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SC TECHNICAL ADVICE MEMORANDUM #89-20

TO: Mr. Marvin N. Davant, Director
Field Services Division

FROM: Jerry B. Knight, Manager
Tax Policy and Procedures Department

DATE: July 5, 1989

SUBJECT: Substantial Understatement of Tax
Code Section 12-54-155
(All Taxes)

REFERENCE: S.C. Code Ann. Section 12-54-155 (Supp. 1988)

AUTHORITY: S.C. Code Ann. Section 12-3-170 (1976)
SC Revenue Procedure #87-3

SCOPE: A Technical Advice Memorandum is a temporary document issued to an individual within the Commission, upon request, and it applies only to the specific facts or circumstances related in the request. Technical Advice Memoranda have no precedential value and are not intended for general distribution.

Question:

What constitutes "substantial authority", for purposes of the penalty imposed at Code Section 12-54-155?

Facts:

Effective January 1, 1989, a penalty for substantial understatement of tax is imposed, pursuant to Code Section 12-54-155. That section reads, in part:

- (a) If there is a substantial understatement of tax for any taxable period, there must be added to the tax an amount equal to twenty-five percent of the amount of any underpayment attributable to the understatement.

(b)(1)(A) For purposes of this section, there is a substantial understatement of tax for any taxable period if the amount of the under-statement for the taxable period exceeds the greater of ten percent of the tax required to be shown on the return for the taxable period or five thousand dollars.

(B) In the case of a corporation other than an S corporation or a personal holding company (as defined in IRC Section 542), paragraph (1) must be applied by substituting "ten thousand dollars" for "five thousand dollars".

(2)(A) For purposes of paragraph (1), "Understatement" means the excess of the amount of the tax required to be shown on the return for the taxable period over the amount of the tax imposed which is shown on the return.

(B) The amount of the understatement under sub-paragraph (A) must be reduced by that portion of the understatement which is attributable to (i) the tax treatment of any item by the taxpayer if there is or was substantial authority for such treatment or (ii) any item with respect to which the relevant facts affecting the item's tax treatment are adequately disclosed in the return or in a statement attached to the return (emphasis added).

Discussion:

The question at hand is: What constitutes "substantial authority", as used in the above underlined portion of Code Section 12-54-155?

Code Section 12-54-155 was modeled after Section 6661 of the Internal Revenue Code. That section reads, in part:

(a) Addition To Tax. - If there is a substantial under- statement of income tax for any taxable year, there shall be added to the tax an amount equal to 20 percent of the amount of any underpayment attributable to such under-statement.

(b) Definition and Special Rule. -

(1) Substantial Understatement. -

(A) In General. - For purposes of this section, there is a substantial understatement of income tax for any taxable year if the amount of the understatement for the taxable year exceeds the greater of-

(i) 10 percent of the tax required to be shown on the return for the taxable year, or

(ii) \$5,000.

(B) Special Rule For Corporations. - In the case of a corporation other than an S corporation or a personal holding company (as defined in section 542), paragraph (1) shall be applied by substituting "\$10,000" for "\$5,000".

(2) Understatement. -

(A) In General. - For purposes of paragraph (1), the term "understatement" means the excess of -

(i) the amount of the tax required to be shown on the return for the taxable year, over

(ii) the amount of the tax imposed which is shown on the return, reduced by any rebate (within the meaning of section 6211(b)(2)).

(B) Reduction for Understatement Due to Position of Taxpayer or Disclosed Item. - The amount of the understatement which is attributable to -

(i) the tax treatment of any item by the tax-payer if there is or was substantial authority for such treatment, or

(ii) any item with respect to which the relevant facts affecting the item's tax treatment are adequately disclosed in the return or in a statement attached to the return.

The Internal Revenue Code, like the South Carolina statute, does not define the phrase "substantial authority"; however, Regulation 1.6661-3 of the Internal Revenue Service does outline what constitutes "substantial authority". Commerce Clearing House, in its Federal Tax Guide, Volume 1A - Paragraph 6631EE, provides a good summary of the code and regulation, as to what is "substantial authority". Paragraph 6631EE reads, in part:

Substantial authority

For purposes of penalty reduction, the following are accepted as authorities:

- (1) code and other statutory provisions,
- (2) temporary and final regulations,
- (3) court cases,
- (4) administrative pronouncements (including revenue rulings and procedures),
- (5) tax treaties, and
- (6) congressional intent as reflected in
 - (a) committee reports,
 - (b) joint explanatory statements of managers included in conference committee reports, and

(c) floor statements by a manager of a bill made prior to enactment.

However, the following are not authorities:

- (1) legal periodicals,
- (2) legal opinions or opinions rendered by tax professionals,
- (3) post-enactment explanations, such as "General Explanations" prepared by the Staff of the Joint Committee on Taxation,
- (4) actions on decisions, and
- (5) general counsel memoranda.

There is substantial authority for the tax treatment of an item only if the weight of the authorities supporting the treatment is substantial in relation to the weight of authorities supporting contrary positions. This is decided on the basis of a "facts and circumstances" test. The weight of authorities depends on their persuasiveness and relevance as well as their source. Thus, a district court case that is on appeal but that has not been reversed would not have the same weight as a final decision of a court of appeals.

The relevant dates on which substantial authority must exist are the later of (a) the date the return was filed, or (b) the last day of the taxable year to which the return relates.

In summary, "substantial authority" exist only if "the weight of the authorities supporting the [tax] treatment is substantial in relation to the weight of authorities supporting contrary positions".

Conclusion:

"Substantial Authority" for purposes of Code Section 12-54-155, based on the similar federal statute, includes:

1. Code and Regulations,
2. Court Cases,
3. Revenue Rulings, Revenue Procedures, Private Letter Rulings and Technical Advice Memorandum.
4. Commission Decisions

However, in determining whether such authority is substantial, "the weight of [the] authorities depends on their persuasiveness...relevance...[and] source". In addition, the weight of such authorities, in relation to the weight of authorities supporting a different tax treatment, must be considered.

NOTE: SEE REVENUE PROCEDURE #89-2 AND INFORMATION LETTER #89-26, CONCERNING THE DISCLOSURE STATEMENT REQUIRED BY CODE SECTION 12-54-155.