

**Interpretation No. 1-1,
“Reporting and Disclosure Standards”**

and

**Interpretation No. 1-2,
“Tax Planning”**

of

**Statement on Standards for Tax
Services No. 1, *Tax Return Positions***

October 20, 2011

Notice to Readers

The Statements on Standards for Tax Services (SSTSs) and interpretations, promulgated by the AICPA Tax Executive Committee (TEC), reflect the AICPA's standards of tax practice and delineate members' responsibilities to taxpayers, the public, the government, and the profession. The SSTSs are intended to be part of an ongoing process that may require changes to, and interpretations of, current SSTSs in recognition of the accelerating rate of change in tax laws and the continued importance of tax practice to members. The original Interpretations No. 1-1, "Realistic Possibility of Success," and No. 1-2, "Tax Planning," were adopted in 2000 and 2003, respectively, and updated in 2010. The TEC adopted the updated Interpretations No. 1-1, "Reporting and Disclosure Standards," and No. 1-2, "Tax Planning," on August 15, 2011, effective on January 31, 2012.¹

The SSTSs have been written in as simple and objective a manner as possible. However, by their nature, ethical standards provide for an appropriate range of behavior that recognizes the need for interpretations to satisfy a broad range of personal and professional situations. The SSTSs recognize this need by, in some sections, providing relatively subjective rules and leaving certain terms undefined. These terms and concepts are generally rooted in tax concepts and, therefore, they should be readily understood by tax practitioners. It is, therefore, recognized that the enforcement of these rules, as part of the AICPA Code of Professional Conduct, Rule 201, *General Standards* (AICPA, *Professional Standards*, ET sec. 201 par. .01), and Rule 202, *Compliance With Standards* (AICPA, *Professional Standards*, ET sec. 202 par. .01), will be undertaken with flexibility in mind and handled on a case-by-case basis. Members are expected to comply with them.

¹ These interpretations do not consider any impact of Section 1409 of the Health Care and Education Reconciliation Act of 2010, P.L. 111-152 (Codification of Economic Substance Doctrine and Penalties). Under Section 7701(o) of the Internal Revenue Code, in the case of any transaction to which the economic substance doctrine is relevant, the transaction shall be treated as having economic substance only if the transaction changes in a meaningful way (apart from federal income tax effects) the taxpayer's economic position, and the taxpayer has a substantial purpose (apart from federal income tax effects) for entering into such transaction. Understatements of tax attributable to a failure to satisfy the economic substance doctrine, where relevant, can result in substantial taxpayer penalties.



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Preface

Statement on Standards for Tax Services (SSTS) No. 1, *Tax Return Positions* (AICPA, *Professional Standards*), provides that a member should not recommend a tax return position or take a position on a tax return that the member prepares unless that position satisfies applicable reporting and disclosure standards. The tax laws of various taxing jurisdictions contain similar limitations on the ability to recommend or take certain tax return positions. This preface provides an overview of the most common tax return reporting standards and issues to be considered in determining if the applicable reporting standards and disclosure requirements have been satisfied.

Description of Various Reporting Standards

A brief description of the most common tax return reporting standards follows.¹

More likely than not. The more likely than not standard generally is satisfied if it is reasonable to conclude in good faith that there is a greater than 50-percent likelihood that the position will be upheld on its merits if it is challenged.²

Substantial authority. The substantial authority standard is an objective standard and is satisfied if the weight of the authorities supporting the position is substantial in relation to the weight of authorities supporting a contrary treatment.³ In practice, the substantial authority standard generally is interpreted as requiring approximately a 40-percent likelihood that the position will be upheld on its merits if it is challenged.⁴

Realistic possibility of success. The realistic possibility of success standard generally is satisfied if there is approximately a one-in-three (33 percent) likelihood that the position will be upheld on its merits if it is challenged.⁵

Reasonable basis. The reasonable basis standard is satisfied if the position is reasonably based on one or more authorities, taking into account the relevance and persuasiveness of those authorities. The reasonable basis standard is lower than the realistic possibility of success standard but is “significantly higher than not frivolous or not patently improper . . . [and] is not satisfied by a return position that is merely arguable or that is merely a colorable claim.”⁶ In practice, the reasonable basis standard generally is interpreted as

¹ In some cases, the taxing authority may require that more than one standard be satisfied with respect to a return position. For example, in the case of a listed transaction or other reportable transaction with a significant tax avoidance purpose, a taxpayer penalty may apply under Internal Revenue Code Section 6662A unless the taxpayer reasonably believed the position satisfied the more likely than not standard, and the position does or did, in fact, satisfy the substantial authority standard.

² Treasury Regulation Section 1.6662-4(g)(4).

³ Treasury Regulation Section 1.6662-4(d).

⁴ Joint Committee on Taxation, *Study of Present-Law Penalty and Interest Provisions as Required by Section 3801 of the Internal Revenue Service Restructuring And Reform Act of 1998 (Including Provisions Relating to Corporate Tax Shelters)* (JCS-3-99) (July 22, 1999), 1:152.

⁵ Treasury Regulation Section 1.6694-2(b) (prior to the revisions made by T.D. 9436, which became effective December 22, 2008).

⁶ Treasury Regulation Section 1.6662-3(b)(3).

requiring that there be approximately a 20-percent likelihood that the position will be upheld on its merits if it is challenged.⁷

Nature of the Analysis

The analysis used in determining if a reporting standard has been satisfied should involve a well-reasoned application of the relevant authorities to all pertinent facts and circumstances. The weight to be given to a particular authority depends on its relevance and persuasiveness. For example, all else being equal, more weight is given to a case or ruling that has facts similar to those at issue than to a case or ruling that has distinguishable facts. Similarly, more weight may be given to a case or ruling that provides an analysis of the facts and law, as opposed to one that merely states a conclusion. Assuming the same or similar issues, the type of authority also is significant; for example, more weight is given to a case or revenue ruling than to a private letter ruling issued to a third party, and more weight is given to an appellate court decision than to a lower court decision. For additional examples, see Treasury Regulation Section 1.6662-4(d)(3), which deals with the analysis used to determine if the substantial authority standard is satisfied for purposes of the federal taxpayer substantial understatement penalty.⁸

Note also that what constitutes an “authority” for purposes of the analysis can vary. For example, in determining if the realistic possibility of success standard and the reasonable basis standard of paragraph 5 of SSTS No. 1 have been satisfied, a member may rely on well-reasoned treatises, articles in recognized professional tax publications, and other reference tools and sources of analysis commonly used by tax advisers and return preparers. In contrast, these authorities cannot be relied upon in determining if the substantial authority or more likely than not standards have been satisfied for purposes of Internal Revenue Code (IRC) Section 6662 (or 6694).

