

Updates to Preparer Penalties,  
Code Sections 6694 & 6676

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The Small Business and Work  
Opportunity Tax Act

**P.L. 110-28 enacted on May 25, 2007**

- New Section 6676 – Penalty for erroneous claims for refunds
- Amends §7701(a)(36) to broaden definition of a tax return preparer
- Amends §6695(b) to broaden signature requirements beyond just “income” tax returns

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- Amends §6694 to increase dollar amounts of preparer penalties

- Amends §6694 to increase the standard from

“a realistic possibility”

to

“more likely than not”

in situations where no disclosure is provided

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▪ Amends §6694 to increase the standard from  
“not frivolous”  
to  
“reasonable basis”  
For positions where disclosure IS provided

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▪ Amends §6330(h) to deny CDP hearings relative to a “Disqualified Employment Tax Levy”

▪ Amends §6404(g) to change from 18 months to 36 months the period which must run prior to the suspension of interest on IRS proposed changes to tax (i.e. from examinations)

Reversal of rights granted in 1998.

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**IRS GUIDANCE**

▪ Notice 2007-54 provided transitional relief moving effective date from May 25, 2007:

- To after December 31, 2007 for all tax returns;
- To estimated tax returns due after January 15, 2008; and
- To employment and excise tax returns due after January 31, 2008

▪ Notice 2008-11 clarified 2007-54

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IRS GUIDANCE (Continued)

- Notice 2008-12 provided guidance with respect to tax preparer signature requirements of §6695(b)
- Notice 2008-13, issued on 12/31/07 provided pre-regulatory guidance for changes in §7701(a)(36) and §6694.
- Notice 2008-46 supplementing exhibits attached to Notice 2008-13 issued on April 16, 2008

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IRS GUIDANCE (Continued)

- Chief Counsel Notice CC-2008-013, effective until the issuance of final regulations, requires that “Chief Counsel attorneys must consult with the Office of the Associate Chief Counsel (Procedures & Administration) on any issues under section 6694 and the related definitional provisions as amended by the Act.”

Issued on April 11, 2008 by Deborah A. Butler, Associate Chief Counsel.

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IRS GUIDANCE (Continued)

- Chief Counsel Advice CCA-200747020 (October 3, 2007) clarifies that §6676:
  - Applies to all excessive or erroneous claims for refund or credit with respect to income taxes; and
  - Can be applied to ANY income tax return, whether original or amended.

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IRS GUIDANCE (Continued)

- Proposed Regulations issued on June 16, 2008.
  - Over 200 Pages
  - Covers sections 6694 and 6695
  - Covers related provisions under sections 6060, 6107, 6109, 6696, and 7701(a)(36)
  - Regulations to be effective no sooner than December 31, 2008
  - Provide the first significant step towards “a comprehensive review and overhaul of all the tax return preparer penalties and related regulatory provisions.”

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IRS GUIDANCE (Continued)

- Proposed Regulations issued on June 16, 2008.  
(continued)
- What’s Next?
  - Public Hearing on August 18, 2008
  - Intention to issue final regulations by 12/31/08

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IRS GUIDANCE (Continued)

- Revisions to IRM on July 1, 2008:
  - 20.1.5.14 regarding New Code §6676 regarding Erroneous Claim for Refund or Credit
  - IRM includes examples of the penalty computations

Note: Part 20 of the IRM deals with penalties & interest in a comprehensive fashion. 20.1.5 deals with Return Preparer Penalties

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Part 20. Penalties & Interest

Table of Contents

- **20.1 Penalty Handbook**
  - 20.1.1 [Introduction and Penalty Relief](#)
  - 20.1.1 [Introduction and Penalty Relief \(Cont. 1\)](#)
  - 20.1.2 [Failure To File/Failure To Pay Penalties](#)
  - 20.1.3 [Estimated Tax Penalties](#)
  - 20.1.3 [Estimated Tax Penalties \(Cont. 1\)](#)
  - 20.1.4 [Failure to Deposit Penalty](#)
  - 20.1.4 [Failure to Deposit Penalty \(Cont. 1\)](#)
  - 20.1.4 [Failure to Deposit Penalty \(Cont. 2\)](#)
  - 20.1.5 [Return Related Penalties](#)
  - 20.1.5 [Return Related Penalties \(Cont. 1\)](#)
  - 20.1.6 [Preparer, Promoter Penalties](#)
  - 20.1.6 [Preparer, Promoter Penalties \(Cont. 1\)](#)
  - 20.1.6 [Preparer, Promoter Penalties \(Cont. 2\)](#)

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Part 20. Penalties & Interest

