

time for filing) is on or before September 1, 1995 and after December 31, 1989. For transactions occurring after December 8, 1994, §1.6664-4 (as contained in 26 CFR part 1 revised April 1, 1995) is applied taking into account the changes made to section 6662(d)(2)(C) (relating to the substantial understatement penalty for tax shelter items of corporations) by section 744 of Title VII of the Uruguay Round Agreements Act, Pub. L. 103-465 (108 Stat. 4809).

[T.D. 8381, 56 FR 67506, Dec. 31, 1991, as amended by T.D. 8617, 60 FR 45666, Sept. 1, 1995]

**§ 1.6664-2 Underpayment.**

(a) *Underpayment defined.* In the case of income taxes imposed under subtitle A, an underpayment for purposes of section 6662, relating to the accuracy-related penalty, and section 6663, relating to the fraud penalty, means the amount by which any income tax imposed under this subtitle (as defined in paragraph (b) of the section) exceeds the excess of—

(1) The sum of—

(i) The amount shown as the tax by the taxpayer on his return (as defined in paragraph (c) of this section), plus

(ii) Amounts not so shown previously assessed (or collected without assessment) (as defined in paragraph (d) of this section), over

(2) The amount of rebates made (as defined in paragraph (e) of this section).

The definition of underpayment also may be expressed as—

$$\text{Underpayment} = W - (X + Y - Z),$$

where *W*=the amount of income tax imposed; *X*=the amount shown as the tax by the taxpayer on his return; *Y*=amounts not so shown previously assessed (or collected without assessment); and *Z*=the amount of rebates made.

(b) *Amount of income tax imposed.* For purposes of paragraph (a) of this section, the “amount of income tax imposed” is the amount of tax imposed on the taxpayer under subtitle A for the taxable year, determined without regard to—

(1) The credits for tax withheld under sections 31 (relating to tax withheld on

wages) and 33 (relating to tax withheld at source on nonresident aliens and foreign corporations);

(2) Payments of tax or estimated tax by the taxpayer;

(3) Any credit resulting from the collection of amounts assessed under section 6851 as the result of a termination assessment, or section 6861 as the result of a jeopardy assessment; and

(4) Any tax that the taxpayer is not required to assess on the return (such as the tax imposed by section 531 on the accumulated taxable income of a corporation).

(c) *Amount shown as the tax by the taxpayer on his return—*(1) *Defined.* For purposes of paragraph (a) of this section, the “amount shown as the tax by the taxpayer on his return” is the tax liability shown by the taxpayer on his return, determined without regard to the items listed in §1.6664-2(b) (1), (2), and (3), except that it is reduced by the excess of—

(i) The amounts shown by the taxpayer on his return as credits for tax withheld under section 31 (relating to tax withheld on wages) and section 33 (relating to tax withheld at source on nonresident aliens and foreign corporations), as payments of estimated tax, or as any other payments made by the taxpayer with respect to a taxable year before filing the return for such taxable year, over

(ii) The amounts actually withheld, actually paid as estimated tax, or actually paid with respect to a taxable year before the return is filed for such taxable year.

(2) *Effect of qualified amended return.* The “amount shown as the tax by the taxpayer on his return” includes an amount shown as additional tax on a qualified amended return (as defined in paragraph (c)(3) of this section), except that such amount is not included if it relates to a fraudulent position on the original return.

(3) *Qualified amended return defined.* A qualified amended return is an amended return, or a timely request for an administrative adjustment under section 6227, filed after the due date of the return for the taxable year (determined with regard to extensions of time to file) and before the earliest of—

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(i) The time the taxpayer is first contacted by the Internal Revenue Service concerning an examination of the return;

(ii) The time any person described in section 6700(a) (relating to the penalty for promoting abusive tax shelters) is first contacted by the Internal Revenue Service concerning an examination of an activity described in section 6700(a) with respect to which the taxpayer claimed any tax benefit on the return directly or indirectly through the entity, plan or arrangement described in section 6700(a)(1)(A); or

(iii) In the case of a pass-through item (as defined in §1.6662-4(f)(5)), the time the pass-through entity (as defined in §1.6662-4(f)(5)) is first contacted by the Internal Revenue Service in connection with an examination of the return to which the pass-through item relates.

A qualified amended return includes an amended return that is filed solely to disclose information pursuant to §1.6662-3(c) or §1.6662-4 (e) and (f) and that does not report any additional tax liability.

(4) *Special rule for qualified amended returns.* The Commissioner may by revenue procedure prescribe the manner in which the rules of paragraph (c) of this section regarding qualified amended returns apply to particular classes of taxpayers.

(d) *Amounts not so shown previously assessed (or collected without assessment).* For purposes of paragraph (a) of this section, “amounts not so shown previously assessed” means only amounts assessed before the return is filed that were not shown on the return, such as termination assessments under section 6851 and jeopardy assessments under section 6861 made prior to the filing of the return for the taxable year. For purposes of paragraph (a) of this section, the amount “collected without assessment” is the amount by which the total of the credits allowable under section 31 (relating to tax withheld on wages) and section 33 (relating to tax withheld at source on nonresident aliens and foreign corporations), estimated tax payments, and other payments in satisfaction of tax liability made before the return is filed, exceed the tax shown on the return (provided

such excess has not been refunded or allowed as a credit to the taxpayer).

