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The IRS' New Teeth:
Don't Get Bitten

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Introduction: Much has been made over the last several years about the 2005 changes to Circular 230. These changes focused on new rules for “covered opinions” and other restrictions on the manner in which tax professionals may give written tax advice. Like probably every other law firm and accounting firm, our firm started adding a boilerplate “Circular 230 disclaimer” to every email. I am sure you are familiar with such disclaimers and probably have your own version, such as: “although this email may look like tax advice upon which you can rely to avoid penalties, and although you are paying me for such tax advice, you are mistaken.” The long-term effects the 2005 changes will have on the communication of tax professionals remain to be seen; however, that is not the topic of this presentation. There are more important topics at hand. The 2005 changes were not the result of any statutory changes and were largely a regulatory swinging broadsword reaction to the growing practice of sometimes questionable legal opinions being used as sales pieces. Instead, this presentation covers even newer and sharper teeth with statutory roots and an intended target of many tax professionals who are unaware they are “tax return preparers” who can suffer a damaging bite. This presentation covers both the “surprise” 2007 changes to the law regarding tax return preparer penalties and the 2008 partial statutory retreat, along with the related changes to regulations and Circular 230 (both finalization of prior proposed regulations and expected changes resulting from the new statutory landscape).

I. **Overview - Strength and Certainty of Tax Return Positions.** Before an explanation of the statutory changes and the changes to Cir 230 would make any sense, a review of the levels of authority and certainty when filing a tax return need to be addressed.

A. “More Likely Than Not” (50%+). Reg §1.6662-4(d)(2) defines this standard as “the standard that is met when there is a greater than 50-percent likelihood of the position being upheld.” Reg §1.6694-2(b)(1) states it is “reasonable to believe that a position would more likely than not be sustained on its merits” if “the tax return preparer analyzes the pertinent facts and authorities and, in reliance upon that analysis, reasonably concludes in good faith that the position has a greater than 50 percent likelihood of being sustained on its merits.” The IRS again confirms this definition in the proposed regulation changes to Cir 230 §10.34(a) (Sept 2007):

“A practitioner is considered to have a reasonable belief that the tax treatment of a position is **more likely than not** the proper tax treatment if the practitioner analyzes the pertinent facts and authorities, and based on that analysis reasonably concludes, in good faith, that there is a greater than fifty-percent likelihood that the tax treatment will be upheld if the IRS challenges it. The authorities described in 26 CFR 1.6662-4(d)(3)(iii), or any successor provision, of the substantial understatement penalty regulations may be taken into account for purposes of this analysis.” [emphasis added]

B. Substantial Authority (less than 50% and more than 33.3%/1 in 3). Reg. §1.6662-4(d)(2) defines this standard as:

“an objective standard involving an analysis of the law and application of the law to relevant facts. The **substantial authority** standard is **less stringent than the more likely than not** standard (the standard that is met when there is a greater than 50-percent likelihood of the position being upheld), but **more stringent than the reasonable basis**

standard as defined in §1.6662-3(b)(3). The possibility that a return will not be audited or, if audited, that an item will not be raised on audit, is not relevant in determining whether the substantial authority standard (or the reasonable basis standard) is satisfied.” [emphasis added]

C. Realistic Possibility (33.3% - 1 in 3). According to Reg. §1.6694-2(b)(1),

“A position is considered to have a **realistic possibility** of being sustained on its merits if a reasonable and well-informed analysis by a person knowledgeable in the tax law would lead such a person to conclude that the position has approximately a **one in three, or greater, likelihood of being sustained on its merits (realistic possibility standard)**. In making this determination, the possibility that the position will not be challenged by the Internal Revenue Service (e.g., because the taxpayer's return may not be audited or because the issue may not be raised on audit) is not to be taken into account. The analysis prescribed by §1.6662-4(d)(3)(ii) for purposes of determining whether substantial authority is present applies for purposes of determining whether the realistic possibility standard is satisfied.” [emphasis added]

D. Reasonable basis (less than 33% - maybe 20% - 25%). The “Reasonable Basis” standard in Reg. §1.6662-3(b)(3) (and also almost copied word-for-word into the proposed changes to Cir 230 §10.34(a)):

