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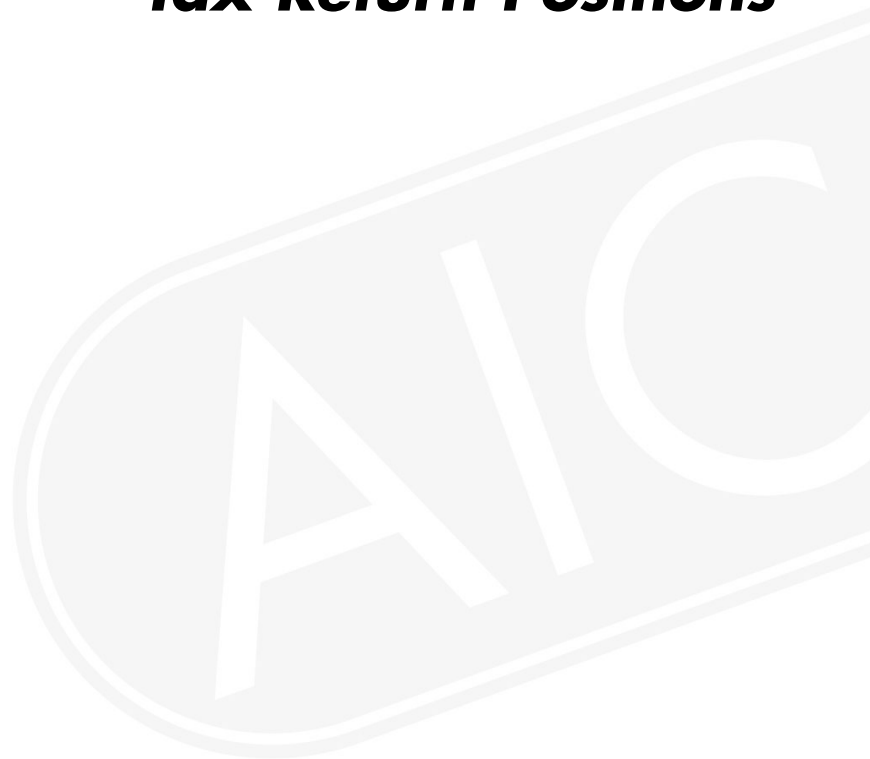
# Statement on Standards for Tax Services

Issued by the Tax Executive Committee

AICPA

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

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



## Notice to Readers

The Statements on Standards for Tax Services (SSTs) and Interpretations, promulgated by the Tax Executive Committee, reflect the AICPA's standards of tax practice and delineate members' responsibilities to taxpayers, the public, the government, and the profession. The Statements are intended to be part of an ongoing process that may require changes to and Interpretations of current SSTs in recognition of the accelerating rate of change in tax laws and the continued importance of tax practice to members. Interpretation No. 1-2 was approved by the Tax Executive Committee on August 21, 2003; its effective date is December 31, 2003.

The SSTs 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 meet a broad range of personal and professional situations. The SSTs recognize this need by, in some sections, providing relatively subjective rules and by leaving certain terms undefined. These terms and concepts are generally rooted in tax concepts, and therefore should be readily understood by tax practitioners. It is, therefore, recognized that the enforcement of these rules, as part of the AICPA's Code of Professional Conduct Rule 201, *General Standards*, and Rule 202, *Compliance With Standards*, will be undertaken with flexibility in mind and handled on a case-by-case basis. Members are expected to comply with them.

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# Contents

Background .....	5
General Interpretation.....	6
Specific Illustrations.....	7





## Background

1. Statements on Standards for Tax Services (SSTSs) are enforceable standards that govern the conduct of members of the AICPA in tax practice. A significant area of many members' tax practices involves assisting taxpayers in tax planning. Two of the eight SSTSs issued as of the date of this Interpretation's release 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*, vol. 2, TS sec. 100), including Interpretation No. 1-1, "Realistic Possibility Standard" (AICPA, *Professional Standards*, vol. 2, TS sec. 9100), and SSTS No. 8, *Form and Content of Advice to Taxpayers* (AICPA, *Professional Standards*, vol. 2, TS sec. 800).

