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From:

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To:

Cc:

Subject: 6662A penalty applicability to excise tax

You asked whether the section 6662A penalty applies to excises taxes. We have taken the position that it does not.

Section 6662A imposes a 20 percent accuracy-related penalty on reportable transaction understatements. While section 6662A(a) is silent as to which type of tax understatement the penalty applies, subsection (b) defines the term "reportable transaction understatement." That definition is limited to understatements involving taxable income.

A reportable transaction understatement is the sum of the product of (i) the amount of the increase in taxable income which results from the difference between proper tax treatment of an item to which section 6662A applies and the taxpayer's treatment of such item, and (ii) the highest rate of tax imposed by section 1 (section 11 for corporations), plus the amount of the decrease in the aggregate amount of credits determined under subtitle A which results from a difference between the taxpayer's treatment of an item to which section 6662A applies and the proper tax treatment of the item. IRC § 6662A(b)(1). Subsection (b)(1) goes on to state that any reduction of the excess of deductions allowed for the taxable year over gross income for such year, and any reduction in the amount of capital losses which would (without regard to section 1211) be allowed for such year, shall be treated as an increase in taxable income. Id. In summary, the amount of the reportable transaction understatement is calculated by adding the product of the increase in taxable income (which includes the excess of deductions allowed over gross income and reduction of capital losses) and the highest rate of income tax, to the amount of the decrease in subtitle A (income tax) credits.

An excise tax adjustment does not increase taxable income or decrease the amount of credits under subtitle A. Without an increase in taxable income or decrease in subtitle A credits resulting from the proper treatment of an excise tax, there cannot be a reportable transaction understatement as defined by the statute. There is no reference to excise taxes at all in the definition of a reportable transaction understatement. We also note that the statute prescribes rates to determine the amount of the understatement (i.e., section 1 and section 11) that are income tax rates, not excise tax rates or amounts. To determine a reportable transaction understatement amount by reference to some amount of excise tax and without reference to the definition of the term "reportable transaction understatement" would be to disregard part of the statute altogether. That approach would not be a proper form of statutory interpretation.

If you would like to discuss this issue further, we can schedule a teleconference to address any concerns you may have.

