Penalties Against Tax Professionals: Investigations of Tax Return Preparers, Promoters, and Appraisers

The ABA Section of Taxation’s 2020 Midyear Meeting
Presented at the Boca Raton Resort and Club
Saturday, February 1, 2020

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I. Introduction

Penalties against paid return preparers and promoters of tax avoidance transactions are an important part of the Service’s enforcement strategy. Most tax professionals make a good faith effort to follow, and help their clients comply with, the law. However, abusive tax professionals undeniably exist, preying on taxpayers and threatening the American system of voluntary tax compliance. Abusive tax professionals can face a litany of civil and criminal penalties, including monetary sanctions, censure, revocation of electronic filing privileges, suspension or disbarment from practice before the Internal Revenue Service (”Service” or “IRS”), enjoinder from providing tax preparation or advisory services, and criminal prosecutions.

The Service’s oversight of tax professionals has historically been lacking. But, recent evidence suggests that this trend of non-enforcement may soon be changing. In July 2018, the Treasury Inspector General for Tax Administration (“TIGTA”) criticized the Service for lacking a coordinated strategy to address tax return preparer misconduct.2 In response to TIGTA’s criticisms, the Service implemented educational, civil, and criminal enforcement actions across all Service functions to encourage Service employees to impose penalties against tax professionals in appropriate cases.3 Indeed, in connection with the Service’s recent enforcement initiatives against syndicated conservation easements, micro-captive insurance companies, and abusive international tax avoidance schemes, revenue agents are asserting tax return preparer and promoter penalties with increased frequency. The Tax Division of the U.S. Department of Justice (“DOJ-Tax”), for its part, continues to seek injunctions against unscrupulous tax professionals in appropriate cases. It is against this background that tax professionals should be mindful of the civil and criminal penalties that may be imposed against tax return preparers, promoters of abusive tax schemes, and appraisers.

1 This article was authored by Lawrence A. Sannicandro, Esq. The views herein are his own and do not necessarily reflect the position of any of the other panelists or the organizations with which they are affiliated.


3 Id. at p. 40.
This article examines the tools the Service can use to hold tax return preparers and promoters accountable, available defenses, and the Service’s approach to investigating, imposing, and collecting penalties against abusive tax professionals. Part II of this article examines the penalties that may be imposed against tax return preparers, and available defenses, including: penalties under Code Section 6694 of the Internal Revenue Code (“Code” or “I.R.C.”) for causing an understatement of tax due to an unreasonable position or willful or reckless conduct; penalties under Code Section 6695 for failing to provide taxpayers with required information or take deliberate care in preparing tax returns or claims for refund; the penalty under Code Section 6701 for aiding and abetting an understatement of tax liability (as a tax return preparer); and actions to enjoin preparers under Code Sections 7402 and 7407 from the continued preparation of tax returns. Part III of this article surveys the penalties that may be imposed against promoters of abusive tax schemes, and available defenses, including: the penalty under Code Section 6700 for promoting abusive tax avoidance transactions; the penalty under Code Section 6701 for aiding and abetting an understatement of tax liability (as an advisor); and actions to enjoin promoters under Code Sections 7402 and 7408 from continuing to advise with respect to tax shelters and reportable transactions. Part IV of this article reviews penalties that specifically apply to appraisers. Part V of this article examines the information gathering and assessment process relative to tax return preparer, promoter, and appraiser penalties.

II. Paid Tax Return Preparer Penalties and Defenses

Numerous civil tax penalties may be imposed against a paid tax return preparer. In addition, the Service may seek to enjoin a tax return preparer from the continued preparation of tax returns. The penalties and actions to enjoin that may be imposed against tax return preparers include:

- The penalties under Code Section 6694(a) and (b), which generally may be imposed when a tax return preparer causes an understatement of a taxpayer’s tax liability due to an unreasonable position or willful or reckless conduct;

- The penalties under Code Section 6695(a) through (g), which generally may be imposed when a tax return preparer: fails to furnish a copy of a tax return or claim for refund to the taxpayer; fails to sign a tax return or claim for refund which he is required by Treasury Regulations to sign; fails to provide certain identifying information; fails to retain a copy or list of tax returns and claims for refund prepared; fails to file correct information statements; negotiates a check for taxes issued to a taxpayer; fails to be diligent with respect to determining a taxpayer’s eligibility to use the head of household filing status or to claim the earned income credit;

- The penalty under Code Section 6701 penalty, which generally may be imposed when a tax return preparer aids and abets an understatement of tax liability;

- An action to enjoin a tax return preparer from the continued preparation of tax returns under Code Section 7407; and
A referral to the Service’s Office of Professional Responsibility (the “IRS-OPR”) for sanctions, including a public reprimand (i.e., a censure), suspension or disbarment from continuing to practice before the Service, and a monetary penalty.\textsuperscript{4}

Revenue agents are instructed to make a determination in every audit as to whether a tax return preparer penalty should be imposed.\textsuperscript{5} The determination concerning the imposition of a paid tax return preparer penalty should be based on all the facts and circumstances of the case, including oral testimony and written evidence developed during the examination process.\textsuperscript{6} The procedures the Service follows once a revenue agent determines that a paid tax return preparer penalty should be imposed are discussed \textit{infra} at Part V.

Empirical evidence supports the fact that the Service has not historically enforced paid tax return preparer penalties. For example, during the Service’s 2016 fiscal year, the Service investigated only 140 of 950 misconduct referrals, representing an investigation rate of less than 15\%.\textsuperscript{7} In addition, only approximately 15\% of paid tax return preparer penalties that have historically been assessed were ever collected.\textsuperscript{8} Notwithstanding the historical trend of noncompliance, as noted, the Service’s response to TIGTA’s July 2018 report supports the expectation that paid tax return preparer penalties will play an increasingly important role to ensure tax compliance.\textsuperscript{9}

A. Paid Tax Return Preparer Penalties Under Code Section 6694 and Defenses

The Internal Revenue Code (“Code”) authorizes the Service to impose a penalty on a tax return preparer who prepares a tax return (including an amended tax return) or a claim for refund which contains an unreasonable position that results in an understatement of a taxpayer’s tax liability and either (1) the position was properly disclosed, but there was no reasonable basis for the position, or (2) the position was not properly disclosed and there was not substantial authority

\textsuperscript{4} Paid tax return preparers may also be subject to penalties under Code Section 6713 for the unauthorized disclosure of information furnished in connection with preparing a tax return or for the unauthorized use of a taxpayer’s information for a purpose other than to prepare or assist in preparing the taxpayer’s tax return.


