

Should You Get a Tax Opinion Before Filing Taxes or Only if Audited?

By Robert W. Wood

As year-end approaches, it is nearly time to start preparing for the annual drudgery that leads up to tax filings. For individuals and for businesses, it can be a major time drain, not to mention financial crush. It can even bring on some hand-wringing and frayed nerves. Even among sophisticated businesspeople, the topic of tax opinions can prompt puzzling responses.

Should you get one? Why, and under what circumstances? And *when* should you get it? If your tax issue is large or unusual, someone might suggest it to you, as in, "you should get a tax opinion on this." Yet many taxpayers and even tax advisers have trouble saying exactly why one should get a tax opinion or how to use it.

A tax opinion can be about almost any tax issue. You might be structuring your legal fees over time. You might be doing litigation funding, either on a particular case or based on a portfolio of cases. You might be operating in multiple states and have state income tax questions. You might be adding partners, independent contractors, or making other structural changes.

You might be trying to deduct contingent fee client costs despite the general IRS prohibition that says you must wait until the case resolves, which might be years later. You might have sold off cases or other assets and hope for capital gain treatment rather than ordinary income. You might have accepted stock or crypto for payment and need tax guidance what your tax reporting choices are.

You get the idea, a tax opinion can address just about anything. A good tax opinion discusses the facts, legal arguments, and pertinent authorities. One portion of the opinion says, "it is our opinion that...." But the vast majority of the opinion should analyze the facts and the law, presenting an even-handed assessment. Tax opinions do not bind the IRS, but are worth the investment. Here's why.

Tax opinions give penalty protection. The most commonly-stated reason to get a tax opinion is to avoid penalties. Just about everyone in the tax business says this at one time or another. But I do not believe most tax opinions are primarily for purposes of penalty protection. It's arguably one of the misconceptions about tax opinions.

It is true that a tax opinion will almost always provide protection from penalties. However, no client wants or expects the claimed tax position to fail. If all the opinion accomplishes is preventing penalties, the client won't be happy. Clients want their tax position to be upheld in full. Or if that isn't possible, they want it to be compromised on an acceptable basis. They don't want merely to save penalties.

Tax opinions evaluate your facts and apply the tax law. Clients may like an opinion that is one-sided (in their favor) rather than wishy-washy. The tax opinion's bottom line may be that there is substantial authority (or some other level of confidence) for the position. But it should be accompanied

by a thorough examination of the relevant authorities, both positive and negative.

This balancing of the facts and tax authorities on both sides ties in to one of the key IRS requirements for a tax opinion. A tax opinion must conform to one of the following levels of confidence about the strength of your tax position:

- Not frivolous = There's a 10% to 20% chance your argument will prevail.
- Reasonable Basis = There's a roughly 20% or 25% chance you'll win.
- Substantial Authority = There are cases both ways, but there's probably about a 40% chance you'll win.
- More Likely Than Not = The odds are better than 50% that you'll win.
- Should = It's about 60% likely that you'll win.
- Will = Your tax treatment is nearly assured.

If you know something about IRS audit rates, you probably know that the percentage chance of being audited is relatively low. Yet under the IRS tax opinion standards, the tax opinion must assume that there will be an audit in every case. That way, the opinion is not based on audit lottery. In reality, of course, audits really occur infrequently. But when they do occur, you'll be glad you have a tax opinion in hand.

The question whether to get a tax opinion now or later can seem like a chicken or egg question. Why spend money on a tax opinion if the IRS or the California Franchise Tax Board may not audit? Doesn't it make more sense to wait? It might seem that way, but it is too late to get a tax opinion if you are audited. There is rarely time to get a good and thoughtful opinion at the audit stage.

Even if there were, the legal impact is not the same as one done before tax return filing. In fact, you do not get *any* penalty protection if you get the opinion after you file your return. And you if you are trying to convince your tax preparer that the tax position you are reporting is legal, you need the opinion before you file your returns. Opinions should be written before the tax return is filed.

