

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

Rev. Proc. 2002-66

SECTION 1. PURPOSE

.01 This revenue procedure updates Rev. Proc. 2001-52, 2001-2 C.B. 491, and identifies circumstances under which the disclosure on a taxpayer's return of a position with respect to an item is adequate for the purpose of reducing the understatement of income tax under § 6662(d) of the Internal Revenue Code (relating to the substantial understatement aspect of the accuracy-related penalty), and for the purpose of avoiding the preparer penalty under § 6694(a) (relating to understatements due to unrealistic positions). This revenue procedure does not apply with respect to any other penalty provisions (including the negligence or disregard provisions of the § 6662 accuracy-related penalty).

.02 This revenue procedure applies to any return filed on 2002 tax forms for a taxable year beginning in 2002, and to any re-

turn filed on 2002 tax forms in 2003 for short taxable years beginning in 2003.

SECTION 2. CHANGES FROM REV. PROC. 2001-52

Section 4.01(1)(d), concerning contributions on Form 1040, Schedule A, has been revised and editorial changes have been made in updating Rev. Proc. 2001-52.

SECTION 3. BACKGROUND

.01 If § 6662 applies to any portion of an underpayment of tax required to be shown on a return, an amount equal to 20 percent of the portion of the underpayment to which the section applies is added to the tax. (The penalty rate is 40 percent in the case of gross valuation misstatements under § 6662(h).) Under § 6662(b)(2), § 6662 applies to the portion of an underpayment that is attributable to a substantial understatement of income tax.

.02 Section 6662(d)(1) provides that there is a substantial understatement of income tax if the amount of the understatement exceeds the greater of 10 percent of the amount of tax required to be shown on the return for the taxable year or \$5,000 (\$10,000 in the case of a corporation other than an S corporation or a personal holding company). Section 6662(d)(2) defines an understatement as the excess of the amount of tax required to be shown on the return for the taxable year over the amount of the tax that is shown on the return reduced by any rebate (within the meaning of § 6211(b)(2)).

.03 In the case of an item not attributable to a tax shelter, § 6662(d)(2)(B)(ii) provides that the amount of the understatement is reduced by the portion of the understatement attributable to any item with respect to which the relevant facts affecting the item's tax treatment are adequately disclosed on the return or on a statement attached to the return, and there is a reasonable basis for the tax treatment of such item by the taxpayer.

.04 In general, this revenue procedure provides guidance in determining when disclosure is adequate for purposes of § 6662(d). For purposes of this revenue procedure, the taxpayer must furnish all required information in accordance with the applicable forms and instructions, and the money amounts entered on these forms

must be verifiable. Guidance under § 6662(d) for returns filed for 2001, 2000, and 1999 is provided in Rev. Proc. 2001-52; Rev. Proc. 2001-11, 2001-1 C.B. 275; and Rev. Proc. 99-41, 1999-2 C.B. 566, respectively.

SECTION 4. PROCEDURE

.01 Additional disclosure of facts relevant to, or positions taken with respect to, issues involving any of the items set forth below is unnecessary for purposes of reducing any understatement of income tax under § 6662(d), provided that the forms and attachments are completed in a clear manner and in accordance with their instructions. The money amounts entered on the forms must be verifiable, and the information on the return must be disclosed in the manner described below. For purposes of this revenue procedure, a number is verifiable if, on audit, the taxpayer can demonstrate the origin of the number (even if that number is not ultimately accepted by the Internal Revenue Service) and the taxpayer can show good faith in entering that number on the applicable form.

(1) Form 1040, Schedule A, *Itemized Deductions*:

(a) Medical and Dental Expenses: Complete lines 1 through 4, supplying all required information.

(b) Taxes: Complete lines 5 through 9, supplying all required information. Line 8 must list each type of tax and the amount paid.

(c) Interest Expense: Complete lines 10 through 14, supplying all required information. This section 4.01(1)(c) does not apply to (I) amounts disallowed under § 163(d) unless Form 4952, *Investment Interest Expense Deduction*, is completed, or (ii) amounts disallowed under § 265.

