

Tax Opinion Just Might Make Or Break The Case

By Robert W. Wood

When clients think about a legal opinion, they may imagine that a one-line email should suffice. Perhaps that is a wake-up call to all attorneys who send frequent and cryptic emails to our clients! When lawyers talk about a legal opinion, they are generally discussing a formal and thoroughly cited letter. These heavy opinion letters are required in many transactions.

For example, a buyer in a corporate transaction needs a legal opinion from the seller's counsel stating that the seller is in good standing, is authorized and that the deal is binding. An opinion in a real estate deal might say a lease is binding. Tax opinions represent a special type of legal opinion about tax issues. They don't bind the Internal Revenue Service, but they are regulated by it.

This is on top of the usual state law, bar association and ethical restrictions that apply to legal opinions more generally. Although I write many tax opinions, it surprises me how many people do not request tax opinions despite a crying need. Conversely, some clients ask for a tax opinion, but do not know why or how it can help them.

Tax opinions usually recite the specific facts of your situation, analyze and apply the tax law to those facts, and reach a reasoned conclusion. Clients want an opinion that is as strong as possible. The common notion is that a tax opinion is just to provide protection against penalties the IRS might otherwise impose.

In reality, though, I have never met a client who is willing to pay assessed taxes and interest and who would be satisfied merely with achieving penalty protection from an opinion! Understandably, clients want to win and to have their tax position upheld. If they can't win, they at least want to compromise the taxes on an acceptable basis. Tax opinions are far more valuable in advancing the clients position and prevailing.

In that sense, the "penalty protection" reason for getting an opinion is a red herring. It is far more important to get all the arguments pro and con on the table so you know the strengths and weaknesses of your position. If you act promptly, you will be writing the opinion while you are planning, so the facts are not static. In that way, an opinion can often improve the facts, and in turn make for a stronger opinion when it is finalized.

You should distinguish between customized tax opinions and ones attached to an investment program. Tax opinions that are marketed in connection with investment offerings (including tax shelters) are subject to different standards with the IRS and raise different issues. You probably don't think of the law or accounting firm rendering this kind of tax opinion as looking out for your interests.

The authors of this variety of tax opinion are representing the promoter or sponsor of the investment program. We'll sidestep such offering opinions and focus on customized tax opinions. One reason for tax opinions is to tell you or your accountant what you can or cannot do on your tax return, and how you should describe it. Tax opinion standards vary, but generally conform to one of the following choices:

- Not frivolous = There's a 10 percent to 20 percent 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 percent chance you'll win.
- More likely than not = The odds are better than 50 percent that you'll win.

- Should = It's about 60 percent likely that you'll win.
- Will = Your tax treatment is nearly assured.

Under IRS standards, the tax practitioner must assume the tax return in question will be audited. Thus, the confidence level expressed must take into account that the IRS is examining the return and considering the issue on the merits. The conclusion expressed in the opinion cannot be based on audit lottery. In reality, audits occur only rarely.

Even though penalty protection is not the best reason for getting an opinion, clients always ask. Does an opinion get you out of penalties if the IRS disagrees with your treatment? It depends on the type of opinion and the confidence level it expresses.

If an opinion is marketed (like tax shelter opinions), it must say that tax benefits are "more likely than not" or that they "should" be upheld to get penalty relief. 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 (if your position is disclosed). But the highest level of penalty protection comes with an opinion that your position is "more likely than not" correct.

The best reason to get a tax opinion is to help secure your tax position. Timing also matters. An opinion — especially one prepared not at tax return time but while you are still documenting a purchase, transaction or legal settlement — can help put you in the best possible light on both the facts and the law.

Only a small percentage of tax cases end up in a dispute with the IRS. Should that happen, however, the tax opinion has another huge benefit. There will be tight deadlines, whatever form the tax controversy takes, and whether or not the lawyer who wrote the opinion becomes involved. At the audit stage, in the IRS Appeals division or in court, there is rarely enough time to do everything you want to do and to respond fully.

In this sense, because the opinion lays out the facts, the legal arguments and the authorities in detail, it is a ready-made source of correspondence and briefing. When a tax return is audited, the ability to open the file and withdraw a thorough legal opinion is a luxury. It can often spell the difference between a good and a bad result in the tax controversy.

Of course, it is rarely appropriate to simply hand over a legal opinion to the IRS. Opinions are usually balanced documents laying out the strengths and weaknesses of the tax issue in question. However, a tax opinion can be an excellent document from which to cut and paste when writing as an advocate.

Indeed, access to a tax opinion could make or break the case. If a client has 30 days to respond to an IRS letter or notice about why a position was claimed, that time can be tight. With busy schedules, it may not be enough time to do a thorough job, particularly if the file is bare. Adding to time pressures, the client may not tell you about a notice (or may not hire you) until there is only a week left to respond.

Whatever the dynamics, having a thorough and thoughtful legal opinion in your hands can prove invaluable. It may be that the only party who will see the full text of the opinion is the client. However, both at tax return time and much later in the event of an audit, a tax opinion can be a resource that is worth its weight in gold.



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