

Part III

Administrative, Procedural, and Miscellaneous

26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.

(Also Part 1, §§ 6662, 6694, 1.6662-4, 1.6694-2)

Rev. Proc. 2008-14

SECTION 1. PURPOSE

This revenue procedure updates Rev. Proc. 2006-48, 2006-47 I.R.B. 934, and identifies circumstances under which the disclosure on a taxpayer's return with respect to an item or a position is adequate for the purpose of reducing the understatement of income tax under section 6662(d) of the Internal Revenue Code (relating to the substantial understatement aspect of the accuracy-related penalty), and for the purpose of avoiding the preparer penalty under section 6694(a) (relating to understatements due to unreasonable positions) with respect to income tax returns. This revenue procedure does not apply with respect to any other penalty provisions (including the disregard provisions of the section 6662 accuracy-related penalty, which are subject to an exception for adequate disclosure). Also, under this revenue procedure, no disclosure on a return other than an income tax return will be adequate with respect to a preparer penalty under section 6694(a).

This revenue procedure applies to any income tax return filed on 2007 tax forms for a taxable year beginning in 2007, and to any income tax return filed on 2007 tax forms in 2008 for short taxable years beginning in 2008.

SECTION 2. CHANGES FROM REV. PROC. 2006-48

.01. Editorial changes and line reference changes to Form 1040, Schedule A, have been made in updating Rev. Proc. 2006-48.

.02. This revenue procedure has been updated to reflect changes made to section 170(f) by Public Law 109-280, section 1217, and to section 6694 by Public Law 110-28, section 8246.02.

.03. Section 4.02(3)(f) concerning difference in book and income tax reporting is expanded by adding Form 1120-F, Schedule M-3 (Form 1120-F), *Net Income (Loss) of Foreign Corporations With Total Assets of \$10 Million or More*: Column (b), *Temporary Difference*, and Column (c), *Permanent Difference*, of Part II, (reconciliation of income (loss) items) and Part III (reconciliation of expense/deduction items).

SECTION. 3. BACKGROUND

.01 If section 6662 applies to any portion of an underpayment of tax required to be shown on a return, an amount equal to 20 percent of the portion of the underpayment to which the section applies is added to the tax. (The penalty rate is 40 percent in the case of gross valuation misstatements under section 6662(h).) Section 6662(b)(2) applies to the portion of an underpayment of tax that is attributable to a substantial understatement of income tax.

.02 Section 6662(d)(1) provides that there is a substantial understatement of income tax if the amount of the understatement exceeds the greater of 10 percent of the amount of tax required to be shown on the return for the taxable year or \$5,000. Section 6662(d)(1)(B) provides special rules for corporations. A corporation (other than an S corporation or personal holding company) has a substantial understatement of income tax if the amount of the understatement exceeds the lesser of 10 percent of the tax required to be shown on the return for a taxable year (or, if greater, \$10,000) or \$10,000,000. Section 6662(d)(2) defines an understatement as the excess of the amount of tax required to be shown on the return for the taxable year over the amount of the tax that is shown on the return reduced by any rebate (within the meaning of section 6211(b)(2)).

.03 In the case of an item not attributable to a tax shelter, section 6662(d)(2)(B)(ii) provides that the amount of the understatement is reduced by the portion of the understatement attributable to any item with respect to which the relevant facts affecting the item's tax treatment are adequately disclosed in the return or in a statement attached to the return, and there is a reasonable basis for the tax treatment of the item by the taxpayer.

.04 Section 6694(a) imposes a penalty on a tax return preparer for filing a return or claim for refund that results in an understatement of liability due to a position of which the preparer knew or should have known, if the preparer did not have a reasonable

belief that the position would more likely than not be sustained on the merits and the position was not disclosed in accordance with section 6662(d)(2)(B)(ii). The penalty is equal to the greater of \$1,000 or 50% of the income derived (or to be derived) by the preparer with respect to the return or claim.

