



# Internal Revenue Service

DEPARTMENT OF THE TREASURY

## LB&I Concept Unit

<b>Unit Name</b>	Overview of Accuracy-Related Penalties	
<b>Primary UIL Code</b>	6662.00-00	Accuracy-Related Penalties

<b>Library Level</b>	<b>Title</b>
<b>Knowledge Base</b>	Penalties
<b>Shelf</b>	Functional Penalty Procedures
<b>Book</b>	LB&I Penalties Procedures (Domestic)
<b>Chapter</b>	Accuracy-Related Penalties

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# General Overview

## Overview of Accuracy-Related Penalties

Taxpayers who do not use reasonable care in complying with federal income tax laws may be subject to penalties. Penalties are used to encourage taxpayers to voluntarily comply. If a taxpayer underpays and has no valid defense, penalties will apply.

IRC 6662 summarizes penalties related to return accuracy. An accuracy-related penalty can apply to an income, estate or gift tax return. IRC 6751(b)(1) requires that the examiner's immediate supervisor approve the penalty assertion. The supervisory approval must be documented in the workpaper or lead sheet and must be obtained prior to issuing any written communication of the penalty to the taxpayer that offers an opportunity to sign agreeing to the proposal or assessment of it. Refer to IRM 20.1.1 for additional guidance.

The Service applies accuracy-related penalties to tax underpayments caused by one or more of the prohibited acts described in this Unit. Generally, the penalty is 20%, but may be 40% in certain situations. Accuracy-related penalties are not cumulative; the penalty cannot be imposed more than once, even if the underpayment is attributable to several types of misconduct. If two penalties could apply to the same underpayment, you must only impose the penalty with the highest rate or broadest applicability.

An accuracy-related penalty does not apply in three instances:

1. The penalty does not apply if the Internal Revenue Service files the return under IRC 6020(b), Substitute for Return procedures. The return must have been filed by the taxpayer to apply.
2. The accuracy-related penalty does not apply to any portion of an underpayment associated with a fraud penalty under IRC 6663.
3. The penalty does not apply to any portion of an underpayment subject to the reportable transaction penalty under IRC 6662A.

Before imposing an accuracy-related penalty, carefully consider if the taxpayer can rely on any exceptions and defenses. The general rule is an accuracy-related penalty does not apply to any portion of an underpayment if the taxpayer has reasonable cause and acted in good faith. Additionally, the taxpayer may be able to rely on other defenses for some of the accuracy-related penalties, such as adequate disclosure, reasonable basis, and substantial authority. These taxpayer defenses will be discussed in this Unit.

Deficiency procedures under IRC 6665 allow a taxpayer to challenge penalty assertion in Tax Court before it is assessed.

# General Overview (cont'd)

## Overview of Accuracy-Related Penalties

An accuracy-related penalty is imposed at a rate of 20% of the underpayment resulting from the following prohibited conduct:

Negligence or Disregard of Rules or Regulations	IRC 6662(b)(1)
Substantial Understatement of Income Tax	IRC 6662(b)(2)
Substantial Valuation Statement	IRC 6662(b)(3)
Substantial Overstatement of Pension Liabilities	IRC 6662(b)(4)
Substantial Estate or Gift Tax Valuation Understatement	IRC 6662(b)(5)
Underpayment Attribute to Transactions Lacking Economic Substance	IRC 6662(b)(6)
Underpayment Attribute to Undisclosed Foreign Financial Asset Understatement	IRC 6662(b)(7)
Inconsistent Estate Basis Reporting	IRC 6662(b)(8)

