

[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-140280-09]

RIN 1545-BK16

Tax Return Preparer Penalties Under Section 6695

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations that would modify existing regulations related to the tax return preparer penalties under section 6695 of the Internal Revenue Code (Code). These proposed regulations are necessary to monitor and to improve compliance with the tax return preparer due diligence requirements of section 6695(g). The proposed regulations affect tax return preparers. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by November 10, 2011. Outlines of topics to be discussed at the public hearing scheduled for November 7, 2011, must be received by November 1, 2011.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-140280-09), room 5205, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-140280-09), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC, or sent electronically via the Federal eRulemaking Portal at <http://www.regulations.gov/Regs> (IRS REG-140280-09). The public hearing will be held in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Spence Hanemann, (202) 622-4940; concerning submissions of comments, the hearing, or to be placed on the building access list to attend the hearing, Richard Hurst, (202) 622-7180 (not toll-free numbers) or [richard.a.hurst@irscounsel.treas.gov](mailto:richard.a.hurst@irscounsel.treas.gov).

SUPPLEMENTARY INFORMATION:

**Paperwork Reduction Act**

The collection of information contained in these proposed regulations was previously reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d))

under control number 1545-1570. Comments on the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, D.C. 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, D.C. 20224. Comments on the collection of information should be received by November 10, 2011. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the IRS, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proper collection of information;

How the quality, utility, and clarity of the information to be collected may be enhanced; and

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology.

The collection of information is in §1.6695-2(b)(1) and (b)(4) of these proposed regulations, and is an increase in the total annual burden from the burden in the

current regulations. The collection of this information will improve the IRS' ability to enforce compliance with the due diligence requirements under section 6695(g) with respect to determining eligibility for, or the amount of, the earned income credit (EIC) under section 32.

Currently, the IRS estimates that there are 550,000 persons who are tax return preparers with respect to determining the eligibility for, or the amount of, EIC.

This collection of information is mandatory. The likely respondents are individuals and businesses.

Estimated total annual recordkeeping and reporting burden is 3,025,000 hours.

Estimated annual burden per tax return preparer varies from 30 minutes to 10 hours, depending on individual circumstances, with an estimated average of 5 hours and 30 minutes.

Estimated number of affected practitioners is 550,000.

Estimated annual frequency of responses is one time per tax return or claim for refund on which EIC is reported.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law.

### **Background**

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) under section 6695 of the Code.

The Treasury Department and the IRS published final regulations in the **Federal Register** on December 22, 2008, as TD 9436, 73 FR 78430 (the December 2008 final regulations). The December 2008 final regulations were a product of a comprehensive review and overhaul of the regulations related to tax return preparer penalties, including those under section 6695. These proposed regulations introduce additional measures intended to improve compliance with the tax return preparer EIC due diligence requirements of section 6695(g).

### **Explanation of Provisions**

The following is a summary of the proposed changes to the existing regulations affecting tax return preparers.

#### Tax Return Preparers Subject to Due Diligence Requirements

Section 301.7701-15(a) of the Procedure and Administration regulations defines a "tax return preparer" as "any person who prepares for compensation, or who employs one or more persons to prepare for compensation, all or a substantial portion of any return of tax or any claim for refund of tax . . . ." Proposed §1.6695-2(a) changes "signing tax return preparer" to "tax return preparer." Consequently, under the proposed regulations, all tax return preparers (whether an individual or firm) who determine eligibility for, or amount of, EIC under section 32 of the Code and who fail to satisfy the due diligence requirements of paragraph (b) of these proposed regulations are subject to the penalty under section 6695(g). Under the proposed regulations, a firm that employs a person to prepare for compensation a tax return or claim for refund may be subject to the penalty for its employee's failure to comply with the due diligence requirements.

Because a firm might not have direct knowledge of an employee's failure to comply with the due diligence requirements, however, proposed §1.6695-2(c) provides additional requirements that must be met before the penalty will be imposed on a firm. Proposed §1.6695-2(c)(1) provides that a firm will be subject to the penalty if a

member of its principal management or the principal management of a branch office participated in or knew of the failure to comply with the due diligence requirements. Proposed §1.6695-2(c)(2) also provides that a firm will be subject to the penalty if it failed to establish reasonable and appropriate procedures to ensure compliance with the due diligence requirements. Finally, proposed §1.6695-2(c)(2) provides that, even if a firm has established reasonable and appropriate compliance procedures, it will be subject to the penalty if it disregarded its compliance procedures through willfulness, recklessness, or gross indifference in the preparation of the tax return or claim for refund for which the penalty is imposed. A firm has demonstrated gross indifference if it ignores facts that would lead a person of reasonable prudence and competence to investigate or ascertain whether an employee is complying with the due diligence requirements.

#### Submission of Form 8867

Current §1.6695-2(b)(1) requires a tax return preparer to complete Form 8867, "Paid Preparer's Earned Income Credit Checklist," or otherwise record the information required by Form 8867 in the tax return preparer's files. In response to concerns over improper payments of EIC determined by tax return preparers, the Department of the

Treasury and the IRS are proposing to require tax return preparers to submit the Form 8867 with the tax return or claim for refund claiming the EIC.

