tax return preparer. The return preparer must make reasonable inquiries if the information as furnished appears to be incorrect or incomplete. Disclosure on the Form 8275 is not going to protect a return preparer if there is no reasonable basis for the position taken on the return because the tax return preparer failed to make reasonable inquiries when the information furnished by the taxpayer appeared to be incorrect or incomplete.

Q8. Which specific penalties are we responsible to disclose to the taxpayer regarding their unreasonable position on the tax return, referenced on slide 21 of the presentation? Further, does this apply only to "tax shelter" positions or to other information, such as certain questionable business deductions or other issues on a tax return? If this applies only to tax shelters, are there disclosure requirements for non-tax shelter positions on a tax return?

A. Notice 2009-5 provides that if there is substantial authority and a reasonable belief that that the tax treatment was more likely than not correct, a position with respect to a tax

shelter will not be deemed an unreasonable position if the tax return preparer advises the taxpayer of the applicable penalty standards that will apply if the IRS determines that the position is deemed to have a significant purpose of tax avoidance or evasion under § 6662(d). The return preparer must advise the taxpayer that disclosure on the return will not protect the taxpayer from assessment of an accuracy-related penalty under § 6662.

For non-tax shelter positions where there is a reasonable basis for the position, but not substantial authority, a signing tax return preparer must advise the taxpayer that the position lacks substantial authority and the taxpayer may be subject to an accuracy related penalty under § 6662 unless the position is disclosed in a disclosure statement included in the return.

Q9. Do you believe that each client should receive a copy of the protective speech clause in order to protect the preparer from penalties for not disclosing possible IRS penalties to the client? Specifically, is it recommended for preparers that do not have a tax attorney on staff?

- A. Boilerplate language will not satisfy the disclosure standards set out in the regulations. There is no standard “protective speech” that can be given to each client. The regulations require that the when a preparer is advising a client regarding the consequences of not disclosing a position on his tax return, the advice to the taxpayer must be particular to the taxpayer and tailored to the taxpayer’s facts and circumstances. The regulations require the return preparer to contemporaneously document in his files that the advice was provided. There is no language in the regulations that requires or prohibits sending a copy of the advice provided to the client.

Q10. If a Form 8275 was prepared but the TP does not file it with the return, what constitutes adequate proof that the return preparer has met his/her responsibilities?

- A. Example one in Treas. Reg. § 1.6694, addresses this factual scenario. In the example (which involves a non-shelter/non-reportable transaction) the return preparer prepares the Form 8275, signs the return and delivers the return to the taxpayer to sign and file. The return contains a position for which there is no substantial authority, but where there is a reasonable basis. The taxpayer signs and files the return without disclosing the position. The return preparer is not liable for a 6694 penalty when the position creates an understatement on the return. The return preparer is required to contemporaneously document his file regarding the disclosure advice given, including documentation that the Form 8275 was prepared and given to the taxpayer.

Q11. If a Practitioner receives at least 80% of the substantiating documentation from the client, then would it be acceptable to file the return and attaching the Form 8275 making a full disclosure?

- A. The Form 8275 will not protect practitioners from taking a position on a return where there is no reasonable basis for the position. Reasonable basis for 6694 has the same meaning as Treas. Reg. § 1.6662-3(b)(3), which states that the reasonable basis standard is not satisfied by a return position that is merely arguable or that is merely a colorable claim.

The return preparer may claim a reasonable cause exception to the assertion of the penalty. The regulations provide that the tax return preparer generally may rely in good faith without verification upon information furnished by the taxpayer. The tax return preparer is not required to audit, examine or review books and records, business operations, documents or other evidence to verify independently information provided by the taxpayer. The tax return preparer, however, may not ignore the implications of information furnished to the tax return preparer or actually known by the tax return preparer.

Q12. In this defining what is not substantial authority is there a safe clear definition regarding what might qualify or be considered as substantial authority?

- A. See answer to Question 4

Definitions of “Reasonable” & Due Diligence

Q13. Are preparer penalties applicable when the IRS determines that an S Corporation shareholder’s compensation is not “reasonable”?

