

## LB&I Process Unit

<b>Unit Name</b>	Accuracy-Related Penalty on Understatements With Respect to Reportable Transactions	
<b>Primary UIL Code</b>	6662A.00-00	Accuracy-Related Penalty on Understatements with Respect to Reportable Transactions

Library Level	Title
<b>Knowledge Base</b>	Penalties
<b>Shelf</b>	Functional Penalty Procedures
<b>Book</b>	LB&I Penalties Procedures (Domestic)
<b>Chapter</b>	Accuracy-Related Penalty on Understatement with Respect to Reportable Transactions

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# Process Overview

## Accuracy-Related Penalty on Understatements With Respect to Reportable Transactions

Treasury Regulation 1.6011-4 requires taxpayer to disclose participation in a reportable transaction on their income tax return and, when applicable, with the IRS Office of Tax Shelter Analysis (OTSA). IRC 6662A of the Internal Revenue Code imposes an accuracy-related penalty on any reportable transaction understatement. The penalty is effective for tax years ending after October 22, 2004.

The IRC 6662A penalty applies to the following:

- Any listed transaction, and
- Any other reportable transaction (other than a listed transaction) if a significant purpose of such transaction is the avoidance or evasion of federal income tax.

Taxpayers who are required to file a disclosure statement pursuant to Treas. Reg. 1.6011-4 must file Form 8886, *Reportable Transaction Disclosure Statement*, with their returns and, when applicable, with OTSA.

The IRC 6662A penalty is 20 percent of the reportable transaction understatement when the taxpayer adequately discloses his participation. The penalty is increased to 30 percent when the taxpayer does not adequately disclose participation in the transaction. IRC 6662A(c). The initial determination of the penalty must be approved in writing by the immediate supervisor. IRC 6751(b). If the penalty is asserted at the 30% rate in IRC 6662A(c), the immediate supervisor should approve the penalty both at the 20% rate in IRC 6662A(a) and the 30% rate in IRC 6662A(c). See *Oropeza v. Commissioner*, 155 T.C. No. 9 (2020).

Except for reportable transaction understatement attributable to a transaction lacking economic substance prescribed in IRC 6662(b)(6), the IRC 6662A penalty will not apply if the taxpayer establishes reasonable cause and good faith in accordance with the provisions of IRC 6664(d). For purposes of IRC 6662A, reasonable cause and good faith requires (a) adequate disclosure of the relevant facts affecting the tax treatment of the item in accordance with the regulations under IRC 6011, (b) substantial authority for the treatment, and (c) the taxpayer's reasonable belief (as defined in IRC 6664(d)(4)) that the tax treatment was more likely than not the proper treatment. IRC 6664(d)(3).

# Process Overview (cont'd)

## Accuracy-Related Penalty on Understatements With Respect to Reportable Transactions

Per IRC 6662A(e)(2), the IRC 6662A penalty cannot be imposed on the same portion of the understatement where the following penalties are imposed:

- IRC 6663, fraud penalty,
- IRC 6662(h), increase in accuracy-related penalty in case of gross valuation understatement, and
- IRC 6662(i), increase in accuracy-related penalty in case of nondisclosed noneconomic substance transactions.

Per IRC 6662A(e)(1), the understatement attributable to the IRC 6662A reportable transaction is included in the IRC 6662(d) understatement calculation to determine whether such understatement is a substantial understatement under section 6662(d)(1). However, the reportable transaction understatement upon which the IRC 6662A penalty is asserted is not included in the amount of the understatement used to determine underpayment upon which the 20 percent penalty under IRC 6662(d) is asserted. IRM 20.1.5.17.3 at (3)

If the IRC 6662A penalty is imposed, the penalty under IRC 6676, *Erroneous Claim for Refund or Credit*, cannot be imposed as a primary position, but should be developed as an alternative position where appropriate. IRM 20.1.5.17.3 at (2)

Unlike IRC 6662 accuracy-related penalties, the IRC 6662A penalty will apply even if there is no underpayment of tax on the taxpayer's tax return due to the definition of "reportable transaction understatement". IRM 20.1.5.17.2