Proposed §1.6695-2(b)(1)(i), therefore, requires that the Form 8867 be submitted to the IRS in the manner required by forms, instructions, or other appropriate guidance. Comments are specifically requested regarding the best way for the Department of Treasury and the IRS to implement this submission requirement. Comments are also requested regarding how Form 8867 and Schedule EIC might be revised to reduce payments of improper EIC claims and to improve the IRS' ability to detect these claims.

A tax return preparer has satisfied the due diligence requirements of current §1.6695-2(b)(1) if the tax return preparer records, in paper or electronic files, the information necessary to complete Form 8867. Under proposed §1.6695-2(b)(1), the due diligence requirements of paragraph (b)(1) can only be satisfied by completion and submission of the Form 8867 (or its successor form) and, therefore, cannot be satisfied by submission of any other form or document.

#### Computation of Credit

The amendments in proposed §1.6695-2(b)(2) are not substantive. The term "tax return preparer" has been



substituted for the term "preparer." Under the proposed regulations, tax return preparers would continue to complete the EIC Worksheet in the Form 1040 Instructions or any other form prescribed by the IRS, or otherwise record in paper or electronic files their EIC computation, including the method and information used to make the computation. To improve clarity, however, the defined terms "Computation Worksheet" and "Alternative Computation Record" have been replaced throughout the proposed regulation with descriptive language.

#### Retention of Records

Under proposed §1.6695-2(b)(4)(i)(C), tax return preparers must still retain a record of how and when the information used to complete Form 8867 and the EIC Worksheet (or other record of the tax return preparer's EIC computation permitted under §1.6695-2(b)(2)(i)(B)) was obtained. Additionally, a tax return preparer must also retain a copy of any document that was provided by the taxpayer and on which the tax return preparer relied to complete Form 8867 or the EIC Worksheet (or other record of the tax return preparer's EIC computation permitted under §1.6695-2(b)(2)(i)(B)).

Proposed §1.6695-2(b)(4)(ii) makes two changes. It substitutes "paragraph (b)(4)(i)" for "paragraph (b)(4)" in

order to account for prior restructuring of paragraph (b)(4). It also changes the date through which tax return preparers must retain the records required by this section. The current retention date is three years after the June 30th following the date the return or claim for refund was presented to the taxpayer for signature. The proposed retention date is three years from the later of the due date of the return (determined without regard to any extension of time for filing) or the date the return or claim for refund was filed. This revision to the retention date will simplify the determination of the retention date for both the IRS and tax return preparers.

#### Exception to the Penalty Under Section 6695(g)

Proposed §1.6695-2(d) retains the existing exception to the penalty, but excludes from the exception a firm that is subject to the penalty under the special rules for firms in proposed §1.6695-2(c). Thus, in no case could a firm that is subject to the penalty under proposed §1.6695-2(c) satisfy the facts and circumstances test provided in proposed §1.6695-2(d).

#### Proposed Effective and Applicability Dates

Proposed §1.6695-2(e) provides that the rules in this notice of proposed rulemaking will apply to tax returns and claims for refund for tax years ending on or after December

31, 2011 that are filed after the date the final regulations are published in the **Federal Register**.

### **Special Analyses**

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations.

When an agency issues a rulemaking proposal, the Regulatory Flexibility Act (RFA) (5 U.S.C. chapter 6), requires the agency to "prepare and make available for public comment an initial regulatory flexibility analysis" that will "describe the impact of the proposed rule on small entities." (5 U.S.C. 603(a)). Section 605 of the RFA provides an exception to this requirement if the agency certifies that the proposed rulemaking will not have a significant economic impact on a substantial number of small entities.

The proposed rules affect tax return preparers who determine the eligibility for, or the amount of, EIC. The NAICS code that relates to tax preparation services (NAICS code 541213) is the appropriate code for tax return

preparers subject to this notice of proposed rulemaking. Entities identified as tax preparation services are considered small under the Small Business Administration size standards (13 CFR 121.201) if their annual revenue is less than \$7 million. The IRS estimates that approximately 75 to 85 percent of the 550,000 persons who work at firms or are self-employed tax return preparers are operating as or employed by small entities. The IRS has determined that these proposed rules will have an impact on a substantial number of small entities.

The IRS has determined, however, that the impact on entities affected by the proposed rule will not be significant. The current regulations under section 6695(g) already require tax return preparers to complete the Form 8867 or otherwise record in their files the information necessary to complete the form. Tax return preparers also must currently maintain records of the checklists and EIC computations, as well as a record of how and when the information used to compute the EIC was obtained by the tax return preparer. The amount of time necessary to submit, record, and retain the additional information required in these proposed regulations, therefore, should be minimal for these tax return preparers.

