

From the desk of  
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# IRS updates adequate Disclosure Rules

The IRS has announced new rules relating to adequate and required disclosures which requires informing the IRS of anything that one believes to be incorrect, or noncompliant within the tax return as filed.

The Revenue Procedure identifies when disclosure of an item or position is adequate for purposes of reducing the penalty for understatement of income tax and to avoid the tax return preparer penalty under Code Sec. 6694(a).

## **The Underpayment Penalty for Substantial Understatement of Tax**

Should there be an underpayment of income tax on a tax return due to a substantial understatement of income tax, the penalty assessable is 20% of the portion of the underpayment is added to the tax. (Code Sec. 6662(a), Code Sec. 6662(b)(2))

In general, there is a substantial understatement of income tax if the amount of the understatement exceeds the greater of:

1. 10% of the amount of tax required to be shown on the return for the tax year or
2. \$5,000. (Code Sec. 6662(d)(1)(A))

An "understatement" is the excess of:

1. The amount of the tax required to be shown on a return for the tax year, or
2. The amount of the tax imposed which is shown on the return, reduced by any rebate (within the meaning of Code Sec. 6211(b)(2)). (Code Sec. 6662(d)(2)(A))

For corporations (other than S corporations or a personal holding companies), a substantial understatement of income tax exists when the amount of the understatement exceeds the lesser of

1. 10% of the tax required to be shown on the return for a tax year (or, if greater, \$10,000) or
2. 10,000,000. (Code Sec. 6662(d)(1)(B))

In general, if the taxpayer has a reasonable basis for the tax treatment of the item, then the amount of the understatement is reduced by the portion of the understatement attributable to the item with respect to which the relevant facts affecting the item's tax treatment is adequately disclosed within the return, or in a statement attached to the return. (Code Sec. 6662(d)(2)(B)(ii))

### **Tax Return Preparer Penalty**

Internal Revenue Code Sec. 6694(a) imposes a penalty on a tax return preparer who prepares a return or claim for refund reflecting an understatement of tax liability due to an "unreasonable position" if the tax return preparer knew (or reasonably should have known) of the position.

For purposes of the Code Sec. 6694(a) return preparer penalty, a position (other than a position with respect to a tax shelter or a reportable transaction to which Code Sec. 6662A applies) is unreasonable unless

1. There is or was substantial authority for the position, or
2. The position was properly disclosed under Code Sec. 6662(d)(2)(B)(ii)(I) and had a reasonable basis.

A position taken with respect to a tax shelter or a reportable transaction is unreasonable unless it is reasonable for the return preparer to believe that the position would more likely than not be sustained on the merits. (Code Sec. 6694(a)(2))

In addition to the above, it is a federal crime to file fraudulent, or misleading statements relating to collection matters which would mislead or inadequately disclose factual information the IRS would or could use in determining collection procedures, and/or agreements.

In essence, a CPA, Attorney, or tax preparer who engages in willful misconduct in preparation of a tax position that is not substantiable is subject to sanctions.

**Our position as to such matters is that we will not take a position for any client that does not have a basis in law, or inadequately discloses information that the IRS would otherwise require or need for the lawful administration of the tax laws.**

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**We here at Muffoletto & Company believe that the more informed you are in regards to the rules and regulations that affect you the more we can be of service.**

**Should you have questions relating to any tax or financial matters call at**

**(818) 346-2160,**

**or you can visit us on the web at**

**[www.petemcpa.com](http://www.petemcpa.com)!**