TAX PREPARER PENALTIES FOR (NON TAX) LAWYERS

A. **Background**.

1. circular 230.

(**Note**: Ethics violations under Circular 230 include referral to the IRS Office of Professional Responsibility, which generate referrals to the State Bar.)

2. old law/old standards.

a. For undisclosed positions, the "old" (pre-2007) standard required the income tax return preparer to have a "*realistic possibility* of being sustained on its merits" with respect to any position taken on a return. (Reg § 1.6694-2(b) translated "*realistic possibility* of being sustained on its merits" as at least a one in three likelihood of being sustained on its merits.)

(i) Taxpayers (as opposed to income tax return preparers) were required to have *substantial authority* to support undisclosed tax positions

b. For disclosed positions, the old standard required the position taken on the return to be *not frivolous.*

3. The **Small Business and Work Opportunity Tax Act of 2007** (the "07 Act").

a. undisclosed positions. As part of the 07 Act, Congress enacted new preparer penalty rules under irc §6694 that required tax return "preparers" to have a reasonable belief that an undisclosed position taken on a return would *more likely than not* ("*MLTN*") be sustained on its merits (that required a greater than 50% chance of being sustained on the merits). Note that the 07 Act removed the word "income" from the definition of "income tax return preparer" in irc §7701(a)(36), thereby expanding its scope encompass "preparers" of any federal tax return (including income tax returns, estate and gift tax returns, generation-skipping transfer tax returns, employment tax returns, excise tax returns, and not-for-profit tax returns).

(i) The taxpayer accuracy-related penalty requiring *substantial authority* to support undisclosed tax positions was not changed.

b. Disclosed positions must meet a *reasonable basis* standard.

c. "Tax Shelters" and "Reportable Transactions". If a position is with respect to a "tax shelter" (as defined in irc section 6662(d)(2)(C)(ii)) or a "reportable transaction"

to which irc section 6662A applies, it must be "reasonable to believe that the position *more likely than not* will be sustained on the merits" (*MLTN*).

d. Penalties. Failing to meet these new standards will expose the preparer to the §6694 penalty for "unreasonable positions," which was increased to the greater of $1,000 or 50% of the preparer's income derived (or to be derived) by the tax return preparer with respect to the return or claim.

4. Tax Extenders and Alternative Minimum Tax Relief Act of 2008, (the "08 Act").

a. For undisclosed positions, the 08 Act changed the standard from *MLTN* to "*substantial authority* for the position."

b. for disclosed positions, the 08 Act maintained the "*reasonable basis*" standard.

c. Tax Shelters and "Reportable Transactions. If a position is with respect to a tax shelter or a reportable transaction, it must be *MLTN* (no change).

Recap of standards:

not frivolous

"*realistic possibility* of being sustained on the merits"

reasonable basis

substantial authority

more likely than not it will be sustained on the merits" (*MLTN*)—the preparer must analyze the pertinent facts and authorities and, in reliance upon that analysis, reasonably conclude in good faith that the position has a greater than 50% likelihood of being sustained on the merits.

B. key questions of interest:

1. Who is subject to the irc §6694 preparer penalty provisions?
2. How is the particular tax return preparer for a particular position on a return identified?
3. What standard of conduct is required of the tax return preparer?
4. How can the tax return preparer avoid application of the penalty? And
5. How is the penalty calculated and allocated among tax return preparers?

C. Who Is Subject to the Penalty Provisions?

§6694, as amended by the Small Business Act, now applies to the universe of paid tax advisers and preparers with respect to all federal tax issues. Any person who receives compensation with respect to a federal tax matter that will or may eventually be reported on a return or claim for refund is potentially a "tax return preparer" and, as such, may be subject to the §6694 preparer penalty. Thus, the applicability of the preparer penalty to a particular practitioner depends on who is treated as a tax return preparer under the new proposed regulations.

