

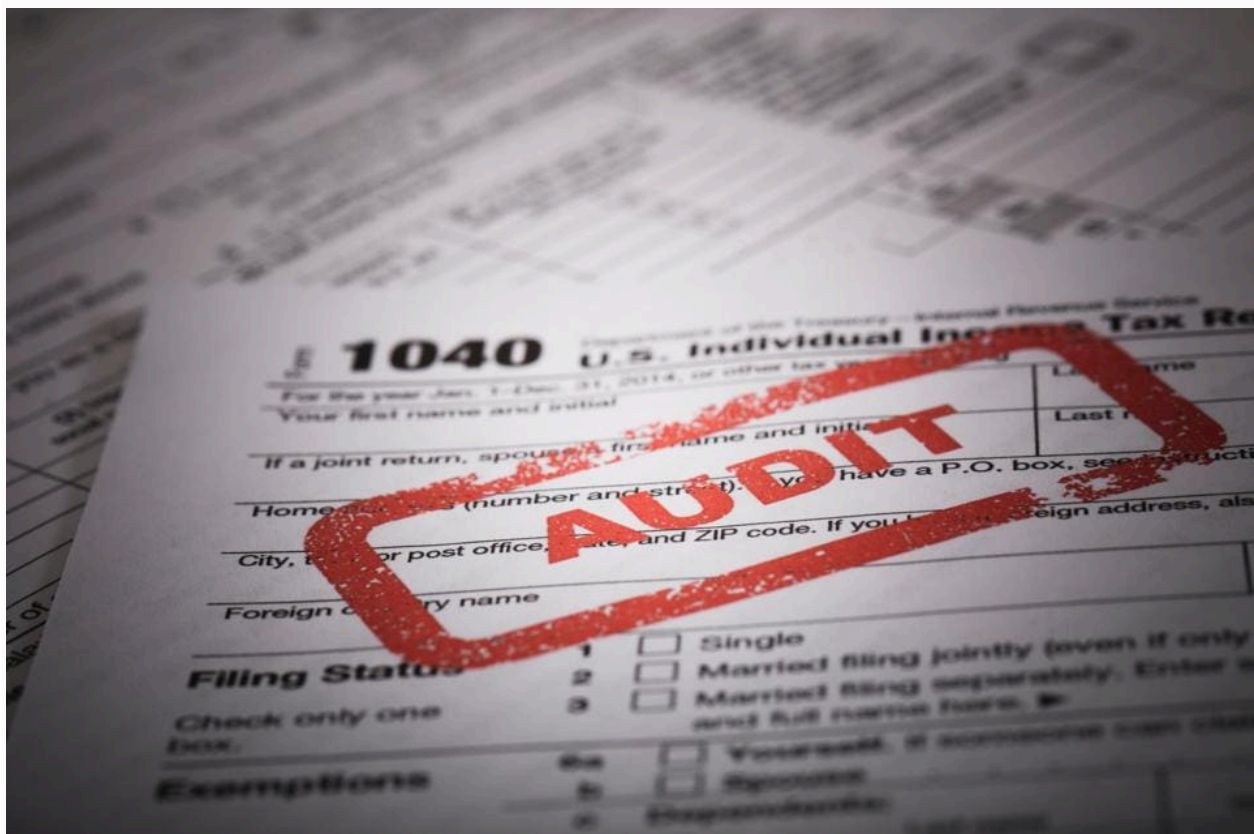


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## IRS Says To Disclose Aggressive Tax Positions, Is It An Audit Trigger?

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May 23, 2025

The IRS wants you to “disclose” if you do not have at least “substantial authority” for your tax position. Disclosure is more than the usual listing of income or expense. It is simply an extra explanation. How much extra varies considerably, not only in legal requirements but also in practice. Sometimes, the IRS says disclosure is required. You might be claiming legal expenses for a fight with your siblings over an heirloom. Or you might be claiming that you had an ordinary loss rather than a capital one when stock became worthless.

### **When To Disclose**

There are almost infinite circumstances in which disclosure could be required, yet many people do not want to draw attention to their tax returns. Disclosure sounds like it exposes you to extra audit risk, and no one wants a tax audit, since extra audit attention is the last thing anyone wants. Ironically, though, disclosure can actually reduce risk in some cases. So what is disclosure anyway? Suppose that you are writing off the cost of getting your law degree. Almost all case law is against that deduction because a law degree qualifies you for a new profession.

So, if you claim it and you want to avoid penalties if the IRS disallows it, you must disclose it. You do so because your position is weak, and you are pointing out to the IRS that you are claiming it nevertheless. Yes, that sounds like you are asking for the IRS to audit you or to disallow the deduction. Technically, you do not *have* to disclose. But disclosing is a way to get out of penalties, and it can also prevent the IRS from extending the usual three-year limitations period for assessment of income tax.

### **IRS Statute of Limitations**

No one wants to be audited, and it pays to know the rules. The [IRS audit period is usually three years, but it can be six or more in some cases](#). If you omit more than 25 percent of the gross income from your tax return, the

normal IRS three-year statute of limitations is extended to six years. However, in determining whether you omitted income from your return, the IRS counts what you *disclosed* too, even if you say it isn't taxable. So, you help yourself by disclosing. There is also a penalty for a substantial understatement of income tax. An individual who understates his tax by more than 10 percent or \$5,000, whichever is greater, can end up with this penalty. One way to avoid the penalty is to *adequately disclose* the item.

All you need is disclosure plus a reasonable basis for your tax position. How do you disclose a tax position to be sure you aren't hit with a substantial understatement penalty? The classic way, which the IRS clearly prefers, is by form. There are two disclosure forms, IRS Form 8275 and IRS Form 8275-R. Form 8275-R is for positions that contradict the law, so it is best avoided. Form 8275 (*without* the R) is a common form and is commonly filed. Most tax returns attaching Form 8275 are not audited, so the form does not automatically trigger an audit. Check out the IRS views [about Form 8275](#).

### **Be Concise**

But how much detail to provide is another matter. Some people go on for pages on Form 8275, and even send attachments. Some proposed Forms 8275 are long-winded arguments about the law, sometimes all in capital letters, citing many legal authorities. That is not appropriate material for a disclosure, nor are attachments. If the IRS wants your legal agreement or contract, the IRS will ask for it. In short, going overboard in a disclosure seems unwise. You are required to disclose enough detail to tell the IRS what you are doing. But keep it short and succinct.