\textsuperscript{6} \textit{Id}.

\textsuperscript{7} TIGTA, \textit{The Internal Revenue Service Lacks a Coordinated Strategy to Address Unregulated Return Preparer Misconduct}, Ref. No. 2018-30-042, p. 11 (July 25, 2018).

\textsuperscript{8} \textit{Id}, at p. 15.

\textsuperscript{9} The Service may impose penalties against material advisors under Code Section 6707 for the failure to furnish information regarding certain reportable transactions and Code Section 6708 for the failure to maintain a list of advisees with respect to a reportable transaction. This article does not address the penalties which may be imposed against, or the tax compliance requirements of, material advisors.
for the position.\textsuperscript{10} A position will be deemed to have been adequately disclosed only if the taxpayer provides the required information on Form 8275, \textit{Disclosure Statement}, Form 8275-R, \textit{Regulation Disclosure Statement}, or (for corporate taxpayers) on Schedule UTP, \textit{Uncertain Tax Position Statement}.\textsuperscript{11} Substantial authority for a position exists where the weight of the authorities supporting the treatment is substantial in relation to the weight of the authorities in support of contrary treatment.\textsuperscript{12} Reasonable basis for a position exists where the position is reasonably based on one or more primary sources of law.\textsuperscript{13}

In the case of an unreasonable position, the amount of the penalty with respect to each return or claim for refund is equal to the greater of $1,000 or 50\% of the income the preparer derives from the return or the claim for refund.\textsuperscript{14} In the case of willful or reckless conduct, the amount of the penalty with respect to each return or claim for refund is equal to the greater of (1) $5,000 or (2) 50\% of the income the preparer derived from the return or claim for refund.\textsuperscript{15}

1. \textbf{Tax Return Preparer Defined}

For purposes of Code Section 6694, the term “tax return preparer” is broadly defined to mean any person who prepares for compensation, or who employs one or more persons to prepare for compensation, all or a substantial portion of any tax return or claim for refund of tax under the Code.\textsuperscript{16} Tax return preparers are generally of two varieties: signing tax return preparers and nonsigning tax return preparers.\textsuperscript{17} 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 the return or the claim for refund.\textsuperscript{18} A nonsigning tax return preparer is any tax

\footnotesize{\textsuperscript{10} I.R.C. \textsection 6694(a)(1), (2)(A) and (B); see also I.R.M., pt. 20.1.6.4.6(2) (Aug. 29, 2019).}

\footnotesize{\textsuperscript{11} See I.R.M., pt. 20.1.6.4.9.1(2) (Aug. 29, 2019).}

\footnotesize{\textsuperscript{12} See Treas. Reg. \textsection 1.6662-4(d)(3)(i).}

\footnotesize{\textsuperscript{13} See Treas. Reg. \textsection 1.6662-3(b)(3).}

\footnotesize{\textsuperscript{14} I.R.C. \textsection 6694(a).}

\footnotesize{\textsuperscript{15} I.R.C. \textsection 6694 (b). A preparer is considered to have recklessly or intentionally disregarded a rule or regulation if the preparer takes a position on the return or the claim for refund that is contrary to a rule or and the preparer knows of, or is reckless in not knowing of, the rule or regulation in question. I.R.M., pt. 20.1.6.4.13.1 (Aug. 29, 2019).}

\footnotesize{\textsuperscript{16} I.R.C. \textsection 7701(a)(36)(A). The definition of a “tax return preparer” was significantly expanded in the Small Business Work Opportunity Tax Act of 2007, Title VIII-B of Pub. L. No. 110-28, \textsection 8246, 121 Stat. 190 (May 25, 2007) (codified as amended at Code Section 7701(a)(36)). In Rev. Proc. 2009-11, \textsection 3, 2009-3 I.R.B. 313, the Service identified the following categories of returns to which the paid tax return preparer penalty under Code Section 6694 applies: (a) income tax returns; (b) estate, gift, and generation skipping transfer tax returns; (c) employment tax returns; and (d) miscellaneous excise tax returns.}

\footnotesize{\textsuperscript{17} Treas. Reg. \textsection 301.7701-15(b). For periods prior to May 26, 2007, the term “tax return preparer” is limited to income tax return preparers. See I.R.M., pt. 20.1.6.4.2(2) (Aug. 29, 2019).}

\footnotesize{\textsuperscript{18} Treas. Reg. \textsection 301.7701-15(b)(1).}
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.\textsuperscript{19} The definition of a paid return preparer is broad, and may include signing and nonsigning certified public accountants, enrolled agents, attorneys, and appraisers, among other tax professionals.

The conduct of appraisers is routinely scrutinized in tax cases where valuation is at issue. Treasury Regulations expressly provide that an appraiser may be subject to penalties under Code Section 6694 as a nonsigning tax return preparer if the appraisal is a substantial portion of the return or claim for refund and the applicable standards of care under Code Section 6694 have been breached.\textsuperscript{20} Significantly, a single tax entry may constitute a substantial portion of a tax return or the claim for refund.\textsuperscript{21} Whether a schedule, entry, or other portion of a return or claim for refund is a substantial portion of the return or the claim for refund is determined on the basis of whether the person knows or reasonably should know that the tax attributable to the schedule, entry, or other portion of a return or claim for refund is a substantial portion of the tax required to be shown on a return.\textsuperscript{22}

2. \textit{De Minimis Exception}

Treasury Regulations provide a de minimis exception that prevents a nonsigning tax return preparer’s work from being a substantial portion of the return if “the amounts of gross income, amounts of deductions, or amounts on the basis of which credits are determined are (1) less than $10,000, or (2) less than $400,000 if the items are also less than 20% of the taxpayer’s gross income.”\textsuperscript{23} In applying the de minimis rule, all schedules, entries, and other items on the return or claim for refund are aggregated.\textsuperscript{24}

