

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

Number: **202244010**

Release Date: 11/4/2022

CC:PA:01:CWhitcomb
POSTS-111532-22

UILC: 6662.00-00

date: October 03, 2022

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from: Kevin Gillin, Senior Technician Reviewer (Branch 1)
(Procedure & Administration)

subject: Adequate Disclosure Under Section 6662(i)

This Chief Counsel Advice responds to your request for assistance asking whether disclosure of micro-captive insurance transactions on a Form 8886, and not on Form 8275 as required by Notice 2010-62, is sufficient to avoid the 40 percent penalty for a nondisclosed noneconomic substance transaction under 26 U.S.C. § 6662(i). This advice may not be used or cited as precedent.

ISSUE

Do taxpayers adequately disclose noneconomic substance transactions for purposes of section 6662(i)(2) where the material facts of the transactions are disclosed as reportable transactions on Forms 8886 but are not separately disclosed on Forms 8275?

CONCLUSION

Yes. To avoid the 40 percent penalty under section 6662(i), Notice 2010-62 requires taxpayers to disclose noneconomic substance transactions on Form 8275 or 8275-R. Notice 2010-62 further requires that for transactions that are both reportable transactions under section 6011 and transactions lacking economic substance under section 6662(b)(6), taxpayers must disclose the transaction both on Form 8886 and Form 8275. However, the 2019 Policy Statement on the Tax Regulatory Process

prevents the IRS from arguing that Notice 2010-62 has the force and effect of law. <https://home.treasury.gov/system/files/131/Policy-Statement-on-the-Tax-Regulatory-Process.pdf>. It is likely that a timely filed Form 8886 that completely describes the material facts of a micro-captive transaction, or another noneconomic substance transaction, meets the disclosure requirements under section 6662(i)(2).

ANALYSIS

Taxpayers are liable for 20 percent accuracy-related penalties under section 6662(b)(6) for the disallowance of tax benefits as a result of a transaction lacking economic substance. These penalties are increased to 40 percent under section 6662(i) when taxpayers fail to adequately disclose transactions lacking economic substance on a return or statement attached to a return. 26 U.S.C. § 6662(i)(2).

No regulations have been promulgated under section 6662(i). Interim guidance regarding section 6662(i) is set forth in Notice 2010-62 which provides a method for taxpayers to make a disclosure that is adequate for purposes of section 6662(i)(2), in part by filing a Form 8275 or 8275-R. Notice 2010-62 further provides that noneconomic substance transactions under section 6662(b)(6) that are also reportable transactions under section 6011 must be disclosed both on Form 8886 and on Form 8275.

However, the IRS cannot contend that Notice 2010-62 imposes an obligation for taxpayers to file a Form 8275 because that position would not adhere to a March 5, 2019, Policy Statement on the Tax Regulatory Process. That policy statement states that “[s]ubregulatory guidance is not intended to affect taxpayer rights or obligations independent from underlying statutes or regulations” and that the “Treasury Department and the IRS . . . will not argue that subregulatory guidance has the force and effect of law.” There are no regulations that require taxpayers to file a Form 8275 to disclose noneconomic substance transactions to defend against section 6662(i) penalties.¹

Thus, in the absence of regulations requiring a Form 8275 to disclose a noneconomic substance transaction, the IRS must rely on the language of section 6662(i)(2) and relevant case law to determine whether a disclosure is adequate. Section 6662(i)(2) defines a “nondisclosed noneconomic substance transaction” as “any portion of a transaction described in subsection (b)(6) with respect to which the relevant facts affecting the tax treatment are not adequately disclosed in the return nor in a statement attached to the return.” 26 U.S.C. § 6662(i)(2).

Although courts have not addressed what constitutes an adequate disclosure under section 6662(i)(2), case law interpreting similar disclosure requirements provides helpful examples on what constitutes an adequate disclosure. The Tax Court has explained

¹ Treas. Reg. § 1.6662-3(c)(2) provides that taxpayers must disclose positions contrary to a rule or regulation on a Form 8275 or 8275-R in order to avoid penalties under section 6662(b)(1). Treas. Reg. § 1.6662-4(f)(1) prescribes the same disclosure requirement to avoid penalties for substantial understatement of income tax under section 6662(d)(2)(B).

that “[w]hat is critical is whether the taxpayer adequately disclosed enough relevant data concerning the treatment of the item to alert the Commissioner to potential controversy.” *Elliott v. Commissioner*, T.C. Memo. 1997-294; *Estate of Ervin A. Reinke v. Commissioner*, T.C. Memo. 1993-197 (adequate disclosure under old section 6661 requires that petitioner “disclose the relevant facts”), *aff’d*, 46 F.3d 760, 765 (8th Cir. 1995) (“To satisfy the disclosure requirement, the tax return must at least provide sufficient information to enable the Commissioner to identify the potential controversy involved.”); *see also Crouch v. Commissioner*, T.C. Memo. 1995-289 (Form 8275 not per se sufficient for adequate disclosure under section 6662(b)(1) if a “material fact” is not disclosed).

Therefore, where Form 8886 is timely filed with a return or a qualified amended return and provides a complete description of the relevant facts of a noneconomic substance transaction, taxpayers have a strong argument that they have adequately informed the IRS of the transaction consistent with the requirements of section 6662(i). In contrast, Forms 8886 that are deficient or omit material facts regarding the transaction can be argued to fall short of the disclosure required by section 6662(i).

Please call (202) 317-4210 if you have any further questions.