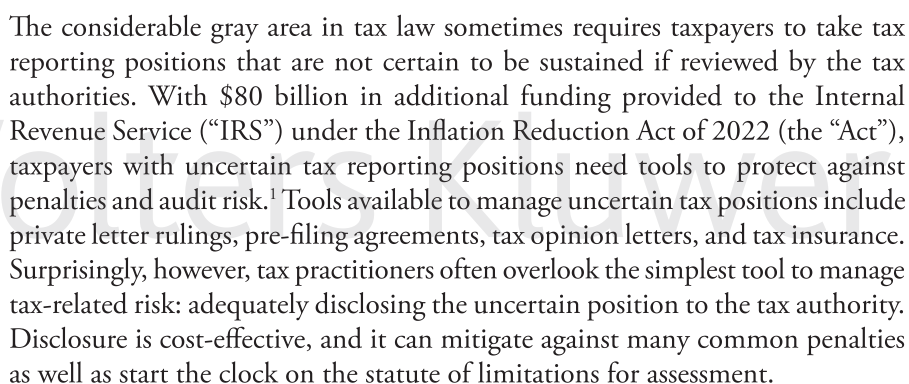
Using Disclosure Statements to Proactively Manage Tax Controversies

By Lawrence A. Sannicandro

I. Introduction



The considerable gray area in tax law sometimes requires taxpayers to take tax reporting positions that are not certain to be sustained if reviewed by the tax authorities. With $80 billion in additional funding provided to the Internal Revenue Service ("IRS") under the Inflation Reduction Act of 2022 (the "Act"), taxpayers with uncertain tax reporting positions need tools to protect against penalties and audit risk.[1] Tools available to manage uncertain tax positions include private letter rulings, pre-filing agreements, tax opinion letters, and tax insurance. Surprisingly, however, tax practitioners often overlook the simplest tool to manage tax-related risk: adequately disclosing the uncertain position to the tax authority. Disclosure is cost-effective, and it can mitigate against many common penalties as well as start the clock on the statute of limitations for assessment.

This article focuses on the use of disclosure statements in modern tax practice. It discusses the following: ethical and professional duties tax professionals owe to clients and the IRS concerning mandatory and elective tax disclosures; circumstances in which disclosure of an item or a tax reporting position is required by the federal internal revenue laws; situations in which disclosure of an uncertain tax reporting position, while not mandated by the internal revenue laws, is still advisable to manage penalties or statutes of limitation; and the reasons a well-crafted tax disclosure is sometimes preferred to a private letter ruling, a pre-filing agreement, a tax opinion letter, or tax insurance.

II. Ethical and Professional Duties Concerning Tax Disclosures

A. Tax Return Preparers

1. Generally

Irrespective of whether disclosures are required or elective, tax professionals are subject to ethical and professional rules that dictate their obligations to clients and

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the IRS concerning these disclosures. Tax returns involving an item or a position to be disclosed on the tax return are typically prepared by one or more signing or nonsigning tax return preparers who are subject to the requirements of title 31 of the Code of Federal Regulations ("Circular 230"). The class of persons subject to Circular 230 is broad, including the following:

- A signing tax return preparer, which is the individual tax return preparer who has the primary responsibility for the overall substantive accuracy of the preparation of the tax return or claim for refund; and
- A nonsigning tax return preparer, which generally includes any tax return preparer who is not a signing tax return preparer but who prepares all or a substantial portion of a tax return or claim for refund by, for example, rendering oral or written tax advice to a taxpayer or another tax return preparer on a position that is directly relevant to the determination of the existence, characterization, or amount of any entry on a tax return or claim for refund.[2]

Tax professionals may be surprised to find that they are nonsigning tax return preparers, even if they advised on a single, but significant, aspect of a tax return or claim for refund. To be sure, Treasury Regulations provide numerous examples of signing and nonsigning tax return preparers under the Code. Among the persons specified as nonsigning tax return preparers are individuals who provide written or oral advice to a taxpayer (or to another tax return preparer) when that advice leads to a position or entry that constitutes a substantial portion of the tax return or claim for refund.[3] Furthermore, a person who furnishes to a taxpayer or other tax return preparer sufficient information and advice so completion of the return or claim for refund is largely a mechanical or clerical matter is considered a tax return preparer, even though that person does not actually place or review placement of information on the return.[4] Under these authorities, a nonsigning tax return preparer (and therefore a tax return preparer under the Code) specifically includes a lawyer who renders advice directly relevant to the determination of an entry on a taxpayer's tax return.[5]

It is against this background that a tax professional who advises a taxpayer on a position making up a portion of a tax return can unwittingly be subject to the requirements of Circular 230, including numerous affirmative obligations concerning tax disclosure statements.

2. De Minimis Exception

Treasury Regulations provide a *de minimis* exception that prevents a nonsigning tax return preparer's work from being a substantial portion of the return if the amounts of gross income, amounts of deductions, or amounts on the basis of which credits are determined are (1) less than $10,000, or (2) less than $400,000, if the items are also less than 20% of the taxpayer's gross income.[6] In applying the *de minimis* rule, all schedules, entries, and other items on the tax return or claim for refund are aggregated.[7]

B. Ethical and Professional Obligations Concerning Mandatory Disclosures

Practitioners subject to Circular 230 have clearly defined duties to their clients regarding the disclosures of certain tax items and tax reporting positions. These duties vary by reference to whether the disclosure "must" be made under the internal revenue laws or "may" be made to mitigate penalty exposure. As to disclosures that are required to be made under the internal revenue laws, by way of background, Circular 230 prohibits any practitioner from advising a client to take a position on a tax return, or preparing all or a portion of a tax return, containing a position that lacks a reasonable basis, is unreasonable, or is an intentional disregard of rules or regulations.[8] Thus, if a regulation requires a taxpayer to file a disclosure statement, then the practitioner *must* advise a client to make the required disclosure because to counsel otherwise would cause a taxpayer to take a position that is an intentional disregard of rules or regulations and lacks a reasonable basis.

C. Ethical and Professional Obligations Concerning Elective Disclosures

As to elective disclosures that may be made regarding an item or a tax reporting position, Circular 230 requires a practitioner to inform a client of penalties that are reasonably likely to apply with respect to a position taken on a tax return if the practitioner either advised the client with respect to the position or prepared or signed the tax return.[9] Furthermore, and quite significantly, Circular 230 requires practitioners to inform a client of any opportunity to use a tax disclosure to avoid penalties that are reasonably likely to apply and of the requirements to adequately disclose the item or tax reporting position to avoid penalties.[10] Thus, even if a tax disclosure is not specifically required under the internal revenue laws, but may instead mitigate against the imposition of accuracy-related penalties, a practitioner *must* advise a client of the ability to disclose, the mechanics of adequately disclosing that position, and the consequences of disclosing (or failing to disclose) an item or a tax reporting position.[11] This duty extends to both signing and nonsigning tax return preparers.

D. Many Practitioners Are Not Advising Clients of the Benefits of Tax Disclosures

Anecdotally, many practitioners have historically not advised clients of the requirement to disclose certain tax reporting positions to the IRS or of the benefits of proactively making elective disclosures. Consequently, even sophisticated clients are sometimes unaware of disclosure requirements or benefits. As clients increasingly seek advice about how to obtain penalty protection with respect to current reporting positions, and in order for practitioners to satisfy the minimum standards of competence under Circular 230 and other professional rules, practitioners must advise clients on the availability, procedures, and benefits and drawbacks of tax disclosures.

III. Disclosure

A. Adequate Disclosure Generally

The IRS, through publication of a periodic revenue procedure, prescribes the circumstances under which the reporting of information with respect to certain enumerated items or tax reporting positions on a tax return or a qualified amended return is, without more, adequate disclosure of the item or position.[12] If the then-operative revenue procedure does not identify a particular item or tax reporting position, then disclosure is generally adequate with respect to that item or position only if it is made on the appropriate form—a properly completed Form 8275, *Disclosure Statement*, Form 8275-R, *Regulation Disclosure Statement*, or Schedule UTP, *Uncertain Tax Position Statement*—attached to the tax return or qualified amended return for the year for which the item is reported.[13] Adequately disclosing an uncertain position to a tax authority can have many benefits, the most significant of which is mitigating against many common civil tax penalties and beginning the running of the statute of limitations for assessment.

