

THE YEAR IN REVIEW:

Cases, Rulings, Legislative Changes, and Proposals of Interest

To The Estate Planning Professional

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THE YEAR IN REVIEW: **Cases, Rulings, Legislative Changes, And Proposals Of** **Interest To The Estate Planning Professional**

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If you have any questions with regard to this presentation, please send an email to: Ms. Heather Hartel, hhartel@mfzlaw.com with the subject line “Question About GSCPA – Year In Review Presentation”, outline briefly your question, and don’t forget to include your contact information. We will be happy to try and help you.

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BIOGRAPHY

Lawrence H. Freiman, a founding partner of Menden, Freiman & Zitron, LLP, received his J.D./M.B.A. degree, *with highest honors*, from the University of Florida in 1993, and a Bachelor of Arts in Economics, *magna cum laude*, from the State University of New York at Albany in 1989. Mr. Freiman has earned an “AV” rating from the Martindale-Hubbell Law Directory – the highest rating given, indicating that his professional colleagues rate his legal ability as “very high to preeminent.” His peers also previously selected him as one of *Georgia Trend Magazine’s* “Legal Elite.” He has served as the Chief Tax Editor of the Florida Law Review, and earned a number of academic achievement awards in his law and business endeavors, including the honorary Order of the Coif, Beta Gamma Sigma and Matherly Scholarship. He is a Director for the Estate Planning Council of North Georgia and a member of the Lawyer’s Club of Atlanta. He is a frequent lecturer to various groups on tax, estate planning and charitable giving.

Larry designs estate plans and provides other legal services for wealthy individuals, families and business owners.

Larry has been married to his wife Tara for 15 years, and has four children

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Estate and Gift Tax Reform – Current Activity

- On April 3, 2008, Senate Finance Committee Chairman Max Baucus (D-MT) convened the third hearing in a series of committee hearings on reform alternatives to the current estate and gift tax system.
- Other Senators present:
 - Ken Salazar (D-CO)
 - Pat Roberts (R-KS)
 - Blanche Lincoln (D-AR)
 - Jon Kyl (R-AZ)
- Several tax professionals advocated various reforms in the estate tax, including:
 - Section 6166 (deferral of tax on closely-held business)
 - “Reunification” of estate and gift tax rates
 - “Portability” of credit shelter exemption amount of the first of two spouses to die

Estate and Gift Tax Reform – Current Activity

- Senator Kyl: Republican losses in the Senate in the recent election didn't make the job of passing a permanent estate tax reform bill any easier.
- Last year, Kyl and Democratic allies, including Baucus, fell three votes shy of defeating a filibuster on a bill that would have exempted all estates under \$5 million, taxed those between \$5 million and \$25 million at the capital gains rate, and taxed those over \$25 million at 30 percent.

Estate & Gift Tax Reform – What You Might See in Near Future...

- There will be debate about a complete overhaul of the estate and gift tax system – but expect lawmakers to stop short of total repeal.
- The “sunset” provision could create a real mess for everyone. Lawmakers know this, but election year politics will likely delay real solutions until 2009.
- The numbers:
 - Exemption amount will likely hold at \$3.5 million (or increase)
 - Top estate tax rate will likely be at least 45% if a Democrat is elected President (or slightly lower if McCain becomes President)

Estate & Gift Tax Reform – What You Might See in Near Future...

- One of the big changes to expect is that lawmakers could make tax planning easier for surviving spouses by permitting “portability.”
 - Current problem: if one spouse dies without fully using up his or her \$2 million exemption, that amount is wasted. This can happen when the first spouse to die doesn’t own enough assets in his or her name or when many or all assets go to the survivor.
 - The fix: Congress may allow unused exemption amounts to pass to surviving spouses and be available for use when the spouse dies. This will eliminate the need for spouses to have to establish trusts in their wills solely to save on estate taxes.
- “Inheritance tax” in lieu of the current tax? Don’t bet on it...

Estate Inclusion Issues with Retained-Interest Trusts

- Proposed Regulations (REG-119097-05) issued June 7, 2007
- Provides guidance on portion of a trust that will be includible in a grantor's gross estate under Sections 2036 and 2039 if the grantor has retained:
 - use of property in a trust; or
 - the right to an annuity, unitrust or other income payment from trust
- Types of trusts impacted: CRTs, GRATs, GRUTs, QPRTs, non-qualified PRTs
- Section 2036 – not 2039 – will now govern estate inclusion of these trusts

Estate Inclusion Issues with Retained-Interest Trusts

- Proposed Regs amend Regs. Section 20.2036-1 to follow prior guidance given under Rev Rulings 76-273 and 82-105
- The Proposed Regs state that the portion of the trust corpus includible in the decedent's gross estate under Section 2036 is that portion:
 - valued as of date of death (or alternative valuation date), that is
 - necessary to produce enough income to fund annual payment (or use),
 - assuming an income yield at the Section 7520 rate.
 - (*i.e.*, Section 7520 rate in effect on date of death/alternative valuation date)

Estate Inclusion Issues with Retained-Interest Trusts

- Proposed Regs contain examples for calculation of estate inclusion amount
- Illustration:
 - During lifetime:
 - Client transfers \$1m to five-year GRAT
 - Section 7520 rate is 3%
 - Annuity payment is \$120,000 per year
 - Client dies after third annuity payment:
 - Section 7520 rate is now 3.5%
 - Determine amount necessary to generate \$120,000 of income, assuming income yield is 3.5% → $\$3,428,571$ ($\$120,000 \div .035 = \$3,428,571$)
 - So, only the portion of the GRAT in excess of \$3,428,571 escapes taxation under Section 2036
- Conclusion: the inclusion method under these Regs will provide little or no help to *Walton* GRATs because the annuity payment will almost always result in all (or nearly all) of the GRAT's value being included in the estate.

Estate Tax Deductions: Proposed Regs. under IRC § 2053

- IRC § 2053 allows deductions for funeral expenses; administration expenses, claims against the estate, and unpaid mortgages or indebtedness on property in the gross estate.
- April 23, 2007 – IRS issued proposed regulations clarifying that events occurring after a decedent's death are to be considered when determining estate tax deductions.
- Court determinations of the amount and enforceability of creditor claims against the estate will be honored by the IRS when the estate is determining deductions.
- Settlements of claims falling under IRC § 2053 also will be accepted as deductible expenses when they are reached in “bona fide” negotiations between adverse parties.

Estate Tax Deductions: Proposed Regs. under IRC § 2053

- Claims must be enforceable at the time the 706 is filed in order to be deductible.
- For those claims not enforceable at the time of filing, there is a limitations period during which the estate may preserve a right to a refund for claims that become enforceable after the 706 filing.
- In addition, protective claims may be filed to preserve the estate's right to claim a refund for specified anticipated future claims or expenses that will not be ascertainable by the time the limitations period has expired. No dollar amount must be specified, but the claim must be identified along with the reasons for delay in payment of the claim.
- *Attorneys' fees may be deducted based on the total fees that are reasonably expected to be paid as estimated at the time of filing.*

Estate Tax Deductions: Proposed Regs. under IRC § 2053

AICPA Comment

- Will not accomplish the goal of the Treasury Department of reducing costs for estates and the IRS in administering IRC section 2053.
- Creates a series of traps for unwary executors and tax preparers.
- Creates situations where an estate must be held open for decades until contingent obligations are finalized and paid.
- Creates a rebuttable presumption that all family claims against the estate are illegitimate.
- Encourages executor applications for the IRS to calculate the estate taxes owed pursuant to IRC § 2204 thereby relieving executor's of liability.

Estate Asset Valuation: Stone v. U.S.

- U.S. District Court in California rejected application of standard fractional interest discount factors in determining the fair market value of a 50% interest in artwork.
- Court held that discount factors for artwork are limited to the cost and time to obtain a court ordered partition, including costs of 1) legal fees and court costs, 2) sale at auction, and 3) the time value of potential delays in the forced partition sale.
- Planning Note: Transfer artwork to FLP or LLC to obtain standard discounts on minority entity ownership.

Estate Asset Valuation: FLP Reminders

- Estate v. Gore – Taxpayer executed an assignment agreement transferring assets to her FLP, but she failed to transfer assets by executing deeds, changing title to bank accounts, executing stock transfer powers, etc. Consequently, assets were included in her estate.
- Estate of Erickson – Assets transfers from Hilde Erickson to FLP were completed, but property was included in Erickson's estate for multiple reasons including: the family did not respect the formalities of the partnership agreement; Hilde was allowed to retain the economic benefits of her property; the FLP did not have a legitimate non-tax business purpose; and the asset transfers to the FLP were not considered bona fide sales.

Estate Tax Valuation – Alternate Valuation of the Same Asset under IRC § 2032

- Kohler v. Commissioner – After a shareholder's death in March, the privately held business underwent a §368(a) tax-free recapitalization in May in which new transfer restrictions and purchase options were placed on the stock but the stock value before and after the reorganization was the same. On the alternate valuation date in September, the stock was appraised at a lower value due to the additional transfer restrictions. The IRS objected to the taxpayer's use of the alternate valuation, claiming that the value on the date of the recapitalization must be used as the alternate valuation.
- Treasury Regulation §20.2032-1(c)(1) provides that a tax-free reorganization under IRC § 368(a) is not a disposition that accelerates the alternate valuation date.
- The Court ruled the taxpayer could use the value of the post-reorganization stock as of the Alternate Valuation Date since the recapitalization only caused a change in the form of the stock rather than a disposition that accelerated the alternate valuation date.

Estate Tax Valuation – Proposed Treasury Regulation §20.2032

- The Treasury responded to Kohler by issuing changes to the §2032 Regulations.
- The Treasury’s proposed regulations specify that only valuation changes attributable to “market conditions” may affect the federal estate tax value of assets. Market conditions are defined as “events outside the control of the decedent (or the decedent’s executor or trustee)”. The proposed Regulation identifies other events that would not qualify as “market conditions” including entity reorganizations and distributions of fractional entity ownerships.

Estate Tax Valuation – Proposed Treasury Regulation §20.2032

- The proposed Regulation gives several examples of post-mortem estate planning that illustrate the government's primary concerns.
 - An estate that contributes property to an FLP for LP interests subject to transfer restrictions may not take discounts for lack of marketability and lack of control for estate tax valuation purposes. The Treasury stresses that while such contributions are not tax realization events, they will be treated as accelerating the alternate valuation date to the contribution dates.
 - If an estate owns 100% of a closely held business and distributes small fractional shares before the alternate valuation date, the distributed shares will, of course, be valued as of the distribution date (without minority discounts). However, the Treasury also stresses that the remaining undistributed fractional share also may not benefit from minority discounts following the prior distributions.

IRC § 6166: Estate of Roski

- IRC § 6166(a)(1) allows estate taxes to be paid in installments when private business assets represent at least a certain proportion of the gross estate.
- Assets of the Roski estate were part of a profitable business run by decedent's only child.
- The IRS told the estate that it would have to secure a bond or provide a special lien under IRC § 6324A to qualify under IRC § 6166.

IRC § 6166: Estate of Roski – Continued

- The Roski estate told the IRS no company would underwrite the bond, a lien already secured the estate tax payment, and a special lien would violate partnership covenants.
- The IRS denied the § 6166 election.
- When the Estate alleged the IRS abused its discretion, the Tax Court held that the IRS could not require security by bond or special lien in all cases and indicated the Service had to use its discretion on a case by case basis.

Guidance under Code Section 6166 – Notice 2007-90, IRB 2007-46

- IRS issued this Notice on November 13, 2007 (shortly after *Roski* decision)
- This Notice concerns each estate:
 - that elects to pay the estate tax in installments under Section 6166 on a return timely filed on or after 11/13/07
 - whose return the IRS was classifying, surveying or auditing as of 4/17/07
 - that is currently in the deferred payment period, *but* that has not yet provided a bond or special lien, *if*:
 - the general fed estate tax lien will expire w/in 2 years of 11/13/07, or
 - IRS reasonably believes that the government's interest in collecting tax is sufficiently at risk to require bond or special lien

Guidance under Code Section 6166 – Notice 2007-90, IRB 2007-46

- Regs forthcoming: standards to identify estates in which government's interest in deferred estate tax is sufficiently at risk to justify requiring a bond or special lien
- In the meantime, the IRS will evaluate on a case-by-case basis
- Factors to be considered:
 - duration and stability of business
 - ability to make timely installment payments of tax and interest
 - compliance history
- No single factor is determinative, and not all factors relevant in each case

GST Tax – Final Regulations Concerning Qualified Severance

- Final Regulations under Code Section 2642(a)(3) effective August 2, 2007 (amending/finalizing 2004 Regs)
- Regs provide rules for “qualified severance” of GST trusts
- Does not govern severances that are effective retroactively to transferor’s DOD (see Code Section 2654)
- Rules:
 - Severance must be done on fractional or percentage basis, not pecuniary basis
 - Formula OK
 - *Pro rata* based on total asset value
 - Focus on value, not assets → planning opportunity: built-in gains

GST Tax – Final Regulations Concerning Qualified Severance (cont.)

- *Trust funding must be done within reasonable time of severance date*
 - Date of severance: court ordered or trustee chooses
 - “Reasonable” varies, but in no event more than 90 days
- *If severance triggers GST-taxable event, the taxable event is deemed to occur right after severance (so that no GST tax occurs for what would otherwise be a taxable distribution to a “skip person”)*
- *Beneficial interests in resulting trusts must be same as original trust (or if not defined in trust instrument, *per capita*)*

GST Tax –Proposed Regulations Concerning Qualified Severance

- Proposed Regs under Code Section 2642 were issued on same date as Final Regs on qualified severances
- Rules:
 - Cannot use valuation premiums or discounts when funding the resulting trusts on a non-*pro rata* basis.
 - A trust with an inclusion ratio between zero and one can be severed into more than two resulting trusts
 - Trusts resulting from a non-qualified severance will be recognized as separate trusts for GST tax purposes if recognized as separate trusts under state law

Grantor Trusts: IRC § 671 – § 678

- IRC § 678 allows a person who is not the grantor of a trust (e.g. a beneficiary) to be treated as the owner of a portion of the trust if the person has certain controls over the trust.
- Under certain circumstances, the owner of a trust under IRC § 678 may be different than the owner of a trust under IRC §§ 671 through 677.
- In 2007, the IRS issued PLR 200730011 and PLR 200729005 both indicating that in conflicts between IRC § 678 and IRC §§ 671 through 677 as to the proper owner of the trust, IRC §§ 671 through 677 will trump IRC § 678.