Appropriate Disclosure

In some instances, a member can satisfy the reporting and disclosure requirements of the applicable taxing authority or of SSTS No. 1 only if the particular tax position at issue is appropriately disclosed. The laws and regulations of the applicable taxing authority should be followed to ensure that pertinent disclosure provisions are satisfied. A member should consider all the facts and circumstances in evaluating whether a position is appropriately disclosed. SSTS No. 1 notes that, in the case of a nonsigning preparer, the adequate disclosure requirement is satisfied if the member advises the taxpayer regarding appropriate disclosure.

For purposes of the federal tax return preparer penalty provisions of IRC Section 6694(a), in general, a signing preparer satisfies the disclosure requirement if one of the following actions is taken:

⁷ Joint Committee on Taxation, *supra* at 152, assigns a 20-percent likelihood of success for the reasonable basis standard.

⁸ Treasury Regulation Section 1.6694-2(b) incorporates this analysis in applying preparer standards for federal income tax purposes.

1. The position is disclosed on Form 8275, "Disclosure Statement," or Form 8275-R, "Regulation Disclosure Statement," as appropriate, or in accordance with the requirements set forth in the annual revenue procedure regarding disclosure.
2. The preparer provides the taxpayer with a return that includes the appropriate disclosure.

Similarly, a nonsigning preparer who provides advice to a taxpayer satisfies the disclosure requirement for IRC Section 6694 purposes by (1) advising the taxpayer of any opportunity to avoid accuracy-related penalties that could apply with respect to the position and of the requirements for any applicable disclosure, and (2) contemporaneously documenting that advice in the files.⁹

⁹ Treasury Regulation Section 1.6694-2(d)(3).

Interpretation No. 1-1, “Reporting and Disclosure Standards,” of Statement on Standards for Tax Services No. 1, *Tax Return Positions*

Background

1. Statement on Standards for Tax Services (SSTS) No. 1, *Tax Return Positions* (AICPA, *Professional Standards*), contains the standards a member should follow when recommending tax return positions or preparing or signing tax returns.

2. A member should determine and comply with the reporting and disclosure standards, if any, that are imposed by the applicable taxing authority with respect to recommending a tax return position or preparing or signing a tax return.

If the applicable taxing authority has no written standards that apply with respect to recommending a tax return position or preparing or signing a tax return or if its standards are lower than the standards set forth in this paragraph, the following standards will apply:

a. A member should not recommend a tax return position or prepare or sign a tax return taking a position unless the member has a good-faith belief that the position has at least a realistic possibility of being sustained administratively or judicially on its merits, if challenged (commonly referred to as the *realistic possibility of success* standard).

b. Notwithstanding paragraph 2(a), a member may *recommend a tax return position* if the member (i) concludes that there is a reasonable basis for the position, and (ii) advises the taxpayer to appropriately disclose that position. Notwithstanding paragraph 2(a), a member may *prepare or sign a tax return* that reflects a position if (i) the member concludes there is a reasonable basis for the position, and (ii) the position is appropriately disclosed.

3. Federal, state, local, and other taxing authorities may impose specific reporting and disclosure standards with respect to recommending tax return positions or preparing or signing tax returns that apply in addition to the AICPA standards. These standards vary among taxing jurisdictions and by type of tax. A member should refer to the current version of Internal Revenue Code (IRC) Section 6694, “Understatement of Taxpayer’s Liability by Tax Return Preparer,” and the regulations thereunder to determine the reporting and disclosure standards applicable to preparers of federal tax returns.

4. When recommending a tax return position, or when preparing or signing a tax return on which a position is taken, a member should, when relevant, advise the taxpayer regarding the potential penalty consequences of the tax return position and the opportunity, if any, to avoid such penalties through disclosure.

5. A member should not recommend a tax return position or prepare or sign a tax return reflecting a position that the member knows exploits the audit selection process of a taxing authority or serves as a mere arguing position advanced solely to obtain leverage in a negotiation with a taxing authority.

6. When recommending a tax return position, a member has both the right and the responsibility to be an advocate for the taxpayer with respect to any position satisfying the aforementioned standards.

7. A member also should consider SSTS No. 3, *Certain Procedural Aspects of Preparing Returns* (AICPA, *Professional Standards*), regarding the obligation to examine or verify certain supporting data or consider information related to another taxpayer, when preparing a taxpayer's tax return.

General Interpretation

8. As described in the preface, the realistic possibility of success standard is a lower standard than the substantial authority standard and the more likely than not standard, but it is a higher standard than the reasonable basis standard. Therefore, if the standard of the applicable taxing authority is, for example, substantial authority, more likely than not, or some other standard that is higher than the realistic possibility of success standard, then the member should comply with that higher standard. In that case, the member is held to a standard higher than realistic possibility of success.

If the standard of the applicable taxing authority is lower than the realistic possibility of success standard, then the member should comply with the realistic possibility of success standard, which is reflected in paragraph 2(a) of this interpretation, or the reasonable basis standard with appropriate disclosure, which is reflected in paragraph 2(b) of this interpretation.

For purposes of this interpretation, the reporting and disclosure standards that apply in a given situation in accordance with SSTS No. 1 and this interpretation will be referred to as the *required reporting and disclosure standards*.

