

**MEMO# 22668**

July 11, 2008

## **Treasury Releases Proposed Regulations Regarding Return Preparer Penalties; Comments Requested**

[22668]

July 11, 2008

TO: ADVISER DISTRIBUTOR TAX ISSUES TASK FORCE No. 12-08  
TAX COMMITTEE No. 23-08 RE: TREASURY RELEASES PROPOSED REGULATIONS  
REGARDING RETURN PREPARER PENALTIES; COMMENTS REQUESTED

Treasury has released the attached proposed regulations (the "Regulations") under Code sections 6694, 6695 and related provisions to reflect changes enacted by the Small Business and Work Opportunity Tax Act of 2007 (the "Act"). [\[1\]](#) The Regulations provide guidance regarding the Act's amended disclosure and signature obligations for persons paid to prepare tax returns and information statements ("preparers"). The Regulations generally incorporate the interim guidance provided in Notices 2008-11, 2008-12 and 2008-13. [\[2\]](#)

Section 6694(a) imposes a penalty [\[3\]](#) on an undisclosed position if the preparer knew (or reasonably should have known) of the position and there was not a reasonable belief that the position would more likely than not be sustained on its merits. A preparer may reasonably believe that a position would more likely than not be sustained on its merits if the preparer analyzes the pertinent facts and authorities, and in reliance upon that analysis, reasonably concludes in good faith that the position has a greater than 50 percent likelihood of being sustained on its merits ("more likely than not standard"). Prop. Reg. § 1.6694-(2)(d) provides that the penalty will not be imposed if, considering all the facts and circumstances, the understatement was due to reasonable cause and the preparer acted in good faith.

## **Reliance on Generally Accepted Administrative or Industry Practice**

As requested by the Institute, the Regulations permit a consideration of “generally accepted administrative or industry practice” in determining whether a preparer has properly complied with section 6694’s disclosure obligations. Specifically, Prop. Reg. §1.6694-(2)(d)(6) provides that, among other factors, reasonable cause includes a preparer’s reasonable reliance in good faith on generally accepted administrative or industry practice in taking the position that resulted in the understatement. A preparer is not considered to have relied in good faith if 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 administrative or industry practice was no longer reliable due to developments in the law or IRS administrative practice since the time the practice was developed. The Preamble to the Regulations states that this provision is intended to address situations in the absence of published guidance when administrative or industry practice has developed that would not reasonably be subject to challenge by the IRS.

## **Positions Meeting “Reasonable Basis” Standard But Not “More Likely Than Not” Standard**

The Regulations provide disclosure rules for signing and non-signing preparers for a tax position that satisfies the “reasonable basis” standard but does not meet the “more likely than not” standard. Signing preparers must comply with one of the following rules:

1. disclose the position on Form 8275 (Disclosure Statement) or Form 8275-R (Regulation Disclosure Statement), as appropriate, or on a tax return in accordance with the applicable revenue procedure;
2. for income tax returns, give the taxpayer a prepared return that includes the disclosure -- if substantial authority (the section 6662 disclosure standard) *does not* exist for a position;
3. for income tax returns, both (i) advise the taxpayer of all the penalty standards applicable to the taxpayer under section 6662 and (ii) contemporaneously document this advice in the preparer’s files -- if substantial authority *does* exist for a position;
4. for income tax returns subject to either section 6662(d)(2)(C) (tax shelters) or section 6662A (reportable transactions), both (i) contemporaneously document this advice in the preparer’s files and (ii) advise the taxpayer that:
  - there must be, at a minimum, substantial authority for the position;
  - the taxpayer must have a reasonable belief that the tax treatment was more likely than not the proper treatment in order to avoid applicable penalties; and
  - disclosure will not protect the taxpayer from assessment of an accuracy-related penalty if either section 6662(d)(2)(C) or 6662A applies to the position; or
5. for tax returns or refund claims that are subject to penalties under section 6662 other than the substantial understatement penalty under section 6662(b)(2) and (d), both (i) advise the taxpayer of the penalty standards applicable to the taxpayer and (ii) contemporaneously document the advice in the preparer’s files. This rule is intended to address situations when an applicable penalty standard is based on compliance with requirements other than disclosure (e.g., section 6662(e)’s valuation requirements).

