

Office of Chief Counsel
Internal Revenue Service
memorandum

CC:PA:1:MEHara
POSTS-130054-10

date: August 24, 2010

to: Lorraine Byrd
HQ Policy Tax Analyst
Office of Servicewide Penalties

from: Blaise Dusenberry
Senior Technical Reviewer, Branch 1
(Procedure & Administration)

subject: Penalty Provisions of H.R. 2847

This memorandum responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUES

1. What is the effective date for imposition of the I.R.C. § 6662(i) penalty for underpayments attributable to nondisclosed noneconomic transactions?
2. What is the effective date for imposition of the I.R.C. § 6662(j) penalty for understatements attributable to undisclosed foreign financial assets?
3. Whether the I.R.C. § 6622A penalty will not apply to any portion of an understatement on which the I.R.C. §§ 6662(i) and 6662(j) penalties are applicable?
4. Whether in cases where the Internal Revenue Service (Service) asserts penalties under I.R.C. §§ 6662(h), (i) and (j), the Service should assert the penalty that is most strongly supported by the facts and circumstances and, in unagreed cases, include the other penalties as an alternative.

CONCLUSIONS

1. The penalty under I.R.C. § 6662(i) applies to transactions entered into after the date of enactment, March 30, 2010. Accordingly, if a fiscal year taxpayer enters into a transaction lacking economic substance on March 31, 2010, the last day of its taxable year, and claims a deduction on its fiscal year ending March 31, 2010 tax return, the I.R.C. § 6662(i) penalty is applicable to the

PMTA 2010-55

April 1, 2009 to March 31, 2010 fiscal year.

2. The penalty under I.R.C. § 6662(j) applies to transactions entered into after the date of enactment, March 18, 2010. Accordingly, if a fiscal year taxpayer has a taxable year ending March 31, 2011, and it is determined that an underpayment is attributable to an undisclosed foreign financial asset in that taxable year, the penalty is applicable to the April 1, 2010 to March 31, 2011 fiscal year.

3. The I.R.C. § 6662A penalty will not apply to any portion of an understatement on which the I.R.C. § 6662(i) penalty is applicable, but may apply to that portion of an understatement to which the I.R.C. § 6662(j) penalty is applicable.

4. In cases where the Internal Revenue Service (Service) asserts penalties under I.R.C. §§ 6662(h), (i) and (j), the Service should assert the penalty that is most strongly supported by the facts and circumstances and, in unagreed cases, include the other penalties as an alternative.

LEGAL ANALYSIS

1. The penalty under I.R.C. § 6662(i) applies to transactions entered into after the date of enactment, March 30, 2010. Accordingly, if a fiscal year taxpayer enters into a transaction lacking economic substance on March 31, 2010, the last day of its taxable year, and claims a deduction on its fiscal year ending March 31, 2010 tax return, the I.R.C. § 6662(i) penalty is applicable to the April 1, 2009 to March 31, 2010 fiscal year.

Section 1409(b)(1) of the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1070 (2010 Reconciliation Act) added I.R.C. § 6662(b)(6) that provides for the imposition of the 20% accuracy-related penalty on any portion of an underpayment attributable to disallowance of claimed tax benefits by reason of a transaction lacking economic substance or failing to meet the requirements of any similar rule of law. Section 1409(b)(2) of the 2010 Reconciliation Act added I.R.C. § 6662(i)(2) that provides that any portion of such a transaction for which the relevant facts affecting the tax treatment are not adequately disclosed in the return or in a statement attached to the return is a “nondisclosed economic substance transaction.” Section 1409(b)(2) of the 2010 Reconciliation Act also added I.R.C. § 6662(i)(2) that provides that in the case of any portion of an underpayment which is attributable to one or more nondisclosed noneconomic substantive transactions, the accuracy related penalty is 40% rather than 20%.

Section 1409(e)(2) of the 2010 Reconciliation Act provides that “The amendments made by subsections (b) and (c)(1) shall apply to underpayments attributable to transactions entered into after the date of the enactment of this

Act.” The 2010 Reconciliation Act was enacted on March 30, 2010. Accordingly, applying the plain language of this section, if a fiscal year taxpayer enters into a transaction lacking economic substance on March 31, 2010, the last day of its taxable year, and claims a deduction on its fiscal year ending March 31, 2010 tax return, the I.R.C. § 6662(i) penalty is applicable to the April 1, 2009 to March 31, 2010 fiscal year.

2. The penalty under I.R.C. § 6662(j) applies to transactions entered into after the date of enactment, March 18, 2010. Accordingly, if a fiscal year taxpayer has a taxable year ending March 31, 2011, and it is determined that an underpayment is attributable to an undisclosed foreign financial asset in that taxable year, the penalty is applicable to the April 1, 2010 to March 31, 2011 fiscal year.

Section 511(a) of the Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147 (HIRE Act) provides that individuals who hold any interest in specified foreign financial assets during the tax year must attach to their tax return certain information with respect to each asset if the aggregate value of all assets exceeds \$50,000. I.R.C. § 6038D. An individual who fails to furnish the required information with respect to any tax year at the prescribed time and in the prescribed manner is subject to a penalty of \$10,000. I.R.C. § 6038D(d). An additional penalty may apply if the Secretary of the Treasury notifies the individual by mail of the failure to disclose and the failure to disclose continues. In such cases, if the failure to disclose the required information for more than 90 days after the day on which the notice was mailed, the individual is subject to an additional penalty of \$10,000 for each 30-day period (or a fraction thereof) during which the failure continues after the expiration of the 90 day period. The additional penalty with respect to any failure may not exceed \$50,000.

