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From: [REDACTED]
Sent: Monday, May 21, 2018 2:41:25 PM
To: [REDACTED]
Cc: [REDACTED]
Bcc: [REDACTED]
Subject: RE: IRC 6694(b) request for informal guidance

Hi

You have asked for our recommendation of whether we think an assessment of the penalty provided for under section 6694(b) on the individual SSN of a co-owner of an S-Corporation (S-Corp) could be a legal hazard. You have also asked whether we are aware of any situations where the owner of an S-Corp may be held personally liable for the penalty provided for under section 6694(b). Below, we have provided a summary of the relevant Code sections and regulations to assist you with your decision. We have also identified the one case we are aware of in which the owner of an S-Corp was found personally liable for the penalty under section 6694.

Section 6694(b)(1) generally provides that a tax return preparer who prepares any return or claim for refund with respect to which any part of any understatement of liability is due to conduct described in paragraph (b)(2) shall pay a penalty with respect to each such return or claim. Paragraph (b)(2) generally sets forth willful or reckless conduct taken by a tax return preparer. Section 6694(f) cross references section 7701(a)(36) for the definition of "tax return preparer." Section 7701(a)(36) provides that "tax return preparer" means any person who prepares for compensation, or who employs one or more persons to prepare for compensation, any return of tax imposed by this title or any claim for refund of tax imposed by this title, subject to certain exceptions not relevant here. See also Treas. Reg. § 301.7701-15.

Treasury regulation § 1.6694-1(b) provides that "[f]or the purposes of this section, 'tax return preparer' means any person who is a tax return preparer within the meaning of section 7701(a)(36) and § 301.7701-15 of this chapter. An individual is a tax return preparer subject to section 6694 if the individual is primarily responsible for the position(s) on the return or claim for refund giving rise to an understatement. See § 301.7701-15(b)(3). There is only one individual within a firm who is primarily responsible for each position on the return or claim for refund giving rise to an understatement. ... In some circumstances, there may be more than one tax return preparer who is primarily responsible for the position(s) giving rise to an understatement if multiple tax return preparers are employed by, or associated with, different firms."

Treasury regulation § 1.6694-3(a)(2) provides that "[a] *firm that employs a tax return preparer* subject to a penalty under section 6694(b) (or a firm of which the individual tax

return preparer is a partner, member, shareholder or other equity holder) is also subject to penalty if, and only if—(i) One or more members of the principal management (or principal officers) of the firm or a branch office participated in or knew of the conduct proscribed by section 6694(b); (ii) The corporation, partnership, or other firm entity failed to provide reasonable and appropriate procedures for review of the position for which the penalty is imposed; or (iii) The corporation, partnership, or other firm entity disregarded its reasonable and appropriate review procedures though willfulness, recklessness, or gross indifference (including ignoring facts that would lead a person of reasonable prudence and competence to investigate or ascertain) in the formulation of the advice, or the preparation of the return or claim for refund, that included the position for which the penalty is imposed.” (emphasis added). See also IRM 20.1.6.4.4.

Our interpretation of Treasury regulation § 1.6694-3(a)(2) is that generally, the entity (corporation, partnership, or other firm entity) that employs a tax return preparer will simultaneously be subject to the penalty under section 6694(b) only if the specific conditions set forth in the regulation are met. Otherwise, only the individual(s) that is primarily responsible for the position(s) on the return or claim for refund that gives rise to the understatement will be subject to the penalty.

We did find one case in which the owner of an entity was subject to the section 6694 penalty. In United States v. Elsass, 978 F. Supp. 2d 901 (S.D. Ohio 2013), aff'd, 769 F.3d 390 (6th Cir. 2014), the court found that the owner of an entity was a “tax return preparer” for the purposes of the penalties provided for under sections 6694 and 6695. However, in that case, the owner was the sole-owner of the entity *and* personally signed or prepared over twenty-eight of the tax returns at issue. Additionally, the owner and the entity “were the moving force behind the decisions and calculations regarding the returns.” Id. at 911. The court notes that “Congress intended the definition of tax return preparer to encompass those contributing to the material decisions regarding tax returns.” Id. at 912.

We think that unless your co-owner acted similarly to the owner in Elsass, an assessment of the penalty provided for under section 6694(b) against that taxpayer could present a legal hazard. Alternatively, the S-Corp may be a tax return preparer within the definition of section 7701(a)(36), and the proper person on which to assess the penalty under section 6694(b), but only if the requirements set forth in Treasury regulation § 1.6694-3(a)(2) are met. We do not have enough facts in our possession to make a recommendation as to whether the S-Corp in your case meets these requirements.

Please let me know if you have any questions, or would like to discuss further.

Thanks,