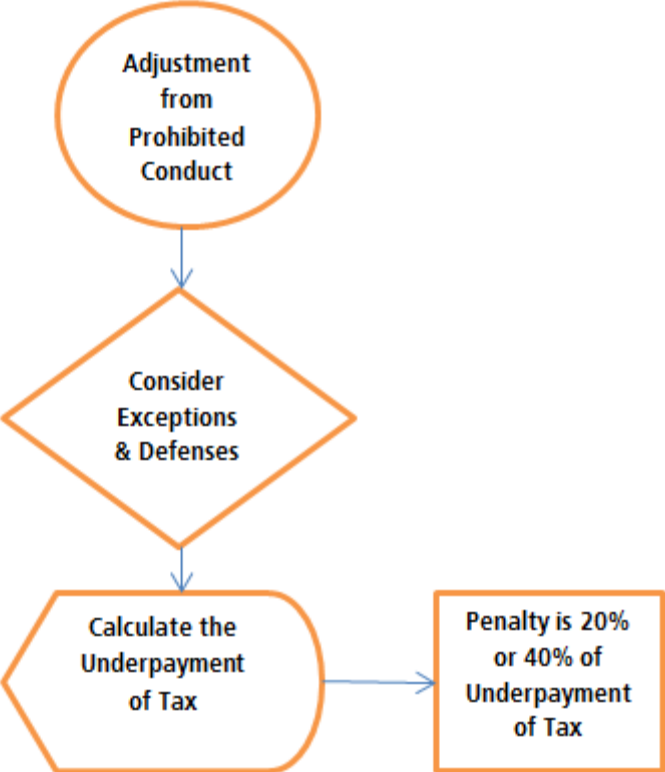
The penalty rate increases to 40% in the case of underpayment attributable to the following prohibited conduct:

Gross Valuation Misstatement	IRC 6662(h)
Nondisclosed Noneconomic Substance Transactions	IRC 6662(i)
Nondisclosed Foreign Financial Asset Understatement	IRC 6662(j)
Gross Overstatement of Pension Liability	IRC 6662(f)
Gross Overstatement of Estate or Gift Tax Valuation	IRC 6662(g)

# Diagram of Concept

## Overview of Accuracy-Related Penalties


### Diagram of Concept



# Detailed Explanation of the Concept

## Overview of Accuracy-Related Penalties

Application of penalty, exceptions and defenses.

Analysis	Resources
<p><u>Calculation of the Underpayment</u></p> <p>An accuracy-related penalty can only be imposed if the adjustment from the prohibited conduct results in an underpayment of tax. An underpayment exists when the correct amount of tax exceeds the amount on the return. Refer to IRC 6664(a) for the definition of underpayment.</p> <p>An underpayment is calculated as follows:</p> <ol style="list-style-type: none"><li>1. Tax as corrected (tax required to be shown on the return);</li><li>2. Less: Tax as shown on the return;</li><li>3. Plus: Any amounts assessed before the return is filed that were not shown on the return, such as termination assessments under IRC 6851 and jeopardy assessments under IRC 6861, or amount collected without assessment;</li><li>4. Plus: any amount of rebates made. A rebate is an abatement, credit or refund made when the tax imposed is less than the amount shown on the taxpayer's return.</li></ol> <p>When calculating the amount of the underpayment, any refundable credits are included when determining the amount of income tax imposed and the amount shown by the taxpayer on the return.</p> <p> <b>CAUTION:</b> The <i>Protecting Americans from Tax Hikes (PATH) Act</i>, enacted December 18, 2015, amended IRC Section 6664(a) to clarify that tax can be reduced below zero.</p>	<ul style="list-style-type: none"><li>▪ IRC 6664(a)</li><li>▪ Treas. Reg. 1.6664-2(a)</li><li>▪ IRM 20.1.5.2.1(9)</li><li>▪ <i>Protecting Americans from Tax Hikes Act of 2015</i></li></ul>

# Detailed Explanation of the Concept (cont'd)

Overview of Accuracy-Related Penalties	
Analysis	Resources
<p><u>Conduct That Can Result in Accuracy-Related Penalty</u></p> <p><u>Negligence</u></p> <p>Negligence is defined as the failure to do what a reasonable and ordinarily prudent person would do to comply with IRS rules and regulations in preparing a return.</p> <p>Examples of negligence include failures to:</p> <ul style="list-style-type: none"> <li>▪ Make a reasonable attempt to comply with the tax law;</li> <li>▪ Keep adequate books and records to support credits or deductions claimed;</li> <li>▪ Report income on the return from an information return (such as a Form 1099);</li> <li>▪ Reasonably check the accuracy of a deduction or credit that seems “too good to be true”;</li> <li>▪ Satisfy the consistency requirements on the returns of partners or S corporation shareholders and applicable entities;</li> <li>▪ Correct reoccurring mistakes which take place even after notification.</li> </ul> <p>Defenses to avoid the negligence penalty are reasonable basis under Treas. Reg. 1.6662-3(b)(3) and reasonable cause with good faith under Treas. Reg. 1.6664-4.</p>	<ul style="list-style-type: none"> <li>▪ IRC 6662(c)</li> <li>▪ Treas. Reg. 1.6662-3(b)(1)</li> <li>▪ IRM 20.1.5</li> <li>▪ IRC 6662(b)(1)</li> <li>▪ Treas. Reg. 1.6662-3(b)(3)</li> <li>▪ Treas. Reg. 1.6664-4</li> </ul>

