

**Office of Chief Counsel
Internal Revenue Service
Memorandum**

Number: **201220029**

Release Date: 5/18/2012

CC:PA:01:

POSTN-150045-11

UILC: 6664.01-00

date: February 10, 2012

to: David P. Fuller
Trial Attorney (SL) (Los Angeles)
(Large Business & International)

from: Elizabeth G. Chirich
Branch Chief
(Procedure & Administration)

subject: Calculating Accuracy-Related Penalty-Definition of "Underpayment"

This Chief Counsel Advice responds to your request for assistance dated December 2, 2011. This advice may not be used or cited as precedent.

LEGEND

T

CTY

State

Y1 Tax Year Ended

Y2 Tax Year Ended

Y3 Tax Year Ended

(\$N1)

\$N2

\$N3

\$N4

\$N5

\$N6

ISSUE

Whether the calculation of “underpayment,” as defined in I.R.C. § 6664, includes a taxpayer’s liability for alternative minimum tax (AMT) under I.R.C. § 55?

CONCLUSION

Yes

FACTS

T is a C corporation with offices in CTY, State, and is the parent corporation of seven subsidiaries. The Service is currently examining T’s income tax returns for taxable years Y1, Y2 and Y3. The Service is considering making a number of adjustments to the income reported by T for each of the taxable years, including an adjustment pursuant to I.R.C. § 162(m), which pertains to the disallowance of a business expense deduction for excess employee remuneration.¹

A member of the Service’s exam team reviewing T’s returns has questioned one aspect of the calculations made by a tax-computation specialist from the Service’s Office of Appeals, specifically whether the tax-computation specialist has correctly calculated the accuracy-related penalty for T’s taxable year Y1 by including T’s liability for AMT. Your question is thus whether the “underpayment,” on which the accuracy-related penalty under I.R.C. § 6662 is based, takes into account a taxpayer’s liability for AMT under I.R.C. § 55.

In other words, which is the correct way to calculate the penalty?

- apply the appropriate regular tax rate to the understatement of income caused by the 162(m) item, then apply the 20% penalty to the resulting underpayment of regular tax (i.e. the change in AMT does not figure into the calculation of “underpayment”); or
- include the taxpayer’s liability for AMT as part of the calculation of “underpayment” (which is what the tax-computation specialist did) and apply the accuracy-related penalty to the total underpayment

¹ That section disallows a deduction to a publicly held corporation to the extent employee remuneration for a covered employee for a taxable year exceeds 1 million dollars.

Attached to your request is a draft deficiency notice respecting T's taxable years Y1, Y2 and Y3.² The last page of this document is labeled as EXHIBIT A, which is a spread sheet showing the calculations for accuracy-related penalties for each of T's 3 taxable years noted above. EXHIBIT A includes columns that show T's income and tax liabilities both with and without the adjustment under I.R.C. § 162(m). The third column of numbers shows the Service's calculation of an underpayment for tax year Y1 and the AMT liability is (\$N1). Because the schedule shows the AMT amount in parentheses and hence suggests that this is a negative number, it suggests T owes no AMT for Y1, or perhaps that T overpaid AMT for Y1. Because of this ambiguity, our office contacted the tax-computation specialist from Appeals to get clarification on the meaning of the figures in this column.

The tax-computation specialist from Appeals furnished to our office a separate schedule, labeled "Schedule 3," which is an overview of T's AMT liabilities of T. Schedule 3 states, in part:

Year Ending	Y1	Y2	Y3
* * *			
Alternative Minimum Tax			
Tentative Minimum Tax	\$N2		
Regular Tax after FTC	\$N3		
AMT Before Adjustment	\$N4		
Adjustment to AMT	\$N5		
Alternative Minimum Tax			
-to Schedule 1	\$N6		

Schedule 3 reflects that the Service determined T to be liable for AMT for taxable Y1 in the sum of \$N6, and the tax-computation specialist included this as part of the calculation of "underpayment" for such year.

LAW AND ANALYSIS

The accuracy-related penalty under I.R.C. § 6662 applies to the portion of any underpayment attributable to: 1) negligence or disregard of rules or regulations; 2) a substantial understatement of tax; 3) a substantial valuation misstatement; 4) a substantial overstatement of pension liabilities; or 5) a substantial estate or gift tax

² It is our understanding that the Service has already issued the deficiency notice for the above periods using the calculation of the accuracy-related penalty as described in the second bullet above. You nonetheless request our views on this legal issue.

valuation understatement. Your question implicates the proper method for calculating an “underpayment,” which is defined in I.R.C. § 6664(a) as:

(a) Underpayment.

. . . For purposes of this part, the term “underpayment” means the amount by which any tax imposed by this title exceeds the excess of-

(1) the sum of-

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

(B) amounts not so shown previously assessed (or collected without assessment), over

(2) the amount of rebates made . . .

The implementing regulation for section 6664 sheds light on the taxes included in the calculation of an *underpayment*. This states, in part, as follows:

§ 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:

* * *

(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 the source on nonresident aliens and foreign corporations);

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

(3) Any credit resulting from collection of amounts assessed under section 6851 as the result of a termination assessment, or section 6861 as a 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). (emphasis added).

* * *

Under this regulation, the taxes imposed on a taxpayer under subtitle A of Title 26 make up the “amount of income tax imposed” in the definition of an underpayment.³ Because AMT under I.R.C. § 55 is one of the taxes imposed under subtitle A, it is included as part of the calculation of “underpayment,” upon which the accuracy-related penalty is based.

Here, Exhibit 3 reflects that the Service determined T’s AMT liability to be \$N6 for taxable year Y1. Although the AMT liability for Y1 is listed as (\$N1), a negative number on EXHIBIT A, we learned from the tax-computation specialist that she expressed the AMT in this manner because of the differential tax rates between AMT (20%) and the regular income tax rate (35%).

In light of this explanation and the information included in Schedule 3, the Service determined AMT against T for Y1. Consequently, our office agrees with your conclusion. T’s AMT liability for T’s taxable year Y1 is to be included when calculating the “underpayment” under section 6664 and Treas. Reg. § 1.6664-2; Appeals correctly computed the underpayment on which the accuracy-related penalty was computed for Y1.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

None identified

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call (202) 622-4910 if you have any further questions.

³ Treas. Reg. § 1.6664-2(a) expresses this definition with the following formula:

“underpayment” = $W - (X + Y - Z)$, where W is the amount of income tax imposed, X is the amount shown as the tax by the taxpayer on his return, Y is the amount not so shown previously assessed (or collected without assessment), and Z is the amount of rebates made. A more extensive discussion of these variables is beyond the scope of this memorandum.