

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

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date: November 07, 2014

to: Rochelle Armijo
ATTI Exam Group Manager
Southwest Area
(Small Business/Self-Employed)

from: Blaise G. Dusenberry
Senior Technical Reviewer
(Procedure & Administration)

subject: Limitation Periods on Preparer Penalty under I.R.C. § 6694(a)

This Chief Counsel Advice responds to your August inquiry regarding the above topic. This advice may not be used or cited as precedent.

ISSUES

(1) What is the limitation period for making an assessment of the return preparer penalty authorized by I.R.C. § 6694 for preparing a return or claim for refund with an understatement of tax liability in the circumstances noted below?

(2) What is the limitation period on a refund of the preparer penalty assessed pursuant to I.R.C. § 6694(a)?

CONCLUSION

(1) The Service must assess the penalty within 3 years of the date the underlying tax return or claim for refund is filed.

(2) Any claim for refund of an overpayment of a penalty assessed under I.R.C. § 6694(a) must be filed within 3 years of the date the penalty was paid to the Service.

FACTS

You indicated that the Service's exam group in your area often confronts the situation of a tax return preparer who prepares an amended income tax return (Form 1040X), which includes a refund claim, which you described as "poorly prepared." We interpret this to mean that such amended income tax return includes an understatement of tax liability attributable to an unreasonable filing position. You seek guidance on the following fact pattern:

A tax return preparer (P) prepares an amended tax return (Form 1040X) for a taxpayer for taxable year 2011. Such amended return shows an overpayment and includes a claim for refund. The return, though, contains a meritless filing position and the taxpayer's reported overpayment on the amended return is based on the incorrect, meritless, position. The period of limitations on refunds or credits for taxable year 2011 will expire on the later of April 15, 2015 (3 years following the filing of the return), or two years following payment of 2011 tax. The taxpayer's Form 1040X for year 2011 was a timely claim for refund because it was filed on or before April 15, 2015.

We address the limitation period during which the Service can assess the penalty under section 6694(a) and the refund period. In an email to our office dated October 23, 2014 you stated that your exam group does not have a current open case involving this fact pattern. Rather, you would like an opinion examiners can rely upon for future cases.

DISCUSSION

Code section 6694(a) imposes a penalty on a tax return preparer for any return or claim for refund that he prepares resulting in an understatement of liability due to an unreasonable position, about which the preparer knew or reasonably should have known. The penalty is the greater of \$1,000 or 50 percent of the income derived by the preparer from the return or claim. The regulation implementing section 6694(a) divides reporting positions into two categories in describing the standards against which the return preparer's conduct is measured. Treas. Reg. § 1.6694-1(a)(1).

For positions other than those relating to tax shelters and reportable transactions,¹ this preparer penalty applies when the return or refund claim includes an understatement of tax liability that is due to an undisclosed position for which the return preparer did not have substantial authority, or due to a disclosed position for which there is no reasonable basis. Treas. Reg. § 1.6694-1(a)(1). For positions respecting tax shelters or reportable transactions, the preparer penalty applies if the return or claim includes an understatement of liability for which it is not reasonable to believe that the position is more likely than not to be sustained on the merits. *Id.*; see generally United States v.

¹ "Tax shelters" in this context means the shelters defined in section 6662(d)(2)(C) and "reportable transaction" means a transaction that can be penalized under section 6662A.

Pugh, 717 F.Supp.2d 271, 288-89 (E.D. N.Y. 2010)(evidence was sufficient to sustain penalty against preparer who prepared returns containing understatements of tax due to the subtraction of wage and salary income when calculating gross income and deductions based on a frivolous “claim of right” scheme).

Section 6696(d) includes limitation periods:

(1) . . .The amount of any penalty under section 6694(a), section 6695, or 6695A shall be assessed within 3 years after the return or claim for refund with respect to which the penalty is assessed was filed, and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period . . .

(2) Except as provided in section 6694(d), any claim for refund of an overpayment of any penalty assessed under section 6694 . . . shall be filed within 3 years from the time the penalty was paid.²

For purposes of this memorandum, we assume that the taxpayer’s amended 2011 return, which includes a claim for refund based on a meritless position, is filed April 15, 2015. The Service will have until April 15, 2018 to assess the preparer penalty under section 6694(a) against P. Assuming P pays the penalty, section 6696(b) requires that he file a claim for refund within 3 years of payment in order to secure a refund. P’s entitlement to a refund assumes he can show the penalty was incorrectly determined or that he had reasonable cause and acted in good faith. I.R.C. § 6694(a)(3).

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views. I trust that this satisfies your inquiry.

Please call (202) 317-5414 if you have any further questions.

² The exception under section 6694(d) is as follows. Section 6694(d) requires the Service to refund any part of a preparer penalty assessed pursuant to section 6694(a) or (b), irrespective of any limitation period on such refund, if there is a final administrative or judicial determination that the tax return or refund claim did not contain an understatement of liability.