

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

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Revenue Agent
Abusive Transactions Technical Issues
Small Business/Self Employed
SE:S:E:FE:SW:SD:5

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subject: Assessing Preparer Penalties

This memorandum responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUES

Issue 1: May the I.R.C. § 6694(b) preparer penalty for understatement of liability due to willful or reckless conduct be assessed if the return preparer made an amended return which was never filed.

Issue 2: May the I.R.C. § 6694(b) preparer penalty for understatement of liability due to willful or reckless conduct be assessed if amended returns were filed but the Internal Revenue Service (Service) disallowed the refund?

Issue 3: May the I.R.C. § 6694(a) preparer penalty for understatement of liability due to unreasonable positions, the I.R.C. § 6694(b) preparer penalty for understatement of liability due to willful or reckless conduct or the I.R.C. § 6701 penalty for aiding and abetting understatements of tax liability be assessed if the return preparer made and filed a claim for refund after the period of limitations for refund claims had expired?

SHORT CONCLUSIONS

Issue 1: Yes. If the return is not filed, a penalty under I.R.C. § 6694(b) may be assessed if the return preparer signed the return and the return preparer's conduct was willful or reckless.

Issue 2: Yes. Under the language of I.R.C. § 6694(b)(1), the return preparer penalty may be assessed if the tax return preparer *prepares any return or claim for refund with respect to which any part of an understatement of liability is due to willful or reckless conduct*. There is no requirement that the Service allow the amounts claimed on an amended return before the I.R.C. § 6695(b) penalty may be assessed.

Issue 3. The penalties under I.R.C. §§ 6694(a), 6694(b) or 6701 should not be assessed merely because the return preparer made and filed a claim for refund after the period of limitations for refunds had expired, because an "understatement of liability" does not include claims that are barred by the period of limitations. In addition, there may be extenuating circumstances that weigh against asserting the penalty. The amended return, for example, may be perfecting an earlier timely informal claim for refund.

FACTUAL SCENARIOS

Scenario 1. Return preparer made amended returns for three consecutive years which contained an understatement of liability due to willful or reckless conduct. The taxpayer filed the year 1 amended return but not the subsequent year amended returns, waiting to see if the amended return was accepted. The refund claimed on the year 1 amended return was not allowed. Examination has a copy of the amended returns for all three years from the taxpayer. Each has the return preparer's signature on them. Examination also has copies of the amended returns for all three years from the return preparer obtained during the investigation which do not have his signature on them but have a watermark stating "Preparer Copy."

Scenario 2. Return preparer made an amended return that contained an understatement of liability due to willful or reckless conduct. The refund claimed on the amended return was disallowed by the Service Center, but Examination has only secured a copy of the amended return from the return preparer that is not signed by him.

Scenario 3. Return preparer made an amended return that contained an understatement of liability due to willful or reckless conduct. The amended return was not filed, and Examination has only secured copies of an unsigned copy from the return preparer.

Scenario 4. Return preparer made an amended return after the period of limitations for refunds had expired and the amended return was filed.

LAW AND ANALYSIS

Issue 1: May the I.R.C. § 6694(b) preparer penalty for understatement of liability due to willful or reckless conduct be assessed if the return preparer made an amended return which was never filed.

Yes. If the return is not filed, a penalty under I.R.C. § 6694(b) may be asserted if the return preparer signed the return. The language of I.R.C. § 6694(b) does not require that a return be filed for the penalty to apply, only that a return is prepared. And Treas. Reg. § 1.6694-1(a)(2) provides that a return is prepared when it is signed.

I.R.C. § 6694(a)(1) provides that if a tax return preparer—

- (A) prepares any return or claim of refund with respect to which any part of an understatement of liability is due to an unreasonable position, and
- (B) knew (or reasonably should have known) of the position,

such tax return preparer shall pay a penalty with respect to each such return or claim in an amount equal to the greater of \$1,000 or 50 percent of the income derived (or to be derived) by the tax return preparer with respect to the return or claim.

The penalty may be increased under I.R.C. § 6694(b) if any part of the understatement is due to a willful attempt in any manner to understate the liability for tax on the return or claim, or a reckless or intentional disregard of rules or regulations.

Treas. Reg. § 1.6694-1(a)(2) provides that:

[f]or purposes of the penalties under section 6694, **a return or claim for refund is deemed prepared on the date it is signed by the tax return preparer.** If a signing tax return preparer within the meaning of §301.7701-15(b)(1) of this chapter fails to sign the return, the return or claim for refund is deemed prepared on the date the return or claim is filed.

A strict reading of the Code thus suggests that if an amended return made by a return preparer contained an understatement of liability due to willful or reckless conduct, the penalty under I.R.C. § 6694(b) could technically apply if the amended return is either

signed by the return preparer, or if it not signed by the return preparer, if the amended return is filed.

Accordingly, in Scenario 1, the I.R.C. § 6694(b) return preparer penalty for understatement of liability due to willful or reckless conduct may be assessed for all three years because the return preparer made an amended return that he signed that contained an understatement due to willful or reckless conduct. Treas. Reg. § 1.6694-1(a)(2).

In Scenario 2, the I.R.C. § 6694(b) return preparer penalty for understatement due to willful or reckless conduct may be assessed because the return preparer made an amended return that contained an understatement of liability due to willful or reckless conduct that was filed. Treas. Reg. § 1.6694-1(a)(2).

In Scenario 3, the I.R.C. § 6694(b) return preparer penalty for understatement due to willful or reckless conduct should not be assessed because although the return preparer made an amended return that he signed that contained an understatement due to willful or reckless conduct, the amended return was not filed and there is no evidence the return preparer signed the amended return. Treas. Reg. § 1.6694-1(a)(2).

