- (2) Tax shelter.
- (i) In general.
- (ii) Principal purpose.
- (3) Tax shelter item.
- (4) Reasonable belief.
- (i) In general.
- (ii) Facts and circumstances; reliance on tax advisor.

## Par. 3. Section 1.6662-2 is amended by:

- 1. Redesignating the text of paragraph (d) following the heading as paragraph (d)(1), adding a new heading for newly designated paragraph (d)(1), and revising the second sentence of newly redesignated paragraph (d)(1).
- 2. Adding a new paragraph (d)(2). The additions and revisions read as follows:

## § 1.6662-2 Accuracy-related penalty.

- (d) Effective date—(1) In general. \* \* Except as provided in the preceding sentence and in paragraph (d)(2) of this section,  $\S\S 1.6662-1$ through 1.6662-5 apply to returns the due date of which (determined without regard to extensions of time for filing) is after December 31, 1989. \* \* \*
- (2) Special rules for tax shelter items. Sections 1.6662-4(g)(1) and 1.6662-4(g)(4) apply to returns the due date of which (determined without regard to extensions of time for filing) is after the date on which final regulations are published in the Federal Register. Sections 1.6662-4(g)(1) and (4) (as contained in 26 CFR Part 1 revised April 1, 1994) apply to returns the due date of which (determined without regard to extensions of time for filing) is on or before the date on which final regulations are published in the Federal **Register** and after December 31, 1989, subject to changes resulting from Section 744 of Title VII of the Uruguay Round Agreements Act, Pub. L. 103-465 (108 Stat, 4809).
- Par. 4. Section 1.6662–4 is amended by revising paragraphs (g)(1), (g)(4), and (g)(5) to read as follows:

## § 1.6662-4 Substantial understatement of income tax.

(g) Items relating to tax shelters—(1) In general—(i) Non-corporate taxpayers. Tax shelter items (as defined in paragraph (g)(3) of this section) of a taxpayer other than a corporation are treated for purposes of this section as if such items were shown properly on the return for a taxable year in computing the amount of tax shown on the return, and thus the tax attributable to such items is not included in the understatement for the year, if-

- (A) There is substantial authority (as provided in paragraph (d) of this section) for the tax treatment of that item; and
- (B) The taxpayer reasonably believed at the time the return was filed that the tax treatment of that item was more likely than not the proper treatment.
- (ii) Corporate taxpayers—(A) In general. Except as provided in paragraph (g)(1)(ii)(B) of this section, all tax shelter items (as defined in paragraph (g)(3) of this section) of a corporation are taken into account in computing the amount of any understatement.
- (B) Special rule for transactions occurring prior to December 9, 1994. The tax shelter items of a corporation arising in connection with transactions occurring prior to December 9, 1994 are treated for purposes of this section as if such items were shown properly on the return if the requirements of paragraph (g)(1)(i) are satisfied with respect to such items.
- (iii) Disclosure irrelevant. Disclosure made with respect to a tax shelter item of either a corporate or non-corporate taxpayer does not affect the amount of an understatement.
- (iv) Cross-reference. See § 1.6664-4(e) for certain rules regarding the availability of the reasonable cause and good faith exception to the substantial understatement penalty with respect to tax shelter items of corporations.
- (4) Reasonable belief—(i) In general. For purposes of section 6662(d) and paragraph (g)(1)(i)(B) of this section (pertaining to tax shelter items of noncorporate taxpayers), a taxpayer is considered reasonably to believe that the tax treatment of an item is more likely than not the proper tax treatment if (without taking into account the possibility that a return will not be audited, that an issue will not be raised on audit, or that an issue will be settled)-
- (A) The taxpayer analyzes the pertinent facts and authorities in the manner described in paragraph (d)(3)(ii) of this section, and in reliance upon that analysis, reasonably concludes in good faith that there is a greater than 50percent likelihood that the tax treatment of the item will be upheld if challenged by the Internal Revenue Service; or
- (B) The taxpayer reasonably relies in good faith on the opinion of a professional tax advisor, if the opinion is based on the tax advisor's analysis of the pertinent facts and authorities in the manner described in paragraph (d)(3)(ii) of this section and unambiguously states that the tax advisor concludes that there

- is a greater than 50-percent likelihood that the tax treatment of the item will be upheld if challenged by the Internal Revenue Service.
- (ii) Facts and circumstances; reliance on professional tax advisor. All facts and circumstances must be taken into account in determining whether a taxpayer satisfies the requirements of paragraph (g)(4)(i) of this section. However, in no event will a taxpayer be considered to have reasonably relied in good faith on the opinion of a professional tax advisor for purposes of paragraph (g)(4)(i)(B) of this section unless the requirements of § 1.6664– 4(c)(1) are met. The fact that the requirements of  $\S 1.6664-4(c)(1)$  are satisfied will not necessarily establish that the taxpayer reasonably relied on the opinion in good faith. For example, reliance may not be reasonable or in good faith if the taxpayer knew, or should have known, that the advisor lacked knowledge in the relevant aspects of Federal tax law.
- (5) Pass-through entities. In the case of tax shelter items attributable to a pass-through entity, the actions described in paragraphs (g)(4)(i)(A) and (B) of this section, if taken by the entity, are deemed to have been taken by the taxpayer and are considered in determining whether the taxpayer reasonably believed that the tax treatment of an item was more likely than not the proper tax treatment.
- Par. 5. Section 1.6664-0 is amended by revising the entries for §§ 1.6664–1(b) and 1.6664-4 to read as follows:

## §1.6664-0 Table of contents.

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§ 1.6664-1 Accuracy-related and fraud penalties; definitions and special rules.

- \* (b) Effective date.
  - (1) In general.
  - (2) Reasonable cause and good faith exception to section 6662 penalties.

- § 1.6664-4 Reasonable cause and good faith exception to section 6662 penalties.
- (a) In general.
- (b) Facts and circumstances taken into account.
  - (1) In general.
  - (2) Examples.
- (c) Reliance on opinion or advice.
  - (1) Fact and circumstances; minimum requirements.
  - (i) All facts and circumstances considered.
  - (ii) No unreasonable assumptions.
  - (iii) Law is related to actual facts.
  - (2) Definitions.
  - (i) Advice.