“Reasonable basis is a **relatively high standard of tax reporting**, that is, significantly **higher than not frivolous or not patently improper**. The reasonable basis standard is not satisfied by a return position that is merely arguable or that is merely a colorable claim. If a return position is reasonably based on one or more of the authorities set forth in §1.6662-4(d)(3)(iii) (taking into account the relevance and

persuasiveness of the authorities, and subsequent developments), the return position will generally satisfy the reasonable basis standard even though it may not satisfy the substantial authority standard as defined in § 1.6662-4(d)(2). (See §1.6662-4(d)(3)(ii) for rules with respect to relevance, persuasiveness, subsequent developments, and use of a well-reasoned construction of an applicable statutory provision for purposes of the substantial understatement penalty.)” [emphasis added]

- E. Non-Frivolous (maybe 5% - 10% chance of be sustained). Self-defining, see “Frivolous” below.
- F. Frivolous (2% +/- if the IRS and U.S. Tax Court is awake). I would put this at 0%, but you can always sue for a refund in US District Court where I will say with kindness that the judges are less familiar with tax law and less interested than they are unfamiliar. Both Reg. §1.6694-2(c)(2) and the proposed changes to Cir 230 §10.34(a) define frivolous as “patently improper.”
- G. SUMMARY
 - “More Likely Than Not” (50%+)
 - Substantial Authority (less than 50% and more than 33.3%/1 in 3)
 - Realistic Possibility (33.3% - 1 in 3)
 - Reasonable basis (less than 33% - maybe 20% - 25%)
 - Non-Frivolous (maybe 5% - 10%)
 - Frivolous (2% +/-)

II. **The Ground Shifts - Changes in the Law and Regulations.**

- A. §6702 - Frivolous Return Civil Penalty.
 - 1. History. §6702 was first passed in 1982 as a response to “tax protestor” returns being filed (at the time there were approximately 14,000 protestor returns under examination). The maximum penalty was \$500

until it was increased to \$5,000 in 2006 (along with being made applicable to all returns instead of just income tax returns). (Note the 2006 legislation also required that the IRS publish a list of frivolous arguments for which this penalty could be imposed, and the most recent publication is Notice 2008-14.)

2. Application to Preparers. Despite the higher penalty, it remained difficult to assess this penalty on return preparers, except when the preparer was acting as the agent of the taxpayer and the taxpayer had not signed the return (Chief Counsel Advice 200526001).

B. §6694 - Return Preparer Penalty.

1. History. Passed originally as part of the Tax Reform Act of 1976, these penalties have been around for three decades. §6694 was amended as part of the Small Business and Work Opportunity Tax Act of 2007, Title VIII, Subtitle B of U.S. Troop Readiness, Veterans' Care, Katrina Recovery and Iraq Accountability Appropriations and became law as Public Law 110-28 on May 25, 2007 (and then again as to the standard for application by the Tax Extenders and Alternative Minimum Tax Relief Act of 2008, Pub. L. No. 110-343 (2008)).
2. Old §6694.
 - i. Applies only to income tax return preparers.
 - ii. \$250 penalty,
 - a. An undisclosed position if there was not a realistic possibility of success **or**

- b. A disclosed position that is not frivolous.
 - c. Reasonable cause exception if acting in good faith.
 - iii. \$1,000 penalty for willful and reckless conduct,
 - a. Willful attempt to understate the tax liability **or**
 - b. Reckless or intentional disregard of rules and regulations.
 - c. No reasonable cause exception.
- 3. New §6694.
 - i. Applies to all “tax return preparers” (v. only income tax return preparers).
 - ii. Penalty for taking an “unreasonable position” is the greater of \$1,000 or 50% of the income derived from preparing the return.
 - a. A position is an “unreasonable” position if
 - (1) there is not substantial authority for the position (§6694(a)(2)(B) – 2008 version) (this standard was lowered from the 2007 “more likely than not” standard by the 2008 legislation but left the higher standard in place for tax shelters and listed transaction, i.e. the position is unreasonable “. . . unless it is reasonable to believe that the position would more likely than not be sustained on its merits.” §6694(a)(2)(C))

(2) there is at least a reasonable basis for the return position **and** the position is adequately disclosed as described in 6662(d)(2)(B)(ii) (properly completed Form 8275 or 8275R). (Note – The lower standard with disclosure does not apply to tax shelters and listed transactions.

§6694(a)(2)(C))

b. Reasonable cause exception if acting in good faith.

iii. Penalty for willful or reckless conduct, is the greater of \$5,000 or 50% of the income derived from preparing the return.

a. Willful attempt to understate the tax liability **or**

b. Reckless or intentional disregard of rules and regulations.

c. No reasonable cause exception.