1. Tax Return Preparer Defined.

IRC §7701(a)(36)(A) defines the term "tax return preparer" to mean any person who prepares for compensation, or who employs one or more persons to prepare for compensation, any federal tax return or claim for refund of tax under the Internal Revenue Code. The section further provides that the preparation of a substantial portion of a return or claim for refund constitutes the preparation of such return or claim for refund. Thus, the IRC §7701(a)(36) designation of a tax return preparer hinges on determining what constitutes a "substantial portion" for purposes of return preparation.

Consistent with the above definition, new Prop. Regs. §301.7701-15(a) defines a tax return preparer as "any person who prepares for compensation, or who employs one or more persons to prepare for compensation, all or a substantial portion of any return of tax or any claim for refund of tax under the Internal Revenue Code."

Prop. Regs. §301.7701-15(f) lists persons who are not tax return preparers. The list includes:

- Employees of the IRS;
- Individuals working for various volunteer assistance organizations;
- Employees preparing returns or claims of their employers;
- Fiduciaries, or officers, partners, or employees of a fiduciary preparing returns or claims of a trust, estate, or other similar entity; and
- Individuals providing only typing, reproduction, or other mechanical assistance in the preparation of a return or claim.

2. Signing and Nonsigning Tax Return Preparers.

Signing tax return preparer: Prop. Regs. §301.7701-15(b)(1) defines a signing tax return preparer as any tax return preparer who signs or is required to sign a return or claim for refund under Prop. Regs. §1.6695-1(b). Prop. Regs. §1.6695-1(b)(1) provides that returns that

are not electronically filed must be signed by the individual who is a "tax return preparer" with respect to the return or claim as described in Prop. Regs. §301.7701-15.

Under Prop. Regs. §301.7701-15, more than one person within a firm may be treated as being a tax return preparer with respect to one or more positions on the return or claim. In such a case, Prop. Regs. §1.6695-1(b)(3) provides that the individual tax return preparer who has the primary responsibility for the overall substantive accuracy of the preparation of the return or claim is the signing preparer.

Nonsigning tax return preparer: 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. Thus, advice given by a tax practitioner with respect to events that have not yet occurred is considered tax planning rather than tax preparation.

The proposed regulations do not provide a definition of the term "advice," leaving the definition of nonsigning preparer vague.

***De Minimis* Rule 1: The 5% Rule**

Prop. Regs. §301.7701-15(b)(2)(i) provides a safe-harbor provision that protects practitioners who primarily have provided tax advice regarding events that have not yet occurred. The safe harbor provides that, in determining whether an individual prepares a substantial portion of the return or claim for refund (i.e., whether the individual is a nonsigning tax return preparer), time spent on advice given by the individual after events have occurred that represents less than 5% of the aggregate time incurred by that same individual on advice given before and after the events have occurred is not taken into account. The preamble to the proposed regulations states:

> The Treasury Department and the IRS believe that this less than 5 percent test will encourage tax professionals who principally rendered advice regarding events that had not yet occurred to provide follow-up advice requested by a taxpayer without the concern that, by providing such advice to a taxpayer, the advisor would become a tax return preparer under proposed §301.7701-15(b)(2) and (3).

***De Minimis* Rule 2: The 20% Rule**

Current Regs. §301.7701-15(b)(2) contains a *de minimis* rule providing that if the amount involved is (i) less than $2,000; or (ii) less than $100,000 and also less than 20% of the gross income (or adjusted gross income if the taxpayer is an individual) shown on the return or claim for refund, then the schedule or other portion is not considered to be a substantial portion. If

more than one schedule entry or other portion is involved, they must be aggregated in applying the rule.

This *de minimis* provision is in Prop. Regs. §301.7701-15(b)(3)(ii) and, pursuant to AICPA recommendations, has been increased to (i) less than $10,000; or (ii) less than $400,000 and also less than 20% of the gross income as shown on the return or claim for refund.

The *de minimis* rules do not apply to a signing tax return preparer. The rule is applicable only in determining if a person is a nonsigning preparer.

