

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

**Comments on Proposed Regulations, REG-129243-07
Regarding Tax Return Preparer Penalties**

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General Comments

The American Institute of Certified Public Accountants wishes to thank the Treasury Department and the Internal Revenue Service for your prompt and thoughtful guidance addressing the challenges posed to taxpayers, tax practitioners, and our tax system by the May 2007 changes to the tax return preparer penalty provisions in the Internal Revenue Code. The transitional relief (Notice 2007-54) provided within approximately two weeks of the date of enactment was critical for many practitioners, particularly those working on returns due a few weeks after the legislation was enacted.

Further, the notices issued on December 31, 2007 (Notices 2008-11, 2008-12, 2008-13) provided practical guidance that enabled the 2008 tax filing season to proceed without any serious disruption caused by the changes to the preparer penalty. Issuance of the proposed regulations in just over one year after the legislative changes, with the declared intent to issue final regulations by year end, also helped to further meaningful discussion of the potentially broader impact of the legislative changes on the preparer penalty regime.

We also thank you for working with the practitioner community while you developed the interim guidance and proposed regulations. In particular, we believe your efforts to understand the practical problems created by the statutory changes have contributed to guidance that generally strikes an appropriate balance between the obligations of those persons striving to comply with the tax laws and those responsible for administering these laws.

Although we generally are highly supportive of the proposed regulations, we have concerns with some provisions and suggestions as to how the guidance may be clarified in certain areas. Our suggestions, categorized as policy recommendations and technical recommendations, are set forth below with our reasons for proposing the modifications. If you have any questions regarding these recommendations, we would be happy to discuss them with you.

Policy Recommendations

1. Prop. Reg. section 301.7701-15(b)(1): “Signing Tax Return Preparer”

A. Define in a Single Section

The term “signing tax return preparer” is described in multiple sections of the proposed regulations--section 301.7701-15(b)(1), section 1.6694-1(b)(2), section 1.6695-1(b)(1)

and section 1.6695-1(b)(3). In addition, although the definition of the term “signing tax return preparer” is purported to be provided in section 301.7701-15(b)(1), in fact that section merely provides a cross-reference to section 1.6695-1(b) for the definition of signing tax return preparer. We recommend that the term “signing tax return preparer” be defined in section 301.7701-15(b)(1), rather than in section 1.6695-1(b). Other sections that rely on a definition of “signing tax return preparer” should cross reference to section 301.7701-15(b)(1).

B. Provide a Clear Definition

Although there are a number of sections in the proposed regulations that refer to “signing tax return preparer,” none of them provides a clear definition of the term. For example:

- Section 301.7701-15(b)(1) provides that a signing preparer is “any tax return preparer who signs or who is required to sign a return or claim for refund as a tax return preparer pursuant to section 1.6695-1(b).”
- Section 1.6695-1(b)(1) merely states that a preparer must sign a return after it is completed and before it is provided to the taxpayer for signature. This section also provides rules for another signer if the preparer is unavailable at the time a signature is required.
- Section 1.6695-1(b)(3) provides rules for deciding who is required to sign a return if there are multiple preparers associated with the return. That section provides in the case of multiple preparers, “the individual tax return preparer who has primary responsibility as between or among the tax return preparers for the overall substantive accuracy of the preparation of such return or claim for refund shall be considered to be the signing tax return preparer.” This language provides a rule to determine who is required to sign when there are multiple preparers. However, it does not define the term “signing tax return preparer.”
- Section 1.6694-1(b)(2) states that the signing tax return preparer “will generally be considered the person who is primarily responsible for all of the positions on the return or claim for refund giving rise to an understatement.” But this statement appears to be more of a presumption that the IRS will use to determine who is responsible for the understatement, rather than a definition of the term “signing tax return preparer.”

Accordingly, we strongly recommend that Treasury and the IRS provide a clear and concise definition of the term “signing tax return preparer” that does not, in a circular manner, define the signing tax return preparer as the person who signs the return. Rather the definition should clarify who is required to sign a tax return.

C. Clarify When a Preparer Is Required To Sign a Return

The current regulations address two kinds of services provided by a section 7701 tax return preparer: (1) the situation where the preparer, or someone at the preparer's direction, actually completes the return, claim, or schedule ("**preparation**"); and (2) the situation where the preparer provides advice with respect to the determination of the existence, characterization, or amount of an entry on a return or claim for refund ("**advice**"). However, there is another type of service that is commonly performed by a section 7701 tax return preparer: (3) the situation where a taxpayer engages a preparer to review all or part of a tax return or claim for refund that has already been prepared by the taxpayer (including the taxpayer's employees or the general partner in the case of a partnership) or another preparer ("**review**").

The main difference between preparation and the other two situations is that in preparation, the preparer actually fills in the return, claim or schedule and determines the appropriate presentation of the information on the return, claim, or schedule. Even if the preparer uses computer software, professional judgment is required to determine the information to be collected from the taxpayer, necessary due diligence, how the taxpayer's information should be analyzed under the tax law, and the appropriate placement of the information on the return, claim, or schedule.

In contrast, individuals who provide advice or who review a return, claim, or schedule do so with respect to select items or particular transactions. In addition, individuals who provide advice or who review a return, claim or schedule generally do not take responsibility for placement or presentation on the return, claim, or schedule of the item or transaction on which they provided advice. With respect to both advice and review, the preparer will not generally fill in or complete a return, claim, or schedule.

While some tax advice may be provided before the preparation of the return, claim, or schedule has even begun, review of a tax return or claim occurs after it has been prepared (either by the taxpayer or by another preparer). As with any tax advice, the tax system benefits when a competent tax return preparer reviews the taxpayer's return or claim and advises the taxpayer about the proper tax treatment of an item or transaction.

As noted above, the proposed regulations do not clearly define the term "signing tax return preparer" and the rules are unclear regarding who is required to sign a return or claim for refund. However, the following premises are generally understood and should be the foundation for guidance in this area:

- In the case of a single tax return preparer who collects the taxpayer's information and prepares or oversees preparation of the entire tax return (including all schedules), that individual is the preparer and should be required to sign the return. The current and proposed regulations provide that even if another preparer prepares a single schedule that is included in the overall return, the first preparer is required to sign the return because this is the individual with primary responsibility for the overall substantive accuracy of the preparation of the return.