9. A member should determine and comply with the rules of the applicable taxing authority regarding reliance on authorities (cases, rulings, regulations, treatises, and so forth). However, notwithstanding the rules of the applicable taxing authority, in determining whether a tax return position satisfies the realistic possibility of success standard or the reasonable basis standard with appropriate disclosure for purposes of paragraph 2(a)–(b) of this interpretation, a member may rely on authorities in addition to those evaluated when determining whether substantial authority exists for a return position or whether a position is more likely than not to prevail under IRC Section 6662. For purposes of paragraph 2(a)–(b) of this interpretation, a member may rely on well-reasoned treatises, articles in recognized professional tax publications, and other reference tools and sources of tax analyses commonly used by tax advisers and preparers of returns. A member should exercise caution in relying on materials, such as treatises, that may not be accepted as authorities in all situations, such as under federal tax law.

10. If particular facts and circumstances lead a member to believe that a taxpayer penalty could be asserted, then the member should so advise the taxpayer and should discuss with the taxpayer the opportunity, if any, to avoid such penalty by disclosing the position on the tax return. Although a member should so advise the taxpayer with respect to disclosure, it is the taxpayer's responsibility to decide whether and how to disclose.

11. In determining if the required reporting and disclosure standards have been satisfied, a member should do all of the following:

- Establish the relevant background facts.

- Consider the reasonableness of the assumptions and representations.
- Consider applicable regulations and standards regarding reliance on information and advice received from a third party.
- Apply the pertinent authorities to the relevant facts.
- Consider the business purpose and economic substance of the transaction, if relevant to the tax consequences of the transaction. (Mere reliance on a representation that there is a business purpose or economic substance generally is insufficient.)
- Consider whether the issue involves a listed transaction or a reportable transaction (or their equivalents) as defined by the applicable taxing authority.¹
- Arrive at a conclusion supported by the authorities.

12. A member should consider the weight of each authority to determine whether the required reporting and disclosure standards have been satisfied. In determining the weight of an authority, a member should consider its source, relevance, and persuasiveness. Therefore, the type of authority is a significant factor. Other important factors include whether the facts stated by the authority are distinguishable from those of the taxpayer's situation and whether the authority contains an analysis of the issue or merely states a conclusion.

13. A standard may be satisfied despite the absence of certain types of authority. For example, a member may conclude that the substantial authority standard has been satisfied when the position is supported only by a well-reasoned construction of the applicable statutory provision.

14. In determining whether the required reporting and disclosure standards have been satisfied, the extent of research required is left to the professional judgment of the member, given the facts and circumstances known to the member. A member may conclude that more than one position satisfies a given reporting standard, such as the substantial authority standard.

Specific Illustrations

15. The following illustrations address general fact patterns only. Accordingly, the application of guidance, as discussed in the previous section, "General Interpretation," to variations in such general fact patterns or to particular facts or circumstances may lead to different conclusions. In each illustration, no authority exists other than that which is indicated. A decision regarding what are the required reporting and disclosure standards for tax return positions should be consistent with the provisions of SSTS No. 1, as explained in the previous section, "Background."

Determination of the Standards

16. *Illustration 1.* A member is preparing a U.S. income tax return at a time when the federal reporting standard is substantial authority for undisclosed positions and reasonable basis for

¹ See, for example, Treasury Regulation Section 1.6011-4(b).

disclosed positions.² One of the issues the member needs to address in preparing the return is the deductibility of a particular expenditure.

17. Conclusion. The federal standard of substantial authority is higher than the realistic possibility of success standard; therefore, the member is required to comply with the federal standard of substantial authority for undisclosed positions on the return. If the member analyzes the law and applicable authorities regarding whether the expenditure is deductible and concludes that there is not substantial authority to support taking a deduction for the expenditure, the member should not prepare the return taking the deduction as an undisclosed position.

If the member concludes that there is sufficient authority to provide a reasonable basis for claiming the deduction, the member may prepare the return claiming the deduction if that position is appropriately disclosed.

18. Illustration 2. A member is preparing a state inheritance tax return and needs to address the deductibility of a particular expenditure. The state does not have specific tax return reporting standards that apply.

19. Conclusion. Because the applicable taxing authority (the state) does not have written tax return reporting standards that apply, the realistic possibility of success standard for an undisclosed position and the reasonable basis standard for an appropriately disclosed position apply. The member can prepare the return claiming the deduction if either of these is satisfied.

20. Illustration 3. A taxpayer wants to take a position that a member has determined does not satisfy the reasonable basis standard. The taxpayer maintains that even if the taxing authority examines the return, the issue will not be raised.

21. Conclusion. The member should not consider the likelihood of the issue being raised on examination when determining whether any reporting or disclosure standard has been satisfied. The member should not prepare or sign a return that contains a position that does not satisfy the reasonable basis standard, even if the position is disclosed.

22. Illustration 4. A taxpayer wants to take a position on a federal tax return without disclosure; the member concludes that the position satisfies the substantial authority standard provided an assumption regarding an underlying nontax legal issue is appropriate. The member recommends that the taxpayer seek advice from its legal counsel, and the taxpayer's attorney gives an opinion on the nontax legal issue that is consistent with the assumption.

23. Conclusion. A member may, in general, rely on a legal opinion on a nontax legal issue. A member should use professional judgment when relying on a legal opinion. If, on its face, the opinion of the taxpayer's attorney appears to be unreasonable, unsubstantiated, or unwarranted, the member, with appropriate consents from the taxpayer, should consult the member's attorney before relying on the opinion. A member should also refer to the illustrations in Interpretation No. 1-2, "Tax Planning," of SSTS No. 1, regarding the circumstances in which it is appropriate to rely on an opinion of legal counsel.

24. Illustration 5. A taxpayer has obtained from its attorney an opinion on the tax treatment of an item and requests that a member rely on the opinion.

² See the preface for a description of the various reporting standards.

25. *Conclusion.* If a member is satisfied about the source (for example, the knowledge and expertise of the issuer), relevance, and persuasiveness of the legal opinion, then the member may rely on that opinion when determining whether the required reporting and disclosure standards have been satisfied. The member should also refer to the illustrations in Interpretation No. 1-2 of SSTS No. 1 regarding the circumstances in which it is appropriate to rely on an opinion of legal counsel.