\textsuperscript{19} Treas. Reg. § 301.7701-15(b)(2).
\textsuperscript{20} T.D. 9436, 73 Fed. Reg. 78430 (Preamble).
\textsuperscript{21} Treas. Reg. § 301.7701-15(b)(3)(i).
\textsuperscript{22} Treas. Reg. § 301.7701-15(b)(3).
\textsuperscript{24} Treas. Reg. § 301.7701-15(b)(3)(ii)(B).
3. **Defenses**

There are three key substantive defenses to negate the imposition of a paid preparer penalty under Code Section 6694. First, if the position was adequately disclosed, the preparer might assert that there was a “reasonable basis” for the position taken.\(^{25}\) Second, even if the position was not adequately disclosed, the preparer might assert that there was “substantial authority” for the position taken.\(^{26}\) Third, the preparer might assert that there was reasonable cause for the understatement of tax and that the preparer acted in good faith.\(^{27}\) The following factors should be considered when determining whether reasonable cause existed for the understatement of tax:

- The nature of the error causing the understatement (i.e., whether the error resulted from a complex, uncommon, or highly technical provision for which a competent paid preparer could have reasonably made the error);
- The frequency of errors (i.e., whether the understatement was the result of an isolated error such as an inadvertent mathematical or clerical error or whether the understatement was the result of numerous errors);
- The materiality of the errors (i.e., whether the understatement was not material in relation to the correct tax liability);
- The tax return preparer’s normal office practice (i.e., whether the tax return preparer’s normal office practice indicates that the error in question would occur rarely and the normal office practice was followed in preparing the return or the claim for refund);
- The reliance in good faith on the advice of information or schedules provided by the taxpayer, another adviser, another tax return preparer, or another party; and
- The reliance on generally accepted administrative or industry practice.\(^{28}\)

\(^{25}\) I.R.C. § 6694(a)(1), (2)(A); see also I.R.M., pt. 20.1.6.4.6(2) (Aug. 29, 2019).

\(^{26}\) I.R.C. § 6694(a)(1), (2)(B); see also I.R.M., pt. 20.1.6.4.6(2) (Aug. 29, 2019).

\(^{27}\) I.R.C. § 6694(a)(3).

\(^{28}\) Treas. Reg. § 1.6694-2(e).
In addition to the foregoing substantive defenses, there may also be procedural defenses available with respect to a paid tax return preparer penalty. By way of background, under Code Section 7491(c), the Service bears the burden of production with respect to a paid tax return preparer penalty. The burden of production necessarily includes proof of compliance with the requirements of Code Section 6751(b)(1),\(^{29}\) which provides: “[n]o penalty under this title shall be assessed unless the initial determination of such assessment is personally approved (in writing) by the immediate supervisor of the individual making such determination or such higher level official as the Secretary may designate.” Insofar as the Service did not comply with the requirements of Code Section 6751(b)(1) in assessing a paid tax return preparer penalty, then the collection of that penalty should not be sustained in a collection review proceeding (the likely avenue for a tax return preparer to challenge the imposition of a paid tax return preparer penalty).\(^{30}\)

**B. Paid Tax Return Preparer Penalties Under Code Section 6695 and Defenses**

The Service is also authorized under Code Section 6695 to impose a monetary penalty against a tax return preparer who engages in certain enumerated misconduct. The penalty under Code Section 6695 applies to tax return preparers only. And, for this purpose, the definition of “tax return preparer” that applies under Code Section 6694 also applies for purposes of the penalty under Code Section 6695.

The paid tax return preparer penalties under Code Sections 6694 and 6695 are intended to penalize different types of misconduct, so there is no general prohibition against stacking of penalties (as there is with respect to the paid return preparer under Code Section 6701 for aiding and abetting an understatement of tax). Moreover, the paid tax return preparer penalties under Code Sections 6694 and 6695 are typically coordinated with other penalties under the Code, such as the injunction authorized by Code Section 7407, the criminal tax provisions of the Code, and professional sanctions under the rules set forth at 31 C.F.R. Subtitle A, Part 10 (Circular 230, Regulations Governing Practice before the IRS (“Circular 230”). Thus, tax practitioners should understand that professional misconduct may, and often does, give rise to multiple sanctions under various sources of the law.

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\(^{29}\) See Chai v. Commissioner, 851 F.3d 190, 221 (2d Cir. 2017); Graev v. Commissioner, 149 T.C. 485, 493(2017).

\(^{30}\) See Rockafellar v. Commissioner, T.C. Memo. 2019-160, 2019 BL 476417 (2019); I.R.M., pt. 20.1.6.1.3.2 (Aug. 29, 2019) (both suggesting that the procedural requirements of Code Section 6751(b)(1) apply to the paid tax return preparer penalty under Code Section 6694).
1. **Penalty Under Code Section 6695(a) for Failure to Furnish Copy of Tax Return or Claim for Refund**

   Code Section 6107(a) requires a signing tax return preparer to furnish a completed copy of a tax return or claim for refund to the taxpayer-client before (or at the same time) the tax return or claim for refund is presented to the taxpayer for signature.\(^{31}\) Code Section 6695(a) authorizes the Service to impose a penalty on a tax return preparer who fails to furnish a copy of a tax return or claim for refund required to be provided pursuant to Code Section 6107.\(^{32}\) The amount of the penalty is $50 for each failure, with a maximum penalty of $25,000 per tax return preparer per calendar year.\(^{33}\) The penalty under Code Section 6695(a) does not apply if the failure to provide a copy of the tax return or the claim for refund was due to reasonable cause and not due to willful neglect.\(^{34}\)

2. **Penalty Under Code Section 6695(b) for Failure to Sign a Tax Return**

   Treasury Regulations may require a tax return preparer to sign a tax return or a claim for refund that she prepares.\(^{35}\) If the tax return preparer is required by Treasury Regulations to sign a tax return or a claim for refund, but fails to do so, the preparer may be subject to a penalty under Code Section 6695(b). The amount of the penalty for a violation of Code Section 6695(b) is $50 for each failure, with a maximum penalty of $25,000 per tax return preparer per calendar year.\(^{36}\) The penalty under Code Section 6695(b) does not apply if the failure to sign the tax return or the claim for refund was due to reasonable cause and not due to willful neglect.\(^{37}\) If the signing tax return preparer asserts reasonable cause for a failure to sign a tax return or a claim for refund, then the preparer is required to substantiate the preparer’s claim of reasonable cause with a written statement.\(^{38}\) For purposes of Code Section 6695(b), “reasonable cause is a cause that arises despite ordinary care and prudence exercised by the individual tax return preparer.”\(^{39}\)

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\(^{31}\) The copy of the return or the claim for refund may be given to the taxpayer in any medium, including electronic media, that is acceptable to both the taxpayer and the tax return preparer. See I.R.M., pt. 20.1.6.5.1 (July 26, 2017).