# Detailed Explanation of the Concept (cont'd)

Overview of Accuracy-Related Penalties	
Analysis	Resources
<p><u>Defenses to Assertion of Negligence Penalty</u></p> <p>Taxpayers may rely on two defenses to avoid the negligence penalty. The first is reasonable basis under Treas. Reg. 1.6662-3(b)(3), and the second is reasonable cause with good faith under Treas. Reg. 1.6664-4.</p> <p><u>Reasonable Basis</u></p> <p>The reasonable basis standard is usually met when the position:</p> <ol style="list-style-type: none"> <li>1. Has a greater than 50% likelihood of being sustained if litigated, and</li> <li>2. Is based on substantial authority.</li> </ol> <p>A position is based on substantial authority if it is reasonably based on one or more of authorities in Treas. Reg. 1.6662-4(d)(3)(iii). The substantial authority standard involves an analysis of the law and application of the law to relevant facts. Some of the substantial authorities listed in Treas. Reg. 1.6662-4(d)(3)(iii) include the following:</p> <ul style="list-style-type: none"> <li>▪ Applicable provisions of the Internal Revenue Code and other statutory provisions;</li> <li>▪ Proposed, temporary and final regulations construing such statutes;</li> <li>▪ Revenue rulings and revenue procedures;</li> <li>▪ Tax treaties and regulations, and Treasury Department and other official explanations of such treaties;</li> <li>▪ Court cases.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.6662-3(b)(2)</li> <li>▪ Treas. Reg. 1.6662-3(b)(3)</li> <li>▪ Treas. Reg. 1.6662-4(d)(3)(iii)</li> </ul>



# Detailed Explanation of the Concept (cont'd)

Overview of Accuracy-Related Penalties	
Analysis	Resources
<p><u>Defenses to Assertion of Negligence Penalty (cont'd)</u></p> <p><u>Reasonable Cause (cont'd)</u></p> <p>Negligence penalty can also be avoided if the taxpayer has reasonable cause and acted in good faith. Reasonable cause is based on all the facts and circumstances in each situation. The Service accepts this defense when the taxpayer exercises ordinary business care and prudence. The ordinary care and prudence standard requires that a taxpayer make reasonable efforts to determine the correct tax obligation. In determining whether a taxpayer exercised ordinary care and prudence, you should secure and review the following information:</p> <ol style="list-style-type: none"><li>1. The taxpayer's reason(s) for the non-compliance;</li><li>2. The taxpayer's history of compliance or non-compliance with regards to the issue;</li><li>3. The taxpayer's circumstances - whether there were circumstances beyond the taxpayer's control that caused the non-compliance.</li></ol> <p>You may refer to Treas. Reg. 1.6664-4 and IRM 20.1.5.6.1 for additional guidance regarding reasonable cause.</p>	<ul style="list-style-type: none"><li>▪ IRC 6662(c)</li><li>▪ Treas. Reg. 1.6664-4</li><li>▪ IRM 20.1.5.6.1</li></ul>


# Detailed Explanation of the Concept (cont'd)

Overview of Accuracy-Related Penalties	
Analysis	Resources
<p><u>Disregard of Rules or Regulations</u></p> <p>Disregard of rules or regulations includes any careless, reckless or intentional disregard of the Code, temporary or final regulations, revenue rulings or notices, and in some cases, revenue procedures.</p> <ul style="list-style-type: none"><li>▪ "Careless" is when a taxpayer does not exercise reasonable care to determine the correct amount of tax.</li><li>▪ "Reckless" is when a taxpayer makes little or no effort to determine whether a rule or regulation exists.</li><li>▪ "Intentional" is when a taxpayer knowingly ignores a rule or regulation.</li></ul> <p>The concepts of "careless" and "reckless" focus on comparing the taxpayer's behavior to that of "a reasonable person." If the taxpayer takes a position contrary to a revenue ruling or notice that has a realistic possibility of being sustained on its merits, the disregard of rules or regulations penalty will not be imposed. However, positions related to a reportable transaction are excluded from this "realistic possibility of being sustained" exception.</p>	<ul style="list-style-type: none"><li>▪ Treas. Reg. 1.6662-4(f)</li></ul>

