- (ii) Material.
- (d) Pass-through items.
- (e) Special rules for substantial understatement penalty attributable to tax shelter items of corporations.
 - (1) In general; facts and circumstances.
- (2) Reasonable cause based on legal iustification.
- (i) Minimum requirements.
- (A) Authority requirement.
- (B) Belief requirement.
- (ii) Legal justification defined.
- (3) Minimum requirements not dispositive.
- (4) Other factors.
- (f) Transactions between persons described in section 482 and net section 482 transfer price adjustments. [Reserved]
- (g) Valuation misstatements of charitable deduction property.
 - (1) In general.
 - (2) Definitions.
 - (i) Charitable deduction property.
 - (ii) Qualified appraisal.
 - (iii) Qualified appraiser.

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Par. 6. Section 1.6664–1 is amended by:

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

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

(b) Effective date—(1) In general. Sections 1.6664–1 through 1.6664–3 apply to returns the due date of which (determined without regard to extensions of time for filing) is after December 31, 1989.

(2) Reasonable cause and good faith exception to section 6662 penalties. Section 1.6664–4 applies to returns the due date of which (determined without regard to extensions of time for filing) is after the date on which the final regulations are published in the **Federal** Register. Section 1.6664-4 (as contained in 26 CFR Part 1 revised April 1, 1994) applies to returns the due date of which (determined without regard to extensions of time for filing) is on or before the date on which the 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. 7. Section 1.6664–4 is amended by:

- 1. Revising the last sentence of paragraph (a).
- 2. Revising paragraph (b)(1).
- 3. Revising the introductory language of paragraph (b)(2) and *Example 1*.

- 4. Redesignating paragraphs (c), (d) and (e) as paragraphs (d), (f) and (g), respectively.
- 5. Revising newly designated paragraph (d).
- 6. Adding new paragraphs (c) and (e). The revisions and additions read as follows:

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

(a) * * * Rules for determining whether the reasonable cause and good faith exception applies are set forth in paragraphs (b) through (g) of this section.

(b) Facts and circumstances taken

- into account—(1) In general. The determination of whether a taxpayer acted with reasonable cause and in good faith is made on a case-by-case basis, taking into account all pertinent facts and circumstances. (See paragraph (e) of this section for certain rules relating to a substantial understatement penalty attributable to tax shelter items of corporations.) Generally, the most important factor is the extent of the taxpayer's effort to assess the taxpayer's proper tax liability. Circumstances that may indicate reasonable cause and good faith include an honest misunderstanding of fact or law that is reasonable in light of all of the facts and circumstances, including the experience, knowledge and education of the taxpayer. An isolated computational or transcriptional error generally is not inconsistent with reasonable cause and good faith. Reliance on an information return or on the advice of a professional tax advisor or an appraiser does not necessarily demonstrate reasonable cause and good faith. Similarly, reasonable cause and good faith is not necessarily indicated by reliance on facts that, unknown to the taxpayer, are incorrect. Reliance on an information return, professional advice or other facts, however, constitutes reasonable cause and good faith if, under all the circumstances, such reliance was reasonable and the taxpayer acted in good faith. (See paragraph (c) of this section for certain rules relating to reliance on the advice of others.) For example, reliance on erroneous information (such as an error relating to the cost or adjusted basis of property, the date property was placed in service, or the amount of opening or closing inventory) inadvertently included in data compiled by the various divisions of a multidivisional corporation or in financial books and records prepared by those divisions generally indicates reasonable cause and good faith, provided the corporation employed internal controls and procedures,
- reasonable under the circumstances, that were designed to identify such factual errors. Reasonable cause and good faith ordinarily is not indicated by the mere fact that there is an appraisal of the value of property. Other factors to consider include the methodology and assumptions underlying the appraisal, the appraised value, the relationship between appraised value and purchase price, the circumstances under which the appraisal was obtained, and the appraiser's relationship to the taxpayer or to the activity in which the property is used. (See paragraph (g) of this section for certain rules relating to appraisals for charitable deduction property.) A taxpayer's reliance on erroneous information reported on a Form W-2, Form 1099 or other information return indicates reasonable cause and good faith, provided the taxpayer did not know or have reason to know that the information was incorrect. Generally, a taxpayer knows or has reason to know that the information on an information return is incorrect if such information is inconsistent with other information reported or otherwise furnished to the taxpayer, or with the taxpayer's knowledge of the transaction. This knowledge includes, for example, the taxpayer's knowledge of the terms of his employment relationship or of the rate of return on a payor's obligation.
- (2) Examples. The following examples illustrate this paragraph (b). They do not involve tax shelter items. (See paragraph (e) of this section for certain rules relating to the substantial understatement penalty in connection with the tax shelter items of corporations.)

Example 1. A, an individual calendar year taxpayer, engages B, a professional tax advisor, to give A advice concerning the deductibility of certain state and local taxes. A provides B with full details concerning the taxes at issue. B advises A that the taxes are fully deductible. A, in preparing his own tax return, claims a deduction for the taxes. Absent other facts, and assuming the facts and circumstances surrounding B's advice and A's reliance on such advice satisfy the requirements of paragraph (c) of this section, A is considered to have demonstrated good faith by seeking the advice of a professional tax advisor, and to have shown reasonable cause for any underpayment attributable to the deduction claimed for the taxes. However, if A had sought advice from someone that A knew, or should have known, lacked knowledge in the relevant aspects of Federal tax law, or if other facts demonstrate that A failed to act reasonably or in good faith, A would not be considered to have shown reasonable cause or to have acted in good faith.

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