4. §6694 Regulations (12/15/2008).

i. How We Got Here - From all accounts, the 2007 changes in §6694 were a surprise to everyone outside of Congress, including the IRS. The passage of this law with an immediate effective date and obvious problems caused some scrambling at the IRS and a series of Notices described as “Transitional Relief.” These included Notices 2007-54, 2008-11, 2008-12, and 2008-13. I list these Notice numbers because, while they were released within the last 18 months, they have already been

almost entirely superseded by proposed and then finalized regulations. Any material you see that is authored after December 15, 2008 (the date the latest regulations under §6694, §6695, and §7701 were finalized) is most likely somewhat outdated.

- ii. Back to “Substantial Authority” with §1.6694-1 (12/15/2008). Notice 2008-13 was a very lengthy attempt by the Treasury to reconcile a higher reporting standard for tax preparers (more likely than not) than for taxpayers (substantial authority). After Congress brought the return preparer standard back to “substantial authority” for tax preparers not reporting a tax shelter or listed transaction, Notice 2008-13 became irrelevant (except for the listings of which tax returns are covered by these new rules – see iv below). The Treasury quickly cut and pasted the new standard into the existing proposed regulations and released them as final in December of 2008.
- iii. “One Preparer per Position” v. “One Preparer per Firm.” With differing standards becoming a non-issue, the Treasury decided to complicate things by deciding that “one preparer per firm” was way too simple and that “one preparer per position” provided a more acceptable level of uncertainty for tax professionals, Reg. §1.6694-1(b)(1). Although the “signing” preparer will “generally” be held responsible for the positions

on the return (§1.6694-1(b)(2)), under these new final regulations there can now be multiple preparers per firm that can be on the hook for multiple separate penalties for a single tax return. In fact, according to the preamble to the regulations under §6694, there can even be multiple penalties per position if there were preparers from different firms on the same position.

- iv. Verification of Information. Reg. §1.6694(e)
 - a. “the tax return preparer generally **may rely in good faith** without verification upon information **furnished by the taxpayer**. A tax return preparer also may **rely in good faith** and without verification upon information and advice **furnished by another advisor, another tax return preparer or other party** (including another advisor or tax return preparer at the tax return preparer's firm). The tax return preparer is **not required to audit**, examine or review books and records, business operations, documents, or other evidence to verify independently information provided by the taxpayer, advisor, other tax return preparer, or other party. The tax return preparer, **however, may not ignore the implications of information furnished to the tax return preparer or actually known by the tax return preparer**. The tax return preparer must make **reasonable inquiries** if the information as furnished appears to be **incorrect or incomplete**. Additionally, some provisions of the Code or regulations require that specific facts and circumstances exist (for example, that the taxpayer maintain specific documents) before a deduction or credit may be claimed. The tax return preparer must **make appropriate inquiries to determine** the existence of facts and circumstances required by a Code section or regulation as a condition of the claiming of a deduction or credit.” [emphasis added]
 - b. “For purposes of section 6694(a) and (b) (including meeting the reasonable to believe that the position would more likely than not be sustained on its merits and reasonable basis standards in §§1.6694-2(b) and (d)(2),

and demonstrating reasonable cause and good faith under Sec. 1.6694-2(e)), a tax return preparer may rely in good faith without verification upon a tax return that has been previously prepared by a taxpayer or another tax return preparer and filed with the IRS.”

- v. Remnants of Notice 2008-13. The surviving applicability of Notice 2008-13 is the listing of tax returns (v. “income” tax returns) to which the penalties can apply (the Exhibits to Notice 2008-13 are attached as Exhibit 1 to this manuscript).
 - a. **Tax returns reporting liability.** Each of the returns in this category is listed in Exhibit 1 to Notice 2008-13 (e.g. Form 1040, Form 1041, Form 709, Form 706).
 - b. **Information returns that report information that becomes a “substantial portion” of another tax return reporting liability.** Each of the returns in this category is listed in Exhibit 2 to Notice 2008-13 (e.g. Form 1065, Form 1120S, Form 5500).
 - c. **Other documents constituting a “substantial portion” of another return.** Explained by example as “a depreciation schedule or cost, expense or income allocation studies, that do not report a tax liability but which will affect an entry or entries on a tax return that does report a tax liability, and that constitute a substantial portion of such tax return.”

d. **Other Documents Not Constituting a Substantial Portion of a Taxpayer's Tax Return Unless Prepared Willfully to Understate Tax or in Reckless or Intentional Disregard of the Rules or Regulations.**

Each of the returns in this category is listed in Exhibit 3 to Notice 2008-13 (e.g. Form 1099, Form 990, Form 1040-ES).

