

Office of Chief Counsel
Internal Revenue Service
memorandum

CC:SB:TTravers

date: March 24, 2015

to: Linda G. Franke
Senior Legal Advisor
SB/SE Examination Operations

from: Thomas Travers
Assistant Division Counsel (Tax Litigation)
SB/SE Division Counsel

subject: Accuracy-Related Penalties and the Automated Underreporter Program

This Memorandum responds to your request for advice.

ISSUE

Whether the Automated Underreporter (AUR) Program appropriately applies the accuracy-related penalty on the basis of negligence [REDACTED]

CONCLUSION

The Service has a longstanding policy to design, administer, and evaluate penalty programs based on how those programs can most efficiently encourage voluntary compliance. See Policy Statement 20-1, IRM 1.2.20.1.1 (1)-(2). The amount of penalty dollars involved is not an appropriate consideration in determining whether to apply penalties. While negligence is strongly indicated where a taxpayer fails to include on an income tax return an amount of income shown on an information return, an isolated computational or transcription error is not inconsistent with reasonable cause and good faith. [REDACTED]

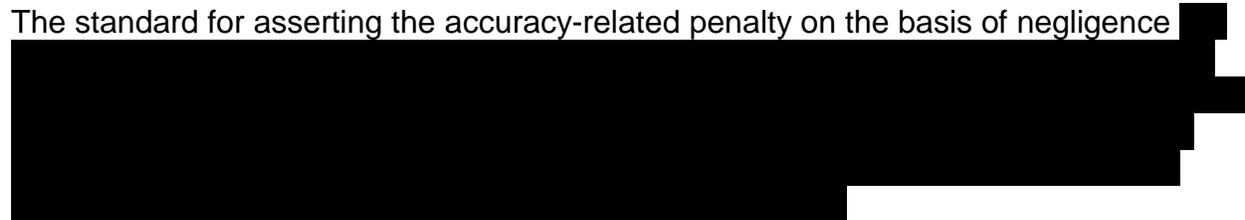
[REDACTED]. In contrast, the determination of a substantial understatement of income tax is a mathematical calculation that involves more certainty than the determination of negligence.

FACTS

The AUR Program matches taxpayer income and deductions submitted on information returns by third parties against amounts reported by taxpayers on their individual income tax return to identify discrepancies. The IRS has developed controls to ensure that penalties are asserted when warranted.

The standard for asserting the accuracy-related penalty on the basis of substantial understatement is essentially a mathematical test (understatement for the year exceeds the greater of 10% of the tax required to be shown on the return or the sum of \$5,000.00), and the business rules in the AUR system will automatically include the accuracy-related penalty on the CP 2000 Notices for those cases that involve a substantial understatement of income tax.

The standard for asserting the accuracy-related penalty on the basis of negligence



The Office of Chief Counsel previously issued guidance regarding Accuracy-Related Penalties and the Automated Underreported Program in an internal Memorandum dated October, 22, 2007.



LAW AND ANALYSIS

Among other things, the accuracy-related penalty pursuant to I.R.C. § 6662(a) may be based upon a taxpayer's substantial understatement of tax or negligence. For individuals, an understatement of income tax is substantial if the understatement for the year exceeds the greater of 10% of the tax required to be shown on the return or \$5,000.00. Negligence includes a taxpayer's failure to reasonably comply with the tax laws, failure to exercise reasonable care in the preparation of a tax return, failure to keep adequate books and records, or failure to properly substantiate items properly. Treas. Reg. § 1.6662-3(b)(1).

The accuracy-related penalty is not imposed with respect to any portion of the underpayment as to which the taxpayer acted with reasonable cause and in good faith. I.R.C. § 6664(c). In considering the reasonable cause exception to penalties, the regulations specifically refer to isolated errors not being inconsistent with reasonable cause or good faith: “An isolated computational or transcriptional error generally is not inconsistent with reasonable cause and good faith.” Treas. Reg. § 1.6664-4(b)(1).

With respect to the penalty under I.R.C. § 6662(a), the Service has the burden of production. I.R.C. § 7491(c). The Service bears the burden of producing sufficient evidence to indicate that it is appropriate to impose any additions to tax or penalties provided by the Internal Revenue Code. Higbee v. Commissioner, 116 T.C. 438, 446-447 (2001). Once The Service meets the burden of production, the taxpayer will bear the burden of establishing that an exception applies. Higbee v. Commissioner, supra at 447.

Policy Statement 20-1 provides that penalties are used to enhance voluntary compliance. The Service has a responsibility to collect the proper amount of tax revenue in the most efficient manner. Penalties provide the Service with an important tool to achieve that goal because they enhance voluntary compliance by taxpayers. In order to make the most efficient use of penalties, the Service will design, administer, and evaluate penalty programs based on how those programs can most efficiently encourage voluntary compliance. IRM 1.2.20.1.1 (1)-(2).

The AUR Program’s policy decision

[REDACTED]

[REDACTED]

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 view.

Please let me know if you have any questions regarding this Memorandum.

/s/ Thomas Travers
Thomas Travers
Assistant Division Counsel (TL)