\(^{32}\) I.R.C. § 6695(a).

\(^{33}\) Id.

\(^{34}\) Id.

\(^{35}\) See Treas. Reg. § 1.6695-1(b)(1), (2).

\(^{36}\) I.R.C. § 6695(b).

\(^{37}\) Id.

\(^{38}\) Treas. Reg. § 1.6695-1(b)(3).

\(^{39}\) Id.
3. **Penalty Under Code Section 6695(c) for Failure to Furnish Certain Identifying Information**

Code Section 6109(a)(4) generally requires a signing tax return preparer to include her identifying number on any return or claim for refund prepared by her. Effective January 1, 2011, the required identifying number is the preparer’s preparer tax identification number (PTIN). If a signing tax return preparer fails to include her PTIN on a tax return or a claim for refund, then the preparer may be subject to a penalty under Code Section 6695(c). The amount of the penalty for a violation of Code Section 6695(c) is $50 for each failure, with a maximum penalty of $25,000 per tax return preparer per calendar year. The penalty for the preparer’s failure to provide her identifying number does not apply if the failure was due to reasonable cause and not due to willful neglect.

4. **Penalty Under Code Section 6695(d) for Failure to Retain a Copy or List of Tax Returns or Claims for Refund Prepared**

Code Section 6107(b) requires a tax return preparer of any tax return or claim for refund to retain (and make available to the Service upon request), for the three-year period ending after the close of the tax return period, a completed copy of the return or the claim for refund or a list of the name and taxpayer identification number of the taxpayer for whom the tax return or claim for refund was prepared. If a signing tax return preparer fails to retain the required copies or list, then the preparer may be subject to a penalty under Code Section 6695(d). The amount of the penalty for a violation of Code Section 6695(d) is $50 for each failure, with a maximum penalty of $25,000 per tax return preparer per calendar year. The penalty for the preparer’s failure to retain a copy of, or the required list with respect to, tax returns or claims for refund does not apply if the failure was due to reasonable cause and not due to willful neglect.

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40 A tax return preparer is not required to affix her identification number to the taxpayer’s copy of the tax return. See T.D. 9436, 2009-3 I.R.B. 268.

41 I.R.C. § 6695(c). Additionally, a penalty under Code Section 6695(c) will not be imposed against a tax return preparer who is: (a) employed or engaged by a person who is also a preparer of the return or the claim for refund; or (b) a partner in a partnership which is also a preparer of the return or claim for refund. I.R.M., pt. 20.1.6.5.3(5) (Aug. 29, 2019).

42 Id.

43 I.R.C. § 6695(d).

44 Id.
5. **Penalty Under Code Section 6695(e) for Failure to File a Correct Information Statement**

Code Section 6060(a) requires each person, who employs or engages one or more signing tax return preparers, to make a return setting forth the name, taxpayer identification number, and place of work of each tax return preparer employed (or engaged) by him at any time during the reporting period. 45 If the employer fails to make the required return, then the preparer may be subject to a penalty under Code Section 6695(e). 46 The amount of the penalty for a violation of Code Section 6695(e) is $50 for each failure to file a return as required by Code Section 6060 and $50 for each failure to include a required item in the return. The maximum penalty that can be imposed upon a person under Code Section 6695(e) is $25,000. The penalty for the preparer’s failure to make the required return does not apply if the failure was due to reasonable cause and not due to willful neglect. 47

6. **Strict Liability Penalty Under Code Section 6695(f) for Negotiation of a Check for Taxes Issued to a Taxpayer**

If a tax return preparer directly or indirectly endorses or otherwise negotiates a tax refund check, including an electronic version of a check, issued to a taxpayer other than the preparer, then the tax return preparer may be subject to a penalty under Code Section 6695(f). 48 The amount of the penalty for a violation of Code Section 6695(f) is $500 per check. 49 There is no limit on the amount of the penalty that can be imposed under Code Section 6695(f). Moreover, unlike the other penalties imposed by Code Section 6695, a reasonable cause defense is not available. The Service takes the position, and a plain reading of the statute supports, that the penalty applies even if the taxpayer consents to the deposit. Thus, the penalty under Code Section 6695(f) is a strict liability penalty.

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45 See also Treas. Reg. § 1.6060-1(a)(1).
46 I.R.C. § 6695(e).
47 Id.
48 I.R.C. § 6695(f).
49 Id.
7. **Strict Liability Penalty Under Code Section 6695(g) for Failure to be Diligent in Using the Head of Household Filing Status or Claiming the Earned Income Credit**

Treasury Regulations impose due diligence requirements with respect to claiming the head of household filing status or the earned income credit.\(^{50}\) The scope of diligence varies by reference to the year to which the tax return or claim for refund relates.\(^{51}\) For tax returns or claims for refund for tax years beginning after December 31, 2017, Treasury Regulations Section 1.6995-2(b) requires tax return preparers to comply with the following due diligence requirements:

- Complete an eligibility checklist using Form 8867, *Paid Preparers Earned Income Credit Checklist*, or a personalized form that provides the same information, on the basis of information provided by the taxpayer to the tax return preparer or otherwise reasonably obtained or known by the tax return preparer;

- Compute the earned income credit using the earned income credit worksheet or a personalized worksheet that contains the same information, on the basis of information provided by the taxpayer to the tax return preparer or otherwise reasonably obtained or known by the tax return preparer;

- 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 the head of household filing status, or the eligibility or the amount of, the earned income credit is incorrect. In this regard, the tax return preparer may not ignore the implications of information furnished to, or known by, the tax return preparer, and must make reasonable inquiries if the information furnished to the tax return preparer appears to be incorrect, inconsistent, or incomplete. A tax return preparer must make reasonable inquiries if a reasonable and well-informed tax return preparer who is knowledgeable in the law would conclude that the information furnished to the tax return preparer appears to be incorrect, inconsistent, or incomplete. Finally, the tax return preparer must also contemporaneously document in the files the reasonable inquiries made and the responses to these inquiries.\(^{52}\)

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\(^{50}\) See Treas. Reg. § 1.6695-2(b).