Issue 2: Can the I.R.C. § 6694(b) return preparer penalty for understatement of liability due to willful or reckless conduct be assessed if amended returns were filed but the Service disallowed the refund.

Yes. Under the language of I.R.C. § 6694(b), the return preparer penalty may be assessed if a tax return preparer “**prepares any return or claim of refund with respect to which any part of an understatement of liability is due to**” willful or reckless conduct. There is no requirement that the Service allow the amounts claimed on an amended return before the I.R.C. § 6695(b) penalty may be assessed. See *James J. Schneider, CPA v. United States*, 257 F. Supp. 1154 (S.D. Ind. 2003) (deduction for artwork disallowed, preparer penalty for willful or reckless conduct under I.R.C. § 6694(b) assessed); *Swart v. United States*, 568 F. Supp. 763 (C.D. Cal. 1982) (casualty loss disallowed, preparer penalty under I.R.C. § 6694(a) assessed); *Pickering v. United States*, 82-1 U.S.T.C. ¶ 9375 (E.D. Ark. 1982) (business deduction disallowed, preparer penalty under I.R.C. § 6694(a) assessed).

Issue 3: May the I.R.C. § 6694(a)(2) preparer penalty for understatement of liability due to unreasonable positions, the I.R.C. § 6694(b) preparer penalty for understatement of liability due to willful or reckless conduct, or the I.R.C. § 6701¹ penalty for aiding and

¹ I.R.C. § 6701, Penalties for aiding and abetting understatement of tax liability, provides in part:

(a) Imposition of penalty.--Any person--

(1) who aids or assists in, procures, or advises with respect to, the preparation or presentation of any portion of a return, affidavit, claim, or other document,

abetting understatement of tax liability be assessed if the return preparer made and filed an amended return after the period of limitations for refund claims had expired?

The penalties under I.R.C. §§ 6694(a)(2), 6694(b), or 6701 should not be assessed merely because the return preparer made and filed a claim for refund after the period of limitations for refunds had expired, because an “understatement of liability” does not include refund claims that are barred by the period of limitations.

I.R.C. § 6694(e) defines the term “understatement of liability” as follows:

For purposes of this section, the term “understatement of liability” means any understatement of the net amount payable with respect to any tax imposed by this title or any overstatement of the net amount creditable or refundable with respect to any such tax. Except as otherwise provided in subsection (d), the determination of whether or not there is an understatement of liability shall be made without regard to any administrative or judicial action involving the taxpayer.

I.R.C. § 6511 establishes the basic rules for refund or credit of an overpaid tax. I.R.C. § 6511(b) states, “no credit or refund shall be allowed or made after the expiration of the period of limitations prescribed ... for the filing of a claim for credit or refund, unless a claim for credit or refund is filed by the taxpayer within such period.”

When a refund is denied because the period of limitations had lapsed, it is not denied because there is, under I.R.C. § 6694(e), an “understatement of the net amount payable with respect to any tax imposed by this title or any overstatement of the net amount creditable or refundable with respect to any such tax.” The claim for refund may, in fact, reflect the correct tax liability. The refund is barred merely because the claim was made too late.

Accordingly, the penalties under I.R.C. §§ 6694(a)(2) and 6694(b) do not apply because a time barred claim does not fall under the definition of an understatement of liability as defined in I.R.C. § 6694(e). For that same reason, the penalty under I.R.C. § 6701 should not asserted for time barred claims. For although I.R.C. 6694(e) applies for “purposes of this section,” that is, section 6694, identical words in the same statute usually have the same meaning. See *Gustafson v. Alloyd Co., Inc.*, 513 U.S. 561, 570

(2) who knows (or has reason to believe) that such portion will be used in connection with any material matter arising under the internal revenue laws, and

(3) who knows that such portion (if so used) would result in an understatement of the liability for tax of another person,

shall pay a penalty with respect to each such document in the amount determined under subsection (b).

(1995) (normal rule of statutory construction is that identical words used in different parts of the same act are intended to have the same meaning); 2A NORMAN J. SINGER & SHAMBIE SINGER, STATUTES AND STATUTORY CONSTRUCTION § 46.6 at 261-3 (7th Ed. 2014).

In addition, there may be extenuating circumstances that weigh against asserting the penalty when an amended return appears to be filed out of time. The amended return may, for example, be perfecting an earlier timely informal claim for refund. Despite the requirement that a claim be submitted on one of the Service's forms supplied for that purpose, a document submitted to the Service that fails to satisfy Treasury Regulations² can be treated as an informal refund claim. It has long been recognized that a claim for refund need not be in any specific form, and informal refund claims, timely filed, which adequately notify the Internal Revenue Service that a refund is being sought, have been held to toll the statute of limitations and, if defective, may be perfected by the filing of a formal claim after the lapse of the statutory period. *United States v. Kales*, 314 U.S. 186, 194 (1941); *American Radiator & Standard Sanitary Corp. v. United States*, 162 Ct. Cl. 106, 113-114, 318 F.2d 915, 920 (1963); *Hollie v. Commissioner*, 73 T.C. 1198 (1980).

Accordingly, we conclude that the penalties under I.R.C. §§ 6694(a)(2), 6694(b), or 6701 should not be assessed merely because the return preparer made and filed an amended return after the period of limitations for refunds had expired.

Please call (202) 317-5417 if you have any further questions.

² See Treas. Reg. §§ 1.6402-2 and 1.6402-3.