# Detailed Explanation of the Concept (cont'd)

Overview of Accuracy-Related Penalties	
Analysis	Resources
<p><u>Taxpayer Defenses to Disregard of Rules or Regulations</u></p> <p>Taxpayers may have a defense against this penalty if the position taken is “adequately disclosed.” This requires that the taxpayer to have disclosed their position on a Form 8275 <i>Disclosure Statement</i>, or Form 8275-R, <i>Regulation Disclosure Statement</i>, (if the position is contrary to the regulation) attached to the return. If the taxpayer is required to file a Schedule UTP, (Form 1120), <i>Uncertain Tax Position</i>, it can be used instead of Form 8275 or Form 8275-R when it is attached to a return or a qualified amended return.</p> <p>Transactions that are defined as reportable transactions under IRC 6011 must be disclosed on Form 8886. A disclosure is considered adequate when it sufficiently apprises the Internal Revenue Service of the details and amount of the potential issue.</p> <p>In the case of a position contrary to a regulation, the position must be disclosed and must represent a good faith challenge to the validity of the regulation. The disclosure exception does not apply, however, where the disclosed position does not have a “reasonable basis” or where the taxpayer fails to keep adequate books and records or to substantiate items properly.</p> <p>The penalty can also be avoided if the taxpayer has reasonable cause and acted with good faith. However, a taxpayer cannot rely on an opinion or advice that a regulation is invalid to establish that the taxpayer acted with reasonable cause and good faith unless the claim that the regulation is invalid is adequately disclosed on the return.</p>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.6662-4(f)</li> <li>▪ Form 8275 - <i>Disclosure Statement</i></li> <li>▪ Form 8275-R - <i>Regulation Disclosure Statement</i></li> <li>▪ Form 1120, Schedule UTP - <i>Uncertain Tax Position</i></li> <li>▪ Form 8886 - <i>Reportable Transaction Disclosure Statement</i></li> <li>▪ IRC 6011</li> </ul>

# Detailed Explanation of the Concept (cont'd)

Overview of Accuracy-Related Penalties	
Analysis	Resources
<p><u>Substantial Understatement of Tax</u></p> <p>An understatement is defined as the excess of the amount of tax owed in a taxable year over the correct amount of tax reduced by any rebates.</p> <p>An understatement of income tax under IRC 6662(d) is “substantial” for a taxable year if the understatement exceeds the greater of:</p> <ul style="list-style-type: none"> <li>▪ 10% of the correct tax; or</li> <li>▪ \$5,000 (except for corporations other than S corporations or personal holding companies).</li> </ul> <p>In the case of a corporation, other than an S corporation or a personal holding company, an understatement of income tax for a taxable year beginning after October 22, 2004, is considered “substantial” if the understatement exceeds the lesser of 10% of the actual tax liability (or if greater, \$10,000), or \$10 million. For example, if the actual tax liability is \$12,000, the understatement is \$10,000. If the actual tax liability is \$15 million, the understatement is \$10 million</p> <p> <b>CAUTION:</b> The <i>Consolidation Appropriations Act</i>, enacted March 23, 2018, amended the substantial understatement penalty when the taxpayer claims an IRC 199A deduction for tax years beginning after December 31, 2017. If a taxpayer claims an IRC 199A deduction, a substantial understatement under IRC 6662(d)(1)(A) will be determined by substituting 5% for 10%. For example, an individual taxpayer examination results in a 199A adjustment. There is a substantial understatement of the amount of tax required to be shown on the return, if the amount of tax shown on the return exceeds the greater of 5% (rather than 10%) or \$5,000.</p>	<ul style="list-style-type: none"> <li>▪ IRC 6664(d)</li> <li>▪ Treas. Reg. 1.6662-4</li> <li>▪ IRC 6662(b)(2)</li> <li>▪ IRC 6662(d)</li> <li>▪ <i>Consolidation Appropriations Act of 2018</i></li> <li>▪ IRC 199A</li> </ul>

