



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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SMALL BUSINESS/SELF-EMPLOYED DIVISION

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MEMORANDUM FOR EMPLOYMENT TAX TERRITORY MANAGERS, GROUP
MANAGERS AND SPECIALISTS

FROM: John Tuzynski /s/ *John Tuzynski*
Chief, Employment Tax Operations

SUBJECT: Interim Guidance on Preparer Penalty Procedures for
Employment Tax

The purpose of this memorandum is to issue procedures for employment tax examiners for opening preparer penalty cases and assessing preparer penalties under IRC §§ 6694 and 6695.

Prior to May 25, 2007, preparer penalties under IRC §§ 6694 and 6695 were not applicable to employment tax returns. IRC §§ 6694 and 6695 were applicable only to preparers of income tax returns. The Small Business and Work Opportunity Tax Act (SBWOTA) of 2007 amended IRC §§ 6694 and 6695 to include any tax return preparer. Preparer penalties became applicable to employment tax returns filed on or after May 25, 2007.

IRC § 6694 provides, in part, for penalties against tax return preparers due to an understatement of a taxpayer's liability by a tax return preparer. IRC § 6694(a) applies to an understatement due to unreasonable positions. If a tax return preparer prepares any return or claim for refund with respect to which any part of an understatement of liability is due to an unreasonable position and knew (or reasonably should have known) of the position, the tax return preparer can be subject to a penalty with respect to each return.

IRC § 6694(b) provides for increased penalties where the understatement was due to willful or reckless conduct of the tax return preparer.

IRC § 6695 provides for various other assessable penalties with respect to the preparation of tax returns for other persons.

A preparer penalty case is separate and distinct from the employment tax examination of the preparer's client. A preparer penalty case can be started based on the examination of one client or the result of a preparer project.

The following procedures should be followed for preparer penalty cases based on employment tax examinations:

1. During all field and office examinations, a determination will be made as to whether the facts and circumstances of the examination give rise to the development of a penalty issue. This determination will be made based on oral testimony and/or written evidence obtained during the examination process. Examiners are required to comment on preparer penalties on all cases examined.
2. If a preparer penalty is not appropriate, no further action is required.
3. Examiners will not propose or discuss preparer penalties in the presence of the taxpayer. All information regarding the return preparer's activities and the applicability of any penalties relating to the return preparer should be separated from the taxpayer's case file.
4. Generally, no return preparer penalty will be proposed until the employment tax examination is completed at the group level. If the employment tax case is unagreed, the examiner may pursue the preparer penalty after the unagreed employment tax case is submitted at the group level.
5. Manager approval must be obtained prior to initiating a preparer penalty case.
6. The Return Preparer Coordinator (RPC) should be contacted prior to initiating a preparer penalty case. Employment Tax does not currently have a formal RPC. Until the RPC position is established, the Employment Tax Policy Analyst will be responsible for RPC duties. The RPC can advise the examiner if the Return Preparer is being investigated by Criminal Investigation (CI), the Lead Development Center, or one of the Income Tax Examination Areas. The RPC can also provide coordination if more than one investigation is ongoing or contemplated.
7. Examiners will establish ERCS control using Form 5809, *Preparer Penalty Case Control Card*, as the ERCS Input Document.
8. Examiners must ensure that the statute of limitations for the preparer penalty case has not expired. The statute of limitations on assessment for IRC §§ 6694(a) and 6695 expires three years from the later of the due date of the related (client) return or the date the return was filed. The deemed due date of 4/15 of the subsequent year is used to determine the statute date for all Forms 941 filed in a calendar year. There is no statute of limitations on assessment for IRC §§ 6694(b), 6700, and 6701 penalties. There is no statute of limitations on actions to enjoin preparers or promoters under IRC § 7407 or 7408.
9. The statute of limitations on a return preparer penalty case under IRC §§ 6694(a) and 6695 can be extended using Form 872-D, *Consent to Extend the Time on Assessment of a Tax Return Preparer Penalty*. See Rev. Rul. 78-245. Form 872-D is sent to the Return Preparer via Letter 907P.
10. Examiners will forward, via e-mail, a copy of the Form 5809 (Copy B) prepared to establish the preparer penalty case to the Return Preparer Coordinator at the start of the penalty investigation.
11. The preparer should be afforded an opportunity to meet with the Group Manager to resolve the issues.