In fact, when possible, the opinion should be done in parallel with the event or transaction. That is the best way to help shape the transaction or issue. And in any event, you need the tax opinion in hand before you file your tax return. That way, you are relying on the opinion when you file. And remember, all tax returns must be filed under penalties of perjury.

If you get an opinion but are audited, you'll be very happy that you have the opinion. But the reasons might surprise you. After all, don't you just want to hand the tax opinion to the IRS? Hardly. Opinions are valuable, but not to give to the IRS. A legal opinion is a sensitive document, usually prepared by a lawyer for a client, subject to attorney client privilege.

As such, it is worth asking who should receive it and to whom it should be disclosed, both then and later. The client

will receive it, but be careful whom you copy, since that simple act may waive the privilege. You do not want to waive privilege, since you rarely want to give it to the IRS. That surprises most clients, who ask, then how exactly do I benefit from the opinion?

Tax opinions help you assess your risks, to determine how solid or risky your tax position might be. They also get your tax preparer comfortable that he or she can rely on someone else for the return preparer liability. But another huge benefit of a tax opinion is that it will help in any audit or tax dispute. Tax opinions are of enormous value as a resource for cutting and pasting.

For the small percentage of tax cases that ultimately end up in controversy, there will be deadlines. In an audit, there is rarely enough time to prepare thorough and targeted responses that will be convincing to the IRS. A thorough legal opinion is a luxury. You can use the opinion's best facts and best arguments to draft advocacy letters or briefs, targeting the issues the IRS is raising. In effect, much of the work is done for you, which can make the dispute easier and faster to resolve.

How about penalties, since that is often why people say they need a tax opinion? If you can address the tax issues in an audit and resolve them favorably, you may not need to talk about penalties at all. Even if you do, you rarely have to actually give the tax opinion to the IRS. Although I have written large numbers of tax opinions across many years, I have never handed an opinion to the IRS. The only reason one would do so is for penalty protection, and once again, I do not think tax opinions are primarily about penalty protection.

Opinions give directions to tax return preparers. Some clients are told by their tax preparer that they will not take a particular position without a formal tax opinion. But even if that isn't your circumstance, tax preparers like opinions and want to be able to reply upon a tax lawyer's opinion. But how do you convey that, provide the tax opinion to the CPA? Curiously, no, you generally don't want or need to do that.

Tax return preparers usually do not need the whole opinion. Most accountants are satisfied with a short directive letter telling them there is a written opinion protected by attorney client privilege, giving the top line conclusion of the opinion, and telling the accountant that they can rely on the tax lawyer's opinion when preparing the return. That way, the accountant is not ever tempted to give the opinion to the IRS during an audit.

In my experience across many hundreds of examples, this procedure works well. It is efficient, protects everyone's interests, and doesn't end up creating tax risks or expecting the CPA to read through many pages of tax case law that he doesn't really need. A short letter that invites the accountant to rely on the opinion and that gives explicit tax return preparation instructions nearly always does the risk.

In the rare case where the accountant is not satisfied with this procedure, the accountant can be brought within the attorney-client privilege with a *Kovel* letter. The attorney hires the accountant and remains subject to the direction of the attorney as part of the representation. In effect, the accountant becomes a subcontractor of the lawyer for specified purposes, to import attorney client privilege.

A tax opinion is formal written advice about your own tax circumstances, whatever they are. You might have settled some litigation and received money or paid money. You might have paid big legal fees. You might have moved states, liquidated a business, sold or a stockpile of crypto, or had an involuntary conversion or casualty loss.

You might be claiming that your stock sale proceeds are tax exempt as qualified small business stock. In these and other circumstances, tax opinions can provide enormous practical comfort and significant legal protection. Whatever your situation, getting formal tax advice about the strengths and weaknesses of your position before you file your return can provide protection and help in audit defense.

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