B. Changes to Adequate Disclosure for Certain Large Business Taxpayers—Form 15307

Special rules respecting adequate disclosure apply to certain large business taxpayers (*i.e.*, business taxpayers with assets equal to or greater than $10 million). As necessary context, under recently obsoleted Rev. Proc. 94-69, the IRS had historically allowed a very limited subset of business taxpayers to proactively disclose an item or a tax reporting position, even after an audit for a year is formally initiated, to avoid accuracy-related penalties for a substantial understatement of income tax or negligence or disregard of rules or regulations.[14] If this post-filing disclosure was made, the IRS effectively treated the statement as a qualified amended return and certain accuracy-related penalties did not apply.[15] For a disclosure under Rev. Proc. 94-69 to have constituted an adequate disclosure, an eligible taxpayer was required to submit to the IRS agent assigned to the audit a written statement with the following information:

- The caption "Furnished under Rev. Proc. 94-69";
- A description of all items that would result in adjustments if the taxpayer, in lieu of furnishing a written statement, filed a properly completed tax return or qualified amended return. The description of an item is adequate if it consists of information that reasonably may be expected to apprise the IRS of the identity of the item, its amount, and the nature of the controversy or potential controversy; and
- The following declaration signed by a person authorized to sign the taxpayer's tax return: "Under penalties of perjury, I declare that I have examined this written statement, and to the best of my knowledge and belief this written statement is true, correct, and complete."

On November 16, 2022, the IRS obsoleted Rev. Proc. 94-69 through Rev. Proc. 2022-39.[16] In Rev. Proc. 2022-39, the IRS prescribed special procedures for certain eligible taxpayers to make adequate disclosure with respect to an item or a tax reporting position on a previously filed tax return to avoid the imposition of certain accuracy-related penalties.[17] Now, to facilitate the making of a post-filing disclosure by eligible taxpayers, the IRS has introduced a new draft Form 15307, *Post-Filing Disclosure for Specified Large Business Taxpayers*. The new draft Form 15307, which must be signed under penalties of perjury, requires the taxpayer to identify the number of disclosures being made with respect to the tax return and provide specific information about each disclosure, including:

- The adjustment type (*e.g.*, ordinary income, capital gain or loss, Code Sec. 1231 gain or loss, expense deduction, tax credit, *etc.*);
- The timing effect of the adjustment (*e.g.*, permanent or temporary);
- Whether there is an effect on any carryover;
- A brief description of the disclosed item;
- The overall increase or decrease to taxable income or tax credits; and
- A detailed explanation of the item being disclosed, providing the necessary facts and circumstances to understand the nature and implication of the disclosure.[18]

The law concerning adequate disclosure for large business taxpayers is mutable, and eligible companies should carefully monitor developments in this area to evaluate whether a post-filing disclosure is advisable to protect against potential accuracy-related penalties.

C. Using a Simple Disclosure to Bolster Defenses Grounded in Substantial Authority and/or Reasonable Cause

"Adequate disclosure" is to be contrasted with the so-called "simple disclosure" (not a technical term). In its most basic form, simple disclosure refers to the process of attaching a statement to a tax return that discloses to the IRS some facts and/or some laws the taxpayer considers appropriate to disclose, but not for the sake of obtaining benefits available for an adequate disclosure. Instead, a simple disclosure may (but need not) be filed, among other reasons, to lay the foundation for the defense in a potential tax controversy that no penalty should be imposed because the taxpayer had substantial authority and/or reasonable cause for the reporting position.

Defenses grounded in substantial authority and reasonable cause are distinct from any disclosure-related defense, though a disclosure can strategically bolster the substantial authority or reasonable cause defenses. To truly appreciate the complementary nature between, on the one hand, disclosures, and on the other hand, the substantial authority or reasonable cause defenses, it is important to understand the features related to the defenses for substantial authority and reasonable cause. Specifically:

> *Substantial authority*: Under Code Sec. 6662(d)(2)(B)(i), an accuracy-related penalty does not apply to the portion of an understatement of tax if the taxpayer's position with respect to such portion is supported by substantial authority.[19] Substantial authority exists where the weight of relevant and persuasive authorities for the taxpayer's position outweighs those in favor of the opposing position;[20] and
>
> *Reasonable cause*: Accuracy-related penalties generally do not apply to any portion of an underpayment of tax where it is shown that the taxpayer acted with reasonable cause and in good faith.[21] Reasonable cause is an amorphous concept that is highly dependent upon the facts and circumstances. As it relates to disclosure statements, various reasons may establish a reasonable cause for being subjected to an accuracy-related penalty, including but not limited to: the issue is one of first impression and it involves unclear statutory language;[22] and the taxpayer relied on the advice of a professional tax advisor, such as an attorney or an accountant, with respect to the disclosed tax reporting position.[23]

Depending upon the client's objectives, and the reason(s) a disclosure is appropriate, taxpayers may require an adequate disclosure instead of a simple disclosure. But, especially when there is substantial authority for a position or when a taxpayer reasonably relied on the advice of a competent tax professional, a simple disclosure can achieve all of the client's objectives without filing Form 8275, Form 8275-R, or Schedule UTP. As discussed herein, a simple disclosure (as opposed to an adequate disclosure) can also achieve other objectives, such as avoiding criminal tax penalties, where it is reasonably certain that, for good reason, a tax return is not necessarily complete, true, and correct as to each material fact.

IV. Mandatory Disclosures

A. Generally

Treasury Regulations sometimes require a taxpayer to attach to a tax return or qualified amended return a disclosure statement or other information respecting a transaction. Situations in which a disclosure statement must be attached by a taxpayer to a tax return or qualified amended return include the following:

- A taxpayer generally must file with the IRS Form 8886, *Reportable Transaction Disclosure Statement*,[24] for each reportable transaction in which the taxpayer participated;[25]
- Certain corporations must file Schedule UTP if the corporation's total assets equal or exceed the applicable asset threshold for the reporting tax year (currently $10 million), the corporation or a related party is required to maintain audited financial statements, and, for financial accounting purposes, those financial statements create a reserve (or no reserve was created because of expected litigation) for an uncertain tax position taken by the taxpayer or a related party;[26]
- A partner in a partnership must file with the IRS Form 8275, or a statement containing equivalent information, for the taxable year in which money or other consideration is transferred by a partnership to a partner within two years of a transfer of property by the partner to the partnership (*i.e.*, in situations involving a presumed disguised sale);[27] and
- A partnership with a bottom dollar payment obligation regarding a partnership liability must file with the IRS Form 8275 for the taxable year in which the

bottom dollar payment obligation is undertaken or modified.[28]

This article does not further discuss the more nuanced disclosure statements required with respect to disguised sales and bottom dollar payment obligations.

There may be other situations in which a party other than the taxpayer must file a disclosure statement with the IRS. For example, a material advisor with respect to any reportable transaction generally must file with the IRS Form 8918, *Material Disclosure Statement*, for each reportable transaction on which the material advisor advised.[29] This taxpayer-centric article does not discuss the reporting requirements of a material advisor with respect to a reportable transaction.

