

## Sec. 6662. Imposition of Accuracy-Related Penalty on Underpayments.

**(a) Imposition of Penalty.** If this section applies to any portion of an underpayment of tax required to be shown on a return, there shall be added to the tax an amount equal to 20 percent of the portion of the underpayment to which this section applies.

**(b) Portion of Underpayment to Which Section Applies.** This section shall apply to the portion of any underpayment which is attributable to 1 or more of the following:

- (1) Negligence or disregard of rules or regulations.
- (2) Any substantial understatement of income tax.
- (3) Any substantial valuation misstatement under chapter 1.
- (4) Any substantial overstatement of pension liabilities.
- (5) Any substantial estate or gift tax valuation understatement.
- (6) Any disallowance of claimed tax benefits by reason of a transaction lacking economic substance (within the meaning of section 7701(o)) or failing to meet the requirements of any similar rule of law.
- (7) Any undisclosed foreign financial asset understatement.

This section shall not apply to any portion of an underpayment on which a penalty is imposed under section 6663. Except as provided in paragraph (1) or (2)(B) of section 6662A(e), this section shall not apply to the portion of any underpayment which is attributable to a reportable transaction understatement on which a penalty is imposed under section 6662A.

**(c) Negligence.** For purposes of this section, the term “negligence” includes any failure to make a reasonable attempt to comply with the provisions of this title, and the term “disregard” includes any careless, reckless, or intentional disregard.

### **(d) Substantial Understatement of Income Tax.**

#### **(1) Substantial understatement.**

**(A) In general.** For purposes of this section, there is a substantial understatement of income tax for any taxable year if the amount of the understatement for the taxable year exceeds the greater of—

- (i) 10 percent of the tax required to be shown on the return for the taxable year, or
- (ii) \$5,000.

**(B) Special rule for corporations.** In the case of a corporation other than an S corporation or a personal holding company (as defined in section 542), there is a substantial understatement of income tax for any taxable year if the amount of

the understatement for the taxable year exceeds the lesser of—

- (i) 10 percent of the tax required to be shown on the return for the taxable year (or, if greater, \$10,000), or
- (ii) \$10,000,000.

#### **(2) Understatement.**

**(A) In general.** For purposes of paragraph (1), the term “understatement” means the excess of—

- (i) the amount of the tax required to be shown on the return for the taxable year, over
- (ii) the amount of the tax imposed which is shown on the return, reduced by any rebate (within the meaning of section 6211(b)(2)).

The excess under the preceding sentence shall be determined without regard to items to which section 6662A applies.

**(B) Reduction for understatement due to position of taxpayer or disclosed item.** The amount of the understatement under subparagraph (A) shall be reduced by that portion of the understatement which is attributable to—

- (i) the tax treatment of any item by the taxpayer if there is or was **substantial authority** for such treatment, or
- (ii) any item if—

**(I)** the relevant facts affecting the item's tax treatment are **adequately disclosed** in the return or in a statement attached to the return, and

**(II)** there is a **reasonable basis** for the tax treatment of such item by the taxpayer.

For purposes of clause (ii)(II), in no event shall a corporation be treated as having a reasonable basis for its tax treatment of an item attributable to a multiple-party financing transaction if such treatment does not clearly reflect the income of the corporation.

#### **(C) Reduction not to apply to tax shelters.—**

**(i) In general.** Subparagraph (B) shall not apply to any item attributable to a tax shelter.

**(ii) Tax shelter.** For purposes of clause (i), the term “tax shelter” means—

- (I)** a partnership or other entity,
  - (II)** any investment plan or arrangement, or
  - (III)** any other plan or arrangement,
- if a significant purpose of such partnership, entity, plan, or arrangement is the avoidance or evasion of Federal income tax.

## **Sec. 6694. Understatement of Taxpayer's Liability by Tax Return Preparer.**

### **(a) Understatement Due to Unreasonable Positions.**

**(1) In general.** - If **a tax return preparer**-

**(A)** prepares any return or claim of refund with respect to which any part of an understatement of liability is due to a position described in **paragraph (2)**, and

**(B)** knew (or reasonably should have known) of the position,

**such tax return preparer shall pay a penalty** with respect to each such return or claim in an amount equal to the **greater of \$1,000 or 50 percent** of the income derived (or to be derived) by the tax return preparer with respect to the return or claim.

### **(2) Unreasonable position.**

**(A) In general.** - Except as otherwise provided in this paragraph, a position is described in this paragraph unless there is or was **substantial authority** for the position.

