
MEMORANDUM

RE: **UNREPORTED INCOME (IRS):** AIDING & ABETTING
 UNDERSTATEMENTS (TAX PREPARER PENALTIES)

DATE: NOVEMBER 27, 2007

1. Aiding and Abetting Tax Understatements (Penalty)

Any person who aids or assists in, or gives advice concerning, the preparation or presentation of any portion of a return, affidavit, claim, with the knowledge that the portion, if submitted, will create an understatement of the tax liability of another person must pay a penalty for each document that the person helps in preparing. (IRC § 6701(a)).

The penalty applies when a person orders a subordinate to act in a manner that violates this provision (or when a person knows that a subordinate will violate this provision and does not attempt to prevent the violation). (IRC § 6701(a), (c)).

A person who provides only mechanical assistance for a document, such as typing or photocopying, does not aid or assist in the preparation of the document. (IRC § 6701(e)).

The penalty applies regardless of whether the taxpayer was aware of, or consented to, the document that causes the understatement. (IRC § 6701(d)).

The penalty is \$1,000 per violation with regard to a return or document concerning a taxpayer other than a corporation, and \$10,000 with regard to a return or other document concerning the tax liability of a corporation.

The penalty applies only once for assistance given to a taxpayer for a specific tax period regardless of the number of documents prepared that cause an understatement for that tax period. (IRC § 6701(b)).

The penalty is generally in addition to any other penalty provided by law.

2. IRS: Burden of Proof

The burden of proof involving the issue of whether any person is liable for the penalty is on the IRS. (IRC § 6703(a)). (The government must prove its case by a preponderance of the evidence.)

3. Contest Penalty

The penalty is an assessable penalty. (IRC § 6703(b)). Accordingly, it is due after notice and demand from the IRS. (IRC § 6671(a)). It can not be challenged in the Tax Court prior to payment of the penalty because the deficiency procedures do not apply. (IRC § 6703(b)).

IRC § 6703(c) provides an alternative method for contesting assessment. The alternative method applies if, within 30 days after notice and demand for the penalty, the preparer pays not less than 15 percent of the asserted penalty and files a claim for refund of the amount paid. The IRS may file a counterclaim for the unpaid remainder of the penalty in such a proceeding. (IRC § 6703(c)(1)).

If the requirements as to timely payment of the 15 percent amount and as to filing of a refund claim are satisfied, then the IRS is prohibited from further collection activities with respect to the penalty until completion of the preparer's challenge to the penalty. (IRC § 6703(c)(1)). The next step in the process occurs if the IRS denies the refund claim or fails to act on the claim within six months of filing, at which time the preparer has 30 days within which to initiate a refund suit in the United States district court to determine liability for the IRC § 6701 penalty.

During the pendency of the refund suit, the statute of limitations on collection is suspended. (IRC § 6703(c)(3)). The IRS may not make,

begin, or prosecute a levy or proceeding in court for collection of the unpaid remainder of the penalty until final resolution of the refund suit. Final resolution of the proceeding includes any settlement between the IRS and the preparer, and any final determination by the court (for which the period of appeal has expired).

Gary S. Wolfe
A PROFESSIONAL LAW CORPORATION
9100 Wilshire Blvd., Suite 505 East
Beverly Hills, CA 90212
Tel: 310-274-3116 Fax: 310-274-3118
<http://www.gswlaw.com>
email: gsw@gswlaw.com