- A tax return preparer who provides oral or written tax advice and who takes primary responsibility for the overall substantive accuracy of the preparation of the return will be required to sign the return or claim for refund.

In our experience, there is significant confusion and uncertainty regarding whether a preparer who reviews a return or claim for refund is required to sign it. Compare PLR 7902033 (holding that the reviewing CPA is a nonsigning preparer) with Rev. Rul. 84-3, 1984-1 C.B. 264 (holding that the reviewing CPA is a signing preparer).¹ The lack of a definition of the term “signing tax return preparer,” including who is required to sign a return, makes it very difficult for the preparer to determine how to comply with the law. Given the uncertainty regarding the issue, we recommend that the final regulations specifically address this point. It is incumbent on the government to clearly define who is required to sign a return or claim for refund.

We recommend the regulations provide that the determination of whether a preparer who reviews a tax return or claim for refund is required to sign the return or claim should be based on all of the facts and circumstances including the scope of services to be provided and the reviewer’s relative responsibility for the overall substantive accuracy of the return in relation to the taxpayer or the other preparer who completed the return.

We further recommend that there be a presumption in the regulations that a preparer who reviews a return or claim for refund is not primarily responsible for the overall substantive accuracy of that return or claim, and therefore not required to sign it, unless:

- there is a written agreement stating that the reviewer will sign the return or claim; or
- facts and circumstances otherwise demonstrate that the reviewer has taken primary responsibility for the overall substantive accuracy of the preparation of the return or claim for refund.

Given the fact that reviewing a return is essentially the same as providing advice, a preparer who reviews a return should be regarded as the nonsigning preparer of those positions he or she in fact reviews, and the regulations should clearly state that conclusion. Any concerns regarding what some have referred to as the “shadow preparer” phenomenon are unfounded. First, taxpayers who engage a preparer to review a return will readily identify the preparer who reviewed the return. Second, even without signing the return, if an individual received compensation to review a substantial portion of the return or claim for refund, the individual will be a preparer subject to the penalty under section 6694.

2. Prop. Reg. section 1.6694-1(b)(3): Responsibility of Nonsigning Preparers

¹ Note also that although there is a reference in the PLR to law firms providing the same advice as a CPA, it is unclear in the PLR the status of the law firms and why the law firms are referenced in the examples at all. This guidance should be reconciled with the ultimate position adopted in the regulations.

The preamble to the proposed regulations specifically requests comments on the approach taken in Prop. Reg. section 1.6694-1(b)(3). That provision generally provides that the individual nonsigning preparer within a firm with overall supervisory responsibility for the position(s) at issue is the preparer with respect to those positions for section 6694 purposes in the following circumstances: (1) there is no signing preparer in the firm; (2) there is a signing preparer, but the IRS concludes he or she is not primarily responsible for the position(s); or (3) “the IRS cannot conclude which individual (as between the signing tax return preparer and other persons within the firm) is primarily responsible for the position. . .”

We are concerned that the default situation described in (3) above (that is, imposing the penalty on the individual with overall supervisory responsibility, but not necessarily primary responsibility, for a position when the IRS cannot reach a conclusion as to who is primarily responsible) will lead to more harm than good and should not be adopted. We do not believe that a serious penalty, such as a section 6694 penalty, should be imposed on a person merely because the IRS is not able to reach a conclusion as to who is primarily responsible for the conduct giving rise to the penalty. For example, a section 6694 penalty not only may seriously compromise a professional’s career, but also may result in a referral to the IRS Office of Professional Responsibility with the ensuing sanctions under Circular 230. In addition, such an approach would indirectly undercut the general rule that the signing preparer is responsible. That is, the default rule inevitably will tip towards penalizing the supervisory individual, as opposed to the signing preparer, assuming the signing preparer has some information indicating he or she was not primarily responsible. While we support the approach in the proposed regulations that the signing preparer should not always be the individual responsible for the penalty, we believe the default rule goes too far in the other direction by making it more likely that the individual with overall supervisory responsibility will be the individual who is penalized.

We appreciate the Service and Treasury were trying to balance fairness with administrability in arriving at the default rule. We do not believe, however, that the potential administrative hurdles are likely to be so high as to justify a default rule with so many negatives, particularly if preparer penalties are not to be imposed routinely, but only when clearly warranted. Accordingly, we recommend that the following phrase be stricken from Prop. Reg. section 1.6694-1(b)(3): “or the IRS cannot conclude which individual (as between the signing tax return preparer and other persons within the firm) is primarily responsible for the position.”

3. Prop. Reg. section 1.6694-1(f)(4): No Preparer Liable for the Section 6694 Penalty

Prop. Reg. section 1.6694-1(f)(4), Example 3, describes a situation where there is an understatement, multiple practitioners involved, yet no one is liable for a section 6694 penalty (the tax advisor is not liable for a section 6694 penalty because the events had not occurred when the advice was given, and the signing preparer is not liable because he or she reasonably relied on the advice of the tax advisor). We agree with the example and

the need to provide guidance that makes it clear that even if there is an understatement of tax, the section 6694 penalty may not apply. To reinforce this message within the IRS, we recommend that guidance to IRS personnel, including the Internal Revenue Manual, specifically set forth a statement consistent with Example 3 that there may be instances where there is an understatement of tax, and yet no section 6694 penalty may be asserted because no preparer is responsible for the position resulting in the understatement.

4. Prop. Reg. section 301.7701-15(b)(4): Definition of “Return”

A. Definition of “Return”

Section 301.7701-15(b)(4) of the proposed regulations defines a return as any return (including amended or adjusted return) reporting the taxpayer’s tax liability. Also included in the definition of return is “any information return or other document identified in published guidance . . . that reports information that is or may be reported on another taxpayer’s return under the Code if the information reported on the information return or other document constitutes a substantial portion of the taxpayer’s return” For the reasons described below, we believe the proposed regulations have exceeded the authority provided by Congress and should limit the definition of return to exclude documents that do not report a tax liability.

1. Consistency with Sections 7701 and 6696

Code section 7701(36) provides that a tax return preparer means “any person who prepares . . . *any return of tax imposed by this title* or any claim for refund of tax imposed by this title.” (Emphasis added.) Section 6696(e)(1) provides that for purposes of section 6694, section 6695, and section 6695A, the term “return” means any return of any tax imposed by the Internal Revenue Code. These provisions of the Code are clear that not every document created and prescribed for use by the IRS is a return. Rather, only documents that are *returns of tax imposed* are treated as “returns” for purposes of the preparer penalties. In order to give this language meaning, Prop. Reg. section 301.7701-15(b)(4) should be revised so that only documents reporting a tax liability are treated as returns subject to preparer penalties.