\(^{51}\) See id.; see also I.R.M., pts. 20.1.6.5.7 (Aug. 29, 2019), 20.1.6.5.7.1 (Aug. 29, 2019), 20.1.6.5.7.2 (Aug. 29, 2019), 20.1.6.5.7.3 (Aug. 29, 2019).

\(^{52}\) See also I.R.M., pt. 20.1.6.5.7.3 (Aug. 29, 2019).
If the tax return preparer fails to conduct the required due diligence, then the preparer may be subject to a penalty under Code Section 6695(g). The amount of the penalty for a violation of Code Section 6695(g) is $500 for each failure to conduct the required due diligence. There is no limit on the amount of the penalty that can be imposed under Code Section 6695(g), and the reasonable cause defense is not available. Thus, the penalty under Code Section 6695(g) is a strict liability penalty.

C. Penalties Under Section 6701 for Aiding and Abetting an Understatement of Tax

The Code authorizes the Service to impose a penalty on any person who:

1. Aids or assists in, procures, or advises with respect to, the preparation or presentation of any portion of a return, affidavit, claim, or other document,

2. Knows or has reason to believe that such portion will be used in connection with any material matter arising under the internal revenue laws; and

3. Knows that such portion, if so used, would result in an understatement of the tax liability of another person.

The amount of the penalty that may be imposed under Code Section 6701 is equal to $1,000 for each false document, except that the amount of the penalty is increased to $10,000 if the return, affidavit, claim for refund, or other document relates to a corporation. Only one Code Section 6701 penalty may be imposed for any false document relating to any taxpayer for any tax period.

The aiding and abetting an understatement of tax under Code Section 6701 is coordinated with other penalties imposed upon parties other than the taxpayer whose liability is at issue. In this regard, the Service is statutorily prohibited from assessing both a penalty for aiding and abetting an understatement of tax liability under Code Section 6701 and a paid tax return preparer penalty under Code Section 6694. Also, the Service cannot assess the penalty for aiding and abetting an understatement of tax liability under Code Section 6701 and the penalty for promoting a tax shelter under Code Section 6700 with respect to the same document.

Code Section 6701(a), by its terms, broadly applies to “any person.” Thus, the following persons may be subject to a penalty under Code Section 6701 for aiding and abetting an

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53 I.R.C. § 6695(g).
54 Id.
55 I.R.C. § 6701(a).
56 I.R.C. § 6701(b)(1), (2).
57 I.R.C. § 6701(b)(3).
understatement of tax:

- Tax advisors, including but not limited to tax return preparers, who advise clients to take unsupported filing positions or to file false or fraudulent tax returns;
- The authors of legal opinions made available to promoters of tax avoidance transactions;
- Providers of gratuitous advice or assistance in preparing any document that leads to an understatement of a taxpayer’s tax liability; and
- A person who controls the activities of subordinates and either orders the subordinates to act, or does not prevent the subordinate from acting when the person knows that the subordinate’s actions will cause an understatement of tax.60

D. Actions to Enjoin Tax Return Preparers Under Code Section 7407

The Code authorizes the Service to bring a civil action to enjoin an individual from engaging in prohibited conduct such as the type of conduct which is subject to a penalty under Code Section 6701.61 Thus, a tax professional who is assessed a paid return preparer penalty faces the added risk of being enjoined by the United States Government from preparing tax returns in the future. To obtain an injunction against a tax return preparer, the Government must prove two key elements. First, the Government must prove that the tax return preparer has:

1. Engaged in any conduct subject to penalty under Code Section 6694 or 6695, or subject to any criminal penalty provided by this title;
2. Misrepresented his eligibility to practice before the Service or otherwise misrepresented his experience or education as a tax return preparer;
3. Guaranteed the payment of any tax refund or the allowance of any tax credit; or
4. Engaged in any other fraudulent or deceptive conduct which substantially interferes with the proper administration of the internal revenue laws.62

Second, the Government must prove that the injunctive relief is appropriate to prevent the recurrence of such conduct.63 Although Code Section 7407 refers only to the paid return preparer penalties under Code Sections 6694 and 6695 and the criminal provisions of the Code, the I.R.M. instructs Service employees to consider whether an injunction should be sought any time a penalty is imposed under Code Sections 6694, 6695, 6700, 6701, 6707, or 6708.64 Thus,

61 I.R.C. § 7407(a), (b).
62 I.R.C. § 7407(b)(1).
63 I.R.C. § 7407(b)(2).
64 I.R.M., pt. 20.1.6.10.1 (Sept. 17, 2010).
an action to enjoin under Code Section 7407 may be pursued in most (if not all) cases involving alleged misconduct by a tax return preparer or other tax professional. Finally, an action to enjoin under Code Section 7407 may be pursued without regard to whether penalties have been or may be assessed against a tax return preparer.65

E. Referrals to the IRS-OPR for Professional Sanctions and Monetary Penalties

The IRS-OPR is responsible for all matters related to practitioner misconduct, discipline, and practice before the IRS under Circular 230.66 The IRS-OPR administers the law and regulations governing the practice of tax professionals and other individuals who interact with the tax administration system on behalf of taxpayers, including, but not limited to, attorneys, certified public accountants, enrolled agents, enrolled actuaries, enrolled retirement plan agents, tax return preparers who represent clients before the IRS, and appraisers who provide valuations contained in documents submitted to the Service.67 Among other things, the IRS-OPR:

- Receives, reviews and investigates evidence of alleged misconduct by individuals covered by Circular 230;
- Evaluates allegations to determine whether they evidence actions which constitute disreputable or incompetent conduct, or otherwise reflect violations of Circular 230; and
- When warranted, proposes and negotiates a level of discipline appropriate with the misconduct.