# Detailed Explanation of the Concept (cont'd)

Overview of Accuracy-Related Penalties	
Analysis	Resources
<p><u>Taxpayer Defenses for Substantial Understatement of Tax</u></p> <p>The defenses to avoid the penalty are:</p> <ol style="list-style-type: none"> <li>1. Adequate disclosure on the return using Form 8275 or Form 8275-R;</li> <li>2. Reliance on substantial authority such as the Code, Regulations, recent court rulings and notices;</li> <li>3. Reasonable cause.</li> </ol> <p>Under Treas. Reg. 1.6662-5(f), a disclosure is adequate if:</p> <ul style="list-style-type: none"> <li>▪ It is made on a properly completed and filed Form 8275 or Form 8275-R.</li> <li>▪ It is disclosed on a return in accordance with an annual revenue procedure addressing return disclosure (Refer to IRM 20.1.5.8.1.2 (2) for current Revenue Procedure). The annual revenue procedure allows for disclosure of certain common deductions and other items on a tax return to be deemed “adequate disclosure” to reduce or eliminate the substantial understatement penalty. The taxpayer must furnish all required information in a clear manner and the dollar amount entered on the applicable form must be verifiable.</li> <li>▪ Recurring items are disclosed in each relevant tax year.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.6662-4(f)</li> <li>▪ Treas. Reg. 1.6662-5(f)</li> <li>▪ Form 8275 - <i>Disclosure Statement</i></li> <li>▪ Form 8275-R - <i>Regulation Disclosure Statement</i></li> <li>▪ IRM 20.1.5.8.1.2(2)</li> </ul>

# Detailed Explanation of the Concept (cont'd)

Overview of Accuracy-Related Penalties	
Analysis	Resources
<p><u>Substantial Valuation Misstatement</u></p> <p>A substantial valuation misstatement occurs if the value or adjusted basis of any property is incorrectly claimed to be 150% or more of the actual value or adjusted basis. "Property," for purposes of this penalty, includes both tangible and intangible property. The penalty applies when the tax attributable to the valuation overstatement exceeds \$5,000 (\$10,000 in the case of corporations other than S corporations or personal holding companies). Generally, the taxpayer can avoid the penalty if reasonable cause is established. However, there is an exception for charitable deduction property.</p> <p><u>Charitable Deduction Property</u></p> <p>Charitable deduction property means any property (other than money or publicly traded securities) contributed by the taxpayer in a contribution for which a deduction was claimed under IRC 170.</p> <p>Generally, the reasonable cause and good faith exception to the accuracy-related penalty under IRC 6664(c)(1) does not apply to any underpayment attributable to a substantial or gross valuation overstatement with respect to charitable deduction property. However, an exception applies to a substantial valuation overstatement (but not a gross valuation overstatement) with respect to charitable property if:</p> <ul style="list-style-type: none"> <li>▪ The taxpayer shows that the claimed value of the property was based on a qualified appraisal made by a qualified appraiser and,</li> <li>▪ In addition to getting the appraisal, the taxpayer made a good faith investigation of the value of the contributed property.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.6662-5</li> <li>▪ IRC 6662(e)</li> <li>▪ IRC 6662(b)(3)</li> <li>▪ IRC 170</li> <li>▪ IRC 6664(c)(1)</li> </ul>

# Detailed Explanation of the Concept (cont'd)

Overview of Accuracy-Related Penalties	
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<p><u>Gross Valuation Misstatement</u></p> <p>Overstating the value or basis of property by 200% or more results in a gross misstatement of value. You must evaluate each property separately. The penalty is 40% of the portion of the underpayment attributable to the overstatement.</p> <p>The penalty applies when the tax attributable to the valuation overstatement exceeds \$5,000 (\$10,000 in the case of corporations other than S corporations or personal holding companies).</p> <p>The reasonable cause exception is not available for returns filed after August 17, 2006.</p>	<ul style="list-style-type: none"><li>▪ Treas. Reg. 1.6662-6</li><li>▪ IRC 6662(h)</li></ul>