- A. This question cannot be answered without more information. The preparer penalty under IRC § 6694(a) is applicable when there is an understatement of liability due to a position which the preparer knew (or reasonably should have known) was unreasonable. In general, a position is not unreasonable if there is or was substantial authority for the position. However, if the position is disclosed as provided in IRC § 6662(d)(2)(B)(ii)(I) and this position is not a tax shelter or reportable transaction, then the position is unreasonable unless there is a reasonable basis for the position. If the position is with respect to a tax shelter as defined in IRC § 6662(d)(2)(C)(ii) or reportable transaction to which IRC § 6662A applies, then the position is unreasonable unless it is reasonable to believe that the position would more likely than not be sustained on the merits. There is also a reasonable cause exception to IRC § 6694(a). No penalty shall be imposed under IRC § 6694(a) if it is shown that there is reasonable cause for the understatement and the tax return preparer acted in good faith.

The preparer penalty under IRC § 6694(b) is applicable when there is an understatement of liability due to conduct that is willful or reckless. Willful or reckless conduct is conduct by the tax return preparer which is a “willful attempt in any manner to understate the liability for tax on the return or claim” or a “reckless or intentional disregard of rules or regulations.”

Q14. I have clients that come to me with a summary of their expenses for a rental property. These expenses are for repairs, supplies, assessments from the condo association, etc. Do I need to verify these amounts with their detail records or is this summary acceptable? When clients come to me with their non-cash contributions can I accept the values they have assigned to their donations?

- A. Under Treas. Reg. § 1.6694-1(e)(1), the preparer generally may rely in good faith without verification upon information furnished by the taxpayer. Thus, the preparer is not required to audit, examine or review books and records, business operations, or documents or other evidence in order to verify independently the taxpayer's information. However, the preparer may not ignore the implications of information furnished to the preparer or actually known by the preparer. The preparer must make reasonable inquiries, if the information as furnished appears to be incorrect or incomplete. Additionally, some provisions of the Code or regulations require that specific facts and circumstances exist – for example that the taxpayer maintain specific documents before the deduction may be claimed. The preparer must make appropriate inquiries to determine the existence of facts and circumstances required by a Code section or regulation as a condition to claiming that deduction.

Q15. If preparing a return that includes a schedule C, is it safe to rely on figures given by the taxpayer (income amounts, expense amounts etc)...if the taxpayer keeps his own set of books. Or is it suggested to review the books to avoid possible penalties to myself (which of course would create more expense to the taxpayer)?

- A. Same answer as above.

Q16. If a married couple each with a W-2 and filing MFJ, for example, have 2 kids both from them, and everything seems correct, do I need to ask them for identification and do I need to keep a copy for the IRS and do I need to document the due diligence interview?

- A. Under Treas. Reg. § 1.6694-1(e)(1), the preparer generally may rely in good faith without verification upon information furnished by the taxpayer. Thus, the preparer is not required to audit, examine or review books and records, business operations, or documents or other evidence in order to verify independently the taxpayer's information. However, the preparer may not ignore the implications of information furnished to the preparer or actually known by the preparer. The preparer must make reasonable inquiries if the information as furnished appears to be incorrect or incomplete. Additionally, some provisions of the Code or regulations require that specific facts and circumstances exist – for example that the taxpayer maintain specific documents before the deduction may be claimed. The preparer must make appropriate inquiries to determine the existence of facts and circumstances required by a Code section or regulation as a condition to claiming that deduction.

If the EITC is involved, then the preparer must follow the due diligence requirements under Treas. Reg. § 1.6695-2(b).

Q17. Does IRC 6694 and 6695 Due Diligence interview apply only for cases where there is EIC or EITC involved? And what if the TP has little or no income?

- A. Treas. Reg. § 1.6695-2 covers "EITC Due Diligence Rules" and provides clear examples on the need to ask the client a series of questions and then documenting both the questions and responses provided by the taxpayer the case file. The due diligence rules

were significantly tightened based on recommendations provided by both the National Taxpayer Advocate and Wage and Investment Counsel.

Q18. Slide #18 relates to Reasonable Cause Exception. Is an article included in a Reputable Tax Service such as (RIA, PPC, CCH) or one written by a reputable author (Sydney Kess) considered reliance on advice of others if the facts are similar in order to assert reasonable cause to avoid the preparer penalties?

