New York State Bar Association

One Elk Street, Albany, New York 12207 • 518/463-3200 • http://www.nysba.org

TAX SECTION

2007-2008 Executive Committee

PATRICK C. GALLAGHER
Chair
Kirkland & Ellis LLP
153 East 53rd Street
New York, NY 10022
212/446-4998
DAVID S. MILLER
First Vice-Chair
212/504-6318
CHARLES MORGAN
Second Vice-Chair
212/735-2470
ERIKA W. NIJENHUIS
Secretary
212/225-2980
COMMITTEE CHAIRS:
Bankruptcy and Operating Losses
Kathleen L. Ferrell
Stuart J. Goldring
Compliance, Practice & Procedure
Elliot Pisem
Bryan C. Skarlatos
Consolidated Returns
Lawrence M. Garrett
David H. Schnabel
Corporations
David R. Sicular
Karen Gilbreath Sowell
Employee Benefits
Andrew L. Oringer
Max J. Schwartz
Estates and Trusts
Carlyn S. McCaffrey
Jeffrey N. Schwartz
Financial Instruments
Michael S. Farber
Stephen B. Land
"Inbound" U.S. Activities of Foreign Taxpayers
William B. Brannan
David R. Hardy
Individuals
Elizabeth T. Kessenides
Sherry S. Kraus
Multistate Tax Issues
Robert E. Brown
Paul R. Comeau
New York City Taxes
Robert J. Levinsohn
Irwin M. Slomka
New York State Franchise and Income Taxes
Maria T. Jones
Arthur R. Rosen
"Outbound" Foreign Activities of U.S. Taxpayers
Peter H. Blessing
Deborah L. Paul
Partnerships
Andrew W. Needham
Joel Scharfstein
Pass-Through Entities
James R. Brown
Marc L. Silberberg
Real Property
Robert Cassanos
Jeffrey Hochberg
Reorganizations
Jodi J. Schwartz
Linda Z. Swartz
Securitizations and Structured Finance
Jiyeon Lee-Lim
W. Kirk Wallace
Tax Accounting
Gary B. Mandel
Yaron Z. Reich
Tax Exempt Bonds
Bruce M. Serchuk
Patti T. Wu
Tax Exempt Entities
Michelle P. Scott
Richard R. Upton
Tax Policy
David W. Mayo
Diana L. Wollman

MEMBERS-AT-LARGE OF EXECUTIVE COMMITTEE

Andrew H. Braiterman, Peter J. Connors, Edward E. Gonzalez, Mary L. Harmon, Charles I. Kingson, Douglas R. McFadyen, William L. McRae, David M. Schizer, Andrew P. Solomon, Andrew Walker, Gordon Warnke, Victor Zonana

December 20, 2007

The Honorable Eric Solomon
Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

The Honorable Linda E. Stiff
Acting Commissioner
Internal Revenue Service
Room 3000 IR
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Re: Report on the Definition of "Tax Return Preparer" and Other Issues Under Code Sections 6694, 6695 and 7701(a)(36)

Dear Assistant Secretary Solomon and Acting Commissioner Stiff:

I am pleased to submit the New York State Bar Association Tax Section Report No. 1139 (the "Report"). The Report responds to the amendments made to the "tax return preparer" rules in Sections 6694, 6695, 6696 and 7701(a)(36)[1] by H.R. 2206 (the "May 2007 amendments") and related issues.[2] While these developments raise numerous issues worthy of being addressed, this Report primarily addresses the specific problems that we believe result from the expansive and vague definition of "income tax return preparer" in the existing Treasury Regulations when considered in the

---

1 All "Section" references are to sections of the Internal Revenue Code of 1986, as amended (the "Code") unless otherwise noted.

2 These changes were contained in §8246 of the U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability Appropriations Act of 2007, Subtitle B Small Business and Work Opportunity Tax Act of 2007 (Pub. L. No. 110-28) ("H.R. 2206").