Application of the Taxing Authority's Standards

26. As noted previously, SSTS No. 1 requires a member to determine and comply with the required reporting and disclosure standards, if any, that are imposed by the applicable taxing authority with respect to recommending a tax return position or preparing or signing a tax return. These standards, and the methods in which they are to be applied, vary among taxing authorities based on the laws and regulations of the relevant jurisdictions; therefore, illustrating all specific taxing authority standards is beyond the scope of this interpretation. To assist members in their analysis of whether the standards of an applicable taxing authority have been satisfied, the preface contains a description of the most common tax return reporting standards, the nature of the analysis to be applied, and the common requirements for appropriate disclosure.

Application of the Realistic Possibility of Success and the Reasonable Basis Standards

27. If the applicable taxing authority has no written tax return reporting or disclosure standards that apply or if its standards are lower than the realistic possibility of success standard for undisclosed positions or the reasonable basis standard for appropriately disclosed positions, SSTS No. 1 requires a member to comply with these latter standards, as stated in paragraph 2(a)–(b) of this interpretation.

The following illustrations pertain to situations in which a member is required to comply with these standards because the applicable taxing authority either has no written standards that apply or has standards that are lower than those described in paragraph 2(a)–(b) of this interpretation.

28. *Illustration 6.* A taxpayer has engaged in a transaction that is adversely affected by a new statutory provision. Prior law supports a position favorable to the taxpayer. The taxpayer believes, and the member concurs, that the new statute is inequitable as applied to the taxpayer's situation. The statute is constitutional, clearly drafted, and unambiguous. The legislative history discussing the new statute contains general comments that do not specifically address the taxpayer's situation.

29. *Conclusion.* The member cannot recommend the return position that is contrary to the new statute. A position contrary to a constitutional, clear, and unambiguous statute would ordinarily be considered a frivolous position and, even if appropriately disclosed, would not satisfy the reasonable basis standard.

30. *Illustration 7.* The facts are the same as in illustration 6 except that the legislative history discussing the new statute specifically addresses the taxpayer's situation and supports a position favorable to the taxpayer.

31. *Conclusion.* In a case in which the statute is clearly and unambiguously against the taxpayer's position but a contrary position exists based on legislative history specifically

addressing the taxpayer's situation, a return position based either on the statutory language or on the legislative history satisfies the realistic possibility of success standard. (It also may satisfy the substantial authority standard.) A member should, when relevant, advise the taxpayer regarding potential penalty consequences of the tax return position and the opportunity, if any, to avoid such penalties through disclosure.

32. *Illustration 8.* The facts are the same as in illustration 6 except that the legislative history can be interpreted to provide some evidence or authority in support of the taxpayer's position; however, the legislative history does not specifically address the taxpayer's situation.

33. *Conclusion.* In a case in which the statute is clear and unambiguous, a contrary position based on an interpretation of the legislative history that does not explicitly address the taxpayer's situation does not satisfy the realistic possibility of success standard. However, because the legislative history provides some support or evidence for the taxpayer's position, a member may recommend the position to the taxpayer if the member determines that there is a reasonable basis for the position and advises the taxpayer to appropriately disclose the position. Also, a member may prepare a return for the taxpayer taking such a position if the member determines that there is a reasonable basis for the position, and the position is appropriately disclosed. A member should, when relevant, advise the taxpayer regarding potential penalty consequences of the tax return position and the opportunity, if any, to avoid such penalties through disclosure.

34. *Illustration 9.* A taxpayer is faced with an issue involving the interpretation of a new statute. Following its passage, the statute was widely recognized to contain a drafting error, and a technical correction proposal has been introduced. The taxing authority issues a pronouncement indicating how it will administer the provision. The pronouncement interprets the statute in accordance with the proposed technical correction.

35. *Conclusion.* A return position based on either the existing statutory language or the taxing authority's pronouncement satisfies the realistic possibility of success standard. (It also may satisfy the substantial authority standard.) A member should, when relevant, advise the taxpayer regarding potential penalty consequences of the tax return position and the opportunity, if any, to avoid such penalties through disclosure.

36. *Illustration 10.* The facts are the same as in illustration 9 except that no taxing authority pronouncement has been issued.

37. *Conclusion.* In the absence of a taxing authority pronouncement interpreting the statute in accordance with the proposed technical correction, only a return position based on the existing statutory language will satisfy the realistic possibility of success standard. A member may recommend the position to the taxpayer if, based on the facts and circumstances, the member determines that a reasonable basis exists for the position and advises the taxpayer to appropriately disclose the position. Also, a member may prepare a return for the taxpayer taking such a position if, based on the facts and circumstances, the member determines that there is a reasonable basis for the position, and the position is appropriately disclosed. A member should, when relevant, advise the taxpayer regarding potential penalty consequences of the tax return position and the opportunity, if any, to avoid such penalties through disclosure.

38. *Illustration 11.* A taxpayer is seeking advice from a member regarding a recently amended statute. The member has reviewed the statute, the legislative history that specifically addresses the issue, and a recently published notice issued by the taxing authority. No cases,

rulings, or other pronouncements exist regarding the statute. The member has concluded in good faith that, based on the statute and the legislative history, the taxing authority's position as stated in the notice does not reflect legislative intent.

39. *Conclusion.* A return position supported by the statute and the legislative history satisfies the realistic possibility of success standard. (It also may satisfy the substantial authority standard.) A member should, when relevant, advise the taxpayer regarding potential penalty consequences of the tax return position and the opportunity, if any, to avoid such penalties through disclosure.

40. *Illustration 12.* The facts are the same as in illustration 11 except that the taxing authority's pronouncement is a temporary regulation.