C. §7701(a)(36) - Definition of Tax Return Preparer. §7701(a)(36) is identical to the old version, except that “income tax return preparer” was changed (Public Law 110-28) in the same to “tax return preparer.”

1. §7701(36)(A) states that

“The term “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. For purposes of the preceding sentence, the preparation of a **substantial portion** of a return or claim for refund shall be treated as if it were the preparation of such return or claim for refund.” [emphasis added]

2. Exceptions (§7701(36)(B))

“A person shall not be a ‘tax return preparer’ merely because such person— (i) furnishes typing, reproducing, or other mechanical assistance, (ii) prepares a return or claim for refund of the employer (or of an officer or employee of the employer) by whom he is regularly and continuously employed, (iii) prepares as a fiduciary a return or claim for refund for any person, or (iv) prepares a claim for refund for a taxpayer in response to any notice of deficiency issued to such taxpayer or in response to any waiver of restriction after the commencement of an audit of such taxpayer or another taxpayer if a determination in such audit of such other taxpayer directly or indirectly affects the tax liability of such taxpayer.”

4. §7701 Regulations (§301.7701-15, 12/15/2008).
 - i. Signing and Nonsigning Preparer - The new §7701 regulations officially created two sub-categories of preparers, “signing” and “non-signing.”
 - ii. Signing Preparer – “A signing tax return preparer is the individual tax return preparer who has the primary responsibility for the overall substantive accuracy of the preparation of such return or claim for refund.” Reg. §301.7701-15(a)
 - iii. Nonsigning Preparer.
 - a. “A nonsigning tax return preparer is any tax return preparer who is not a signing tax return preparer but who prepares all or a substantial portion of a return or claim for refund . . . with respect to events that have occurred at the time the advice is rendered.” Reg. §301.7701-15(b)(2)(i)
 - b. Substantial Portion.

“Factors to consider in determining whether a schedule, entry, or other portion of a return or claim for refund is a substantial portion include but are not limited to (A) the size and complexity of the item relative to the taxpayer's gross income; and (B) the size of the understatement attributable to the item compared to the taxpayer's reported tax liability.” Reg. §301.7701-15(b)(3)(i)

There is a de minimis rule for nonsigning preparers:

“if the schedule, entry, or other portion of the return or claim for refund involves amounts of gross income, amounts of deductions, or amounts on the basis of which credits are determined that are (1) Less than \$10,000; or (2) Less than \$400,000 and also less than 20 percent of the gross income as shown on the return or claim for refund (or, for an individual, the individual's adjusted gross income).” Reg. §301.7701-15(b)(3)(ii)

- c. Timing Safe Harbor. A tax professional can only become a nonsigning preparer for advice after the events have occurred. However, if only 5% of total advice was given after the events occurred, then that 5% will not turn the advisor into a nonsigning preparer.

D. §6695 - Tax Return Preparer Signing Requirements. As with §7701(a)(36) the new and old versions of §6695 are identical except that “income tax return preparer” was changed to “tax return preparer.” §6695 and its regulations define and describe the “signing preparer.”

1. While all of §6695 has a certain degree of impact on preparers, it is §6695(b) that has garnered the most attention (the regulations are fairly straight forward and render Notice 2008-12 obsolete).

“Any person who is a tax return preparer with respect to any return or claim for refund, who is required by regulations prescribed by the Secretary to sign such return or claim, and who fails to comply with such regulations with respect to such return or claim shall pay a penalty of \$50 for such failure, unless it is shown that such failure is due to reasonable cause and not due to willful neglect. The maximum penalty imposed under this subsection on any person with respect to documents filed during any calendar year shall not exceed \$25,000.”

2. The “signing preparer” is defined by reference to §301.7701-15(b)(1)

III. **Circular 230 §10.34 - Tax Return Standards**

- A. Authority and Scope . As with all federal regulations, the authority for existence must come from federal law. (For the extremely interested, the authority for Circular 230 is listed in detail in paragraph 1 of Circular 230). Circular 230 governs the practice of attorneys, Certified Public Accountants,

Enrolled Agents, Enrolled Actuaries, Enrolled Retirement Plan Agents, and Appraisers before the Internal Revenue Service.