FORMER CHAIRS OF SECTION:

Samuel Brodsky, Edwin M. Jones, Peter Miller, John E. Morrissey, Jr., Martin D. Ginsburg, Peter L. Faber, Hon. Renato Beghe, Alfred D. Youngwood, Gordon D. Henderson, David Sachs, J. Roger Mentz, Willard B. Taylor, Richard J. Hiegel, Dale S. Collinson, Richard G. Cohen, Donald Schapiro, Herbert L. Camp, William L. Burke, Arthur A. Feder, James M. Peaslee, John A. Corry, Peter C. Canellos, Michael L. Schler, Carolyn Joy Lee, Richard L. Reinhold, Richard O. Loengard, Steven C. Todrys, Harold R. Handler, Robert H. Scarborough, Robert A. Jacobs, Samuel J. Dimon, Andrew N. Berg, Lewis R. Steinberg, David P. Hariton, Kimberly S. Blanchard

context of the May 2007 amendments. The Report discusses several possible regulatory responses to these problems. This Report also identifies various other aspects of the existing Treasury Regulations under Sections 6694, 6695 and 7701(a)(36) that we believe should be clarified or reconsidered in response to the May 2007 amendments. Accompanying this Report is an Appendix which contains a detailed description of (i) the relevant statutory and regulatory rules, (ii) their history, and (iii) other background.

We believe there is an urgent need for regulatory or other administrative guidance on revised Sections 6694, 6695, 6696 and 7701(a)(36), because the May 2007 amendments radically changed these rules. We, like many others, are quite concerned about the difference between the penalty standards that now apply to "preparers" (Section 6694) and those that apply to their taxpayer clients (Sections 6662 and 6664). That is not the focus of this Report, but we do consider this disparity a serious problem.

To organize our discussion, the Report identifies five different types of service providers: the "Classic Preparer," the "Shadow Preparer," the "Pure Advisor," the "Schedule Preparer," and the "Indirect Preparer." All five types of service providers are currently subject to Section 6694.

This Report makes the following recommendations:

1. <u>One preparer per return</u>. We recommend revising the applicable Regulations so that the term "tax return preparer" in Section 7701(a)(36) describes at most one individual (and his or her employer, if any, whether that employer is an entity or an individual sole proprietor) with respect to any single tax return. That one preparer would be the person who the current Section 6695 Regulations (subject to the other changes recommended in the Report) require to sign the return (the "signing preparer"). The concept of "nonsigning preparer" would be removed from the Regulations (and thereby eliminated entirely, since it does not and has never appeared in the Code itself).

2. <u>Pure advisors are not preparers</u>. We recommend revising the Regulations so that the person we call the "Pure Advisor" is never a "tax return preparer." We believe that Congress never intended (in 1976, 1989 or 2007) for Pure Advisors to be subject to Sections 6694 and 6695 and that subjecting them to those rules is inappropriate and unworkable. Pure Advisors are subject to other rules and other bodies of law, including Circular 230, that are more appropriate for regulating their advice-rendering actions. We believe this change should be made whether or not the multiple-preparer concept is retained.

3. <u>Define "pure advisor" as someone who never reviews, drafts or discusses the actual return</u>. A Pure Advisor should be defined for this purpose as someone who never gives advice about how the actual return should be completed and never assists in the preparation or review of any aspect of the return. Those would be "preparation" activities and therefore would make this person potentially a "tax return preparer".

4. <u>Clarify meaning of "substantial portion" and increase minimum threshold</u>. The regulatory definition of what constitutes a "substantial portion" of a tax return should be clarified and the existing minimum thresholds should be increased. This is intended in part to help

practitioners determine when their activities may cause them to be treated as a "tax return preparer."

5. Clarify "reasonable cause and good faith" defense. The existing "reasonable cause and good faith" defense in Treas. Reg. §1.6694-2(d) should be revised to clarify that a preparer's ability to use the defense based upon reliance on a third party's tax advice does not depend on that third party also qualifying as a "preparer."

