Frequently Asked Questions

Statements on Standards for Tax Services

Issued by the Tax Executive Committee

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Contents

Introduction

Statements on Standards for Tax Services (SSTSs) and related interpretations are issued by the AICPA Tax Executive Committee (TEC), the senior technical body of the AICPA designated to promulgate standards of tax practice. The "General Standards Rule" (ET secs. 1.300.001 and 2.300.001) and the "Compliance With Standards Rule" (ET secs. 1.310.001 and 2.310.001)[1] of the AICPA Code of Professional Conduct require compliance with these standards. Many state boards of accountancy also incorporate the SSTSs as part of their professional rules of conduct for CPAs.

[1] All ET sections can be found in AICPA *Professional Standards*.

Background

The Statements on Standards for Tax Services (SSTSs) and interpretations, promulgated by the AICPA Tax Executive Committee (TEC), reflect the AICPA's standards of tax practice and delineate members' responsibilities to taxpayers, the public, the government, and the profession. The SSTSs are intended to be part of an ongoing process that may require changes to, and interpretations of, current SSTSs in recognition of the accelerating rate of change in tax laws and the continued importance of tax practice to members. The original Interpretations No. 1-1, *Realistic Possibility of Success*, and No. 1-2, *Tax Planning*, were adopted in 2000 and 2003, respectively, and updated in 2010. The TEC adopted the updated Interpretations No. 1-1, *Reporting and Disclosure Standards*, and No. 1-2, *Tax Planning*, on August 15, 2011, effective on January 31, 2012.[2]

These frequently asked questions (FAQs) were developed in connection with the version of the SSTSs that became effective January 1, 2010. On May 18, 2023, the TEC approved revisions to the SSTSs effective January 1, 2024. Much of the content from the existing SSTSs were incorporated into the revised SSTSs, which were reorganized to reflect a practice-based structure, ordered by type of tax work performed.

These FAQs have been updated to reflect the reorganization of the SSTSs as reflected in the revised standards. As part of the reorganization, the subject of "tax positions" was addressed in both SSTS No. 1 and No. 2, and the revisions to these FAQs indicate where this subject is addressed in the revised standards.. No other material changes were made to the existing guidance that follows.

The answers to these FAQs are based on guidance developed by the Statements on Standards for Tax Services Guidance Task Force in response to questions that were presented during the public exposure period for the SSTSs that became effective on January 1, 2010 and, since that time, in administering the SSTSs. These FAQs are not rules, regulations, or official statements of the Tax Executive Committee issued pursuant to its rule-making authority and therefore are not authoritative guidance.

The SSTSs should be used in conjunction with these FAQs. The answers to these FAQs may not necessarily address the requirements of other regulatory bodies, including state boards of accountancy, the IRS, and other tax regulatory bodies whose rules may differ from those of the AICPA. A member should always consult these other sources to ensure compliance with all appropriate regulatory requirements.

The AICPA's Statements on Standards for Tax Services (SSTSs) are enforceable tax practice standards for members of the AICPA. Additional guidance is also found in the corresponding interpretations and FAQs. Access to the complete set of SSTSs and guidance are available in the AICPA's Statements on Standards for Tax Services Library.

[2] These interpretations do not consider any impact of Section 1409 of the Health Care and Education Reconciliation Act of 2010, P.L. 111-152 (Codification of Economic Substance Doctrine and Penalties). Under Section 7701(o) of the Internal Revenue Code, in the case of any transaction to which the economic substance doctrine is relevant, the transaction shall be treated as having economic substance only if the transaction changes in a meaningful way (apart from federal income tax effects) the taxpayer's economic position, and the taxpayer has a substantial purpose (apart from federal income tax effects) for entering into such transaction. Understatements of tax attributable to a failure to satisfy the economic substance doctrine, where relevant, can result in substantial taxpayer penalties.