Whenever the Service imposes a paid tax return preparer penalty or investigates a tax return preparer for violations of the internal revenue laws, a referral to the IRS-OPR should follow. Indeed, Circular 230 requires an officer or employee of the Service to promptly make a written report of a suspected violation of Circular 230.68 The IRS-OPR, in turn, may suspend or disbar a tax professional from practice before the U.S. Department of the Treasury (“Treasury

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65 I.R.M., pt. 20.1.6.10.2(2) (Sept. 17, 2010).
67 Id.
68 Circular 230, § 10.53. The I.R.M. grants Service employees more discretion than Circular 230 in deciding whether to refer a tax practitioner to the IRS-OPR. Under the I.R.M., when paid tax return preparer penalties are assessed under Code Section 6694(b) for willful or reckless conduct pertaining to a closed agreed or unagreed examination, a referral to IRS-OPR is “mandatory.” I.R.M., pt. 20.1.6.12.3(7) (Aug. 29, 2019). Likewise, referrals to the IRS-OPR are “mandatory” whenever a penalty under Code Section 6701 is assessed. I.R.M., pt. 20.1.6.12.3(10) (Aug. 29, 2019). But, the I.R.M. advises examiners to “exercise discretion” in making referrals of assessed penalties under Code Sections 6694(a) and 6695 to the IRS-OPR. I.R.M., pt. 20.1.6.12.3(6), (8) (Aug. 29, 2019). Rather, the Service instructs employees that referrals of assessed penalties under Code Sections 6694(a) and 6695 to the IRS-OPR should be based on “a pattern of failing to meet the required penalty standards under [Code Section] 6694(a).” I.R.M., pt. 20.1.6.12.3(6), (8) (Aug. 29, 2019).
Department”) or the Service if the professional is incompetent, is disreputable, violates Circular 230, or with intent to defraud, willfully and knowingly misleads or threatens the person being represented or a prospective person to be represented.”

Additionally, the IRS-OPR may also impose a monetary penalty on any practitioner who engaged in conduct subject to sanction under Circular 230.

These same provisions apply to appraisers, except that appraisers face the additional penalties of a determination that appraisals prepared by the appraiser shall have no probative effect in any administrative proceeding before the Treasury Department or the Service. In addition, the appraiser may be barred from presenting evidence or testimony in any such proceeding.

III. Promoter Penalties and Defenses

The Service is also authorized to impose various civil tax penalties against, and pursue actions to enjoin, promoters of abusive tax schemes. The term “promoter” has been defined to mean “an adviser who participated in structuring the transaction or is otherwise related to, has an interest in, or profits from the transaction.” The penalties and actions to enjoin that may be imposed against a promoter include:

- The penalty under Code Section 6700, which generally may be imposed upon any person who promotes abusive tax shelters;
- The penalty under Code Section 6701 penalty, which generally may be imposed against a promoter who aids and abets an underatement of tax liability;
- An action under Code Section 7408 to enjoin a promoter from promoting abusive tax avoidance transactions; and
- A referral to the IRS-OPR for professional sanctions and a monetary penalty.

A. Promoter Penalties Under Code Section 6700 and Defenses

The Code authorizes the Service to impose a penalty on any person who:

1. Organizes or assists in the organization of a partnership or other entity, any investment plan or arrangement, or any other plan or arrangement;

2. Participates, directly or indirectly, in the sale of any of the foregoing interests in

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69 Circular 230, § 10.50(a).
70 Circular 230, § 10.50(b).
71 Id.
any entity or plan or arrangement; and

3. In connection with such organization or sale, makes or furnishes or causes another to make or furnish (a) a statement with respect to the allowance of any deduction or credit, the excludability of any income, or the securing of any tax benefit by reason of holding an interest in the entity or participating in the plan or arrangement which the person knows or has reason to know is false or fraudulent as to any material matter, or (b) a gross valuation overstatement as to any material matter.73

The amount of the penalty that may be imposed under Code Section 6700 is equal to $1,000 for each activity or 100% of the gross income derived from the activity.74

The Service takes the position that there is no statute of limitations on assessment with respect to the promoter penalty imposed by Code Section 6700 or the aiding and abetting an understatement of tax penalty imposed by Code Section 6701.75 Taxpayers have argued that, absent a specific statutory exception to the contrary, 28 U.S.C. § 2462 establishes an outside date of five years by which all penalties must be asserted.76 The statute provides:

Except as otherwise provided by Act of Congress, an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued if, within the same period, the offender or the property is found within the United States in order that proper service may be made thereon.77

By its terms, § 2462 governs only an “action, suit or proceeding for the enforcement of” a fine or penalty. In Capozzi v. United States,78 the U.S. Court of Appeals for the Second Circuit stated that the terms “action,” “suit,” and “proceeding” implicate some adversarial adjudication, be it administrative or judicial.” The courts in considering whether penalties assessed under Code Section 6700 and 6701 arise in an adversarial proceeding, have all held that the proceedings with the Service are ex parte and therefore excepted from the provisions of 28 U.S.C. § 2462.79 In other words, because the penalties under Code Section 6700 and 6701 are assessable, meaning the deficiency procedures do not apply, then there is no action, suit, or proceeding to support that

73 I.R.C. § 6700(a).
74 Id.
78 980 F.2d 872, 874 (2d Cir. 1992).
79 See, e.g., Capozzi, 980 F.2d at 874-875; Lamb v. United States, 977 F.2d 1296, 1297 (8th Cir. 1992); Mullikin v. United States, 952 F.2d 920, 928 (6th Cir. 1991).
a court acquires subject matter jurisdiction over the penalty. It is against this background that taxpayers will face considerable difficult in using 28 U.S.C. § 2462 to argue that a penalty under Code Section 6700 or 6701 must be assessed, if at all, within five years of the act giving rise to the assessment.

The promoter penalty is in addition to all other penalties that may be imposed under the Code, except that no penalty may be assessed under Code Section 6700 on any person with respect to any document for which a penalty is assessed on the person under Code Section 6701. Thus, the penalty under Code Section 6700 may be assessed in addition to (1) the paid return preparer penalty under Code Section 6694(b) for causing an understatement of tax due to an unreasonable position or willful or reckless conduct, (2) the criminal penalty under Code Section 7206(2) for willfully aiding or assisting in making a fraudulent or false statement, and (3) an action to enjoin a promoter under Code Section 7408.

B. Promoter Penalties Under Code Section 6701

The penalty for aiding and abetting an understatement of tax applies with full force to promoters of abusive tax avoidance transactions. The penalty under Code Section 6701, as well as available defenses, is discussed supra at Part II.C.