6. Clarify preparer's ability to rely on factual (non-legal) matters. The extent to which a preparer may rely upon non-legal ("factual") data, such as transfer pricing and valuation information, provided by the taxpayer and other parties should be clarified. There are many reasons for this, one of which is to hopefully lessen somewhat the monetary cost of these new rules on taxpayers who engage third party preparers.

7. Revise Section 6694(a) disclosure requirements for signing preparers and (if applicable) nonsigning preparers. For a signing preparer, so long as the current disparity between the taxpayer penalty standards (Sections 6662 and 6664) and the preparer penalty standards (Section 6694) remains, filing IRS Form 8275 or Form 8275-R with the return should not be the sole means by which the preparer is permitted to satisfy the "disclosure" prong of the Section 6694(a) "reasonable basis plus disclosure" exception. Currently, disclosure is required for a taxpayer to avoid understatement penalties under Section 6662 in much narrower circumstances than those in which disclosure is required for a "tax return preparer" to avoid understatement penalties under Section 6694(a). Therefore, in any situation where disclosure would not be required for the client taxpayer to avoid a Section 6662 penalty, the signing preparer should be able to satisfy the Section 6694(a) disclosure requirement by counseling the taxpayer in writing regarding how the penalty rules applicable to the taxpayer (including the disclosure aspects of those rules) work. In any situation where the taxpayer would still need disclosure to avoid the Section 6662 penalty, the signing preparer should be able to satisfy the Section 6694 disclosure requirement only when the return, as filed, also satisfies the Section 6662 disclosure requirement.

If the concept of "nonsigning preparer" is retained, there should be clear rules for how a nonsigning preparer can satisfy the Section 6694(a) "disclosure" requirement, including when the nonsigning preparer has provided only oral advice. One permissible way should be for the nonsigning preparer to explain to the taxpayer (in writing if the nonsigning preparer gave written advice, and orally if the nonsigning preparer gave only oral advice) how the penalty rules applicable to the taxpayer (including the disclosure aspects of those rules) work. The regulations should provide an example of a specific statement that would suffice for this purpose, and the Report proposes possible language.

8. Clarify what "a reasonable belief" means. Section 6694(a) applies only if "there was not a reasonable belief" of MLTN as to a return position. The Regulations should clarify what this means by explaining (i) whether it is an objective test or a subjective test (based upon what the preparer really believes) and (ii) how a preparer may establish that the reasonable belief test is met.

9. Clarify treatment of a person who prepares an information return.

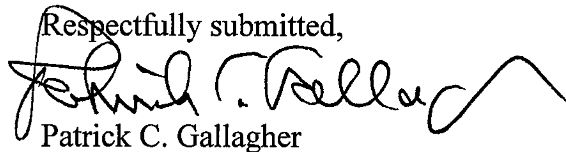
10. Reconsider the "Indirect Preparer" rule. The "Indirect Preparer" rule in Treas. Reg. §301.7701-15(b)(3) is troubling and should be eliminated or at least clarified.

11. Clarify calculation of the Section 6694 monetary penalty.

12. If nonsigning preparers are retained, revise the Section 6695 Regulations so nonsigners are not obligated to perform the Section 6695 actions.

We appreciate your consideration of our comments. Please let us know if you would like to discuss these matters further or if we can assist you in any other way.

Respectfully submitted,



Patrick C. Gallagher
Chair

cc:

Donald L. Korb
Chief Counsel
Internal Revenue Service

Karen Gilbreath Sowell
Deputy Assistant Secretary for Tax Policy
Department of the Treasury

Michael J. Desmond
Tax Legislative Counsel
Department of the Treasury

Anita C. Soucy, Attorney-Advisor
Office of Tax Legislative Counsel
Department of Treasury

Deborah A. Butler
Associate Chief Counsel (Procedure & Administration)
Internal Revenue Service

Michael R. Chesman
Director, Office of Professional Responsibility
Internal Revenue Service

Edward D. Kleinbard
Chief of Staff
Joint Committee on Taxation