Table of Contents

- **20.1 Penalty Handbook** (continued)
  - 20.1.7 [Information Return Penalties](#)
  - 20.1.7 [Information Return Penalties \(Cont. 1\)](#)
  - 20.1.8 [Employee Plans and Exempt Organizations Penalties](#)
  - 20.1.8 [Employee Plans and Exempt Organizations Penalties \(Cont. 1\)](#)
  - 20.1.9 [International Penalties](#)
  - 20.1.10 [Excise Tax Penalties and Miscellaneous Penalties](#)
  - 20.1.10 [Excise Tax Penalties and Miscellaneous Penalties \(Cont. 1\)](#)
  - 20.1.10 [Excise Tax Penalties and Miscellaneous Penalties \(Cont. 2\)](#)

■ <http://www.irs.gov/irm/part20/index.html>

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**New Section 6676**

- Applies to claims for refunds on both Amended and Original Returns:
  - > to the extent such claim is for an “Excessive Amount” and
  - > There is no “reasonable basis” for claiming such excessive amount.
- “Excessive Amount” is defined by §6676(b) as “the amount of such claim allowable” under the Internal Revenue Code
- Does not apply to Earned Income Credit claims.

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New Section 6676 (continued)

- Penalty equals 20% of excessive amount.
- §6676(c) provides that no penalty shall be applied if to the extent the “excessive amount” is also subject to a penalty pursuant to:
  - §6662 relating to Accuracy-Related penalties;
  - The Reportable Transaction penalties of §6662A;
  - The Civil Fraud penalty of §6663

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New Section 6676 (continued)

- Section 6676 applies to INCOME tax refunds only.
- The IRM attempts to reserve broad discretion for the IRS to impose the penalty multiple times on multiple claims.

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Amended Section 7701(a)(36)

- The Code subsection is changed  
from  
“Income Tax Return Preparer”  
to  
“Tax Return Preparer”  
  
and eliminates the limitation to only Subtitle A of USC 26.

Note: Subtitle A is income taxes, Subtitle B is Estate and Gift Taxes, Subtitle C is Employment Taxes, Subtitle D is Miscellaneous Excise Taxes, Subtitle E is Alcohol, Tobacco, and Certain Other Excise Taxes, etc.

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**Section 6694 Changes**

- **Changes to Level of Penalties:**
  - Minimum Penalty Per Incident Increased from \$250 to the greater of:
    - A. \$1,000, or
    - B. 50% of the income earned by the tax return preparer with respect to the tax return
  - Increased minimum penalty for willful or reckless positions from \$1,000 per incident to the greater of \$5,000 or the 50% of income standard above.
- Applies penalties to preparers of all tax returns, not just INCOME tax returns

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**Section 6694 Changes** (continued)

- Amends §6694 to increase the standard from  
  
“a realistic possibility”  
  
to  
  
“more likely than not”  
  
in situations where no disclosure is provided

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**Section 6694 Changes** (continued)

- Amends §6694 to increase the standard from  
  
“not frivolous”  
  
to  
  
“reasonable basis”  
  
For positions where disclosure IS provided

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**Section 6696(d) – Periods of Limitations**

- 3 Years from date of filing of return or claim for refund relating to 6694(a) penalties (\$1,000). This covers both the “more likely than not” standard without disclosure and the “reasonable basis” standard with disclosure.
  
- No Limitation (that is penalty may be assessed at any time) with respect to 6694(b) penalties (\$5,000). The standards here are:
  - Willful attempts to understate a tax liability on a return; and
  - Reckless or intentional disregard of rules & regulations.

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**Section 6694 (c): Process for Challenging Preparer Penalties**

- Collection Activities Placed on Hold if:
  - Preparer pays 15% of penalty within 30 days of “notice and demand”
  - Preparer files claim for refund of 15% paid within the same 30-day period. [§6694(c)(1)]
  
- The Hold is lifted within 30 days of the denial of the refund claim or 6 months after filing the refund claim, if preparer fails to file “begin a proceeding in the appropriate United States district court for the determination of his liability for such penalty” [§6694(c)(2)]

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**Overview of Regulatory Approach**

- The preamble to the Proposed Regulations attempt to carefully balance the IRS approach and:
  - a. Acknowledge that “the majority of tax return preparers serve the interests of their clients and the tax system by preparing complete and accurate returns.”
  
  - b. Proposes to “modify guidance so that a referral by revenue agents to the IRS Office of Professional Responsibility (OPR) will not be per se mandatory when the IRS assesses a ... penalty under section 6694(a)...”

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**Overview of Regulatory Approach**  
(continued)

c. "In matters involving non-willful conduct, the IRS will generally look for a pattern of failing...before making a referral to OPR..."