- A. The penalty under § 6694(a) will not be imposed if, considering all the facts and circumstances, it is determined the understatement was due to reasonable cause and the tax return preparer acted in good faith. Under Treas. Reg. § 1.6694-2(e), all the facts and circumstances will be considered to determine if the understatement was due to reasonable cause and that the preparer acted in good faith. Factors to consider include: nature of the error causing the understatement, frequency of errors, materiality of errors, preparer's normal office practice, reliance on generally accepted administrative or industry practice, and reliance on the advice of another preparer. A preparer will not be considered to have relied in good faith on the advice of another preparer if the advice is unreasonable on its face, the preparer knew or should have known that the other preparer was not aware of all relevant facts, or the preparer knew or should have known (given the nature of the preparer's practice), at the time the return or claim for refund was prepared, that the advice was no longer reliable due to the developments in the law since the time the advice was given.

Q19. Will the IRS consider drafting examples of the minimum due diligence standards that a practitioner should follow to avoid being put in the position of a taxpayer providing misleading or inaccurate statements to the IRS?

- A. OPR and Counsel are open to any suggestions and recommendations to improve the process.

Suggestions and examples can be sent to: comments@irscounsel.treas.gov.

Or they may be forwarded through the affiliated organization to:

Internal Revenue Service, CC:PA:LPD:PR
Room 5203, P.O. Box 7604,
Ben Franklin Station, Washington, DC 20224.

Q20. Do I understand you to say to rely on information from the taxpayer by giving them 8275R?

- A. No. The Form 8275R is used to disclose a position in a return that is contrary to Treasury Regulations. The form is used for disclosures relating to the preparer penalties for tax understatements due to positions taken contrary to regulations.

It is the regulations that permit a return preparer to rely on information provided by the taxpayer. Under Treas. Reg. § 1.6694-1(e)(1), the preparer generally may rely in good faith without verification upon information furnished by the taxpayer. Thus, the preparer is not required to audit, examine or review books and records, business operations, or documents or other evidence in order to verify independently the taxpayer's information. However, the preparer may not ignore the implications of information furnished to the preparer or actually known by the preparer. The preparer must make reasonable inquiries if the information as furnished appears to be incorrect or incomplete.

Signature Requirement

Q21. With regard to the preparer signature requirement under Section 6695b, is a "mechanical signature," such as a software-generated or rubber-stamped signature, acceptable?

- A. Notice 2004-54 provides that a return preparer, as defined by Section 301.7701-15(a), may sign original returns which includes claims for refund, amended returns and requests for filing extensions by means of a rubber stamp, mechanical device, or computer software program. These alternative methods of signing must include either a facsimile of the individual preparer's signature or the individual preparer's printed name. Return preparers utilizing one of these alternative means are personally responsible for affixing their signatures to returns or requests for extension.

Q22. Is it acceptable for a preparer to use an electronic signature, such as an Adobe Signature?

- A. See answer to question 30.

Q23. I have a question regarding the signing of returns- referenced on your slide 11. I pulled the Rev Pro 2009-11 which gives a list of the returns and claims for refund subject to the section 6694 penalty. This list is unclear - section 3 Returns and claims for refund subject to the section 6694 penalty

- **01 -- identifies categories**
- **02 -- tax return reporting tax liability**
- **then in a box you have a very long list of forms- these start off with (1) Income tax returns -subtitle A**

- Does this mean (1) is the .01 above, (2) Estate and Gift Tax Returns - Subtitle B Is this the 02 section?

Then, in the box of forms is (3) Employment Tax Returns -subtitle C; listing the payroll tax forms, most commonly used by my firm 940, 941, 944 plus all the x forms and Schedule H the box has (4), (5), (6) out of the lined box below it is .03 information returns and other documents and it further has (1) and (2) under it.

This is all very confusing as to what is being referenced or is it basically all returns need to be signed? Is it now required that we sign employment tax returns like the 941 and 940 returns? If yes, and I have already sent out some of these to clients and they have filed them - Now what do I do?