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 legitimate. At the same time, it must be recognized that taxpayers have a legitimate interest in arranging their affairs so as to pay no more than the taxes they owe. It must be recognized that tax professionals, including 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 when providing services in connection with tax planning. The Interpretation does not change or elevate any level of conduct prescribed by any standard. Its goal is to clarify existing standards. It was determined that there was a compelling need for a comprehensive Interpretation of a member's responsibilities in connection with *tax planning*, with the recognition that such guidance would 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. The realistic possibility standard (see SSTS No. 1, TS sec. 100.02(a), and Interpretation No. 1-1) applies to a member when providing professional services that involve *tax planning*. A member may still recommend a nonfrivolous position provided that the member recommends appropriate disclosure (see SSTS No. 1, TS sec. 100.02(c)).

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.

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.
- 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.
- Arrive at a conclusion supported by the authorities.

7. In assisting a taxpayer in a tax planning transaction in which the taxpayer has obtained an opinion from a third party, and the taxpayer is looking to the member for an evaluation of the opinion, the member should be satisfied as to the source, 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
- 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
- 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 other procedures to support the advice or a representation from the taxpayer or another person. A member should also consider whether the member's tax advice will 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 must 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 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 insufficient to merely assume that a transaction is entered into for valid business reasons without specifying what those reasons are.

11. The scope of the engagement should be appropriately determined. A 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.

## **Specific Illustrations**

12. The following illustrations address general fact patterns. Accordingly, the application of the guidance discussed in the "General Interpretation" section to variations in such general facts or

to particular facts or circumstances may lead to different conclusions. In each illustration, there is no authority other than that indicated.

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

14. *Conclusion.* In assisting the taxpayer in tax planning in which any associated underpayment would be 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 that satisfies the realistic possibility of success standard, but does not possess sufficient authority to satisfy the substantial authority standard.

15. *Illustration 2.* The relevant tax code imposes penalties on 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 that satisfies the realistic possibility of success standard, but does not possess sufficient authority to satisfy the more likely than not standard.

17. *Illustration 3.* 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 support for the associated tax return position (for example, even if there is substantial authority or a higher level of comfort for the position). While preparing the taxpayer's return for the year, the member is aware that an attachment is required.

18. *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 realistic possibility standard. 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 realistic possibility standard and there are reasonable grounds 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*, vol. 2, TS sec. 200.01 and .05), 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."

19. *Illustration 4.* 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, regardless of the support for the associated tax return position (for example, even if there is substantial authority or a higher level of support for the position). Under the regulations, if a listed transaction is not disclosed as required, the taxpayer will have additional penalty risks. While researching the tax consequences of a proposed transaction, a member concludes that the transaction is a listed transaction.

20. *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 proposed tax return position satisfies the realistic possibility standard. However, the member should inform the taxpayer of the enhanced disclosure requirements of listed transactions and the additional penalty risks for nondisclosure.

21. *Illustration 5.* The same regulations apply as in Illustration 4. 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.

22. *Conclusion.* The member should inform the taxpayer of the enhanced disclosure requirement and the additional penalty risks for nondisclosure. If the taxpayer agrees to make the disclosure required by the regulation, the member may sign the return if the member concludes the associated tax return position satisfies the realistic possibility standard. Reasonable grounds for nondisclosure (see the conclusion to Illustration 3) generally are not present for a listed transaction. The member should not sign the return if the transaction is not disclosed. If the member is a nonsigning preparer of the return, the member should recommend that the taxpayer disclose the transaction.

23. *Illustration 6.* The same regulations apply as in Illustration 4. 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.