**(B) Disclosed positions.** -

If the position was disclosed as provided in section 6662(d)(2)(B)(ii)(I) and is not a position to which subparagraph (C) applies, the position is described in this paragraph unless there is a **reasonable basis** for the position.

**(C) Tax shelters and reportable transactions.** -

If the position is with respect to a tax shelter (as defined in section 6662(d)(2)(C)(ii)) or a reportable transaction to which section 6662A applies, the position is described in this paragraph unless it is reasonable to believe that the position would more likely than not be sustained on its merits.

**(3) Reasonable cause exception.** - No penalty shall be imposed under this subsection if it is shown that there is reasonable cause for the understatement and the tax return preparer acted in good faith.

### **(b) Understatement Due to Willful or Reckless Conduct.**

**(1) In general.** **Any tax return preparer** who prepares any return or claim for refund with respect to which any part of an understatement of liability is due to a conduct described in paragraph (2) **shall pay a penalty** with respect to each such return or claim in an amount equal to the greater of—

**(A)** \$5,000, or

**(B)** 50 percent of the income derived (or to be derived) by the tax return preparer with respect to the return or claim.

**(2) Willful or reckless conduct.** Conduct described in this paragraph is conduct by the tax return preparer which is—

**(A)** a willful attempt in any manner to understate the liability for tax on the return or claim, or

**(B)** a reckless or intentional disregard of rules or regulations.

**(3) Reduction in penalty.** The amount of any penalty payable by any person by reason of this subsection for any return or claim for refund shall be reduced by the amount of the penalty paid by such person by reason of subsection (a).

### **(e) Understatement of Liability Defined.**

For purposes of this section, the term “understatement of liability” means any understatement of the net amount payable with respect to any tax imposed by this title or any overstatement of the net amount creditable or refundable with respect to any such tax. Except as otherwise provided in subsection (d), the determination of whether or not there is an understatement of liability shall be made without regard to any administrative or judicial action involving the taxpayer.

**(c) Extension of Period of Collection Where Preparer Pays 15 Percent of Penalty.**

**(1) In general.** If, within 30 days after the day on which notice and demand of any penalty under subsection (a) or (b) is made against any person who is a tax return preparer, such person pays an amount which is not less than 15 percent of the amount of such penalty and files a claim for refund of the amount so paid, no levy or proceeding in court for the collection of the remainder of such penalty shall be made, begun, or prosecuted until the final resolution of a proceeding begun as provided in paragraph (2). Notwithstanding the provisions of section 7421(a), the beginning of such proceeding or levy during the time such prohibition is in force may be enjoined by a proceeding in the proper court. Nothing in this paragraph shall be construed to prohibit any counterclaim for the remainder of such penalty in a proceeding begun as provided in paragraph (2).

**(2) Preparer must bring suit in district court to determine his liability for penalty.** If, within 30 days after the day on which his claim for refund of any partial payment of any penalty under subsection (a) or (b) is denied (or, if earlier, within 30 days after the expiration of 6 months after the day on which he filed the claim for refund), the tax return preparer fails to begin a proceeding in the appropriate United States district court for the determination of his liability for such penalty, paragraph (1) shall cease to apply with respect to such penalty, effective on the day following the close of the applicable 30-day period referred to in this paragraph.

**(3) Suspension of running of period of limitations on collection.** The running of the period of limitations provided in section 6502 on the collection by levy or by a proceeding in court in respect of any penalty described in paragraph (1) shall be suspended for the period during which the Secretary is prohibited from collecting by levy or a proceeding in court.

**(d) Abatement of Penalty Where Taxpayer Liability Not Understated.** If at any time there is a final administrative determination or a final judicial decision that there was no understatement of liability in the case of any return or claim for refund with respect to which a penalty under subsection (a) or (b) has been assessed, such assessment shall be abated, and if any portion of such penalty has been paid the amount so paid shall be refunded to the person who made such payment as an overpayment of tax without regard to any period of limitations which, but for this subsection, would apply to the making of such refund.

**(e) Understatement of Liability Defined.** For purposes of this section, the term “understatement of liability” means any understatement of the net amount payable with respect to any tax imposed by this title or any overstatement of the net amount creditable or refundable with respect to any such tax. Except as otherwise provided in subsection (d), the determination of whether or not there is an understatement of liability shall be made without regard to any administrative or judicial action involving the taxpayer.