2. Unaltered Definition of “Return”

Although the Small Business and Work Opportunity Act of 2007 generally extended the preparer penalty regime to apply not just to income tax, but to all types of tax, Congress did not amend the long-established definition of return for purposes of income taxes. Because Congress did not change the law in this area, longstanding and generally accepted rules relating to what is a return of income tax should continue to apply. The language in the proposed regulations defining a return, and the inclusion of many of the documents in the list of “returns” published in Notice 2008-11 and supplemented in Notice 2008-46, are contrary to established law regarding what is a return of income tax. The final regulations should limit the documents treated as a return to be consistent with IRS’s authority under existing law.

3. Definition of “Return” as Developed in Case Law

The Supreme Court defined a return of income tax for purposes of the statute of limitations in the seminal case of *Beard v. Commissioner*, 82 T.C. 766, 777 (1984), affd. per curiam 793 F.2d 139 (6th Cir. 1986). That Court cited *Badaracco v. Commissioner*, 464 U.S. 386, 78 L. Ed. 2d 549, 104 S. Ct. 756 (1983) and its predecessors, including *Germantown Trust Co. v. Commissioner*, 309 U.S. 304, 84 L. Ed. 770, 60 S. Ct. 566, 1940-1 C.B. 178 (1940); *Zellerbach Paper Co. v. Helvering*, 293 U.S. 172, 79 L. Ed. 264, 55 S. Ct. 127, 1934-2 C.B. 341 (1934); *Florsheim Bros. Drygoods Co. v. United States*, 280 U.S. 453, 74 L. Ed. 542, 50 S. Ct. 215, 1930-1 C.B. 260 (1930), to establish a four-part test for what constitutes a return of income tax. Under this test, for a document to be treated as a return it must: (1) calculate tax liability, (2) purport to be a return, (3) represent an honest and reasonable attempt to satisfy the requirements of the tax law, and (4) be executed by the taxpayer under penalties of perjury. *Beard v. Commissioner, supra* at 777.

We recommend that the regulations adopt the four-part *Beard* test to define a return. With respect to income taxes, the law is clear that this is the test of a return. We urge that the *Beard* test also be adopted for all types of tax, with the recognition that there may need to be some flexibility regarding the jurat requirement (some non-income tax forms would need to be modified to include a jurat, or the jurat requirement would have to be waived for non-income tax forms that do not include a jurat). Regardless of whether the specific language in the *Beard* test is adopted, the language in the proposed regulations stating that any document identified by IRS as a return will be treated as a return must be modified to be consistent with the limitations set forth in case law.

4. IRS Published Guidance

IRS published guidance specifically excludes the Form W-2 from being a return covered by section 6694 and section 6695 before those provisions were amended to include non-income tax returns.² The government’s rationale for now proposing to include a Form W-2 in the list of “returns” covered by these provisions is that the information on the form will be used to compute the income tax liability of the employee. As stated above, there has been no change to the definition of return for purposes of income taxes. Thus, a Form W-2 should be excluded from the definition of return under the final regulations.

Similarly, section 301.7701-15(c)(1)(ii) of the current regulations provides that certain forms that relate to income tax, such as estimated tax declarations (since eliminated, but comparable to the Form 2210 and Form 2220 today), extensions of time to file, Form 1099, or any similar form, are not treated as returns. Again, nothing in the 2007 Act changed the definition of return for purposes of income tax. Accordingly, these forms should also be excluded from the definition of return under the final regulations.

² See PLR 8034159 (June 2, 1980); PLR 8035069 (June 6, 1980); and GCM 38648 (March 3, 1981).

5. Treatment of Information Returns under OBRA '89

As part of the comprehensive penalty reform last undertaken in 1989, Congress structured the civil penalty regime to avoid stacking. Rules were created around different categories of penalties, including accuracy-related penalties such as section 6662 and section 6663, delinquency penalties such as section 6651, information return penalties such as those under section 6721 through section 6724, and preparer and promoter penalties such as those under section 6694, section 6695, section 6700, and section 6701. Each penalty was intended to address particular behavior.

If information returns are included in the category of returns covered by the preparer penalties, the penalty structure established by Congress in 1989 will have been altered. The amendments made by the Small Business and Work Opportunity Act of 2007 and its legislative history do not reflect an intent by Congress to alter the structure put in place in 1989. Therefore, information returns that are covered by separate information reporting penalties should not be included in the category of returns covered by section 6694 and section 6695. Accordingly, Form 1099 and similar returns should be excluded from the definition of return in the final regulations.

6. Form 5500

Similarly, we recommend that the Form 5500 be eliminated from the scope of the section 6694 preparer penalties regime. No taxes are paid with Form 5500, and information reported on Form 5500 generally is not used in preparing any tax return. If the Form 5500 is not eliminated, we suggest (1) that the IRS identify the specific line items on the Form 5500 to which the preparer penalties apply, and (2) that welfare plans, which are required to file a Form 5500 only by ERISA and not by the Internal Revenue Code, be completely exempt from section 6694.

B. Publication of the List of Returns

The preamble of the proposed regulations states that the list of returns subject to section 6694 and section 6695 will be published simultaneously with the final regulations. We believe that a list of the forms designated as returns is crucial to the preparer's understanding of when the preparer's conduct can be penalized. Accordingly, we believe that the list of returns should be published in a regulation subject to notice and comment. At a minimum, the list should first be published in proposed form to allow the public to provide comments. In addition, the list should provide sufficient lead time within a prospective effective date to permit preparers sufficient time to develop and implement processes and procedures to comply with the requirements of section 6107, section 6109, section 6694, and section 6695. Any additions to the list should have an effective date that does not impose new requirements in the middle of a filing season and should take into account fiscal-year returns.

