

# 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 (SSTs) 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 SSTs issued as of the date of this interpretation's release (that is, the revised SSTs that became effective on Jan. 1, 2010) directly set forth standards that affect the most common activities in tax planning.

Several other SSTs set forth standards related to specific factual situations that may arise while a member is assisting a taxpayer in tax planning. The two SSTs 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 Practice before the Internal Revenue Service*<sup>13</sup>; 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 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 non-signing 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.<sup>14</sup>
  - 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.

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<sup>13</sup> Title 31, *Money and Finance: Treasury of U.S. Code of Federal Regulations*.

<sup>14</sup> See, for example, Treasury Regulation Section 1.6011-4(b).

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.
  - 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.<sup>15</sup>
  - 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.

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<sup>15</sup> See footnote 14.

## 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.<sup>16</sup> 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 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.

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<sup>16</sup> The Internal Revenue Code Section 6662 substantial understatement penalty cannot be avoided by disclosure in the context of a tax shelter.

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 non-rescindable 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 non-rescindable 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 non-signing 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.