B. Reportable Transactions

As noted, a taxpayer must file with the IRS Form 8886 for each reportable transaction in which the taxpayer participated.[30]

1. Reportable Transaction Defined

Taxpayers are required to disclose any "reportable transaction," meaning, a listed transaction, a confidential transaction, a transaction with contractual provisions, a Code Sec. 165 loss transaction, or a transaction of interest.[31] These highly technical terms are, respectively, defined as follows:

- *Listed transactions*: A listed transaction is a transaction that is the same as or substantially similar to one of the types of transactions that the IRS has determined to be a tax avoidance transaction and identified by notice, regulation, or other form of published guidance as a listed transaction;[32]
- *Confidential transactions*: A confidential transaction is a transaction that is offered to a taxpayer under conditions of confidentiality and for which the taxpayer has paid an advisor a minimum fee.[33] A transaction is considered offered to a taxpayer under conditions of confidentiality if the advisor who is paid the minimum fee places a limitation on disclosure by the taxpayer of the tax treatment or tax structure of the transaction and the limitation on disclosure protects the confidentiality of that advisor's tax strategies.[34] A transaction is treated as confidential even if the conditions of confidentiality are not legally binding on the taxpayer;[35]
- *Transactions with contractual protections*: A transaction with contractual protection is a transaction for which the taxpayer or a related party (as described in Code Sec. 267(b) or 707(b)) has the right to a full or partial refund of fees if all or part of the intended tax consequences from the transaction are not sustained.[36] A transaction with contractual protection also is a transaction for which fees are contingent on the taxpayer's realization of tax benefits from the transaction;[37]
- *Transactions of interest*: A transaction of interest is a transaction that is the same as or substantially similar to one of the types of transactions that the IRS has identified by notice, regulation, or other form of published guidance as a transaction of interest;[38]
- *Code Sec. 165 loss transactions*: A loss transaction is any transaction resulting in the taxpayer claiming a loss under Code Sec. 165 of at least:
  - $10 million in any single taxable year or $20 million in any combination of taxable years for corporations;
  - $10 million in any single taxable year or $20 million in any combination of taxable years for partnerships that have only corporations as partners (looking through any partners that are themselves partnerships), whether or not any losses flow through to one or more partners;
  - $2 million in any single taxable year or $4 million in any combination of taxable years for all other partnerships, whether or not any losses flow through to one or more partners;
  - $2 million in any single taxable year or $4 million in any combination of taxable years for individuals, S corporations, or trusts, whether or not any losses flow through to one or more shareholders or beneficiaries; or
  - $50,000 in any single taxable year for individuals or trusts, whether or not the loss flows through from an S corporation or partnership if the loss arises with respect to a Code Sec. 988 transaction (as defined in Code Sec. 988(c)(1) relating to foreign currency transactions).[39]

2. Method for Adequately Disclosing a Reportable Transaction

A taxpayer will be deemed to have adequately disclosed a transaction only if the taxpayer attaches to the taxpayer's tax return, for each year the taxpayer participated in the transaction, the information required to be reported on Form 8886.[40] To be considered complete, the information provided on Form 8886 must describe the expected tax treatment and all potential tax benefits expected to result from the transaction, describe any tax result protection (as defined in Reg. §301.6111-3(c)(12)) with respect to the transaction, and identify and describe the transaction in enough detail for the IRS to be able to understand the

tax structure of the reportable transaction and the identity of all parties involved in the transaction.[41] An incomplete Form 8886 containing a statement that information will be provided upon request is not considered a complete disclosure statement.[42]

3. Timing to Adequately Disclose a Reportable Transaction

The disclosure statement for a reportable transaction must be attached to the taxpayer's tax return for each taxable year for which a taxpayer participates in a reportable transaction.[43] In the case of a taxpayer that is a partnership, an S corporation, or a trust, the disclosure statement for a reportable transaction must be attached to the partnership, S corporation, or trust's tax return for each taxable year in which the partnership, S corporation, or trust participates in the transaction.[44] A disclosure statement for a reportable transaction must also be attached to each amended tax return that reflects a taxpayer's participation in a reportable transaction.[45] If a reportable transaction results in a loss that is carried back to a prior year, the disclosure statement for the reportable transaction must be attached to the taxpayer's application for tentative refund or amended tax return for that prior year.[46]

A copy of the disclosure statement must be sent to the Office of Tax Shelter Analysis ("OTSA") at the same time that any disclosure statement is first filed by the taxpayer pertaining to a particular reportable transaction.[47] If a transaction becomes a listed transaction or a transaction of interest after a taxpayer's tax return was filed (including an amended tax return) reflecting the taxpayer's participation in the listed transaction or transaction of interest and before the end of the period of limitations for assessment of tax for any taxable year in which the taxpayer participated in the listed transaction or transaction of interest, then a disclosure statement must be filed, regardless of whether the taxpayer participated in the transaction in the year the transaction became a listed transaction or a transaction of interest. The disclosure statement must be filed with OTSA within 90 calendar days after the date on which the transaction became a listed transaction or a transaction of interest.[48]

4. Significance of Disclosing a Reportable Transaction

In addition to the requirement to disclose under Reg. §1.6011-4, disclosing a reportable transaction has other benefits as it relates to penalty protection. As explained herein, accuracy-related penalties attributable to certain reportable transactions under Code Sec. 6662A may be reduced, potentially to zero, by timely making an adequate disclosure.

C. Uncertain Tax Positions for Corporations

Corporations required to file Form 1120, Form 1120-F, Form 1120-L, or Form 1120-PC must file Schedule UTP if the corporation's total assets equal or exceed the applicable asset threshold for the reporting tax year ($10 million for 2022), the corporation or a related party must maintain audited financial statements, and the corporation's audited financial statements create a reserve (or no reserve was created because of expected litigation), for financial accounting purposes, for an uncertain tax position taken by the taxpayer or a related party.[49]

On October 11, 2022, the IRS released a draft of a new Schedule UTP.[50] The new draft Schedule UTP requires corporations to:

- Identify relevant statutory provisions, revenue rulings, revenue procedures, or other guidance for tax positions contrary to a rule (such as a statutory provision or Revenue Ruling);
- Identify the form or schedule, line number, and amount associated with the line on the return. This additional information is required for all items included on Schedule UTP, including any items of deferred income or unearned revenue; and
- Include a concise description of the uncertain tax position with the relevant facts affecting the tax treatment of the position and information that identifies the tax position, its amount, unit of account, and the nature of the controversy or potential controversy.[51]

The new Schedule UTP also adds a new field to report the dollar amount of the uncertain tax positions taken.[52]

The law concerning the filing of Schedule UTP is changing, and corporate taxpayers should carefully monitor developments in this area to ensure compliance with all mandatory reporting requirements.

V. Elective Disclosures

A. Generally

Even if a disclosure statement is not specifically required by law to be filed, it may still be advisable to proactively disclose an item or uncertain tax reporting position to manage audit risk, statutes of limitation, and exposure to civil and criminal tax penalties. The decision of whether to disclose belongs to the taxpayer,

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which is the principal reason Circular 230 requires practitioners to inform a client of any opportunity to use a tax disclosure to avoid penalties that are reasonably likely to apply and of the requirements to adequately disclose the item or tax reporting position so as to avoid penalties.[53]

Common situations in which a taxpayer may desire to attach a disclosure statement to a tax return or qualified amended return include, but are not limited to, the following:

- Where a taxpayer desires to mitigate the risk that certain civil tax penalties will be imposed with respect to an item or uncertain tax reporting position, in which case disclosure may be made on Form 8275, potentially in addition to other forms;
- Where a taxpayer desires to manage audit risk by ensuring the statute of limitations on tax assessments with respect to a tax return or transaction begins to run, in which case disclosure may be made on Form 8275, potentially in addition to other forms;
- Where a taxpayer's treatment of an item or reporting position is contrary to a Treasury Regulation, in which case the taxpayer may disclose that item or position to the IRS on Form 8275-R;[54] and
- Where a taxpayer desires to make clear they are not attempting to evade the assessment of tax, in which case the taxpayer may choose to attach to the tax return a "Best Efforts Disclosure Statement."

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B. Penalties Able to Be Mitigated Through Disclosure

1. Overview

The Code authorizes the IRS to impose more than 150 civil penalties, additions to tax, and additional taxes for various misdeeds. Most of these penalties can effectively be managed through adequate recordkeeping, timely and accurate financial and tax reporting, and good faith reliance on one or more fully informed, qualified tax professionals.[55] But, when the federal tax treatment of an item is unclear, a well-crafted disclosure statement can provide an added level of protection from certain common accuracy-related penalties.

