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February 11, 2011

David R. Williams  
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Internal Revenue Service  
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VIA EMAIL

RE: Comments on New Preparer Taxpayer Identification Number Requirements

Dear Mr. Williams:

Tax Executives Institute is pleased to submit the following comments regarding issues specific to the implementation of new Treasury regulations governing tax return preparers. Final regulations requiring certain tax return preparers to obtain and renew a preparer taxpayer identification number (PTIN) were published in September 2010 (PTIN rules),<sup>1</sup> and were supplemented by Notice 2011-6 (the Notice)<sup>2</sup> and Frequently Asked Questions posted on the Internal Revenue Service's website.<sup>3</sup>

As the preeminent association of in-house tax professionals worldwide, TEI applauds the IRS and Treasury for their efforts to bring greater professionalism, oversight, and accountability to the tax return preparer industry. Those efforts included a comprehensive review of the industry which culminated in the "Return Preparer Review" (Preparer Review),<sup>4</sup> issued by the IRS in December 2009, which noted that, "[m]ore than ever, taxpayers are relying on tax return preparers . . . to help them prepare their returns."<sup>5</sup>

The Preparer Review recommended that certain tax return preparers:

- (1) register with the IRS;
- (2) pass a competency examination;
- (3) complete continuing professional education requirements; and

<sup>1</sup> T.D. 9501 (Sep. 30, 2010).

<sup>2</sup> Notice 2011-6, 2011-3 I.R.B. 315 (Dec. 30, 2010). The IRS provided additional guidance with respect to the PTIN rules in Notice 2011-11, 2011-7 I.R.B. (Jan. 24, 2011) and Rev. Proc. 2010-41, 2010-48 I.R.B. 781 (Oct. 26, 2010).

<sup>3</sup> <http://www.irs.gov/taxpros/article/0,,id=218611,00.html>.

<sup>4</sup> Publication 4832 (Rev. 12-2009) (hereinafter "Preparer Review").

<sup>5</sup> *Id.* at 5.

- (4) comply with the ethical standards of Treasury Department Circular 230.

The PTIN rules and subsequent guidance represent a significant step in implementing the Preparer Review recommendations. TEI believes the PTIN rules and subsequent guidance will benefit both the IRS and taxpayers by improving the administration of, and compliance with, the Internal Revenue Code and elevating the quality of advice and service provided by tax return preparers.

While the PTIN rules and other guidance generally hit the mark to regulate the population of tax return preparers that was the subject of the Preparer Review, they are regrettably overbroad. TEI believes the final regulations, if left unchanged, will unintentionally subject a substantial number of individuals who are properly not the focus of the Preparer Review to the PTIN rules. In particular, the definition of “tax return preparer” along with the specification in the Notice that, unless specifically excepted, “all tax returns, claims for refund, or other tax forms submitted to the IRS are considered tax returns or claims for refund for purposes” of the PTIN rules, will require many in-house tax professionals, including TEI members, to unnecessarily comply with the rules.

### **Summary of Recommendations**

The current PTIN rules partially address the over-breadth issue by cross-referencing the definition of “tax return preparer” under section 7701 of the Internal Revenue Code, including the exceptions to such definition.<sup>6</sup> In particular, the section 7701(a)(36)(B)(ii) and (iii) exceptions from the definition of tax return preparer for individuals who prepare tax returns or claims for refund of (i) their “employer” (Employer Exception), or (ii) entities for which their employer serves as a fiduciary (Fiduciary Exception) will exclude many in-house tax professionals from the PTIN rules.<sup>7</sup> The PTIN rules do not go far enough, however, to exclude from their application in-house tax professionals who in many common situations prepare tax returns of entities with which their employer has an ownership or fiduciary relationship. In addition, the PTIN rules do not sufficiently address the practical issues confronted by in-house tax professionals in respect of entity separations.

To address these concerns, TEI recommends that:

- (1) the term “employer” for purposes of the Employer Exception include entities with which the in-house tax professional’s actual employer has a significant ownership relationship to determine which entities a professional may prepare tax returns for without being subject to the PTIN rules;

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<sup>6</sup> Treas. Reg. § 1.6109-2(a).

<sup>7</sup> *Id.* See also Treas. Reg. § 1.6109-2(g) (specifically cross-referencing the exceptions to the definition of tax return preparer under section 7701 and its regulations). The cross-reference incorporates several other exceptions to the definition of tax return preparer under section 7701 into the PTIN rules.

- (2) an individual's employer under the Employer Exception include any member of a "controlled group" of corporations, as that term is defined in section 267(f), as well as "controlled partnerships" as described in section 707(b),<sup>8</sup> except that
  - i. the ownership threshold in those sections be reduced to 10 percent of the voting power or value in the case of a corporation and 10 percent of the capital or profits interest in the case of a partnership; and
  - ii. the constructive ownership rules referenced in those sections apply for purposes of determining the 10-percent ownership threshold;
- (3) the term "fiduciary" for purposes of which tax returns an "employee of a fiduciary" may prepare under the Fiduciary Exception without application of the PTIN rules include entities connected to the employee's actual employer via the same ownership relationship described above under the Employer Exception; and
- (4) in-house tax professionals be permitted to prepare tax returns of entities with which their employer was formerly connected and for which the employer had previously prepared tax returns for a limited period without being subject to the PTIN rules.

