

NOTICE 2009-5, 2009-5 I.R.B. (1/21/2009)

Part III - Administrative, Procedural, and Miscellaneous

GUIDANCE UNDER THE PREPARER PENALTY MODIFICATION IN THE TAX EXTENDERS AND ALTERNATIVE MINIMUM TAX RELIEF ACT OF 2008

Notice 2009-5

This notice provides guidance regarding implementation of the tax return preparer penalty under section 6694(a) of the Internal Revenue Code, as amended by the Tax Extenders and Alternative Minimum Tax Relief Act of 2008, Div. C. of Pub. L. No. 110-343, 122 Stat. 3765 (October 3, 2008) (the 2008 Act).

With this notice, the Treasury Department and the IRS are simultaneously issuing final regulations revising the regulatory scheme governing tax return preparer penalties in accordance with the amendments to sections 6694 and 6695 (and related provisions under sections 6060, 6107, 6109, 6696, and 7701(a)(36)) in both the 2008 Act and the Small Business and Work Opportunity Tax Act of 2007, Title VIII-B of Pub. L. No. 110-28 (121 Stat. 190) (May 25, 2007)(the 2007 Act). Section 1.6694-2 of the final regulations, however, does not provide substantive guidance reflecting certain amendments to section 6694(a) made by the 2008 Act. Rather, the Treasury Department and the IRS are reserving § 1.6694-2(c) in those final regulations and are issuing this notice. This notice provides interim guidance on the 2008 Act's changes to section 6694(a) and solicits public comments on this guidance.

BACKGROUND

Section 6694(a) imposes a penalty on a tax return preparer who prepares a return or claim for refund reflecting an understatement of liability due to an "unreasonable position" if the tax return preparer knew (or reasonably should have known) of the position. No penalty is imposed, however, if it is shown that there is reasonable cause for the understatement and the tax return preparer acted in good faith. Immediately prior to the 2008 Act, under the standards of conduct implemented by the 2007 Act's amendment to section 6694(a), a position would be treated as unreasonable unless (i) there was a reasonable belief that it would more likely than not be sustained on the merits, or (ii) the position was properly disclosed and had a reasonable basis. 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). On December 31, 2007, the Treasury Department and the IRS released both Notice 2008-11, 2008-3 I.R.B. 279, which clarified the earlier transition relief provided in Notice 2007-54, and Notice 2008-13, 2008-3 I.R.B. 282, which provided interim penalty compliance rules under the 2007 Act version of section 6694. On June 17, 2008, the Treasury Department and the IRS published in the **Federal Register** (73 F.R. 34560) proposed amendments to the section 6694 regulations reflecting amendments made by the 2008 Act.

After the issuance of the proposed regulations, the 2008 Act revised section 6694(a) to provide that a position would be treated as unreasonable unless (i) there is or was substantial authority for the position or (ii) the position was properly disclosed and had a reasonable basis. The 2008 Act also enacted a special rule if the position is with respect to a tax shelter (as defined in section 6662(d)(2)(C)(ii)) or a reportable transaction to which section 6662A applies (including both reportable transactions with a significant purpose of Federal tax avoidance or evasion and listed transactions), under which a position is treated as unreasonable unless it is reasonable to believe that the position would more likely than not be sustained on the merits. The 2008 Act did not modify the section 6694(b) penalty for understatements due to willful or reckless conduct.

The 2008 Act's change in the general standard under section 6694(a) to substantial authority is retroactively effective for tax returns and claims for refund prepared after May 25, 2007. The special rule applicable to tax shelters and reportable transactions to which section 6662A applies is effective for tax returns and claims for refund prepared for taxable years ending after October 3, 2008, the 2008 Act's date of enactment.

This notice provides interim guidance to tax return preparers regarding the application of section 6694(a) as revised by the 2008 Act in order to provide immediate guidance for signing and nonsigning tax return preparers. Specifically, this interim guidance discusses the following issues: (1) the effect of the 2008 Act's changes to Notices 2007-54, 2008-11, and 2008-13, which provide guidance on the application of section 6694(a) under the 2007 Act; (2) the definition of substantial authority for purposes of section 6694(a)(2)(A); and (3) the interim penalty compliance rules for "tax shelter" transactions as defined in section 6662(d)(2)(C)(ii). Tax return preparers may rely on the interim guidance in this notice with respect to these issues until further guidance is issued. The final regulations under section 6694 govern all other issues with respect to this penalty.