# Detailed Explanation of the Concept (cont'd)

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<p><u>Valuation Misstatement Penalties and Pass-through Entities</u></p> <p>For pass-through entities, determine if there is a substantial or gross valuation misstatement at the entity level, but apply the dollar limitation for the amount of the underpayment at the taxpayer level. At the taxpayer level, the portion of the underpayment attributable to the pass-through entity is added with other underpayments on the taxpayer's return attributable to substantial or gross valuation misstatements to determine whether the dollar threshold was satisfied.</p> <p><u>Example</u></p> <p>The X Partnership's return reflects a \$50,000 basis in depreciable assets. However, the actual basis is only \$20,000. A gross valuation misstatement exists, based on X's return (<math>\\$50,000 / \\$20,000 = 250\%</math>). When determining whether the amount of the tax attributable to the valuation overstatement exceeds the \$5,000 threshold (\$10,000 threshold for corporations other than S corporation or personal holding companies) amount for each of the partners, you must determine the amount of the underpayment attributable to the partner's share of the depreciation deduction, and add this amount to any underpayments also attributable to a valuation misstatement.</p>	<ul style="list-style-type: none"><li>▪ Treas. Reg. 1.6662-5(h)(2)</li></ul>



# Detailed Explanation of the Concept (cont'd)

Overview of Accuracy-Related Penalties	
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<p><u>Substantial Overstatement of Pension Liabilities</u></p> <p>Companies may deduct the employer contribution to pension plans under IRC 404(a)(1). However, IRC 404(o) limits a single-employer defined benefit plan's deduction. In general, the maximum deduction is the greater of:</p> <ol style="list-style-type: none"> <li>1. The sum of the amounts calculated under IRC 404(c)(2), with respect to each plan year ending with or within the taxable year, or</li> <li>2. The sum of the minimum required contribution under IRC 430.</li> </ol> <p>The penalty for a substantial overstatement of pension liabilities applies if a company overstates the penalty liabilities by 200% or more of the amount determined to be correct for purposes of computing the employer contribution deduction under IRC 404(a)(1). The percentage is determined by dividing the pension deduction claimed on the return by the correct pension deduction. The penalty applies only if the underpayment attributable to the overstatement exceeds \$1,000.</p> <p>The amount of the substantial overstatement of pension liabilities penalty is 20% of the underpayment attributable to a substantial overstatement of pension liabilities. The penalty rate increases to 40% of the underpayment attributable to a gross valuation misstatement if the substantial overstatement of pension liabilities is 400% or more of the correct amount of such liabilities. This penalty has no disclosure exception. The penalty is not applicable if the taxpayer shows reasonable cause and acted in good faith for the valuation or assumptions used in deriving the deduction on the return.</p>	<ul style="list-style-type: none"> <li>▪ IRC 6662(f)</li> <li>▪ IRC 6662(b)(4)</li> <li>▪ IRC 404 (a)(1)</li> <li>▪ IRC 404(o)</li> <li>▪ IRC 404(c)(2)</li> <li>▪ IRC 430</li> </ul>

# Detailed Explanation of the Concept (cont'd)

Overview of Accuracy-Related Penalties	
Analysis	Resources
<p><u>Substantial Estate or Gift Tax Valuation Understatement</u></p> <p>Taxpayers who file estate or gift tax returns are required to properly value the decedent's estate or the donor's gift. The estate or gift tax is calculated based on the value of the property. If the value reported is 65% or less than the correction amount, a 20% penalty for a substantial estate or gift tax valuation understatement is imposed on the resulting understatement.</p> <p>If the value reported is 40% or less than the correct amount, the penalty is 40%. The penalty only applies if the tax owed is over \$5,000.</p> <p>Section 301(c) of the <i>Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010</i> allows the executor of the estate of any decedent who died in 2010 to elect not to have the estate tax rules apply and instead to have modified carryover basis rules apply. A special rule may apply in determining tax items including basis, gain, loss, holding period, and character of the acquired property.</p> <p>The taxpayer may avoid this penalty by establishing reasonable cause.</p>	<ul style="list-style-type: none"><li>▪ IRC 6662(g)</li><li>▪ IRC 6662(b)(5)</li><li>▪ <i>Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010</i></li></ul>