(e) *Rebates.* The term “rebate” means so much of an abatement credit, refund or other repayment, as was made on the ground that the tax imposed was less than the excess of—

(1) The sum of—

(i) The amount shown as the tax by the taxpayer on his return, plus

(ii) Amounts not so shown previously assessed (or collected without assessment), over

(2) Rebates previously made.

(f) *Underpayments for certain carryback years not reduced by amount of carrybacks.* The amount of an underpayment for a taxable year that is attributable to conduct proscribed by sections 6662 or 6663 is not reduced on account of a carryback of a loss, deduction or credit to that year. Such conduct includes negligence or disregard of rules or regulations; a substantial understatement of income tax; and a substantial (or gross) valuation misstatement under chapter 1, provided that the applicable dollar limitation is satisfied for the carryback year.

(g) *Examples.* The following examples illustrate this section:

*Example 1.* Taxpayer’s 1990 return showed a tax liability of \$18,000. Taxpayer had no amounts previously assessed (or collected without assessment) and received no rebates of tax. Taxpayer claimed a credit in the amount of \$23,000 for income tax withheld under section 3402, which resulted in a refund received of \$5,000. It is later determined that the taxpayer should have reported additional income and that the correct tax for the taxable year is \$25,500. There is an underpayment of \$7,500, determined as follows:

Tax imposed under sub-		
title A .....	\$25,500	
Tax shown on return ....	\$18,000	
Tax previously assessed		
(or collected without		
assessment) .....	None	
Amount of rebates		
made .....	None	
Balance .....		\$18,000
Underpayment ....		\$7,500

*Example 2.* The facts are the same as in *Example 1* except that the taxpayer failed to claim on the return a credit of \$1,500 for income tax withheld. This \$1,500 constitutes an amount collected without assessment as defined in paragraph (d) of this section. The

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underpayment is \$6,000, determined as follows:

Tax imposed under subtitle A .....		\$25,500
Tax shown on return ....	\$18,000	.....
Tax previously assessed (or collected without assessment) .....	1,500	.....
Amount of rebates made .....	None	.....
Balance .....		\$19,500
Underpayment ....		\$6,000

*Example 3.* On Form 1040 filed for tax year 1990, taxpayer reported a tax liability of \$10,000, estimated tax payments of \$15,000, and received a refund of \$5,000. Estimated tax payments actually made with respect to tax year 1990 were only \$7,000. For purposes of determining the amount of underpayment subject to a penalty under section 6662 or section 6663, the tax shown on the return is \$2,000 (reported tax liability of \$10,000 reduced by the overstated estimated tax of \$8,000 (\$15,000-\$7,000)). The underpayment is \$8,000, determined as follows:

Tax imposed under subtitle A .....		\$10,000
Tax shown on return ....	\$2,000	.....
Tax previously assessed (or collected without assessment) .....	None	.....
Amount of rebates made .....	None	.....
Balance .....		\$2,000
Underpayment ....		\$8,000

[T.D. 8381, 56 FR 67506, Dec. 31, 1991; T.D. 8381, 57 FR 6165, Feb. 20, 1992]

**§ 1.6664-3 Ordering rules for determining the total amount of penalties imposed.**

(a) *In general.* This section provides rules for determining the order in which adjustments to a return are taken into account for the purpose of computing the total amount of penalties imposed under sections 6662 and 6663, where—

(1) There is at least one adjustment with respect to which no penalty has been imposed and at least one with respect to which a penalty has been imposed, or

(2) There are at least two adjustments with respect to which penalties have been imposed and they have been imposed at different rates.

This section also provides rules for allocating unclaimed prepayment credits to adjustments to a return.

(b) *Order in which adjustments are taken into account.* In computing the portions of an underpayment subject to penalties imposed under sections 6662 and 6663, adjustments to a return are considered made in the following order:

(1) Those with respect to which no penalties have been imposed.

(2) Those with respect to which a penalty has been imposed at a 20 percent rate (*i.e.*, a penalty for negligence or disregard of rules or regulations, substantial understatement of income tax, or substantial valuation misstatement, under sections 6662(b)(1) through 6662(b)(3), respectively).

(3) Those with respect to which a penalty has been imposed at a 40 percent rate (*i.e.*, a penalty for a gross valuation misstatement under sections 6662 (b)(3) and (h)).

(4) Those with respect to which a penalty has been imposed at a 75 percent rate (*i.e.*, a penalty for fraud under section 6663).

(c) *Manner in which unclaimed prepayment credits are allocated.* Any income tax withholding or other payment made before a return was filed, that was neither claimed on the return nor previously allowed as a credit against the tax liability for the taxable year (an “unclaimed prepayment credit”), is allocated as follows—

(1) If an unclaimed prepayment credit is allocable to a particular adjustment, such credit is applied in full in determining the amount of the underpayment resulting from such adjustment.

(2) If an unclaimed prepayment credit is not allocable to a particular adjustment, such credit is applied in accordance with the ordering rules set forth in paragraph (b) of this section.

(d) *Examples.* The following examples illustrate the rules of this § 1.6664-3. These examples do not take into account the reasonable cause exception to the accuracy-related penalty under § 1.6664-4.

*Example 1.* A and B, husband and wife, filed a joint federal income tax return for calendar year 1989, reporting taxable income of \$15,800 and a tax liability of \$2,374. A and B had no amounts previously assessed (or collected without assessment) and no rebates