Grantor Trusts: Insurance and “Transfer for Value”

- Although life insurance proceeds are generally received free from income tax, IRC § 101(a)(2) provides if a policy that is sold from one policy owner to another, the insurance proceeds above and beyond the purchase price of the policy will be taxable income.
- Revenue Ruling 2007-13 confirms that this “Transfer for Value” rule does not apply to life insurance policies sold from an individual to that individual’s grantor trust or between grantor trusts owned by the same individual.

Trust Income Tax Deductions: Knigh t v. Commissioner

- The issue in Knigh t v. Comm. was whether trusts and estates may fully deduct investment advisory fees under IRC 67(e) or are subject to the 2% floor on miscellaneous itemized deductions under IRC §67(a) the same as individual taxpayers.
- After oral argument in November, 2007, the US Supreme Court ruled on January 16, 2008 that the investment advisory fees incurred in the Knigh t case are subject to the 2% floor and “*only those costs that it would be uncommon (or unusual, or unlikely) for ... a hypothetical individual to incur*” would be excepted from the rule.
- There is nothing in the Knigh t opinion to suggest that full deductibility of legal and accounting fees are at risk despite certain similarities in services provided to both trusts and individuals.

Trust Income Tax Deductions: Proposed Treas. Reg. §1.67-4

- In July 2007, in anticipation of the Supreme Court's review of Knight, the IRS issues proposed Treas. Reg. §1.67-4 providing that only expenses that are “unique” to fiduciary administration would be fully deductible and giving examples of “unique” expenses and expenses subject to the 2% floor.
- The Court's ruling in Knight articulates a standard that seems less harsh to the taxpayer but arguably more difficult to apply.
- After the Knight opinion, the IRS released Notice 2008-32 in February, 2008 allowing the possibility for full deduction of “bundled fiduciary fees” without regard to the 2% floor.

IRS Approves Joint Purchase PRT on an Existing Home

- IRS issued PLR 200728018 on March 19, 2007.
- Proposed transaction:
 - Husband and wife transfer a residence that they own to a trust intending to meet the requirements of a PRT (see Regs.25.2702-5(b)(1)-(3));
 - Under trust, spouses have exclusive lifetime rent-free use of residence;
 - Under trust, residence is distributed to children’s subtrust (“purchasing trust”) on 2nd death;
 - Spouses and purchasing trust to pay residence’s expenses as provided under state law;
 - Purchasing trust pays spouses an amount equal to value of the remainder interest (based on FMV of residence and date-of-transfer 7520 rate)
- Ruling:
 - Transaction fell under the joint purchase rule of Code Section 2702(c)(2);
 - Thus, IRS deems this a transfer of spouses’ remainder interests to trust, with retention by each of life interest in residence;
 - Value of spouses’ retained interests would be valued under Section 7520

IRS Approves Joint Purchase PRT on an Existing Home

- Similar PLRs: 9841017 (issued 10/9/98) and 200112023 (issued 12/18/00), in which IRS concluded that such PRTs would not give rise to taxable gifts.
- Key distinction: in those rulings, spouses and purchasing trust contributed cash to trust, and then acquired residence from third party.
- Main risk: applicability of Code Section 2036(a)?
- Potential advantages to joint purchase PRT vs. traditional PRT for term of years:
 - No mortality risk (*i.e.*, inclusion if grantor dies during term)
 - No relinquished right to reside in residence at end of a term

Changes to UBTI Rule for Charitable Remainder Trusts

- Tax Relief and Health care Act of 2006 provides that unrelated business taxable income (UBTI) no longer causes a CRT to lose its income tax exemption.
- UBTI is generally income of an exempt organization from any unrelated trade or business regularly carried on by the organization (see Code Section 512).
- Old rule: a CRT is exempt from income taxes unless it has any UBTI. If a CRT has even \$1 of UBTI, it loses its income tax exemption for all income during that year.
- New rule (effective 2007): Code Section 664 was amended so that a CRT with UBTI will not lose its tax-exempt status. Instead, an excise tax equal to 100% of UBTI is imposed.
- Potential Ramifications:
 - CRTs making more aggressive investments? (Be careful...)
 - More tax payable under new rule?

IRS Clarifies - HEETs Are Not Subject to Private Foundation Rule

- IRS issued PLR 200714025 on April 6, 2007.
- Ruling clarifies that a “HEET” should not be treated as a split-interest trust subject to the private foundation rules.
- A HEET is a trust that can pay tuition and medical care expenses of descendants without having to allocate GST tax exemption to the trust.
- Takes advantage of education/medical expense exclusions under Code Section 2503(e).
- Most logical use of HEET: testamentary – not lifetime – transfers

IRS Clarifies - HEETs Are Not Subject to Private Foundation Rule

- Charitable beneficiaries often used to avoid “taxable termination” of HEET under GST tax rules. See Code Sections 2613(a) and 2612(a).
- Practitioner’s concern: GST tax avoidance rule under Code Section 2652(c)(2).
- Without this PLR 200714025, Code Sections 642(c) and 4947(a)(2) suggest that the HEET is subject to private foundation rules.
- Section 642(c) permits an income tax deduction to the trust upon making a distribution to a charitable beneficiary.
- Section 4947(a) applies private foundation rules to a “split interest trust,” defined as a trust:
 - that is not tax-exempt under 501(a);
 - as to which some interests are not charitable; and
 - has some amounts “in trust” for which a 642(c) deduction was allowed.

IRS Clarifies - HEETs Are Not Subject to Private Foundation Rule

- PLR facts:
 - Trust terms permitted trustee to distribute all or part of income to charity
 - Trustee represented that trust was not tax-exempt under Section 501(a)
 - Trustee stated that no deduction was taken under Sections 170, 545(b)(2), 642(c), 2055, 2106(a)(2) or 2422 for contributions or retained amounts
 - Trustees had not permanently set aside amounts for 170(c) purposes
 - Income distributions to charities would be made free of trust
- Ruling:
 - 642(c) deduction itself does not cause foundation rules to apply to trust
 - 4927(a)(2) applies only if property for which such a deduction was taken is still held in the trust
 - the only type of property that can both be held in trust for and which 642(c) deduction can be taken is property that is “permanently” set aside in trust for charitable purposes
- Ramifications: most HEETs – and other trusts permitting discretionary distributions to charity – should be safe from application of private foundation rules

IRS Guidance on Non-Spousal Inherited IRAs

- Before the Pension Protection Act of 2006, only spouses named as designated beneficiaries of a decedent's qualified retirement plan could roll over the plan benefits into an IRA.
- The PPA changed the rules to allow non-spouse beneficiaries to roll retirement plan benefits into an IRA which will be treated as an inherited IRA for distribution and income tax purposes.
- IRS Notice 2007-7 clarifies the new rules regarding the availability of direct "trustee-to-trustee" IRA rollovers by non-spouse beneficiaries and certain qualifying trusts beneficiaries.
- The Notice has left many experts and advisors disappointed because the anticipated benefit of non-spouse beneficiaries escaping the lump-sum or 5-year payout requirements imposed by retirement plan was largely undercut by the IRS claim that the inherited IRA *must use the same distribution period that was in effect under the plan.*

Practice Points on Inherited IRAs

- Make certain that direct “trustee-to-trustee” rollover procedures are followed. Any amounts distributed to the beneficiary may not be subsequently rolled over into an inherited IRA.
- Follow the IRS examples on correctly titling the inherited IRA.
- If the retirement plan applies the 5-year payout rule as the default payout rule, pay attention to the new rules and exception regarding the timing and amount of the direct rollover and distributions.
- **Exception:** For deaths in 2007 and later where the plan requires a 5-year payout, the key is for the beneficiary to do the “trustee to trustee” rollover before December 31st of the year following the year of the plan participant's death, and take the first “life expectancy” distribution prior to end of that year.

Inflation Adjustments Effective January 1, 2008

- Revenue Procedure 2007-66 issued November 5, 2007 sets certain inflation adjusted tax items for 2008.
- The amount of qualifying gifts to a non-citizen spouse not included in taxable gifts under IRC §§ 2503 and 2523 is increased to \$128,000 from \$125,000 previously.
- The amount used to calculate the “2 percent portion” for purposes of IRC § 6166 is now \$1.28 million, up from \$1.25 million.
- For decedents dying in 2008, if the executor elects to use the special use valuation method under IRC § 2032A for qualified real estate, the resulting aggregate decrease in the property’s value of the qualifying real estate may not exceed \$960,000, up from \$940,000.

Tax Strategy Patents

- March 9, 2007 *Wealth Transfer Group LLC v. John W. Rowe* was settled between the litigants pursuant to a confidential patent licensing agreement. The parties stipulated as part of the settlement that the patent was presumed valid.
- The patent in *Wealth Transfer* involved the use of stock options to fund a GRAT. Wealth Transfer Group, LLC had obtained a patent over this common estate planning technique (the “SOGRATS” patent).
- The *Wealth Transfer* case served as an additional reminder to tax professionals that well known tax strategies might be patented; might subject tax advisers and their clients to damages for patent infringement; and that tax professionals might be required to search patent databases as part of their development of tax strategies for their clients.

Tax Strategy Patents – Continued

- Tax Strategy Patents are a subset of Business Method Patents.
- Prior to 1998 business method patents were not allowed.
- Since 1998 over 60 tax strategy patents have been granted by the USPTO, and over 100 additional tax strategy patent applications are currently pending.
- Since 1998 over 50,000 business method patent applications have been filed, and several thousand business method patents have been granted. Business method patents are classification 705 at the USPTO, and tax strategy patents are sub-classification 36T.

Tax Strategy Patents – Continued

- Relief from this patent nightmare is likely in 2008. However, until the law is changed tax strategy patents remain serious potential problems for all tax professionals and their clients.
- On May 8, 2008, the Court of Appeals for the Federal Circuit heard oral argument in the case of Ex Parte Bilski, and the court appears to have signaled its intent to revisit prior rulings as to whether and to what extent business methods are proper subject matter for patents under § 101, Title 35, U.S.C.A.
- Several bills currently pending in both the House and the Senate have bipartisan support to remove tax strategy patents from the definition of those things that are allowed to be patented.

Estate And Gift Tax Return Preparer Penalties – IRC § 6694

OVERVIEW: NOW EVERYONE CAN BE PENALIZED

- Small Business and Work Opportunity Act of 2007 (SBWOA) extends application of the income tax return preparer penalties to all return preparers. Including those who prepare trust, estate, and gift tax returns.
- SBWOA increases the amount of the IRC § 6694(a) & 6694(b) penalties.
 - IRC § 6694(a) – Greater of \$1,000 or 50% of fees charged, per violation.
 - IRC § 6694(b) – Greater of \$5,000 or 50% of fees charged, per violation, for understatements caused by willful or reckless conduct.
- SBWOA creates the need for new procedures of documentation and paperwork handling and storage to protect both the return preparer and the taxpayer during future audits.

Estate And Gift Tax Return Preparer Penalties – IRC § 6694

OVERVIEW: NOW EVERYONE CAN BE PENALIZED

- SBWOPA expands the definition of who is a return preparer.
 - Persons who sign the return as a preparer are potentially subject to the penalty; AND
 - Persons who merely consulted on even a single item that is reported on a return are potentially subject to the penalty (i.e. penalty can apply to Non-Signing Preparers).
 - A person who merely consults on a single item reported on a return might be considered a non-signing preparer of all the returns affected by a K-1 or other similar document issued by the entity for which the non-signing preparer consulted, and therefore potentially subject to a separate penalty for each and every one of these returns.

Estate And Gift Tax Return Preparer Penalties – IRC § 6694

OVERVIEW: NOW EVERYONE CAN BE PENALIZED

- SBWOA creates a difference between the penalty provisions and disclosure reporting requirements for taxpayers under IRC § 6662 and return preparers under § 6694.
 - These differences can create potential conflicts of interest between the taxpayer and the return preparer.
 - These differences and the need to try and protect oneself from possible penalty create the need for special “Discussions” with the taxpayer prior to filing the return.
- IRS guidance with regard to the implementation and requirements of new IRC § 6694 can be found in:
 - IRS Notice 2007-54 (June, 2007).

Estate And Gift Tax Return Preparer Penalties – IRC § 6694

OVERVIEW: NOW EVERYONE CAN BE PENALIZED

- IRS Notices 2008-11, 2008-12, and 2008-13 (December 31, 2007)
- IRS Notice 2008-46 (April 16, 2008)
- SBWOA provisions changing IRC § 6694 were passed by Congress in 2007 to increase revenues to the federal government, and not just to deter “bad” conduct. Congress did this so the SBWOA could be called revenue neutral for budgeting purposes.
- With a new left leaning Congress and soon a new President, expect more government spending and pressure to increase revenues to offset some of the new spending.
- As a result expect increasing pressure on the IRS to meet and exceed Congress’ increased revenue projections from IRC § 6694 penalties.

Estate And Gift Tax Return Preparer Penalties – IRC § 6694

OVERVIEW: NOW EVERYONE CAN BE PENALIZED

- April 13, 2008 memorandum from Department of Treasury, Director of Planning, Quality, Analysis and Support to the IRS Large and Mid-Sized Business audit group:

“This law change will greatly expand the number of practitioners subject to return preparer penalty consideration. ... During every field examination, examiners should determine if return preparer violations exist.” (emphasis added).

- The above is just the beginning. We won't know how this will play out until the audits of 2007 and 2008 returns begin (about 2 years from now).