- A. Revenue Procedure 2009-11 lists all the forms that are considered a return or claim for refund for purposes of IRC § 6694 as well as listing all forms that now require a return preparer's signature pursuant to IRC § 6695. The Revenue Procedure was effective as of January 1, 2009 for all forms, tax returns, amended tax returns and claims for refund filed after that date.

Every form listed in Section 4.02 of the Revenue Procedure must be signed by a tax return preparer to avoid a penalty under Internal Revenue Code § 6695(b) for failure to sign the return. The list is broken down into four types of returns that need to be signed by return preparers; Income Tax, Estate and Gift Tax, Employment Tax, and Excise Tax. Employment Tax Returns are included in the list, and must be signed by the preparer beginning with returns filed after January 1, 2009.

Q24. What assurance do I have that by signing the payroll tax returns the IRS will not come to me to collect for any taxes the employer fails to pay?

- A. The return preparer is signing as the return preparer, not as the employer/taxpayer. Internal Revenue Policy Statement P-5-60 (IRM 1.2.1.5.14) addresses Trust Fund Penalty Assessments. The Policy Statement provides that responsibility is a matter of status, duty and authority. Those performing ministerial acts without exercising independent judgment will not be deemed responsible.

Non-signing preparer

Q25. Suppose a preparer calls his attorney for advice on a taxpayer issue. Taxpayer is NOT identified by name/number, but the issue and specific facts are related by the preparer to the attorney in a way that the specific taxpayer is not identified. Based on what the attorney is told, attorney does research and later advises that taxpayer is entitled to claim item in question as a deduction based on the information supplied.

Attorney follows up with an e-mail to that effect with the common disclaimer. Is the attorney a preparer of that taxpayer's return?

- A. The answer to this question depends on the timing of the events and the amount of time the attorney spends on answering this question.

The definition of a "tax return preparer" is in IRC § 7701(a)(36) and Treas. Reg. § 301.7701-15. Under Treas. Reg. § 301.7701-15(a)(2) a "nonsigning tax return preparer" is any tax return preparer who is not a signing tax return preparer but who prepares all or a substantial portion of a return or claim for refund with respect to events that have occurred at the time the advice is rendered.

In determining whether an individual is a nonsigning tax return preparer, time spent on advice that is given after events have occurred that represents less than 5 percent of the aggregate time incurred by the individual with respect to the position giving rise to the understatement shall not be taken into account. Notwithstanding the prior sentence, time spent on advice before the events have occurred will be taken into account if all facts and circumstances show that the position giving rise to the understatement is primarily attributable to the advice, the advice was substantially given before events occurred primarily to avoid treating the person giving the advice as a tax return preparer, and the advice given before events occurred was confirmed after events had occurred for purposes of preparing a tax return.

Q26. An unenrolled person provides a tax research service (TRS), normally by phone, nationwide. Customers contact the tax research service by phone or fax, and pay a fee based on the time to provide an answer (exclusive of research time). Un-enrolled person is the only employee of TRS. TRS provides specific advice on a specific taxpayer situation (assume the preparer has taxpayer consent to disclose the information) as to an item of gain or loss upon liquidation of a partnership interest. Is TRS a non-signing preparer? There is no written communication from TRS to the preparer, and no disclaimer.

- A. As in question 35, the answer to this question depends on the timing of the events and the amount of time the unenrolled person spends on answering this question. The fact that this person is unenrolled does not prevent him/her from being a tax return preparer as long as he/she satisfies the definition of a "tax return preparer."

A "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" (emphasis added). Treas. Reg. § 301.7701-15(a). Under Treas. Reg. § 301.7701-15(a)(2) a "nonsigning tax return preparer" is any tax return preparer who is not a signing tax return preparer but who prepares all or a substantial portion of a return or claim for refund with respect to events that have occurred at the time the advice is rendered.

In determining whether an individual is a nonsigning tax return preparer, time spent on advice that is given after events have occurred that represents less than 5 percent of the aggregate time incurred by the individual with respect to the position giving rise to the understatement shall not be taken into account. Notwithstanding the prior sentence, time spent on advice before the events have occurred will be taken into account if all facts and circumstances show that the position giving rise to the understatement is primarily attributable to the advice, the advice was substantially given before events occurred primarily to avoid treating the person giving the advice as a tax return preparer, and the advice given before events occurred was confirmed after events had occurred for purposes of preparing a tax return.