In this regard, a significant purpose of filing an elective disclosure statement is to mitigate the likelihood that certain accuracy-related penalties will be imposed with respect to a tax reporting position for which there is a reasonable basis, but not a substantial authority in support of the proposed reporting position.[56] The accuracy-related penalties that can be managed through a properly completed disclosure statement specifically include penalties for the following:

- Substantial understatement of income tax;
- Disregard of rules or regulations;
- Transactions subject to challenge under the economic substance doctrine;
- Undisclosed foreign financial asset understatement; and
- Reportable transactions.

A well-crafted disclosure statement, coupled with reasonable, actual, and good faith reliance on the advice of a fully informed, competent tax professional, can provide as much penalty protection as a tax opinion letter.

2. Accuracy-Related Penalties on Account of a Substantial Understatement of Income Tax

One penalty that can be managed through a carefully written disclosure statement is the accuracy-related penalty on account of a substantial understatement of income tax. By way of background, the IRS may impose a penalty where there is a substantial understatement of tax on the taxpayer's tax return.[57] The amount of the accuracy-related penalty for a substantial understatement of tax liability is equal to 20% of the underpayment of tax attributable to the understatement of tax.[58] An understatement is generally defined as the difference between (1) the amount of tax required to be shown on the tax return, and (2) the amount of the tax imposed that is shown on the tax return, reduced by any rebate.[59] The amount of an understatement computed under the general rule is reduced, however, by the portion attributable to (1) an item for which the taxpayer had substantial authority,[60] or (2) any item for which the taxpayer, in the tax return or an attached statement, adequately disclosed the relevant facts affecting the item's tax treatment and the taxpayer had a reasonable basis for the tax treatment.[61] Thus, where a taxpayer has a reasonable basis for a reporting position, but not a substantial authority, a disclosure statement may mitigate the risk that an accuracy-related penalty on account of a substantial understatement of income tax will apply with respect to that reporting position.

3. Accuracy-Related Penalties on Account of Negligence or Disregard of Rules or Regulations

a) Accuracy-Related Penalties on Account of Disregard of Rules or Regulations. Another penalty that can be managed by way of a well-crafted disclosure statement is the accuracy-related penalty on account of disregard of rules or

regulations. The IRS' position is that the accuracy-related penalty for disregard of rules or regulations does not apply if the taxpayer has reasonable basis for the reporting position and adequately discloses the position on Form 8275, Form 8275-R, or Schedule UTP.[62]

b) Accuracy-Related Penalties on Account of Negligence. The IRS' position is that adequate disclosure is an exception to the penalty attributable to disregard of rules or regulations, but not to the penalty attributable to negligence.[63] Since the penalty attributable to negligence is not subject to a disclosure exception, the distinction between negligence and disregard of rules or regulations must sometimes be made.[64] The distinction between negligence and disregard of rules or regulations is fine, yet distinct. The term "negligence" means any failure to make a reasonable attempt to comply with the provisions of the Code.[65] By comparison, the term "disregard of rules or regulations" means any careless, reckless, or intentional disregard of internal revenue rules or regulations.[66]

Taxpayers are sometimes required to take tax reporting positions that are not certain to be sustained if reviewed by the tax authorities.

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Fortunately, a well-advised taxpayer will never need to explain this distinction to a revenue agent. Typically, a well-crafted disclosure statement, coupled with reasonable, actual, and good faith reliance on the advice of a fully informed, competent tax professional, can protect a taxpayer from the accuracy-related penalty on account of negligence or disregard of rules or regulations.

4. Accuracy-Related Penalties for Transactions Subject to Challenge Under the Codified Economic Substance Doctrine

Yet another penalty that can be managed through a disclosure statement is the accuracy-related penalty for transactions lacking economic substance. By way of background, in 2010, Congress codified the economic substance doctrine in Code Sec. 7701(o).[67] Under the codified economic substance doctrine, a transaction has economic substance only if: (1) the transaction changes in a meaningful way (apart from federal income tax effects) the taxpayer's economic position; and (2) the taxpayer has a substantial purpose (apart from federal income tax effects) for entering into the transaction.[68]

The IRS may impose an accuracy-related penalty for an underpayment of tax attributable to any disallowance of tax benefits by reason of a transaction lacking economic substance.[69] The amount of the accuracy-related penalty for a disallowance of claimed tax benefits due to a properly disclosed transaction lacking economic substance is equal to 20% of the underpayment of tax attributable to the transaction.[70] The amount of the accuracy-related penalty increases to 40%, however, if the relevant facts affecting the tax treatment of the transaction are not properly disclosed on the tax return or in a statement attached to the tax return.[71]

A taxpayer is deemed to have adequately disclosed a transaction lacking economic substance only if the taxpayer provides the required information on Form 8275, Form 8275-R, or Schedule UTP.[72] If the transaction is also a reportable transaction (*e.g.*, if the taxpayer claims a loss in connection with the transaction under Code Sec. 165 and the amount of the loss is $10 million in any single taxable year or $20 million in any combination of taxable years), the Internal Revenue Manual ("I.R.M.") instructs that a taxpayer has not adequately disclosed a transaction unless the transaction is reported in accordance with both the reportable transaction reporting rules (*i.e.*, on Form 8866) and on Form 8275, Form 8275-R, or Schedule UTP. Also, an eligible business taxpayer will be deemed to have adequately disclosed if it makes a disclosure consistent with the procedures in Rev. Proc. 94-69.[73]

The IRS has recently signaled in at least two ways it may increasingly look to assert the economic substance doctrine and related penalties against taxpayers. As to the first signal, on April 22, 2022, the IRS' Large Business & International ("LB&I") division issued to all employees in the LB&I and Small Business/Self-Employed divisions a memorandum eliminating a relatively long-standing requirement that executive approval be obtained before asserting the codified economic substance doctrine.[74] As to the second signal, on October 14, 2022, the IRS Associate Chief Counsel (International) stated that the government could "look to bring up the economic substance doctrine to a greater extent than in the past."[75] Indeed, given the IRS' recent difficulty in prevailing in cases concerning abusive tax transactions, such as syndicated conservation easements,[76] it is reasonable to expect the IRS to ground its argument in the broad-based codified economic substance doctrine.

In order to proactively manage risk related to the IRS' assertion of the codified economic substance doctrine, taxpayers entering into a transaction that potentially lacks economic substance can limit the accuracy-related penalties applicable to the transaction by disclosing the transaction on, as appropriate, Form 8275, Form 8275-R, or Schedule UTP.

5. Accuracy-Related Penalties on Account of an Undisclosed Foreign Financial Asset Understatement

Another penalty that can be managed by way of a well-crafted disclosure statement is the accuracy-related penalty on account of an undisclosed foreign financial asset understatement. By way of background, the IRS may impose an accuracy-related penalty for an underpayment of tax attributable to any undisclosed foreign financial asset understatement.[77] The accuracy-related penalty for an understatement of tax attributable to an undisclosed foreign financial asset is 40% of the resulting underpayment of tax.[78] The term "undisclosed foreign financial asset understatement" means, for any taxable year, the portion of the understatement of tax for such taxable year attributable to any transaction involving an undisclosed foreign financial asset.[79] The term "undisclosed foreign financial asset," in turn, means (with respect to any taxable year) any asset with respect to which information was required to be provided under Code Sec. 6038, 6038B, 6038D, 6046A, or 6048 for such taxable year but was not provided by the taxpayer as required under the provisions of those sections.[80] The forms required under these Code Sections include the following:

- Form 5471, *Information Return of U.S. Persons With Respect to Certain Foreign Corporations*;
- Form 8865, *Return of U.S. Persons With Respect to Certain Foreign Partnerships*;
- Form 8858, *Information Return of U.S. Persons With Respect to Foreign Disregarded Entities*;
- Form 8938, *Statement of Specified Foreign Financial Assets*;
- Form 3520, *Annual Return to Report Transactions With Foreign Trusts and Receipt of Foreign Gifts*; and
- Form 3520-A, *Annual Information Return of Foreign Trust With a U.S. Owner*.

