

Reg. Section 1.6694-2(b)

Penalty for understatement due to an unreasonable position.

(a) In general -- (1) Proscribed conduct. Except as otherwise provided in this section, a tax return preparer is liable for a penalty under section 6694(a) equal to the greater of \$ 1,000 or 50 percent of the income derived (or to be derived) by the tax return preparer for any return or claim for refund that it prepares that results in an understatement of liability due to a position if the tax return preparer knew (or reasonably should have known) of the position and either --

(i) The position is with respect to a tax shelter (as defined in section 6662(d)(2)(C)(ii)) or a reportable transaction to which section 6662A applies, and it was not reasonable to believe that the position would more likely than not be sustained on its merits;

(ii) The position was not disclosed as provided in this section, the position is not with respect to a tax shelter (as defined in section 6662(d)(2)(C)(ii)) or a reportable transaction to which section 6662A applies, and there was not substantial authority for the position; or

(iii) The position (other than a position with respect to a tax shelter or a reportable transaction to which section 6662A applies) was disclosed as provided in this section but there was no reasonable basis for the position.

(2) Special rule for corporations, partnerships, and other firms. A firm that employs a tax return preparer subject to a penalty under section 6694(a) (or a firm of which the individual tax return preparer is a partner, member, shareholder or other equity holder) is also subject to penalty if, and only if --

(i) One or more members of the principal management (or principal officers) of the firm or a branch office participated in or knew of the conduct proscribed by section 6694(a);

(ii) The corporation, partnership, or other firm entity failed to provide reasonable and appropriate procedures for review of the position for which the penalty is imposed; or

(iii) The corporation, partnership, or other firm entity disregarded its reasonable and appropriate review procedures through willfulness, recklessness, or gross indifference (including ignoring facts that would lead a person of reasonable prudence and competence to investigate or ascertain) in the formulation of the advice, or the preparation of the return or claim for refund, that included the position for which the penalty is imposed.



(b) Reasonable to believe that the position would more likely than not be sustained on its merits -- (1) In general. If a position is with respect to a tax shelter (as defined in section 6662(d)(2)(C)(ii)) or a reportable transaction to which section 6662A applies, it is "reasonable to 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. In reaching this conclusion, the possibility that the position will not be challenged by the Internal Revenue Service (IRS) (for example, because the taxpayer's return may not be audited or because the issue may not be raised on audit) is not to be taken into

account. The analysis prescribed by § 1.6662-4(d)(3)(ii) (or any successor provision) for purposes of determining whether substantial authority is present applies for purposes of determining whether the more likely than not standard is satisfied. 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. A tax return preparer may reasonably believe that a position more likely than not would be sustained on its merits despite the absence of other types of authority if the position is supported by a well-reasoned construction of the applicable statutory provision. For purposes of determining whether it is reasonable to believe that the position would more likely than not be sustained on the merits, a tax return preparer may rely in good faith without verification upon information furnished by the taxpayer and information and advice furnished by another advisor, another 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) and 1.6694-2(e)(5).

(2) Authorities. The authorities considered in determining whether a position satisfies the more likely than not standard are those authorities provided in § 1.6662-4(d)(3)(iii) (or any successor provision).

(3) Written determinations. The tax return preparer may avoid the section 6694(a) penalty by taking the position that the tax return preparer reasonably believed that the taxpayer's position satisfies the "more likely than not" standard if the taxpayer is the subject of a "written determination" as provided in § 1.6662-4(d)(3)(iv)(A).

(4) Taxpayer's jurisdiction. The 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 it is reasonable to believe that the position would more likely than not be sustained on the merits. Notwithstanding the preceding sentence, the tax return preparer may reasonably believe that the position would more likely than not be sustained on the merits if the position 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.

(5) When "more likely than not" standard must be satisfied. For purposes of this section, the requirement that a position satisfies the "more likely than not" standard must be satisfied on the date the return is deemed prepared, as prescribed by § 1.6694-1(a)(2).

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