

## *Far Tougher Tax Preparer Rules? Not Me, I'm a Business Lawyer*

If you do not sign client tax returns, why should you be concerned with the pernicious new federal tax "return preparer" rules? A simple example answers your question. You write a memo, an e-mail, or send a letter recommending that a given transaction be entered into, or that a transaction or a piece of it be structured in a certain way. The advice can even be oral. On the tax return, which you never saw, it was reported accordingly. It was later determined that was not the correct treatment as a result of one of the increasing number of IRS audits. You are a "non-signing preparer" subject to the new amendments to IRC §6694 and Circular 230. Before the 2007 amendments, these return preparer rules only applied to preparers of income tax returns. Now they also regulate signing and non-signing preparers of income, gift, estate, employment, and excise tax returns.

The rules apply if an item that is the subject of your advice is "substantial" on a return. There is a trap here as a non-signing preparer of an item on a pass-through entity return, such as an S corporation, an LLC taxed as a partnership, estate or trust, is also deemed, as to that item, a preparer of all returns to which that flows. Whether an item is substantial or not is measured on each return. For example, an issue may not be substantial on a Form 1040 of a deep-pocket majority shareholder, but could be substantial to a small shareholder. Therefore, in a pass-through situation, you could be subject to exposure for a tax return that you never saw, for a taxpayer about which you know absolutely nothing.

The 2007 IRC §6694 and Circular 230 amendments essentially apply FIN 48 GAAP accounting to the front end of tax compliance by now generally requiring that every item on a tax return satisfy the more demanding "more likely than not" (i.e., over 50 percent) standard. Prior law had only mandated a 30 percent or

higher likelihood of success on the merits. Alternatively, penalties can be avoided by a combination of the position having both a) a 20 percent or greater possibility of being sustained on the merits (the previous standard was "not frivolous," i.e., 5 percent to 10 percent or better chance), plus b) full and adequate disclosure on IRS Form 8275. The filing of such disclosure statements, however, has long been viewed by the tax bar as an open invitation to an IRS audit.

What are the consequences of running afoul of these new rules? The old \$250 penalty days are now history. Revenue agents were simply not interested in doing considerable work for a mere \$250 penalty. You and your firm are now liable for penalties under IRC §6694 and Circular 230 totaling up to 150 percent of the "fees." The fees are not just for your work on your piece of the larger puzzle, but can include the entire fees for a transaction, such as an acquisition, sale of business, restructuring, or sophisticated estate plan. Additionally, you can be suspended from practice before the IRS under Circular 230. Today, tax malpractice complaints routinely assert violations of a known federal tax standard of care, Circular 230, as determinative of liability.

On December 31, 2007, the IRS issued twenty-seven pages of guidance on these new standards in general and penalty defenses in particular. See Notice 2008-13. The new regime is generally applicable to signing preparers for returns filed on or after January 1, 2008, such as 2007 Forms 1040, 1065, 1120, and 1120S. For non-signing preparers, the effective date is generally written or oral "advice" given on or after January 1, 2008. At least on some returns, virtually every business lawyer is now a statutory non-signing preparer subject to the new regime.

Why did Congress adopt these rules, imposing such large potential liabilities on lawyers, among others?

Congress is like your parents when you were teenagers—it either over-reacts or does nothing. The over-reactive legislation was in direct response to the tax shelter scandals that have become public through senate hearings and elsewhere. Accountants were historically viewed as the gatekeepers. After the tax shelter scandals, Enron and other prominent examples of corporate fraud, the old gatekeeper system was viewed as broken. You may view this as the tax version of Sarbanes Oxley, or the parental version of being grounded for "the rest of your life!"

At the recent American Bar Association Taxation Section meetings, these new preparer standards were both the number one topic and the leading concern. There were numerous presentations. The biggest fear within the tax community was not for those in the tax departments of their respective firms, as they are sensitized to the issues. The largest concern was that attorneys who tangentially touch on tax matters in corporate, litigation, estate, labor, and other practice groups would unwittingly stumble into traps for the unwary. There is considerable value in having a practitioner in your firm with a tax background who is familiar with these rules present an in-house program for those whose practices touch tax, or seek an outside tax professional to make the presentation.



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