Some individuals, especially fiduciaries acting on behalf of an estate or trustees acting on behalf of a bankruptcy estate, may not have complete information regarding foreign financial assets. In such situations, the fiduciary may seek to avoid the accuracy-related penalty on account of an undisclosed foreign financial asset by reporting the information known about the income-producing foreign financial asset, including any income earned during the taxable year with respect to that asset.

6. Accuracy-Related Penalties for Reportable Transactions

Still another penalty that can be managed through a disclosure statement is the accuracy-related penalty for understatements of tax with respect to reportable transactions. By way of background, the IRS generally may impose an accuracy-related penalty for any understatement of tax attributable to a reportable transaction understatement.[81] The penalty rate depends upon whether the transaction was properly disclosed. The accuracy-related penalty for a properly disclosed reportable transaction is equal to 20% of the reportable transaction understatement.[82] The accuracy-related penalty increases to 30% of the reportable transaction understatement if the transaction is not properly disclosed.[83]

> *As compared to costly or unattainable letter rulings, pre-filing agreements, tax opinion letters, and tax insurance, a well-crafted disclosure statement allows taxpayers to cost-effectively manage audit risk and mitigate against the imposition of civil and criminal tax penalties.*

The reportable transaction understatement penalty under Code Sec. 6662A generally applies to (1) any listed transaction, and (2) any reportable transaction if a significant purpose of the transaction is the avoidance or evasion of federal income tax.[84] Listed transactions and reportable transactions are defined above.

Accuracy-related penalties attributable to certain reportable transactions under Code Sec. 6662A may be reduced by timely making an adequate disclosure. In fact, the IRS takes the position that adequate disclosure of a reportable transaction, when accompanied by the existence of reasonable cause and good faith for entering into the reportable transaction, may altogether mitigate the reportable transaction penalty.[85] On this point, the I.R.M. instructs IRS

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employees not to impose the Code Sec. 6662A penalty if the taxpayer:

- Adequately disclosed its reportable transaction as required under Code Sec. 6011 and related Treasury Regulations; and
- Meets other criteria set out in Code Sec. 6664(d) to establish the existence of reasonable cause and good faith.[86]

Thus, accuracy-related penalties attributable to a listed transaction or certain reportable transactions may be mitigated, perhaps to zero, by timely making an adequate disclosure Form 8866 and Form 8275, Form 8275-R, or Schedule UTP, as appropriate.

C. Managing Statutes of Limitation

1. Generally

Taxpayers and tax advisors should also seek to use disclosure statements to manage statutes of limitation on tax assessments with respect to uncertain tax reporting positions. As a necessary pretext, the IRS typically has three years from the date on which a taxpayer files a tax return to audit that tax return and assess additional tax with respect to it.[87] There are various exceptions to this general rule, any of which may be mitigated through a carefully written disclosure statement. One such exception is that the IRS has six years from the date on which a tax return is filed (or deemed filed) to audit that tax return and assess additional tax with respect to it, if the taxpayer omits additional gross income in excess of 25% of the gross income stated in the tax return filed with the IRS.[88] Another exception is that the statute of limitations generally does not begin to run with respect to an income tax return if the taxpayer fails to notify the IRS of its participation in a listed transaction.[89] Yet another exception is that gift tax may be assessed at any time if a gift is not shown on a gift tax return in a manner adequate to apprise the IRS of the nature of the gift.[90]

2. Disclosure to Avoid Triggering a Six-Year Statute of Limitations on Account of a Substantial Omission from Income

A well-crafted disclosure statement may allow a taxpayer to limit the period of limitations on assessment to three years with respect to a potential omission from gross income arising from an uncertain tax position. Code Sec. 6501(e)(1) extends the period of limitations on assessment from three years to six years if a taxpayer omits from gross income an amount properly includible as gross income and the omitted amount exceeds 25% of the income stated on the tax return. For this purpose, the term "gross income" is broadly defined to mean all income from whatever source derived, specifically including the total of the amounts received or accrued, to the extent required to be shown on the tax return.[91] Moreover, with respect to amounts received or accrued that relate to the disposition of property, "gross income" means the excess of the amount realized from the disposition of the property over the unrecovered cost or other basis of the property.[92] An amount is not considered omitted from gross income if information sufficient to apprise the IRS of the nature and amount of the item is disclosed on the tax return, including any schedule or statement attached to the tax return.[93]

The purpose of extending the period of limitations on assessment under Code Sec. 6501(e) is to level the playing field when the taxpayer's omission of income places the IRS at a disadvantage in discovering errors on tax returns.[94] Under Code Sec. 6501(e)(1)(B)(ii), items that are adequately disclosed on the return (or attachments and schedules) are not considered omissions for purposes of determining a substantial omission of gross income (and a six-year period of limitations on assessment). To adequately apprise the IRS of the item of gross income, "[t]he statement must be sufficiently detailed to alert the Commissioner and his agents as to the nature of the transaction so that the decision as to whether to select the return for audit may be a reasonably informed one."[95]

Thus, by disclosing the nature and amount of unreported income so as to apprise the IRS of the exclusion, a potentially six-year period of limitations on assessment can be shortened to three years. For example, in *Benderoff v. Commissioner*, the U.S. Court of Appeals for the Eighth Circuit held that a taxable distribution by an S corporation to a shareholder was adequately disclosed on the shareholder's personal income tax return where the shareholder's personal income tax return reported his allocable share of the corporation's earnings, but not the distribution of taxable income by the S corporation.[96] In ruling that the taxpayer's personal income tax returns adequately disclosed the shareholder's income, the Eight Circuit also considered that the corporate income tax return disclosed the distribution on the balance sheet included with the corporate tax return.[97]

Where a tax reporting position is certain, it is typically in the taxpayer's best interest to bring that issue to a head, if at all, before interest accrues, memories fade, and documents are lost. Disclosure is a way to make sure the statute of limitations on assessment is three years, even in the case of a substantial omission of gross income.

3. Special Rules Respecting Listed Transactions

Under Code Sec. 6501(c)(10), the three-year period of limitations on assessment is extended where a taxpayer fails to include on any tax return any information required to be reported under Code Sec. 6011 with respect to a listed transaction. Specifically, the period of limitations on assessment is extended until one year after the earlier of the following:

- The date on which the Commissioner is furnished the required information; or
- The date that a material advisor meets the requirements of Code Sec. 6112 with respect to a request by the Commissioner under Code Sec. 6112(b) relating to such a transaction with respect to such a taxpayer.

Additionally, certain disclosure requirements apply to so-called "reportable transactions." The term "reportable transaction" means, among other things discussed previously, listed transactions.[98] A listed transaction is a transaction that is the same as or substantially similar to one of the types of transactions that the IRS has determined to be a tax avoidance transaction and identified by notice, regulation, or other form of published guidance as a listed transaction.[99]

Failing to make the required disclosures can suspend the statute of limitations until one year after the IRS is provided with the required information. Thus, the sufficiency of the disclosure may affect whether the statute of limitations remains open under Code Sec. 6501(c)(10).

4. Special Rules Respecting Gift Tax Returns

a) Generally. Adequately disclosing a gift, and filing a protective gift tax return even though a gift tax return may technically not be required, can also help manage statutes of limitation respecting federal estate and gift tax liabilities. Code Sec. 6501(c)(9) provides that if a gift is not shown on a gift tax return in a manner adequate to apprise the IRS of the nature of the gift, then the gift tax may be assessed at any time with respect to that gift. Most typically, this additional assessment occurs in connection with the filing of the estate tax return, many years after the gift was made and adding to the assessment potentially significant interest. The I.R.M. instructs that a gift may be inadequately disclosed if it is:

- Omitted completely from the tax return; or
- Shown on the tax return, but the manner in which it is shown is not adequate to apprise the IRS as to the nature of the gift.[100]

b) Protective Gift Tax Returns. In situations in which the taxpayer wants to take the reporting position that a gift was not made (*e.g.*, in connection with a potential bargain sale), it is usually advisable to file a gift tax return reporting a zero tax liability with respect to the "sale." The protective gift tax return should disclose all facts and supporting documentation surrounding the "sale." The purpose of filing this protective gift tax return is to have the statute of limitations with respect to that "sale" expire from a gift tax perspective.