Estate And Gift Tax Return Preparer Penalties – IRC § 6694

IRC § 6694(a) – APPLIES TO UNDERSTATEMENTS DUE TO UNREASONABLE POSITIONS

- Penalty Is The Greater Of:
 - \$1,000 per return or claim for refund (hereafter “return” shall mean “return or claim for refund”); or
 - 50% of the income derived (or to be derived) by the preparer with respect to the return.
- Penalty applies if any part of an understatement of liability on the return, taken as a whole, is due to an unreasonable position taken on the return or claim for refund.
- An “unreasonable position” is any position that:
 - The preparer actually knew or reasonably should have known was taken in the return; and

Estate And Gift Tax Return Preparer Penalties – IRC § 6694

- There was not a reasonable belief that the position would more likely than not (“MLTN”) be sustained on its merits (Note: MLTN means greater than 50% chance of winning); and
- The position was not disclosed to the IRS, by the taxpayer, by including with the return a Form 8275 or Form 8275-R (see IRC § 6662(d)(2)(B)(ii)).
- Penalty can apply to any person who prepares virtually any return.
- No longer limited to income tax returns. “Return” is defined by IRC § 6696(e) as “any return of any tax imposed by” Title 26. Includes information returns such as partnership and Subchapter S returns and trust, estate, and gift tax returns.

Estate And Gift Tax Return Preparer Penalties – IRC § 6694

WHO IS A RETURN PREPARER ?

- The definition of who is a preparer has been expanded and includes many persons other than the person who actually signs the return as the preparer.
- IRC § 7701(a)(36) defines a tax return preparer as:
 - Any person who prepares for compensation, or who employs one or more persons to prepare for compensation, any return of tax imposed by Title 26.
 - This definition specifically includes any person who prepares a substantial portion of a return, even if they are not the preparer who signs the return.

Estate And Gift Tax Return Preparer Penalties – IRC § 6694

WHO IS A RETURN PREPARER ? – Continued

- Now we have both “Signing Preparers” and “Non-Signing Preparers” and both kinds of preparers are potentially subject to this penalty.
- A person who prepares a substantial portion of a return is a preparer for purposes of these penalties even if they are only a preparer of one or more entries on a return (Treas. Reg. §301.7701-15).
 - A person can be a return preparer for one or more entries on a return even if all they do is give oral advice:
 - with regard to events that have already occurred; and
 - the advice is directly relevant to the determination of the existence, characterization, or amount of any entry on a return.

Estate And Gift Tax Return Preparer Penalties – IRC § 6694

WHO IS A RETURN PREPARER ? – Continued

- A return preparer can be a person who provides only advice without even reviewing the return in question, if that person furnishes sufficient information and advice so that completion of the return is largely a mechanical or clerical matter. (Treas. Reg. §301.7701-15).
- Treas. Reg. §301.7701-15(b)(3) provides the preparer of a partnership, S corporation, trust, or estate tax return is also a preparer of the individual partners or beneficiaries returns, if the entries reported on the partnership, S corporation, trust, or estate tax return (including K-1's and similar items) are:
 - directly reflected on the partners/beneficiaries returns; and
 - the amounts directly reflected constitute a substantial portion of the individual partners' or beneficiaries' entire return.

Estate And Gift Tax Return Preparer Penalties – IRC § 6694

WHO IS A RETURN PREPARER ? – Continued

- There can be more than one preparer of any given return for preparer penalty purposes.
 - There is no specified limit on the number of preparers for any one return.
 - The employer of a preparer is also a preparer and both are potentially subject to these penalties (Treas. Reg. §301.7701-15).

Estate And Gift Tax Return Preparer Penalties – IRC § 6694

WHAT IS A SUBSTANTIAL PORTION ? HOW MUCH IS TOO MUCH ?

- In general: Compare the length and complexity of the portion prepared to the length and complexity of the total return (Treas. Reg. §301.7701-15(b)(1)). However, the IRS has provided some further guidance in the dollar amounts cited below.
- **Step 1:** If it is \$2,000 or more it might be a “substantial portion”, so go to Step 2;
- **Step 2:** If it is more than \$2,000 but less than \$100,000 is it 20% or more of the gross income on the return (adjusted gross income in the case of an individual taxpayer). If the answer is yes then it IS a “substantial portion”.
- **Step 3:** If it is \$100,000 or more it IS a substantial portion regardless of the % of gross or adjusted gross income.
- If more than one schedule or entry is involved on the same return they are aggregated together for the above tests (Treas. Reg. §301.7701-15(b)(2)).

Estate And Gift Tax Return Preparer Penalties – IRC § 6694

HOW TO AVOID THE PENALTY?

- Must not have known the position was taken in the return; or
- Must have a reasonable belief that the position would MLTN be sustained on its merits; or
- Reasonable Basis PLUS DISCLOSURE.
- No doubling up of § 6694(a) and § 6694(b) penalties.
- Disclosure Rules:
 - **Signing Preparers.**
 - **Non-Signing Preparers.**

USE DISCLOSURE TO AVOID PENALTIES

	Level Of Authority (% Chance That The Position Taken Will Be Upheld By The Courts)					
	MLTN > 50%	Substantial Authority ≥ 40%	Realistic Possibility ≥ 33%	Reasonable Basis ≥ 20%	Non- Frivolous ≥ 5%	Frivolous < 5%
Transactions Where Tax Avoidance Or Evasion Is <u>NOT</u> A Significant Purpose (Note: Significant purpose is much less than a primary purpose.)						
Taxpayer (IRC § 6662(d) Penalties):	No Disclosure	No Disclosure	Disclosure Required	Disclosure Required	Penalty Can't Be Avoided	Penalty Can't Be Avoided
Return Preparer (IRC § 6694(a) Penalties):	No Disclosure	Disclosure Required New ↑	Disclosure Required New ↑	Disclosure Required	Penalty Can't Be Avoided	Penalty Can't Be Avoided
Transactions Where Tax Avoidance Or Evasion <u>IS</u> A Significant Purpose (Note: Significant purpose is much less than a primary purpose.)						
Taxpayer (IRC § 6662(d) & § 6662(A)** Penalties):	No Disclosure	Penalty Can't Be Avoided	Penalty Can't Be Avoided	Penalty Can't Be Avoided	Penalty Can't Be Avoided	Penalty Can't Be Avoided
Return Preparer (IRC § 6694(a) Penalties):	No Disclosure	Disclosure Required	Disclosure Required	Disclosure Required	Penalty Can't Be Avoided	Penalty Can't Be Avoided

** Note: There is a reasonable cause exception possible for the penalty under IRC § 6662(A)

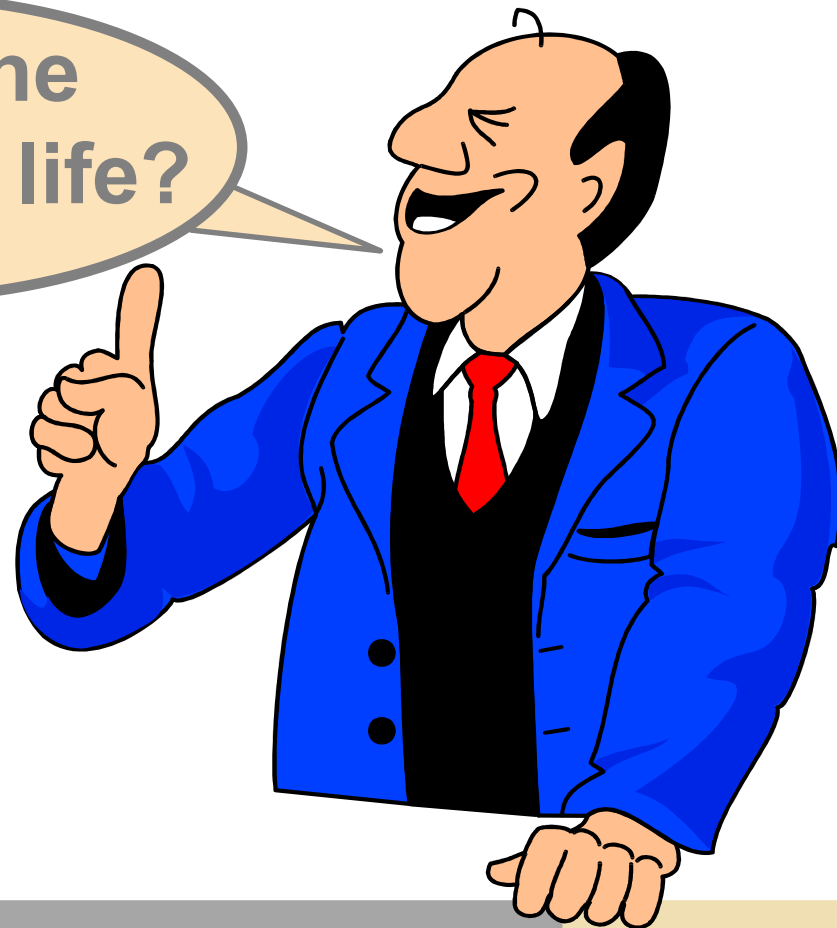
Estate And Gift Tax Return Preparer Penalties – IRC § 6694

“THE SPEECH”

- Client Discussion Documentation Template.
- Record retention and the Work Product Doctrine.
- Ethical considerations.
- Recent IRS tactics that could portend what the future might hold.
 - *Regions Financial Corp, et al v. U.S.*

Any Questions?

What's the
meaning of life?



If you would like a copy of this template in Microsoft Word format, please send an email to: Ms. Heather Hartel, hhartel@mfzlaw.com requesting a copy of the "Discussion Template".

NOTICE 2008-13 CLIENT DISCUSSION DOCUMENTATION

TEMPLATE FOR: SIGNING RETURN PREPARERS

Date discussion held: _____ Today's Date: _____

Taxpayer's name as shown on return: _____

Return type: _____ Taxpayer ID # _____

List names of all persons at discussion. Complete all 3 of the following sections:

Attendees: _____

Notice 2008-13 § G(2) – Positions that have **reasonable basis**, *without substantial authority* and are **not** associated with **significant tax purpose transactions**.

- N/A. There are no positions as described in Notice 2008-13 § G(2); or
- Signed return that contains disclosures to comply with Notice 2008-13 § G(2) is stored at _____ in _____ and was delivered to client on _____.
- Client engaged our firm to e-file this return, and a copy of the electronic file is stored at _____. After delivery to the client of the return, signed by the preparer and with the Notice 2008-13 § G(2) disclosures attached, as detailed above at the second checkbox, the client instructed us to make the following changes before e-filing this return:
 - None.
 - Remove the disclosures required by Notice 2008-13 § G(2). _____ (Client Initials).
 - _____ (Other).
- This is a pass-through entity (i.e., partnership, S corporation, estate, trust, RIC, REIT, REMIC) that could decide not to disclose certain positions. We advised the client that Reg. § 1.6662-4(f)(5) permits an owner of a pass-through entity (partner, etc.) to make adequate disclosure by filing a disclosure statement with the owner's return and filing a copy with the Service Center where the pass-through entity's return is filed.

NOTICE 2008-13 CLIENT DISCUSSION DOCUMENTATION
TEMPLATE FOR: SIGNING RETURN PREPARERS

Notice 2008-13 § G(3) – Positions that have **substantial authority**, but may **not** meet More Likely Than Not (MLTN) standard, and are **not** associated with **significant tax purpose transactions**.

- N/A. There are no positions as described in Notice 2008-13 § G(3).
- We discussed the position(s) described below or on the attached schedule, and advised the client of the difference between the penalty standards applicable to the taxpayer under IRC § 6662 and the tax return preparer penalty standards under IRC § 6694. (Attach a description of the content of, or notes of, your client discussion. This can be in the form of detailed talking points and charts used in the client discussion).
- See attached for description of position(s), or;
- Description of position(s):
 - _____
 - _____

Notice 2008-13 § G(4) – Positions that **are** associated with **significant tax purpose transactions**.

- N/A. There are no positions as described in Notice 2008-13 § G(4).
- We discussed the position(s) described below or on the attached schedule, and advised the client of the penalty standards applicable to the taxpayer under IRC § 6662(d)(2)(C) and the difference, if any, between these standards and the tax return preparer standards under IRC § 6694. (Attach a description of the content of, or notes of, your client discussion. This can be in the form of detailed talking points and charts used in the client discussion).
- See attached for description of position(s), or;
- Description of position(s):
 - _____
 - _____

Part III – Administrative, Procedural, and Miscellaneous

PREPARER PENALTY PROVISIONS UNDER THE SMALL BUSINESS AND WORK OPPORTUNITY ACT OF 2007

NOTICE 2007-54

This notice provides guidance and transitional relief for the return preparer penalty provisions under section 6694 of the Internal Revenue Code, as amended by the Small Business and Work Opportunity Act of 2007.

SCOPE

The transitional relief provided by this notice will apply to all returns, amended returns, and refund claims due on or before December 31, 2007 (determined with regard to any extension of time for filing); to 2007 estimated tax returns due on or before January 15, 2008; and to 2007 employment and excise tax returns due on or before January 31, 2008.

BACKGROUND

The Small Business and Work Opportunity Act of 2007, Pub. L. No. 110-28, 121 Stat. ____, (the Act) was enacted into law on May 25, 2007. Section 8246 of the Act amends several provisions of the Code to extend the application of the income tax return preparer penalties to all tax return preparers, alter the standards of conduct that must be met to avoid imposition of the penalties for preparing a return which reflects an understatement of liability, and increase applicable penalties. The amendments are effective for tax returns prepared after the date of the enactment, May 25, 2007.

The amendments made by the Act raise questions regarding activities representing preparation of a tax return, who is a return preparer within the meaning of section 7701(a)(36) (as amended), and how the statute applies to signing and non-

signing preparers. In order to address these questions, the Internal Revenue Service and the Treasury Department are considering whether regulations or other published guidance are needed, including but not limited to, amendments to Treas. Reg. sections 301.7701-15 and 1.6694-0 through 1.6694-4. Because the Act extends the types of returns subject to the new provisions, changes are also required to the relevant forms and publications. The Service must also alter existing procedures in order to process disclosures with certain forms and in electronic formats. Because the amendments to section 6694 are effective immediately for returns prepared after May 25, 2007, the Service and the Treasury Department believe that effective tax administration requires transitional relief with respect to the new standards of conduct under section 6694(a).

PENALTY UNDER SECTION 6694

Prior to amendment by the Act, the penalty under section 6694(a) applied if:

- (1) any part of an understatement of liability with respect to any return or claim for refund is due to a position for which there was not a realistic possibility of being sustained on its merits,
- (2) any person who is an income tax return preparer with respect to such return or claim knew (or reasonably should have known) of such position, and,
- (3) such position was not disclosed as provided in section 6662(d)(2)(B)(ii) or was frivolous.