.05 In general, this revenue procedure provides guidance for determining when disclosure is adequate for purposes of section 6662(d)(2)(B)(ii) and section 6694(a)(2)(C)(i). For purposes of this revenue procedure, the taxpayer must furnish all required information in accordance with the applicable forms and instructions, and the money amounts entered on these forms must be verifiable. Annual guidance under Treas. Reg. § 1.6662-4(f)(2) and Treas. Reg. § 1.6694-3(e)(1) and (2) for returns filed on 2006, 2005, and 2004 tax forms is provided in Rev. Proc. 2006-48, 26 I.R.B. 667, Rev. Proc. 2005-75, 50 I.R.B. 1137, and Rev. Proc. 2004-73, 2004-2 C.B. 999, respectively.

.06 Fiscal and short tax year returns. (a) In general. This revenue procedure may apply to a return for a fiscal tax year that begins in 2007 and ends in 2008. This revenue procedure may also apply to a short year return for a period beginning in 2008 if the return is to be filed before the 2008 forms are available. (Note that individuals are generally not put in this position as a decedent's final return for a fractional part of a year is due the fifteenth day of the fourth month following the close of the 12-month period which began with the first day of such fractional part of the year. See Treas. Reg. section 1.6072-1(b).) In the case of fiscal year and short year returns, the taxpayer must take into account any tax law changes that are effective for tax years beginning after December 31, 2007, even though these changes are not reflected on the form.

(b) Tax law changes effective after December 31, 2007. This document does not take into account the effect of tax law changes effective for tax years beginning after December 31, 2007. If a line referenced in this revenue procedure is affected by such a change and requires additional reporting, a taxpayer may have to file Form 8275, *Disclosure Statement*, or Form 8275-R, *Regulation Disclosure Statement* until the Service prescribes criteria for complying with the requirement.

SECTION 4. PROCEDURE

.01 General.

(1) Additional disclosure of facts relevant to, or positions taken with respect to, issues involving any of the items set forth below is unnecessary for purposes of reducing any understatement of income tax under section 6662(d) (except as otherwise provided in section 4.02(3) concerning Schedules M-1 and M-3), provided that the forms and attachments are completed in a clear manner and in accordance with their instructions.

(2) The money amounts entered on the forms must be verifiable, and the information on the return must be disclosed in the manner described below. For purposes of this revenue procedure, a number is verifiable if, on audit, the taxpayer can demonstrate the origin of the number (even if that number is not ultimately accepted by the Internal Revenue Service) and the taxpayer can show good faith in entering that number on the applicable form.

(3) The disclosure of an amount as provided in section 4.02 below is not adequate when the understatement arises from a transaction between related parties. If an entry may present a legal issue or controversy because of a related party transaction, then that transaction and the relationship must be disclosed on a Form 8275, *Disclosure Statement*, or Form 8275-R, *Regulation Disclosure Statement*.

(4) When the amount of an item is shown on a line that does not have a preprinted description identifying that item (such as on an unnamed line under an "Other Expense" category) the taxpayer must clearly identify the item by including the description on that line. For example, to disclose a bad debt for a sole proprietorship, the words "bad debt" must be written or typed on the line of Schedule C that shows the amount of the bad debt. Also, for Schedule M-3 (Form 1120), Part II, line 25, Other income (loss) items with differences, or Part III, line 35, Other expense/deduction items with differences, the entry must provide descriptive language; for example, "Cost of non-compete agreement deductible not capitalizable." If space limitations on a form do not allow for an adequate description, the description must be continued on an attachment.

(5) Although a taxpayer may literally meet the disclosure requirements of this revenue procedure, the disclosure will have no effect for purposes of the section 6662 accuracy-related penalty if the item or position on the return: (1) Does not have a reasonable basis as defined in Treas. Reg. § 1.6662-3(b)(3); (2) Is attributable to a tax shelter item as defined in section 6662(d)(2) and Treas. Reg. § 1.6662-4(g); or (3) Is not properly substantiated or the taxpayer failed to keep adequate books and records with respect to the item or position. See I.R.C. § 6694(a), as amended by the Small Business and Work Opportunity Tax Act of 2007, Pub. L. No. 110-28, 121 Stat. 190, and any guidance published thereunder regarding limitations on the effectiveness of a disclosure on the applicability of the section 6694 return preparer penalty.