Miscellaneous

Q27. If a preparer files an Amended Return, does this constitute an admission that he previously underreported income? Will he be subject to a preparer penalty?

- A. While the amended return may be an admission that income was previously underreported, it is not an admission that the tax return preparer should be subject to the preparer penalty since it does not necessarily follow that the understatement of liability was due to a position which the preparer knew (or reasonably should have known) was unreasonable, or was a willful attempt in any manner to understate the liability for tax on the return or claim or a reckless or intentional disregard of the rules or regulations.

Remember that the effective dates for the preparer penalties are based on the date in which the return, amended return, or claim for refund was prepared.

Notice 2009-5 states that the special rule for tax shelters and reportable transactions to which IRC Section 6662A applies does not apply retroactively, and that the provisions of Notice 2008-13 will apply to tax shelter and section 6662A reportable transaction positions on returns or claims for refund for tax years ending prior to the date of enactment of the Tax Extenders and Alternative Minimum Tax Relief Act of 2008 ("TEAMTRA"). Notice 2008-13 only applies to income tax returns filed after January 1, 2008. Notice 2007-54 provided transitional relief to income tax preparers on or before January 1, 2008. Under this Notice, the standard in place for tax preparers for income tax returns prepared on or before December 31, 2007, is the pre-SBWOTA standard of realistic possibility (33%). The pre-SBWOTA standard only applied to undisclosed positions and frivolous disclosed positions and did not separately distinguish tax shelter or reportable transaction positions.

Q28. Is there a specific IRS requirement for tax preparers to keep copies of taxpayers' supporting documents? It is my understanding the Forms W-2 must be retained for electronic filing compliance. Are there documents that practitioners must retain to meet IRS requirements?

- A. For purposes of IRC § 6694, the return preparer must contemporaneously document his file to show that he satisfied the adequate disclosure rules of Treas.Reg. § 1.6694-

2(d)(3). For IRC § 6695 the return preparer must comply with the rules set out in Treas. Reg. § 1.6695-1(d) (1), which require the return preparer to retain, for three years, a completed copy of a prepared return or a list of the name and TIN for whom such return or claim was prepared. Treas. Reg § 1.6695-2(b)(3) requires that signing return preparers for returns or claims for refund that claim the Earned Income Credit must make reasonable inquiries regarding any information that appears incorrect. The return preparer must contemporaneously document his file to show the inquiries and responses.

Other Internal Revenue Code sections may require additional record retention and return preparers need to be aware of those rules.

Q29. I was a "public accountant" for many years and have taken a job at a University. I want to know whether the same preparer penalties apply when the tax return you are preparing is your employer's. In other words, if the tax return is examined and found to be incorrect, who at the entity is ultimately responsible for any preparer penalties... or since we don't have a "paid preparer" are those penalties not assessed?

- A. Under Treas. Reg. § 301.7701-15(f)(ix), an individual who prepares a return for an employer by whom the individual is regularly and continuously employed or compensated is not a "tax return preparer."

Q30. If after preparing a tax return and signing the form, if I do not get paid, am I still liable for penalties (should the client get audited)? What recourse do I have? Can I notify the IRS and indicate that I wasn't paid?

- A. Yes, a person is a tax return preparer if he/she prepared a tax return with the expectation of compensation whether it is actually received or not. Recourse against the client is a private matter not involving the IRS.

Q31. A client treats his "employees" as subcontractors and issues 1099 forms. The client requests that a preparer prepare these 1099 forms. The preparer has informed the client of the potential penalties if these workers are reclassified as employees by the IRS, but at the clients request does prepare the 1099 forms year after year. There is a "possibility" that "industry practice" could allow the 1099 practice. Would preparing the 1099 forms by a tax preparer be subject to the preparer penalties?

- A. The return preparer may be liable for the penalty if there is no reasonable basis for treating these workers as independent contractors. Disclosing the potential penalties to the client protects the return preparer when there is a reasonable basis for the position, but no substantial authority. Treas.Reg § 6694-2(d)(ii).