Prior to amendment by the Act, the penalty under section 6694(b) applied if any part of an understatement was due to:

- (1) a willful attempt in any manner by an income tax return preparer to
understate the liability for tax; or

- (2) to any reckless or intentional disregard of rules or regulations by an income tax return preparer.

Section 8246 of the Act amended several provisions of the Code to extend the scope of the income tax return preparer penalties to preparers of all tax returns, amended returns and claims for refund, including estate and gift tax returns, generation-skipping transfer tax returns, employment tax returns, and excise tax returns. The Act amended section 6694(a) to provide that the penalty would apply if:

(A) the tax return preparer knew (or reasonably should have known) of the position,

(B) there was not a reasonable belief that the position would more likely than not be sustained on its merits, and

(C)(i) the position was not disclosed as provided in section 6662(d)(2)(B)(ii), or

(ii) there was no reasonable basis for the position.

Although the Act did not alter the standard of conduct under section 6694(b), it increased the amount of the penalty and made the penalty applicable to all tax return preparers.

Section 8246 of the Act amends the standards of conduct under section 6694(a) in two ways. First, for undisclosed positions, the Act replaces the realistic possibility standard with a requirement that there be a reasonable belief that the tax treatment of the position would more likely than not be sustained on its merits. Second, for disclosed positions, the Act replaces the not-frivolous standard with the requirement that there be a reasonable basis for the tax treatment of the position.

The Act also increased the first-tier section 6694(a) penalty for understatements from \$250 to the greater of \$1000 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. The Act increased the second-tier section 6694(b) penalty for willful or reckless conduct from \$1000 to the greater of \$5,000 or 50% of the income derived (or to be derived) by the tax return preparer.

Under both the prior and current law, disclosure under section 6694(a) is adequate if made on a Form 8275, Disclosure Statement, or Form 8275-R, Regulation Disclosure Statement, attached to the return, amended return, or refund claim, or pursuant to the annual revenue procedure authorized in Treasury Regulation sections 1.6694-2(c)(3) and 1.6662-4(f)(2). In addition, under both the prior and current law, the penalty under section 6694(a) would not be imposed if it is shown that there is reasonable cause for the understatement and the tax return preparer acted in good faith.

TRANSITIONAL RELIEF

In order to provide sufficient time to address issues pertaining to the implementation of the Act, the Service is providing the following transitional relief: For income tax returns, amended returns, and refund claims, the standards set forth under the previous law and current regulations under section 6694 will be applied in determining whether the Service will impose a penalty under section 6694(a). Generally, in applying transitional relief for income tax returns, amended returns or refund claims, disclosure would be adequate if made on a Form 8275, Disclosure Statement, or Form 8275-R, Regulation Disclosure Statement, attached to the return, amended return, or refund claim, or pursuant to the annual revenue procedure authorized in Treasury Regulation sections 1.6694-2(c)(3) and 1.6662-4(f)(2).

For all other returns, amended returns, and claims for refund, including estate, gift, and generation-skipping transfer tax returns, employment tax returns, and excise tax returns, the reasonable basis standard set forth in the regulations issued under section 6662, without regard to the disclosure requirements contained therein, will be applied in determining whether the Service will impose a penalty under section 6694(a).

This transitional relief will apply to all returns, amended returns, and refund claims due on or before December 31, 2007 (determined with regard to any extension of time for filing); to 2007 estimated tax returns due on or before January 15, 2008; and to 2007 employment and excise tax returns due on or before January 31, 2008.

No transitional relief is available under section 6694(b) as transitional relief is not appropriate for return preparers who exhibit willful or reckless conduct, regardless of the type of return prepared.

EFFECTIVE DATE

This Notice is effective as of May 25, 2007.

CONTACT INFORMATION

The principal author of this notice is Michael E. Hara of the Office of Associate Chief Counsel (Procedure and Administration). For further information regarding this notice, contact Mr. Hara at (202) 622-4910 (not a toll-free call).

Part III – Administrative, Procedural, and Miscellaneous

CLARIFICATION OF NOTICE 2007-54 PROVIDING GUIDANCE AND TRANSITIONAL RELIEF UNDER THE PREPARER PENALTY PROVISIONS OF THE SMALL BUSINESS AND WORK OPPORTUNITY TAX ACT OF 2007

NOTICE 2008-11

This notice clarifies Notice 2007-54, 2007-27 I.R.B. 12, which provided guidance and transitional relief for the tax return preparer penalty provisions under section 6694 of the Internal Revenue Code, as amended by the Small Business and Work Opportunity Tax Act of 2007.

BACKGROUND

The Small Business and Work Opportunity Tax Act of 2007 (the Act), Pub. L. No. 110-28, 121 Stat. 190, was enacted on May 25, 2007. Section 8246 of the Act amended several provisions of the Code to extend the application of the income tax return preparer penalties to all tax return preparers, alter the standards of conduct that must be met to avoid imposition of the penalties for preparing a return which reflects an understatement of liability, and increase applicable penalties. The amendments are effective for tax returns prepared after the date of the enactment, May 25, 2007.

In order to provide sufficient time to address issues pertaining to the implementation of the Act, the Treasury Department and the IRS issued Notice

2007-54 on June 11, 2007, and which provided the following transitional relief: For income tax returns, amended returns, and refund claims, the standards set forth under the previous law and current regulations under section 6694 will be applied in determining whether the IRS will impose a penalty under section 6694(a), as amended by the Act. Notice 2007-54 provided that generally, in applying transitional relief for income tax returns, amended returns or refund claims, disclosure would be adequate if made on a Form 8275, Disclosure Statement, or Form 8275-R, Regulation Disclosure Statement, attached to the return, amended return, or refund claim, or pursuant to the annual revenue procedure authorized in Treasury Regulation sections 1.6694-2(c)(3) and 1.6662-4(f)(2).

Notice 2007-54 further provided that for all other returns, amended returns, and claims for refund, including estate, gift, and generation-skipping transfer tax returns, employment tax returns, and excise tax returns, the reasonable basis standard set forth in the regulations issued under section 6662, without regard to the disclosure requirements contained therein, will be applied in determining whether the IRS will impose a penalty under section 6694(a).

Notice 2007-54 provided that the transitional relief applies to all returns, amended returns, and refund claims due on or before December 31, 2007 (determined with regard to any extension of time for filing), and to 2007 employment and excise tax returns due on or before January 31, 2008. Notice 2007-54 also provided that no transitional relief was provided under section

6694(b) as transitional relief is not appropriate for tax return preparers who exhibit willful or reckless conduct, regardless of the type of return prepared.

TRANSITIONAL RELIEF CLARIFICATIONS

Questions have arisen regarding the extent to which amended returns or claims for refund qualify for transitional relief under Notice 2007-54. There is no set due date for such returns and claims other than prior to the expiration of the period proscribed by the applicable statute of limitations. The transitional relief described in Notice 2007-54 applies to timely amended returns or claims for refund (other than 2007 employment and excise tax returns) filed on or before December 31, 2007, and to timely amended employment and excise tax returns or claims for refund filed on or before January 31, 2008 .

Questions have arisen regarding the extent to which original tax returns due on extension after December 31, 2007, but filed before December 31, 2007, qualify for transitional relief. The transitional relief described in Notice 2007-54 applies to original returns (other than 2007 employment and excise tax returns) filed on or before December 31, 2007, and to original employment and excise returns filed on or before January 31, 2008.

Questions have also arisen regarding the extent to which advice rendered by nonsigning preparers qualifies for transitional relief under Notice 2007-54. The transitional relief described in Notice 2007-54, as clarified by this notice, applies to nonsigning preparers for advice provided on or before December 31, 2007.

In future guidance, the Treasury Department and the IRS intend to provide transitional rules to address amended returns filed after the expiration of the transitional relief period described in Notice 2007-54 that relate to original returns filed under previous law or during the transitional relief period, as clarified by this notice.

EFFECTIVE DATE

This notice is effective as of May 25, 2007.

EFFECT ON OTHER DOCUMENTS

Notice 2007-54, 2007-27 I.R.B. 12, is clarified.

CONTACT INFORMATION

The principal authors of this notice are Matthew S. Cooper and Michael E. Hara of the Office of the Associate Chief Counsel (Procedure and Administration). For further information regarding this notice, contact Mr. Cooper at (202) 622-4940 or Mr. Hara at (202) 622-4910 (not toll-free calls).

Part III - Administrative, Procedural, and Miscellaneous

PREPARER SIGNATURE REQUIREMENTS UNDER SECTION 6695(b), AS AMENDED BY THE SMALL BUSINESS AND WORK OPPORTUNITY TAX ACT OF 2007

Notice 2008-12

This notice provides guidance to the public regarding implementation of the tax return preparer signature requirement penalty provisions under section 6695(b) of the Internal Revenue Code, as amended by the Small Business and Work Opportunity Tax Act of 2007.

BACKGROUND

The Small Business and Work Opportunity Tax Act of 2007 (the Act), Pub. L. No. 110-28, 121 Stat. 190, was enacted on May 25, 2007. Section 8246 of the Act amended several provisions of the Code, including section 6695(b), to extend the application of the income tax return preparer penalties to all tax return preparers. As amended by the Act, section 6695(b) imposes a penalty on a tax return preparer of any return or claim for refund who fails to sign a return when required by regulations prescribed by the Secretary, unless it is shown that the failure is due to reasonable cause and not due to willful neglect. The penalty under section 6695(b) is \$50 for each

failure to sign, with a maximum of \$25,000 per person imposed with respect to each calendar year. The amendments to section 6695(b) made by section 8246 of the Act are effective for tax returns and claims for refund prepared after May 25, 2007.

INTERIM AND PLANNED GUIDANCE

The Treasury Department and the Internal Revenue Service intend to issue regulations that implement the signature requirements under section 6695(b) for certain 2008 tax year returns and claims for refund. In advance of these regulations, guidance is being issued to (1) identify the returns and claims for refund required to be signed by a tax return preparer in order to avoid a section 6695(b) penalty under current regulations, and (2) identify the returns and claims for refund that will be required to be signed by a tax return preparer in order to avoid a section 6695(b) penalty under future regulations published by the Treasury Department and IRS. This interim guidance will apply until further guidance is issued and tax return preparers may rely on the interim guidance in this notice.

A. Signing Tax Return Preparer

For purposes of section 6695(b), an individual who is a tax return preparer with respect to a return of tax or claim for refund of tax listed below in paragraph (B)(1) of this notice shall sign the return or claim for refund after it is completed and before it is presented to the taxpayer (or nontaxable entity) for signature. If the tax return preparer is unavailable for signature, another tax return preparer shall review the entire preparation of the return or claim for refund, and then shall sign the return or claim for refund.

If more than one tax return preparer is involved in the preparation of the return or claim for refund, the individual tax return preparer who has the primary responsibility as between or among the preparers for the overall substantive accuracy of the preparation of such return or claim for refund shall be considered to be the tax return preparer for purposes of section 6695(b).

B. Forms Requiring Signature of Tax Return Preparer

(1) Consistent with existing regulations, in order to avoid the imposition of a penalty under section 6695(b), a signing tax return preparer described above in paragraph (A) of this notice must provide a signature on any income tax returns or claim for refund of income tax that are filed after December 31, 2007, including but not limited to the following:

- Form 990-T, Exempt Organization Business Income Tax Return
- Form 990-PF, Return of Private Foundation or Section 4947(a)(1) Nonexempt Charitable Trust Treated as a Private Foundation
- Form 1040, U.S. Individual Income Tax Return
- Form 1040A, U.S. Individual Income Tax Return
- Form 1040-C, U.S. Departing Alien Income Tax Return
- Form 1040EZ, Income Tax Return for Single and Joint Filers With No Dependents
- Form 1040NR, U.S. Nonresident Alien Income Tax Return
- Form 1040NR-EZ, U.S. Income Tax Return for Certain Nonresident Aliens With No Dependents
- Form 1040-PR, Planilla para la Declaración de la Contribución Federal sobre el Trabajo por Cuenta Propia (Incluyendo el Crédito Tributario Adicional por Hijos para Residentes *Bona fide* de Puerto Rico)
- Form 1040-SS, U.S. Self-Employment Tax Return (Including the Additional Child Tax Credit for Bona Fide Residents of Puerto Rico)
- Form 1040X, Amended U.S. Individual Income Tax Return
- Form 1041, U.S. Income Tax Return for Estates and Trusts
- Form 1041-N, U.S. Income Tax Return for Electing Alaska Native Settlement Trusts

- Form 1041-QFT, U.S. Income Tax Return for Qualified Funeral Trusts
- Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons
- Form 1065, U.S. Return of Partnership Income
- Form 1065-B, U.S. Return of Income for Electing Large Partnerships
- Form 1066, U.S. Real Estate Mortgage Investment Conduit (REMIC) Income Tax Return
- Form 1120, U.S. Corporation Income Tax Return
- Form 1120-C, U.S. Income Tax Return for Cooperative Associations
- Form 1120-F, U.S. Income Tax Return of a Foreign Corporation
- Form 1120-FSC, U.S. Income Tax Return of a Foreign Sales Corporation
- Form 1120-H, U.S. Income Tax Return for Homeowners Associations
- Form 1120IC-DISC, Interest Charge Domestic International Sales Corporation Return
- Form 1120-L, U.S. Life Insurance Company Income Tax Return
- Form 1120-ND, Return for Nuclear Decommissioning Funds and Certain Related Persons
- Form 1120-PC, U.S. Property and Casualty Insurance Company Income Tax Return
- Form 1120-POL, U.S. Income Tax Return for Certain Political Organizations
- Form 1120-REIT, U.S. Income Tax Return for Real Estate Investment Trusts
- Form 1120-RIC, U.S. Income Tax Return For Regulated Investment Companies
- Form 1120S, U.S. Income Tax Return for an S Corporation
- Form 1120-SF, U.S. Income Tax Return for Settlement Funds (Under Section 468B)
- Form 1120X, Amended U.S. Corporation Income Tax Return
- Form 2438, Undistributed Capital Gains Tax Return

(2) In the absence of Treasury regulations requiring signature, a signing tax return preparer described above in paragraph (A) of this notice will not be subject to the penalty under section 6695(b) with respect to tax returns or refund claims for taxes other than income taxes that are filed after December 31, 2007 but on or before December 31, 2008, including the filing of the following returns:

- Form CT-1, Employer's Annual Railroad Retirement Tax Return
- Form CT-2, Employee Representative's Quarterly Railroad Tax Return
- Form 11-C, Occupational Tax and Registration Return for Wagering

- Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return
- Form 706-A, United States Additional Estate Tax Return
- Form 706-D, United States Additional Estate Tax Return Under Code Section
- Form 706-GS(D), Generation-Skipping Transfer Tax Return For Distributions
- Form 706-GS(T), Generation-Skipping Transfer Tax Return For Terminations
- Form 706-NA, United States Estate (and Generation-Skipping Transfer) Tax Return - Estate of nonresident not a citizen of the United States Trusts
- Form 706-QDT, United States Estate Tax Return for Qualified Domestic Trusts
- Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return
- Form 720, Quarterly Federal Excise Tax Return
- Form 720X, Amended Quarterly Federal Excise Tax Return
- Form 730, Monthly Tax Return for Wagers
- Form 843, Claim for Refund and Request for Abatement
- Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return
- Form 940-PR, Planilla para la Declaración Federal ANUAL del Patrono de la Contribución Federal para el Desempleo (*FUTA*)
- Form 941, Employer's QUARTERLY Federal Tax Return
- Form 941-PR, Planilla para la Declaración Federal TRIMESTRAL del Patrono
- Form 941-SS, Employer's QUARTERLY Federal Tax Return
- Form 941-M, Employer's MONTHLY Federal Tax Return
- Form 943, Employer's Annual Federal Tax Return for Agricultural Employees
- Form 943(PR), Planilla Para la Declaración ANUAL De La Contribución Del Patrono De Empleados Agrícolas
- Form 944, Employer's ANNUAL Federal Tax Return
- Form 944-PR, Planilla para la Declaración ANUAL de la Contribución Federal del Patrono 944(SP), Declaración Federal ANUAL de Impuestos del Patrono o Empleador
- Form 944-SS, Employer's ANNUAL Federal Tax Return
- Form 945, Annual Return of Withheld Federal Income Tax
- Form 1040 (Schedule H), Household Employment Taxes
- Form 1040-PR (Anexo H-PR), Contribuciones sobre el Empleo de Empleados Domesticos
- Form 2290, Heavy Highway Vehicle Use Tax Return
- Form 2290(FR), Declaration d'Impot sur L'utilisation des Vehicules Lourds sur les Routes
- Form 2290(SP), Declaración del Impuesto sobre el Uso de Vehículos Pesados en las Carreteras
- Form 4720, Return of Certain Excise Taxes on Charities and Other Persons Under Chapters 41 and 42 of the Internal Revenue Code
- Form 5330, Return of Excise Taxes Related to Employee Benefit Plans
- Form 8612, Return of Excise Tax on Undistributed Income of Real Estate

Investment Trusts

- Form 8613, Return of Excise Tax on Undistributed Income of Regulated Investment Companies
- Form 8725, Excise Tax on Greenmail
- Form 8831, Excise Taxes on Excess Inclusions of REMIC Residual Interests
- Form 8849, Claim for Refund of Excise Taxes
- Form 8876, Excise Tax on Structured Settlement Factoring Transactions
- Form 8924, Excise Tax on Certain Transfers of Qualifying Geothermal or Mineral Interests

The tax return preparer shall sign the return in the manner prescribed by the Commissioner in forms, instructions, or other appropriate guidance.

The Treasury Department and IRS intend to issue regulations on or before December 31, 2008 requiring signatures under section 6695(b) for all the above listed forms that are filed after December 31, 2008.

Information on the preparer signature requirement for electronically filed returns will be announced in IRS publications, instructions, and information posted electronically on the IRS.gov website.

EFFECTIVE DATE

This Notice is effective as of January 1, 2008.

CONTACT INFORMATION

The principal authors of this notice are Matthew S. Cooper and Michael E. Hara of the Office of the Associate Chief Counsel (Procedure and Administration). For further information regarding this notice contact Mr. Cooper at 202-622-4940 or Mr. Hara at (202) 622-4910 (not toll-free calls).

Part III – Administrative, Procedural, and Miscellaneous

GUIDANCE UNDER THE PREPARER PENALTY PROVISIONS OF THE SMALL BUSINESS AND WORK OPPORTUNITY TAX ACT OF 2007

NOTICE 2008-13

This notice provides guidance regarding implementation of the tax return preparer penalty provisions under section 6694 and the related definitional provisions under section 7701(a)(36) of the Internal Revenue Code (Code), as amended by the Small Business and Work Opportunity Tax Act of 2007 (the Act), Pub. L. No. 110-28, 121 Stat. 190.

In 2008, the Treasury Department and the IRS intend to revise the regulatory scheme governing tax return preparer penalties, which has remained substantially unchanged since the late 1970's. Until then, this notice provides interim guidance on the application of the tax return preparer penalties as amended by the Act. This notice also solicits public comments regarding the revision of the regulatory scheme governing tax return preparer penalties in order to enable the Treasury Department and the IRS to complete their work on the overhaul of these rules by the end of 2008.

BACKGROUND

Section 8246 of the Act amended several provisions of the Code to extend the application of the income tax return preparer penalties to all tax return preparers, alter

the standards of conduct that must be met to avoid imposition of the section 6694(a) penalty for preparing a return which reflects an understatement of liability, and increase applicable penalties under section 6694(a) and (b). The amendments made by the Act to section 6694 are effective for tax returns and claims for refund prepared after May 25, 2007. The Treasury Department and the IRS issued Notice 2007-54, 2007-27 I.R.B. 12, on June 11, 2007, which provided transitional relief under section 6694(a). Concurrent with the issuance of this notice, the Treasury Department and the IRS are issuing additional guidance clarifying Notice 2007-54. See Notice 2008-11.

Prior to amendment by the Act, section 7701(a)(36) defined *income tax return preparer* as any person who prepared for compensation an income tax return or claim for refund, or a substantial portion of an income tax return or claim for refund. As amended by the Act, section 7701(a)(36) now defines *tax return preparer* as any person that prepares for compensation a tax return or claim for refund, or a substantial portion of a tax return or claim for refund, and is no longer limited to persons who prepare income tax returns.

Section 301.7701-15 of the current Procedure and Administration Regulations defines the term *income tax return preparer* to include any person who prepares for compensation all or a substantial portion of a tax return or claim for refund under Subtitle A of the Code. Operation of the current regulations brings into the preparer penalty regime a wide range of activities performed by persons who do not sign the tax return or claim for refund, who may have no knowledge of how their work is ultimately reported on the tax return or claim for refund, or who may have no knowledge of the size or complexity of the schedule, entry, or other portion of a tax return or claim for

refund relative to the entire tax return. For example, current regulations broadly define the term *substantial portion* using a facts and circumstances test that compares the relative length, complexity, and tax liability of a particular schedule, entry, or other portion of a tax return or claim for refund to the length, complexity, and tax liability of the tax return or claim for refund as a whole. Case law, including *Goulding v. United States*, 717 F. Supp. 545 (N.D. Ill. 1989), *aff'd*, 957 F.2d 1420 (7th Cir. 1992), supports the current regulations which deem the preparer of a Schedule K-1 for a partnership to be the preparer of a partner's income tax return on which the partnership items were reported, if the Schedule K-1 constitutes a substantial portion of the partner's tax return.

The Act also amended section 6694(a) by raising the standards of conduct for tax return preparers. For *undisclosed positions*, the Act replaced the realistic possibility standard with a requirement that there be a reasonable belief that the tax treatment of the position would more likely than not be sustained on its merits. For *disclosed positions*, the Act replaced the nonfrivolous standard with the requirement that there be a reasonable basis for the tax treatment of the position.

The amendments made by the Act did not modify the exception to liability under section 6694 that is applicable when it is shown, considering all the facts and circumstances, that the tax return preparer has acted in good faith and there is reasonable cause for the understatement.

As part of the regulatory rulemaking process, the Treasury Department and IRS will determine the appropriate modifications to the existing regulatory framework, given the complexities and anomalies created by the inter-relationship of the amendments to section 6694 applicable to tax return preparers and the various accuracy-related penalty

provisions applicable to taxpayers, as well as the inter-relationship of the amendments to section 6694 and the regulations governing the practice before the IRS in Circular 230 (31 CFR part 10). In advance of publication of regulations in 2008, this notice provides interim guidance to tax return preparers regarding the definitions and standards of conduct that must be met by a tax return preparer to avoid a penalty under section 6694(a). Tax return preparers may rely on the interim guidance in this notice until further guidance is issued. It is important to note that the regulations expected to be finalized in 2008 may be substantially different from the rules described in this notice, and in some cases more stringent.

Section 7805(a) provides the Treasury Department and the IRS with authority to issue regulations and other published guidance interpreting the Code, including sections 6694 and 7701(a)(36). Consistent with the legislative history of section 6694, the Treasury Department and the IRS promulgated regulations dating back to 1977 that interpreted the statutory term *disclosed* in section 6694(a)(3), as applied to *nonsigning preparers*, to include making statements, either orally or in writing. See Treas. Reg. § 1.6694-2(c)(3)(ii)(A) and (B). Section 6694(a)(3) provides the Treasury Department and the IRS with authority to grant relief from penalty liability if a tax return preparer has acted in good faith and there is reasonable cause for any understatement of tax that may result from a position taken on a return. In addition, in the past, reasonable cause relief (such as in section 6694(a)) has been provided to implement appropriate transitional rules for a new or revised statutory provision.

This interim guidance discusses the following issues: (1) relevant categories of tax returns or claims for refund for purposes of section 6694; (2) the definition of *tax return preparer* under sections 6694 and 7701(a)(36); (3) standards of conduct applicable to tax return preparers for disclosed and undisclosed positions taken on tax returns; and (4) interim penalty compliance obligations applicable to tax return preparers. It is the IRS's intent to administer these provisions in a fair and equitable manner that will promote compliance with the requirements of the Code and effective tax administration.

INTERIM GUIDANCE UNDER SECTION 6694

Except to the extent modified by the interim guidance in this notice, and until further guidance is issued, existing regulations and guidance under sections 6694 and 7701(a)(36) will remain in effect.

A. Returns and Claims for Refund Subject to 6694 Penalty

Interim guidance discussed below describes categories of returns to which section 6694 could apply and includes associated exhibits to this notice. The Treasury Department and the IRS may choose to add or remove documents from any of the categories or exhibits to this notice in future guidance as they gain experience in implementing the provisions of the Act and receive public comments.

1. Tax Returns Reporting Tax Liability

Until further guidance is issued, solely for purposes of section 6694, a *return* or *claim for refund* includes the tax returns listed on Exhibit 1 or a claim for refund with respect to any such return. A claim for refund of tax includes a claim for credit against any tax. A person who for compensation prepares all or a substantial portion of a tax

return listed on Exhibit 1, or a claim for refund with respect to any such tax return, is a tax return preparer who is subject to section 6694.

2. Information Returns and Other Documents

Under current regulations, a person who for compensation prepares information returns or other documents that include information that is or may be reported on a taxpayer's tax return is subject to section 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 liability of the taxpayer. The current regulatory definitions of *substantial portion* and *substantial preparation* require a facts and circumstances analysis of each document prepared and a comparison of the items included on that document with the tax return that actually reports a tax liability. Section 301.7701-15(b). Thus, for example, under current regulations, the preparer of a Form 1065, U.S. Return of Partnership Income, may be deemed to be the preparer of any of the partners' individual income tax return (e.g., Form 1040, U.S. Individual Income Tax Return), if the items on the partnership return constitute a substantial portion of that partner's income tax return. Section 301.7701-15(b)(3).

(a) Information Returns Constituting a Substantial Portion of a Taxpayer's Tax Return

Until further guidance is issued, solely for purposes of section 6694, an information return listed on Exhibit 2 that includes information that is or may be reported on a taxpayer's tax return or claim for refund is a return to which section 6694 could apply if the information reported constitutes a *substantial portion* of that taxpayer's tax

return or claim for refund. A person who for compensation prepares any of the forms listed on Exhibit 2, which form does not report a tax liability but affects an entry or entries on a tax return and constitutes a substantial portion of the tax return or claim for refund that does report a tax liability, is a tax return preparer who is subject to section 6694.

(b) Other Documents Constituting a Substantial Portion of a Taxpayer's Tax Return

Until further guidance is issued, solely for purposes of section 6694, a document that includes information that is or may be reported on a taxpayer's tax return or claim for refund is treated as a return to which section 6694 could apply if the information reported constitutes a *substantial portion* of that taxpayer's tax return or claim for refund. For example, a person who for compensation prepares documents, such as depreciation schedules or cost, expense or income allocation studies, that do not report a tax liability but which will affect an entry or entries on a tax return that does report a tax liability, and that constitute a substantial portion of such tax return, is a tax return preparer who is subject to section 6694.

(c) Other Documents Not Constituting a Substantial Portion of a Taxpayer's Tax Return Unless Prepared Willfully to Understate Tax or in Reckless or Intentional Disregard of the Rules or Regulations

Until further guidance is issued, solely for purposes of section 6694, a document listed on Exhibit 3 that includes information that is or may be reported on a taxpayer's tax return or claim for refund (and that constitutes a substantial portion of such tax return or claim for refund) will not subject the preparer to a penalty under section

6694(a). A document listed on Exhibit 3, however, may subject the preparer to a willful or reckless conduct penalty under section 6694(b) if the information reported on the document constitutes a substantial portion of the tax return or claim for refund and is prepared willfully in any manner to understate the liability of tax on a tax return or claim for refund, or in reckless or intentional disregard of rules or regulations. For example, preparation of a Form W-2, Wage and Tax Statement, reporting certain executive compensation may constitute preparation of a substantial portion of the Form 1040 return on which the compensation is reported if it is prepared willfully in a manner to understate the liability of tax. A person who for compensation prepares all or a substantial portion of any of the forms or other documents listed on Exhibit 3 is not a tax return preparer subject to section 6694(a) unless the form or document was prepared willfully in any manner to understate the liability of tax on a tax return or claim for refund or in reckless or intentional disregard of rules or regulations.