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Regina Johnson	202-622-7180
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**Specific Regulatory Provisions**  
(continued)

- §1.6060-1 Reporting requirements for tax return preparers:
  - Retains requirement to retain a record of the name, taxpayer identification number ("TIN"), and principal place of work for each tax return preparer employed, including oneself if self-employed.
  - Retains requirement that such records be maintained for 3 years and "kept available for inspection".
  - Imposes a penalty for failure to retain or make available such a record of tax return preparers of up to \$50 per such failure up to a maximum of \$25,000 per person per year. This same penalty rate applies to §1.6107-1 requirements below.

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**Specific Regulatory Provisions**  
(continued)

- §1.6107-1 Tax return preparer must furnish copy of return to taxpayer and must retain copy or record.
  - Retains requirement to provide Taxpayer a copy of tax return.
  - In the case of electronically-filed returns, the revised regulations allow one to provide "a replica of an official form that provides all of the information." *However, it remains unclear whether such "replica" may be provided in electronic format.*
  - Retains requirement to retain copies of tax returns or to retain a record of taxpayer names, tax returns prepared and of the signing tax return preparer for 3 years.

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**Specific Regulatory Provisions**  
(continued)

- Who is the tax return preparer subject to penalties?
- Code Section 7701(a)(36) defines a “tax return preparer” as one who “prepares for compensation, or who employs one or more persons to prepare for compensation, any return of tax...or any claim for refund of tax...”
- Exempted from the definition are [§7701(a)(36)(B)] :
  - Typing, reproducing or other mechanical assistance;
  - Returns prepared for one’s employer (or for an officer or employee of the employer);
  - A return prepared as a fiduciary;
  - Certain claims for refund in response to a Notice of Deficiency

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**Specific Regulatory Provisions**  
(continued)

- Who is the tax return preparer subject to penalties?
- See §301.7701-15 for definitions.
- A “signing tax return preparer” is any tax return preparer who signs or who is required to sign a return or claim for refund. [§301.7701-15(b)(1) and see §1.6695-1(b)]
- A “non-signing 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. [§301.7701-15(b)(2) & (3)]
  - One who renders “tax advice on a position that is directly relevant to...an entry on a return will be regarded as having prepared that entry.”
  - The determination is made on a position-by-position basis.

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**Specific Regulatory Provisions**  
(continued)

- “Non-signing tax return preparer” (continued)
  - Only advice for past transactions can make someone a “non-signing tax return preparer.”
  - If less than 5% of the aggregate time by an individual on a specific position is spent AFTER events have occurred, such position will not be taken into account in determining whether the advisor is a non-signing preparer.
  - Items of gross income, deductions, amounts upon which credits are determined, in aggregate, as either:
    - (1) Less than \$10,000; or
    - (2) Less than \$400,000 and also less than 20% of the gross income (AGI in the case of an individual)then such amount will be considered not “substantial” and there will be no non-signing tax return preparer with respect to such positions (which are to be aggregated).

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**Specific Regulatory Provisions**  
(continued)

- “Non-signing tax return preparer” (continued)
- Other factors to be considered in determining “substantial”:
  - The size and complexity of the item relative to the taxpayer’s gross income;
  - The size of the understatement attributable to the item compared to the taxpayer’s reported tax liability;
  - Did the person know or reasonably should have known that the position was a “substantial portion of the tax required to be shown on the return”.
- Examples [301.7701-15(b)(3)(iv)]:
  - The preparation of a form 8886, Reportable Transaction Disclosure Statement does not make one a preparer.

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**Specific Regulatory Provisions**  
(continued)

- §1.6994 This is the core of the proposed regulations.
- IRS abandons the “one preparer per firm rule” and has adopted “a framework defining a preparer-per-position within a firm.”
- See 1.6994-1(b) for who is the “Tax Return Preparer” for purposes of the assessment of penalties, which provide in part:
  - An individual is a tax return preparer subject to section 6694 if the individual is primarily responsible for the position(s) on the return giving rise to an understatement.
  - There is only one individual within a firm who is primarily responsible for each position giving rise to an understatement.

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**Specific Regulatory Provisions**  
(continued)

- See §1.6994-1(e), Reliance on Information Provided:
  - One may rely upon facts provided by a Taxpayer, but must make reasonable inquiries if the information appears incorrect or incomplete.
  - One may NOT rely upon the taxpayer with respect to legal conclusions on Federal tax issues.
  - One may rely “in good faith without verification upon a tax return that has been previously prepared by a taxpayer or another tax return preparer and filed with the IRS.”
  - One may not “ignore the implications of information furnished to the preparer or actually known by the preparer.