3. Multiple Preparers.

If the signing preparer provides, or other information indicates, that a non-signing preparer is the tax return preparer for one or more of the positions on the return, then the signing preparer would no longer be treated as the "tax return preparer" of that or those positions.

If the position treated as having been prepared by the nonsigning preparer, who is now deemed to be the position's "tax return preparer," falls within the thresholds of the 20% *de minimis* rule, then neither the nonsigning nor the signing preparer will be subject to a penalty with respect to the position.

Note: It appears that a firm will be subject to a penalty only in cases where a tax return preparer within the firm is subject to a penalty and certain other conditions are present. The nonsigning preparer alternatively may be able to diminish exposure to the penalty through an application of the 5% *de minimis* rule.

4. Substantial Portion.

Prop. Regs. §301.7701-15(b)(3)(i) provides that factors to be considered in determining whether a schedule, entry, or other portion of a return or claim for refund is a substantial portion include:

- The item's size and complexity relative to the taxpayer's gross income;
- The size of the understatement attributable to the item compared to the taxpayer's reported tax liability; and
- Whether the person knew or reasonably should have known that the tax attributable to the item represented a substantial portion of the tax required to be shown on the return.

5. Return (and Claim for Refund) Defined.

Before the Small Business Act, a "return" was defined as a return of tax under subtitle A (income tax). The Small Business Act expanded coverage of §6694 to all returns under the IRC, encompassing estate and gift taxes, employment taxes, excise taxes, and other returns under the

Code. Similarly, a claim for refund of tax under prior law related only to income tax and has now been expanded.

In Notice 2008-13, the Service addressed what constitutes a return or claim for refund under the expanded §6694 by listing in Exhibits 1–3 the specific tax return forms and claims for refund forms that may be included. The forms are categorized as:

a. tax returns reporting tax liability (Exhibit 1);

b. certain information returns that may subject a preparer to the 6694(a) penalty (Exhibit 2); and

c. forms that would not subject a preparer to the §6694 penalty unless there is a showing of willfulness to understate tax liability or reckless or intentional disregard of rules and regulations (Exhibit 3).[1]

Subsequent to Notice 2008-13, the IRS issued Notice 2008-46, which added 19 forms to Exhibit 1, seven forms to Exhibit 2, and two forms to Exhibit 3.[2]

In Notice 2008-13, the Service explains that, although the information form does not report a tax liability, a person who prepares such a form for compensation is subject to §6694 if the information reported on the information return or other document constitutes a substantial portion of the taxpayer's tax return, notwithstanding the fact that the information return or other document may not be reporting the taxpayer's liability.

The new definition of "return" is located in Prop. Regs. §301.7701-15(b)(4)(i) and provides that a return of tax is a return filed by or on behalf of a taxpayer reporting the taxpayer's liability for tax under the Code, if the type of return is identified in published guidance in the Internal Revenue Bulletin ("IRB"). In addition, it includes any information return or other document identified in published guidance in the IRB and that either is or may be reported on another taxpayer's return, if the information reported on the information return or other document meets the definition of a substantial portion of the taxpayer's return under Prop. Regs. §301.7701-15(b)(3).

The definition of "claim for refund" contained in Prop. Regs. §301.7701-15(b)(4)(ii) likewise is substantially changed from its historical definition and is expanded to include a claim for credit against any tax that is included in published guidance in the IRB. The definition also includes a claim for payment under §§6420, 6421, or 6427.

---

[1] Notice 2008-13, §§A.1 and A.2.
[2] Notice 208-46, 2008-18 I.R.B. 868.

B. How Is the Particular Preparer Identified?

Prop. Regs. §1.6694-1(b)(2) provides that the signing tax return preparer generally will be considered the person who is primarily responsible for all the positions on the return or claim for refund giving rise to an understatement. However, all of the burden of showing otherwise is not placed on the signing preparer. The proposed regulations provide that information from the signing tax return preparer, or other relevant information from a source other than the signing tax return preparer, may form the basis of a conclusion that another person within the signing preparer's firm was primarily responsible for one or more of the positions giving rise to the understatement.