41. *Conclusion.* In determining whether a tax return position satisfies the realistic possibility of success standard, a member should determine the weight to be given the temporary regulation by analyzing factors, such as whether the regulation is legislative or interpretative and if it is consistent with the statute. If the member concludes that the position does not satisfy the realistic possibility of success standard, the member may still recommend the position if the member determines that it satisfies the reasonable basis standard, and the member advises the taxpayer to appropriately disclose the position. The member may prepare a return for the taxpayer taking that position if the member determines that the position satisfies the reasonable basis standard, and the position is adequately disclosed. A member should, when relevant, advise the taxpayer regarding potential penalty consequences of the tax return position and the opportunity, if any, to avoid such penalties through disclosure.

42. *Illustration 13.* A statute is passed requiring the capitalization of certain expenditures. The taxpayer believes, and the member concurs, that to comply fully, the taxpayer will have to acquire new computer hardware and software and implement a number of new accounting procedures. The taxpayer and member agree that the costs of full compliance will be significantly greater than the resulting increase in tax due under the new provision. Because of these cost considerations, the taxpayer makes no effort to comply. The taxpayer wants the member to prepare and sign a return on which the new requirement is simply ignored.

43. *Conclusion.* The return position desired by the taxpayer is frivolous, a standard below reasonable basis. The member should not prepare or sign the return.

44. *Illustration 14.* The facts are the same as in illustration 13 except that the taxpayer has made a good-faith effort to comply with the law by calculating an estimate of expenditures to be capitalized under the new provision.

45. *Conclusion.* In this situation, assuming the taxpayer complied with the statutory and regulatory provisions classifying expenditures to be capitalized and those to be expensed and made a good-faith effort to determine the appropriate amounts to be capitalized and expensed, the realistic possibility of success standard would be satisfied for the return positions. (The substantial authority standard also may be satisfied.) When using estimates in the preparation of a return, a member should refer to SSTS No. 4, *Use of Estimates* (AICPA, *Professional Standards*). A member should, when relevant, advise the taxpayer regarding potential penalty consequences of the tax return position and the opportunity, if any, to avoid such penalties through disclosure.

46. *Illustration 15.* On a given issue, a member has located and weighed two authorities concerning the treatment of a particular expenditure. The taxing authority has issued an administrative ruling that requires the expenditure to be capitalized and amortized over several years. On the other hand, a court opinion permits the current deduction of the expenditure. The member has concluded that these are the relevant authorities, considered the source of both authorities, and concluded that both are persuasive and relevant.

47. *Conclusion.* The realistic possibility of success standard is met by either position. (Either or both also may satisfy the substantial authority standard.) A member should, when relevant, advise the taxpayer regarding potential penalty consequences of the tax return position and the opportunity, if any, to avoid such penalties through disclosure.

48. *Illustration 16.* A tax statute is silent on the treatment of an item. However, the legislative history explaining the statute directs the taxing authority to issue regulations that will require a specific treatment of the item. No regulations have been issued at the time the member must recommend a position on the tax treatment of the item.

49. *Conclusion.* The position supported by the legislative history satisfies the realistic possibility of success standard. A member should, when relevant, advise the taxpayer regarding potential penalty consequences of the tax return position and the opportunity, if any, to avoid such penalties through disclosure.

Interpretation No. 1-2, “Tax Planning,” of Statement on Standards for Tax Services No. 1, *Tax Return Positions*

Background

1. Statements on Standards for Tax Services (SSTSs) are enforceable standards that govern the conduct of AICPA members in tax practice. A significant area of many members’ tax practices involves assisting taxpayers in tax planning. Two of the seven SSTSs issued as of the date of this interpretation’s release (that is, the revised SSTSs that became effective on January 1, 2010) directly set forth standards that affect the most common activities in tax planning. Several other SSTSs set forth standards related to specific factual situations that may arise while a member is assisting a taxpayer in tax planning. The two SSTSs that are most typically relevant to tax planning are SSTS No. 1, *Tax Return Positions* (AICPA, *Professional Standards*), including Interpretation No. 1-1, “Reporting and Disclosure Standards,” and SSTS No. 7, *Form and Content of Advice to Taxpayers* (AICPA, *Professional Standards*).

2. Taxing authorities, courts, the AICPA, and other professional organizations have struggled with defining and regulating *tax shelters* and *abusive transactions*. Crucial to the debate is the difficulty of clearly distinguishing between transactions that are abusive and transactions that are aggressive and legitimate. At the same time, it must be recognized that taxpayers have a legitimate interest in arranging their affairs so that they pay no more than the taxes they owe. Tax professionals, including AICPA members, have a role to play in advancing these efforts.

3. This interpretation is part of the AICPA’s continuing efforts at self-regulation of its members in tax practice. It has its origins in the AICPA’s desire to provide adequate guidance to its members with respect to providing services in connection with tax planning. This interpretation does not change or elevate any level of conduct prescribed by any standard. Its goal is to clarify existing standards, recognizing the compelling need for a comprehensive interpretation of a member’s responsibilities in connection with *tax planning*. This guidance is intended to clarify how those standards would apply across the spectrum of tax planning, including those situations involving *tax shelters*, regardless of how that term is defined.

General Interpretation

4. *Tax planning* encompasses a wide variety of situations. It includes situations in which the member provides advice on prospective or completed transactions, whether or not the advice reflects favorable or unfavorable treatment to the taxpayer. When providing professional services that include tax planning, a member should determine and comply with any applicable standards for reporting and disclosing tax return positions or for providing written tax advice. See SSTS No. 1 and Interpretation No. 1-1; SSTS No. 7; U.S. Treasury Department Circular 230, *Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, Enrolled Actuaries, Enrolled Retirement Plan Agents, and Appraisers before the Internal Revenue Service*;¹ and any other standards that may apply. A member may still recommend a position that does not satisfy the realistic possibility standard if (a) a reasonable basis exists for

¹ Title 31, *Money and Finance: Treasury* of U.S. *Code of Federal Regulations*.

the position, (b) the member recommends appropriate disclosure, and (c) a higher standard is not required under applicable taxing authority rules. For purposes of this interpretation, the reporting and disclosure standards that apply in a given situation in accordance with SSTS No. 1 and Interpretation No. 1-1 will be referred to as the “required reporting and disclosure standards.”

