

§ 1.6662-7

percent rate. The remaining amount is subject to the net adjustment penalty at the twenty percent rate, even if such amount is less than the lesser of five million dollars or ten percent of gross receipts.

(2) *Coordination of net section 482 adjustment subject to the net adjustment penalty and substantial valuation misstatements subject to the transactional penalty.* If the net section 482 adjustment exceeds twenty million dollars or 20 percent of gross receipts, the entire amount of the adjustment is subject to the net adjustment penalty at a forty percent rate. No portion of the adjustment is subject to the transactional penalty at a twenty percent rate.

(3) *Examples.* The following examples illustrate the principles of this paragraph (f):

*Example 1.* (i) Applying section 482, the Internal Revenue Service makes the following adjustments for the taxable year:

(1) Attributable to an adjustment that is 400 percent or more of the correct section 482 arm's length result .....	\$2,000,000
(2) Not a 200 or 400 percent adjustment .....	2,500,000
Total .....	4,500,000

(ii) The taxpayer has gross receipts of 75 million dollars after all section 482 adjustments. None of the adjustments is excluded under paragraph (d) (Amounts excluded from net section 482 adjustments) of this section, in determining the five million dollar or 10% of gross receipts test under section 6662(e)(1)(B)(ii). The net section 482 adjustment (4.5 million dollars) is less than the lesser of five million dollars or ten percent of gross receipts (\$75 million × 10% = \$7.5 million). Thus, there is no substantial valuation misstatement. However, the two million dollar adjustment is attributable to a gross valuation misstatement. Accordingly, the taxpayer may be subject to a penalty, under section 6662(h), equal to 40 percent of the underpayment of tax attributable to the gross valuation misstatement of two million dollars. The 2.5 million dollar adjustment is not subject to a penalty under section 6662(b)(3).

*Example 2.* The facts are the same as in *Example 1*, except the taxpayer has gross receipts of 40 million dollars. The net section 482 adjustment (\$4.5 million) is greater than the lesser of five million dollars or ten percent of gross receipts (\$40 million × 10% = \$4 million). Thus, the five million dollar or 10% of gross receipts test has been met. The two million dollar adjustment is attributable to a gross valuation misstatement. Accord-

ingly, the taxpayer is subject to a penalty, under section 6662(h), equal to 40 percent of the underpayment of tax attributable to the gross valuation misstatement of two million dollars. The 2.5 million dollar adjustment is subject to a penalty under sections 6662(a) and 6662(b)(3), equal to 20 percent of the underpayment of tax attributable to the substantial valuation misstatement.

*Example 3.* (i) Applying section 482, the Internal Revenue Service makes the following transfer pricing adjustments for the taxable year:

(1) Attributable to an adjustment that is 400 percent or more of the correct section 482 arm's length result .....	\$6,000,000
(2) Not a 200 or 400 percent adjustment .....	15,000,000
Total .....	21,000,000

(ii) None of the adjustments are excluded under paragraph (d) (Amounts excluded from net section 482 adjustments) in determining the twenty million dollar or 20% of gross receipts test under section 6662(h). The net section 482 adjustment (21 million dollars) is greater than twenty million dollars and thus constitutes a gross valuation misstatement. Accordingly, the total adjustment is subject to the net adjustment penalty equal to 40 percent of the underpayment of tax attributable to the 21 million dollar gross valuation misstatement. The six million dollar adjustment will not be separately included for purposes of any additional penalty under section 6662.

(g) *Effective date.* This section is effective February 9, 1996. However, taxpayers may elect to apply this section to all open taxable years beginning after December 31, 1993.

[T.D. 8656, 61 FR 4880, Feb. 9, 1996; T.D. 8656, 61 FR 14248, Apr. 1, 1996; 62 FR 46877, Sept. 5, 1997]

**§ 1.6662-7 Omnibus Budget Reconciliation Act of 1993 changes to the accuracy-related penalty.**

(a) *Scope.* The Omnibus Budget Reconciliation Act of 1993 made certain changes to the accuracy-related penalty in section 6662. This section provides rules reflecting those changes.

(b) *No disclosure exception for negligence penalty.* The penalty for negligence in section 6662(b)(1) may not be avoided by disclosure of a return position.

(c) *Disclosure standard for other penalties is reasonable basis.* The penalties for disregarding rules or regulations in

section 6662(b)(1) and for a substantial understatement of income tax in section 6662(b)(2) may be avoided by adequate disclosure of a return position only if the position has at least a reasonable basis. See §1.6662-3(c) and §§1.6662-4(e) and (f) for other applicable disclosure rules.

(d) *Reasonable basis.* For purposes of §§1.6662-3(c) and 1.6662-4(e) and (f) (relating to methods of making adequate disclosure), the provisions of §1.6662-3(b)(3) apply in determining whether a return position has a reasonable basis.

[T.D. 8617, 60 FR 45665, Sept. 1, 1995, as amended by T.D. 8790, 63 FR 66435, Dec. 2, 1998]

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  - (1) In general.
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##### *§ 1.6664-2 Underpayment.*

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- (e) Rebates.
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##### *§ 1.6664-3 Ordering rules for determining the total amount of penalties imposed.*

- (a) In general.
- (b) Order in which adjustments are taken into account.
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- (d) Examples.

##### *§ 1.6664-4 Reasonable cause and good faith exception to section 6662 penalties.*

- (a) In general.
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        - (g) Valuation misstatements of charitable deduction property.
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##### *§ 1.6664-4T Reasonable cause and good faith exception to section 6662 penalties*

- (a)–(c) [Reserved]
- (d) Transactions between persons described in section 482 and net section 482 transfer price adjustments.

[T.D. 8381, 56 FR 67505, Dec. 31, 1991, as amended by T.D. 8519, 59 FR 4799, Feb. 2, 1994; T.D. 8617, 60 FR 45666, Sept. 1, 1995; T.D. 8656, 61 FR 4885, Feb. 9, 1996; T.D. 8790, 63 FR 66435, Dec. 2, 1998]

#### § 1.6664-1 Accuracy-related and fraud penalties; definitions and special rules.

(a) *In general.* Section 6664(a) defines the term “underpayment” for purposes of the accuracy-related penalty under section 6662 and the fraud penalty under section 6663. The definition of “underpayment” of income taxes imposed under subtitle A is set forth in §1.6664-2. Ordering rules for computing the total amount of accuracy-related and fraud penalties imposed with respect to a return are set forth in §1.6664-3. Section 6664(c) provides a reasonable cause and good faith exception to the accuracy-related penalty. Rules relating to the reasonable cause and good faith exception are set forth in §1.6664-4.