5. Prop. Reg. section 1.6694-2(b): Definition of "Reasonable Belief"

The preamble to the proposed regulations states that a tax return preparer may meet the reasonable belief/more likely than not standard if “the tax return preparer relies on information *or advice* furnished by a taxpayer, advisor, another tax return preparer, or other party . . . as provided in proposed §1.6694-1(e).” 73 Fed. Reg. 34565 (June 17, 2008). (Emphasis added.) However, the definition of the reasonable belief standard in the text of the regulations omits the word “advice,” and provides merely that a tax return preparer “may rely in good faith without verification upon information furnished by the taxpayer, advisor, other tax return preparer, or other party . . . as provided in §1.6694-1(e).” Prop. Reg. section 1.6694-2(b)(1). We believe that the omission of the word “advice” in the text of the proposed regulations was unintentional, and that the drafters’ intent was to include reliance upon advice as a means to satisfy the reasonable belief standard, as stated in the preamble. As recognized in the preamble, the heightened standards imposed on tax return preparers and the increased complexity of the tax law “often requires signing and nonsigning tax return preparers to rely on the work of others in ensuring compliance.” 73 Fed. Reg. 34564 (June 17, 2008). Indeed, tax return preparers routinely rely on the advice of other preparers and advisors in forming a belief as to the likelihood of a particular tax position being sustained on its merits, and this type of reliance is clearly relevant in assessing the reasonableness of a preparer’s belief regarding the position. However, as the proposed regulation is currently drafted, the only way a tax return preparer can satisfy the reasonable belief standard is to personally engage in the analysis prescribed by Reg. section 1.6662-4(d)(3)(ii). While reliance on advice is specifically identified as a factor to be considered in the reasonable cause provision, *see* Prop. Reg. section 1.6694-2(d)(5), the availability of this defense does not cure the problem for diligent tax return preparers who wish to have clear rules of conduct they can comply with to avoid exposure to section 6694 liability in the first place.

In order to address the above concern, we recommend adding the word “advice” to the text of the reasonable belief definition, in the same manner that it appears in the preamble, or otherwise adding a reliance upon advice clause to the reasonable belief provision. We also recommend the following conforming changes to the regulations:

- In the reasonable belief provision (Prop. Reg. section 1.6694-2(b)), in order to establish the proper standards for advice that a tax return preparer may rely upon, insert either the text of, or a cross-reference to, the requirements for advice provided in the reasonable cause provision (*e.g.*, the tax return preparer had reason to believe the advisor was competent to render the advice, the advice was not unreasonable on its face, *etc.*). See Prop. Reg. section 1.6694-2(d)(5).

If reliance on advice language is not added to section 1.6694-1(e) as recommended below, revise the text of the reasonable cause provision to ensure that the term “as provided in §1.6694-1(e)” modifies the word “information” and not “advice.”

6. Prop. Reg. section 1.6694-2(c)(2): Definition of “Reasonable Basis”

For the same reasons that we recommended adding reliance on advice to the definition of reasonable belief (see above), we also recommend adding reliance on advice to the definition of reasonable basis. In determining “whether the tax return preparer has a reasonable basis for a position” as stated in the proposed regulations, *see* Prop. Reg. section 1.6694-2(c)(2), it is necessary, as it is in determining reasonable belief, to consider whether the tax return preparer reasonably relied upon advice from another advisor or party who was competent to provide the advice. To make this modification, the words “and advice” could be added to the second sentence of the provision, such that it reads “a tax return preparer may rely in good faith without verification upon information *and advice* furnished by the taxpayer, advisor, other tax return preparer or other party (including another advisor or tax return preparer at the tax return preparer's firm), as provided in §1.6694-1(e).”

7. Prop. Reg. section 1.6694-1(e)(1): Reliance on Advice

Consistent with the changes recommended above regarding the definitions of reasonable belief and reasonable basis, we recommend Prop. Reg. section 1.6694-1(e)(1) be amended to refer specifically to reliance on advice from others. We recommend adding the words “and advice” in the third sentence of the provision, such that it reads that a “tax return preparer may also rely in good faith and without verification upon information *and advice* provided by another advisor, another tax return preparer or other party (including another advisor or tax return preparer at the tax return preparer's firm).”

8. Prop. Reg. section 1.6694-1(e)(1): Reliance on Legal Conclusions

Prop Reg section 1.6694-1(e)(1) provides: “A tax return preparer, however, may not rely on information provided by a taxpayer with respect to legal conclusions on Federal tax issues.” We are concerned that this sentence could be interpreted to change the longstanding interpretation of the verification provision in the section 6694 regulations that permits a tax return preparer to rely on information provided by the taxpayer that involves both law and fact. For example, preparers have long been permitted to rely on information from the taxpayer regarding information about basis, earnings and profits, depreciation, inventory, and similar items if the preparer does not have a reason to believe such information is inaccurate or incomplete.

In addition, many large entity taxpayers have in-house tax departments staffed by experienced tax professionals, including CPAs and attorneys who are qualified to perform the research and analysis necessary to address Federal tax issues. The provision in Prop. Reg. section 1.6694-1(e)(1) that states a preparer cannot rely on a client’s legal conclusions on Federal tax issues could effectively require preparers to re-perform the research and analysis conducted by these in-house tax professionals.

To address these concerns, we recommend preparers be permitted to rely on research and analyses performed, and legal conclusions reached by taxpayers regarding Federal tax issues provided the preparer has reason to believe the taxpayer is competent to perform

such services. To effect this recommendation, we suggest that the following language be inserted in Prop. Reg. section 1.6694-1(e):

A preparer may rely without verification on a taxpayer's legal conclusions regarding Federal tax issues that the tax return preparer had reason to believe the taxpayer was competent to provide.

9. Prop. Reg. section 1.6694-1(e)(1): Reliance on Estimates

The nature of accounting, upon which calculations of taxable income are based, requires the use of estimates. The use of estimates is specifically contemplated in the Treasury Regulations, for example Reg. sections 1.448-2(d), 1.451-1(a), and 1.451-5. The AICPA has established standards for the use of the taxpayer's estimates, in Statement on Standard for Tax Services ("SSTS") No. 4, *Use of Estimates*, which permits reliance on estimates of the taxpayer if it is not practical to obtain the exact information and if the preparer determines that the estimates are reasonable based on facts and circumstances known to him or her at the time the return is prepared. A copy of SSTS No. 4 is attached as Appendix A to these comments.

In our previous comments, we recommended that the regulations addressing a preparer's reliance on taxpayer and third-party information address the use of estimates, with that reliance on estimates limited in a manner similar to SSTS No. 4. In view of the important role of estimates in tax compliance, we urge Treasury and IRS to reconsider this issue and to include a specific reference to the use of estimates in the final regulations.

