

# IMPORTANT NOTICE

## 2008 Small Business Act Regulation Imposes Strict New Rules and Penalties for Tax Preparers



The IRS has issued interim guidance on the strict new rules for return preparers under the Small Business and Work Opportunity Act of 2007 (the Small Business Act). Until revised regulations (expected before the end of 2008) are issued, a preparer generally can continue to rely on taxpayer and third party representations in preparing a return, unless he has reason to know they are wrong. Further, preparers of many information returns will not be subject to the new penalty provision unless they willfully understate tax or act in reckless or intentional disregard of the law. In addition, IRS has released two other notices that provide guidance on the tax return preparer signature requirement and clarify previously issued transition relief from the expanded preparer's penalty.

Under the Small Business Act, for returns prepared after May 25, 2007, the definition of an "income tax return preparer" was replaced with an expanded definition of a "tax return preparer," which includes preparers of not only income, but also estate, gift, employment, excise tax, and exempt organization returns. (Code Sec. 7701(a)(36)) Under the Small Business Act, a tax return preparer who prepares a return or refund claim for which any part of a tax liability understatement is due to an unreasonable position must pay a penalty for each return or claim equal to the greater of: (a) \$1,000 or (b) 50% of the income derived (or to be derived) by the tax return preparer for preparing the return or claim. (Code Sec. 6694(a)(1)) A position is unreasonable if:

- the tax return preparer knew (or reasonably should have known) of the position,
- there was not a reasonable belief that the position would more likely than not be sustained on its merits, and the position was not disclosed as provided in Code Sec. 6662(d)(2)(B)(ii), or there was no reasonable basis for the position. (Code Sec. 6694(a)(2))

However, no penalty is imposed if it is shown that there is reasonable cause for the understatement and the tax return preparer acted in good faith. (Code Sec. 6694(a)(3))

**Reasonable belief and reasonable basis.** For purposes of determining whether the tax return preparer has a reasonable belief that the position would more likely than not (greater than 50% chance) be sustained on the merits (Notice 2008-13, Sec. D), and for purposes of determining whether the tax return preparer has a reasonable basis for a position (Notice 2008-13, Sec. E), a tax return preparer may rely in good faith without verification on information furnished by the taxpayer. He can also rely in good faith without verification on information furnished by another advisor, tax return preparer or other third

party. Thus, he isn't required to independently verify or review the items reported on tax returns, schedules or other third party documents to determine if the items meet the standard. However, he can't ignore the implications of information furnished to him or that is actually known by him. He also must make reasonable inquiries if the information furnished by another tax return preparer or a third party appears to be incorrect or incomplete.

**Penalty compliance rules.** A signing tax return preparer will be deemed to meet the Code Sec. 6694 requirements for a position for which there is a reasonable basis but for which the tax return preparer doesn't have a reasonable belief that the position would more likely than not be sustained on the merits, if he meets any of the following:

- ◆ The position is disclosed in accordance with Reg. § 1.6662-4(f);
- ◆ If the position would not meet the standard for the taxpayer to avoid a penalty without disclosure, he provides the taxpayer with a prepared tax return that includes the disclosure;
- ◆ If the position would otherwise meet the requirement for nondisclosure, he advises the taxpayer of the difference between the penalty standards applicable to the taxpayer under Code Sec. 6662 and the penalty standards applicable to the preparer under Code Sec. 6694, and contemporaneously documents in his files that this advice was provided; or
- ◆ If the Code Sec. 6662(d)(2)(B) disclosure provision doesn't apply because the position falls under Code Sec. 6662(d)(2)(C) (dealing with tax shelters), he advises the taxpayer of the penalty standards applicable to the taxpayer under Code Sec. 6662(d)(2)(C) and the difference, if any, between these standards and those under Code Sec. 6694, and contemporaneously documents that this advice was provided. (Notice 2008-13, Sec. G).

A non-signing tax return preparer will be deemed to meet the requirements of Code Sec. 6694 for a position for which there is a reasonable basis but for which he doesn't have a reasonable belief that the position would more likely than not be sustained on the merits, if the advice to the taxpayer includes a statement informing the taxpayer of any opportunity to avoid penalties under Code Sec. 6662 that could apply to the position as a result of disclosure, if relevant, and of the requirements for disclosure. (Notice 2008-13, Sec. G).

If you have any questions or want to schedule an appointment to discuss this in detail, please feel free to contact us.

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