

### Internal Revenue Manual Section 20.1.6.4.11 (05-16-2012)

#### Reasonable Cause Exception

1. The penalty under IRC 6694(a) will not be imposed if, considering all the facts and circumstances, it is determined that the understatement was due to reasonable cause and the tax return preparer acted in good faith. See Treas. Reg. 1.6694-2(e). A tax return preparer will be found to have acted in good faith when the tax return preparer relied on the advice of a third party who is not in the same firm as the tax return preparer and who the tax return preparer had reason to believe was competent to render the advice. The advice may be written or oral, but in either case the burden of establishing that the advice was received is on the tax return preparer. A tax return preparer is not considered to have relied in good faith if—
  1. The advice is unreasonable on its face;
  2. The tax return preparer knew or should have known that the third party advisor was not aware of all relevant facts; or
  3. The tax return preparer knew or should have known (given the nature of the tax return preparer's practice), at the time the tax return or claim for refund was prepared, that the advice was no longer reliable due to developments in the law since the time the advice was given.
2. The other factors to consider include the following:
  1. Nature of the error causing the understatement: Whether the error resulted from a provision that was so complex, uncommon, or highly technical that a competent preparer of returns or claims of the type at issue reasonably could have made the error. The reasonable cause and good faith exception does not apply to an error that would have been apparent from a general review of the return or claim for refund by the preparer.
  2. Frequency of errors: Whether the understatement was the result of an isolated error (such as an inadvertent mathematical or clerical error) rather than a number of errors. Although the reasonable cause and good faith exception generally applies to an isolated error, it does not apply if the isolated error is so obvious, flagrant or material that it should have been discovered during a review of the return or claim. Furthermore, the reasonable cause and good faith exception does not apply if there is a pattern of errors on a return or claim for refund even though any one error, in isolation, would have qualified for the reasonable cause and good faith exception.
  3. Materiality of errors: Whether the understatement was material in relation to the correct tax liability. The reasonable cause and good faith exception generally applies if the understatement is of a relatively immaterial amount. Nevertheless, even an immaterial understatement may not qualify for the reasonable cause and good faith exception if the error or errors creating the understatement are sufficiently obvious or numerous.

4. Preparer's normal office practice: Whether the preparer's normal office practice, when considered together with other facts and circumstances, such as the knowledge of the preparer, indicates that the error in question would rarely occur and the normal office practice was followed in preparing the return or claim in question. Such a normal office practice must be a system for promoting accuracy and consistency in the preparation of returns or claims and generally would include, in the case of a signing preparer, checklists, methods for obtaining necessary information from the taxpayer, a review of the prior year's return, and review procedures. Notwithstanding the above, the reasonable cause and good faith exception does not apply if there is a flagrant error on a return or claim for refund, a pattern of errors on a return or claim for refund, or a repetition of the same or similar errors on numerous returns or claims.