D. Positions Contrary to a Regulation

Where a taxpayer's treatment of an item or reporting position is contrary to a regulation, the taxpayer must disclose that item or position to the IRS on Form 8275-R.[101] Assuming the tax reporting position has a reasonable basis and the position represents a good faith challenge to the regulation, Form 8275-R is typically filed by the taxpayer to avoid the accuracy-related penalty on account of (1) a disregard of rules or regulations, and/or (2) a substantial understatement of income tax.[102]

E. Making an Elective Disclosure

Form 8275 is used by taxpayers and tax return preparers to disclose items or positions, except those taken contrary to a regulation, that are not otherwise adequately disclosed on a tax return to avoid certain penalties. The form is filed to avoid the portions of the accuracy-related penalty due to disregard of rules or to a substantial understatement of income tax for non-tax shelter items if the return position has a reasonable basis. It can also be used for disclosures relating to the economic substance penalty and the preparer penalties for tax understatements due to unreasonable positions or disregard of rules.

F. Using Best Efforts Statements to Mitigate Against Civil and Criminal Tax Penalties

As explained more fully above, a simple disclosure statement, typically styled as a "Best Efforts Disclosure Statement," may be used where a taxpayer expects to take the position in a later tax controversy that (1) no penalty should be imposed because the taxpayer had substantial authority and/or reasonable cause for the reporting position, and/or (2) the taxpayer did not willfully intend to evade an assessment of tax.

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VI. Disclosures May Also Protect Tax Return Preparers from Penalties

It may also be advisable for tax return preparers to recommend disclosing uncertain tax reporting positions because the disclosure may also protect the tax return preparer from penalties. By way of background, as relevant here, the Code lets the IRS impose a penalty on a tax return preparer who prepares a tax return (including an amended tax return) that has an unreasonable position that results in an understatement of a taxpayer's tax liability and either (1) the position was properly disclosed, but there was no reasonable basis for the position, or (2) the position was not properly disclosed and there was not substantial authority for the position.[103] A position will be deemed to have been adequately disclosed only if the taxpayer provides the required information on Form 8275, Form 8275-R, or Schedule UTP, as appropriate.[104]

The preparer penalty under Code Sec. 6694 can be significant. In the case of an unreasonable position, the penalty with respect to each return or claim for refund is equal to the greater of $1,000 or 50% of the income the preparer derives from the return or the claim for refund.[105] In the case of willful or reckless conduct, the penalty with respect to each return or claim for refund is equal to the greater of (1) $5,000 or (2) 50% of the income the preparer derived from the return or claim for refund.[106]

Thus, assuming a tax reporting position has a reasonable basis, a disclosure statement filed by a taxpayer can also be used by the tax return preparer to avoid the preparer penalty under Code Sec. 6694(b) for understatements of tax.

VII. Other Forms of Protection Compared

A disclosure statement is not the only tool available to obtain penalty protection and manage audit risk with respect to uncertain tax reporting positions that may later be scrutinized by tax authorities. Other means of penalty protection and audit risk management include, but are not limited to, private letter rulings, pre-filing agreements, tax opinion letters, and tax insurance. While a complete discussion of these other tools is outside the scope of this article, it is worth noting their shortcomings as compared to the disclosure statement.

Private letter rulings and pre-filing agreements, while generally effective at minimizing tax controversies, are sometimes not preferable because of the cost, the length of time needed to get this guidance from the IRS (assuming the IRS will issue guidance on the subject matter to which the request relates), the sometimes unwanted attention the IRS will place on a transaction or set of facts that is the subject of the request, and the unwelcome (or impermissible) disclosure of sensitive information.[107] Tax opinion letters, while sometimes effective at managing civil tax penalties and related interest, are often not desirable because of the cost, the assumptions and limiting conditions contained in a tax opinion letter that restrict its usefulness, and the general aversion of many reputable law firms and accounting firms to issue tax opinion letters, unless the tax treatment of an item is not reasonably in dispute. Tax insurance, while potentially effective at managing audit risk and the related costs of an incorrect tax reporting position (*e.g.*, taxes, penalties, interest, and the cost of representation), is costly, difficult to obtain, not available to many taxpayers, and of limited use given the policy limits and deductible that might be due in the event of a claim.

VIII. Conclusion

Taxpayers are sometimes required to take tax reporting positions that are not certain to be sustained if reviewed by the tax authorities. As compared to costly or unattainable letter rulings, pre-filing agreements, tax opinion letters, and tax insurance, a well-crafted disclosure statement allows taxpayers to cost-effectively manage audit risk and mitigate against the imposition of civil and criminal tax penalties. At the same time, however, the law concerning adequate disclosure is mutable, and taxpayers should carefully monitor developments in this area to make sure a disclosure statement accomplishes the objectives for which it is submitted.

ENDNOTES

1 Inflation Reduction Act of 2022, H.R. 5376, Part 3 of Title I, Subtitle A (Aug. 7, 2022). The Act provides for roughly $80 billion in additional funding for the IRS over approximately 10 years, including more than $45 billion for civil and criminal tax enforcement. *Id.* at §10301.

2 *See* Circular 230 §10.2(a)(8) (defining a tax return preparer by cross-reference to Code Sec. 7701(a)(36) and Reg. §301.7701-15). Code Sec. 7701(a)(36)(A), in turn, generally defines a tax return preparer as any person who prepares for compensation, or who employs one or more persons to prepare for compensation, all or a substantial portion of any tax return or claim for refund. *See also* Reg. §301.7701-15(a). As noted, a tax return preparer includes: (1) a signing tax return preparer, which is the individual tax return preparer who has the primary responsibility for the overall substantive accuracy of the preparation of the tax return or claim for refund; and (2) a nonsigning tax return preparer, which generally includes any tax return preparer who is not a signing tax return preparer but who prepares all or a substantial portion of a tax return

or claim for refund by, for example, rendering tax advice on a position that is directly relevant to the determination of the existence, characterization, or amount of any entry on a tax return or claim for refund. *Compare* Reg. §301.7701-15(b)(1) (defining a signing tax return preparer), *with* Reg. §301.7701-15(b)(2)(i) (defining a nonsigning tax return preparer), *and* Reg. §301.7701-15(b)(3) (defining when it is appropriate to treat a nonsigning tax return preparer as a tax return preparer).

[3] Reg. §301.7701-15(b)(2).

[4] Reg. §301.7701-15(c).

[5] *See* Reg. §301.7701-15(b)(2)(ii), Ex. 1. The example and related conclusion is as follows:

> Attorney A, an attorney in a law firm, provides legal advice to a large corporate taxpayer regarding a completed corporate transaction. The advice provided by A is directly relevant to the determination of an entry on the taxpayer's return, and this advice leads to a position(s) or entry that constitutes a substantial portion of the return. A, however, does not prepare any other portion of the taxpayer's return and is not the signing tax return preparer of this return. A is considered a nonsigning tax return preparer.

Id.

[6] Reg. §301.7701-15(b)(3)(ii)(A).

[7] Reg. §301.7701-15(b)(3)(ii)(B).

[8] *See* Circular 230 §10.34(a)(1)(ii). This obligation also extends to claims for refund. *Id.* Reasonable basis for a position exists where the position is reasonably based on one or more primary sources of law. *See* Reg. §1.6662-3(b)(3). A return position that is "arguable, but fairly unlikely to prevail in court" satisfies the reasonable basis standard. Reg. §1.6662-4(d)(2).

[9] *See* Circular 230 §10.34(c)(1).

[10] *See* Circular 230 §10.34(c)(2).

[11] Furthermore, a practitioner must possess the appropriate level of knowledge, skill, thoroughness, and preparation necessary for the matter for which the practitioner is engaged. Circular 230 §10.35(a). Arguably, any competent practitioner should advise a client of the ways in which an elective tax disclosure can be used to mitigate against civil and criminal tax penalties, manage audit risk, and of the resulting impact on statutes of limitation.