5. For purposes of this interpretation, *tax planning* includes, both with respect to prospective and completed transactions, recommending or expressing an opinion (whether written or oral) on (a) a tax return position or (b) a specific tax plan developed by the member, the taxpayer, or a third party. For tax planning with respect to a completed transaction, the member may be considered a nonsigning tax return preparer with respect to the items for which the tax planning is undertaken that subsequently are reflected on the taxpayer’s tax return. The member should comply with tax return preparer standards promulgated by the applicable taxing authority.

6. When issuing an opinion to reflect the results of the tax planning service, a member should do all of the following:

- Establish the relevant background facts.
- Consider the reasonableness of the assumptions and representations.
- Consider applicable regulations and standards regarding reliance on information and advice received from a third party.
- Apply the pertinent authorities to the relevant facts.
- Consider the business purpose and economic substance of the transaction, if relevant to the tax consequences of the transaction. (Mere reliance on a representation that there is a business purpose or economic substance generally is insufficient.)
- Consider whether the issue involves a *listed transaction* or a *reportable transaction* (or their equivalents) as defined by the applicable taxing authority.²
- Consider other regulations and standards applicable to written tax advice promulgated by the applicable taxing authority.
- Arrive at a conclusion supported by the authorities.

The member also should consider SSTS No. 1, SSTS No. 7, Treasury Department Circular 230, and any other standards that may apply.

7. In assisting a taxpayer in a tax planning transaction in which the taxpayer has obtained an opinion from a third party and is looking to the member for an evaluation of the opinion, the member should be satisfied about the source (for example, the knowledge and expertise of the issuer), relevance, and persuasiveness of the opinion, which would include considering whether the opinion indicates the third party did all of the following:

- Established the relevant background facts.
- Considered the reasonableness of the assumptions and representations.
- Considered applicable regulations and standards.

² See, for example, Treasury Regulation Section 1.6011-4(b).

- Applied the pertinent authorities to the relevant facts.
- Considered the business purpose and economic substance of the transaction, if relevant to the tax consequences of the transaction. (Mere reliance on a representation that a business purpose or economic substance exists generally is insufficient.)
- Considered whether the issue involves a listed transaction or a reportable transaction (or their equivalents) as defined by the applicable taxing authority.³
- Arrived at a conclusion supported by the authorities.

8. In conducting the due diligence necessary to establish the relevant background facts, the member should consider whether it is appropriate to rely on an assumption concerning facts in lieu of either (a) other procedures to support the advice, or (b) a representation from the taxpayer or another person. A member should also consider whether the member's tax advice might be communicated to third parties, particularly if those third parties may not be knowledgeable or may not be receiving independent tax advice with respect to a transaction.

9. In tax planning, members often rely on assumptions and representations. Although such reliance is often necessary, the member should take care to assess whether such assumptions and representations are reasonable. In deciding whether an assumption or representation is reasonable, the member should consider its source (for example, the knowledge and expertise of the issuer), and consistency with other information known to the member. For example, depending on the circumstances, it may be reasonable for a member to rely on a representation made by the taxpayer but not on a representation made by a person who is selling, or otherwise promoting, the transaction to the taxpayer.

10. When engaged in tax planning, the member should understand the business purpose and economic substance of the transaction when relevant to the tax consequences. If a transaction has been proposed by a party other than the taxpayer, the member should consider whether the assumptions made by the third party are consistent with the facts of the taxpayer's situation. If written advice is to be rendered concerning a transaction, the business purpose for the transaction generally should be described. If the business reasons are relevant to the tax consequences, it is not sufficient to assume merely that a transaction is entered into for valid business reasons without specifying what those reasons are. Similarly, if economic substance is relevant to the tax consequences, it is insufficient to assume merely that a transaction has economic substance without specifying the basis for making that determination. In providing written advice on these issues, the member should consider the written advice regulations and standards, if any, promulgated by the applicable taxing authority. The member also should consider SSTS No. 1, SSTS No. 7, Treasury Department Circular 230, and any other standards that may apply.

11. The scope of the engagement should be appropriately determined, and the member should consider the necessity for an engagement letter. The member should be diligent in applying such procedures as are appropriate under the circumstances to understand and evaluate the entire transaction. The specific procedures to be performed in this regard will vary with the circumstances and the scope of the engagement.

³ See footnote 2.

Specific Illustrations

12. The following illustrations address general fact patterns. Accordingly, the application of the guidance that is discussed in the previous section, “General Interpretation,” to variations in such general fact patterns or to particular facts or circumstances, may lead to different conclusions. In each illustration, no authority exists other than that which is indicated.

13. *Illustration 1.* The relevant tax code imposes penalties on taxpayers for substantial underpayments that are not associated with *tax shelters* as defined in such code, unless the positions resulting in the underpayments are supported by substantial authority.

14. *Conclusion.* In assisting the taxpayer in tax planning in which any associated underpayment would be considered substantial, the member should inform the taxpayer of the penalty risks associated with the tax return position recommended with respect to any plan under consideration if that position does not satisfy the substantial authority standard. The member also should inform the taxpayer of the opportunities, if any, to avoid such penalties through appropriate disclosure. In such a situation, applicable standards may prohibit the member from preparing the tax return without appropriate disclosure.

15. *Illustration 2.* The relevant tax code imposes penalties on taxpayers for underpayments attributable to *tax shelters* as defined in such code unless the taxpayer concludes that a position taken on a tax return associated with such a tax shelter is more likely than not the correct position.

16. *Conclusion.* In assisting the taxpayer in tax planning, the member should inform the taxpayer of the penalty risks associated with the tax return position recommended with respect to any plan under consideration if that position satisfies the substantial authority standard but does not satisfy the more likely than not standard. This would also include advice regarding whether penalties can be avoided through disclosure by the taxpayer.⁴ In such a situation, applicable standards may prohibit the member from preparing the tax return without appropriate disclosure.