Adopting TEI's recommendations and providing exceptions to the PTIN rules for in-house tax professionals – individuals who prepare returns of their employers and related entities and generally do not prepare tax returns for the general public in exchange for a fee – is entirely consistent with the policy concerns underlying the PTIN rules.<sup>9</sup> In particular, in-house professionals have ongoing, day-to-day relationships with their employers and are subject to employer policies, standards, direction and control, and evaluation, for example, with respect to the employees' maintaining professional standards. In addition, to the extent the PTIN rules were motivated by IRS concerns about the education and competency of tax return preparers, the overwhelming majority of in-house tax professionals are licensed attorneys or certified public accountants and, hence, are already subject to standards of conduct and continuing education requirements (as well as other regulation). Further, these indicia of competency and reliability continue to be present even where in-house tax professionals no longer have a direct, ongoing

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<sup>8</sup> TEI recommends that subchapter S corporations also be included for purposes of determining what entities an individual employee can prepare tax returns for without being subject to the PTIN rules.

<sup>9</sup> Adopting TEI's recommended exceptions to the PTIN rules is well within the IRS's regulatory authority to "prescribe exceptions" to the rules "through forms, instructions, or other appropriate guidance . . ." Treas. Reg. § 1.6109-2(h).

relationship with the entity for which they are preparing returns, for example in cases where the entity has been recently spun-off or sold. In sharp contrast, the paid tax return preparers who are the central focus of the PTIN effort likely have a more limited and transitory relationship with the individual taxpayers whose tax forms they prepare. Adopting TEI's recommended exceptions for in-house tax professionals will not impede the IRS's goal of bringing greater professionalism and accountability to tax return preparers and the tax return preparer industry.

### **Tax Executives Institute**

Tax Executives Institute is the preeminent association of business tax executives worldwide. Our nearly 7,000 members represent 3,000 of the leading corporations in the United States, Canada, Europe, and Asia. TEI represents a cross-section of the business community, and is dedicated to developing and effectively implementing sound tax policy, to promoting the uniform and equitable enforcement of the tax laws, and to reducing the cost and burden of administration and compliance to the benefit of taxpayers and government alike. As a professional association, TEI is firmly committed to maintaining a tax system that works – one that is administrable and with which taxpayers can comply in a cost-efficient manner.

TEI members are accountants, lawyers, and other corporate and business employees who are responsible for the tax affairs of their employers in executive, administrative, and managerial capacities. They are exclusively “in-house” tax professionals, including chief tax officers, tax directors, compliance managers, tax analysts, specialists, and other corporate tax department employees with varying titles. Our members are engaged in the regular, day-to-day operation and management of the tax affairs of their employers and related entities, including tax return preparation and filing, research and planning, general tax compliance, tax accounting, and managing tax controversies. TEI members subscribe to the organization's *Standards of Conduct*, which were developed almost five decades ago in recognition of the dual role played by tax executives – serving as both an adviser on and implementer of decisions regarding a company's tax matters.<sup>10</sup>

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<sup>10</sup> Originally developed in 1962, TEI's *Standards of Conduct* (as amended) require its members to adhere to the following standards:

1. The member accepts taxes as the cost of civilization and accepts the laws imposing taxes as the mechanisms for distributing that cost among businesses, individuals, and other entities. The member will comply with those laws, whether or not agreeing with them.
2. The member recognizes an obligation to minimize company tax liability, within the bounds of the law and to the extent consistent with policies or objectives of his company.
3. The member recognizes an obligation to make an affirmative contribution to the sound administration of tax laws and to the development and adoption of sound tax legislation, by cooperation and consultation with those persons charged with those functions, having due regard for the interests of the company, its employees, and society as a whole.
4. The member accepts each government representative as a responsible person who is a professional required to fulfill the obligation to collect tax in accordance with the law. The member will deal with the representatives on that basis, and will take occasion with others to uphold this view of government representatives. In case of any deviation of a government

## Background

Tax return preparers play an important and ever-increasing role in ensuring taxpayer compliance in the United States. As noted in the Preparer Review, “a majority of U.S. taxpayers rely on tax return preparers to assist them in meeting their federal tax filing obligations” and “approximately 87 million federal individual income tax returns were prepared by paid tax return preparers” in 2007 and 2008.<sup>11</sup> The IRS estimates that there are between 900,000 and 1.2 million paid tax return preparers in the United States.<sup>12</sup>

The large taxpayer demand for tax return and filing assistance and the rise of a substantial return preparation industry in response raises several tax administration policy concerns. In particular, the Preparer Review found that: (i) any person may prepare a federal tax return for any other person for a fee; (ii) there is no consistent registration of or reporting by tax return preparers; and (iii) return preparers are not required to have any minimum education, knowledge, training, or skill before preparing a tax return.<sup>13</sup>

The Preparer Review highlighted the inadequacy of the prior tax return preparer regulatory regime in ensuring the accuracy of federal tax returns.<sup>14</sup> To address the problem, the IRS made several recommendations to advance the twin goals of “increasing taxpayer compliance and ensuring uniform and high ethical standards of conduct for tax return preparers.”<sup>15</sup> These goals are embraced in the preamble to the PTIN rules:

These final regulations are intended to address two overarching objectives. The first . . . is to provide some assurance to taxpayers that a tax return was prepared by an individual who has passed a minimum competency examination to practice before the IRS as a tax return preparer, has undergone certain suitability checks, and is

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representative from that standard, the member will present the pertinent facts to the authorities authorized to take action with respect to the deviation.

5. The member will present the facts pertinent to the resolution of questions at issue with representatives of the government imposing the tax.
6. The member will employ assistants and outside representatives upon the basis of their technical competence, always having due regard for the highest standards of professional ethics.
7. The member will at all times recognize a duty of professionalism and will not use TEI membership to solicit business or sell products to other members.