B. Definition of Tax Return Preparer

Until further guidance is issued, solely for purposes of section 6694, the term *tax return preparer* in section 7701(a)(36) is defined by using the definitions in §§ 1.6694-1, 1.6694-3 and 301.7701-15, with the following modifications:

1. Eliminating the word *income* as a modifier to *tax return preparer* throughout §§ 1.6694-1, 1.6694-3, and 301.7701-15. This modification conforms the current regulations to amendments made by the Act.
2. Expanding the definition of returns and claims for refund from *returns of tax under subtitle A, claims for refund under subtitle A*, or similar language, to include returns of tax and claims for refund under subtitles A

through E of the Code throughout §§ 1.6694-1, 1.6694-3, and 301.7701-15. This modification conforms the current regulations to amendments made by the Act.

3. Interpreting the term *substantial portion* in § 301.7701-15(b)(1) to mean a schedule, entry, or other portion of a tax return or claim for refund that, if adjusted or disallowed, could result in a deficiency determination (or disallowance of refund claim) that the preparer knows or reasonably should know is a significant portion of the tax liability reported on the tax return (or, in the case of a claim for refund, a significant portion of the tax originally reported or previously adjusted). This clarifies that any determination as to whether a person has prepared a substantial portion of a tax return and thus is considered a tax return preparer will depend on the relative size of the deficiency attributable to the schedule, entry, or other portion.

For examples illustrating the provisions of this section B, see section H below.

C. Date Return is Prepared

Until further guidance is issued, solely for purposes of section 6694, a return or claim for refund is deemed prepared on the date reflected by the tax return preparer's signature. If a signing preparer fails to sign the tax return, the tax return is deemed prepared on the date the tax return is filed. In the case of a nonsigning preparer, the relevant date is the date the person provides the advice, which date will be determined based on all the facts and circumstances. For purposes of this interim guidance, the rules described in this section will apply instead of § 1.6694-2(b)(5).

D. Reasonable Belief that the Tax Treatment of the Position Would More Likely Than Not Be Sustained on the Merits

Until further guidance is issued, solely for purposes of section 6694, a tax return preparer is considered reasonable to believe that the tax treatment of an item is more likely than not the proper tax treatment (without taking into account the possibility that the tax return will not be audited, that an issue will not be raised on audit, or that an issue will be settled) if the tax return preparer analyzes the pertinent facts and authorities in the manner described in § 1.6662-4(d)(3)(ii) and, in reliance upon that analysis, reasonably concludes in good faith that there is a greater than fifty percent likelihood that the tax treatment of the item will be upheld if challenged by the IRS. For purposes of interim guidance, the standard described in this section will apply instead of § 1.6694-2(b).

For purposes of determining whether the tax return preparer has a reasonable belief that the position would more likely than not to be sustained on the merits, a tax return preparer may rely in good faith without verification upon information furnished by the taxpayer, as provided in § 1.6694-1(e). In addition, a tax return preparer may rely in good faith and without verification upon information furnished by another advisor, tax return preparer or other third party. Thus, a tax return preparer is not 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 requiring a reasonable belief that the position would more likely than not be sustained on the merits. The tax return preparer, however, may not ignore the implications of information furnished to the tax return preparer or actually known to the tax return preparer. The tax return preparer

also must make reasonable inquiries if the information furnished by another tax return preparer or a third party appears to be incorrect or incomplete.

For examples illustrating the provisions of this section D, see section H below.

E. Reasonable Basis

Until further guidance is issued, solely for purposes of section 6694, reasonable basis will be interpreted in accordance with § 1.6662-3(b)(3). For purposes of this interim guidance, the standards described in this section will apply instead of § 1.6694-2(c). The *reasonable basis* standard will also apply for purposes of § 1.6694-3(c)(2).

For purposes of determining whether the tax return preparer has a reasonable basis for a position, a tax return preparer may rely in good faith without verification upon information furnished by the taxpayer, as provided in § 1.6694-1(e). In addition, a tax return preparer may rely in good faith and without verification upon information furnished by another tax return preparer or other third party. Thus, a tax return preparer is not 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 requiring a reasonable basis for a position. The tax return preparer, however, may not ignore the implications of information furnished to the tax return preparer or actually known to the tax return preparer. The tax return preparer also must make reasonable inquiries if the information furnished by another tax return preparer or a third party appears to be incorrect or incomplete.

For examples illustrating the provisions of this section E, see section H below.

F. Reasonable Cause and Good Faith

Until further guidance is issued, solely for purposes of section 6694, the IRS will continue to consider the factors described in §§ 1.6694-2(d)(1) to -2(d)(4), but the factor regarding reliance on advice found in § 1.6694-2(d)(5) is replaced by the rules described in this section F. For purposes of this interim guidance, 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--

(i) The advice is unreasonable on its face;

(ii) The tax return preparer knew or should have known that the third party advisor was not aware of all relevant facts; or

(iii) 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.

For examples illustrating the provisions of this section F, see section H below.

G. Interim Penalty Compliance Rules

Until further guidance is issued, solely for purposes of section 6694, a *signing tax return preparer* shall be deemed to meet the requirements of section 6694 with respect to a position for which there is a reasonable basis but for which the tax return preparer does not have a reasonable belief that the position would more likely than not be

sustained on the merits, if the tax return preparer meets any of the following requirements:

1. The position is disclosed in accordance with § 1.6662-4(f) (which permits disclosure on a properly completed and filed Form 8275, Disclosure Statement, or 8275-R, Regulation Disclosure Statement, as appropriate, or on the tax return in accordance with the annual revenue procedure described in § 1.6662-4(f)(2));
2. If the position would not meet the standard for the taxpayer to avoid a penalty under section 6662(d)(2)(B) without disclosure, the tax return preparer provides the taxpayer with the prepared tax return that includes the disclosure in accordance with § 1.6662-4(f);
3. If the position would otherwise meet the requirement for nondisclosure under section 6662(d)(2)(B)(i), the tax return preparer advises the taxpayer of the difference between the penalty standards applicable to the taxpayer under section 6662 and the penalty standards applicable to the tax return preparer under section 6694, and contemporaneously documents in the tax return preparer's files that this advice was provided; or
4. If section 6662(d)(2)(B) does not apply because the position may be described in section 6662(d)(2)(C), the tax return preparer advises the taxpayer of the penalty standards applicable to the taxpayer under section 6662(d)(2)(C) and the difference, if any, between these standards and the

standards under section 6694, and contemporaneously documents in the tax return preparer's files that this advice was provided.

For purposes of this interim guidance, the rules applicable to signing tax return preparers described in this section will apply instead of § 1.6694-2(c)(3)(i).

Until further guidance is issued, solely for purposes of section 6694, a *nonsigning tax return preparer* shall be deemed to meet the requirements of section 6694 with respect to a position for which there is a reasonable basis but for which the nonsigning tax return preparer does not 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 section 6662 that could apply to the position as a result of disclosure, if relevant, and of the requirements for disclosure. If a nonsigning tax return preparer provides advice to another tax return preparer, a nonsigning tax return preparer shall be deemed to meet the requirements of section 6694 with respect to a position for which there is a reasonable basis but for which the nonsigning tax return preparer does not have a reasonable belief that the position would more likely than not be sustained on the merits, if the advice to the tax return preparer includes a statement that disclosure under section 6694(a) may be required. If the advice with respect to a position is in writing, the statement must be in writing. If the advice with respect to a position is oral, the statement also may be oral. Contemporaneously prepared documentation in the nonsigning tax return preparer's files is sufficient to establish that the statement was given to the taxpayer or other tax return preparer. For purposes of this interim guidance, the rules applicable to

nonsigning tax return preparers described in this section will apply instead of § 1.6694-2(c)(3)(ii).

For examples illustrating the provisions of this section G, see section H below.

H. Examples

Examples illustrating the provisions of this notice and existing rules under current regulations:

Example 1. Accountant A prepares a Form 8886, Reportable Transaction Disclosure Statement, that is used to disclose reportable transactions. Accountant A does not prepare the tax return or advise the taxpayer regarding the tax return reporting position of the transaction to which the Form 8886 relates. The preparation of the Form 8886 is not directly relevant to the determination of the existence, characterization, or the amount of an entry on a tax return or claim for refund. Rather, the Form 8886 is prepared by Accountant A to disclose a reportable transaction. Accountant A has not prepared a substantial portion of the tax return and is not considered a tax return preparer under section 6694.

Example 2. Accountant B prepares a partnership's Form 1065 (including Schedules K-1) allocating the partnership's losses among its partners in proportion to their original investment. Accountant B is not an employee of either the partnership or the general partner. Accountant B knows that the loss deduction calculated by Accountant B and claimed by one of the partners on that partner's tax return, if disallowed, is the most significant portion of the liability on that partner's tax return. Accountant B has prepared a substantial portion of that partner's tax return and is considered a tax return preparer under section 6694.

Example 3. Attorney C, an attorney in a law firm, advises a large corporate taxpayer on specific issues of law regarding the tax consequences of a proposed corporate transaction. Based upon this advice, the corporate taxpayer enters into the transaction. Once the transaction is completed, the corporate taxpayer does not receive any additional advice from Attorney C or anyone in Attorney C's firm with respect to the proposed corporate transaction. Six months later, the corporate taxpayer hires Preparer D, who is not associated with the same firm as Attorney C, to prepare its entire tax return. Attorney C has not prepared a substantial portion of the corporation's tax return and is not considered a tax return preparer under section 6694.

Example 4. Attorney D, an attorney in a law firm, advises a large corporate taxpayer concerning the proper treatment and amount of a single entry on the corporate taxpayer's tax return. The tax liability involved in this entry is an

insignificant portion of the tax liability for the corporate tax return as a whole. Neither Attorney D nor any other attorney associated with Attorney D's firm signs the corporate taxpayer's tax return as a tax return preparer. Attorney D has not prepared a substantial portion of the corporation's tax return and is not considered a tax return preparer under section 6694.

Example 5. Attorney E specializes in tax planning at a law firm and develops Strategy Y, a plan with a significant purpose of tax avoidance. Attorney E provides advice with respect to Strategy Y to 50 taxpayers. The 50 taxpayers implement Strategy Y in a manner that significantly reduces the Federal tax liability that would otherwise be reported on their tax returns. After Strategy Y is entered into, Attorney E advises each of the 50 taxpayers on the reporting of specific amounts that Attorney E knows will be placed on the tax return of each of the 50 taxpayers. Attorney E knows that the tax liability involved in this entry, if disallowed, is a significant portion of the tax liability for each of the tax returns. Neither Attorney E nor any other person associated with Attorney E's firm signs the taxpayers' tax returns as a tax return preparer. The advice relating to Strategy Y constitutes preparation of a substantial portion of each of the 50 taxpayers' tax returns. Thus, Attorney E is a tax return preparer under section 6694.

Example 6. During an interview conducted by Preparer F, the taxpayer provided a schedule prepared by another advisor in Preparer F's firm for use in preparing the taxpayer's tax return. The schedule did not appear to be incorrect or incomplete. On the basis of this information, Preparer F completed the tax return. It is later determined that there is an understatement of liability for tax that resulted from incorrect information on the schedule. Preparer F is not required to audit, examine or review the schedule in order to verify independently that the information on the schedule met the standard requiring a reasonable belief that the position would more likely than not be sustained on the merits. Preparer F is not subject to a penalty under section 6694.

Example 7. In preparing a tax return, Accountant G relies on the advice of an actuary concerning the limit on deductibility under section 404(a)(1)(A) of a contribution by an employer to a qualified pension trust. The actuary providing the advice was not associated with Accountant G's firm. On the basis of this advice, Accountant G completed the tax return. It is later determined that there is an understatement of liability for tax that resulted from incorrect advice provided by the actuary. Accountant G had no reason to believe that the advice was incorrect or incomplete, and the advice appeared reasonable on its face. Accountant G was also not aware of any reason why the actuary did not know all of the relevant facts or that the advice was no longer reliable due to developments in the law since the time the advice was given. Accountant G is not subject to a penalty under section 6694.

Example 8. During an interview conducted by Preparer H, a taxpayer stated that he had made a charitable contribution of real estate in the amount of \$50,000 during the tax year, when in fact he had not made this charitable contribution. Preparer H did not inquire about the existence of a qualified appraisal or complete a Form 8283 in accordance with the reporting and substantiation requirements under section 170(f)(11). Preparer H reported deductions on the tax return for the charitable contribution which resulted in an understatement of liability for tax. Preparer H is subject to a penalty under section 6694.

Example 9. Preparer I prepared the tax returns of a taxpayer for each of the past three years. While preparing this year's tax return, Preparer I realizes that the taxpayer did not provide a Form 1099 for a bank account that produced significant taxable income in each of the previous three years. When Preparer I asked the taxpayer about any other existing income and the lack of this Form 1099, the taxpayer furnishes the Form 1099 to Preparer I for use in preparation of the tax return. Preparer I did not know that the taxpayer owned an additional bank account this past year that generated taxable income and the taxpayer did not reveal this information to the tax return preparer. Preparer I is not subject to a penalty under section 6694.

Example 10. A corporate taxpayer hires Accountant J to prepare its tax return. Accountant J encounters an issue regarding various small asset expenditures. Accountant J researches the issue and concludes that there is a reasonable basis for a particular treatment of the issue. Accountant J cannot, however, reach a reasonable belief whether the position would more likely than not be sustained on the merits because it was impossible to make a precise quantification regarding whether the position would more likely than not be sustained on the merits. The position is not disclosed on the tax return. Accountant J signs the tax return as the tax return preparer. The IRS later disagrees with this position taken on the tax return. Accountant J is not subject to a penalty under section 6694.

Example 11. A corporate taxpayer hires Accountant K to prepare its income tax return. Accountant K does not reasonably believe that a particular position taken on the tax return would more likely than not be sustained on its merits although there is substantial authority for the position. Accountant K prepares and signs the tax return without disclosing the position taken on the tax return, but advises the corporate taxpayer of the difference between the penalty standards applicable to the taxpayer under section 6662 and to the tax return preparer under section 6694, and contemporaneously documents in the tax return preparer's files that this advice was provided. The corporate taxpayer signs and files the tax return without disclosing the position because the position meets the requirements for nondisclosure under section 6662(d)(2)(B)(i). The IRS later disagrees with the position taken on the tax return, resulting in an understatement of liability reported on the tax return. Accountant K is not subject to a penalty under section 6694.