# Process Applicability

## Accuracy-Related Penalty on Understatements With Respect to Reportable Transactions

Criteria	Resources
<p>The penalty can be considered only when it is established that the taxpayer participated in a reportable transaction. IRC 6662A applies to understatements that are attributable to listed transactions as defined by IRC 6707A(c)(2) and other reportable transactions as defined by IRC 6707A(c)(1), if a significant purpose of the transaction is the avoidance of or evasion of federal income tax.</p>	<ul style="list-style-type: none"><li>▪ IRC 6662A</li><li>▪ IRC 6707A</li></ul>
<p>Treas. Reg. 1.6011-4(b) lists five types of reportable transactions:</p> <ol style="list-style-type: none"><li>1. Listed transactions,</li><li>2. Confidential transactions,</li><li>3. Transactions with contractual protection,</li><li>4. Loss transactions, and</li><li>5. Transactions of interest.</li></ol>	<ul style="list-style-type: none"><li>▪ Treas. Reg. 1.6011-4</li></ul>

# Step 1: Compute the Understatement

## Accuracy-Related Penalty on Understatements With Respect to Reportable Transactions

### Step 1

Compute the reportable transaction understatement.

Considerations	Resources
<p>The reportable transaction understatement is the sum of:</p> <ol style="list-style-type: none"><li>1. The increase in taxable income that results from a difference between the proper tax treatment of the item related to the transaction and the taxpayer's treatment of the item multiplied by the highest tax rate imposed by IRC 1 for individuals or IRC 11 for corporations, and</li><li>2. Any decrease in the total amount of credits which results from the difference between the credits the taxpayer claimed and the proper amount.</li></ol> <p><u>Example</u></p> <p>XYZ Corporation is a C Corporation. For calendar tax year ending 2018, XYZ participated in a reportable transaction that had a significant purpose of tax evasion and generated a \$300,000 loss. XYZ adequately disclosed the reportable transaction. Upon audit, IRS disallowed the \$300,000 loss pertaining to the reportable transaction.</p>	<ul style="list-style-type: none"><li>▪ IRC 6662A</li><li>▪ IRM 20.1.5.3.1 at (8)</li><li>▪ IRM 20.1.5.17 at (2)</li></ul>

# Step 1: Compute the Understatement (cont'd)

## Accuracy-Related Penalty on Understatements With Respect to Reportable Transactions

### Step 1

Considerations	Resources
<p><u>Example (cont'd)</u></p> <p>The “reportable transaction understatement” = <math>\\$300,000 \times 21\% + \\$0 = \\$63,000</math></p> <p>\$300,000 equals increase in taxable income resulting from the difference between the proper tax treatment of the reportable transaction and the taxpayer’s treatment of the item attributable to the original tax loss.</p> <p>21% is the highest corporate income tax rate imposed by IRC 11 for tax year 2018.</p> <p>\$0 equals the decrease in total amount of credits which results from the difference between the credits the taxpayer claimed from the reportable transaction and the proper amount.</p>	



# Step 2: Apply the Penalty Rate

## Accuracy-Related Penalty on Understatements With Respect to Reportable Transactions

### Step 2

Apply the appropriate penalty rate to the reportable transaction understatement.

Considerations	Resources
<ul style="list-style-type: none"><li>▪ The IRC 6662A penalty is 20 percent of the reportable transaction understatement if the taxpayer properly disclosed the transaction.</li><li>▪ The penalty rate increases to 30 percent if the reportable transaction is not properly disclosed pursuant to IRC 6011 and Treas. Reg. 1.6011-4 (including, when applicable, filing a disclosure with OTSA. Treas. Reg. 1.6011-4(e).</li></ul> <p><u>Example</u> (Continuation from Step 1)</p> <p>XYZ's reportable transaction understatement is \$63,000. The 20 percent penalty rate applies because XYZ adequately disclosed the reportable transaction. XYZ's accuracy-related penalty under IRC 6662A is \$12,600 for tax year 2018.</p> <p>IRC 6662A accuracy-related penalty = \$63,000 x 20% = \$12,600</p>	<ul style="list-style-type: none"><li>▪ IRC 6011</li><li>▪ Treas. Reg. 1.6011-4</li><li>▪ IRM 4.32.4.2</li><li>▪ IRC 6662A</li><li>▪ IRM 20.1.5.17 at (3)</li></ul>

# Exceptions

## Accuracy-Related Penalty on Understatements With Respect to Reportable Transactions

### Description

Except for reportable transaction understatement attributable to a transaction lacking economic substance, the IRC 6662A penalty will not be imposed if the taxpayer satisfies the requirements of IRC 6664(d)(3) to establish reasonable cause and good faith.

