

**Office of Chief Counsel
Internal Revenue Service
memorandum**

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subject: Electronic Return Originators

This Chief Counsel Advice responds to your request for assistance dated September 6, 2013. This advice may not be used or cited as precedent.

ISSUES

1. Whether it is a violation of IRS *e-file* rules for an Electronic Return Originator (ERO) to share its Electronic Filing Identification Number (EFIN) with others?
2. Whether it is a violation of IRS *e-file* rules for an employee of an ERO to prepare returns at a location other than the business location provided on the ERO's Form 8633, *Application to participate in the IRS e-file Program*?
3. Whether it is a violation of IRS *e-file* rules for a subcontractor of an ERO to prepare returns at a location other than the ERO's business location?
4. What are an ERO's due diligence requirements with respect to returns prepared by employees of the ERO?
5. What are an ERO's due diligence requirements with respect to returns prepared by a subcontractor of the ERO?
6. Whether a return that is electronically filed by a return preparer using a borrowed EFIN is valid?

7. If an ERO violates IRS *e-file* rules, can return preparer penalties be imposed on the ERO?

CONCLUSIONS

1. It is a violation of IRS *e-file* rules for an ERO to share its Electronic Filing EFIN with others.
2. It is not a violation of IRS *e-file* rules for an employee of an ERO to prepare returns at a location other than the business location provided on the ERO's Form 8633.
3. It is a violation of IRS *e-file* rules for an ERO to electronically originate returns prepared by a subcontractor, regardless of where the returns are prepared.
4. An ERO that is also a return preparer must exercise due diligence in accordance with the provisions of the Code, Treasury Regulations, and Publication 1345, *Handbook for Authorized IRS e-file Providers of Individual Income Tax Returns*.
5. It is a violation of IRS *e-file* rules for an ERO to electronically originate returns that it did not prepare or collect from a taxpayer. IRS *e-file* rules do not address whether an ERO must exercise due diligence in reviewing returns that are prepared by, or collected from, a subcontractor of the ERO. An ERO becomes an income tax return preparer of the returns, and is subject to return preparer due diligence requirements, when, as a result of entering data from a return prepared by a subcontractor, it discovers errors that require substantive changes and then corrects the errors before filing the return.
6. Electronically filing an income tax return with a borrowed EFIN does not alone invalidate a return. If the tax return otherwise meets the established criteria for a valid return, it should be processed, despite being filed with a borrowed EFIN.
7. Whether return preparer penalties may be imposed against an ERO depends on whether the ERO is a tax return preparer. Return preparer penalties may be imposed against an ERO that meets the definition of a tax return preparer under Internal Revenue Code (Code) § 7701(a)(36) and Treasury Regulation § 301.7701-15.

LAW AND ANALYSIS

Revenue Procedure 2007-40 specifies the requirements for participating as an Authorized *e-file* Provider and is the official set of rules that govern participation in IRS *e-file*. To participate in the IRS *e-file* Program, an Authorized *e-file* Provider must comply with all the provisions of Rev. Proc. 2007-40 and all publication and notices governing IRS *e-file*. Rev. Proc. 2007-40, section 4.04.

A participant in the IRS *e-file* is referred to as an "Authorized IRS *e-file* Provider" or "Provider". Electronic Return Originators (EROs) are one category of Providers. An

ERO is defined as a Provider that originates the electronic submission of returns. Section 3.01(1) of Rev. Proc. 2007-40.

As a condition of participating in the IRS *e-file* program, Publication 3112, *IRS e-file Application and Participation*, states that Providers “must protect their EFINs, ETINs, and passwords from unauthorized use. *Providers must never share the number and passwords with others* including not transferring EFINs or ETINs to another entity when transferring the business by sale, gift, or other disposition.” (Emphasis added.) Furthermore, Form 8633, *Application to Participate in the IRS e-file Program*, requires EFIN applicants to sign an agreement, which states, in part: “Acceptance for participation is not transferrable. I understand that if this firm is sold or its organizational structure changes, a new application must be filed. I further understand that noncompliance will result in the firms and/or the individuals listed on this application, being suspended from participation in the IRS *e-file* program.” Accordingly, the IRS may suspend an ERO who shares its EFIN, or impose other sanctions, including expulsion from the program.