- B. Practice before the Internal Revenue Service. Not to be tedious but to be sure that no tax professional thinks that Cir 230 does not apply to them because they do not “practice” in front of the IRS, the following is the regulation’s definition: Cir 230 §10.2(4) “*Practice before the Internal Revenue Service* comprehends all matters connected with a presentation to the Internal Revenue Service or any of its officers or employees relating to a taxpayer’s rights, privileges, or liabilities under laws or regulations administered by the Internal Revenue Service. Such presentations include, but are not limited to, preparing and filing documents, corresponding and communicating with the Internal Revenue Service, rendering written advice with respect to any entity, transaction, plan or arrangement, or other plan or arrangement having a potential for tax avoidance or evasion, and representing a client at conferences, hearings and meetings.” [emphasis added]
- C. Recent Changes. Cir 230 has historically tracked the §6694 preparer penalty language. When the new §6694 became law in 2007, there were already Cir 230 §10.34 changes in the works. Prior to these changes §10.34 had four paragraphs: (a) related to the “realistic possibility” standard for signing a return, (b) advising clients of the ability of avoiding penalties with disclosure, (c) reliance on information provided by clients, and (d) definitions. (old §10.34 in its entirety is attached as Exhibit 2) The IRS went ahead and finalized the

changes that were in the works and issued proposed changes to conform Cir 230 to the changes in §6694.

1. Final Changes (new §10.34 from April 2008) in its entirety is attached as Exhibit 3).
 - i. A new paragraph (b) was inserted that expanded the “position” standard to more than just tax returns.
 - ii. Paragraph (b) became paragraph (c) and was broadened to require advice as to penalty avoiding disclosure with regard to any document (not just tax returns).
 - iii. Paragraphs (a) and (e) (old (d)) were “reserved” and new (a) and (e) were proposed to replace them.
2. Proposed Changes.

- i. New paragraph (a), as proposed is:

*“(a)Tax returns. A practitioner may not sign a tax return as a preparer unless the practitioner has a reasonable belief that the tax treatment of each position on the return would **more likely than not** be sustained on its merits (the more likely than not standard), or there is a reasonable basis for each position and each position is adequately disclosed to the Internal Revenue Service. A practitioner may not advise a client to take a position on a tax return, or prepare the portion of a tax return on which a position is taken, unless--*

(1) The practitioner has a reasonable belief that the position satisfies the more likely than not standard; or

(2) The position has a reasonable basis and is adequately disclosed to the Internal Revenue Service.”

As §6694 has been dialed back to “substantial authority,” it is reasonable to assume that when the final paragraph (a) is released the “more likely than not” will be replaced with “substantial authority.”

- ii. New paragraph (e), as proposed is:

“(e) Definitions. For purposes of this section--

(1) More likely than not. A practitioner is considered to have a reasonable belief that the tax treatment of a position is more likely than not the proper tax treatment if the practitioner analyzes the pertinent facts and authorities, and based on that analysis reasonably concludes, in good faith, that there is a greater than fifty-percent likelihood that the tax treatment will be upheld if the IRS challenges it. The authorities described in 26 CFR 1.6662-4(d)(3)(iii), or any successor provision, of the substantial understatement penalty regulations may be taken into account for purposes of this analysis.

(2) Reasonable basis. A position is considered to have a reasonable basis if it is reasonably based on one or more of the authorities described in 26 CFR 1.6662-4(d)(3)(iii), or any successor provision, of the substantial understatement penalty regulations. Reasonable basis is a relatively high standard of tax reporting, that is, significantly higher than not frivolous or not patently improper. The reasonable basis standard is not satisfied by a return position that is merely arguable or that is merely a colorable claim. The possibility that a tax return will not be audited, that an issue will not be raised on audit, or that an issue will be settled may not be taken into account.

(3) Frivolous. A position is frivolous if it is patently improper.”

Other than becoming less important with the return of “substantial authority,” there is nothing incorrect about this proposed paragraph (e) and so it should be finalized as proposed.

