

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.

(Also: Part I, §§ 6011, 6662, 6662A, 6707A; 1-6011-4.)

## Rev. Proc. 2005-51

### SECTION 1. PURPOSE

This revenue procedure provides guidance to persons who may be required to pay certain penalties under sections 6662(h), 6662A, or 6707A of the Internal Revenue Code, and who may be required under section 6707A(e) to disclose those penalties on reports filed with the Securities and Exchange Commission. This revenue procedure describes the report on which the disclosures must be made, the information that must be disclosed, and the deadlines by which persons must make the disclosures on reports filed with the SEC in order to avoid additional penalties under section 6707A(e).

### SECTION 2. BACKGROUND

.01 Section 6011 and the regulations thereunder require a taxpayer that has participated in a reportable transaction to disclose certain information with respect to the reportable transaction with its tax return. Section 1.6011-4(b) of the Income Tax Regulations describes six categories of reportable transactions. One category of reportable transactions is a transaction that is the same as, or substantially similar to, one of the types of transactions that the Internal Revenue Service has determined to be a tax avoidance transaction and has identified by notice, regulation, or other form of published guidance as a “listed transaction.” Treas. Reg. § 1.6011-4(b)(2).

.02 The American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418 (the Act) was enacted on October 22, 2004. Section 811 of the Act added section 6707A to the Code to provide a monetary penalty for the failure to include on any return or statement any information required to be disclosed under section 6011 with respect to a reportable transaction. Section 6707A(b)(1) provides that the penalty for failure to include information with respect to a reportable transaction, other than a listed transaction, is \$10,000 in the case of

a natural person, and \$50,000 in any other case. Section 6707A(b)(2) provides that for a listed transaction, the penalty is increased to \$100,000 in the case of a natural person, and \$200,000 in any other case.

.03 Section 812 of the Act, which added section 6662A to the Code, provides that a 20-percent accuracy-related penalty may be imposed on any “reportable transaction understatement,” as defined in section 6662A(b). Section 6662A(c) increases the penalty rate to 30-percent for the portion of any reportable transaction understatement with respect to which the relevant facts affecting the tax treatment of the item were not adequately disclosed in accordance with regulations prescribed under section 6011. If the penalty under section 6707A for failure to include reportable transaction information with a return is rescinded pursuant to section 6707A(d), the taxpayer is treated as having adequately disclosed the relevant facts with respect to that reportable transaction, and the 30-percent penalty rate under section 6662A(c) does not apply. See I.R.C. § 6664(d)(2). In addition, section 6662A(e)(2)(C)(ii) provides that the reportable transaction understatement penalty does not apply to any portion of an understatement on which the 40-percent accuracy-related penalty for a gross valuation misstatement is imposed under section 6662(h).

.04 Section 6707A(e) requires a person that is required to file periodic reports under section 13 or 15(d) of the Securities Exchange Act of 1934, or is required to be consolidated with another person for purposes of those reports, to disclose in those reports for the periods specified by the Secretary the requirement to pay the penalties set forth in section 6707A(e)(2). If the person fails to disclose the requirement to pay the penalties, as required by section 6707A(e), that failure shall be treated as a failure to disclose a listed transaction and shall be subject to an additional penalty.

.05 Under section 6707A(e), the penalties a person must disclose in periodic reports filed with the SEC are as follows:

(1) the penalty imposed by section 6707A(a) in the amount determined under section 6707A(b)(2) for failure to disclose a listed transaction;

(2) the accuracy-related penalty imposed by section 6662A(a) at the 30-percent rate determined under section 6662A(c) for a reportable transaction

understatement with respect to which the relevant facts affecting the tax treatment of the item were not adequately disclosed in accordance with regulations prescribed under section 6011;

(3) the accuracy-related penalty imposed by section 6662(a) at the 40-percent rate determined under section 6662(h) for a gross valuation misstatement, if the person would (but for the exclusionary rule of section 6662A(e)(2)(C)(ii)) have been subject to the accuracy-related penalty under section 6662A(a) at the 30-percent rate determined under section 6662A(c); and

(4) the penalty imposed by section 6707A(e) for failure to disclose any of the penalties described in section 2.05(1) – (3) of this revenue procedure in periodic reports required under section 13 or 15(d) of the Securities Exchange Act of 1934, as specified in this revenue procedure.

### SECTION 3. SCOPE

This revenue procedure applies to any person required to pay any penalty described in section 2.05 of this revenue procedure that is also required to file periodic reports under section 13 or 15(d) of the Securities Exchange Act of 1934 or is required to be consolidated with another person for purposes of those reports. Further guidance will be issued providing pre-assessment administrative appeal rights to persons required to pay the penalties described in section 2.05(1). The administrative appeal rights for the penalties described in section 2.05(2) and (3) are the same as the administrative appeal rights afforded with respect to the deficiency determinations (or proposed deficiency determinations) with which those penalties are associated, and no separate administrative appeal rights regarding those penalties are available. There are no administrative appeal rights with respect to penalties described in section 2.05(4).

### SECTION 4. APPLICATION

.01 *Periodic reports required under the Securities Exchange Act of 1934.* In accordance with section 6707A(e), a person who files SEC Form 10-K, Annual Report, pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934, either separately or consolidated with another per-

son, must disclose in Item 3 (Legal Proceedings) of Form 10-K the requirement to pay any penalty specified in section 2.05 of this revenue procedure.