.02 Items.

(1) Form 1040, Schedule A, *Itemized Deductions*:

(a) Medical and Dental Expenses: Complete lines 1 through 4, supplying all required information.

(b) Taxes: Complete lines 5 through 9, supplying all required information. Line 8 must list each type of tax and the amount paid.

(c) Interest Expenses: Complete lines 10 through 15, supplying all required information. This section 4.02(1)(c) does not apply to (i) amounts disallowed under section 163(d) unless Form 4952, *Investment Interest Expense Deduction*, is completed, or (ii) amounts disallowed under section 265.

(d) Contributions: Complete lines 16 through 19, supplying all required information. Enter the amount of the contribution reduced by the value of any substantial benefit (goods or services) provided by the donee organization in consideration, in whole or in part. Entering the value of the contribution unreduced by the value of the benefit received will not constitute adequate disclosure. If a contribution of \$250 or more is made, this section will not apply unless a contemporaneous written acknowledgment, as required by section 170(f)(8), is obtained from the donee organization. If contribution of cash of less than \$250 is made, this section will not apply unless a bank record or written communication from the donee, as required by section 170(f)(17), is obtained from the donee organization. If a contribution of property other than cash is made and the amount claimed as a deduction exceeds \$500, attach a properly completed Form 8283, *Noncash Charitable Contributions*, to the return. In addition to the Form 8283, if a contribution of a qualified motor vehicle, boat, or airplane has a value of more than \$500, this section will not apply unless a contemporaneous written acknowledgment, as required by section 170(f)(12), is obtained from the donee organization and attached to the return. An acknowledgment under section 170(f)(8) is not required if an acknowledgment under section 170(f)(12) is required.

(e) Casualty and Theft Losses: Complete Form 4684, *Casualties and Thefts*, and attach to the return. Each item or article for which a casualty or theft loss is claimed must be listed on Form 4684.

(2) Certain Trade or Business Expenses (including, for purposes of this section, the following six expenses as they relate to the rental of property):

(a) Casualty and Theft Losses: The procedure outlined in section 4.02(1)(e) must be followed.

(b) Legal Expenses: The amount claimed must be stated. This section does not apply, however, to amounts properly characterized as capital expenditures, personal expenses, or non-deductible lobbying or political expenditures, including amounts that are required to be (or that are) amortized over a period of years.

(c) Specific Bad Debt Charge-off: The amount written off must be stated.

(d) Reasonableness of Officers' Compensation: Form 1120, Schedule E, *Compensation of Officers*, must be completed when required by its instructions. The time devoted to business must be expressed as a percentage as opposed to "part" or "as needed." This section does not apply to "golden parachute" payments, as defined under section 280G. This section will not apply to the extent that remuneration paid or incurred exceeds the \$1 million-employee-remuneration limitation, if applicable.

(e) Repair Expenses: The amount claimed must be stated. This section does not apply, however, to any repair expenses properly characterized as capital expenditures or personal expenses.

(f) Taxes (other than foreign taxes): The amount claimed must be stated.

(3) Differences in book and income tax reporting.

(a) Form 1065. Schedule M-3 (Form 1065), *Net Income (Loss) Reconciliation for Certain Partnerships*: Column (b), *Temporary Difference*, and Column (c), *Permanent Difference*, of Part II, (reconciliation of income (loss) items) and Part III (reconciliation of expense/deduction items).

(b) Form 1120. (i) Schedule M-1, *Reconciliation of Income (Loss) per Books With Income per Return*.

(ii) Schedule M-3 (Form 1120), *Net Income (Loss) Reconciliation for Corporations with Total Assets of \$10 Million or More*: Column (b), *Temporary Difference*, and Column (c), *Permanent Difference*, of Part II, (reconciliation of income (loss) items) and Part III (reconciliation of expense/deduction items).