FAQs for Statement on Standards for Tax Services No. 1, *General Standards for Members Providing Tax Services,* Section 1.1, Advising on Tax Positions

Statement on Standards for Tax Services No. 2, *Standards for Members Providing Tax Compliance Services, Including Tax Return Positions* Section 2.1, Tax Return Positions

Adequate Disclosure, Filing Returns, and Reasonable Basis

A member has concluded there is a reasonable basis for a tax return position and recommends the position to a taxpayer. What are the basic considerations in recommending disclosure that will constitute adequate disclosure?

Paragraph 2.1.14 of section 2.1 of SSTS No. 2 provides that a member's determination of whether information is "appropriately disclosed" by the taxpayer "should be based on the facts and circumstances of the particular case and the disclosure requirements of the applicable taxing authority." Disclosure should generally include a description of the position that is being taken, the amount of tax at issue, and the basis for the position. It is also important to consider whether the relevant taxing authority has specific disclosure requirements.

What constitutes appropriate disclosure for purposes of paragraph 1.1.5c of section 1.1 of SSTS No. 1?

- When the tax authority has a specific form for disclosure – The member should use the specific form of the tax authority for purposes of disclosure.
- When the taxing jurisdiction has administrative or guidance with required contents for disclosure – The member should follow the procedures set forth in the administrative or judicial guidance.
- When there is neither form nor guidance – The member should disclose the position being taken, the amount of tax in issue, and the basis for the position.

How does a member satisfy the disclosure requirements of section 2.1 of SSTS No. 2, when the member merely recommends a tax position but is not engaged to prepare or sign the related tax return?

Pursuant to paragraph 2.1.14 of section 2.1 of SSTS No. 2, a member who advises on a position but is not engaged to prepare or sign the related tax return will be deemed to meet the disclosure requirement, if the member advises the client concerning the appropriate disclosure of the position.

Should a member prepare and sign a tax return on the basis of the taxpayer's appraisal report (in the following situation)?

> *A member is preparing an income tax return for a taxpayer who has made a substantial charitable contribution of artwork. Although the member believes there is a reasonable basis for the appraisal report provided by the taxpayer, he does not believe it meets the tax authority's higher standard for undisclosed tax positions. Should the member prepare and sign the tax return on the basis of the taxpayer's appraisal report?*

A member may still prepare or sign the return if the member concludes there is a reasonable basis for the position and the member advises the taxpayer to appropriately disclose the position.

If the particular facts and circumstances lead a member to believe a taxpayer penalty might be asserted, the member should also advise the taxpayer and should discuss with the taxpayer the opportunity, if any, to avoid such penalty by disclosing the position on the tax return. Although a member should advise the taxpayer with respect to disclosure, it is the taxpayer's responsibility to decide whether and how to disclose.

If a member concludes there is reasonable basis for a position that income is not subject to taxation in a particular state, what disclosure is required under paragraph 1.1.5c of section 1.1 of SSTS No. 1 (in the following situation)?

> *A member has been engaged by a taxpayer to prepare an income tax return that will be filed in State T. State T has written reporting and disclosure standards with respect to recommending tax return positions and preparing and signing tax returns. State T's standards are lower than the realistic possibility of success (RPOS) standard. The taxpayer wants to take a position that a significant amount of income is not taxable in State T because the income is not properly sourced to State T under existing statutes, regulations, and case law. The member concludes the position does not satisfy the RPOS standard. However, the member believes that State T's statutes and regulations are not entirely clear, and the taxpayer has a reasonable basis for taking the position. If the member concludes there is reasonable basis for the position that the income is not subject to taxation in State T, what disclosure is required under paragraph 1.1.5c of section 1.1 of SSTS No. 1?*

If the taxpayer's position does not satisfy the RPOS standard, the member should use professional judgment to determine whether the taxpayer has a reasonable basis for the position that the income is not subject to taxation in State T.

May a member prepare and sign a return with 100% business use of an automobile on Schedule C if the taxpayer doesn't have adequate substantiation (in the following situation)?