See <http://www.tei.org/membership/Pages/StandardsofConduct.aspx>; see generally, Leonard E. Kurst, *Standards of Conduct for Tax Executives*, 14 Tax Executive 283 (July 1962).

<sup>11</sup> *Preparer Review* at 7.

<sup>12</sup> *Id.* at 8.

<sup>13</sup> *Id.*

<sup>14</sup> The prior rules generally consisted of civil (and potentially criminal) penalties, (see, e.g., I.R.C. §§ 6694 and 6695) as well as sanctions by the IRS’s Office of Professional Responsibility.

<sup>15</sup> *Preparer Review* at 6.

subject to enforceable rules of practice. The second . . . is to further the interests of tax administration by improving the accuracy of tax returns and claims for refund and by increasing overall tax compliance.<sup>16</sup>

The PTIN rules and subsequent guidance represent the first major step of implementing the new tax return preparer regulatory regime recommended in the Preparer Review.

### The PTIN Regulatory Framework

Final regulations implementing a portion of the Preparer Review's recommendations were issued under section 6109 in September 2010.<sup>17</sup> In general, the new rules require a return of tax or claim for refund of tax to include the identifying number of the tax return preparer required by Treas. Reg. § 1.6695-1(b) to sign the return or claim.<sup>18</sup> More broadly, the PTIN rules require all "tax return preparers" to obtain and renew a PTIN.<sup>19</sup>

The PTIN rules define a "tax return preparer" by cross reference to section 7701(a)(36) and Treas. Reg. § 301.7701-15, which define tax return preparer for general purposes of the Code and regulations. Section 7701 provides that a tax return preparer is "any person who prepares for compensation, or who employs one or more persons to prepare for compensation, any return of tax . . . or claim for refund . . . ." <sup>20</sup> A tax return preparer also includes a person who prepares a "substantial portion" of a tax return or claim for refund whether or not the preparer signs the return or claim.<sup>21</sup>

The PTIN rules modify the definition of tax return preparer for certain purposes, including the determination of who must obtain a PTIN and comply with the other requirements of the rules. Solely for purposes of the PTIN rules,<sup>22</sup> the term tax return preparer means "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."<sup>23</sup> Thus, while the general definition of tax return preparer includes a person who prepares for compensation a "substantial portion" of a return, the PTIN rules impose a higher standard, applying only to individuals who prepare or

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<sup>16</sup> T.D. 9501.

<sup>17</sup> See Treas. Reg. § 1.6109-2.

<sup>18</sup> Treas. Reg. § 1.6109-2(a)(1).

<sup>19</sup> Treas. Reg. § 1.6109-2(d).

<sup>20</sup> I.R.C. § 7701(a)(36)(A); see also Treas. Reg. § 301.7701-15(a).

<sup>21</sup> I.R.C. § 7701(a)(36)(A); see also Treas. Reg. §§ 301.7701-15(a) and (b)(2) (defining "nonsigning tax return preparer").

<sup>22</sup> The modification to the general definition of a tax return preparer does not apply to tax return preparers required to sign a tax return.

<sup>23</sup> Treas. Reg. § 1.6109-2(g). The regulations contain a non-exhaustive list of factors to consider in determining whether an individual has prepared all or substantially all of a tax return or claim for refund, along with several examples. See *id.*

assist in preparing for compensation “all or substantially all” of a return.<sup>24</sup> A person may therefore be a tax return preparer under section 7701 but nevertheless not be subject to the PTIN rules. Thus, the PTIN rules target a narrower class of tax return preparers than the general rules governing preparers under section 7701.

The PTIN rules also incorporate the many exceptions to section 7701’s definition of tax return preparer and provide that a “tax return preparer does not include an individual who is not otherwise a tax return preparer as that term is defined in § 301.7701-15(b)(2) or who is an individual described in § 301.7701-15(f).”<sup>25</sup> Our comments focus on the two exceptions most relevant to in-house tax professionals.

First, the Employer Exception, which applies to a person who “prepares a return or claim for refund of the employer (or an officer or employee of the employer) by whom he is regularly and continuously employed.”<sup>26</sup> The regulations expand the Employer Exception, providing that a tax return preparer does not include “an individual preparing a return or claim for refund of a taxpayer, or an officer, a general partner, member, shareholder, or employee of a taxpayer, by whom the individual is regularly and continuously employed or compensated or in which the individual is a general partner.”<sup>27</sup> For purposes of the Employer Exception, “the employee of a corporation owning more than 50 percent of the voting power of another corporation, or the employee of a corporation more than 50 percent of the voting power of which is owned by another corporation, is considered the employee of the other corporation as well” (50-percent Owner Rule).<sup>28</sup> Second, the Fiduciary Exception, which applies to a person who “prepares as a fiduciary a return or claim for refund for any person . . . .”<sup>29</sup> The regulations expand the Fiduciary Exception to exclude from the definition of tax return preparer an “individual preparing a return or claim for refund for a trust, estate, or other entity of which the individual either is a fiduciary or is an officer, general partner, or employee of the fiduciary.”<sup>30</sup> Unlike the Employer Exception, however, the 50-percent Owner Rule does not apply for purposes of the Fiduciary Exception.

The PTIN rules provide that the IRS “through forms, instructions, or other appropriate guidance, may prescribe exceptions to the requirements” of the rules.<sup>31</sup> Finally, the IRS may “specify specific returns, schedules, and other forms that qualify as tax returns or claims for

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<sup>24</sup> The PTIN regulations confirm that the “substantially all” standard under the PTIN rules is higher than the “substantial portion” standard under the general tax return preparer rules of section 7701. *See* Treas. Reg. § 1.6109-2(g) Example 4 (noting that individuals are not required to obtain a PTIN so long as they do not prepare all or substantially all of a tax return, even if they otherwise prepare a substantial portion of the return).