## **Non-signing preparers must comply with one of the following rules:**

1. disclose the position on Form 8275 or Form 8275-R, as appropriate, or on a tax return in accordance with the applicable revenue procedure;
2. for advice to taxpayers, both (i) advise the taxpayer of any opportunity to avoid penalties under section 6662 that could apply to the position (if relevant) and of applicable disclosure standards; and (ii) contemporaneously document the advice in the preparer's files; or
3. for advice to another preparer, both (i) advise the other preparer that disclosure under section 6694 may be required and (ii) contemporaneously document the advice in the preparer's files.

To satisfy the disclosure requirements, a preparer must address each return position that meets the “reasonable basis” standard but not the “more likely than not” standard. The preparer must provide disclosures that are particular to the taxpayer and cannot provide general disclaimers. Disclosure is adequate for a pass-through entity if a preparer makes the disclosure to the entity (e.g., disclosure to a partnership and not individual partners).

## **Forms Subject to Section 6694**

The Regulations revise the definition of return and refund claim to include only preparers of specifically identified returns and refund claims. Guidance identifying such returns and refund claims will be published simultaneously with final regulations and likely will maintain the three-tiered approach used in the exhibits in interim guidance. [\[4\]](#)

## **Other Issues**

The Regulations address several other issues, including (i) defining “signing” and “non-signing” preparer, (ii) adopting a framework for assigning responsibility for particular tax positions when multiple preparers provide advice regarding the same return; (iii) computing “income derived” with respect to a return or refund claim for purposes of assessing a penalty; and (iv) use of electronic returns. The Regulations also make conforming changes to cross-references in several regulations consistent with the Act.

## **Effective Date**

The Regulations generally will be effective after the date that final regulations are published in the Federal Register.

## **Comments Requested**

The Regulations provide a notice of public hearing (scheduled for Monday, August 18, 2008) and invite comments. Interested parties must submit comments by August 18, 2008 and outlines of topics to be discussed at the public hearing by August 4, 2008. We

will discuss the Regulations during this month's Tax Committee call on July 16, 2008 [\[5\]](#). Please provide any additional comments to the undersigned by August 8, 2008.

Lisa Robinson  
Associate Counsel

## [Attachment](#)

### **endnotes**

[\[1\]](#) Congress is considering legislation to conform the standards regarding undisclosed positions for preparers and taxpayers to the current standard applicable to taxpayers (substantial authority). This legislation was included in H.R. 5719, the "Taxpayer Assistance and Simplification Act of 2008, which passed the House of Representatives. See Institute Memorandum ([22436](#)) to Tax Members, dated April 24, 2008. H.R. 6049, the "Renewable Energy and Job Creation Act of 2008," and S. 3125, the "Energy Independence and Tax Relief Act of 2008, also include provisions to conform the disclosure standards. If enacted, the revised standard would apply to returns prepared after May 25, 2007.

[\[2\]](#) See Institute Memorandum ([22105](#)) to Tax Members, dated January 8, 2008.

[\[3\]](#) The penalty is equal to the greater of \$1000 or 50 percent of the income derived by the preparer for any return or refund claim resulting in an understatement of liability for the undisclosed position. Section 6694(a) also imposes a penalty on disclosed positions if a preparer does not have a reasonable basis for the position ("reasonable basis standard").

[\[4\]](#) See Institute Memorandum ([22105](#)) to Tax Members, dated January 8, 2008, and Institute Memorandum ([22435](#)) to Tax Members No. 10-08, dated April 21, 2008.

[\[5\]](#) See Institute Memorandum ([22670](#)) to Adviser Distributor Tax Issues Task Force No. 11-08 and Tax Committee No. 22-08, dated July 9, 2008.