# Detailed Explanation of the Concept (cont'd)

Overview of Accuracy-Related Penalties	
Analysis	Resources
<p><u>Undisclosed Foreign Financial Assets Understatement</u></p> <p>Certain U.S. taxpayers holding specified foreign financial assets with an aggregate value exceeding \$50,000 must annually report information about those assets on their income tax return. Higher asset thresholds apply to U.S. taxpayers who file a joint tax return or who reside abroad. When calculating the total value of specified foreign financial assets in which the taxpayer has an interest during the tax year or on the last day of the tax year, determine the fair market value for each asset.</p> <p>IRC 6662(b)(7) imposes an accuracy-related penalty for an underpayment due to undisclosed foreign financial asset understatement. An understatement is attributable to an undisclosed foreign financial asset if it is the result of any transaction involving the asset. For example, if a taxpayer fails to disclose amounts held in a foreign financial account, any underpayment related to the transaction that gave rise to the income would be subject to the penalty (as would any underpayment related to interest, dividends or other returns accrued on such undisclosed amounts).</p> <p>A foreign financial asset means any asset with respect to which information is required to be provided under IRC 6038, IRC 6038B, IRC 6038D, IRC 6046A or IRC 6048 but which the taxpayer failed to provide for the applicable taxable year.</p> <p>The penalty rate is generally 20%. However, the <i>Hiring Incentives to Restore Employment Act of 2010</i> (2010 HIRE) added a 40% accuracy-related penalty on any understatement attributable to an “undisclosed foreign financial asset.” The penalty is effective for taxable years beginning after March 18, 2010. This penalty does not apply if the understatement is due to reasonable cause and the taxpayer acted in good faith.</p>	<ul style="list-style-type: none"> <li>▪ IRC 6662(j)</li> <li>▪ IRC 6662(b)(7)</li> <li>▪ IRC 6038</li> <li>▪ IRC 6038B</li> <li>▪ IRC 6038D</li> <li>▪ IRC 6046A</li> <li>▪ IRC 6048</li> <li>▪ <i>Hiring Incentives to Restore Employment Act of 2010</i></li> </ul>

# Detailed Explanation of the Concept (cont'd)

## Overview of Accuracy-Related Penalties

### Analysis

### Resources

#### Underpayment Attributable to Transactions Lacking Economic Substance

Generally, taxpayers can decrease their taxes in any way allowed by law. However, transactions must have a business or corporate purpose and have economic substance as defined in IRC 7701(o).

An accuracy-related penalty is imposed under IRC 6662(b)(6) on an underpayment from a transaction lacking economic substance as defined under IRC 7701(o) or failing to meet the requirements of any similar rule of law. The penalty is effective for transactions entered into after March 30, 2010.

The penalty is equal to 20% of the underpayment. The penalty rate is increased to 40% if the taxpayer does not adequately disclose the relevant facts affecting the tax treatment in the return or a statement attached to the return. A nondisclosed, noneconomic substance transaction means any portion of a transaction under IRC 6662(b)(6) where the relevant facts affecting the tax treatment are not adequately disclosed in the return or in a statement attached to the return. A taxpayer will be deemed to have adequately disclosed the transaction only if the required information is provided on Form 8275, Form 8275-R, or on Schedule UTP (Form 1120), *Uncertain Tax Position Statement*, if required.

If the transaction is a reportable transaction pursuant to Treas. Reg. 1.6011-4, adequate disclosure requires the taxpayer to report both in accordance with the reportable transaction reporting rules and on Form 8275, Form 8275-R or Schedule UTP.

- IRC 6662(i)
- IRC 6662(b)(6)
- IRC 7701(o)
- Form 8275 - *Disclosure Statement*
- Form 8275-R - *Regulation Disclosure Statement*
- Form 1120, Schedule UTP - *Uncertain Tax Position*
- Treas. Reg. 1.6011-4

