

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).