Accordingly, we recommend that the following language be inserted in Prop. Reg. section 1.6694-1(e)(1) before the third sentence thereof (as originally proposed):

A preparer may rely on the taxpayer's estimates if (1) it is not practical to obtain the exact information, (2) the preparer determines that the estimates are reasonable based on facts and circumstances known to the preparer at the time the return is prepared, (3) the estimates are not presented in a manner that would imply greater accuracy than exists; and (4) the use of or reliance on estimates is not otherwise prohibited by the Code, the Treasury Regulations, or any Revenue Procedure, Revenue Ruling, or Notice published by the Internal Revenue Service.

10. Prop. Reg. sections 1.6694-2(b)(1) and (d)(6): Reliance on Generally Accepted Administrative or Industry Practice

We commend Treasury and the Service for recognizing the importance of generally accepted administrative and industry practice in the work of return preparers, and for including a provision in the proposed regulations that would permit return preparers to rely upon generally accepted administrative or industry practice in establishing reasonable cause relief from penalties. Prop. Reg. section 1.6694-2(d)(6). However, we believe that reliance on generally accepted administrative or industry practice also should

be recognized as a relevant factor in determining whether the reasonable belief/more likely than not standard is satisfied. Clearly articulating relevant criteria on the front end (before a penalty is asserted) helps professionals in understanding their obligations and in complying with the tax laws, notwithstanding that relief ultimately may be available on the back end (through reasonable cause). Taking generally accepted administrative or industry practice into account up front also would further more consistent application of the penalty rules in that the role of this practice would not be fleshed out only on a case-by-case basis through individual reasonable cause determinations.

Certainly, based on public statements, Treasury and IRS believe that tax administration is best served by preventing a flood of disclosures that report positions consistent with generally accepted administrative or industry practice that are recognized by the government as sound. Preparers will more readily forgo disclosures in these situations if the regulations affirmatively state that the penalty will not apply in the first instance (such that reasonable belief/more likely than not is satisfied) if the position is consistent with generally accepted administrative or industry practice. Therefore, we urge the government to provide for reliance on generally accepted administrative or industry practice in both section 1.6694-2(b) with respect to reasonable belief and in section 1.6694-2(d)(6) with respect to reasonable cause. This change could be effectuated simply by adding a cross reference to Prop. Reg. section 1.6694-2(d)(6) in the definition of reasonable belief.

The AICPA would be happy to facilitate an ongoing dialog between Treasury and the IRS industry groups and AICPA members with specialized industry experience, to assist with the development of additional guidance in this area after the proposed regulations have been finalized.

11. Prop. Reg. section 1.6694-2(b)(1): Consideration of Item's Relative Size and Complexity in Establishing Reasonable Belief

Prop. Reg. section 1.6694-2(b)(1) provides that:

A tax return preparer may “reasonably believe that a position would more likely than not be sustained on its merits” if the tax return preparer analyzes the pertinent facts and authorities, and in reliance upon that analysis, reasonably concludes in good faith that the position has a greater than 50 percent likelihood of being sustained on its merits. . . . Whether a tax return preparer meets this standard will be determined based upon all facts and circumstances, including the tax return preparer’s diligence. In determining the level of diligence in a particular situation, the tax return preparer’s experience with the area of Federal tax law and familiarity with the taxpayer’s affairs, as well as the complexity of the issues and facts, will be taken into account.

Each tax return contains a multitude of positions. Some of these issues are extremely complex, although the impact of any particular issue on the taxpayer’s overall tax liability

could be relatively small. This is particularly true with respect to accounting methods where issues include revenue recognition, inventory, capitalization and depreciation, allocation of costs, and valuation.

There are economic constraints on any taxpayer's expenditures for tax return preparation. Signing tax return preparers operating within these constraints should not be expected to address every tax return position in the same manner, regardless of its relative size or complexity in relation to the taxpayer's overall return. Rather, tax administration is benefited if preparers devote a greater degree of scrutiny to those items having a greater impact on the taxpayer's overall tax liability.

Accordingly, we recommend that the proposed regulations expressly provide that the amount of an item or position relative to the amount of the other items or positions shown on the return is a factor to be considered in assessing the appropriate level of due diligence with respect that item or position. We recommend that the last sentence of Prop. Reg. section 1.6694-2(b)(1), quoted above, be revised to read:

Factors that will be taken into account in determining the level of diligence in a particular situation include the tax return preparer's experience with the area of Federal tax law and familiarity with the taxpayer's affairs, the complexity of the issues and facts, and the amount of the item or position relative to the amount of the other items or positions on the return.

In making this recommendation, we are not suggesting that the relative size of an item prevent the application of the section 6694 penalty in the case of smaller items, only that it be an express consideration in evaluating the sufficiency of the preparer's due diligence. A preparer of a return knowingly reporting a position that is unsupported should be subject to the section 6694 penalty, regardless of the amount of the item in relation to the resulting understatement.

12. Prop. Reg. section 1.6694-2(b)(4): Effect of Conflict Between Circuits

In defining reasonable belief, Prop. Reg. section 1.6694-2(b)(4), Example 4, posits a situation involving a split of authority between federal circuits. However, this Example does not specifically address whether a preparer is bound by a decision of the federal Circuit Court of Appeals to which an appeal would lie in the event of such a conflict. We note that in applying the accuracy-related penalty for substantial understatements, Reg. section 1.6662-4(d)(3)(iv)(B) provides that “[t]he applicability of court cases to the taxpayer by reason of the taxpayer's residence in a particular jurisdiction is not taken into account in determining whether there is substantial authority for the tax treatment of an item. Notwithstanding the preceding sentence, there is substantial authority for the tax treatment of an item if the treatment is supported by controlling precedent of a United States Court of Appeals to which the taxpayer has a right of appeal with respect to the item.”

We believe that the proposed regulations should adopt the same rule as Reg. section 1.6662-4(d)(3)(iv)(B), so that the application of the reasonable belief/more likely than not standard and the determination of when a position must be disclosed do not vary based upon the taxpayer's residence. This approach supports uniform disclosure by return preparers (and taxpayers) of similar positions across the country. In addition, incorporating the accuracy-related penalty principles regarding jurisdiction into the preparer penalty regulations will prevent conflicts between taxpayers and preparers in complying with the tax laws.

