COMMISSIONER
LARGE AND MID-SIZE
BUSINESS DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

July 10, 2003

MEMORANDUM FOR LARGE AND MID-SIZE BUSINESS DIVISION
EXECUTIVES, MANAGERS AND AGENTS

FROM: Deborah M. Nolan Deborah M. Nolan
Commissioner, Large and Mid-Size Business Division

SUBJECT: Penalty Policy in Disclosure Initiative Cases

It has come to my attention that there may be some confusion regarding the application of penalties in cases where taxpayers disclosed their participation in abusive tax avoidance transactions under the Announcement 2002-2 Disclosure Initiative. As a result, I am taking this opportunity to reiterate our penalty policy in these cases.

Under the Disclosure Initiative, the IRS is committed to waiving the accuracy related penalty under § 6662(b) for that section of an underpayment attributable to the disclosed item and due to one or more of the following: (i) negligence or disregard of rules or regulations; (ii) any substantial understatement of income tax; (iii) any substantial or gross valuation misstatement, except for any underpayment attributable to a net § 482 transfer price adjustment; and (iv) any substantial overstatement of pension liabilities.

Disclosure under Announcement 2002-2 does not affect whether the IRS will impose, as appropriate, any other civil penalty that may be applicable under the Code or will investigate any associated criminal conduct or recommend prosecution for violation of any criminal statute. However, the IRS will waive the accuracy related penalty under §6662(b) for all cases that otherwise qualify under the terms of Announcement 2002-2. As a result, examiners should not develop the accuracy related penalty in cases where the taxpayer filed and was considered qualified under the terms of Announcement 2002-2. This determination should be confirmed by the team manager and no further approval is required. This applies for all years for which the taxpayer voluntarily disclosed and was considered eligible under the terms of Announcement 2002-2.

With respect to cases not qualifying for treatment under the Disclosure Initiative, we will continue our policy of mandatory penalty consideration. If an underpayment of tax is attributable to a taxpayer's participation in a listed transaction, the examiner must develop the accuracy-related penalty issue and prepare a written report supporting the recommendation to impose or not to impose the penalty. In all cases in which there is an underpayment attributable to a listed transaction, the Director of Field Operations (DFO) must approve the decision to impose or not to impose the accuracy-related penalty.

In cases involving potentially abusive tax shelters, examiners should identify and evaluate the facts regarding the shelter, then contact LMSB field counsel and the Office of Tax Shelter Analysis (OTSA), which is responsible for coordinating and assisting in the identification of tax shelters. If the examiner concludes that the accuracy-related penalty should be imposed, the DFO must approve that decision.

Please follow these guidelines in your examination. If you have any questions, please call John Risacher, Acting Manager, Office of Tax Shelter Analysis at (202) 283-8386 or Kathy K. Petronchak, Acting Director, PFTG at (202) 283-8463.