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From: [REDACTED]
Sent: Monday, August 27, 2018 4:09:38 PM
To: [REDACTED]
Cc: [REDACTED]
Bcc: [REDACTED]
Subject: FW: Request for written response

Hi ,

You have asked for our recommendation of whether we think an assessment of the penalty provided for under section 6695(g) on the individual SSN of a 25% 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 can be held personally liable for the penalty provided for under section 6695(g). Below, we have provided a summary of the relevant Code sections and regulations to assist you with your decision. We did not find any cases where the owner of an S-Corp was held personally liable for the penalty provided for under section 6695(g).

Section 6695(g) generally provides that any person who is a tax return preparer with respect to any return or claim for refund who fails to comply with due diligence requirements imposed by the Secretary of Treasury by Treasury Regulations with respect to certain credits shall pay a penalty of \$500 for each failure (subject to adjustments for inflation). Treasury regulation § 1.6695-2(b) sets forth the due diligence requirements that a tax return preparer must comply with to avoid the penalty under section 6695(g). Generally, a tax return preparer must complete and submit with the filed tax return a Form 8867, *Paid Preparer's Due Diligence Checklist*, and retain a copy of the Form 8867. See Treas. Reg. § 1.6695-2. In addition, the preparer must not know or have reason to know that any of the information used to compute the relevant credit or credits is incorrect and must make reasonable, documented inquiries concerning the correctness of the information.

Temporary regulation § 1.6695-2T(a)(1) (effective for tax returns or claims for refund filed tax years beginning after December 31, 2015) provides that a person who is a tax return preparer (as defined in section 7701(a)(36)) of a tax return or claim for refund under the Code with respect to determining the eligibility for, or the amount of certain credits and who fails to satisfy the due diligence requirements of paragraph (b) of this section will be subject to a penalty as prescribed in section 6695(g) for each such failure. Section 7701(a)(36) defines "tax return preparer" as 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. This definition applies when the term is used in Title 26, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof. See also Treas. Reg. § 301.7701-15.

The treasury regulation in effect prior to December 5, 2016 did not provide a cross-reference to section 7701(a)(36) for the definition of “tax return preparer.” See Treas. Reg. § 1.6695-2 (effective December 20, 2011 to December 4, 2016). However, because neither section 6695 nor its related regulations at that time give any indication that the definition under section 7701(a)(36) is manifestly incompatible with their intent, we conclude that section 7701(a)(36) also provides the correct definition of “tax return preparer” for the purposes of section 6695 prior to the issuance of the temporary regulation.

Temporary regulation § 1.6695-2T(b)(3) provides generally that the tax return preparer must not know, or have reason to know that any information used by the tax return preparer in determining the taxpayer’s eligibility for, or the amount of, any credit described in paragraph (a) of this section and claimed on the return or claim for refund is incorrect. We think that this specific knowledge requirement would present a legal hazard for assessing the penalty provided for under section 6695(g) directly on the SSN of the 25% co-owner of the S-Corp. However, we do not have enough facts in our possession to make a recommendation in your specific case.

The regulations provide a special rule for a firm that employs a tax return preparer subject to the penalty provided for under section 6695(g). Treasury regulation § 1.6695-2(c) provides that a firm that employs a tax return preparer subject to a penalty under section 6695(g) is also subject to penalty if, and only if—(1) One or more members of the principal management (or principal officers) of the firm or a branch office participated in or, prior to the time the return was filed, knew of the failure to comply with the due diligence requirements of this section; (2) The firm failed to establish reasonable and appropriate procedures to ensure compliance with the due diligence requirements of this section; or (3) the firm disregarded its reasonable and appropriate compliance procedures through willfulness, recklessness, or gross indifference (including ignoring facts that would lead a person of reasonable prudence and competence to investigate) in the preparation of the tax return or claim for refund with respect to which the penalty is imposed.” See also Treas. Reg. § 1.6695-2T; IRM 20.1.6.5.7.1 (for tax years ending on or after December 31, 2011 and before January 1, 2016); IRM 20.1.6.5.7.1 (for tax years beginning after December 31, 2015).

The S-Corp may be a tax return preparer within the definition of section 7701(a)(36) if it employs a person who prepares a tax return for compensation. The S-Corp may be the proper person on which to assess the penalty under section 6695(g) pursuant to Treasury regulation § 1.6695-2(c) if one of the requirements set forth in that section 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. In addition, there are likely legal hazards with assessing the penalty provided for under section 6695(g), pursuant

to Treasury regulation § 1.6695-2(c), directly on the SSN of the 25% co-owner of the S-Corp because it is the S-Corp that employees the preparers and not the co-owner.

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

Thanks,