13. Prop. Reg. section 1.6694-3(c)(2): Definition of “Contrary to” a Regulation or Rule

Prop. Reg. section 1.6694-3(c)(2) addresses whether a preparer will be deemed to have acted recklessly or intentionally with respect to positions “contrary to” a regulation that are disclosed on Form 8275-R. Prop. Reg. section 1.6694-3(c)(2) further states that such a position must be a good faith challenge to the validity of a regulation. Neither Prop. Reg. section 1.6694-3(c)(2) nor Prop. Reg. section 1.6662-4(f) defines the term “contrary to” a regulation.

Because the regulations mandate the filing of the Form 8275-R, as opposed to Form 8275, to satisfy the adequate disclosure obligations of the taxpayer and the tax return preparer in certain situations, we recommend that the instructions to Form 8275-R be expanded to explain when the Form 8275-R must be used by taxpayers and preparers. This will help ensure that positions “contrary to” a regulation are appropriately identified, while avoiding situations where the Form 8275 is filed but the Form 8275-R should have been used.

Similarly, we recommend that the IRS also clarify in the instructions to Form 8275 when a position is considered to be “contrary to” a rule (*i.e.*, a statute, revenue ruling or notice) to assist taxpayers and preparers in determining whether disclosure of a position on a Form 8275 is necessary to avoid a disregard-of-a-rule penalty.

14. Prop. Reg. section 1.6694-3(c)(3): Standard for Positions Contrary to Revenue Rulings or Notices

The proposed regulations tighten the provision in the current regulations for positions contrary to revenue rulings or notices (other than notices of proposed rulemaking) to provide that a preparer is not considered to have recklessly or intentionally disregarded a revenue ruling or notice if the preparer reasonably believes the position satisfies the more likely than not standard. Prop. Reg. section 1.6694-3(c)(3). In such a case, a preparer would not have to disclose the position to avoid violating section 6694(b), even if the preparer knew or was reckless in not knowing that the position was contrary to a revenue ruling or notice. Under current regulations, a preparer is not considered to have disregarded a revenue ruling or notice if the position satisfies the realistic possibility standard. Thus, the proposed change would increase the situations in which a preparer must disclose a position contrary to a revenue ruling or notice to avoid a section 6694(b)

penalty. The proposed change also would create a standard for preparers in this context that would be stricter than the standard for taxpayers. Under the current regulations, a taxpayer is not considered to have recklessly or intentionally disregarded a revenue ruling or notice if a position (other than with respect to a reportable transaction) is contrary to the ruling or notice, as long as the position satisfies the realistic possibility standard. See Reg. section 1.6662-3(b)(2).

The original carve-outs from the sections 6662 and 6694 “disregard penalties” for positions contrary to revenue rulings or notices were made because revenue rulings and notices typically receive less rigorous internal review before publication and less weight by courts than regulations. Requiring disclosure of all positions contrary to revenue rulings or notices to avoid a disregard penalty also could pose a trap for the unwary and burden the government with too many disclosures of routine return positions or positions potentially covered by outdated guidance.

We continue to believe that the original balance struck in the existing regulations makes sense from the standpoint of the government, as well as the taxpayer and practitioner communities, although we appreciate the more recent focus on reportable transactions. Accordingly, we recommend that the carve-out for preparers in the case of positions contrary to revenue rulings or notices be revised to conform to the standard for taxpayers. Under this approach, a preparer (like a taxpayer) would not be considered to have intentionally or recklessly disregarded a revenue ruling or notice if the contrary position did not involve a reportable transaction and satisfied the realistic possibility standard. This approach also would conform the preparer standard to the taxpayer standard in this context and avoid problems associated with a discontinuity in taxpayer and preparer standards. Finally, this approach would reduce the circumstances in which a preparer may inadvertently be subject to a section 6694(b) penalty (with the heightened prospect of referral to OPR).

15. Effective Date

The proposed regulations indicate that the final regulations will be applicable to returns and claims for refund filed, and advice provided, after the date that final regulations are published in the Federal Register. This would result in a mid-year revision to the standards for tax return preparers, and does not allow return preparers the opportunity to review the final regulations, train their employees, and revise forms and practice aids to promote compliance before they become effective.

We recognize that the proposed regulations, and ultimately the final regulations, are more comprehensive than the interim guidance and address issues that were not addressed in Notice 2008-13. It is appropriate that the final regulations become effective as soon as possible to provide preparers with guidance in these areas. To allow preparers a reasonable opportunity to adapt to any changes between Notice 2008-13 and the final regulations, we recommend that Treasury adopt a transition rule providing that a preparer who complies with the requirements of Notice 2008-13 for any return filed or any advice

given within the 60 days following publication of the final regulations will be deemed to have satisfied his or her obligations under the final regulations.

Technical Recommendations

16. Prop. Reg. section 1.6107-1(b)(1): Record Retention by Signing Preparers

Internal Revenue Code section 6107 requires that tax return preparers furnish copies of returns to the taxpayer, retain copies of returns for a period of three years, and make these copies of returns available upon the request of the Secretary.

Proposed Reg. section 1.6107-1(c) appears to provide that, if a signing preparer is employed by, or a partner in, a corporation or partnership, the organization will be treated as the signing preparer for purposes of the section 6107 requirements. While we agree with this approach, some of the wording of Prop. Reg. section 1.6107-1(c) is confusing. We recommend that Proposed Reg. section 1.6107-1(c)(1) and (2) be replaced by the following language:

(c) Tax return preparer. For the definition of “signing tax return preparer,” see section 7701(a)(36) and 301.7701-15(b)(1) of this chapter. For purposes of applying this section, a corporation, partnership or other organization that employs a signing tax return preparer to prepare for compensation (or in which a signing tax return preparer is compensated as a partner or member to prepare) a return of tax or claim for refund shall be treated as the sole signing preparer.

17. Prop. Reg. section 1.6694-1(b)(1) and Sec. 301.7701-15(b)(3): “Tax Return Preparer”

Prop. Reg. section 1.6694-1(b)(1) references Code section 7701(a)(36) and Prop. Reg. sec. 301.7701-15 for the definition of a “tax return preparer” and notes that a person is a tax return preparer subject to section 6694 “if the individual is primarily responsible for the position(s) on the return or claim for refund giving rise to an understatement.” It would be helpful if there were a cross-reference in this section to the language in Sec. 301.7701-15(b)(3) which states: “A person who renders tax advice on a position that is directly relevant to the determination of the existence, characterization, or amount of an entry on a return or claim for refund will be regarded as having prepared that entry.”

