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The Tax Adviser

AICPA finalizes new standards on tax positions

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On May 18, 2023, the AICPA Tax Executive Committee unanimously approved [revisions to the AICPA's Statements on Standards for Tax Services](https://www.aicpa-cima.com/resources/download/revised-statements-on-standards-for-tax-services-no-1-4-1-1-2024) (SSTs). These revisions, the most significant updates since 2009, will be effective Jan. 1, 2024. The SSTs are enforceable standards that apply to all AICPA members providing tax services. Certain states also incorporate the SSTs as part of their professional rules of conduct for CPAs.

One revision to the SSTs relates to tax positions. Prior to revision, SSTS No. 1, *Tax Return Positions*, was the only standard that addressed AICPA member responsibilities when recommending tax return positions, or preparing or signing tax returns filed with any taxing authority. Subsequent to revision, the previous standard has been split into two sections: Section 1.1, *Advising on Tax Positions*, of SSTS No. 1, *General Standards for Members Providing Tax Services*, and Section 2.1, *Tax Return Positions*, of SSTS No. 2, *Standards for Members Providing Tax Compliance Services, Including Tax Return Positions*. This column examines the general requirements of each standard and explains the reason for splitting the standard across two sections.

General requirements under SSTS Sections 1.1 and 2.1

The standards included in the revised SSTs Sections 1.1 and 2.1 are heavily based on the prior SSTS No. 1, *Tax Return Positions*. This discussion focuses on the revised standards, which generally apply to all members providing tax services included in Section 1.1. Differences specific to the preparation of tax returns included in Section 2.1 are separately addressed following the general discussion.

Definition of 'tax position'

"Tax position" is a term that can have multiple definitions. To minimize uncertainty, the SSTs establish a definition for purposes of the standards. Section 1.1, Paragraph 4, defines a tax position as "a conclusion reached" by a member "when applicable tax law, regulations, case law, or other regulatory or recognized guidance is applied to a

particular transaction, a specific set of facts and circumstances, or a controversy.”

This general definition can be divided into three components. First, the conclusion reached in a tax position must be applied to a specific set of facts and circumstances. This serves to limit the standard’s reach to situations in which a member is working with a taxpayer in relation to a specific matter. This can apply both to members in public practice preparing a tax return for a client and members working in industry preparing a tax return on behalf of their employer.

Members should also note that although the SSTs are generally intended to apply to advising a client/employer regarding a particular tax position, the standard also more broadly applies to advice provided in other circumstances. For example, members preparing marketing materials for services related to a particular tax position should ensure they apply the standards in Sections 1.1 and 2.1 to the extent they are providing examples of which tax positions a taxpayer may take in a particular factual situation.

Second, a tax position involves applying tax law and other guidance to the taxpayer’s fact pattern. When applying tax law, the member must comply with the level of authority required for that particular position (see the sidebar “Levels of Authority”). Paragraph 5(a) of Section 1.1 establishes a base-level requirement for a tax position’s level of authority: “[A] member should not advise a taxpayer to take a tax position unless the member has a good-faith belief that the position has at least a realistic possibility of being sustained administratively or judicially on its merits, if challenged.”

However, there are two exceptions to this. First, Paragraph 5(b) of Section 1.1 states that members must comply with any written standards of a taxing authority if they exceed the “realistic possibility” level of authority. Second, Paragraph 5(c) of Section 1.1 allows a member, as permitted by a taxing authority, to advise a taxpayer to take a position where there is a “reasonable basis” if that position is adequately disclosed to the taxing authority. “Reasonable basis” is a lower level of authority than the “realistic possibility” standard but is still higher than a frivolous position. This exception only applies if the taxpayer follows the requirements of the taxing authority when taking the position.

The third component of a tax position is that the member must reach a conclusion. The standard does not specify whether that conclusion must be written and provided to the taxpayer; members should use their professional judgment in determining whether written advice regarding a tax position is appropriate. For example, a member preparing a Form 1040, *U.S. Individual Income Tax Return*, with charitable contributions is not required to observe physical receipts for each charitable contribution the taxpayer wishes to claim a deduction for (see SSTs Section 2.3, *Reliance on Information From Others*). However, the IRS requires the taxpayer to retain and provide on request contemporaneous documentation of the contribution prepared by the donee organization. It is generally in the best interest of both the member and the taxpayer for the member to send written advice to the taxpayer of the documentation requirement where the member has not confirmed the documentation’s existence.

Due diligence and advocacy standards

In addition to defining “tax position” and setting requirements for a basic level of authority, SSTs Section 1.1 includes two other requirements related to tax positions. First, Paragraph 6 of Section 1.1 establishes a requirement that members exercise due diligence and professional judgment when advising on a tax position. Due diligence and professional judgment are not specifically defined in the SSTs; members should therefore follow definitions commonly used for both terms in accounting and tax literature. However, the *Explanations* portion of Section 1.1 does provide some guidance on suggested sources a member should consider when advising on a tax

position. Paragraph 10, Section 1.1, states that a member may consider “a well-reasoned construction of the applicable statute and related regulations of that jurisdiction, if any” as well as “well-reasoned articles, treatises, or guidance issued by the applicable taxing authority.” This list is not intended to be all-inclusive but does provide a starting point for members when considering whether relying on information from a particular source would be considered as having met the due-diligence requirement.

Second, Paragraph 7 of Section 1.1 establishes the right of members to be an advocate for the taxpayer when providing advice regarding a tax position. *Explanation* Paragraph 9 of Section 1.1 expands on this concept when it states that “the taxpayer has no obligation to pay more taxes than are legally owed, and a member has a duty to the taxpayer to assist in achieving that result or any other legally valid tax outcome the taxpayer desires.” The standard does not, however, establish a requirement that a member find and/or recommend to the taxpayer every position that could lower tax liability. For example, members often decide not to raise positions that are overly aggressive or not cost-effective to a taxpayer. Additionally, *Explanation* Paragraph 11 of Section 1.1 encourages members to provide a taxpayer with the level of authority for multiple positions where there is a good-faith belief that more than one position meets the requirements of Section 1.1 or 2.1.