The guidance regarding effective dates addresses the retroactive effect of the 2008 Act's revisions to section 6694 and also addresses the different effective dates for the 2008 Act's general standard (which applies retroactively) and the special rule for tax shelters and reportable transactions to which section 6662A applies (which does not apply retroactively). The guidance also clarifies the interaction between the 2008 Act's effective dates and the effective dates for Notices 2007-54, 2008-11, and 2008-13.

The interim guidance regarding substantial authority generally adopts the analysis provided under existing substantial authority regulations under section 6662. The interim guidance clarifies certain aspects of the application of the substantial authority regulations in § 1.6662-4(d) in the context of section 6694.

This interim guidance addresses the application of section 6694 while the Treasury Department and IRS consider further guidance for tax return preparers and taxpayers on the definition of tax shelter for purposes of sections 6694 and 6662(d)(2)(C). A broad interpretation of tax shelter for purposes of section 6694 could be inconsistent with the 2008 Act's changes to section 6694 by requiring tax return preparers to comply with the general standard previously imposed under the 2007 Act (a reasonable belief that the position would more likely than not be sustained on the merits) rather than the new general standard under the 2008 Act (substantial authority).

INTERIM GUIDANCE UNDER SECTION 6694(a)

A. Effect of the 2008 Act on Applicability of Notices 2007-54, 2008-11, and 2008-13

Notices 2007-54 and 2008-11 provided transitional relief for (1) all tax returns, amended tax returns, and claims for refund (other than employment and excise tax returns) filed on or after May 25, 2007, and on or before December 31, 2007; (2) all employment and excise tax returns filed on or after May 25, 2007, and on or before January 31, 2008; and (3) advice provided on or after May 25, 2007, and on or before December 31, 2007. Tax return preparers may continue to rely upon the transitional relief rules provided in Notices 2007-54 and 2008-11 for returns or claims for refund for the periods covered by those notices.

Notice 2008-13 provided interim guidance on, among other issues, the standards of conduct applicable to tax return preparers under section 6694(a) and interim penalty compliance obligations applicable to tax return preparers. Notice 2008-13 is effective for (1) all tax returns, amended tax returns, and claims for refund (other than 2007 employment and excise tax returns) filed on or after January 1, 2008, and before January 1, 2009 (the effective date of the final regulations under section 6694(a)); (2) all 2007 employment and excise tax returns filed on or after February 1, 2008, and before January 1, 2009; and (3) advice provided on or after January 1, 2008 and before January 1, 2009.

Consistent with the 2007 Act, the interim guidance provided by Notice 2008-13 generally held tax return preparers to a more stringent standard under section 6694(a) than the substantial authority standard imposed by the 2008 Act's revisions to section 6694. Accordingly, for positions other than with respect to tax shelters (as defined in section 6662(d)(2)(C)(ii)) and reportable transactions to which section 6662A applies, tax return preparers may apply the substantial authority standard consistent with the 2008 Act or may rely upon the interim guidance provided in Notice 2008-13 when preparing returns or claims for refund for the periods covered by that notice.

The 2008 Act's special rule for tax shelters (as defined in section 6662(d)(2)(C)(ii)) and reportable transactions to which section 6662A applies does not apply retroactively, and therefore the provisions of Notice 2008-13 will apply to tax shelter and section 6662A reportable transaction positions on returns or claims for refund for tax years ending prior to the date of enactment of the 2008 Act and otherwise covered by Notice 2008-13, as set forth above. The interim guidance provided in this notice with respect to tax shelters(as defined in section 6662(d)(2)(C)(ii)) and reportable transactions to which section 6662A applies is effective for returns or claims for refund for tax years ending after the date of enactment of the 2008 Act.

B. Definition of Substantial Authority

Until further guidance is issued, solely for purposes of section 6694(a), "substantial authority" has the same meaning as in § 1.6662-4(d)(2) (or any successor provision) of the accuracy-related penalty regulations. The analysis prescribed by § 1.6662-4(d)(3)(i) through (ii) (or any successor provisions) applies for purposes of determining whether substantial authority is present. The authorities considered in determining whether there is substantial authority for a position are those authorities described in § 1.6662-4(d)(3)(iii) (or any successor provision).