12. For “no change” preparer penalty cases,
 - a. The Group Manager will review the investigation file and document concurrence.
 - b. Examiners will prepare Letter 1120, *Preparer Penalty No-Change Case Letter*, mail the original to the preparer and include a copy in the case file.
 - c. Examiners will complete Form 5809 and e-mail a copy to the RPC.
 - d. The group clerk will update ERCS to status 90 and forward the case, closed NO CHANGE, to the RPC for review.

13. For agreed cases,
 - a. The preparer will sign Form 5816.
 - b. Solicit payment from preparer and if the preparer pays, prepare Form 3244-A.
 - c. Secure Form 5838, *Waiver of Restrictions on Assessment and Collection of Tax Return Preparer Penalty*.
 - d. Complete Form 8278, *Computation and Assessment of Miscellaneous Penalties*. When more than one penalty under different IRC sections will be assessed against the same preparer for the same period, complete a separate Form 8278 for each penalty.
 - e. Prepare Letter 1195 and addressed envelope and include in case file.
 - f. Attach Form 3198, *Special Handling Notice*, to each penalty case file, identifying it as a return preparer penalty case in the “Other” section and referencing the applicable IRC section.
 - g. If the preparer filed a joint income tax return, annotate with either “Assess on Primary SSN” or “Assess on Secondary SSN” in the ‘Other’ Section to identify the individual against whom the penalty is to be asserted.
 - h. Annotate to forward investigation file to the RPC.
 - i. The group clerk will update the return preparer case on ERCS to status 41 and use Form 3210 to mail the case to the RPC.

14. For unagreed cases the examiner will provide the preparer with:
 - a. Letter 1125 *Preparer Penalty 30-Day Letter*,
 - b. Form 5816 *Report of Tax Return Preparer Penalty* with the bottom part of the form removed;
 - c. Form 886A *Explanation of Items* [equivalent form may be used];
 - d. Form 5838 *Waiver of Restrictions on Assessment and Collection of Tax Return Preparer Penalty*
 - e. Pub 1, Pub 5 and Pub 594.
 - f. The case then goes into suspense for 30 days, during which time the preparer may agree or protest.

15. If the preparer submits a pre-assessment protest (written) within 30 days,

- a. The investigation file will be reviewed for (1) adequacy of the protest; (2) development of the issue(s); and (3) managerial involvement.
 - b. The examiner will prepare an assessment document Form 8278, *Computation and Assessment of Miscellaneous Penalties*. When more than one penalty under different IRC sections will be assessed against the same preparer for the same period, complete a separate Form 8278 for each penalty.
 - c. Complete Form 5809 and include in case file for RPC.
 - d. The group clerk will then update ERCS to Status 41 and forward the case, UNAGREED, to the RPC for review. After review, the RPC will update ERCS to Status 21 and forward the case to Technical Services to be sent to Appeals.
16. An unagreed Return Preparer Penalty Case file cannot be submitted to Appeals for pre-assessment consideration if there is less than 180 days remaining on the assessment statute of limitations. If there is less than 180 days remaining on the statute of limitations, examiners must follow prompt assessment procedures.
17. The Office of Professional Responsibility exercises jurisdiction over Attorneys, CPAs, Enrolled Agents, Enrolled Actuaries, Enrolled Retirement Plan Agents and Appraisers. Examiners should exercise discretion in making referrals of specific cases. In matters involving non-willful conduct, a referral should only be made when it can be established that the preparer has a pattern of failing to meet the required standards of Circular 230. An isolated instance in which a penalty may apply should not, in and of itself, require a referral unless willful conduct is involved. Accordingly, the imposition of penalties under IRC § 6694(a), and IRC § 6695(a) through (e) should not automatically generate a referral to the director of the OPR. For a further discussion regarding referral criteria, see IRM 4.11.55.4.2.2. When making a referral to OPR, examiners will:
- a. Prepare Form 8484, *Report of Suspected Practitioner Misconduct*, and obtain signature approval of their manager.
 - b. Send the completed Form 8484 to the Return Preparer Coordinator for routing to the Director, Office of Professional Responsibility.

Effect on Other Documents: This Interim Guidance Memorandum will be incorporated in a new IRM chapter, Preparer Penalty Guidance for Employment Tax:

- IRM 4.23.17

The above guidance is effective immediately. If you have any questions, please contact Ed Hutzmann, Senior Policy Analyst, SB/SE Employment Tax, Specialty Programs.

cc: www.irs.gov