Applicability of penalties

Although not included in the statement portion of SSTS Section 1.1, *Explanation* Paragraph 12 notes that if particular facts and circumstances lead a member to believe a taxpayer penalty might be asserted, the member should advise the taxpayer of the possible penalty and discuss the opportunity, if any, to mitigate the penalty by disclosing the position to the taxing authority. The paragraph makes clear that the decision regarding disclosure is the taxpayer’s responsibility.

Differences between Sections 1.1 and 2.1

As noted previously, Sections 1.1 and 2.1 of the revised SSTSs are based off prior SSTS No. 1, *Tax Return Positions*, and therefore share many of the same components. However, several key differences relate to the additional requirements placed on members who sign tax returns.

First, regarding the purpose for separating Sections 1.1 and 2.1, the task force that prepared the revisions to the SSTSs intended to clearly set the expectation that all members, whether advising on a tax position or preparing a tax return, would be subject to the same basic standards regarding level of authority. Therefore, both Sections 1.1 and 2.1 follow the same definitions regarding the level of authority a member must ensure is in place before advising a taxpayer to take a particular tax position. This ensures that both members who prepare tax returns and members who advise a taxpayer regarding a tax position but do not sign the related return as preparer/taxpayer are subject to similar requirements and seeks to avoid situations in which tax return preparers are placed at a disadvantage relative to third-party tax advisers.

Second, SSTS Section 2.1, Paragraph 7, requires members preparing income tax returns to, when relevant, advise the taxpayer regarding potential penalty consequences of a particular tax position and provide an opportunity, if any, to avoid such a penalty through disclosure. This requirement is often imposed on members by taxing authorities. Establishing this as a standard ensures that members will apply it consistently across jurisdictions.

The explanations in Section 2.1 relating to that section's Paragraph 7 also highlight issues related to penalties that only arise when preparing and signing a tax return. Specifically, *Explanation* Paragraph 15 of Section 2.1 notes that where a member advises a taxpayer that disclosure of a tax position may present the taxpayer with an opportunity to avoid a penalty, but the taxpayer declines to disclose the position, the member should consider whether to continue a professional or employment relationship with the taxpayer. *Explanation* Paragraph 14 of Section 2.1 states that members who advise on a tax position without being required to sign the related tax return, however, are required only to notify the taxpayer of disclosure requirements to meet the disclosure requirements of Sections 1.1 and 2.1.

Third, Paragraph 8 of Section 2.1 establishes a standard that a member should not advise a taxpayer to take a tax return position or prepare or sign a tax return reflecting a position the member knows exploits the audit selection process of a taxing authority or only serves as an arguing position to obtain leverage in a negotiation with a taxing authority. This standard is included in Section 2.1 because these strategies would most commonly be encountered as part of the tax return preparation process. However, members should take note that any member providing advice related to the preparation of a tax return would be expected to follow this standard.

Fourth, Paragraph 9 of Section 2.1 highlights that members preparing and/or signing tax returns may rely in good faith on others' proposed tax positions regarding the issues being considered, providing that Section 2.3, *Reliance on Information From Others*, is satisfied. This affirmatively clarifies that members may prepare and/or sign tax returns including a tax position put forward by the client or other third party.

Guidance and best practices

SSTSs Sections 1.1 and 2.1 include a wealth of guidance for members who provide tax advice, prepare tax returns, and/or sign tax returns. Members should read the standards closely and consider how to incorporate them into daily practice, whether through formalized policies or as best practices.

Levels of authority

The "realistic possibility" standard included in Paragraph 5(a) of SSTS Section 1.1 is often considered to equate to a 1-in-3 chance of success if challenged by the taxing authority. This is generally regarded as a lower standard than "substantial authority," the standard required by Regs. Sec. 1.6664-4(f)(2)(i) (A) to establish reasonable cause for purposes of penalty relief under Sec. 6662 or 6663. Paragraph 5(b) of SSTS Section 1.1 requires members to follow the standard established by the taxing authority, if higher, which is the case in this circumstance. Several comments received as part of the revision process questioned why the standard was not modified to use the higher substantial-authority standard.

The standard intentionally retained the "realistic possibility" standard as a base level of authority to address situations in which Regs. Sec. 1.6664-4 does not apply. For example, although states often conform to IRS rules, some state and local jurisdictions have not clearly adopted a standard level of authority for tax positions. Additionally, "substantial authority" is based on statutory and regulatory constructions that are subject to change. The realistic-possibility standard establishes a fixed-base standard for AICPA members that is in line with historic guidance but does not unnecessarily burden members with a higher level-of-authority requirement than necessary.

Another point members should consider regarding the level of authority is that many taxing authorities establish a level-of-authority requirement only where there is an understatement of tax. Penalties are generally not assessed when taxable income is overstated. Although it is uncommon for most taxpayers to seek ways to increase taxable income, there are situations where that may be desirable, such as when the taxpayer has expiring credits. The requirements in Sections 1.1 and 2.1 apply to any tax position recommended by a member, whether subject to penalty or not. AICPA Tax Section members may download a free “[Levels of Confidence for Tax Return Positions Chart](https://www.aicpa-cima.com/resources/download/levels-of-confidence-for-tax-return-positions-chart) (<https://www.aicpa-cima.com/resources/download/levels-of-confidence-for-tax-return-positions-chart>)” showing the levels of authority required to avoid relevant penalties.

Contributors

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