There is substantial authority for a position for purposes of section 6694 if the taxpayer is the subject of a "written determination" as provided in § 1.6662-4(d)(3)(iv)(A). In the case of a tax return preparer, however, a written determination with a misstatement or omission of material fact is substantial authority unless the tax return preparer knew or should have known of the misstatement or omission of material fact when the return or claim for refund was filed. The applicability of court cases to the taxpayer's situation by reason of the taxpayer's residence in a particular jurisdiction is not taken into account in determining whether there is substantial authority for a position in accordance with § 1.6662-4(d)(3)(iv)(B). Notwithstanding the preceding sentence, there is substantial authority for a position if the position is supported by controlling precedent of a United States Court of Appeals to which the taxpayer has a right of appeal with respect to the position. Finally, there is substantial authority for a position only if there is substantial authority on the date the return or claim for refund is deemed prepared, as prescribed by § 1.6694-1(a)(2), or there was substantial authority on the last day of the taxable year to which the return relates.

Conclusions reached in treatises, legal periodicals, legal opinions, or opinions rendered by tax professionals (including tax return preparers) are not authority. The authorities underlying such expressions of opinion, if applicable to the facts of a particular case, however, may give rise to substantial authority for the position. Solely for purposes of section 6694(a), a tax return preparer nevertheless will be considered to have met the standard in section 6694(a)(2)(A) if the tax return preparer relies in good faith and without verification on the advice of another advisor, another tax return preparer, or other party. Factors used in evaluating a tax return preparer's good faith reliance on the advice of another are found in § 1.6694-2(e)(5).

C. Interim Penalty Compliance Rules for Tax Shelter Transactions

Until further guidance is issued, solely for purposes of section 6694(a), a position with respect to a tax shelter (as defined in section 6662(d)(2)(C)(ii)) will not be deemed an "unreasonable position" described in section 6694(a)(2)(A) through (C) if there is substantial authority for the position and the tax return preparer advises the taxpayer of the penalty standards applicable to the taxpayer in the event that the transaction is deemed to have a significant purpose of Federal tax avoidance or evasion. This advice to the taxpayer must explain that, if the position has a significant purpose of tax avoidance or evasion, then there needs to be at a minimum substantial authority for the position, the taxpayer must possess a reasonable belief that the tax treatment was more likely than not the proper treatment in order to avoid a penalty under section 6662(d) as applicable, and disclosure in accordance with § 1.6662-4(f) will not protect the taxpayer from assessment of an accuracy-related penalty if section 6662(d)(2)(C) applies to the position. The tax return preparer must contemporaneously document the advice in the tax return preparer's files.

If a nonsigning tax return preparer provides advice to another tax return preparer regarding a position with respect to a tax shelter (as defined in section 6662(d)(2)(C)(ii)), the position will not be deemed an "unreasonable position" described in section 6694(a)(2)(A) through (C) if there is substantial authority for the position and the nonsigning tax return preparer provides a statement to the other tax return preparer about the penalty standards applicable to the tax return preparer under section 6694. Contemporaneously prepared documentation in the nonsigning tax return preparer's files is sufficient to establish that the statement was given to the other tax return preparer. If a nonsigning tax return preparer and other tax return preparer are employed by the same firm, then contemporaneous documentation of advice provided by any tax return preparer in that firm to the taxpayer regarding applicable penalty standards, as described in the immediately preceding paragraph, is also sufficient to establish that the statement was given by a nonsigning tax return preparer to the other tax return preparers within the firm.

The above interim penalty compliance rules do not apply to a position described in section 6662A (a reportable transaction with a significant purpose of Federal tax avoidance or evasion or a listed transaction).

REQUESTS FOR COMMENTS

Interested parties are invited to submit comments on this notice by Monday, March 16, 2009. Comments should be submitted to: Internal Revenue Service, CC:PA:LPD:PR (Notice 2009-5), 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 2009-5), 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 2009-5* in the subject line of any electronic submissions.

Effect on Other Documents

This notice modifies and clarifies Notice 2008-13, 2008-3 I.R.B. 282.

EFFECTIVE DATE

For positions other than tax shelters and reportable transaction positions, this notice is effective for all advice rendered or returns, amended returns, and claims for refund prepared after May 25, 2007. The interim guidance in this notice for tax shelters (within the meaning of section 6662(d)(2)(C)(ii)) and reportable transactions to which section 6662A applies is effective for tax shelter and reportable transaction positions on tax returns for taxable years ending after the 2008 Act's date of enactment, October 3, 2008.

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).