(d) Contributions: Complete lines 15 through 18, supplying all required information. Enter the amount of the gift reduced by the value of any substantial benefit (goods or services) provided by the donee organization in consideration, in whole or in part. Entering the amount of the gift unreduced by the value of the benefit received will not constitute adequate disclosure. If a contribution of \$250 or more is made, this section 4.01(1)(d) will not apply unless a contemporaneous written acknowledgment, as required by § 170(f)(8), is obtained from the donee organization. If a contribution of property other than cash

is made and the amount claimed as a deduction exceeds \$500, attach a properly completed Form 8283, *Noncash Charitable Contributions*, to the return.

(e) Casualty and Theft Losses: Complete Form 4684, *Casualties and Thefts*, and attach to the return. Each item or article for which a casualty or theft loss is claimed must be listed on Form 4684.

(2) Certain Trade or Business Expenses (including, for purposes of this section 4.01(2), the following six expenses as they relate to the rental of property):

(a) Casualty and Theft Losses: The procedure outlined in section 4.01(1)(e) above must be followed.

(b) Legal Expenses: The amount claimed must be stated. This section 4.01(2)(b) does not apply, however, to amounts properly characterized as capital expenditures, personal expenses, or non-deductible lobbying or political expenditures, including amounts that are required to be (or that are) amortized over a period of years.

(c) Specific Bad Debt Charge-off: The amount written off must be stated.

(d) Reasonableness of Officers' Compensation: Form 1120, Schedule E, *Compensation of Officers*, must be completed when required by its instructions. The time devoted to business must be expressed as a percentage as opposed to "part" or "as needed." This section 4.01(2)(d) does not apply to "golden parachute" payments, as defined under § 280G. This section 4.01(2)(d) will not apply to the extent that remuneration paid or incurred exceeds the \$1 million-employee-remuneration limitation, if applicable.

(e) Repair Expenses: The amount claimed must be stated. This section 4.01(2)(e) does not apply, however, to any repair expenses properly characterized as capital expenditures or personal expenses.

(f) Taxes (other than foreign taxes): The amount claimed must be stated.

(3) Form 1120, Schedule M-1, *Reconciliation of Income (Loss) per Books With Income per Return*, provided:

(a) The amount of the deviation from the financial books and records is not the result of a computation that includes the netting of items; and

(b) The information provided reasonably may be expected to apprise the Internal Revenue Service of the nature of the potential controversy concerning the tax treatment of the item.

(4) Foreign Tax Items:

(a) International Boycott Transactions: Transactions disclosed on Form 5713, *International Boycott Report*.

(b) Treaty-Based Return Position: Transactions and amounts under § 6114 or § 7701(b) as disclosed on Form 8833, *Treaty-Based Return Position Disclosure*.

(5) Other:

(a) Moving Expenses: Complete Form 3903, *Moving Expenses*, and attach to the return.

(b) Employee Business Expenses: Complete Form 2106, *Employee Business Expenses*, or Form 2106-EZ, *Unreimbursed*

Employee Business Expenses, and attach to the return. This section 4.01(5)(b) does not apply to club dues, or to travel expenses for any non-employee accompanying the taxpayer on the trip.

(c) Fuels Credit: Complete Form 4136, *Credit for Federal Tax Paid on Fuels*, and attach to the return.

(d) Investment Credit: Complete Form 3468, *Investment Credit*, and attach to the return.

SECTION 5. EFFECTIVE DATE

This revenue procedure applies to any return filed on 2002 tax forms for a tax-

able year beginning in 2002, and to any return filed on 2002 tax forms in 2003 for short taxable years beginning in 2003.

SECTION 6. DRAFTING INFORMATION

The principal author of this revenue procedure is John Moran of the Office of Associate Chief Counsel, Procedure & Administration (Administrative Provisions & Judicial Practice Division). For further information regarding this revenue procedure, contact Branch 2 of the Administrative Provisions & Judicial Practice Division at (202) 622-4940 (not a toll-free call).