**(f) Cross Reference.** For definition of tax return preparer, see section 7701(a)(36).

## Joseph Peery - Divorce and Alimony

During the tax year, Joseph Peery made total payments of \$90,264 to Ms. Peery. (Ms. Peery is Joseph's former wife.)  
 The payments were made in compliance with his divorce agreement with Ms. Peery. Joseph claimed an alimony deduction in the amount of \$90,264.  
 Joseph believes that all of the payments of \$90,264 qualify as deductible alimony. The tax return showed the amount of federal income tax after credits to be \$30,000. The IRS issued a notice of deficiency to the taxpayers.  
 The IRS seeks to disallow \$63,500 of the deduction, claiming it is a property settlement. The IRS determined an \$18,000 deficiency on the Federal income tax.  
 The IRS claims that income tax after credits should be \$48,000.  
 An accuracy-related penalty under section 6662(a) is also being proposed by the IRS.

**1** Assume the IRS is correct. The payment of \$63,500 is not deductible.  
 Is the understatement is substantial? Provide computation and citation.

An UNDERSTATEMENT is the excess of: (1) the amount of tax required to be shown on the tax return over (2) the amount of the tax which is shown on the return.	Sec. 6662(d)(2)
An understatement of tax is "substantial" if it exceeds the greater of: (1) 10% of the tax required to be shown on the return, or (2) \$5,000.	Sec. 6662(d)(1)

Amount of tax required to be shown on the return		
Amount of tax shown on the return		
Excess		
Greater of 10% of tax of \$48,000, or \$5,000.		
Underpayment of tax is substantial, because it exceeds threshold.		Sec. 6662(d)(2)

**2** How much penalty under Section 6662 will be proposed by the IRS?  
 Provide computation & citation.

Amount of underpayment		
Penalty rate of 20%		
Penalty amount		Sec. 6662(a)

**3** Assume you prepared the return, and charged a \$3,600 fee return preparation.  
 What is the amount of the penalty under Section 6694 that the IRS may potentially assess against you, the preparer? Provide computation & citation.

Penalty is greater of:		
(1) \$1,000, or		
(2) 50% of your fee for tax preparation		
Fee for preparing the return		
Amount equal to 50% of your fee		
Potential preparer penalty		
Section 6694(a)(1)		

**4** Please identify some factors (or reasons) that may be presented by the taxpayer to convince the IRS or the court that the Section 6662 penalty should not be imposed. Provide citations.

1.	Sec. 6662(d)(2)(B)(i)
2.	Sec. 6662(d)(2)(B)(ii)
3.	Sec. 6664( c)(1)
Includes reliance on tax advice of a tax professional.	

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An UNDERSTATEMENT is the excess of: (1) the amount of tax required to be shown on the tax return over (2) the amount of the tax which is shown on the return.	Sec. 6662(d)(2)
An understatement of tax is "substantial" if it exceeds the greater of: (1) 10% of the tax required to be shown on the return, or (2) \$5,000.	Sec. 6662(d)(1)

Amount of tax required to be shown on the return	\$48,000	
Amount of tax shown on the return	\$30,000	
Excess	\$18,000	
Greater of 10% of tax of \$48,000, or \$5,000.	\$5,000	
Underpayment of tax is substantial, because it exceeds threshold.		Sec. 6662(d)(2)

**2** How much penalty under Section 6662 will be proposed by the IRS?  
 Provide computation & citation.

Amount of underpayment	\$18,000	
Penalty rate of 20%	20%	
Penalty amount	\$3,600	Sec. 6662(a)

**3** Assume you prepared the return, and charged a \$3,600 fee return preparation.  
 What is the amount of the penalty under Section 6694 that the IRS may potentially assess against you, the preparer? Provide computation & citation

Penalty is greater of:		
(1) \$1,000, or		\$1,000
(2) 50% of your fee for tax preparation		
Fee for preparing the return	\$3,600	
Amount equal to 50% of your fee		\$1,800
Potential preparer penalty		\$1,800
Section 6694(a)(1)		

**4** Please identify some factors (or reasons) that may be presented by the taxpayer to convince the IRS or the court that the Section 6662 penalty should not be imposed. Provide citations.

1. Substantial authority	Sec. 6662(d)(2)(B)(i)
2. Adequate disclosure and reasonable basis	Sec. 6662(d)(2)(B)(ii)
3. Reasonable cause and taxpayer acted in good faith.	Sec. 6664( c)(1)
Includes reliance on tax advice of a tax professional.	