IV. **Impact on Tax Planners.** The obvious impact is that both §6694 and Circular 230 can now be applied to the tools of our trade. This should cause some serious pause about the advice we give and how we give it. Are you certain that the IRS will agree there is “substantial authority” for the discount claimed on the Form 709 or Form 706? Are you a non-signing preparer because you gave advice regarding a §355 Spin-Off and then, after the fact, described the transaction for the accountant for proper reporting? Are you a non-signing

preparer because you told the accountant how to report the gift valuation position on the sale of an asset to a grantor trust using a SCIN? Have you prepared the Form 706 without reporting the use of any applicable credit amount, while knowing that the gifts to a deceased client's ILIT were never accompanied by the required crummy/demand notices? In the current climate where tax avoidance is commonly confused by judges and regulatory bureaucrats with tax evasion, it is extremely unsettling to have a host of additional regulatory requirements that dictate our professional practice and add regulatory definitions to our advice to our clients. Is it that big a step from failing to report a prohibited transaction to a conspiracy to defraud the United States (18 U.S.C. 371)? Be careful. Know the rules. Do not be tempted to do something to please a client or avoid a short-term conflict or professional embarrassment when that action can land you in hotter water than a malpractice suit or loss of a client ever will.

Exhibit 1

Exhibits to Notice 2008-13, 2008-3 IRB 282, 01/02/2008, IRC Sec(s). 6694

EXHIBIT 1 — Tax Returns Reporting Tax Liability

Income Tax Returns — Subtitle A

Form 926, Return by a U.S. Transferor of Property to a Foreign Corporation;
Form 990T, Exempt Organization Business Income Tax Return;
Form 1040, U.S. Individual Income Tax Return;
Form 1040A, U.S. Individual Income Tax Return;
Form 1040-EZ, Income Tax Return for Single Filers and Joint Filers With No Dependents;
Form 1040-EZT, Claim for Refund of Federal Telephone Excise Tax;
Form 1040X, Amended U.S. Individual Income Tax Return;
Form 1040-PR (Anexo H-PR), Contribuciones sobre el Empleo de Empleados Domesticos;
Form 1041, U.S. Income Tax Return for Estates and Trusts;
Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons;
Form 1066, U.S. Real Estate Mortgage Investment Conduit (REMIC) Income Tax Return;
Form 1120, U.S. Corporation Income Tax Return;
Form 1120-C, U.S. Income Tax Return for Cooperative Associations;
Form 1120-IC DISC, Interest Charge Domestic International Sales — Corporation Return;
Form 1120-F, U.S. Income Tax Return of a Foreign Corporation;
Form 1120S, U.S. Income Tax Return for an S Corporation;
Form 1120X, Amended U.S. Corporation Income Tax Return;
Form 8831, Excise Taxes on Excess Inclusions of REMIC Residual Interests (I.R.C. § 860E);
and
Form 8924, Excise Tax on Certain Transfers of Qualifying Geothermal or Mineral Interests
(New Form, Exclusion from Capital Gains).

Estate and Gift Tax Returns — Subtitle B

Form 706, U.S. Estate Tax Return;
Form 706-A, United States Additional Estate Tax Return;
Form 706-D, United States Additional Estate Tax Return Under Code Section 2057;
Form 706-GS(D) Generation-Skipping Transfer Tax Return for Distributions;
Form 706-GS(T) Generation-Skipping Transfer Tax Return for Terminations;
Form 706-NA, United States Estate (and Generation-Skipping Transfer) Tax Return — Estate
of nonresident not a citizen of the United States;
Form 706-QDT, United States Estate Tax Return for Qualified Domestic Trusts;
Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return; and
Form 843, Claim For Refund and Request for Abatement (also used to claim refunds for
employment and certain excise tax returns).

Employment Tax Returns — Subtitle C

Form CT-1, Employer's Annual Railroad Retirement Tax Return;
Form CT-2, Employee Representative's Quarterly Railroad Tax Return;
Form 940, Employer's Annual Federal Unemployment Tax Return;
Form 940-PR, Planilla para la Declaración Federal ANUAL del Patrono de la Contribución Federal para el Desempleo (FUTA);
Form 941, Employer's QUARTERLY Federal Tax Return;
Form 941-PR, Planilla para la Declaración Federal TRIMESTRAL del Patrono;
Form 941-SS, Employer's QUARTERLY Federal Tax Return;
Form 941-M, Employer's MONTHLY Federal Tax Return;
Form 943, Employer's Annual Federal Tax Return for Agricultural Employees;
Form 943-PR, Planilla Para la Declaración ANUAL de la Contribución Federal del Patrono De Empleados Agrícolas;
Form 944, Employer's ANNUAL Federal Tax Return;
Form 944-PR, Planilla para la Declaración ANUAL de la Contribución Federal del Patrono;
Form 944(SP), Declaración Federal ANUAL de Impuestos del Patrono o Empleador;
Form 944-SS, Employer's ANNUAL Federal Tax Return;
Form 945, Annual Return of Withheld Federal Income Tax;
Form 1040-SS, U.S. Self-Employment Tax Return.