Prop. Regs. §1.6694-1(b)(3) further provides that where the signing tax return preparer is concluded not to be primarily responsible for a given position, or the IRS cannot conclude whether the signing tax return preparer or another person within the firm is primarily responsible for the position, the tax return preparer for the position or positions is the individual within the firm with overall supervisory responsibility for the position or positions giving rise to the understatement. Thus, the Service will attempt to identify the individuals responsible for the position but, failing that, will treat as the tax return preparer the person with overall supervisory responsibility for the position or positions giving rise to the understatement.

Prop. Regs. §1.6694-1(b)(1) provides that only one individual within a firm will be considered as primarily responsible for each position giving rise to an understatement. However, Prop. Regs. §1.6694-1(b)(1) also provides that more than one tax return preparer may be considered primarily responsible for the position or positions giving rise to the understatement where multiple tax return preparers are employed by, or associated with, different firms.

In the case in which one or more individuals in a firm are nonsigning tax return preparers and no individual in that firm is a signing preparer, Prop. Regs. §1.6694-1(b)(3) provides that the individual within the firm with overall supervisory responsibility for the position or positions giving rise to the understatement is the tax return preparer for the position or positions.

C. What Standard of Conduct Is Required?

1. §6694(a) Penalty.

Prop. Regs. §1.6694-2(a)(1) defines the proscribed conduct as the preparation by the tax return preparer of any return or claim for refund that results in an understatement of liability due to a position if the tax return preparer knew or reasonably should have known of the position, and either

- The position was not disclosed, as provided in Prop. Regs. §1.6694-2(c)(3), and there was not a reasonable belief that the position would more likely than not be sustained on its merits, or
- The position was disclosed but there was no reasonable basis for the position.

An exception applies—and no penalty is imposed—if the preparer shows that there was a reasonable cause for the understatement and the preparer acted in good faith (§6694(a)(3)).

2. Reasonable Belief and More Likely Than Not Defined.

Prop. Regs. §1.6694-2(b)(1), adopting the approach taken in Notice 2008-13,[3] states that

> a tax return preparer may "reasonably believe that a position would more likely than not be sustained on its merits," if the tax return 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.

The proposed regulations further state, "The analysis prescribed by §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."

Where other types of authority are not available, the section provides that a tax return preparer may meet the required standard of conduct by a well-reasoned construction of the statute.[4] In addition, in determining whether a tax return preparer meets the required standard of conduct, the determination will be based on all the facts and circumstances, including the tax return preparer's level of diligence. In this regard, the tax return preparer's federal tax experience and familiarity with the taxpayer's affairs, and the complexity of the issues and facts, will be taken into account. Prop. Regs. §1.6694-2(b)(6) provides that a position must meet the MLTN standard on the date the return is deemed prepared under Prop. Regs. §1.6694-1(a)(2).

3. Reasonable Basis Defined.

Reasonable basis is defined in Prop. Regs. §1.6694-2(c)(2) by reference to the definition in Regs. §1.6662-3(b)(3)(A), which provides that "reasonable basis" is a significantly higher standard than "not frivolous" or "not patently improper" and that the reasonable basis standard cannot be satisfied by a return position that is merely arguable or a colorable claim. It further provides that a return position reasonably based on one or more of the authorities set forth in

[3] Notice 2008-13, §D, at 10.

[4] See Example (1) in Prop. Regs. §1.6694-2(b)(4).

Regs. §1.6662- 4(d)(3)(iii) will generally satisfy the reasonable basis standard, even though it may not satisfy the substantial authority standard as defined in Regs. §1.6662-4(d)(2).