(c) Form 1120-L. Schedule M-3 (Form 1120-L), *Net Income (Loss) Reconciliation for U.S. Life Insurance Companies With Total Assets of \$10 Million or More*: Column (b), *Temporary Difference*, and Column (c), *Permanent Difference*, of Part II, (reconciliation of income (loss) items) and Part III (reconciliation of expense/deduction items).

(d) Form 1120-PC. Schedule M-3 (Form 1120-PC), *Net Income (Loss) Reconciliation for U.S. Property and Casualty Insurance Companies With Total Assets of \$10 Million or More*: Column (b), *Temporary Difference*, and Column (c), *Permanent Difference*, of Part II, (reconciliation of income (loss) items) and Part III (reconciliation of expense/deduction items).

(e) Form 1120S. Schedule M-3 (Form 1120S), *Net Income (Loss) Reconciliation for S Corporations With Total Assets of \$10 Million or More*: Column (b), *Temporary Difference*, and Column (c), *Permanent Difference*, of Part II, (reconciliation of income (loss) items) and Part III (reconciliation of expense/deduction items).

(f) Form 1120-F. Schedule M-3 (Form 1120-F), *Net Income (Loss) for Foreign Corporations With Total Assets of \$10 Million or More*: Column (b), *Temporary Difference*, and Column (c), *Permanent Difference*, of Part II, (reconciliation of income (loss) items) and Part III (reconciliation of expense/deduction items).

For Schedule M-1 and all Schedules M-3, the information provided reasonably must be expected to apprise the Service of the nature of the potential controversy concerning the tax treatment of the item. If the information provided does not so apprise the Service, a Form 8275 or Form 8275-R, must be used to adequately disclose the item (see Part II of the instructions for those forms).

Note: An item reported on a line with a pre-printed description, shown on an attached schedule, or "itemized" on Schedule M-1 may represent the aggregate amount of several transactions producing that item (*i.e.*, a group of similar items, such as amounts paid or incurred for supplies by a taxpayer engaged in business). In some instances, the potentially controversial item may involve a portion of the amount disclosed on the schedule. The Service will not be reasonably apprised of the potential controversy by the amount disclosed. In these instances, the taxpayer must use Form 8275 or Form 8275-R regarding that portion of the item.

The combining of unlike items, whether on Schedule M-1 or Schedule M-3 (or on an attachment when directed by the instructions), will not constitute an adequate disclosure.

(4) Foreign Tax Items:

(a) International Boycott Transactions: Transactions disclosed on Form 5713, *International Boycott Report*. Schedule A, *International Boycott Factor* (Section 999(c)(1)); Schedule B, *Specifically Attributable Taxes and Income* (Section 999(c)(2)); and Schedule C, *Tax Effect of the International Boycott Provisions*, must be completed when required by their instructions.

(b) Treaty-Based Return Position: Transactions and amounts under section 6114 or section 7701(b) as disclosed on Form 8833, *Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b)*.

(5) Other:

(a) Moving Expenses: Complete Form 3903, *Moving Expenses*, and attach to the return.

(b) Employee Business Expenses: Complete Form 2106, *Employee Business Expenses*, or Form 2106-EZ, *Unreimbursed Employee Business Expenses*, and attach to the return. This section does not apply to club dues, or to travel expenses for any non-employee accompanying the taxpayer on the trip.

(c) Fuels Credit: Complete Form 4136, *Credit for Federal Tax Paid on Fuels*, and attach to the return.

(d) Investment Credit: Complete Form 3468, *Investment Credit*, and attach to the return.

SECTION. 5. EFFECTIVE DATE

This revenue procedure applies to any income tax return filed on a 2007 tax form for a taxable year beginning in 2007, and to any income tax return filed on a 2007 tax form in 2008 for a short taxable year beginning in 2008.

SECTION 6. DRAFTING INFORMATION

The principal author of this revenue procedure is Jennifer Wagner of the Office of Associate Chief Counsel (Procedure & Administration). For further information regarding this revenue procedure, contact Branch 2 of Procedure and Administration at (202) 622-4940 (not a toll-free call).