The taxpayer has shown reasonable cause and acted in good faith if:

1. The relevant facts affecting the tax treatment of the item are adequately disclosed in accordance with regulations prescribed under section 6011 (or failure to include reportable transaction information with return penalty under IRC 6707A is rescinded),
2. There is or was substantial authority for such treatment, and
3. The taxpayer reasonably believed that such treatment was more likely than not the proper treatment. "Reasonable belief" is based on the facts and the law at the time the tax return is filed and relates solely to the taxpayer's chances of success on the merits of the treatment and does not take into account the possibility that a return will not be audited, such treatment will not be raised on audit, or such treatment will be resolved through settlement if it is raised. IRC 6664(d)(4).

The taxpayer is treated as meeting the disclosure requirements of IRC 6011 and the associated regulations if the Commissioner (or the Commissioner's delegate) rescinds the penalty under IRC 6707A. However, if the transaction at issue is a listed transaction, rescission under IRC 6707A is not permitted.

# Definitions

## Accuracy-Related Penalty on Understatements With Respect to Reportable Transactions

### Description

- Reportable Transaction – any transaction with respect to which information is required to be included with a return or statement because, as determined under regulations prescribed under section 6011, such transaction is of a type which the Secretary determines as having a potential for tax avoidance or evasion.
- Listed Transaction – a reportable transaction which is the same as, or substantially similar to, a transaction specifically identified by the Secretary as a tax avoidance transaction for purposes of section 6011.
- Confidential Transaction – a transaction that is offered to a taxpayer under conditions of confidentiality and for which the taxpayer has paid an advisor a minimum fee.
- Transaction with Contractual Protection – a transaction for which the taxpayer or related party has the right to a full or partial refund of fees if all or part of the intended tax consequences from the transaction are not sustained.
- Loss Transaction – any transaction resulting in the taxpayer claiming a loss under section 165 that exceeds minimum thresholds.
- Transaction of Interest – a transaction that is the same as or substantially similar to one of the types of transactions that the IRS has identified by notice, regulation, or other form of published guidance as a transaction of interest.

# Examples of the Process

## Accuracy-Related Penalty on Understatements With Respect to Reportable Transactions

### Description

H and W, husband and wife, filed a joint federal income tax return for calendar year 2018, reporting taxable income of \$18,900 and a tax liability of \$1,913. H and W participated in a reportable transaction where a significant purpose was the avoidance of federal income tax. The reportable transaction was not adequately disclosed in accordance with the regulations under IRC 6011. H and W had no amounts previously assessed (or collected without assessment) and no rebates were made. Subsequently, the 2018 return was examined. The examiner initially determined that the penalties below applied and received written supervisory approval of that initial determination. The following adjustments and penalties were agreed:

Adjustment #1, subject to substantial understatement of income tax penalty per IRC 6662(d)	\$35,000
Adjustment #2, subject to civil fraud penalty per IRC 6663	50,000
Adjustment #3, subject to reportable transaction understatement penalty per IRC 6662A	<u>25,000</u>
Total adjustments	<u>\$110,000</u>
Taxable income per return	18,900
Taxable income as corrected, including the IRC 6662A adjustment #3	\$128,900
Tax as corrected, including the IRC 6662A adjustment #3	\$24,313

# Examples of the Process (cont'd)

## Accuracy-Related Penalty on Understatements With Respect to Reportable Transactions

### Description

Computation of underpayment of tax, excluding the underpayment attributable to the reportable transaction understatement:

Taxable income as corrected, excluding the IRC 6662A adjustment #3	\$103,900
Tax as corrected, excluding the IRC 6662A adjustment #3	\$17,563
Tax per return	(\$1,913)
Previous assessment	(\$0)
Rebates	<u>\$0</u>
Underpayment of tax, excluding the underpayment attributable to the reportable transaction understatement (for Step 3)	<u>\$15,650</u>

Step 1: Determine the portion, if any, of the underpayment on which no penalty is imposed.

In this example, the adjustment where the portion of the underpayment on which no penalty is imposed does not exist. Therefore, “adjusted” taxable income from this step is \$18,900, the same as taxable income per return, and tax on “adjusted” taxable income from this step is \$1,913, the same as tax per return.

# Examples of the Process (cont'd)

## Accuracy-Related Penalty on Understatements With Respect to Reportable Transactions

### Description

Step 2: Determine the portion, if any, of the underpayment on which a substantial understatement of income tax penalty of 20 percent is imposed.