4. Preparer Penalty Assessed Against a Firm.

Prop. Regs. Secs. 1.6694-2(a)(2) and 1.6692-3(a)(2) provide that a firm that employs a tax return preparer subject to a penalty under §6694(a) or §6694(b), respectively, also is subject to penalty if, and only if,

- One or more members or the principal management of the firm (or a branch office) participated in or knew of the proscribed conduct;
- The firm failed to provide reasonable and appropriate procedures for reviewing the position for which the penalty is imposed; or
- The firm disregarded such review procedures through willfulness, recklessness, or gross indifference in the formulation of the related advice or preparation of the related return or claim for refund.

D. How Can Preparers Avoid the Penalty?

1. Disclosure on the Tax Return.

The §6693(a) penalty does not apply if there is a reasonable basis for the position and the position is adequately disclosed. The Service identifies in annual revenue procedures the circumstances under which the disclosure on a taxpayer's return with respect to certain items or position will be deemed adequate to avoid the §6694(a) preparer penalty. Rev. Proc. 2008-14[5] is the most recent revenue procedure providing this information.

Further, stated money amounts must be verifiable; the amount must not have arisen from a transaction between related parties; and, when an item is shown on a line that does not have a preprinted description, the item must be clearly labeled by writing in the description on that line.

2. Disclosure Options for Signing Preparers.

Disclosure of a position for which there is a reasonable basis but for which the signing tax return preparer does not have a reasonable belief that the position would more likely than not be sustained on the merits is adequate if the tax return preparer meets any of the following standards found in Prop. Regs. Secs. 1.6694-2(c)(3)(i)(A) through (E), respectively:

[5] Rev. Proc. 2008-14, 2008-7 I.R.B. 435.

- The position is disclosed either on a properly completed and filed Form 8275, Disclosure Statement, or Form 8275-R, Regulation Disclosure Statement, if the position is contrary to a regulation, or on the tax return in accordance with the annual revenue procedure.
- For income tax returns, if the position does not meet the §6662 substantial authority standard for the taxpayer to avoid a penalty without disclosure, the tax return preparer provides the taxpayer with the prepared return that includes a properly completed Form 8275 or Form 8275-R, or discloses the position on the tax return in accordance with the annual revenue procedure.
- For income tax returns, if the position would meet the substantial authority standard for nondisclosure for the taxpayer, the preparer advises the taxpayer of all penalty standards applicable to the taxpayer under §6662 and contemporaneously documents the advice in the tax return preparer's files.
- For tax shelters, reportable transactions with a significant purpose of tax avoidance or evasion, or listed transactions on income tax returns, the tax return preparer advises the taxpayer that there must be a minimum standard of substantial authority for the position, that the taxpayer must possess a reasonable belief that the tax treatment was more likely than not the proper treatment in order to avoid a penalty under §6662(d) or 6662A, and that disclosure will not protect the taxpayer from assessment of an accuracy-related penalty. The tax return preparer must contemporaneously document the advice in his or her files.
- For returns or claims for refund that are subject to §6662 penalties other than the substantial understatement penalty under Secs. 6662(b)(2) and (d), the tax return preparer advises the taxpayer of the penalty standards applicable to the taxpayer under §6662 and documents the advice in the tax return preparer's files.

3. Disclosure Options for Nonsigning Preparers.

Nonsigning tax return preparer disclosure options are outlined in Prop. Regs. §1.6694-2(c)(3)(ii). Where the nonsigning preparer does not have a reasonable belief that the position would more likely than not be sustained on the merits but the position has a reasonable basis, the nonsigning preparer has the following disclosure options:

- Disclosure of the position on a properly completed and filed Form 8275 or Form 8275-R or on the tax return in accordance with the annual revenue procedure.

- For advice to a taxpayer, disclosure by advising the taxpayer of any opportunity to avoid penalties under §6662 that could apply to the position and of the standards for disclosure. The nonsigning preparer must contemporaneously document the advice in the nonsigning preparer's files.
- For advice to another tax return preparer, disclosure by advising the other tax return preparer that disclosure under §6694(a) may be required. The nonsigning preparer must contemporaneously document the advice in the non-signing preparer's files.