Example 12. Attorney L advises a large corporate taxpayer in writing concerning the proper treatment of complex entries on the corporate taxpayer's tax return. Attorney L has reason to know that the tax liability involved in these entries, if disallowed, is a significant portion of the tax liability for the tax return. When providing the advice, Attorney L concludes that one position with respect to these entries does not meet the reasonable belief that the position would more likely than not be sustained on the merits standard and also does not have substantial authority, although the position meets the reasonable basis standard. Attorney L, in good faith, advises the corporate taxpayer in writing that the position lacks substantial authority and the taxpayer will be subject to an accuracy-related penalty under section 6662 unless the position is disclosed in a disclosure statement included in the return. Attorney L also documents the fact that this advice was contemporaneously provided to the corporate taxpayer in writing at the time the advice was provided. The corporate taxpayer decides not to include a disclosure statement in the return. Neither Attorney L nor any other attorney associated with Attorney L's firm signs the corporate taxpayer's return as a tax return preparer, but the advice by Attorney L constitutes preparation of a substantial portion of the tax return. Thus, Attorney L is a tax return preparer for purposes of section 6694. Attorney L, however, will not be subject to a penalty under section 6694.

REQUESTS FOR COMMENTS

Interested parties are invited to submit comments on this notice by March 24, 2008. Comments should be submitted to: Internal Revenue Service, CC:PA:LPD:PR (Notice 2008-13), Room 5203, P.O. Box 7604, Ben Franklin Station, Washington, DC 20224. Alternatively, comments may be hand delivered Monday through Friday between the hours of 8:00 a.m. to 4:00 p.m. to: CC:PA:LPD:PR (Notice 2008-13), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC. Comments may also be submitted electronically via the following e-mail address: Notice.Comments@irs.counsel.treas.gov. Please include *Notice 2008-13* in the subject line of any electronic submissions.

Specifically, this notice requests comments with respect to the definition of a *tax return preparer*. The Treasury Department and the IRS are considering various

modifications to the regulations defining *tax return preparer* for purposes of sections 6694 and 7701(a)(36). These modifications may include limiting the definition or keeping a broader definition in order to clarify the definition of nonsigning tax return preparers in such a manner that nonsigning tax return preparers can more easily identify the circumstances under which they would be subject to section 6694. This may involve the addition of examples or changes to the current de minimis safe harbor in § 301.7701-15(b)(2).

This notice also requests comments with respect to providing additional guidance on defining both the *reasonable belief* and *more likely than not* concepts included in section 6694, as amended by the Act. Comments are requested whether the Treasury Department and the IRS should promulgate rules specifically tailored to common situations when reaching a *more likely than not* level of certainty on a position is not possible or practical as either a legal or factual matter and, specifically, whether disclosure should be necessary to avoid penalties under section 6694(a) and how disclosure should be made in those situations.

EFFECTIVE DATE

This notice is effective as of: (1) January 1, 2008, for all tax returns, amended tax returns, and claims for refund (other than 2007 employment and excise tax returns) filed on after that date with respect to advice provided on or after that date; and (2) February 1, 2008, for all 2007 employment and excise tax returns filed on after that date with respect to advice provided on or after that date.

CONTACT INFORMATION

The principal authors of this notice are Matthew S. Cooper and Michael E. Hara of the Office of Associate Chief Counsel (Procedure and Administration). For further information regarding this notice, contact Mr. Cooper at (202) 622-4940 or Mr. Hara at (202) 622-4910 (not toll-free calls).

EXHIBIT 1 – Tax Returns Reporting Tax Liability

Income Tax Returns – Subtitle A

- Form 926, Return by a U.S. Transferor of Property to a Foreign Corporation;
- Form 990T, Exempt Organization Business Income Tax Return;
- Form 1040, U.S. Individual Income Tax Return;
- Form 1040A, U.S. Individual Income Tax Return;
- Form 1040-EZ, Income Tax Return for Single Filers and Joint Filers With No Dependents;
- Form 1040-EZT, Claim for Refund of Federal Telephone Excise Tax;
- Form 1040X, Amended U.S. Individual Income Tax Return;
- Form 1040-PR (Anexo H-PR), Contribuciones sobre el Empleo de Empleados Domesticos;
- Form 1041, U.S. Income Tax Return for Estates and Trusts;
- Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons;
- Form 1066, U.S. Real Estate Mortgage Investment Conduit (REMIC) Income Tax Return;
- Form 1120, U.S. Corporation Income Tax Return;
- Form 1120-C, U.S. Income Tax Return for Cooperative Associations;
- Form 1120-IC DISC, Interest Charge Domestic International Sales – Corporation Return;
- Form 1120-F, U.S. Income Tax Return of a Foreign Corporation;
- Form 1120S, U.S. Income Tax Return for an S Corporation;

Form 1120X, Amended U.S. Corporation Income Tax Return;
Form 8831, Excise Taxes on Excess Inclusions of REMIC Residual Interests
(I.R.C. § 860E); and
Form 8924, Excise Tax on Certain Transfers of Qualifying Geothermal or Mineral
Interests (New Form, Exclusion from Capital Gains).

Estate and Gift Tax Returns - Subtitle B

Form 706, U.S. Estate Tax Return;
Form 706-A, United States Additional Estate Tax Return;
Form 706-D, United States Additional Estate Tax Return Under Code Section
2057;
Form 706-GS(D) Generation-Skipping Transfer Tax Return for Distributions;
Form 706-GS(T) Generation-Skipping Transfer Tax Return for Terminations;
Form 706-NA, United States Estate (and Generation-Skipping Transfer) Tax
Return - Estate of nonresident not a citizen of the United States ;
Form 706-QDT, United States Estate Tax Return for Qualified Domestic Trusts;
Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return;
and
Form 843, Claim For Refund and Request for Abatement (also used to claim
refunds for employment and certain excise tax returns).

Employment Tax Returns - Subtitle C

Form CT-1, Employer's Annual Railroad Retirement Tax Return;
Form CT-2, Employee Representative's Quarterly Railroad Tax Return;
Form 940, Employer's Annual Federal Unemployment Tax Return;

Form 940-PR, Planilla para la Declaración Federal ANUAL del Patrono de la Contribución Federal para el Desempleo (FUTA);

Form 941, Employer's QUARTERLY Federal Tax Return;

Form 941-PR, Planilla para la Declaración Federal TRIMESTRAL del Patrono;

Form 941-SS, Employer's QUARTERLY Federal Tax Return;

Form 941-M, Employer's MONTHLY Federal Tax Return;

Form 943, Employer's Annual Federal Tax Return for Agricultural Employees;

Form 943-PR, Planilla Para la Declaración ANUAL de la Contribución Federal del Patrono De Empleados Agrícolas;

Form 944, Employer's ANNUAL Federal Tax Return;

Form 944-PR, Planilla para la Declaración ANUAL de la Contribución Federal del Patrono;

Form 944(SP), Declaración Federal ANUAL de Impuestos del Patrono o Empleador;

Form 944-SS, Employer's ANNUAL Federal Tax Return;

Form 945, Annual Return of Withheld Federal Income Tax;

Form 1040-SS, U.S. Self-Employment Tax Return.

Miscellaneous Excise Tax Returns – Subtitle D

Form 11-C, Occupational Tax and Registration Return for Wagering;

Form 720, Quarterly Federal Excise Tax Return;

Form 720X, Amended Quarterly Federal Excise Tax Return;

Form 730, Monthly Tax Return for Wagers;

Form 990-PF, Return of Private Foundation or Section 4947(a)(1) Nonexempt Charitable Trust Treated as a Private Foundation (with respect to the excise tax based on investment income);

Form 2290, Heavy Highway Vehicle Use Tax Return;

Form 2290(FR), Déclaration d'Impôt sur L'utilisation des Véhicules Lourds sur les Routes;

Form 2290(SP), Declaración del Impuesto sobre el Uso de Vehículos Pesados en las Carreteras;

Form 4720, Return of Certain Excise Taxes on Charities and Other Persons Under Chapters 41 and 42 of the Internal Revenue Code;

Form 5330, Return of Excise Taxes Related to Employee Benefit Plans;

Form 8612, Return of Excise Tax on Undistributed Income of Real Estate Investment Trusts;

Form 8613, Return of Excise Tax on Undistributed Income of Regulated Investment Companies; and

Form 8849, Claim for Refund of Excise Taxes.

Alcohol, Tobacco, and Certain Other Excise Taxes – Subtitle E

Form 8725, Excise Tax on Greenmail; and

Form 8876, Excise Tax on Structured Settlement Factoring Transactions.

Exhibit 2 – Information Returns That Report Information That is or May be Reported on Another Tax Return That May Subject a Tax Return Preparer to the Section 6694(a) Penalty if the Information Reported Constitutes a Substantial Portion of the Other Tax Return

Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding;
Form 1065, U.S. Return of Partnership Income (including Schedules K-1);
Form 1120S, U.S. Income Tax Return for an S Corporation (including Schedules K-1);
Form 5500, Annual Return/Report of Employee Benefit Plan;
Form 8038, Information Return for Tax-Exempt Private Activity Bond Issues;
Form 8038-G, Information Return for Government Purpose Tax-Exempt Bond Issues; and
Form 8038-GC, Consolidated Information Return for Small Tax-Exempt Government Bond Issues.

Exhibit 3 - Forms That Would Not Subject a Tax Return Preparer to the Section 6694(a) Penalty Unless Prepared Willfully in any Manner to Understate the Liability of Tax on a Return or Claim for Refund or in Reckless or Intentional Disregard of Rules or Regulations

Form 1099 series of returns;

Form W-2 series of returns;

Form W-8BEN, Beneficial Owner's Certificate of Foreign Status for U.S. Tax Withholding;

Form SS-8, Determination of Worker Status;

Form 990, Return of Organization Exempt from Income Tax;

Form 990-EZ, Short Form Return of Organization Exempt From Income Tax;

Form 990-N, Electronic Notice (e-Postcard) for Tax-Exempt Organizations not Required To File Form 990 or 990-EZ;

Form 1040-ES, Estimated Tax for Individuals;

Form 1120-W, Estimated Tax for Corporations;

Form 2350, Application for Extension of Time to File U.S. Income Tax Return;

Form 2350 (SP), Application for Extension of Time to File U.S. Income tax Return (Spanish Version);

Form 4137, Social Security and Medicare Tax on Unreported Tip Income;

Form 4768, Application for Extension of Time to File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes;

Form 4868, Application for Automatic Extension of Time to File U.S. Individual Income Tax Return;

Form 4868 (SP), Application for Automatic Extension of Time to File U.S. Individual Income Tax Return (Spanish Version);

Form 5558, Application for Extension of Time to File Certain Employee Plan Returns;

Form 7004, Application for Automatic 6-Month Extension of Time To File Certain Business Income Tax, Information, and Other Returns;

Form 8109, Federal Tax Deposit Coupon;

Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips;

Form 8809, Application for Extension of Time to File Information Returns;

Form 8868, Application for Extension of Time To File an Exempt Organization Return;

Form 8892, Application for Automatic Extension of Time to File Form 709 and/or Payment of Gift/Generation-Skipping Transfer Tax; and

Form 8919, Uncollected Social Security and Medicare Tax on Wages.

Internal Revenue Bulletin: 2008-4

January 28, 2008

Notice 2008-14

Frivolous Positions

Table of Contents

- PURPOSE
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- DISCUSSION
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PURPOSE

Positions that are the same as or similar to the positions listed in this notice are identified as frivolous for purposes of the penalty for a “frivolous tax return” under section 6702(a) of the Internal Revenue Code and the penalty for a “specified frivolous submission” under section 6702(b). Persons who file a purported return of tax, including an original or amended return, based on one or more of these positions are subject to a penalty of \$5,000 if the purported return of tax does not contain information on which the substantial correctness of the self-assessed determination of tax may be judged or contains information that on its face indicates the self-assessed determination of tax is substantially incorrect. Likewise, persons who submit a “specified submission” (namely, a request for a collection due process hearing or an application for an installment agreement, offer-in-compromise, or taxpayer assistance order) based on one or more of the positions listed in this notice are subject to a penalty of \$5,000. The penalty may also be applied if the purported return or any portion of the specified submission is not based on a position set forth in this notice, yet reflects a desire to delay or impede the administration of Federal tax laws for purposes of section 6702(a)(2)(B) or 6702(b)(2)(A)(ii).

BACKGROUND

Section 407 of Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432, 120 Stat. 2922, 2960-62 (2006), amended section 6702 to increase the amount of the penalty for frivolous tax returns from \$500 to \$5,000 and to impose a penalty of \$5,000 on any person who submits a “specified frivolous submission.” A submission is a “specified frivolous submission” if it is a “specified submission” (defined in section 6702(b)(2)(B) as a request for a hearing under section 6320 or 6330 or an application under section 6159, 7122 or 7811) and any portion of the submission (i) is based on a position identified by the Secretary as frivolous or (ii) reflects a desire to delay or impede administration of the Federal tax laws. Section 6702 was further

amended to add a new subsection (c) requiring the Secretary to prescribe, and periodically revise, a list of positions identified as frivolous. Notice 2007-30, 2007-14 I.R.B. 883, contained the prescribed list. This notice revises the list to add more positions identified as frivolous. The positions that have been added are found in paragraphs 9(g), 11, 14 and 25.

DISCUSSION

Frivolous Positions. Positions that are the same as or similar to the following are frivolous.