Whether it is a violation of the IRS *e-file* rules for an ERO to originate a return that is not prepared at the fixed business location listed on the ERO’s Form 8633 depends on who prepares the return. It is not a violation of the IRS *e-file* rules for employees of an ERO to prepare returns at a location other than the ERO’s business location *if* the returns are forwarded to another location for electronic return origination. Specifically, Publication 3112 states: “An application is not required for a location if tax returns are only prepared or collected at the location and forwarded to another location for origination of the electronic submission or returns.”

It is a violation of the IRS *e-file* rules, however, for an ERO to electronically originate returns that are prepared by a subcontractor of the ERO, regardless of where the returns are prepared. According to Publication 3112, “[a]n ERO must originate the electronic submission of only returns that the ERO either prepared or collected from a taxpayer.”

An ERO that is also a paid preparer must exercise due diligence in the preparation of returns in accordance with the provisions of the Code, Treasury Regulations (including Circular 230), and Publication 1345. For example, Section 6695(g) requires paid preparers to exercise due diligence in the preparation of returns involving EITC, as it is a popular target for fraud and abuse. Paid preparers must complete all required worksheets and meet all record keeping requirements associated with preparing returns involving EITC. More generally, section 10.22 of Circular 230 states that a return preparer “must exercise due diligence ... [i]n preparing or assisting in the preparation of, approving, and filing tax returns, documents, affidavits, and other papers relating to Internal Revenue Service matters.”

An ERO that chooses to originate returns that it has not prepared, but only collected from taxpayers, becomes an income tax return preparer of the returns, and is subject to

return preparer due diligence requirements, when, as a result of entering data, it discovers errors that require substantive changes, and then corrects the errors before filing the return. See Publication 1345. In addition to complying with the above-referenced due diligence requirements, EROs must ensure that taxpayers execute Form 8879 before the ERO originates the electronic submission of the return. EROs must also comply with all of the direct deposit rules provided in Publication 1345.

As explained above, it is a violation of IRS *e-file* rules for an ERO to electronically originate returns that it did not prepare or collect from a taxpayer. IRS *e-file* rules thus do not address whether an ERO must exercise due diligence in reviewing returns that are prepared by, or collected from, a subcontractor of the ERO. If an ERO violates this provision of the IRS *e-file* rules, the IRS is limited to imposing sanctions against the ERO pursuant to section 7 of Rev. Proc. 2007-40.

The validity of a return that is prepared by a subcontractor of an ERO (or is electronically filed using a borrowed EFIN) depends not on IRS *e-file* rules but on whether the return satisfies the well-known four-part Beard test. Beard v. Commissioner, 82 T.C. 766, 777 (1984), aff'd per curiam, 792 F.2d 139 (6th Cir. 1986). For a return to be valid: (1) the information on the return must be sufficient for the IRS to calculate tax liability; (2) the filed document must purport to be a return; (3) the return must be an honest and reasonable attempt to comply with the tax laws; and (4) the taxpayer must execute the return under penalties of perjury. Id. If a return satisfies these four requirements, it is legally valid, even if it is prepared by a subcontractor of an ERO or is electronically filed using a borrowed EFIN.

Whether return preparer penalties may be imposed against an ERO depends on whether the ERO is a return preparer. An ERO does not automatically become a return preparer by sharing its EFIN. Therefore, return preparer penalties may not be imposed against an ERO if the ERO's only violation is sharing its EFIN.

Return preparer penalties may, however, be imposed against an ERO that meets the definition of a tax return preparer under section 7701(a)(36) and section 301.7701-15. Treasury Regulation Section 301.7701-15(a) defines a tax return preparer as any person who prepares for compensation, all or a substantial portion of any return of tax or claim for refund of tax. Treasury Regulation Section 301.7701-15(f) excludes certain persons from the definition of tax return preparer (for example, any individual who provides only typing, reproduction, or other mechanical assistance in the preparation of a return of claim for refund under Treas. Reg. § 301.7701-15(f)(1)(viii)). Section 6 of Rev. Proc. 2007-40 and Publication 1345 list some of the penalties that may be imposed against an ERO that is also a return preparer, including those set forth in section 6694, 6695, and 6713.

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