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Tax Law

Alert

The New Return Preparer Regulations

BY JOHN H. TURNER, III
AND JEFFREY D. CHADWICK

The Internal Revenue Service recently released final regulations, effective September 30, 2010, which control the registration and regulation of tax return preparers. Under the new regulations, all tax return preparers will be required to obtain a preparer tax identification number (a "PTIN") prior to filing any return due after December 31, 2010. Certain tax preparers will also be required to take and pass a competency exam and fulfill continuing education requirements.

Why Registration Requirements?

Any person, with or without any special training or license, can prepare a federal tax return for any other person for compensation. In 2009, the IRS conducted a comprehensive review of tax return preparers, culminating in Publication 4832, *Return Preparer Review*. Based on this review, the IRS estimated that there are currently between 900,000 and 1.2 million paid tax return preparers. Although a number of these preparers are attorneys, certified public accountants and enrolled agents, few of the other preparers have any special tax education or have passed any type of competency exam before preparing tax returns. The IRS study recommended that (i) all tax return preparers be required to obtain and use a PTIN and (ii) certain taxpayers be subject to new testing, continuing education, and Federal tax compliance checks.

Who Is a Return Preparer?

At the heart of the new regulation is the definition of a return preparer. The definition is much broader than one might assume and includes "any

individual who is compensated for preparing, or assisting in the preparation of, all or substantially all of a tax return or claim for refund of tax." This definition specifically includes all non-signing tax return preparers who prepare all or a substantial portion of a tax return or claim for refund. Thus, you could have several "preparers" of a return even though only one person serves as the signing preparer. The IRS has indicated that certain persons who provide only ministerial or mechanical assistance with the return will not be considered a preparer. Examples 1 and 3 of Treasury Regulation § 1.6109-2(g) illustrate these differences:

Example 1

Employee A, an individual employed by Tax Return Preparer B, assists Tax Return Preparer B in answering telephone calls, making copies, inputting client tax information gathered by B into the data fields of tax preparation software on a computer, and using the computer to file electronic returns of tax prepared by B. Although Employee A must exercise judgment regarding which data fields in the tax preparation software to use, A does not exercise any discretion or independent judgment as to the clients' underlying tax positions. Employee A, therefore, merely provides clerical assistance or incidental services and is not a tax return preparer required to apply for a PTIN or other identifying number as the Internal Revenue Service may prescribe in forms, instructions, or other appropriate guidance.

Tax Law Team

Farhad Aghdami
Chair, Tax Law Team
804.420.6440
aghdami@williamsmullen.com

Jeffrey D. Chadwick
jchadwick@williamsmullen.com

Jenny L. Connors
jconnors@williamsmullen.com

Thomas R. Frantz
tfrantz@williamsmullen.com

J. Conrad Garcia
cgarcia@williamsmullen.com

James Philip Head
jhead@williamsmullen.com

Sean M. King
sking@williamsmullen.com

Montgomery Knight, Jr.
mknight@williamsmullen.com

Steven B. Long
slong@williamsmullen.com

Matthew C. Marshall
mmarshall@williamsmullen.com

Charles B. Neely, Jr.
cneely@williamsmullen.com

Craig L. Rascoe
crascoe@williamsmullen.com

Nancy S. Rendleman
nrendleman@williamsmullen.com

Robert W. Shaw
rshaw@williamsmullen.com

Charles L. Steel, IV
csteel@williamsmullen.com

Maria S. Stefanis
mstefanis@williamsmullen.com

John H. Turner, III
jturner@williamsmullen.com

continued from page 1

Example 3

C is an employee of a firm that prepares tax returns and claims for refund of tax for compensation. C is responsible for preparing a Form 1040, "U.S. Individual Income Tax Return," for a client. C obtains the information necessary for the preparation of the tax return during a meeting with the client, and makes determinations with respect to the proper application of the tax laws to the information in order to determine the client's tax liability. C completes the tax return and sends the completed return to employee D, who reviews the return for accuracy before signing it. Both C and D are tax return preparers required to apply for a PTIN or other identifying number as the Internal Revenue Service may prescribe in forms, instructions, or other appropriate guidance.

The significance of being a return preparer is twofold. First, all preparers are required to obtain a new PTIN before filing a tax return after December 31, 2010. If a preparer already has a previously issued PTIN, he or she must still file a new application and pay the full \$64.25 application fee. The IRS has indicated that it will then re-issue the same PTIN to those who had previously obtained one. Second, any preparer who is not an attorney, CPA or enrolled agent, will now be considered a "registered tax preparer." All registered tax preparers must take and pass a competency exam and attend 15 hours of continuing education annually. Although the IRS will not begin implementing the testing requirements until mid-2011, once the testing requirements are implemented, a registered tax preparer must take and pass the competency exam *before* being issued a PTIN. If a registered tax preparer obtains a PTIN now (prior to the establishment of the testing requirements), he or she will have until December 31, 2013 to take and pass the required test. Notably, the registered tax preparer could continue to prepare returns until that date.

The IRS has not yet issued guidance on the format of the test or the fees that will be charged to take the test. Likewise, there has been no guidance on the timing of the continuing education requirements. The IRS has indicated that the 15 required hours will likely include 3 hours of federal

tax law updates, 2 hours of ethics, and 10 hours of other federal tax law.

Will In-house Tax Departments Need to Meet the Preparer Registration Requirements?

In most cases, in-house tax departments will not need to satisfy the preparer registration requirements. The regulations exclude certain persons from the definition of "preparer" for purposes of the new registration requirements, including those persons who are specifically excluded as return preparers under Treasury Regulation § 301.7701-15(f). One of the key exclusions under this section applies to employees who only prepare tax returns for their employers as a taxpayer. For example, an employee who filed the employer's corporate tax return will not be considered a paid return preparer. In such circumstances, the employee would not need to register or meet the testing requirements as a return preparer.

The regulations also address the common circumstance where fiduciaries prepare returns on behalf of the estates, trusts and other entities they are administering. Under the Treasury Regulations, the definition of preparer also excludes an individual who is an officer, partner or employee of a fiduciary responsible for filing an estate, trust or other fiduciary return. This is consistent with the Circular 230 position that the fiduciary is treated as the "taxpayer," rather than as a "representative" of the taxpayer, for purposes of appearing before the IRS. Therefore, in-house tax departments of corporate fiduciaries that file fiduciary tax returns on behalf of their employer should be exempt from the registration requirements. However, the regulations do not address the circumstance where a corporate fiduciary serves only as agent for a named fiduciary. In such circumstances, the preparer is unlikely to be considered as an employee of the actual fiduciary, and preparation of the tax returns on behalf of the fiduciary could be considered preparation for compensation and subject to the preparer regulations.

For more information about this topic, please contact the authors or any member of the Williams Mullen Tax Law Team.

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Editorial inquiries should
be directed to Farhad Aghdami
at 804.420.6440 or
aghdami@williamsmullen.com

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