<sup>25</sup> Treas. Reg. § 1.6109-2(g).

<sup>26</sup> I.R.C. § 7701(a)(36)(B)(ii).

<sup>27</sup> Treas. Reg. § 301.7701-15(f)(1)(ix).

<sup>28</sup> Treas. Reg. § 301.7701-15(f)(4).

<sup>29</sup> I.R.C. § 7701(a)(36)(B)(iii).

<sup>30</sup> Treas. Reg. § 301.7701-15(f)(1)(x).

<sup>31</sup> Treas. Reg. § 1.6109-2(h).

refund for purposes” of the PTIN rules.<sup>32</sup> The IRS exercised this regulatory authority in the Notice by providing, among other things, that “[a]ll tax returns, claims for refund, or other tax forms submitted to the IRS are considered tax returns or claims for refund for purposes” of the PTIN rules except those specifically listed in the Notice.<sup>33</sup> Thus, “[a]n individual must obtain a PTIN to prepare for compensation all or substantially all of any form except those specifically identified by the IRS . . . .”<sup>34</sup>

In sum, an individual who prepares, or assists in preparing, all or substantially all of any tax return, claim for refund, or other IRS form, for compensation must comply with the PTIN rules unless (i) the individual falls under one of the exceptions to the definition of tax return preparer under section 7701 or (ii) the IRS has excluded the return, claim, or form prepared from the rules.

### **The PTIN Rules and In-House Tax Professionals**

As a threshold matter, in-house tax professionals satisfy the “for compensation” requirement of the PTIN tax return preparer definition because they prepare tax returns in the course of their employment, for which they are compensated. Thus, in-house tax professionals will be subject to the PTIN rules if they prepare or assist in preparing all or substantially all of a tax return or claim for refund, unless they fall within an exception.

#### The Employer Exception

In the simplest case, the Employer Exception applies to in-house tax professionals who prepare, for example, their employers’ Form 1120 and are thus not subject to the PTIN rules in such circumstances.<sup>35</sup> Similarly, under the 50-percent Owner Rule, employees can prepare their employers’ parent corporations’ Form 1120, or a direct subsidiary’s Form 1120, without being subject to the PTIN rules, assuming the corporations satisfy the more than 50-percent voting power ownership requirement.<sup>36</sup> Other common scenarios exist, however, where the Employer Exception and 50-percent Owner Rule will not exempt from the PTIN rules in-house tax professionals who prepare tax returns of entities with which their employers have a significant ownership relationship. This is the case even though these situations do not raise the tax administration and compliance concerns catalogued in the Preparer Review, given the underlying relationship between in-house tax professionals, their employers, and the other entities.

We discuss several common scenarios and other issues below.

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<sup>32</sup> *Id.*

<sup>33</sup> Notice 2011-6, § 1.03.

<sup>34</sup> *Id.*

<sup>35</sup> These comments assume that the in-house tax professionals in each case are “regularly and continuously employed or compensated” by their employers, as required under the Employer Exception.

<sup>36</sup> Under the Employer Exception, an employee can also prepare a tax return of an officer, general partner, member, shareholder, or employee of the employer, or of a partnership if the individual is a general partner in the partnership, without being subject to the PTIN rules.

Partnership Scenarios. The Employer Exception applies if the individual employee prepares a tax return (or claim for refund) “of” the individual’s employer. It is common for an in-house tax professional, however, to prepare a tax return of a partnership in which the individual’s employer is a partner. While the Employer Exception generally applies if the individual is employed by a partnership and prepares the partnership’s or a partner’s return, the exception does not apply if the individual is employed by the partner and prepares the partnership’s return. Thus, in the latter situation, the individual is subject to the PTIN rules if he or she prepares substantially all of any return of the partnership, which under the Notice includes any IRS form not specifically listed; for example, a return for purposes of the PTIN rules includes Form 8832 Entity Classification Election, which is commonly prepared in respect of a foreign entity by employees of its U.S. owner. An in-house tax professional would be subject to the PTIN rules in this scenario even if the individual’s employer were the tax matters partner in the partnership or if the individual’s employer owned a majority interest in the partnership (*i.e.*, the 50-percent Owner Rule applies only to corporations).<sup>37</sup> Similarly, an individual employed by Partnership A who prepares a tax return of Partnership B is subject to the PTIN rules even if the partnerships have the same owners (*i.e.*, they are “brother-sister” partnerships).

The flow-through nature of partnerships presents an additional complication under the PTIN rules, even if an employee could otherwise prepare the partnership’s return without being subject to the rules. Under the general tax return preparer rules of section 7701, which are cross-referenced by the PTIN rules

[a] tax return preparer with respect to one return is not considered to be a tax return preparer of another return merely because an entry or entries reported on the first return may affect an entry reported on the other return, unless the entry or entries reported on the first return are directly reflected on the other return and constitute a substantial portion of the other return. For example, the sole preparer of a partnership return of income . . . is considered a tax return preparer of a partner’s . . . return if the entry or entries on the partnership . . . return reportable on the partner’s . . . return constitute a substantial portion of the partner’s . . . return.<sup>38</sup>

Under the PTIN rules, the entry or entries on the partnership return reportable on the partner’s return must constitute “all or substantially all” of the partner’s return before a preparer of the partnership’s return would also be considered a preparer of the partner’s return. While “substantially all” is a higher standard than “substantial portion,” in-house tax professionals may still commonly encounter this scenario – for example, if one of the partners is a special purpose

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<sup>37</sup> Indeed, the individual preparing the partnership’s return in this example would apparently be subject to the PTIN rules even if all of the partners in the partnership were members of the same consolidated group.