“Adjusted” taxable income from Step 1	\$18,900
Adjustment #1	<u>\$35,000</u>
“Adjusted” taxable income including Adjustment #1	\$53,900
Tax on “adjusted” taxable income	\$7,193
Tax on “adjusted” taxable income from Step 1	<u>(\$1,913)</u>
Portion of underpayment on which 20 percent penalty is imposed	<u>\$5,280</u>

IRC 6662(d) penalty = \$5,280 x 20% = \$1,056

In this step, in order to determine if there is a substantial understatement of income tax subject to IRC 6662(d)(1)(A), i.e., if the understatement exceeds the greater of \$5,000 or 10% of tax required to be shown on the return, we add the \$9,900 reportable transaction understatement calculated based on Adjustment #3 from Step 4 to \$5,280, totaling \$15,180. 10% of tax required to be shown on return is \$2,431 (\$24,313 x 10%). \$15,180 is a substantial understatement of income tax because it exceeds the greater of \$5,000 or \$2,431. The 20 percent substantial underpayment penalty under IRC 6662(d), however, will only be applied to the \$5,280 underpayment from Adjustment #1, as illustrated in this Step.

# Examples of the Process (cont'd)

## Accuracy-Related Penalty on Understatements With Respect to Reportable Transactions

Description	
Step 3: Determine the portion, if any, of the underpayment on which a fraud penalty of 75 percent is imposed.	
Underpayment of tax, excluding the underpayment attributable to the reportable transaction understatement	\$15,650
Less the sum of the portions of such underpayment determined in:	
Step 1	\$0
Step 2	<u>\$5,280</u>
Sum	<u>\$5,280</u>
Portion of understatement on which 75 percent penalty is imposed	<u>\$10,370</u>
IRC 6663 penalty = \$10,370 x 75% = \$7,778	

# Examples of the Process (cont'd)

## Accuracy-Related Penalty on Understatements With Respect to Reportable Transactions

Description	
Step 4: Determine the portion of the understatement of tax on which a reportable transaction understatement penalty of 30 percent is imposed due to non-adequate disclosure.	
Amount of increase in taxable income resulting from Adjustment #3	\$25,000
Multiplied by highest rate of tax imposed by IRC 1	<u>39.6%</u>
Reportable transaction understatement and portion of understatement on which a 30 percent penalty is imposed	<u>\$9,900</u>
IRC 6662A penalty = \$9,900 x 30% = \$2,970	



# Other Considerations / Impact to Audit

<b>Accuracy-Related Penalty on Understatements With Respect to Reportable Transactions</b>	
<b>Considerations</b>	<b>Resources</b>
None at time.	

# Index of Referenced Resources

## Accuracy-Related Penalty on Understatements With Respect to Reportable Transactions

IRC 1 - *Tax Imposed*

IRC 11 - *Tax imposed*

IRC 6011 - *General Requirement of Return, Statement, or List*

IRC 6662 - *Imposition of Accuracy-Related Penalty on Understatements*

IRC 6662A - *Imposition of Accuracy-Related Penalty on Understatements With Respect to Reportable Transactions*

IRC 6663 - *Imposition of Fraud Penalty*

IRC 6664 - *Definitions and Special Rules*

IRC 6676 - *Erroneous Claim for Refund or Credit*

IRC 6707A - *Penalty for Failure to Include Reportable Transaction Information with Return*

IRC 6751(b) - *Approval of Assessment*

Treas. Reg. 1.6011-4 - *Requirement of Statement Disclosing Participation in Certain Transactions by Taxpayers*

IRM 4.32.4.2 - *IRC 6011 Overview of Disclosure Requirements*

IRM 20.1.5.17 - *IRC 6662A, Accuracy-Related Penalty on Understatements with Respect to Reportable Transactions*

Form 8886 - *Reportable Transaction Disclosure Statement*

*Oropeza v. Commissioner* - 155 T.C. No. 9 (2020).

# Training and Additional Resources

<b>Accuracy-Related Penalty on Understatements With Respect to Reportable Transactions</b>	
<b>Type of Resource</b>	<b>Description(s)</b>
Saba Meeting Sessions	▪ Penalties IPG Community Meeting - 2014-05
Other Training Materials	▪ Audit Tool - IRC 6662A Applicability Flowchart

# Glossary of Terms and Acronyms

Term/Acronym	Definition
OTSA	Office of Tax Shelter Analysis

# Index of Related Practice Units

Associated UIL(s)	Related Practice Unit
	None at this time.