New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-M-83
(16) Corporation Tax (Rev.)
(18) Income Tax (Rev.)
January 16, 1984

This memorandum supercedes memorandum TSB-M-83(16)-C and TSB-M-83-(18)-I dated September 15, 1983, which should be destroyed.

1983 Legislation

Penalty for Substantial Understatements of Tax

Chapter 15 of the Laws of 1983 added a new subsection (k) to section 1085 of the New York State Tax Law to impose a penalty on corporations that substantially understate their tax liability. The penalty applies to taxable years beginning after December 3l, 1982. This penalty is in addition to any other penalties that may be imposed under section 1085.

The penalty is 10 percent of the underpayment that is attributable to a substantial understatement. The amount of the understatement subject to the penalty must be reduced by the portion of the understatement that is attributable to (1) the treatment of any item for which there is or was substantial authority, or (2) any item for which there is adequate disclosure on the return or in an attached statement. The penalty may be waived if the taxpayer can show reasonable cause for the understatement and acted in good faith.

Definitions

Substantial understatement - an understatement that exceeds the greater of -

1) 10 percent of the tax required to be shown on the return for the taxable year; or

2) (a) $5,000 in the case of an S Corporation.
(b) $10,000 in the case of a corporation other than an S corporation.

Understatement - the excess of the amount of tax required to be shown on the return for the taxable year, over the amount of tax imposed which is shown on the return.

Tax shown on return - the amount of tax imposed which is shown on the return for the taxable year determined without regard to any amount of additional tax shown on an amended return filed after the due date of the return. If no return was made for the taxable year the amount of tax shown on the return is considered zero.

Substantial Authority - if there is or was substantial authority for the tax treatment of an item, the item is treated as if it were shown properly on the return for the taxable year in computing the amount of tax imposed which is; shown on the return. A position for which there is substantial authority is stronger than one for which there is only a reasonable basis. Substantial authority is required for issues of fact as well as for issues of law.

There is substantial authority for a position if the analysis supporting the position relates authority to the relevant facts and circumstances and concludes that the weight of the authorities supporting the position is substantial when compared to the weight of the authorities contrary to the position. The taxpayers position must be stronger than one that is arguable but fairly unlikely to prevail in court.

Adequate Disclosure - items for which there is adequate disclosure are treated as if such items were shown properly on the return for the taxable year in computing the amount of tax imposed which is shown on the return. Disclosure is adequate with respect to the tax treatment of an item on a return only if it is made on such return or in a statement attached thereto. Thus, disclosure with respect to a recurring item, such as the basis of depreciable property, made on a return or statement attached thereto for one taxable year, is not adequate disclosure with respect to the item for any other taxable year.

Example 1

In 1984, a calendar year corporate taxpayer files a return for 1983, which shows entire net income of $28,500 and a tax liability of $2,850. Subsequent adjustments on audit for 1983 increase entire net income to $128,800 and the tax liability to $12,880. X had no substantial authority for the item resulting in the audit adjustment nor did X adequately disclose the relevant facts affecting the item's tax treatment. The amount of the understatement is $10,030 ($12,880 (the amount required to be shown) less $2,850 (the amount of tax imposed which is shown on the return)). Because the understatement exceeds the greater of 10 percent of the tax required to be shown on the return for the year ($1,288 ($12,880 x . 10)) and also exceeds $10,000, X had a substantial understatement of tax liability for the year. The amount of penalty to be imposed on X is $1,003 ($10,030 x .10).

Example 2

Same facts as example 1, except that X had substantial authority for an item resulting in an adjustment that increases entire net income by $6,000. In computing the amount of understatement the amount of tax shown on X's return is determined as if the item for which X had substantial authority had been given the proper tax treatment. Thus, the amount of tax imposed that is treated as shown on X's return is $3,450 (the tax on $34,500) ($28,500 entire net income actually shown on X's return plus $6,000, the amount of the adjustment for which X had substantial authority). The amount of the understatement is $9,430 ($12,880 less $3,450). Although the understatement does exceed 10% of the tax required to be shown on the return for the year ($1,288 ($12,880 x .10)) it does not exceed $10,000. Therefore, X does not have a substantial understatement of tax liability for the year. Accordingly, the penalty will not be imposed.

NOTE: For personal income tax purposes this penalty does not become effective due to the repeal of Internal Revenue Code Section 3451 on August 5, 1983.