Miscellaneous Excise Tax Returns — Subtitle D

Form 11-C, Occupational Tax and Registration Return for Wagering;
Form 720, Quarterly Federal Excise Tax Return;
Form 720X, Amended Quarterly Federal Excise Tax Return;
Form 730, Monthly Tax Return for Wagers;
Form 990-PF, Return of Private Foundation or Section 4947(a)(1) Nonexempt Charitable Trust Treated as a Private Foundation (with respect to the excise tax based on investment income);
Form 2290, Heavy Highway Vehicle Use Tax Return;
Form 2290(FR), Declaration d'Impot sur L'utilisation des Vehicules Lourds sur les Routes;
Form 2290(SP), Declaración del Impuesto sobre el Uso de Vehículos Pesados en las Carreteras;
Form 4720, Return of Certain Excise Taxes on Charities and Other Persons Under Chapters 41 and 42 of the Internal Revenue Code;
Form 5330, Return of Excise Taxes Related to Employee Benefit Plans;
Form 8612, Return of Excise Tax on Undistributed Income of Real Estate Investment Trusts;
Form 8613, Return of Excise Tax on Undistributed Income of Regulated Investment Companies; and
Form 8849, Claim for Refund of Excise Taxes.

Alcohol, Tobacco, and Certain Other Excise Taxes — Subtitle E

Form 8725, Excise Tax on Greenmail; and

Form 8876, Excise Tax on Structured Settlement Factoring Transactions.

Exhibit 2 — Information Returns That Report Information That is or May be Reported on Another Tax Return That May Subject a Tax Return Preparer to the Section 6694(a) Penalty if the Information Reported Constitutes a Substantial Portion of the Other Tax Return

Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding;

Form 1065, U.S. Return of Partnership Income (including Schedules K-1);

Form 1120S, U.S. Income Tax Return for an S Corporation (including Schedules K-1);

Form 5500, Annual Return/Report of Employee Benefit Plan;

Form 8038, Information Return for Tax-Exempt Private Activity Bond Issues;

Form 8038-G, Information Return for Government Purpose Tax-Exempt Bond Issues; and

Form 8038-GC, Consolidated Information Return for Small Tax-Exempt Government Bond Issues.

Exhibit 3 — Forms That Would Not Subject a Tax Return Preparer to the Section 6694(a) Penalty Unless Prepared Willfully in any Manner to Understate the Liability of Tax on a Return or Claim for Refund or in Reckless or Intentional Disregard of Rules or Regulations

Form 1099 series of returns;

Form W-2 series of returns;

Form W-8BEN, Beneficial Owner's Certificate of Foreign Status for U.S. Tax Withholding;

Form SS-8, Determination of Worker Status;

Form 990, Return of Organization Exempt from Income Tax;

Form 990-EZ, Short Form Return of Organization Exempt From Income Tax;

Form 990-N, Electronic Notice (e-Postcard) for Tax-Exempt Organizations not Required To File Form 990 or 990-EZ;

Form 1040-ES, Estimated Tax for Individuals;

Form 1120-W, Estimated Tax for Corporations;

Form 2350, Application for Extension of Time to File U.S. Income Tax Return;

Form 2350 (SP), Application for Extension of Time to File U.S. Income tax Return (Spanish Version);

Form 4137, Social Security and Medicare Tax on Unreported Tip Income;

Form 4768, Application for Extension of Time to File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes;

Form 4868, Application for Automatic Extension of Time to File U.S. Individual Income Tax Return;

Form 4868 (SP), Application for Automatic Extension of Time to File U.S. Individual Income Tax Return (Spanish Version);

Form 5558, Application for Extension of Time to File Certain Employee Plan Returns;

Form 7004, Application for Automatic 6-Month Extension of Time To File Certain Business Income Tax, Information, and Other Returns;

Form 8109, Federal Tax Deposit Coupon;

Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips;
Form 8809, Application for Extension of Time to File Information Returns;
Form 8868, Application for Extension of Time To File an Exempt Organization Return;
Form 8892, Application for Automatic Extension of Time to File Form 709 and/or Payment
of Gift/Generation-Skipping Transfer Tax; and
Form 8919, Uncollected Social Security and Medicare Tax on Wages.