Q32. An enrolled agent prepares a tax return free of charge. Is he/she responsible for this return?

- A. No, a tax return preparer does not include a person who prepares a return or claim for refund for a taxpayer with no explicit or implicit agreement for compensation. Treas. Reg. § 301.7701-15(f)(xii).

Q33. An enrolled agent gives advice based on the information during a conversation with a tax payer without fees. Then the taxpayer prepares a return referring the agent that he gave this advice. Does the agent responsible for this advice?

- A. Same answer as question 50.

Q34. In slide #6 the speaker mentioned that if a preparer has 5 or more 6694 penalties assessed and preparer fails to take action to correct, IRS can take injunction action. What exactly is the injunction action IRS would take? Would it be to prevent the preparer from preparing returns for compensation or just not allow the preparer to represent taxpayers? Can you be more specific?

- A. Under IRC § 7402 and § 7407, the IRS may enjoin a tax return preparer from either specified conduct or from the preparation of tax returns in general. Further, OPR may disbar a preparer from practice before the IRS for violations of Circular 230.

Q35. Slide #15 Income derived or to be derived. A preparer prepared a return and also handles an IRS audit of the return. Part of the time spent is to handle the audit of the return. Will this be considered part of the income that will determine the 6694(a) or (b) 50% penalty?

- A. The income properly allocated to the IRS audit will not be considered income derived (or to be derived) for purposes of IRC § 6694(a) and (b). Treas. Reg. § 1.6694-1(f) defines income derived (or to be derived) with respect to the return or claim for refund as “all compensation the tax return preparer receives or expects to receive with respect to the engagement of preparing the return or claim for refund or providing tax advice...with respect to the position(s) taken on the return or claim for refund that gave rise to the understatement” (emphasis added).

Q36. How does the liability for employer of a return preparer fit into the new scheme? Is it any different from the prior regime?

- A. Under Treas. Reg. § 1.6694-2(a)(2) and § 1.6694-3(a)(2), a firm that employs a tax return preparer subject to a penalty under IRC § 6694(a) or (b) is also subject to the penalty if, and only if: (1) one or more members of the principal management (or

principal officers) of the firm or a branch office participated in or knew of the conduct; (2) the corporation, partnership, or other firm entity failed to provide reasonable and appropriate procedures for review of the position for which the penalty is imposed; or the corporation, partnership, or other firm entity disregarded its reasonable and appropriate review procedures through willfulness, recklessness, or gross indifference in the formulation of the advice, or the preparation of the return or claim for refund, that included the position for which the penalty is imposed.

Q37. What happens to a zero return that is not filed completely and has an attached statement that the return will be filed through the amended return process because not all documents are available?

- A. There has been litigation as it pertains to zero returns and the attitude is that for income tax purposes a zero return with no liability and/or no schedules is not deemed a valid return and the addition to tax for failure to file may be assessed. If you have a taxpayer that comes in to your office on April 15 without the substantiating documentation, then you might want to tell the taxpayer to come back when they have the documentation and not prepare the return at that time. In short, you don't have to take every return that walks through your door and place yourself at risk, even though you want to help bring a non-filer into the system.

Q38. Often times a corporate return could have a valid zero return, especially when they have been inactive. As a result, would that not be deemed a valid return and be permissible?

- A. Yes, that would be acceptable. Earlier presentation comments primarily dealt with W-2 or information return type filers, that would have possible reportable income not being reported showing all zeros.

Q39. Is there a simple way to get the treasury regulations, since there is no link in the handout?

- A. Yes, you can go directly to IRS.gov or you can Google TD-9936 or type in "Tax Prof Blog".

Q40. Practitioner wanted to know what procedures should be followed to report a negligent preparer?

The following site explains how to file a complaint against a tax preparer – [Make a Complaint Against a Tax Return Preparer](#).

Q41. I understand that this presentation could not be recorded. However, the material was very detailed and valuable. As result, is it possible that the presentation be made available on CD/DVD to participants?

- A. Re-enactments of the March National Phone Forum discussing the tax consequences of canceled debt and the January program on return preparer penalties under IRC 6694 are on the IRS.gov Tax Practitioner Video and Audio Presentations page.

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