<sup>38</sup> Treas. Reg. § 301.7701-15(b)(3)(iii); *see also* Rev. Rul. 81-270, 1981-2 C.B. 250 (general partner who prepared partnership’s return considered a tax return preparer with respect to a limited partner’s return because the entries reported on the limited partner’s return pursuant to the Schedule K-1 prepared by the general partner were a substantial portion of the limited partner’s return; thus return preparer penalties may apply to general partner even though he was not considered a tax return preparer of the partnership’s return under the Employer Exception).

vehicle formed solely to hold the interest in the partnership. Thus, under these circumstances an employee preparing the partnership's return must comply with the PTIN rules even though the employee was not otherwise required to do so to prepare the partnership's return.

Tax return preparers may not be concerned that they could be considered a tax return preparer of a partner's return by preparing the partnership's return under the general tax return preparer rules because such preparers would not be subject to penalties or other sanctions as long as they properly prepare the partnership's return and associated Schedule K-1s. Under the PTIN rules, however, whether the entries on the partnership's return constitute all or substantially all of the entries on a partner's return will determine whether a tax return preparer must comply with the PTIN rules to prepare the partnership's return (in cases where the preparer does not otherwise need to comply with the rules to prepare the partnership's return). In these circumstances, whether the entries on the Schedule K-1 satisfy the all or substantially all threshold with respect to a partner's return may not be determinable by the preparer prior to preparing the partnership's return, and, indeed, may not be determinable until the partnership's return is completed and the relevant entries compared with the rest of the partner's return – yet under the PTIN rules a preparer must determine if the rules apply prior to preparing the partnership's return. Further, in certain cases, a tax return preparer may never know whether the entries on the partnership return constitute all or substantially all of a partner's return because the preparer may not have access to the relevant information (*i.e.*, the partner's tax return).<sup>39</sup> Tax return preparers may therefore unnecessarily obtain a PTIN and otherwise comply with the PTIN rules to avoid these uncertainties, even in situations that do not implicate the tax administration and compliance concerns undergirding the PTIN regime.

Corporate Scenarios. There are many corporate ownership structures where either the PTIN rules currently apply unnecessarily or their application is unclear. For example, assume an individual is employed by Corporation A, which directly owns 40 percent of the voting power and 90 percent of the value of Corporation B. In this case, the individual must comply with the PTIN rules to prepare a tax return or claim for refund of Corporation B because Corporation A does not own more than 50 percent of Corporation B's voting power. In the domestic context, Corporation B may generally have its own employees prepare its tax returns and those employees will not be subject to the PTIN rules under the Employer Exception, but this is not necessarily the case for international operations. For example, the U.S. owner of a foreign corporation may be responsible for preparing the foreign corporation's U.S. tax filings, with the task often falling to an employee of the foreign corporation's U.S. corporate parent, who is not also an employee of

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<sup>39</sup> Under the general tax return preparer rules, whether a portion of a tax return will be considered a “substantial portion” of the return as a whole “is determined based upon whether the person knows or reasonably should know that the tax attributable to the . . . portion of a return . . . is a substantial portion of the tax required to be shown on the return . . .” Treas. Reg. § 301.7701-15(b)(3)(i). If a tax return preparer genuinely never knows whether the entries prepared as part of a partnership return constitute all or substantially of a partner's return, then under a “knows or reasonably should know” standard the preparer may not need to comply with the PTIN rules. Nevertheless, the prospect of having to prove a lack of knowledge may cause many tax return preparers to unnecessarily obtain a PTIN and otherwise comply with the rules.

the foreign corporation or its direct U.S. shareholder.<sup>40</sup> In addition, it is unclear in this and other circumstances whether the 50-Percent Owner Rule applies.

In other cases, the sole U.S. tax filing of a foreign entity partially or wholly owned by a U.S. person may be a Form 8832 Entity Classification Election, or the entity may make minimal U.S. tax filings, such as a Form 8833 Treaty-Based Return Position Disclosure or a protective Form 1120-F. These forms are often prepared and filed by an employee of the foreign entity's U.S. owner or an employee of a U.S. subsidiary of the foreign entity. Under the current rules, the employee will be subject to the PTIN rules when preparing and filing these forms if the 50-percent Owner Rule does not apply, a requirement that does not further the underlying policy goals of the rules.

In addition, as with the brother-sister partnership scenario, an individual employed by Corporation A who prepares a tax return of Corporation B is subject to the PTIN rules as currently written even if the two corporations are wholly owned subsidiaries of a third corporation. The 50-percent Owner Rule does not apply because Corporation A does not own, and is not owned by, Corporation B.

Other Scenarios and Issues. The scope of the 50-percent Owner Rule is unclear in certain cases and wholly inapplicable in others. Thus, the 50-percent Owner Rule does not apply to partnerships and an employee of a partner will never be considered an employee of a partnership for purposes of the PTIN rules even if the individual's employer is the tax matters partner, sole general partner, and majority owner of the partnership. While the Employer Exception would generally apply in the opposite direction – allowing an employee of a partnership to prepare a return of a general partner or member of the partnership without being subject to the PTIN rules – it does not apply to allow an employee of a partner to prepare the partnership's return without complying with the rules.