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**Specific Regulatory Provisions**  
(continued)

- See §1.6994-1(e) – (continued)
  - When the Code or regulations require specific facts (i.e. charitable contributions over \$250), one must make appropriate inquiries to determine the existence of such facts.
  - “...a tax return preparer who prepares an amended return (including a claim for refund) need not verify the positions on the original return.”
  - See examples at §1.6994-1(e)(3).
- See 1.6994-1(f) relating to determine “income derived” to determine the “50 percent of the income derived” measurement of the penalty.

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**Specific Regulatory Provisions**  
(continued)

- See §1.6994-2 – Penalty for understatement due to an unreasonable position.
  - §1.6994-2(b) establishes standards in determining whether one has a reasonable belief that a position would be more likely than not sustained on its merits.
  - A position must not be based upon unreasonable factual or legal assumptions [§1.6994-2(b)(2)].

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**Specific Regulatory Provisions**  
(continued)

- See §1.6994-2 (continued)
- §1.6994-2(c )(3) provides several alternatives for signing preparers to satisfy the “Adequate Disclosure requirement” where a position does not meet the “more likely than not” standard. Some of the alternatives are:
  1. If the position meets the Taxpayer standard for non-disclosure of “substantial authority” as set forth in Code §6662(d)(2)(B)(i), “the tax return preparer advises the taxpayer of all the penalty standards applicable to the taxpayer under section 6662. The tax return preparer must also contemporaneously document the advice in the tax return preparer’s files.”

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**Specific Regulatory Provisions**  
(continued)

- §1.6994-2(c)(3) Alternatives (continued)

2. Disclose position on the tax return to be filed with the IRS on a Form 8275 or in accordance with annual revenue procedure described in §1.6662-4(f)(2).

3. If the position does not meet the Taxpayer standard for non-disclosure of substantial authority as set forth in Code §6662(d)(2)(B)(i), the preparer shall provide “the taxpayer with the prepared tax return that includes the disclosure in accordance with §1.6662-4(f).”

- Note: Non-signing preparers have similar alternatives

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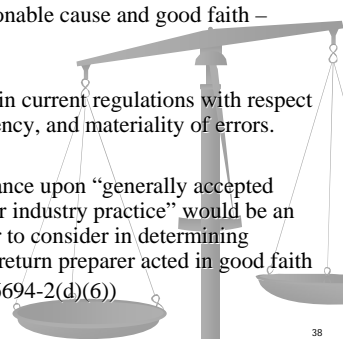
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**Specific Regulatory Provisions**

- Exception for reasonable cause and good faith – §1.6694-2(d):
  - Maintains rules in current regulations with respect to nature, frequency, and materiality of errors.
  - Reasonable reliance upon “generally accepted administrative or industry practice” would be an additional factor to consider in determining whether the tax return preparer acted in good faith (Prop. Reg. §1.6694-2(d)(6))



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**Specific Regulatory Provisions**  
(continued)

§1.6994-3 Penalty for understatement due to willful, reckless, or intentional conduct.

- Covers \$5,000/50% penalty of §6694(b)
- Penalty assessed if any part of an understatement of liability for a return or claim for refund is prepared is due to—
  - i. A willful attempt in any manner to understate the liability for the tax; or
  - ii. Any reckless or intentional disregard of rules or regulations.

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**Specific Regulatory Provisions**  
(continued)

§1.6994-3 (continued)

- 1.6694-3(c) allows a safe harbor to challenge rules and regulations:
  - Adopts the “reasonable basis” standard of 6994(a) and requires adequate disclosure to avoid penalty for positions contrary to a rule or regulation.
  - Positions contrary to regulations must represent a “good faith challenge to the validity of the regulation” and the disclosure “must identify the regulation being challenged to avoid penalty.”

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**Specific Regulatory Provisions**  
(continued)

§1.6994-3 (continued)

- 1.6694-3(c) (continued)
  - Positions contrary to rulings or notices one may also demonstrate that he/she reasonably believes that his/her position will more likely than not be sustained on the merits to avoid penalty.
- 1.6994-3(d) examples reflect some extreme examples, including ignoring facts and overstating expenses.
- 1.6994-3(e) includes as part of “rules or regulations” both temporary and final regulations, the Internal Revenue Code, Revenue Rulings, and Notices.

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**Specific Regulatory Provisions**  
(continued)

§1.6994-3 (continued)

- 1.6994-3(g) addresses burden of proof issues:
  - Government bears the burden to prove “willful” conduct.
  - The preparer bears the burden of proof regarding:
    1. Reckless or intentional disregard for a rule or regulation
    2. Whether a position contrary to a regulation is a “good faith challenge” to the validity of the regulation
    3. The adequacy of disclosure

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