

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Definition of Reasonable Basis

IA-42-95

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to the accuracy-related penalty regulations under chapter 1 of the Internal Revenue Code. These amendments are necessary to define reasonable basis and provide corrections to final regulations relating to the accuracy-related penalty under chapter 1 of the Internal Revenue Code. The proposed regulations would affect all taxpayers who file tax returns. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronically generated comments must be received by February 10, 1997. Outlines of topics to be discussed at the public hearing scheduled for February 25, 1997, must be received by February 4, 1997.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (IA-42-95), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (IA-42-95), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC., or electronically, via the IRS Internet site at: http://www.irs.ustreas.gov/prod/tax_regs/comments.html. The public hearing will be held in room 3313, Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Nancy Romano, 202-622-6232 (not a toll-free number). Concerning submissions and the public hearing, Michael L. Slaughter, 202-622-7190 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On September 1, 1995, the IRS issued Treasury Decision 8617 (60 FR 45663),

setting forth final regulations relating to the accuracy-related penalty under chapter 1 of the Internal Revenue Code. These regulations provided guidance concerning the reasonable basis standard for purposes of the negligence penalty (section 6662(b)(1)) and for purposes of the disclosure exception to the penalties for disregarding rules or regulations (section 6662(b)(1)) and substantial understatement of income tax (section 6662(b)(2)). In the preamble to the final regulations, Treasury requested comments and suggestions on providing further guidance on the reasonable basis standard. Treasury has not received any additional comment letters in response to this request for comments. Previous comments that were addressed in the preamble to the final regulations published on September 1, 1995 have been considered in drafting these proposed regulations.

Explanation of Provision

Under the final regulations currently in place, the reasonable basis standard is "significantly higher than the not frivolous standard applicable to preparers under 6694." These proposed regulations provide that the reasonable basis standard is not satisfied by a return position that is merely arguable or that is merely a colorable claim. A return position will generally satisfy the reasonable basis standard if it is reasonably based on one or more of the authorities set forth in § 1.6662-4(d)(3)(iii) (taking into account the relevance and persuasiveness of the authorities, and subsequent developments). Additionally, the proposed regulations clarify that if a return position does not satisfy the reasonable basis standard, the reasonable cause and good faith exception as set forth in § 1.6664-4 may still provide relief from the penalty.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not

required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely (in the manner described under the ADDRESSES caption) to the IRS. All comments will be available for public inspection and copying.

A public hearing has been scheduled for February 25, 1997, at 10 a.m., in room 3313, Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC. Because of access restrictions, visitors will not be admitted beyond the building lobby more than 15 minutes before the hearing starts.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons that wish to present oral comments at the hearing must submit written or electronically generated comments (in the manner described under the ADDRESSES caption) by February 10, 1997, and submit an outline of the topics to be discussed and the time devoted to each topic by February 4, 1997.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Robert J. Fitzpatrick, formerly of the Office of the Assistant Chief Counsel (Income Tax & Accounting), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

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Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.6662-0 is amended by:

- 1. Revising the entry for § 1.6662-2.
- 2. Removing the entries for §§ 1.6662-3(b)(3)(i) and (ii).
- 3. Revising the entry for § 1.6662-7(d). 4
- . Removing the entries for §§ 1.6662-7(d)(1) and (2).

The amendments and revisions read as follows:

§ 1.6662-0 Table of contents.

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§ 1.6662-2 Accuracy-related penalty.

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

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(d) Reasonable basis.

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Par. 3. Section § 1.6662-3 is amended by:

- 1. Revising the third sentence in paragraph (b)(1) introductory text.
- 2. Revising paragraph (b)(3).

The revisions read as follows:

§ 1.6662-3 Negligence or disregard of rules or regulations.

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(b)* * *(1) * * * A return position that has a reasonable basis as defined in paragraph (b)(3) of this section is not attributable to negligence. * * *

* * * * *

(3) Reasonable basis. Reasonable basis is a relatively high standard of tax reporting, that is, significantly higher than not frivolous or not patently improper. The reasonable basis standard is not satisfied by a return position that is merely arguable or that is merely a colorable claim. If a return position is reasonably based on one or more of the authorities set forth in § 1.6662-4(d)(3)(iii) (taking into account the relevance and persuasiveness of the authorities, and subsequent developments), the return position will generally satisfy the reasonable basis standard even though it may not satisfy the substantial

authority standard as defined in § 1.6662-4(d)(2). In addition, the reasonable cause and good faith exception, as set forth in § 1.6664-4, may provide relief from the penalty, even if a return position does not satisfy the reasonable basis standard.

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Par. 4. In § 1.6662-4, the second sentence in paragraph (d)(2) is revised to read as follows:

§ 1.6662-4 Substantial understatement of income tax.

* * * * *

(d) * * *

(2) * * * The substantial authority standard is less stringent than the more likely than not standard (the standard that is met when there is a greater than 50-percent likelihood of the position being upheld), but more stringent than the reasonable basis standard as defined in § 1.6662-3(b)(3). * * *

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Par. 5. In 1.6662-7, paragraph (d) is revised to read as follows:

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

* * * * *

(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.

Par. 6. Section 1.6664-0 is amended by:

- 1. Revising the entry for paragraph (c)(2) of § 1.6664-4.
- 2. Removing the entries for paragraphs (c)(1)(iii), (c)(2)(i), and (c)(2)(ii) of § 1.6664-4.

The revision reads as follows:

§ 1.6664-0 Table of contents.

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

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(c) * * *

(2) Advice defined.

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Margaret Milner Richardson,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on November 8, 1996, 8:45 a.m., and published in the issue of the Federal Register for November 12, 1996, 61 F.R. 58020)