**.02 Required disclosures.** A person must disclose in the Form 10-K the amount of any penalty specified in section 2.05 of this revenue procedure, whether it has paid the penalty in full, the Code section and subparagraph under which the penalty was determined (*i.e.*, section 6662(h), section 6662A(c), section 6707A(b)(2), or section 6707A(e)), and a description of the penalty (*i.e.*, accuracy-related penalty for gross valuation misstatement, accuracy-related penalty on an understatement attributable to a nondisclosed listed or other avoidance transaction, penalty for failure to include listed transaction information with return, or penalty for failure to disclose imposition of penalty in report filed with the SEC). A person must disclose in its Form 10-K the requirement to pay the 40-percent accuracy-related penalty under section 6662(h) if:

(1) the person consented to the assessment of the 40-percent penalty without the issuance of a statutory notice of deficiency if the Service proposed the 30-percent penalty determined under section 6662A(c) in the alternative in a notice of proposed deficiency (30-day letter);

(2) the person consented to the assessment of the 40-percent penalty or did not timely petition the Tax Court if the Service included the 30-percent penalty determined under 6662A(c) in the alternative in a statutory notice of deficiency;

(3) the government raised the 30-percent accuracy-related penalty under section 6662A(c) in the alternative in any pleading in a judicial proceeding challenging the applicability of the 40-percent penalty and the court expressly determined that the 30-percent penalty applied in the alternative to the 40-percent penalty; or

(4) the person expressly acknowledged the applicability of the 30-percent accuracy-related penalty under section 6662A(c) in the alternative to the 40-percent accuracy-related penalty under section 6662(h) in a written settlement agreement with the government.

**.03 When disclosure must be made.** (1) A person required to pay a penalty specified in section 2.05 of this revenue procedure must disclose the requirement to pay

the penalty on the Form 10-K filed with the SEC that relates to the fiscal year (as defined in 17 C.F.R. § 240.12b-2) in which the Service sends the person notice and demand for payment of the penalty. If the person pays the penalty (not including interest) in full prior to the Service sending notice and demand for payment, the person must disclose the requirement to pay the penalty on the Form 10-K filed with the SEC that relates to the fiscal year in which the person has paid the penalty. If the person fails to disclose the requirement to pay any penalty specified in section 2.05, as specified in the two preceding sentences, the disclosure must be made on the next Form 10-K filed with the SEC after the failure to disclose has occurred. This obligation to disclose on each successive Form 10-K filed will continue until the person actually discloses its requirement to pay each of the penalties specified in section 2.05. Each failure to disclose the requirement to pay a penalty specified in section 2.05, in the manner specified in sections 4.01, 4.02 and this section 4.03, will give rise to a new, separate penalty under section 6707A(e) that also must be disclosed on the Form 10-K in the manner specified.

*Example:* In Year 1, Taxpayer T failed to disclose the requirement to pay a section 6662A(c) accuracy-related penalty on the Form 10-K filed with the SEC (the Year 1 Form 10-K) that relates to the fiscal year in which the IRS sent notice and demand for payment of the penalty. Taxpayer T is subject to a penalty under section 6707A(e) for a failure to disclose the section 6662A(c) accuracy-related penalty. Accordingly, Taxpayer T must disclose on the next Form 10-K filed with the SEC (the Year 2 Form 10-K) the requirement to pay the original section 6662A(c) penalty and, if the IRS sends notice and demand for payment of the section 6707A(e) penalty in the fiscal year to which the Year 2 Form 10-K relates, must disclose the requirement to pay that penalty as well.

(2) If a person brings a refund action seeking recovery of a 40-percent accuracy-related penalty under section 6662(h) and the government raises the 30-percent penalty under section 6662A(c) in the alternative in any pleading filed in that action without having previously raised the 30-percent penalty in a 30-day letter or a statutory notice of deficiency, the requirement to disclose the penalty will only apply if the 30-percent penalty is upheld, either directly or in the alternative to the 40-percent penalty. In that case, the person must disclose the requirement to pay either the 30-percent or 40-percent penalty, as applicable, on the first Form

10-K filed with the SEC that relates to the fiscal year in which a decision upholding the 30-percent penalty (either directly, or in the alternative to the 40-percent penalty) becomes final. If, after commencing a refund action described above, the person enters into a written settlement agreement with the government expressly acknowledging the applicability of the 30-percent penalty in the alternative to the 40-percent penalty, the person must disclose the requirement to pay either the 30-percent or 40-percent penalty, as applicable, on the first Form 10-K filed with the SEC that relates to the fiscal year in which the settlement agreement is entered into.

## SECTION 5. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. § 3507) under control number 1545-1956.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collections of information in this revenue procedure are in sections 4.01 and 4.02. This information is required to enforce the provisions of section 6707A(e) and make investors or potential investors aware of a person's participation in certain reportable transactions that led to penalties under the Internal Revenue Code. The collection of information is mandatory. The likely respondents are businesses that are publicly traded corporations.

The estimated total annual reporting or recordkeeping burden is 429.5 hours.

The estimated annual burden per respondent/recordkeeper varies from .25 to .75 hour, depending on individual circumstances, with an estimated average of .5 hour. The estimated number of respondents or recordkeepers is 859.

The estimated annual frequency of responses (used for reporting requirements only) is 859.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue

law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. § 6103.

#### SECTION 6. EFFECTIVE DATE

This revenue procedure is effective for any penalty specified in section 2.05 that

relates to a return or statement the due date for which is after October 22, 2004.

#### SECTION 7. DRAFTING INFORMATION

The principal author of this revenue procedure is Matthew S. Cooper of the

Office of the Associate Chief Counsel (Procedure & Administration), Administrative Provisions & Judicial Practice Division. For further information regarding this revenue procedure, contact Matthew S. Cooper at (202) 622-4940 (not a toll-free call).