17. *Illustration 3.* The relevant tax code imposes penalties on tax return preparers advising on return positions attributable to potentially abusive arrangements that are designated as listed transactions or reportable transactions with a significant purpose of avoidance or evasion of income tax, if there is a related understatement of income tax. The penalty does not apply if the preparer concludes that the position is more likely than not the correct position. The member advising the taxpayer in planning a transaction is later retained to prepare and sign the taxpayer’s income tax return for the period that includes the taxpayer’s participation in the transaction.

18. *Conclusion.* A member engaged to prepare a return reflecting a transaction that the member assisted in planning should reevaluate the need to satisfy the more likely than not standard to avoid penalties (including potential sanction or discipline) as a preparer and whether potential penalties may be avoided through appropriate disclosure. The member also should consider whether a separate disclosure is required to avoid penalties under other statutory provisions (in addition to penalties applicable to understatement of tax). The member should

⁴ The Internal Revenue Code Section 6662 substantial understatement penalty cannot be avoided by disclosure in the context of a tax shelter.

inform the taxpayer of the taxpayer's penalty risks, as described in illustrations 1 and 2 of this interpretation. The member also should consider SSTS No. 1 and Interpretation No. 1-1.

19. *Illustration 4.* The relevant tax regulation provides that the details of (or certain information regarding) a specific transaction are required to be attached to the tax return, regardless of the level of authority supporting the associated tax return position (for example, even if there is substantial authority or a higher level of confidence for the position). While preparing the taxpayer's return for the year, the member is aware that an attachment is required.

20. *Conclusion.* In general, if the taxpayer agrees to include the attachment required by the regulation, the member may sign the return if the member concludes the associated tax return position satisfies the required reporting and disclosure standards. However, if the taxpayer refuses to include the attachment, the member should not sign the return unless the member concludes the associated tax return position satisfies the required reporting and disclosure standards, and reasonable grounds exist for the taxpayer's position with respect to the attachment. In this regard, the member should consider SSTS No. 2, *Answers to Questions on Returns* (AICPA, *Professional Standards*), which provides that the term *questions*, as used in the standard, "includes requests for information on the return, in the instructions, or in the regulations, whether or not stated in the form of a question," and that a "member should not omit an answer merely because it might prove disadvantageous to a taxpayer." The member also should consider SSTS No. 1 and Interpretation No. 1-1.

21. *Illustration 5.* The relevant tax regulations provide that the details of certain potentially abusive transactions that are designated as listed transactions are required to be disclosed in attachments to tax returns (enhanced disclosure), regardless of the support for the associated tax return position (for example, even if the applicable taxing authority's standard is satisfied). Under the regulations, if the enhanced disclosure requirements for a listed transaction are not satisfied, the taxpayer will have additional penalty risks, including the possibility of a nonrescindable penalty. While researching the tax consequences of a proposed transaction, a member concludes that the transaction is a listed transaction.

22. *Conclusion.* Notwithstanding the member's conclusion that the transaction is a listed transaction, the member may still recommend a tax return position with respect to the transaction if he or she concludes that the position satisfies the required reporting and disclosure standards (other than the enhanced disclosure). However, the member should inform the taxpayer of the enhanced disclosure requirements of listed transactions and the additional penalty risks for noncompliance, including the potential for enhanced or nonrescindable penalties or both.

23. *Illustration 6.* The same regulations apply as in illustration 5. The member first becomes aware that a taxpayer entered into a transaction while preparing the taxpayer's return for the year of the transaction. While researching the tax consequences of the transaction, the member concludes that the taxpayer's transaction is a listed transaction.

24. *Conclusion.* The member should inform the taxpayer of the enhanced disclosure requirements and the additional penalty risks for noncompliance. If the taxpayer agrees to make the enhanced disclosure required by the regulation, the member may sign the return if the member concludes the associated tax return position also satisfies the required reporting and disclosure standards. The member should not sign the return if the enhanced disclosure requirements are not satisfied. If the member is a nonsigning preparer of the return, the member

should recommend that the taxpayer comply with the enhanced disclosure requirements regarding the transaction.

25. *Illustration 7.* The same regulations apply as in illustration 5. The member first becomes aware that a taxpayer entered into a transaction while preparing the taxpayer's return for the year of the transaction. While researching the tax consequences of the transaction, the member concludes that there is uncertainty about whether the taxpayer's transaction is a listed transaction.

26. *Conclusion.* The member should inform the taxpayer of the enhanced disclosure requirements and the additional penalty risks for noncompliance. If the taxpayer agrees to make the enhanced disclosure required by the relevant regulations, the member may sign the return if the member concludes the associated tax return position also satisfies the required reporting and disclosure standards. If the taxpayer does not want to provide the enhanced disclosure of the transaction because of the uncertainty about whether it is a listed transaction, the member may sign the return if the member concludes the associated tax return position satisfies the required reporting and disclosure standards (other than the enhanced disclosure requirements), and reasonable grounds exist for the taxpayer's position with regard to not providing enhanced disclosure of the transaction. In this regard, the member should consider SSTS No. 2, which indicates that the degree of uncertainty regarding the meaning of a question on a return may affect whether reasonable grounds exist for not responding to the question.

27. *Illustration 8.* A member advises a taxpayer concerning the tax consequences of a proposed transaction involving a loan from a U.S. bank. In the process of reviewing documents associated with the proposed transaction, the member uncovers a reference to a deposit the taxpayer will make with an overseas branch of the U.S. bank. The transaction documents appear to indicate that this deposit is linked to the U.S. bank's issuance of the loan.

28. *Conclusion.* The member should consider the effect, if any, of the deposit in advising the taxpayer about the tax consequences of the proposed transaction and with respect to other tax compliance matters reasonably likely to be at issue (for example, foreign bank account reporting).

29. *Illustration 9.* Under the relevant tax law, the tax consequences of a leasing transaction depend on whether the property to be leased is reasonably expected to have a residual value of 15 percent of its value at the beginning of the lease. The member has relied on a taxpayer's instruction to use a particular assumption concerning the residual value.

30. *Conclusion.* Such reliance on the taxpayer's instructions may be appropriate if the assumption is supported by the expertise of the taxpayer, by the member's review of information provided by the taxpayer or a third party, or through the member's own knowledge or analysis.