18. Prop. Reg. section 1.6694-1(b)(2): Responsibility of Signing Tax Return Preparer

Prop. Reg. section 1.6694-1(b)(2) states that: “The signing tax return preparer within the meaning of §301.7701-15(b)(1) of this chapter will generally be considered the person who is primarily responsible for all of the positions on the return or claim for refund giving rise to the understatement.” We believe, based upon the context in which this provision appears, that the intent of this provision was to describe the responsibility of

the signing tax return preparer relative to other preparers within the signing preparer's firm.

Accordingly, we recommend that the language quoted above be clarified by inserting the phrase "within a firm" after "will generally be considered the person," so that the provision reads: "The signing tax return preparer within the meaning of §301.7701-15(b)(1) of this chapter will generally be considered the person *within the firm* who is primarily responsible for all of the positions on the return or claim for refund giving rise to the understatement."

19. Prop. Reg. section 1.6694-2(c)(3)(i): Adequate Disclosure by Signing Preparers

A. Prop. Reg. section 1.6694-2(c)(3)(i)(C)

Prop. Reg. section 1.6694-2(c)(3)(i) describes the means by which a signing preparer satisfies the obligation to make adequate disclosure with respect to a position for which the preparer does not have a reasonable belief that the position is more likely than not correct. Prop. Reg. section 1.6694-2(c)(3)(i)(A) states unconditionally that disclosure is adequate if a position is disclosed on the Form 8275 or Form 8275-R, as appropriate, or in accordance with the annual revenue procedure (actual disclosure). Prop. Reg. section 1.6694-2(c)(3)(i)(B) states that if a position does *not have substantial authority* but has a reasonable basis, a signing preparer may satisfy adequate disclosure by providing the taxpayer with a return that includes the disclosure in accordance with Reg. section 1.6662-4(f). Under this rule, disclosure is adequate even if the taxpayer removes the Form 8275 or Form 8275-R from the return before it is filed. Prop. Reg. section 1.6694-2(c)(3)(i)(C) states that in cases where the position *has substantial authority*, the only way to satisfy adequate disclosure is to advise the taxpayer of the penalty standards applicable to the taxpayer under section 6662 and document this advice in the file.

Reading these sections together, it becomes apparent that one variation of what should be treated as adequate disclosure is not covered. If a position has substantial authority and a preparer delivers to the taxpayer a return with an appropriately completed Form 8275 or Form 8275-R attached, but the taxpayer removes the Form 8275 or Form 8275-R prior to filing the return, the preparer also should be viewed as having satisfied the adequate disclosure requirements.

To remedy this, we recommend that Prop. Reg. section 1.6694-2(c)(3)(i)(C) be revised to read as follows:

(C) For income tax returns, if the position would otherwise meet the standard for nondisclosure under section 6662(d)(2)(B)(i) (substantial authority), either the tax return preparer provides the taxpayer with the prepared tax return that includes the disclosure in accordance with § 1.6662-4(f), or the preparer advises the taxpayer of all the penalty standards applicable to the taxpayer under section 6662. The tax return

preparer must also contemporaneously document any advice in the tax return preparer's files.

B. Prop. Reg. section 1.6694-2(c)(3)(i)(D)

Prop. Reg. section 1.6694-2(c)(3)(i)(D) requires that the preparer advise the taxpayer that "disclosure will not protect the taxpayer from assessment of an accuracy-related penalty if either section 6662(d)(2)(C) or 6662A applies to the position." We recommend adding after the word "disclosure" the words "in accordance with Reg. section 1.6662-4(f)," since appropriate Form 8886 disclosure is relevant both in determining the penalty rate under section 6662A(c) and in the availability of a reasonable cause defense to the section 6662A penalty under section 6664(d).

20. Prop. Reg. section 1.6694-2(c)(3)(ii): Adequate Disclosure by Nonsigning Preparers

A. Prop. Reg. section 1.6694-2(c)(3)(ii)(A): Adequate Disclosure – Advice to Taxpayer

In Prop. Reg. section 1.6694-2(c)(3)(ii)(A) with respect to a nonsigning preparer's advice to a taxpayer, if the firm is advising the taxpayer, the contemporaneous documentation should confirm that the affected taxpayer has been advised by a preparer in the firm of the potential penalties and the opportunity to avoid penalty through disclosure.

B. Prop. Reg. section 1.6694-2(c)(3)(ii)(B): Adequate Disclosure – Advice to Another Tax Return Preparer

In Prop. Reg. section 1.6694-2(c)(3)(ii)(B) with respect to a nonsigning preparer's advice to another tax return preparer, if providing nonsigning preparer advice to another preparer in the same firm, contemporaneous documentation should be satisfied if there is a single instance of contemporaneous documentation within the firm.

If the firm is advising another preparer outside of the firm, this documentation should confirm that the preparer outside the firm has been advised that disclosure under section 6694(a) may be required.

21. Prop. Reg. section 1.6694-3(c)(2): Cross-references

Prop. Reg. section 1.6694-3(c)(2) provides that a preparer is not considered to have recklessly or intentionally disregarded a rule or regulation if the position contrary to the rule or regulation has a reasonable basis and is disclosed in accordance with Prop. Reg. section 1.6694-2(c)(3) – except that disclosure in accordance with an annual revenue procedure would not be adequate for purposes of section 6694(b). (In the case of a position contrary to a regulation, the position also must represent a good faith challenge to the validity of the regulation and the regulation must be identified.)

We believe that the cross-reference to Prop. Reg. section 1.6694-2(c)(3) in Prop. Reg. section 1.6694-3(c)(2) is confusing and either should be revised or replaced with a separate set of disclosure rules for purposes of section 6694(b) along the lines of the current regulations. See Reg. section 1.6694-3(c)(3). At a minimum, the cross-reference should be altered to make clear that the advice a nonsigning preparer gives to another preparer to avoid a section 6694(b) penalty is that disclosure may be necessary in order for the other preparer to avoid a section 6694(b) (instead of a section 6694(a)) penalty. See Prop. Reg. section 1.6694-2(c)(3)(ii)(B), which is caught by the cross-reference.