It is also uncertain whether the 50-percent Owner Rule may be applied down (or up) a chain of corporate ownership. The 50-percent Owner Rule provides that an employee of one corporation is considered the employee of another corporation if the corporations satisfy the more than 50-percent voting power requirement.<sup>41</sup> It is unclear, however, whether the rule operates to consider an individual an actual employee of a subsidiary or parent corporation for purposes of treating the employee as an employee of a second-tier subsidiary or grandparent corporation. That is to say, there is no explicit “re-attribution” rule for the employer-employee relationship under the 50-percent Owner Rule as there is in, for example, the constructive stock ownership rules of section 318 attributing stock ownership from one entity to another. Without such a rule,

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<sup>40</sup> This situation also arises in cases where the foreign entity is a partnership for U.S. tax purposes.

<sup>41</sup> The “parent” portion of the 50-percent Owner Rule seems unnecessary since the Employer Exception itself allows an individual employee to prepare a return of a shareholder of the individual's employer, presumably including the employer's parent corporation. On the other hand, this portion of the 50-percent Owner Rule could be read to permit “re-attribution” of employment up a chain of corporations that satisfies the ownership threshold. At a minimum, it is unclear whether the 50-percent Owner Rule can be applied and then re-applied up and down a chain of corporate ownership, and in any event it is inapplicable to partnerships.

an employee of a parent corporation who prepares a return of a second-tier subsidiary may feel compelled to comply with the PTIN rules out of an abundance of caution.

### The Fiduciary Exception

As with the Employer Exception, in a many cases applying the Fiduciary Exception to in-house tax professionals is straightforward. A professional can prepare a tax return or claim for refund of a trust for which the professional's employer is the trustee without being subject to the PTIN rules. Unlike the Employer Exception, however, the 50-percent Owner Rule does not apply to treat an employee of one corporation as the employee of a second corporation for purposes of the PTIN rules. For example, an employee of a parent corporation cannot prepare the tax return of a trust without being subject to the PTIN rules if it is the subsidiary that is the trust's fiduciary. An in-house tax professional may commonly encounter this scenario, such as where an operating subsidiary is the trustee of a securitization vehicle and employees of the subsidiary's parent prepare the vehicle's return, or where the returns of an employee benefit plan are not prepared by employees of the entity that is the plan's trustee but by professionals employed by an entity related to the trustee.

### Entity Separations

Finally, the current PTIN rules will apply in cases where in-house tax professionals prepare tax returns for entities with which their employers formerly had an ownership relationship. These situations primarily arise with respect to spin-offs and other divestitures where the spun-off or sold entity contracts with its former parent or group, on a temporary basis, to provide the tax return preparation and other administrative services (e.g., accounting and information technology support) that the former parent/group had previously provided until the divested entity has had time to hire its own in-house staff or is fully integrated into its new ownership group. Pursuant to "transitional services" contracts,<sup>42</sup> in-house tax professionals provide tax return preparation services to the divested entity (or entities) in exchange for a fee paid to the professional's employer. These contracts are typically for limited periods and the professionals who prepare the tax returns of the divested entity are generally those who would have prepared the returns of the entity absent the divestiture. Neither the PTIN rules nor the general tax return preparer rules under section 7701 provide an exception for in-house professionals in these circumstances, which TEI submits do not give rise to the tax policy concerns the rules intend to address.

### **TEI Recommendations**

The policy and tax administration concerns that gave rise to the PTIN rules do not apply to the scenarios discussed above in particular, or to in-house tax professionals in general. In the overwhelming majority of cases, in-house tax professionals prepare tax returns of their employer

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<sup>42</sup> Short-term agreements governing tax return preparation and other administrative services should be distinguished from potentially much longer-term "tax sharing" agreements that relate to such matters as who controls tax controversies arising from pre-separation returns and related decisions that do not (generally) implicate post-divestiture tax return preparation matters.

and for entities with which their employer has (or had) an ownership or fiduciary relationship and not for unrelated individuals or businesses.<sup>43</sup> They do not generally “prepare tax returns for a fee” or otherwise hold themselves out to the public as tax return preparers – the class of individuals targeted by the PTIN rules. Accordingly, TEI recommends that these individuals generally be exempt from the PTIN rules pursuant to modified Employer and Fiduciary Exceptions, as well as a limited exception for divested entities.<sup>44</sup>

Specifically, TEI recommends that the IRS issue guidance defining the term “employer” for purposes of applying the Employer Exception to the definition of tax return preparer under the PTIN rules when determining which entities an employee can prepare tax returns for without being subject to the rules. Such definition should encompass (i) all members of the “controlled group” of corporations as defined in section 267(f), and (ii) “controlled partnerships” under section 707(b)(1).<sup>45</sup> Further, for this purpose, TEI recommends that “10 percent or more” be substituted for “more than 50 percent” in section 267(f)(1)(A) (which in turn cross-references section 1563(a) for the definition of controlled group) and section 707(b)(1).<sup>46</sup> In addition, the constructive ownership rules referenced (or cross-referenced) in sections 267 and 707(b) should apply to determine whether an in-house tax professional’s employer owns 10 percent or more of the entity for which the professional is preparing a tax return.

Although lower than the traditional standard under sections 267(f) and 707(b), the 10-percent ownership threshold is consistent with the definition of U.S. shareholder in section 951(b) for purposes of the subpart F rules, a level of ownership considered sufficient for the United States to impose current U.S. tax on a U.S. shareholder for income earned by a foreign entity that the shareholder may not control. Further, a 10-percent ownership threshold should be sufficient to (i) ensure that the in-house tax professional preparing a tax return has adequate access to the information needed to properly prepare the return and (ii) prevent tax return preparers from entering into transitory ownership or partnership arrangements with their clients to avoid the PTIN rules.