C. Actions to Enjoin Tax Return Preparers Under Code Section 7408

In addition to imposing penalties under Code Section 6700 or 6701, Code Section 7408 also authorizes the Service to bring a civil action to enjoin an individual from engaging in certain action (or failing to take certain action) that would support a penalty under Code Section 6700 or 6701 or be a violation of Circular 230. Indeed, any examiner conducting a promoter investigation under Code Section 6700 or 6701 should consider whether an injunction under Code Section 7408 should be brought. To obtain an injunction against a tax promoter, the Government must prove that (1) the person has taken action (or failed to take action that would give rise to a penalty under Code Section 6700 or 6701 or constitute a violation of Circular 230, and (2) injunctive relief is appropriate to prevent recurrence of the specified conduct.

D. Referrals to the IRS-OPR for Professional Sanctions and Monetary Penalties

If the Service imposes a promoter penalty or investigates a promoter for violations of the internal revenue laws, a referral of the promoter to the IRS-OPR should follow. In this regard, referrals to the IRS-OPR are required whenever a penalty under Code Section 6700 or 6701 is assessed. The professional sanctions and monetary penalties which can be imposed against a

See I.R.C. § 6700(c); see also I.R.C. § 6701(f)(3).


I.R.C. § 7408(a), (c).


I.R.C. § 7408(a), (c).

person for promoting abusive tax avoidance transactions is discussed *supra* at Part II.E.

IV. Appraiser-Specific Penalties Under Code Section 6695A

As noted, the conduct of appraisers is routinely scrutinized in tax cases where valuation is at issue. Enacted as part of the Pension Protection Act of 2006,\(^86\) Code Section 6695A authorizes the Service to impose a penalty upon a person who prepares an appraisal and who knows or should reasonably know that the appraisal will be used in connection with filing a return or a claim for refund.\(^87\) If the claimed value of the property based upon the appraisal results to the taxpayer in a substantial valuation misstatement under Code Section 6662(e), a substantial estate or gift valuation overstatement under Code Section 6662(g), or a gross valuation misstatement under Code Section 6662(h), then there is imposed upon the appraiser a penalty equal to the lesser of:

- $1,000 or 10% of the amount of the taxpayer’s underpayment of tax attributable to the misstatement, whichever is greater, or
- 125% of the gross income the appraiser derived from the preparation of the appraisal.\(^88\)

The Code Section 6695A penalty is in addition to any other penalty that may be imposed upon the appraiser, including but not limited to the penalty for aiding and abetting an understatement of tax under Code Section 6701.\(^89\) The Service takes the position that it will not impose both the appraiser penalty under Code Section 6695A and the paid tax return preparer penalty under Code Section 6694.\(^90\) Unlike the Code Section 6701 penalty, discussed *infra* at Part II.C., there is no requirement under Code Section 6695A that the appraiser know that the taxpayer’s use of the appraisal will result in an understatement of tax.

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\(^{87}\) I.R.C. § 6695A.

\(^{88}\) I.R.C. § 6695A(a), (b).

\(^{89}\) I.R.C. § 6696(a).

\(^{90}\) T.D. 9436, 73 Fed. Reg. 78430 (Preamble).
A. Statute of Limitations and Collection of Penalty

The Code Section 6695A penalty may be assessed at any time because the Code does not specify a period of limitations with respect to such penalty. The Service, however, has stated that it will, to the extent practicable, assess such penalty within three years after the filing of the return or the claim for refund. In addition, the Code Section 6695A penalty can be assessed and collected immediately; deficiency procedures do not apply.

B. Defenses

The Code Section 6695A penalty does not apply if the appraiser establishes that the value established in the appraisal was more likely than not the proper value. The reasonable cause exception of Code Section 6664 does not apply to the Code Section 6695A penalty.

C. Referral to the IRS-OPR for Professional Sanctions

Where a Code Section 6695A penalty is assessed, the appraiser may be referred to the IRS-OPR for the imposition of professional sanctions under Circular 230. As discussed infra at Part II.E., among the permissible sanctions against an appraiser allowed by Circular 230 is the disqualification of the appraiser from practicing before the Treasury Department or the Service. An appraiser who has been disqualified under Circular 230 remains disqualified unless and until the Director of the IRS-OPR approves a petition for reinstatement after the expiration of five years following the effective date of disqualification. An appraisal made by a disqualified appraiser after the effective date of disqualification will have no probative effect in any administrative proceeding before the U.S. Treasury Department and/or the Service, and any such appraisal may be admitted into evidence solely for purposes of determining whether a taxpayer relied in good faith on such appraisal.

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91 See I.R.C. § 6696 (providing a three year period of limitations on assessment of the Code Section 6694 and 6695 penalties but not specifying a period of limitations with respect to the Code Section 6695A penalty).

92 Chief Counsel Memorandum AM 2007-017 (Nov. 9, 2007); but see I.R.M. pt. 20.1.12.4(1) (Dec. 18, 2017) (stating that the statute of limitations on assessment for a Code Section 6695A penalty expires three years from the later of the due date of the related return or the date on which the related return was filed).

93 I.R.C. § 6696(b).

94 I.R.C. § 6695A(c).

95 I.R.M. pt. 20.1.12.7 (Dec. 18, 2017) (allowing examiners to exercise discretion when referring an appraisal to the IRS-OPR).

96 Circular 230 § 10.50(b)(1).

97 Circular 230 § 10.50(b)(2).
V. Overview of the Service’s Procedure for Investigating Potentially Abusive Tax Return Preparers and Promoters

The Service prioritizes investigations into paid return preparers and promoters who engage in potentially abusive transactions. For this purpose, abusive transactions include the organization or sale of any plan or arrangement promoting false or fraudulent tax statements or gross valuation misstatements, aiding or assisting in the preparation or presentation of a return or other document to obtain tax benefits not allowed by the internal revenue laws, and actions to impede the proper administration of the Code. Abusive transactions include tax shelters and, more generally, other types of abusive tax promotions and scams.

