

**Office of Chief Counsel  
Internal Revenue Service  
memorandum**

CC:PA:02:DSkinner  
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to: Ronk, Alice L.  
Attorney-advisor  
(SB/SE Headquarters, Exam Operations)

from: Ashton P. Trice   
Chief, Branch 2  
(Procedure & Administration)

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subject: Reportable transaction understatement penalty questions; section 6662A

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

**BACKGROUND**

From 2003 through 2011, taxpayers participated in, but did not disclose, a listed transaction described in Notice 2007-83, 2007-2 C.B. 960, which describes abusive arrangements using cash-value life insurance policies purportedly to provide welfare benefits. On October 17, 2007, when the Service issued Notice 2007-83, tax years 2004 and later were open for assessment. The Service is making a single adjustment for the accumulated value of the insurance policies, in a year for which the assessment period remains open (the adjustment year).

As we understand it, one or more provisions applicable to the taxation of the benefits provided through the arrangement requires the taxpayer to include in income each year the fair market value of the insurance policy(ies) on the life of the taxpayer, but reduced by amounts previously included in income. Thus, in cases where a taxpayer had not yet included any amount in income prior to the adjustment year, the entire amount would be includible in the adjustment year. Generally this amount would be the Accumulation Value (the policy's cash value without regard to surrender charges) of the policy. Questions on adjustments made under these rules should be directed to CC:TEGE. This memorandum considers only the specific penalty issues presented below.

## ISSUES

1. If part of the accumulated value derives from a year before the Service issued Notice 2007-83, but the Service is making the accumulated value adjustment in an open year after the listing notice and for which the taxpayer failed to disclose the transaction, is the entire section 6662A reportable transaction understatement penalty imposed at the thirty-percent rate?
2. When computing the section 6662A penalty, must the Service apportion the penalty between the closed year the transaction was not listed and the open years when it was listed and for which the taxpayers failed to disclose?
3. When proposing for the adjustment year an accumulated-value adjustment resulting from several years of participation in the listed transaction, which "highest rate of tax" applies for computing the section 6662A penalty?
4. Should the Service somehow apportion the accumulated-value to a number of years and compute the penalty using the highest applicable tax rate for each year to that year's portion?

## CONCLUSIONS

1. Yes, the entire section 6662A penalty is properly imposed at the higher thirty-percent rate provided in section 6662A(c), because there is a reportable transaction understatement and the taxpayers failed to satisfy the requirements of section 6664(d)(3)(A) by disclosing their participation in the transaction as required under section 6011 and § 1.6011-4(e)(1) and (e)(2)(i).
2. No. The reportable transaction understatement also occurs in the adjustment year, and apportionment is neither necessary nor appropriate.
3. The "highest rate of tax" is whatever the highest rate of tax is under section 1 for individual taxpayers, for the year of the adjustment.
4. No. The highest rate of tax used to compute the section 6662A penalty is the highest rate for the adjustment year, and no apportionment is appropriate.

## LAW AND ANALYSIS

The section 6662A penalty applies when a taxpayer has a reportable transaction understatement. Sec. 6662A(a).

Section 6662A(c) imports the disclosure requirement from section 6664(d)(3)(A) and imposes a 30-percent penalty, rather than the standard 20-percent penalty, on the portion of any reportable transaction understatement with respect to which the disclosure requirement is not satisfied.<sup>1</sup> Persons liable for tax must make returns or statements as required by regulations. Sec. 6011(a). Taxpayers who participate in reportable transactions and who are required to file tax returns must file a disclosure statement within the time prescribed in § 1.6011-4(e). Treas. Reg. § 1.6011-4(a). Taxpayers must submit the disclosure statement with their tax return and with each

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<sup>1</sup> The reference in sec. 6662A(c) to sec. 6664(d)(2)(A) does not reflect the insertion of new sec. 6664(d)(2) in 2010. Sec. 6662A(c) should be interpreted as referring to current sec. 6664(d)(3)(A).

amended return reflecting their participation. Treas. Reg. § 1.6011-4(e)(1). When a transaction becomes a listed transaction after a return is filed and before the end of the period of limitations on assessment for any year the taxpayer participated in the listed transaction, the taxpayer must file a disclosure statement within 90 days after the date the transaction became a listed transaction.<sup>2</sup> Treas. Reg. § 1.6011-4(e)(2)(i). For years with assessment periods that ended before the Service issued the listing notice, § 1.6011-4(e) does not impose any disclosure obligation.

On the facts you presented, the taxpayers participated in the listed transaction during each year from 2003 through 2011, the Service is making the accumulated-value adjustment in a year with an open assessment period, and the taxpayers did not disclose their participation on the return for that year. The reportable transaction understatement resulting from that transaction, therefore, is subject to the 30-percent penalty for nondisclosed listed transactions. Sec. 6662A(c). The fact that some of the accumulated value could have been reported in a closed year is not relevant. Of course, if the taxpayers had included any of the cash value in income in any year before the adjustment year, that amount would not be part of the accumulated-value adjustment in the adjustment year.

Because the Service is making the adjustment in the adjustment year, the “increase (if any) in taxable income which results from a difference between the proper tax treatment of an item to which this section applies and the taxpayer’s treatment of such item (as shown on the taxpayer’s return of tax)”, sec. 6662A(b)(1)(A), occurs in that year.

To determine the reportable transaction understatement, the increase in taxable income resulting from the difference between the proper tax treatment and the taxpayer’s treatment is multiplied by the highest rate of tax imposed by section 1 for individuals. Sec. 6662A(b)(1)(A). The highest rate under section 1 is currently 39.6 percent. See sec. 1(a), (b), (c), (d), (e), and (i)(3). The penalty is 30 percent of the reportable transaction understatement. Sec. 6662A(C).

The penalty should not be apportioned over several years, nor should the highest rate be some blend of the highest rate from several years. Rather, the penalty is calculated from the adjustment made in the adjustment year, using the highest rate for that year.

#### CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call David Skinner at (202) 317-6844 if you have any further questions.

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<sup>2</sup> Listed transactions are a subset of reportable transaction. Treas. Reg. § 1.6011-4(b)(1), (2).