24. *Conclusion.* The member should inform the taxpayer of the enhanced disclosure requirement and the additional penalty risks for nondisclosure. If the taxpayer agrees to make the disclosure required by the relevant regulation, the member may sign the return if the member concludes the associated tax return position satisfies the realistic possibility standard. If the taxpayer does not want to disclose 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 realistic possibility standard and there are reasonable grounds for the taxpayer's position with regard to nondisclosure. In this regard, the member should consider SSTS No. 2, TS sec. 200.04, which indicates that the degree of uncertainty regarding the meaning of a question on a return may affect whether there are reasonable grounds for not responding to the question.

25. *Illustration 7.* A member advises a taxpayer concerning the tax consequences of a 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 that a wholly owned foreign subsidiary of 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.

26. *Conclusion.* The member should consider the effect, if any, of the deposit in advising the taxpayer about the tax consequences of the proposed transaction.

27. *Illustration 8.* 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.

28. *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.

29. *Illustration 9.* 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.

30. *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 considering 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.

31. *Illustration 10.* The tax consequences of a particular reorganization depend, in part, on the majority shareholder of a corporation not disposing of any stock received in the reorganization pursuant to a prearranged agreement to dispose of the stock.

32. *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 a written representation of the shareholder's intent concerning disposition as a condition to issuing an opinion on the reorganization.

33. *Illustration 11.* 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.

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

35. *Illustration 12.* A member is responsible for advising a taxpayer on the tax consequences of the taxpayer's estate plan.

36. *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.

37. *Illustration 13.* 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.

38. *Conclusion.* The member may rely on the law firm's opinion when determining whether the realistic possibility standard has been satisfied with respect to the tax consequences of the hypothetical transaction if the member is satisfied about the source, 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 by:

- Establishing the relevant background facts
- Considering the reasonableness of the assumptions and representations
- Applying the pertinent authorities to the relevant facts
- Considering 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 business purpose or economic substance is generally insufficient.)
- Arriving at a conclusion supported by the authorities

39. *Illustration 14.* The facts are the same as in Illustration 13 except the member also notes that the law firm that prepared the opinion is one that has a reputation as being knowledgeable about the tax issues associated with the proposed transaction.

40. *Conclusion.* The conclusion is the same as the conclusion to Illustration 13, notwithstanding the expertise of the law firm.

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 opinions described in Illustrations 13 and 14), it is carefully tailored to the taxpayer's facts.

42. *Conclusion.* The member may rely on the opinion when determining whether the realistic possibility standard has been met with respect to the taxpayer's participation in the transaction if the member is satisfied about the source, relevance, and persuasiveness of the opinion. In making that determination, the member should consider whether the opinion indicates the law firm did all of the following:

- Established the relevant background facts
- Considered the reasonableness of the assumptions and representations
- 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 there is business purpose or economic substance is generally insufficient.)
- Arrived at a conclusion supported by the authorities

43. *Illustration 16.* The facts are the same as in Illustration 15, except the member also notes that the law firm that prepared the opinion is one that has a reputation of being knowledgeable about the tax issues associated with the proposed transaction.

44. *Conclusion.* The conclusion is the same as the conclusion to Illustration 15, notwithstanding the expertise of the law firm.

45. *Illustration 17.* 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 liability assuming a contribution of 10,000 shares to a tax-exempt organization 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 indicated that her stock in the corporation was worth \$50 per share.

46. *Conclusion.* The member's calculation of the anticipated tax liability is subject to the general interpretations described in paragraphs 8 and 9. 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.

47. *Illustration 18.* 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. A colleague has drafted a tax opinion for the member's review. That opinion makes an explicit assumption that Acquiring will continue Target's business for two years following the acquisition.

48. *Conclusion.* 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 a representation from another person. In this case, the member should make reasonable efforts to obtain a representation from Acquiring Corporation concerning its plan to continue Target's business and further consider whether to request a written representation to that effect.

49. *Illustration 19.* 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 should be structured so it will qualify as a tax-free acquisition.

50. *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, or complicated transactions. The member should use professional judgment about the need to document oral advice.

51. *Illustration 20.* 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 as to help achieve the taxpayer's objectives.

52. *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.

*This Interpretation was adopted by the assenting votes of the eighteen voting members of the nineteen-member Tax Executive Committee.*

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