4. "In Good Faith" Reliance.

The proposed regulations expand the forms of good-faith reliance over those outlined in Notice 2008-13.

For purposes of satisfying the standards of conduct and reasonable cause/good faith exception: For purposes of meeting the standards of conduct discussed above and demonstrating reasonable cause and good faith under Prop. Regs. §1.6694-2(d), Prop. Regs. §1.6694-1(e) (1) provides that the tax return preparer

- May rely in good faith without verification on information furnished by the taxpayer;
- May not rely on legal conclusions about federal tax issues provided by a taxpayer; and
- May rely in good faith and without verification on information furnished by another adviser, another tax return preparer, or another party from within the tax return preparer's firm or from outside the tax return preparer's firm; provided appropriate inquiries to determine the existence of facts and circumstances required as a condition of claiming a deduction or credit are made.

Prop. Regs. §1.6694-1(e)(2) provides that the tax return preparer

- May rely in good faith and without verification on a tax return that has been previously prepared by a taxpayer or another tax return preparer and filed with the IRS (for example, preparation of an amended return would not require verification of the positions on the original return); but must confirm that the position being relied on has not been adjusted by examination or otherwise.

The tax return preparer

- May not ignore the implications of information furnished to, or actually known by, the tax return preparer; and
- Must make reasonable inquiries if the information appears to be incorrect or incomplete.

For purposes of satisfying the reasonable cause/good faith exception: Prop. Regs. §1.6694-2(d)(5) provides that the tax return preparer is not considered to have relied in good faith if

- The advice or information is unreasonable on its face;
- The tax return preparer knew or should have known that the party providing the advice or information was not aware of all relevant facts; or
- The tax return preparer knew or should have known that the advice or information was no longer reliable due to developments in the law since the time the advice was given.

Further, Prop. Regs. §1.6694-2(d)(6) provides that for purposes of the reasonable cause/good faith exception, the tax return preparer may reasonably rely in good faith on generally accepted administrative or industry practice.

E. How Is the Penalty Calculated?

The §6694(a) penalty amount is calculated as the greater of $1,000 or 50% of the "income derived or to be derived" by the tax return preparer.

The §6694(b) penalty amount is calculated as the greater of $5,000 or 50% of the "income derived or to be derived" by the tax return preparer.

Income, within the context of calculating 50% of the "income derived or to be derived," is based on gross compensation received, not net income (Prop. Regs. §1.6694-1(f)(2)(i)).

Where the tax return preparer or the tax return preparer's firm have multiple engagements relating to the return or claim for refund, only those engagements relating to the position(s) giving rise to the understatement will be considered in calculating the compensation amount (Prop. Regs. §1.6694-1(f)(1)).

Only advice given for events that have occurred at the time the advice is rendered and that relates to the position(s) giving rise to the understatement will be taken into account in calculating the amount of the §6694(a) or (b) penalty (Prop. Regs. §1.6694-1(f)(2)(ii)). The amount of income derived with respect to the position(s) related to an understatement will be based on a reasonable allocation of the lump-sum fee, taking into account the tax advice giving rise to the penalty and the advice that does not give rise to the penalty (Prop. Regs. §1.6694-1(f)(2)(ii)).

If both the firm and an individual employed by or associated with the firm are subject to a penalty under §6694(a) or (b), the amount of the §6694 penalties assessed cannot exceed 50% of the firm's engagement income that is related to the position(s) giving rise to the understatement.

Of this total amount assessed, the portion assessed against the individual tax return preparer cannot exceed 50% of the individual's compensation that can reasonably be allocated to the engagement of preparing the return with respect to the position giving rise to the penalty (Prop. Regs. §1.6694-1(f)(3)).

Where the number of hours of the engagement spent on the position or positions giving rise to an understatement constitutes a subset of the total hours involved in the engagement, the penalty will be calculated based upon the compensation attributable to the position or positions associated with the understatement. Otherwise, the total amount of compensation from the engagement will be the amount of income derived for purposes of calculating the §6694 penalty (Prop. Regs. §1.6694-1(f)(2)(iv)).