# Detailed Explanation of the Concept (cont'd)

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<p><u>Inconsistent Estate Basis Reporting</u></p> <p>The <i>Surface Transaction and Veterans Health Care Choice Improvement Act of 2015</i> amended IRC 1014 to provide that the basis of inherited property must be consistent with what is reported on the estate tax return of the decedent. The Act also amended IRC 6662 to create an accuracy-related penalty to be applied when there is an inconsistency in the estate basis reporting. IRC 6662(b)(8) imposes an accuracy-related penalty on the part of the underpayment attributable to any inconsistent estate basis. IRC 6662(k) states that there is an “inconsistent estate basis” if the basis of property claimed on a return exceeds the basis as determined under IRC 1014(f).</p> <p>According to proposed Treas. Reg. 1.6662-8, there is an inconsistent estate basis when the taxpayer claims a basis amount without considering the adjustments under proposed Treas. Reg. 1.1014-10(a)(2) related to post-death events such as depreciation, capital improvements and adjustments to the basis of a partnership or S corporation interest, that exceeds the property’s final value as determined under Treas. Reg. 1,1014-10(c). Also, post-death payment on debt do not result in an adjustment to the property’s basis.</p> <p>The penalty is effective for property to which an estate tax return is filed after July 31, 2015. The taxpayer may rely on a reasonable cause defense for this penalty.</p>	<ul style="list-style-type: none"> <li>▪ IRC 6662(k)</li> <li>▪ IRC 6662(b)(8)</li> <li>▪ Prop. Treas. Reg. 1.6662-8</li> <li>▪ <i>Surface Transaction and Veterans Health Care Choice Improvement Act of 2015</i></li> <li>▪ IRC 1014(f)</li> <li>▪ IRC 6662</li> <li>▪ Prop. Treas. Reg. 1.1014-10(a)(2)</li> <li>▪ Treas. Reg. 1.1014-10(c)</li> </ul>

# Index of Referenced Resources

## Overview of Accuracy-Related Penalties

IRC 170

IRC 199A

IRC 404

IRC 430

IRC 1014(f)

IRC 6011

IRC 6020(b)

IRC 6038

IRC 6038A

IRC 6038B

IRC 6038D

IRC 6048

IRC 6048A

IRC 6662

IRC 6662A

IRC 6663

# Index of Referenced Resources (cont'd)

## Overview of Accuracy-Related Penalties

IRC 6664

IRC 6665

IRC 6751(b)(1)

IRC 7701(o)

Treas. Reg. 1.1014-10(c)

Treas. Reg. 1.6011-4

Treas. Reg. 1.6662-3(b)

Treas. Reg. 1.6662-4

Treas. Reg. 1.6662-5

Treas. Reg. 1.6662-6

Treas. Reg. 1.6664-2(a)

Treas. Reg. 1.6664-4

Prop. Treas. Reg. 1.1014-10(a)(2)

Prop. Treas. Reg. 1.6662-8

IRM 20.1.5

Form 1120, Schedule UTP - *Uncertain Tax Position*

# Index of Referenced Resources (cont'd)

## Overview of Accuracy-Related Penalties

IRM 20.1.1

Form 8275 - *Disclosure Statement*

Form 8275-R - *Regulation Disclosure Statement*

Form 8886 - *Reportable Transaction Disclosure Statement*

*Consolidation Appropriations Act of 2018*

*Hiring Incentives to Restore Employment Act of 2010*

*Protecting Americans from Tax Hikes Act of 2015*

*Surface Transaction and Veterans Health Care Choice Improvement Act of 2015*

*Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010*



# Training and Additional Resources

Overview of Accuracy-Related Penalties	
Type of Resource	Description(s)
Saba Meeting Sessions	<ul style="list-style-type: none"> <li>Penalty Consideration for LB&amp;I: Examination Supervisory Approval and Involvement, Penalty Determination - 2019 Saba Meeting</li> </ul>
Saba Meeting Sessions	<ul style="list-style-type: none"> <li>Accuracy-Related Penalty Consideration for LB&amp;I Examinations - 2016 Saba Meeting</li> </ul>
Issue Toolkits	<ul style="list-style-type: none"> <li>Audit Tool - Carryback and Carryover Job Aid - Accuracy-Related Penalties</li> <li>Audit Tool - IRC 6662 and IRC 6663 Penalty Calculation Job Aid</li> <li>Audit Tool - IRC 6662 FAQs</li> <li>Audit Tool - Example 886-A Negligence or Disregard of Rules &amp; Regulations Penalty</li> <li>Audit Tool - Example 886-A Substantial or Gross Valuation Misstatement Penalty</li> </ul>
Other Training Materials	<ul style="list-style-type: none"> <li>Managerial Approval of Penalties Under IRC 6751(b)(1) Community Meeting - 2018 Saba Meeting</li> </ul>

# Glossary of Terms and Acronyms

Term/Acronym	Definition
HIRE	Hiring Incentives to Restore Employment Act
PATH	Protecting Americans from Tax Hikes

# Index of Related Practice Units

Associated UIL(s)	Related Practice Unit
6664.03-00	<i>Reasonable Cause and Good Faith</i>