[12] Reg. §1.6662-4(f)(2); *see, e.g.*, Rev. Proc. 2021-52, IRB 2021-51, 883. A qualified amended return is an amended tax return that is filed after the original properly extended due date of the original tax return but before any of the following events: (1) the date the taxpayer is first contacted by the IRS for any examination, including a criminal investigation; (2) the date any person is contacted for a tax shelter promoter examination under Code Sec. 6700 with respect to any tax benefit claimed on the return; (3) the date the IRS issues a John Doe summons under Code Sec. 7609(f) relating to the tax liability of a person, group, or class that includes the taxpayer; (4) the date the Commissioner announces a settlement initiative to compromise or waive penalties with respect to a listed transaction; and/or (5) with respect to a passthrough item, the date the passthrough entity is first contacted by the IRS for any examination with respect to the entity's return. *See* Reg. §1.6664-2(c)(3).

[13] Reg. §1.6662-4(f)(2); *see, e.g.*, Rev. Proc. 2021-52, §1, IRB 2021-51, 883. The guidance periodically published in a revenue procedure identifies circumstances in which an item reported on a tax return is considered adequately disclosed for purposes of the accuracy-related penalty attributable to a substantial understatement of income tax. For example, a taxpayer generally will have met the requirements for adequate disclosure of a charitable contribution deduction if the taxpayer completes the contributions section of Schedule A, supplies all required information, and attaches all related forms required pursuant to statute or regulation. *See, e.g.*, Rev. Proc. 2021-52, §4.02(1)(d), IRB 2021-51, 883. In other words, a disclosure statement does not need to be filed with respect to items that meet the requirements set forth in the revenue procedure.

[14] 1994-2 CB 804, *obsoleted by* Rev. Proc. 2022-39, IRB 2022-49, 507.

[15] Rev. Proc. 94-69, §3.01, IRB 1994-44, 17, *obsoleted by* Rev. Proc. 2022-39, IRB 2022-49, 507.

[16] Rev. Proc. 2022-39, §1, IRB 2022-49, 507.

[17] Rev. Proc. 2022-39, IRB 2022-49, 507.

[18] *See* IRS, *Instructions to Form 15307* (Feb. 2022), *www.irs.gov/pub/irs-utl/f15307draft.pdf*.

[19] *See also* Reg. §1.6662-4(d)(1).

[20] *See* Reg. §1.6662-4(d)(3)(i), (ii). Among the types of authority that should be considered in determining whether there is substantial authority for a position are the following:

- Applicable provisions of the Code and other statutory provisions;
- Proposed, temporary and final regulations construing those statutes;
- Revenue rulings and revenue procedures;
- Tax treaties and regulations thereunder, as well as Treasury Department and other official explanations of such treaties;
- Court cases;
- Congressional intent as reflected in committee reports, joint explanatory statements of bill managers included in conference committee reports, and floor statements made before enactment by one of a bill's managers;
- General Explanations of tax legislation prepared by the Joint Committee on Taxation (a.k.a. the "Blue Book");
- Private letter rulings and technical advice memoranda issued after October 31, 1976;
- Actions on decisions and General Counsel Memoranda issued after March 12, 1981 (as well as General Counsel Memoranda published in pre-1955 volumes of the Cumulative Bulletin);
- IRS information or press releases; and
- Notices, announcements, and other administrative pronouncements published by the IRS in the Internal Revenue Bulletin. Reg. §1.6662-4(d)(3)(iii).

[21] Code Sec. 6664(c)(1).

[22] *See, e.g.*, *M.G. Bunney*, 114 TC 259, 266, Dec. 53,839 (2000).

[23] Reg. §1.6664-4(b)(1). In order to establish that the reliance on a professional tax adviser constitutes reasonable cause and good faith, the taxpayer must generally show the following: (1) the taxpayer reasonably believed the professional upon whom the reliance is placed is a competent tax adviser with sufficient expertise to justify reliance; (2) the taxpayer provided necessary and accurate information to the adviser; and (3) the taxpayer actually relied in good faith on the adviser's judgment. *Neonatology Associates, P.A.*, 115 TC 43, 98-99, Dec. 53,970 (2000), *aff'd*, CA-3, 2002-2 USTC ¶50,550, 299 F3d 221 (2002); *see also* Reg. §1.6664-4(c)(1).

[24] All forms identified include the specified form and any successor forms that may be required.

[25] Reg. §1.6011-4(a), (d).

[26] *See* Reg. §1.6012-2(a)(4); *see also* IRS, *Instructions for Schedule UTP (Form 1120)*, p. 1 (Dec. 2019). The obligation to file Schedule UTP applies to corporations required to file Form 1120, *U.S. Corporation Income Tax Return*, 1120-F, *U.S. Income Tax Return of a Foreign Corporation*, 1120-L, *U.S. Life Insurance Company Tax Return*, or 1120-PC, *U.S. Property and Casualty Insurance Company Income Tax Return*.

[27] Reg. §1.707-3(c)(2); *see also* Reg. §1.707-8. Under the disguised sale rules of Code Sec. 707(a)(2)(B), if a contributor of property to a partnership receives a distribution of cash or property from the partnership within two years of the contribution of property, the contribution and distribution are presumed to constitute a sale of property by the partner to the partnership. *See also* Reg. §1.707-3(c). The presumption of a disguised sale is rebuttable. *See* Reg. §1.707-3(b)(1).

[28] Reg. §1.752-2(b)(3)(ii)(D). Bottom dollar payment obligations are defined to include any payment obligation under a guarantee or similar arrangement when the partner (or related person) is not liable, up to the full amount of the payment obligation in the event of nonpayment by the partnership. Reg. §1.752-2(b)(3)(ii)(C).

[29] Reg. §301.6111-3(a), (d).

[30] Reg. §1.6011-4(a), (d).

[31] *See* Code Secs. 6662A(d) and 6707A(c); *see also* Reg. §1.6011-4(b). The definition of reportable transaction varies greatly depending on which version of the regulations applies to the transaction, so it is important to look to the actual language of the regulations in effect for the year of the transaction. *Id.* Specifically, the Internal Revenue Manual ("I.R.M.") provides: "The version of the regulations that applies to a transaction at the time the transaction was entered into by the taxpayer will remain applicable to the taxpayer, even if the regulations subsequently were modified." IRM pt. 4.32.4.2(3) (Dec. 12, 2013).

[32] Reg. §1.6011-4(b)(2).

[33] Reg. §1.6011-4(b)(3)(i).

