DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

AUG 17 1999

CC:DOM:IT&A:4MCPorter
WTA-N-111859-99

MEMORANDUM FOR DIRECTOR, SPECIAL COMPLIANCE PROGRAMS
OP:EX:CS:SCP
Attn: Dan Driscoll

FROM: Acting Assistant Chief Counsel (Income Tax & Accounting)
CC:DOM:IT&A:4

SUBJECT: Appeal Rights Under § 6695(g)

This responds to your July 7, 1999 request for advice regarding whether the Service's assertion of the § 6695(g) penalty for failure by an income tax return preparer (preparer) to exercise due diligence can be appealed to the National Director of Appeals. For the reasons discussed below, we conclude that the Commissioner has discretion to provide appeal rights to preparers with regard to the § 6695(g) penalty.

Section 6695(g), as added to the Code by § 1085(a)(2) of the Taxpayer Relief Act of 1997, Pub. L. No. 105-34, provides that any preparer with respect to a return or claim for refund who fails to comply with the due diligence requirements (as set forth in regulations) for determining eligibility for, or the amount of, the earned income credit (EIC) under § 32 shall pay a penalty of $100 for each such failure.

Section 1.6695-2T of the Income Tax Regulations provides that to meet the due diligence requirements of § 6695(g), preparers must: 1) complete the Eligibility Checklist (Form 8867) or an acceptable alternative; 2) complete the Computation Worksheet (the "Earned Income Credit Worksheet" contained in the instructions to the Form 1040) or an acceptable alternative; 3) possess no knowledge that the information used to determine EIC eligibility or computation of the EIC is false; and 4) retain the Eligibility Checklist or the acceptable alternative, the Computation Worksheet or the acceptable alternative, and information on where, and by whom, the preparer obtained the information used to complete the Eligibility Checklist and Computation Worksheet (or the alternatives). The preparer may avoid the penalty if the preparer can demonstrate to the satisfaction of the Service that, considering all

the facts and circumstances, the preparer's normal office procedures are reasonably designed and routinely followed to ensure compliance with the due diligence requirements. The § 6695(g) penalty does not have a reasonable cause or reasonable basis exception.

Section 6696(b) provides that the deficiency procedures shall not apply with respect to the assessment or collection of the penalties provided by §§ 6694 and 6695. Section 6671(a) provides that penalties and liabilities provided by subchapter B of chapter 68 (§§ 6671 through 6724) shall be paid upon notice and demand by the Secretary, and shall be assessed and collected in the same manner as taxes. Accordingly, the § 6695(g) penalty is not subject to deficiency procedures and must be paid by a preparer upon notice and demand by the Service. Once the penalty has been assessed, a preparer may contest the assertion of the § 6695(g) penalty by paying the penalty and filing a claim for refund within the applicable limitation period.

Section 601.106(a)(1)(iv) of the Statement of Procedural Rules generally provides appeal rights for certain penalties after assessment. Among the exceptions to this rule are penalties for which there is no reasonable cause or reasonable basis exception. Since § 6695(g) does not have a reasonable cause or reasonable basis exception, it is not subject to the § 601.106(a)(1)(iv) appeal rights.

Proposed regulations amending § 601.106 issued on September 20, 1993, would relax these rules regarding appeal rights for assessable penalties. The proposed regulations would provide that Appeals has exclusive settlement jurisdiction and final authority within the Service for the determination of liability for additions to the tax, additional amounts, and assessable penalties provided under chapter 68 of the Code. Unlike the final regulations, the proposed regulations would not limit the penalties for which post-assessment appeal rights are available. *See* § 601.106(a)(3)(iv) of the proposed regulations.

The Commissioner has discretion regarding whether to assess any penalty. See § 6404(c). Prior to assessment of the § 6695(g) penalty, neither the statute nor the Statement of Procedural Rules precludes the Service from establishing procedures to provide preparers a notice of proposed assessment of the § 6695(g) penalty and to allow the preparer an opportunity to go to Appeals prior to assessment. This would be consistent with the Service's practice with regard to taxes that are not subject to deficiency procedures, such as employment and most excise taxes, and other assessable penalties, such as the information reporting penalties under §§ 6721-6724 and the 100 percent penalty under § 6672. See Rev. Proc. 84-78, 1984-2 C.B. 754.

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If you have any questions regarding this memorandum, please contact Marc C. Porter at (202) 622-4940.

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