The Service, ostensibly in response to TIGTA’s criticisms in 2018, recently revised its procedures for investigating individuals involved with potentially abusive transactions. Under these revised procedures, the Service uses multiple coordinated groups to investigate potentially abusive transactions. These groups include: the Small Business/Self Employed Lead Development Center (“SBSE LDC”); the Office of Tax Shelter Analysis (“OTSA”); the Large Business and International Technical Tax Shelter Promoter Committee (“LBITSPC”); and the Criminal Investigation Division (“IRC-CID”). The Service will, as appropriate, use the following tools to quickly terminate abusive practices (and deter other similar practices):

- Asserting civil penalties against promoters and paid return preparers;
- Seeking timely civil injunctions;
- Providing published guidance on various promotions;
- Conducting taxpayer-client examinations;
- Referring promoters, preparers, and, in appropriate cases, taxpayer-clients, to the IRS-OPR; and
- Criminally prosecuting promoters, paid return preparers, or clients.

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98 See I.R.M., pt. 4.32.2.3 (June 4, 2018).
99 See I.R.M., pt. 4.32.1.1 (June 4, 2018). These groups may also be comprised of various subcommittees, the details of which are generally not discussed in this article. SBSE LDC was established to centralize receipt and development of small business or self-employed abusive transaction promoter leads, conduct research, build promoter cases, and authorize promoter investigations. I.R.M., pt. 4.32.2.4.2(4) (June 4, 2018). SBSE LDC also provides assistance and support to examiners on case development involving most preparer and promoter cases. I.R.M., pt. 4.32.2.4.2(4) (June 4, 2018).
Penalties against paid tax return preparers and promoters can be imposed at various stages of the tax compliance process. Typically, penalties against paid tax return preparers and promoters are imposed following an audit of a taxpayer’s tax return or as part of a focused investigation of the tax professional. A referral is made by using Form 14242, Reporting Abusive Tax Promotions and/or Promoters.\(^{100}\) All potential leads are sent to SBSE LDC or OTSA, as appropriate, for development and evaluation.\(^{101}\) The specialty group develops each referral independently and uses the following nonexclusive factors to authorize or not authorize an investigation:

- The type of promotion;
- The past activity of the promoter;
- Whether the activity is ongoing and the likelihood of recurrence;
- The size of the promotion;
- The tax impact of the promotion;
- Possible tax law violations;
- Favorable public or compliance impact; and
- Existing balance due liabilities including an open collection assignment.\(^{102}\)

And, if a promoter subject to Circular 230 violates any of its provision, then SBSE LDC will make a referral to the IRS-OPR.\(^{103}\) Once an investigation is authorized, then the authorization file is sent to the field to be worked.\(^{104}\) Information is shared among examiners, special agents, and government attorneys.\(^{105}\)

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\(^{100}\) See I.R.M., pt. 4.32.2.4.2(7) (June 4, 2018). Each referral is reviewed and uploaded to the LDC database with an assigned control number. I.R.M., pt. 4.32.2.4.2(9) (June 4, 2018).

\(^{101}\) See I.R.M., pt. 4.32.2.4.1(1), (4) (June 4, 2018).

\(^{102}\) See I.R.M., pts. 4.32.2.4.2(12), (15) (June 4, 2018) (SBSE LDC), 4.32.2.4.3.4 (June 4, 2018) (OTSA).

\(^{103}\) See I.R.M., pt. 4.32.2.4.2(16) (June 4, 2018).

\(^{104}\) See I.R.M., pt. 4.32.2.4.2(17) (June 4, 2018).

\(^{105}\) See I.R.M., pt. 4.32.2.7.7(1) (June 4, 2018).
Significantly, SBSE LDC and OTSA each submit a memorandum to IRS-CID advising of the intention to authorize a civil promoter investigation. 106 Thus, it is not a typically a question of whether a professional accused of misconduct will be referred to IRS-CID, but when. Examiners are generally permitted by the I.R.M. to conduct civil investigations before, during, or after a criminal investigation into the promoter, 107 except that examiners may not assess a preparer or promoter penalty until the criminal investigation is completed. 108 IRS-CID devotes considerable resources to investigating and prosecuting unscrupulous tax professionals. During the 2019 fiscal year, IRS-CID devoted resources to unscrupulous tax return preparers as follows: 109

<table>
<thead>
<tr>
<th>Combined Results (All Programs)</th>
<th>% of Whole</th>
<th>Abusive Return Preparer Program</th>
<th>% of Whole</th>
<th>Abusive Tax Schemes</th>
<th>% of Whole</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investigations initiated</td>
<td>2,485</td>
<td>100.00%</td>
<td>163</td>
<td>6.56%</td>
<td>69</td>
</tr>
<tr>
<td>Prosecutions recommended</td>
<td>1,893</td>
<td>100.00%</td>
<td>203</td>
<td>10.72%</td>
<td>45</td>
</tr>
<tr>
<td>Informations / indictments</td>
<td>1,800</td>
<td>100.00%</td>
<td>138</td>
<td>7.67%</td>
<td>25</td>
</tr>
<tr>
<td>Sentenced</td>
<td>1,726</td>
<td>100.00%</td>
<td>154</td>
<td>8.92%</td>
<td>34</td>
</tr>
</tbody>
</table>

106 See I.R.M., pt. 4.32.2.4.5(1) (June 4, 2018).

107 See I.R.M., pt. 4.32.2.7(1) (June 4, 2018). Nevertheless, examiners must not mislead the promoter regarding the existence of a criminal investigation nor conduct a criminal investigation under the guise of the civil investigation. See United States v. Tweel, 550 F.2d 297 (5th Cir. 1977).

108 I.R.M., pt. 4.32.2.7.10 (June 4, 2018).

Moreover, the Service’s Collection Division ensures that penalties assessed against tax professionals are collected. In this regard, the paid tax return preparer penalties under Code Sections 6694, 6695, and 6695A are assessable penalties, which means the deficiency procedures do not apply to these penalties.\textsuperscript{110} Moreover, the Service’s Office of Chief Counsel supports revenue agents, special agents, and revenue officers in investigating, assessing, and collecting penalties against unscrupulous tax professionals. The Tax Division, often with assistance from Service employees, pursues actions to enjoin tax professionals from preparing tax returns or promoting abusive tax schemes. Collectively, these employees enforce the internal revenue laws against unscrupulous tax professionals.

VI. Conclusion

Paid return preparer and promoter penalties an important part of the Service’s overall compliance strategy. The Service’s renewed emphasis on preventing tax professionals from engaging in abusive practices requires all tax professionals to familiarize themselves with the various tools available to the Service to deter violations of the internal revenue laws by tax professionals.

\textsuperscript{110} I.R.C. § 6696(b).