Based on these facts, the IRS hereby certifies that the collection of information contained in this notice of proposed rulemaking will not have a significant economic impact on a substantial number of small entities. Accordingly, a Regulatory Flexibility Analysis is not required.

Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on the impact on small business.

#### **Comments and Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The Treasury Department and the IRS request comments on the clarity of the proposed regulations and how they can be made easier to understand. All comments will be available for public inspection and copying at [www.regulations.gov](http://www.regulations.gov) or upon request.

A public hearing has been scheduled for November 7, 2011, at 10:00 A.M. in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at

the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "**FOR FURTHER INFORMATION CONTACT**" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments and an outline of the topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) by November 1, 2011. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

#### **Drafting Information**

The principal author of these proposed regulations is Spence Hanemann, Office of the Associate Chief Counsel (Procedure and Administration).

#### **List of Subjects in 26 CFR Part 1**

Income taxes, Reporting and recordkeeping requirements.

**Proposed Amendments to the Regulations**

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

**PART 1--INCOME TAXES**

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Section 1.6695-2 also issued under 26 U.S.C. 6695(g).  
\* \* \*

Par. 2. In §1.6695-2, paragraphs (a), (b)(1), (b)(2), (b)(4), (c), and (d) are revised and new paragraph (e) is added to read as follows:

§1.6695-2 Tax return preparer due diligence requirements for determining earned income credit eligibility.

(a) Penalty for failure to meet due diligence requirements. A person who is a tax return preparer of a tax return or claim for refund under the Internal Revenue Code with respect to determining the eligibility for, or the amount of, the earned income credit (EIC) under section 32 and who fails to satisfy the due diligence requirements of paragraph (b) of this section will be subject to a penalty of \$100 for each such failure.

(b) \* \* \*

(1) Completion and submission of Form 8867--(i) The tax return preparer must complete Form 8867, "Paid Preparer's Earned Income Credit Checklist," or such other form and such other information as may be prescribed by the Internal Revenue Service (IRS), and submit it in the manner required by forms, instructions, or other appropriate guidance.

(ii) The tax return preparer's completion of Form 8867 (or successor form) must be based on information provided by the taxpayer to the tax return preparer or otherwise reasonably obtained by the tax return preparer.

(2) Computation of credit--(i) The tax return preparer must either--

(A) Complete the Earned Income Credit Worksheet in the Form 1040 instructions or such other form and such other information as may be prescribed by the IRS; or

(B) Otherwise record in one or more documents in the tax return preparer's paper or electronic files the tax return preparer's EIC computation, including the method and information used to make the computation.

(ii) The tax return preparer's completion of the Earned Income Credit Worksheet (or other record of the tax return preparer's EIC computation permitted under paragraph



(b)(2)(i)(B) of this section) must be based on information provided by the taxpayer to the tax return preparer or otherwise reasonably obtained by the tax return preparer.

\* \* \* \* \*

(4) Retention of records--(i) The tax return preparer must retain--

(A) A copy of the completed Form 8867 (or successor form);

(B) A copy of the completed Earned Income Credit Worksheet (or other record of the tax return preparer's EIC computation permitted under paragraph (b)(2)(i)(B) of this section); and

(C) A record of how and when the information used to complete Form 8867 (or successor form) and the Earned Income Credit Worksheet (or other record of the tax return preparer's EIC computation permitted under paragraph (b)(2)(i)(B) of this section) was obtained by the tax return preparer, including the identity of any person furnishing the information, as well as a copy of any document that was provided by the taxpayer and on which the tax return preparer relied to complete Form 8867 (or successor form) or the Earned Income Credit Worksheet (or other record of the tax return preparer's EIC computation permitted under paragraph (b)(2)(i)(B) of this section).

(ii) The items in paragraph (b)(4)(i) of this section must be retained for three years from the due date of the return (determined without regard to any extension of time for filing) or the date the return or claim for refund was filed, whichever date is later, and may be retained on paper or electronically in the manner prescribed in applicable regulations, revenue rulings, revenue procedures, or other appropriate guidance (see §601.601(d)(2) of this chapter).

(c) Special rule for firms. 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 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 or ascertain) in the preparation

of the tax return or claim for refund with respect to which the penalty is imposed.

(d) Exception to penalty. The section 6695(g) penalty will not be applied with respect to a particular tax return or claim for refund if the tax return preparer can demonstrate to the satisfaction of the Internal Revenue Service that, considering all the facts and circumstances, the tax return preparer's normal office procedures are reasonably designed and routinely followed to ensure compliance with the due diligence requirements of paragraph (b) of this section, and the failure to meet the due diligence requirements of paragraph (b) of this section with respect to the particular return or claim for refund was isolated and inadvertent. The preceding sentence does not apply to a firm that is subject to the penalty as a result of paragraph (c) of this section.

(e) Effective/applicability date. This section is effective for tax returns and claims for refund filed after the date that these regulations are published as final regulations in the **Federal Register**, and applies to tax returns and claims for refund for tax years ending on or after December 31, 2011.

Steven T. Miller  
Deputy Commissioner for Services and Enforcement.