With respect to the Fiduciary Exception, TEI recommends that the IRS issue guidance providing that for purposes of the phrase “employee of a fiduciary” a fiduciary includes any

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<sup>43</sup> To the extent in-house tax professionals prepare tax returns of unrelated individuals or businesses, the PTIN rules would apply.

<sup>44</sup> Because the Employer and Fiduciary Exceptions, as well as the 50-percent Owner Rule, reside under the section 7701 rules applicable to tax return preparers generally, TEI recommends that the IRS limit the modified Employer and Fiduciary Exceptions, as well as the limited exception for divested entities, to the PTIN rules, which the IRS has authority to do by issuing “appropriate guidance.” See Treas. Reg. § 1.6109-2(h) (providing that the IRS may “prescribe exceptions to the [PTIN] requirements”). Such a limitation would be consistent with the narrower scope of the PTIN rules, which apply only if the individual tax return preparer prepares “all or substantially all” of a tax return for compensation.

<sup>45</sup> Subchapter S corporations should also be included.

<sup>46</sup> TEI has previously recommended that the IRS and Treasury adopt a similar definition of “employer” for purposes of Circular 230 and Treas. Reg. § 301.7701-15(f) generally. See Comments of Tax Executives Institute on the Notice of Proposed Rulemaking, Tax Return Preparer Penalties Under Section 6694 and 6695 [REG-129243-07] (Aug. 21, 2008).

entity connected to an individual's actual employer via a 10-percent ownership relationship. Accordingly, the PTIN rules would not apply to an individual employed by one corporation who prepares the tax return of an entity for which another corporation serves as a fiduciary, as long as the two corporations (or other entities if not all corporations) are in a 10-percent ownership relationship.

Finally, TEI recommends the IRS adopt a time-based exception to the PTIN rules for tax return preparation services provided by an in-house tax professional to entities that were formerly in a 10-percent ownership relationship with the professional's employer where the individual's employer performed tax return preparation services for the divested entity before its separation (Divested Entity Exception). Thus, if a consolidated group sells a member out of the group, for example, the group's in-house tax professionals could continue to prepare the former member's tax returns and other tax filings without being subject to the PTIN rules. TEI recommends the exception be limited to the stub tax return filing period resulting from the divestiture (if any) and the next tax return filing period.

An expanded definition of employer under the Employer Exception would cover the scenarios discussed above, including those where an individual's employer owns a minority interest in another entity but nevertheless prepares the entity's tax returns, except where the employer's ownership interest falls below the recommended 10-percent threshold (actually or constructively). Thus, where the operating agreement among joint-venture parties assigns a non-controlling partner or owner the responsibility of providing tax and related services to the partnership or joint venture, and an employee of that entity prepares the returns, the employee would not be subject to the PTIN rules. (This arrangement is especially common in foreign joint ventures that have a U.S. partner or owner who is assigned the U.S. tax filing and compliance obligations because of the U.S. person's familiarity with the U.S. tax rules, even if the U.S. partner holds a minority interest in the venture.) Lowering the ownership threshold in sections 267(f) and 707(b) for purposes of the definition of employer under the PTIN rules to 10 percent of the vote or value of a corporation (10 percent of the capital or profits interest in the case of a partnership) should encompass the majority of situations in which in-house tax professionals prepare tax returns for entities with which their employers have an ownership relationship and that are not encompassed by the current Employer Exception. Similarly, adopting the same threshold under the Fiduciary Exception for purposes of determining which entities an in-house tax professional may prepare tax returns for as an employee of a fiduciary without being subject to the PTIN rules should encompass those situations where the "employment" entities of a group of related entities do not align perfectly with the "fiduciary" entities of the same group.

In addition, adopting a Divested Entity Exception would acknowledge the practical difficulties confronted by in-house tax professionals with respect to tax returns of separated entities. Frequently, spun-off or sold entities do not have the capacity to immediately assume the tax administration duties associated with the annual, quarterly, and other filings required by the IRS (or, indeed, the ability to assume other "back-office" functions, such as accounting and information technology support). To address these practical concerns and to obtain tax return preparation and other services, divested entities regularly enter into limited service agreements with their former owners until the divested entity is capable of performing the relevant tasks on its own. These agreements are efficient from the standpoint of both the divested entity, which is

able to leverage the knowledge and experience of the in-house tax professionals who had historically prepared the divested entity's return, and its former owner (or owners), which is often preparing the information and supporting schedules necessary to file the divested entity's tax returns in any event. Further, limiting such an exception to an appropriate period of time is proper as the historical knowledge and experience of the retained in-house tax professionals with respect to the divested entity recedes with the passage of time. TEI believes that a "stub period plus one" rule balances the practical difficulties associated with divestitures and the IRS tax administration concerns.<sup>47</sup>

Mechanically, TEI recommends that if an in-house tax professional's employer owns 10 percent of an entity (actually or constructively) then the in-house tax professional should be treated as an employee of the entity for purposes of preparing that entity's return. Thus, the in-house tax professional would not be subject to the PTIN rules when preparing the other entity's return. Under TEI's recommendation, the in-house tax professional would not be treated as an actual employee of the other entity for purposes of determining what other returns the professional could prepare without being subject to the PTIN rules (*e.g.*, the returns of a partner or shareholder of the other entity), except where an in-house tax professional's employer owns 10 percent or more of a partnership (actually or constructively) and under a modified Fiduciary Exception. In the case of a partnership, the professional should be permitted to prepare the partnership's return and associated Schedule K-1s without being subject to the PTIN rules, whether or not the entries on a Schedule K-1 constitute all or substantially all of a partner's tax return.<sup>48</sup> This would eliminate the conundrum confronted by in-house tax professionals of not knowing in advance whether they must obtain a PTIN and otherwise comply with the PTIN rules when they prepare a partnership's return as a result of the entries that will be placed on a partner's return pursuant to the partner's Schedule K-1. In addition, under our recommendation with respect to the Fiduciary Exception, an in-house tax professional should be considered an actual employee of entities connected to the professional's actual employer via 10 percent ownership for purposes of determining the entities a professional can prepare returns for as an "employee of a fiduciary."