31. *Illustration 10.* A member is assisting a taxpayer with evaluating a proposed equipment leasing transaction in which the estimated residual value of the equipment at the end of the lease term is critical to the tax consequences of the lease. The broker arranging the leasing transaction has prepared an analysis that sets out an explicit assumption concerning the equipment's estimated residual value.

32. *Conclusion.* The member should consider whether it is appropriate to rely on the broker's assumption concerning the estimated residual value of the equipment instead of obtaining a representation from the broker concerning estimated residual value or performing other

procedures to validate the amount to be used as an estimate of residual value in connection with the member's advice. In evaluating the appropriateness of the broker's assumption, the member should consider, for example, factors such as the broker's experience in the area, the broker's methodology, and whether alternative sources of information are reasonably available.

33. *Illustration 11.* The tax consequences of a particular reorganization depend, in part, on the majority shareholder of a corporation not disposing of stock received in the reorganization in a manner that would prevent the transaction from qualifying as a reorganization.

34. *Conclusion.* The member should consider whether it is appropriate in rendering tax advice to assume that such a disposition will not occur or whether, under the circumstances, it is appropriate to request written representations regarding the intent of the shareholder and any other parties to the reorganization concerning this requirement, as a condition to issuing an opinion on the reorganization.

35. *Illustration 12.* A taxpayer is considering a proposed transaction. The taxpayer and the taxpayer's attorney advise the member that the member is responsible for advising the taxpayer on the tax consequences of the transaction.

36. *Conclusion.* In addition to complying with the requirements of paragraph 6 of this interpretation, the member generally should review all relevant draft transaction documents in formulating the member's tax advice relating to the transaction.

37. *Illustration 13.* A member is responsible for advising a taxpayer on the tax consequences of the taxpayer's estate plan.

38. *Conclusion.* Under the circumstances, the member should review the will and all other relevant documents to assess whether there appear to be any tax issues raised by the formulation or implementation of the estate plan.

39. *Illustration 14.* A member is assisting a taxpayer in connection with a proposed transaction that has been recommended by an investment bank. To support its recommendation, the investment bank offers a law firm's opinion on the tax consequences. The member reads the opinion and notes that it is based on a hypothetical statement of facts rather than the taxpayer's facts.

40. *Conclusion.* The member may rely on the law firm's opinion when determining whether the required reporting and disclosure standards have been satisfied with respect to the tax consequences of the hypothetical transaction if the member is satisfied about the source (for example, the knowledge and expertise of the issuer), relevance, and persuasiveness of the opinion. However, the member should be diligent in taking such steps as are appropriate under the circumstances to understand and evaluate the transaction as it applies to the taxpayer's specific situation. See paragraph 7 of this interpretation.

41. *Illustration 15.* A member is assisting a taxpayer in connection with a proposed transaction that has been recommended by an investment bank. To support that recommendation, the investment bank offers a law firm's opinion about the tax consequences. The member reads the opinion and notes that unlike the opinion described in illustration 14, it is carefully tailored to the taxpayer's facts.

42. *Conclusion.* The member may rely on the opinion when determining whether the required reporting and disclosure standards have been satisfied with respect to the taxpayer's participation

in the transaction if the member is satisfied about the source (for example, the knowledge and expertise of the issuer), relevance, and persuasiveness of the opinion. In making that determination, the member should consider whether the opinion indicates the law firm performed the steps listed in paragraph 7 of this interpretation.

43. *Illustration 16.* A member is assisting a taxpayer with year-end planning in connection with the taxpayer's proposed contribution of stock in a closely held corporation to a charitable organization. The taxpayer instructs the member to calculate the anticipated tax savings assuming a contribution of 500 shares to a tax-exempt organization and assuming the stock has a fair market value of \$100 per share. The member is aware that on the taxpayer's gift tax returns for the prior year, the taxpayer reported that her stock in the corporation, gifted to her daughter, was worth \$50 per share.

44. *Conclusion.* The member's calculation of the anticipated tax savings is subject to the general interpretations described in paragraphs 8 and 9 of this interpretation. Accordingly, even though this potentially may be a case in which the value of the stock substantially appreciated during the year, the member should consider the reasonableness of the assumption and consistency with other information known to the member in connection with preparing the projection. The member should consider whether to document discussions concerning the increase in value of the stock with the taxpayer. The member also should consider the applicability of the Statements on Standards for Valuation Services (AICPA, *Professional Standards*).

45. *Illustration 17.* The tax consequences to Target Corporation's shareholders of an acquisition turn, in part, on Acquiring Corporation's continuance of the trade or business of Target Corporation for some time after the acquisition. The member is preparing a tax opinion addressed to Target's shareholders. The opinion is based on a written representation from Acquiring Corporation that Acquiring Corporation will continue Target's business for two years following the acquisition.

46. *Conclusion.* In conducting the due diligence necessary to establish the relevant background facts, the member should consider the reasonableness of the representation before determining that it is appropriate to rely on the representation from Acquiring Corporation.

47. *Illustration 18.* The member receives a telephone call from a taxpayer who is the sole shareholder of a corporation. The taxpayer indicates that he is thinking about exchanging his stock in the corporation for stock in a publicly traded business. During the call, the member explains how the transaction could be structured so it will qualify as a tax-free acquisition.

48. *Conclusion.* Although oral advice may serve a taxpayer's needs appropriately in routine matters or in well-defined areas, written communications are recommended in important, unusual, substantial dollar-value, or complicated transactions. The member should use professional judgment about the need to document oral advice. (See SSTS No. 7.)

49. *Illustration 19.* The member receives a telephone call from a taxpayer who wants to know whether he or she should lease or purchase a car. During the call, the member explains how the arrangement should be structured so that it helps achieve the taxpayer's objectives.

50. *Conclusion.* In this situation, the member's response is in conformity with this interpretation in view of the routine nature of the inquiry and the well-defined tax issues.

However, the member should evaluate whether other considerations, such as avoiding misunderstanding with the taxpayer, suggest that the conversation should be documented.