If the tax return preparer should refund to the taxpayer all or a part of the amount paid to the preparer or to the preparer's firm, the refund will not reduce the amount of the §6694 penalty assessed. In this regard, discounted fees or alternative billing arrangements for the services provided are not considered to be refunds (Prop. Regs. §1.6694-1(f)(2)(iii)).

GOOD NEWS(?): The preamble to the proposed regulations states that Treasury anticipates a revision of Circular 230 to state that the Service "generally will not stack the §6694 penalty and monetary penalties under … [i.e., Circular 230] with respect to the same conduct."

§6694(b) Penalty

§6694(b), as amended by the Small Business Act, imposes a penalty on 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 willful or reckless conduct. Willful or reckless conduct is described in §6694(b) as conduct by the tax return preparer that 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.

Under Prop. Regs. Secs. 1.6694-3(c)(2) and (3), respectively, if a position that is contrary to a rule or regulation has a reasonable basis and is adequately disclosed, or a position contrary to a revenue ruling or notice published in the IRB is taken and the tax return preparer reasonably believes that the position would more likely than not be sustained on its merits under Prop. Regs. §1.6694-2(b), the tax return preparer will not be treated as having recklessly or intentionally disregarded a rule or regulation.

Conclusion

The proposed regulations apply to the universe of tax preparers who are engaged with federal tax issues. Tax practitioners must embrace a new and expansive definition of the returns and claims for refund that now come within the §6694 preparer penalty regime.

In the proposed regulations, Treasury divides preparer activities into those that are conducted on the basis of events that have occurred which may be subject to the preparer penalty rules, and those conducted prior to the occurrence of the transaction or event, which are not included in the activities covered by the penalty. A tax return preparer may, of course, be engaged in both types of activities in performing engagements for clients.

The "one preparer per firm" rule has been replaced with a "one preparer per firm per position" rule. A person who is not in the same firm as the signing preparer of a return also may be regarded as a tax return preparer of a portion of the return. Further, where appropriate, preparers from different firms may also be deemed to be the preparers of the same position on a return.

While the universe of preparers has expanded, the preparer definitions delineate the "signing preparer" under one definition and the entire range of other preparers under the definition of "nonsigning preparer." The proposed regulations most often characterize the activities of nonsigning preparers as "advice" but do not define the term within the proposed regulations.

The new proposed regulations establish an operational standard of conduct that alleviates the potential conflict of interest between taxpayers, who must have substantial authority for an undisclosed position, and tax preparers, who must have a reasonable belief that the position will more likely than not be sustained on its merits. In addition, they provide expanded disclosure and reasonable reliance options in support of the standards of conduct and a reasonable cause defense that will help preparers to avoid the imposition of the penalties.

In the preamble to the proposed regulations (pp. 18–19), Treasury states its intention to modify IRS internal guidance so that a referral by revenue agents to the IRS Office of Professional Responsibility (OPR) will not be per se mandatory when the Service assesses a tax return preparer penalty under §6694(a) against a tax return preparer who is also a practitioner within the meaning of Circular 230. Nonetheless, as a matter of course, revenue agents must consider the preparer penalty, if not the referral to OPR, in every audit.

An industry director memorandum issued April 13, 2008,[6] by the IRS Large and Midsize Business Division states:

> The purpose of assessing penalties on return preparers is to increase compliance. When examining a return prepared by a tax return preparer, it is an examiner's responsibility to ensure that the identification[7] and conduct provisions of the Code were followed. If the provisions are not followed, and the preparer cannot show reasonable cause, it is the examiner's responsibility to assert the penalties. During every field examination, examiners should determine if return preparer violations exist.

[6] LMSB-04-0308-009 (4/13/08).
[7] This refers to identifying the item on the return or otherwise properly disclosing.