In addition, a 40% accuracy related penalty is imposed for underpayment of tax that is attributable to an undisclosed foreign financial asset understatement. I.R.C. § 6662(b)(7) and (j). For this purpose, an undisclosed foreign financial asset understatement for any tax year is the portion of the understatement for the year that is attributable to any transaction involving undisclosed foreign financial assets, which includes any asset that are is subject to the information reporting requirements of I.R.C. §§ 6038, 6038B, 6046A, 6048 and new section 6038D., but for which the required information was not provided by the taxpayer as required under the applicable reporting provisions.

Section 512(b) of the HIRE Act provides: “The amendments made by this section shall apply to taxable years beginning after the date of the enactment of this Act.” The HIRE Act was enacted on March 18, 2010. Accordingly, applying the plain language of this section, if a fiscal year taxpayer has a taxable year ending March 31, 2011, and it is determined that an underpayment is attributable to an undisclosed foreign financial asset in that taxable year, the penalty is applicable to the April 1, 2010 to March 31, 2011 fiscal year.

3. The I.R.C. § 6662A penalty will not apply to any portion of an understatement on which the I.R.C. § 6662(i) penalty is applicable, but may apply to that portion of an understatement to which the I.R.C. § 6662(j) penalty is applicable.

The penalty imposed under I.R.C. § 6662A does not apply to any portion of an understatement to which the 40% penalty for gross valuation misstatements under Section 6662(h) applies.¹ Section 1409(b)(3) of the 2010 Reconciliation Act amended I.R.C. § 6662A(e)(2)(B) to provide as follows:

Coordination with certain increased underpayment penalties.—This section shall not apply to any portion of an understatement on which a penalty is imposed under section 6662 if the rate of the penalty is determined under subsections (h) or (i) of section 6662.

Moreover, the Joint Committee on Taxation Technical Explanation of the Revenue Provisions of the Patient Protection and Affordable Care Act of 2010, as amended by the Health Care and Education Reconciliation Act of 2010, provides at footnote 361:

As revised by the provision, new section 6662A(e)(2)(b) provides that section 6662A will not apply to any portion of an understatement due to gross valuation misstatement under section 6662(h) or nondisclosed noneconomic substance transaction under new section 6662(i)

No reference is made to section 6662(j). Accordingly, under this amendment to section 6662A(e)(2)(B), we conclude that the section 6662A penalty will not apply to any portion of an understatement on which the I.R.C. § 6662(i) penalty is applicable, but may apply to that portion of an understatement to which the I.R.C. § 6662(j) penalty is applicable.

4. In cases where the Internal Revenue Service (Service) asserts penalties under I.R.C. §§ 6662(h), (i) and (j), the Service should assert the penalty that is that is most strongly supported by the facts and circumstances and, in unagreed cases, include the other penalties as an alternative.

IRM 20.1.5.2.2(5) states:

(5) Only one penalty rate applies to any portion of an underpayment. When two penalties could apply, the penalty at the higher rate is asserted. If two penalties at the same rate would apply, assert the penalty that is more comprehensively applicable

1. The Section 6662A penalty also does not apply to any portion of an understatement to which a fraud penalty applies under 6663. I.R.C. § 6662A(e)(2)(A).

and, in unagreed cases, include the other penalty in the report as an alternative position.

IRM 20.1.5.2.2(6) provides an example of this no stacking principle

(6) The following illustrates the “no stacking” provision in Treas. Reg. 1.6662-2(c):

- a. If a portion of the underpayment of tax required to be shown on a return is attributable to both negligence and a substantial understatement, the accuracy-related penalty would apply only once at the 20 percent rate to this portion of the underpayment. The examining agent should assert the penalty that is most strongly supported by the facts and circumstances and write up the other as an alternative position.
- b. The penalty is applied at the 40 percent rate on any portion of the underpayment attributable to a gross valuation misstatement. Any penalty at the 20 percent rate that could have applied to this portion is not asserted except as an alternative.

You ask if the Service has a case scenario with three adjustments and adjustment 1 is attributable to a gross valuation misstatement under section 6662(h), adjustment 2 is attributable to a transaction lacking in economic substance under section 6662(i), and adjustment 3 is attributable to undisclosed foreign financial assets, will IRM 20.1.5.2.2(5) still be applicable.

Yes. In cases where the no stacking rule applies, it still is prudent for the Service to assert as its primary position its strongest penalty case, asserting the penalty that is most strongly supported by the facts and circumstances. Which penalty that may be in your scenario depends on the individual facts and circumstances. We understand that may be difficult where the various penalties do not appear to be as interconnected as between the negligence penalty and the substantial understatement penalty, but we believe the underlying principle asserted in IRM 20.1.5.2.2(5) is still sound policy.

We hope this has been helpful. Please contact Michael Hara, CC:PA:1, at (202) 622-4910, if you have any questions or comments regarding this memorandum.