The cross-reference is confusing, because the disclosure rules in Prop. Reg. sections 1.6694-2(c)(3)(i)-(iii) specifically address situations in which the relevant return position has a reasonable basis, but does not satisfy the reasonable belief/more likely than not standard. Putting aside the carve-out for positions contrary to revenue rulings or notices, the section 6694(b) penalty potentially applies, however, regardless of whether the reasonable belief/more likely than not standard is met.

Moreover, in the case of signing preparers under Prop. Reg. section 1.6694-2(c)(3)(i), the cross-reference should be to Prop. Reg. section 1.6694-2(c)(3)(i)(A) and, if the proposed change addressing positions contrary to revenue rulings or notices is adopted, to Prop. Reg. section 1.6694-2(c)(3)(i)(E) as well. The provisions in Prop. Reg. sections 1.6694-2(c)(3)(i)(B)-(D) are irrelevant for purposes of the disregard penalty. A cross-reference to Prop. Reg. section 1.6694-2(c)(3)(i)(A) is necessary to encompass disclosure on a Form 8275-R. The cross-reference to Prop. Reg. section 1.6694-2(c)(3)(i)(E) would be necessary to address the situation in which the preparer may be subject to a section 6694(b) penalty, but the taxpayer is not otherwise subjected to a penalty. As explained previously, this would happen under the proposed change if a position contrary to a revenue ruling or notice not involving a reportable transaction satisfied the realistic possibility, but not the reasonable belief/more likely than not, standard.

22. Prop. Reg. section 1.6694-3(d), Example 3: Example – Section 6694(b) Penalty

Clarification is needed regarding the facts in Example 3, at Prop. Reg. section 1.6694-3(d). The facts should be further refined to make it clear that (1) there are no cases that ruled favorably with respect to the validity of that portion of the regulations, (2) that no other facts would justify a reasonable belief that it is more likely than not that the regulations are valid (*e.g.*, explicit legislative history) and (3) that the U.S. Tax Court case was decided and published before the tax return preparer prepared the return (this could be done by stating the date on which the return was prepared and the year of the case).

23. Prop. Reg. section 1.6694-3(f): Offsetting Section 6694(a) and Section 6694(b) Penalties

Prop. Reg. section 1.6694-3(f) offsets the amount of any section 6694(a) penalty against the amount of any section 6694(b) penalty “for the same return or claim for refund.”

Given that the penalty is assessed and is effectively calculated on a position-by-position basis, any offset should also be addressed on a position-by-position basis.

24. Prop. Reg. section 1.6695-1(f)(2)(ii): Deposit of Refund Checks in the Taxpayer's Account

Prop. Reg. section 1.6695-1(f)(1) prohibits a tax return preparer from endorsing or negotiating a refund check relating to a return for which he or she is a preparer. Many tax return preparers also perform bookkeeping services for the same taxpayers for whom they prepare returns. These bookkeeping services sometimes include arranging for deposits into a taxpayer's account.

The proposed regulation should be clarified to specifically state that a preparer is not prohibited from affixing the taxpayer's name on a refund check (typically accomplished via a mechanical stamp) for the purpose of depositing the check into an account in the name of the taxpayer. For some preparers, it is very common to provide general assistance with general business matters of the client and depositing the refund check into the taxpayer's account may be required as part of this assistance. We believe that this activity would not constitute endorsement or negotiation of a check, but a clarification in the regulations would be helpful to avoid potential confusion among those not familiar with these issues.

Accordingly, we suggest that the regulation be clarified by adding the following language at the end of Prop. Reg. section 1.6695-1(f)(1):

A tax return preparer will not be considered to have endorsed or otherwise negotiated a check for purposes of this paragraph (f)(1) solely as a result of having affixed the taxpayer's name to a refund check for the purpose of depositing the check into an account in the name of the taxpayer or in the joint names of the taxpayer and one or more other persons (excluding the tax return preparer).

Conclusion

As we stated in our opening comments, we greatly appreciate the efforts and approach taken by Treasury and the IRS in providing timely guidance on the revised return preparer penalty provisions. Both the interim guidance and the proposed regulations reasonably balance the interests of taxpayers, tax practitioners, and the government in complying with and administering the new provisions. We offer our recommendations not as criticisms of the proposed regulations, but rather as suggestions to enhance the guidance available to the tax community and facilitate administration of the new provisions. We would be happy to discuss these recommendations or any other aspects of the proposed regulations with you at any time.

Appendix A

AICPA Statement on Standards for Tax Services No. 4, Use of Estimates

Introduction

1. This Statement sets forth the applicable standards for members when using the taxpayer's estimates in the preparation of a tax return. A member may advise on estimates used in the preparation of a tax return, but the taxpayer has the responsibility to provide the estimated data. Appraisals or valuations are not considered estimates for purposes of this Statement.

Statement

2. Unless prohibited by statute or by rule, a member may use the taxpayer's estimates in the preparation of a tax return if it is not practical to obtain exact data and if the member determines that the estimates are reasonable based on the facts and circumstances known to the member. If the taxpayer's estimates are used, they should be presented in a manner that does not imply greater accuracy than exists.

Explanation

3. Accounting requires the exercise of professional judgment and, in many instances, the use of approximations based on judgment. The application of such accounting judgments, as long as not in conflict with methods set forth by a taxing authority, is acceptable. These judgments are not estimates within the purview of this Statement. For example, a federal income tax regulation provides that if all other conditions for accrual are met, the exact amount of income or expense need not be known or ascertained at year end if the amount can be determined with reasonable accuracy.

4. When the taxpayer's records do not accurately reflect information related to small expenditures, accuracy in recording some data may be difficult to achieve. Therefore, the use of estimates by a taxpayer in determining the amount to be deducted for such items may be appropriate.

5. When records are missing or precise information about a transaction is not available at the time the return must be filed, a member may prepare a tax return using a taxpayer's estimates of the missing data.

6. Estimated amounts should not be presented in a manner that provides a misleading impression about the degree of factual accuracy.

7. Specific disclosure that an estimate is used for an item in the return is not generally required; however, such disclosure should be made in unusual circumstances where nondisclosure might mislead the taxing authority regarding the degree of accuracy of the return as a whole. Some examples of unusual circumstances include the following:

- a.* A taxpayer has died or is ill at the time the return must be filed.
- b.* A taxpayer has not received a Schedule K-1 for a pass-through entity at the time the tax return is to be filed.
- c.* There is litigation pending (for example, a bankruptcy proceeding) that bears on the return.
- d.* Fire or computer failure has destroyed the relevant records.