The following example illustrates TEI's recommendations and the application of the constructive ownership rules. Assume Corporation A employs Tax Professional X. Further assume that Corporation A owns 50 percent of Partnership B, which owns 60 percent of Corporation C, which owns 30 percent of Corporation D. Under the constructive ownership rules, Corporation A would be treated as owning 30 percent of the stock of Corporation C (50

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<sup>47</sup> TEI's recommended exceptions would apply only for purposes of the PTIN rules, thus the general definitions relating to tax return preparers under section 7701 and the related preparer penalties under sections 6694 and 6695 would remain applicable to in-house tax professionals (to the extent the current Employer and Fiduciary Exceptions do not otherwise apply).

<sup>48</sup> This could be accomplished by excepting Schedule K-1 from the list of forms subject to the PTIN rules generally, or by providing that if an individual is not subject to the PTIN rules when preparing a partnership's tax return, the individual will not then be subject to the rules merely because the entries on a Schedule K-1 that appear on a partner's return constitute all or substantially all of the partner's return.

percent of 60 percent),<sup>49</sup> and 9 percent of the stock of Corporation D (50 percent of 60 percent of 30 percent).<sup>50</sup> With respect to the Employer Exception, under TEI's recommendation, Tax Professional X could prepare tax returns of Partnership B and Corporation C without being subject to the PTIN rules, because X's actual employer, Corporation A, owns more than 10 percent of those entities (actually or constructively). Further, the Schedule K-1s prepared as part of Partnership B's return would not be taken into account in determining whether Tax Professional X is subject to the PTIN rules, even if the entries on such a schedule constituted all or substantially all of a partner's return. Tax Professional X could not, however, prepare tax returns of Corporation D because Corporation A's constructive ownership of Corporation D falls below the recommended 10-percent ownership threshold. In addition, Tax Professional X could not prepare tax returns for the other partners in Partnership B, or the other shareholders in Corporation C, without being subject to the PTIN rules because Tax Professional X would not be considered an actual employee of those entities through the application of the constructive ownership rules. In other words, the ownership relationship between Corporation A, Tax Professional X's actual employer, and other entities determines which entities' tax returns Tax Professional X may prepare under a modified Employer Exception without being subject to the PTIN rules, but the employment relationship between Corporation A and Tax Professional X is not attributed to the other entities for purposes of further applying the exception.

For purposes of the Fiduciary Exception, in the preceding example Tax Professional X could prepare tax returns of entities for which Partnership B and Corporation C act as fiduciaries because of their connection with Corporation A via 10-percent ownership. However, Tax Professional X could not prepare returns of entities for which Corporation D acts as a fiduciary because it does not meet the ownership threshold with respect to Corporation A. Similarly, under TEI's recommended Divested Entity Exception, if Corporation A sold its interest in Partnership B, or Partnership B sold its interest in Corporation C, Tax Professional A could continue to prepare tax returns of Partnership B or Corporation C for the stub filing period and the following filing period (as long as Tax Professional X or other employees of Corporation A had previously prepared Partnership B's or Corporation C's tax returns).

## Conclusion

TEI acknowledges that a possible alternative for in-house tax professionals would be to obtain a PTIN and comply with the other aspects of the PTIN rules if they are not currently covered by an exception. We believe adopting TEI's recommended exceptions is the better course. In-house tax professionals do not fall within the class of preparers targeted by the IRS under the PTIN rules. These individuals are not "tax return preparers" in the traditional sense because they do not prepare tax returns for the general public in exchange for a fee. Instead, in-house tax professionals have an ongoing, day-to-day relationship with their employers which extends beyond tax return preparation. More to the point, in-house tax professionals are subject to the direction and control of their employer, to their employers' internal policies and

<sup>49</sup> See I.R.C. § 267(c)(1) *cross-referenced by* I.R.C. § 707(b)(3) (stock owned by a partnership shall be treated as owned proportionately by its partners).

<sup>50</sup> See I.R.C. § 267(c)(1) (proportionate stock ownership) and (c)(5) (stock owned constructively shall be treated as actually owned for purposes of re-applying I.R.C. § 267(c)(1)).

procedures, and to discipline in the event they do not perform their duties with sufficient diligence and care. The PTIN rules implicitly recognize the distinction between an employer and an individual taxpayer who hires a paid tax return preparer to prepare a Form 1040 by currently cross-referencing the exceptions to the definition of tax return preparer in the section 7701 regulations, including the Fiduciary and Employer Exceptions. TEI's recommendations except in-house tax professionals from the PTIN rules in many common scenarios without restricting the class of tax return preparers subject to the rules.

Tax Executives Institute appreciates the opportunity to present its views with respect to the PTIN rules and their application to in-house tax professionals. If you have any questions, please do not hesitate to contact Benjamin R. Shreck of the Institute's legal staff at 202.638.5601 or at [bshreck@tei.org](mailto:bshreck@tei.org).

Respectfully submitted,

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