Exhibit 2 (§10.34 - 2005 Version)

§ 10.34 Standards for advising with respect to tax return positions and for preparing or signing returns. 2005 Version

(a) Realistic possibility standard. A practitioner may not sign a tax return as a preparer if the practitioner determines that the tax return contains a position that does not have a realistic possibility of being sustained on its merits (the realistic possibility standard) unless the position is not frivolous and is adequately disclosed to the Internal Revenue Service. A practitioner may not advise a client to take a position on a tax return, or prepare the portion of a tax return on which a position is taken, unless-- (1) The practitioner determines that the position satisfies the realistic possibility standard; or (2) The position is not frivolous and the practitioner advises the client of any opportunity to avoid the accuracy-related penalty in section 6662 of the Internal Revenue Code by adequately disclosing the position and of the requirements for adequate disclosure.

(b) Advising clients on potential penalties. A practitioner advising a client to take a position on a tax return, or preparing or signing a tax return as a preparer, must inform the client of the penalties reasonably likely to apply to the client with respect to the position advised, prepared, or reported. The practitioner also must inform the client of any opportunity to avoid any such penalty by disclosure, if relevant, and of the requirements for adequate disclosure. This paragraph (b) applies even if the practitioner is not subject to a penalty with respect to the position.

(c) Relying on information furnished by clients. A practitioner advising a client to take a position on a tax return, or preparing or signing a tax return as a preparer, generally may rely in good faith without verification upon information furnished by the client. The practitioner may not, however, ignore the implications of information furnished to, or actually known by, the practitioner, and must make reasonable inquiries if the information as furnished appears to be incorrect, inconsistent with an important fact or another factual assumption, or incomplete.

(d) Definitions. For purposes of this section-- (1) Realistic possibility. A position is considered to have a realistic possibility of being sustained on its merits if a reasonable and well informed analysis of the law and the facts by a person knowledgeable in the tax law would lead such a person to conclude that the position has approximately a one in three, or greater, likelihood of being sustained on its merits. The authorities described in 26 CFR 1.66624(d)(3)(iii), or any successor provision, of the substantial understatement penalty regulations may be taken into account for purposes of this analysis. The possibility that a tax return will not be audited, that an issue will not be raised on audit, or that an issue will be settled may not be taken into account.

(2) Frivolous. A position is frivolous if it is patently improper.

Exhibit 3 (§10.34 - April 2008 Version)

§ 10.34 Standards with respect to tax returns and documents, affidavits and other papers.

(a) [Reserved]

(b) *Documents, affidavits and other papers* —

1. A practitioner may not advise a client to take a position on a document, affidavit or other paper submitted to the Internal Revenue Service unless the position is not frivolous.
2. A practitioner may not advise a client to submit a document, affidavit or other paper to the Internal Revenue Service —
 - (i) The purpose of which is to delay or impede the administration of the Federal tax laws;
 - (ii) That is frivolous; or
 - (iii) That contains or omits information in a manner that demonstrates an intentional disregard of a rule or regulation unless the practitioner also advises the client to submit a document that evidences a good faith challenge to the rule or regulation.

(c) *Advising clients on potential penalties* —

1. A practitioner must inform a client of any penalties that are reasonably likely to apply to the client with respect to —
 - (i) A position taken on a tax return if —
 - (A) The practitioner advised the client with respect to the position; or
 - (B) The practitioner prepared or signed the tax return; and
 - (ii) Any document, affidavit or other paper submitted to the Internal Revenue Service.
2. The practitioner also must inform the client of any opportunity to avoid any such penalties by disclosure, if relevant, and of the requirements for adequate disclosure.
3. This paragraph (c) applies even if the practitioner is not subject to a penalty under the Internal Revenue Code with respect to the position or with respect to the document, affidavit or other paper submitted.

(d) *Relying on information furnished by clients.* A practitioner advising a client to take a position on a tax return, document, affidavit or other paper submitted to the Internal Revenue Service, or preparing or signing a tax return as a preparer, generally may rely in good faith without verification upon information furnished by the client. The practitioner may not, however, ignore the implications of information furnished to, or actually known by, the practitioner, and must make reasonable inquiries if the information as furnished appears to be incorrect, inconsistent with an important fact or another factual assumption, or incomplete.

(e) [Reserved]

(f) *Effective/applicability date.* Section 10.34 is applicable to tax returns, documents, affidavits, and other papers filed on or after September 26, 2007.