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Surprisingly Smart Move Before Doing Your Taxes

I often write tax opinions, so I admit I'm biased about their value. Even so, many people don't obtain one despite a crying need. It can be puzzling what people mean by a tax opinion too, since there are different kinds. The best kind is targeted to your facts and the biggest tax issue you face.

Distinguish between tax opinions about your own situation from ones attached to an investment program. The latter are quite different from more customized opinions. I'll try to avoid the term since (perhaps appropriately) it has become a dirty word. Tax opinions that are marketed in connection with investment offerings are subject to different standards, and some are associated with [tax shelters](#).



You may have had no contact with the law or accounting firm rendering the opinion. You probably don't think of them as looking out for your interests, as they are representing the promoter or sponsor of the investment program. Still, it's clear you're supposed to be impressed by the opinion. You may get your own tax adviser to formally or informally opine on it too. It is surprising that more investors do not get their own.

The best kind of tax opinion is about your own situation and the tax consequences it triggers. Whether it is a lawsuit settlement, an environmental cleanup, settling a relative's estate, selling off lots on your property, or swapping shares of stock or apartment buildings, there are tax issues. And just handing over all the financial records to your accountant isn't the best planning.

If the legal settlement, investment, sale, estate, etc. involves significant dollars, the taxes are likely significant too. And the range of possible taxes can be large. Take it seriously, preferably before you sign, close, buy or sell. And as you structure it, think about getting a tax opinion to support what you are doing.

Opinion Standards. Tax opinion standards vary, but generally conform to one of the following:

- **Not frivolous** = There's a 10% to 20% chance your argument will prevail.
- **Reasonable Basis** = There's a roughly one in three 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.

Under IRS standards, the tax practitioner must **assume** an audit so the opinion is not based on audit lottery. In reality, audits occur only rarely.

Penalty Protection? Will an opinion at least get you out of penalties if the IRS disagrees with you? It depends. If an opinion is marketed (like tax shelter opinions), it must say the tax benefits are “more likely than not” or that they “should” be upheld to get penalty relief. The opinion can't blindly rely on representations (for example, “the investor has a motive to make a profit”) if they are unreasonable.

If an opinion is not of the marketed variety, it can help eliminate penalties even if it only sets forth a “reasonable basis” for your tax position (provided your position is disclosed on your return). But the highest level of penalty protection would come with an opinion that your position is “more likely than not” correct or higher.

These standards may seem confusing. What isn't confusing is what most taxpayers want. Most taxpayers don't want to end up paying all of the tax and all of the interest associated with a failed tax position, even if they can get the penalties waived! Thus, much of the penalty protection mantra is a red herring.

Best Protection? What taxpayers **really** want is to have their tax position upheld. The best reason to get a tax opinion is to help secure your position. An opinion—especially one prepared long before tax return time while you are still documenting the subject of the opinion—can help put you in the best possible light.

You can reach me at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.