(1) Compliance with the internal revenue laws is voluntary or optional and not required by law, including arguments that:

- a. Filing a Federal tax or information return or paying tax is purely voluntary under the law, or similar arguments described as frivolous in Rev. Rul. 2007-20, 2007-14 I.R.B. 863.
- b. Nothing in the Internal Revenue Code imposes a requirement to file a return or pay tax, or that a person is not required to file a tax return or pay a tax unless the Internal Revenue Service responds to the person's questions, correspondence, or a request to identify a provision in the Code requiring the filing of a return or the payment of tax.
- c. There is no legal requirement to file a Federal income tax return because the instructions to Forms 1040, 1040A, or 1040EZ or the Treasury regulations associated with the filing of the forms do not display an OMB control number as required by the Paperwork Reduction Act of 1980, 44 U.S.C. § 3501 *et seq.*, or similar arguments described as frivolous in Rev. Rul. 2006-21, 2006-1 C.B. 745.
- d. Because filing a tax return is not required by law, the Service must prepare a return for a taxpayer who does not file one in order to assess and collect tax.
- e. A taxpayer has an option under the law to file a document or set of documents in lieu of a return or elect to file a tax return reporting zero taxable income and zero tax liability even if the taxpayer received taxable income during the taxable period for which the return is filed, or similar arguments described as frivolous in Rev. Rul. 2004-34, 2004-1 C.B. 619.
- f. An employer is not legally obligated to withhold income or employment taxes on employees' wages.
- g. Only persons who have contracted with the government by applying for a governmental privilege or benefit, such as holding a Social Security number, are subject to tax, and those who have contracted with the government may choose to revoke the contract at will.
- h. A taxpayer may lawfully decline to pay taxes if the taxpayer disagrees with the government's use of tax revenues, or similar arguments described as frivolous in Rev. Rul. 2005-20, 2005-1 C.B. 821.
- i. An administrative summons issued by the Service is *per se* invalid and compliance with a summons is not legally required.

(2) The Internal Revenue Code is not law (or "positive law") or its provisions are ineffective or inoperative, including the sections imposing an income tax or requiring the filing of tax returns, because the provisions have not been implemented by regulations even though the provisions in question either (a) do not expressly require the Secretary to issue implementing regulations to become effective or (b) expressly require implementing regulations which have been issued.

(3) A taxpayer's income is excluded from taxation when the taxpayer rejects or renounces United States citizenship because the taxpayer is a citizen exclusively of a State (sometimes characterized as a "natural-born citizen" of a "sovereign state"), that is claimed to be a separate country or otherwise not subject to the laws of the United States. This position includes the argument that the United States does not include all or a part of the physical territory of the 50 States and instead consists of only places such as the District of Columbia, Commonwealths and Territories (*e.g.*, Puerto Rico), and Federal enclaves (*e.g.*, Native American reservations and military installations), or similar arguments described as frivolous in Rev. Rul. 2004-28, 2004-1 C.B. 624, or Rev. Rul. 2007-22, 2007-14 I.R.B. 866.

(4) Wages, tips, and other compensation received for the performance of personal services are not taxable income or are offset by an equivalent deduction for the personal services rendered, including an argument that a taxpayer has a "claim of right" to exclude the cost or value of the taxpayer's labor from income or that taxpayers have a basis in their labor equal to the fair market value of the wages they receive, or similar arguments described as frivolous in Rev. Rul. 2004-29, 2004-1 C.B. 627, or Rev. Rul. 2007-19, 2007-14 I.R.B. 843.

(5) United States citizens and residents are not subject to tax on their wages or other income derived from sources within the United States, as only foreign-based income or income received by nonresident aliens and foreign corporations from sources within the United States is taxable, and similar arguments described as frivolous in Rev. Rul. 2004-30, 2004-1 C.B. 622.

(6) A taxpayer has been untaxed, detaxed, or removed or redeemed from the Federal tax system though the taxpayer remains a United States citizen or resident, or similar arguments described as frivolous in Rev. Rul. 2004-31, 2004-1 C.B. 617.

(7) Only certain types of taxpayers are subject to income and employment taxes, such as employees of the Federal government, corporations, nonresident aliens, or residents of the District of Columbia or the Federal territories, or similar arguments described as frivolous in Rev. Rul. 2006-18, 2006-1 C.B. 743.

(8) Only certain types of income are taxable, for example, income that results from the sale of alcohol, tobacco, or firearms or from transactions or activities that take place in interstate commerce.

(9) Federal income taxes are unconstitutional or a taxpayer has a constitutional right not to comply with the Federal tax laws for one of the following reasons:

- a. The First Amendment permits a taxpayer to refuse to pay taxes based on religious or moral beliefs.
- b. A taxpayer may withhold payment of taxes or the filing of a tax return until the Service or other government entity responds to a First Amendment petition for redress of grievances.
- c. Mandatory compliance with, or enforcement of, the tax laws invades a taxpayer's right to privacy under the Fourth Amendment.
- d. The requirement to file a tax return is an unreasonable search and seizure contrary to the Fourth Amendment.

- e. Income taxation, tax withholding, or the assessment or collection of tax is a “taking” of property without due process of law or just compensation in violation of the Fifth Amendment.
- f. The Fifth Amendment privilege against self-incrimination grants taxpayers the right not to file returns or the right to withhold all financial information from the Service.
- g. The Ninth Amendment exempts those with religious or other objections to military spending from paying taxes to the extent the taxes will be used for military spending.
- h. Mandatory or compelled compliance with the internal revenue laws is a form of involuntary servitude prohibited by the Thirteenth Amendment.
- i. Individuals may not be taxed unless they are “citizens” within the meaning of the Fourteenth Amendment.
- j. The Sixteenth Amendment was not ratified, has no effect, contradicts the Constitution as originally ratified, lacks an enabling clause, or does not authorize a non-apportioned, direct income tax.
- k. Taxation of income attributed to a trust, which is a form of contract, violates the constitutional prohibition against impairment of contracts.
- l. Similar constitutional arguments described as frivolous in Rev. Rul. 2005-19, 2005-1 C.B. 819.

(10) A taxpayer is not a “person” within the meaning of section 7701(a)(14) or other provisions of the Internal Revenue Code, or similar arguments described as frivolous in Rev. Rul. 2007-22, 2007-14 I.R.B. 866.

(11) Only fiduciaries are taxpayers, or only persons with a fiduciary relationship to the United States are obligated to pay taxes, and the United States or the Service must prove the fiduciary status or relationship.

(12) Federal Reserve Notes are not taxable income when paid to a taxpayer because they are not gold or silver and may not be redeemed for gold or silver.

(13) In a transaction using gold and silver coins, the value of the coins is excluded from income or the amount realized in the transaction is the face value of the coins and not their fair market value for purposes of determining taxable income.

(14) A taxpayer who is employed on board a ship that provides meals at no cost to the taxpayer as part of the employment may claim a so-called “Mariner’s Tax Deduction” (or the like) allowing the taxpayer to deduct from gross income the cost of the meals as an employee business expense.

(15) A taxpayer may purport to operate a home-based business as a basis to deduct as business expenses the taxpayer’s personal expenses or the costs of maintaining the taxpayer’s household when the maintenance items or amounts as reported do not correspond to a *bona fide* home business, such as when they are grossly excessive in relation to the conceivable costs for some portion of the home being used exclusively and regularly as a business, or similar arguments described as frivolous by Rev. Rul. 2004-32, 2004-1 C.B. 621.

(16) A “reparations” tax credit exists, including arguments that African-American taxpayers may claim a tax credit on their Federal income tax returns as reparations for slavery or other historical

mistreatment, that Native Americans are entitled to an analogous credit (or are exempt from Federal income tax on the basis of a treaty), or similar arguments described as frivolous in Rev. Rul. 2004-33, 2004-1 C.B. 628, or Rev. Rul. 2006-20, 2006-1 C.B. 746.

(17) A Native American or other taxpayer who is not an employer engaged in a trade or business may nevertheless claim (for example, in an amount exceeding all reported income) the Indian Employment Credit under section 45A, which explicitly requires, among other criteria, that the taxpayer be an employer engaged in a trade or business to claim the credit.

(18) A taxpayer's wages are excluded from Social Security taxes if the taxpayer waives the right to receive Social Security benefits, or a taxpayer is entitled to a refund of, or may claim a charitable-contribution deduction for, the Social Security taxes that the taxpayer has paid, or similar arguments described as frivolous in Rev. Rul. 2005-17, 2005-1 C.B. 823.

(19) Taxpayers may reduce or eliminate their Federal tax liability by altering a tax return, including striking out the penalty-of-perjury declaration, or attaching documents to the return, such as a disclaimer of liability, or similar arguments described as frivolous in Rev. Rul. 2005-18, 2005-1 C.B. 817.

(20) A taxpayer is not obligated to pay income tax because the government has created an entity separate and distinct from the taxpayer—a "straw man"—that is distinguishable from the taxpayer by some variation of the taxpayer's name, and any tax obligations are exclusively those of the "straw man," or similar arguments described as frivolous in Rev. Rul. 2005-21, 2005-1 C.B. 822.

(21) Inserting the phrase "nunc pro tunc" on a return or other document filed with or submitted to the Service has a legal effect, such as reducing a taxpayer's tax liability, or similar arguments described as frivolous in Rev. Rul. 2006-17, 2006-1 C.B. 748.

(22) A taxpayer may avoid tax on income by attributing the income to a trust, including the argument that a taxpayer can put all of the taxpayer's assets into a trust to avoid income tax while still retaining substantial powers of ownership and control over those assets or that a taxpayer may claim an expense deduction for the income attributed to a trust, or similar arguments described as frivolous in Rev. Rul. 2006-19, 2006-1 C.B. 749.

(23) A taxpayer may lawfully avoid income tax by sending income offshore, including depositing income into a foreign bank account.

(24) A taxpayer can claim the section 44 Disabled Access Credit to reduce tax or generate a refund, for example, by purportedly having purchased equipment or services for an inflated price (which may or may not have been actually paid), even though it is apparent that the taxpayer did not operate a small business that purchased the equipment or services to comply with the requirements of the Americans with Disabilities Act.

(25) A taxpayer may claim the section 6421 fuels tax credit, which is limited to gasoline used in an off-highway business use, even though the taxpayer did not purchase and use gasoline during the taxable period for which the credit is claimed for an off-highway business use. Also, if the taxpayer claims an amount of credit that is so disproportionately excessive to any (including

zero) business income reported on the taxpayer's income tax return as to be patently unallowable (e.g., a credit that is 150 percent of business income reported on Form 1040) or facially reflects an impossible quantity of gasoline given the business use, if any, as reported by the taxpayer.

(26) A taxpayer is allowed to buy or sell the right to claim a child as a qualifying child for purposes of the Earned Income Tax Credit.

(27) An IRS Form 23C, *Assessment Certificate — Summary Record of Assessments*, is an invalid record of assessment for purposes of section 6203 and Treas. Reg. § 301.6203-1, the Form 23C must be personally signed by the Secretary of the Treasury for an assessment to be valid, the Service must provide a copy of the Form 23C to a taxpayer if requested before taking collection action, or similar arguments described as frivolous in Rev. Rul. 2007-21, 2007-14 I.R.B. 865.

(28) A tax assessment is invalid because the assessment was made from a section 6020(b) substitute for return, which is not a valid return.

(29) A statutory notice of deficiency is invalid because the taxpayer to whom the notice was sent did not file an income tax return reporting the deficiency or because the statutory notice of deficiency was unsigned or not signed by the Secretary of the Treasury or by someone with delegated authority.

(30) A Notice of Federal Tax Lien is invalid because it is not signed by a particular official (such as by the Secretary of the Treasury), or because it was filed by someone without delegated authority.

(31) The form or content of a Notice of Federal Tax Lien is controlled by or subject to a state or local law, and a Notice of Federal Tax Lien that does not comply in form or content with a state or local law is invalid.

(32) A collection due process notice under section 6320 or 6330 is invalid if it is not signed by the Secretary of the Treasury or other particular official, or if no certificate of assessment is attached.

(33) Verification under section 6330 that the requirements of any applicable law or administrative procedure have been met may only be based on one or more particular forms or documents (which must be in a certain format), such as a summary record of assessment, or that the particular forms or documents or the ones on which verification was actually determined must be provided to a taxpayer at a collection due process hearing.

(34) A Notice and Demand is invalid because it was not signed, was not on the correct form (e.g., a Form 17), or was not accompanied by a certificate of assessment when mailed.

(35) The United States Tax Court is an illegitimate court or does not, for any purported constitutional or other reason, have the authority to hear and decide matters within its jurisdiction.

(36) Federal courts may not enforce the internal revenue laws because their jurisdiction is limited to admiralty or maritime cases or issues.

(37) Revenue Officers are not authorized to issue levies or Notices of Federal Tax Lien or to seize property in satisfaction of unpaid taxes.

(38) A Service employee lacks the authority to carry out the employee's duties because the employee does not possess a certain type of identification or credential, for example, a pocket commission or a badge, or it is not in the correct form or on the right medium.

(39) A person may represent a taxpayer before the Service or in court proceedings even if the person does not have a power of attorney from the taxpayer, has not been enrolled to practice before the Service, or has not been admitted to practice before the court.

(40) A civil action to collect unpaid taxes or penalties must be personally authorized by the Secretary of the Treasury and the Attorney General.

(41) A taxpayer's income is not taxable if the taxpayer assigns or attributes the income to a religious organization (a "corporation sole" or ministerial trust) claimed to be tax-exempt under section 501(c)(3), or similar arguments described as frivolous in Rev. Rul. 2004-27, 2004-1 C.B. 625.

(42) The Service is not an agency of the United States government but rather a private-sector corporation or an agency of a State or Territory without authority to administer the internal revenue laws.

(43) Any position described as frivolous in any revenue ruling or other published guidance in existence when the return adopting the position is filed with or the specified submission adopting the position is submitted to the Service.

Returns or submissions that contain positions not listed above, which on their face have no basis for validity in existing law, or which have been deemed frivolous in a published opinion of the United States Tax Court or other court of competent jurisdiction, may be determined to reflect a desire to delay or impede the administration of Federal tax laws and thereby subject to the \$5,000 penalty.

The list of frivolous positions above will be periodically revised as required by section 6702(c).

EFFECTIVE DATE

This notice is effective for submissions made and issues raised after January 14, 2008. For submissions made and issues raised between March 16, 2007, and January 14, 2008, Notice 2007-30 applies.

EFFECT ON OTHER DOCUMENTS

Notice 2007-30 is modified and superseded.

DRAFTING INFORMATION

The principal author of this notice is the Office of the Associate Chief Counsel (Procedure and Administration). For further information regarding this notice, contact the Office of the Associate Chief Counsel (Procedure and Administration), Branch 2, at (202) 622-4940 (not a toll-free call).

THE YEAR IN REVIEW:
Cases, Rulings, Legislative Changes, And Proposals Of
Interest To The Estate Planning Professional

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