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[34] Reg. §1.6011-4(b)(3)(ii).
[35] *Id.*
[36] Reg. §1.6011-4(b)(4)(i).
[37] *Id.*
[38] Reg. §1.6011-4(b)(6).
[39] Reg. §1.6011-4(b)(5)(i). In determining whether a transaction results in a taxpayer claiming a loss that meets the threshold amounts over a combination of taxable years, only losses claimed in the taxable year that the transaction is entered into and the five succeeding taxable years are combined. Reg. §1.6011-4(b)(5)(ii).
[40] Reg. §1.6011-4(d), (e)(1).
[41] Reg. §1.6011-4(d).
[42] *Id.*
[43] Reg. §1.6011-4(e)(1).
[44] *Id.*
[45] *Id.*
[46] *Id.*
[47] *Id.*
[48] Reg. §1.6011-4(e)(2)(i).
[49] *See* Reg. §1.6012-2(a)(4); *see also* IRS, *Instructions for Schedule UTP (Form 1120)*, p. 1 (Dec. 2019).
[50] *See* IRS, *IRS Statement about Uncertain Tax Positions (UTP) Reporting*, *www.irs.gov/newsroom/irs-statement-about-uncertain-tax-positions-utp-reporting* (last updated on Oct. 20, 2022).
[51] IRS, Schedule UTP (Form 1120), *www.irs.gov/pub/irs-dft/f1120utp--dft.pdf* (rev. Dec. 2022).
[52] *Id.*
[53] *See* Circular 230 §10.34(c)(2).
[54] Reg. §1.6662-4(f)(1).
[55] As explained, accuracy-related penalties generally do not apply to any portion of an underpayment of tax where it is shown that the taxpayer acted with reasonable cause and in good faith. Code Sec. 6664(c)(1).
[56] Reasonable basis for a position exists where the position is reasonably based on one or more primary sources of law. *See* Reg. §1.6662-3(b)(3). Of course, the amount of an understatement of tax to which an accuracy-related penalty is applied is reduced by the portion attributable to an item for which a taxpayer had substantial authority. *See* Code Sec. 6662(d)(2)(B).
[57] Code Sec. 6662(a), (b)(2).
[58] Code Sec. 6662(a), (b)(2).
[59] *See* Code Sec. 6662(d)(2)(A).
[60] As explained, substantial authority exists where the weight of relevant and persuasive authorities for the taxpayer's position outweighs those in favor of the opposing position. *See* Reg. §1.6662-4(d)(3)(i) and (ii).
[61] *See* Code Sec. 6662(d)(2)(B).
[62] IRM pt. 20.1.5.8.2.1(1) (Jan. 24, 2012). If a taxpayer is required to file Schedule UTP for a taxable year, then a complete and accurate Schedule UTP that discloses a tax position attached to a tax return or a qualified amended return will be treated as a Form 8275 or Form 8275-R regarding the tax position. IRM pt. 20.1.5.8.2.1(1) (Jan. 24, 2012). In the case of reportable transactions, taxpayers also must disclose transactions on Form 8886, as required under Code Sec. 6011. IRM pt. 20.1.5.8.2.1(2) (Jan. 24, 2012).
[63] IRM pt. 20.1.5.8.2.1(6) (Jan. 24, 2012).
[64] *Id.*
[65] Code Sec. 6662(c).
[66] *Id.*
[67] Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, §1409, 124 Stat. 1029, 1067.
[68] Code Sec. 7701(o)(1). The potential for profit of a transaction may generally be taken into account in determining whether the requirements of Code Sec. 7701(o) are met with respect to a transaction, but only if the present value of the reasonably expected pre-tax profit from the transaction is "substantial in relation to the present value of the expected net tax benefits that would be allowed if the transaction were respected." Code Sec. 7701(o)(2)(A). Fees and other transaction expenses are taken into account as expenses in determining pre-tax profit under Code Sec. 7701(o)(2)(A). *Id.*
[69] *See* Code Sec. 6662(a), (b)(6).
[70] Code Sec. 6662(a), (b)(6), (i).
[71] *Id.*
[72] IRM pt. 20.1.5.13.1(2) (Dec. 13, 2016).
[73] IRM pt. 20.1.5.13.1(3) (Dec. 13, 2016).
[74] *See* IRS, *Interim Guidance Memorandum on Economic Substance Doctrine and Related Penalties*, *available at www.irs.gov/pub/foia/ig/sbse/lbi-04-0422-0014.pdf* (Apr. 22, 2022).
[75] Andrew Velarde, *Government's Use of Economic Substance Doctrine May Increase*, 108 TAX NOTES INT'L 507 (Oct. 24, 2022).
[76] *See, e.g.*, *Green Valley Investors, LLC*, 159 TC ___, No. 5, Dec. 62,122 (2022).
[77] *See* Code Sec. 6662(a), (b)(7).
[78] Code Sec. 6662(a), (b)(7), (j)(3).
[79] Code Sec. 6662(j)(1).
[80] Code Sec. 6662(j)(2).
[81] *See* Code Sec. 6662A(a). Courts have recently failed to sustain accuracy-related penalties with respect to the failure to disclose listed transactions, which are a type of reportable transaction, on Form 8866. *See, e.g.*, *Green Valley Investors, LLC*, 159 TC ___, No. 5, Dec. 62,122 (2022) (refusing to sustain accuracy-related penalty because the IRS did not comply with the provisions of the Administrative Procedures Act, 5 USC §§551-559, 701-706 in issuing Notice 2017-10, IRB 2017-4, 544); *see also Mann Construction, Inc.*, CA-6, 2022-1 USTC ¶50,122, 27 F4th 1138 (2022) (same conclusion with respect to Notice 2007-83, 2007-2 CB 960).
[82] Code Sec. 6662A(a).
[83] Code Sec. 6662A(a), (c).
[84] Code Sec. 6662A(b)(2). *But see Mann Construction, Inc.*, CA-6, 2022-1 USTC ¶50,122, 27 F4th at 1148; *Green Valley Investors, LLC*, 159 TC at ___, No. 5, Dec. 62,122 (2022).
[85] IRM pt. 20.1.5.17(4) (Aug. 31, 2021).
[86] *Id.*
[87] Where a tax return is filed before the filing deadline, the return is generally deemed filed as of the filing deadline. *See* Code Sec. 6501(b)(1).
[88] Code Sec. 6501(e)(1)(A)(i). Another exception is that the IRS has an indefinite period of time to audit a tax return and assess additional tax in the case of a false or fraudulent return with the intent to evade tax. *See* Code Sec. 6501(c)(1).
[89] Code Sec. 6501(c)(8), (10).
[90] Code Sec. 6501(c)(9).
[91] Reg. §301.6501(e)-1(a)(1)(iii).
[92] *Id.*
[93] Code Sec. 6501(e)(1)(B)(iii); *see also* Reg. §301.6501(e)-1(a)(1)(iv).
[94] *Colony, Inc.*, SCt, 357 US 28, 36, 58-2 USTC ¶9593 (1958).
[95] *Estate of Fry*, 88 TC 1020, 1023, Dec. 43,859 (1987).
[96] CA-8, 68-2 USTC ¶9486, 398 F2d 132, 135 (1968).
[97] *Benderoff*, CA-8, 68-2 USTC ¶9486, 398 F2d at 135-136.
[98] *See* Reg. §1.6011-4(b).
[99] Reg. §1.6011-4(b)(2). As of the time of this writing, there are 35 listed transactions. *See* IRS, *Recognized Abusive and Listed Transactions*, *www.irs.gov/businesses/corporations/listed-transactions* (last updated Nov. 2, 2022). Most recently, basket option and syndicated conservation easement transactions were added as listed transactions in 2015 and 2017, respectively. *See id.*
[100] Reg. §301.6501(c)-1(f)(2); *see also* IRM pt. 4.25.1.2.1.2 (July 7, 2020).
[101] Reg. §1.6662-4(f)(1).
[102] IRM pt. 20.1.5.8.2.1(3) (Jan. 24, 2012). A good faith challenge to the validity of a regulation generally requires a showing that the taxpayer conducted a careful analysis of reasonably available authorities relating to the issue, including statutes, legislative history, related Treasury Decision, and relevant case law (including case law pertaining to the presumption of validity to which regulations are generally entitled). *Id.*
[103] Code Sec. 6694(a)(1), (2)(A) and (B); *see also* IRM pt. 20.1.6.4.6(2) (Aug. 29, 2019).
[104] *See* IRM pt. 20.1.6.4.9.1(2) (Aug. 29, 2019).
[105] Code Sec. 6694(a).
[106] Code Sec. 6694(b). A preparer is considered to have recklessly or intentionally disregarded a rule or regulation if the preparer takes a position on the return or the claim for refund that is contrary to a rule and the preparer knows of, or is reckless in not knowing of, the rule or regulation in question. IRM pt. 20.1.6.4.13.1 (Aug. 29, 2019).
[107] There are many areas in which the IRS will not issue letter rulings. These so-called "no-ruling areas" are typically set forth in the first, second, third, fourth, and seventh annual revenue procedures. *See, e.g.*, Rev. Proc. 2022-1, §6, IRB 2022-1, 1; Rev. Proc. 2022-2, §3, IRB 2022-1, 120; Rev. Proc. 2022-3, §3, IRB 2022-3, 144; Rev. Proc. 2022-4, §§24, 25, IRB 2022-2, 161; Rev. Proc. 2022-7, §3, IRB 2022-1, 297.

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