> *A member is engaged by a taxpayer to prepare her federal individual income tax returns, which includes a Schedule C. The member has been furnished with a copy of the taxpayer's general ledger, which includes expenditures for automobile expenses. The member also furnishes the taxpayer with the substantiation requirements for automobile expenses. The taxpayer has indicated she believes her auto use is 100% business. The member has informed the taxpayer she does not have adequate substantiation to deduct 100% of the automobile expenses. May the member prepare and sign the return with 100% business use of the automobile on Schedule C?*

No. If the member determines that, in the member's professional judgment, the taxpayer does not have reasonable basis for her position of deducting 100% of the automobile expenses recorded in the general ledger, then the member should not prepare or sign the income tax return reflecting such a position. No disclosure can make this an appropriate position to take on the tax return.

Has a member complied with the standards for appropriate disclosure set forth in paragraph 2.1.6c of section 2.1 of SSTS No. 2 if, subsequent to sending the taxpayer a signed original copy of the completed tax return along with the appropriate disclosure attached to the taxpayer for signature and filing by the taxpayer, the taxpayer removes the disclosure and files the return (in the following situation)?

> *A member has completed and sent to the taxpayer a signed original copy of the taxpayer's state tax return for the taxpayer's signature and mailing. The state does not have written standards with respect to preparing tax returns. Included in the return is an appropriate disclosure of a tax return position, as required under paragraph 2.1.6c of section 2.1 of SSTS No. 2, for which the member has concluded there is reasonable basis. Has a member complied*

with the standards for appropriate disclosure set forth in paragraph 2.1.6c if, subsequent to sending the taxpayer a signed original copy of the completed tax return along with the appropriate disclosure attached for signature and filing by the taxpayer, the taxpayer removes the disclosure and files the return with the applicable taxing authority?

Yes. The member's responsibility for advising a taxpayer that a tax return position should be "appropriately disclosed" by the taxpayer is deemed to have been met if, after preparation of the tax return is complete, a copy of the original return along with the appropriate disclosure or disclosures attached is signed by the member and sent by the member to the taxpayer for signature and filing by the taxpayer.

The member should also assess whether to continue a professional or employment relationship with the taxpayer.

If Form 8275, Disclosure Statement, is required, may a member electronically file a return without it (in the following situation)?

A member is engaged to prepare the income tax returns for a corporation. The IRS requires the federal return to be filed electronically. The member has received and reviewed the taxpayer's tax accrual working papers and has concluded there is not "substantial authority" for a position the taxpayer wants to take, but there is a "reasonable basis" for a position that the taxpayer wants to take. The member timely communicates to the taxpayer there is a reasonable basis for taking the position but that it has to be appropriately disclosed by attaching a properly completed Form 8275 to the return. The member prepares a memorandum for her files documenting this communication with the taxpayer. The return with Form 8275 is sent to the taxpayer with an authorization form to electronically file the return with sufficient time for review and completion of the electronic filing authorization. A few days before the filing deadline, the taxpayer returns the signed e-filing authorization but instructs the member to remove Form 8275 before filing. May the member electronically file the return without Form 8275?

No. The member may not electronically file the return without Form 8275, the specified disclosure form.

FAQs for Statement on Standards for Tax Services No. 1, *General Standards for Members Providing Tax Services* Section 1.2, Knowledge of Errors

Errors on Return

What process should a member use in determining if an error on a tax return is insignificant?

Paragraph 1.2.2 of section 1.2 of SSTS No. 1 indicates "[h]owever, an error does not include an item that has an insignificant effect on the taxpayer's tax liability." The following should be considered:

- The amount of the item affected by the error in comparison with the amount of other items on the return.
- The effect on taxable income and tax liability.
- The effect of the item on prior and future returns.
- The nature of the item and possible adverse consequences that result from the nature of the item (for example, interest from a foreign bank account).

Note that Section 10.21 of Circular 230 does not contain an exception for an item with an insignificant effect on the taxpayer's tax liability.

What should a member do when the member determines a taxpayer's overstated deduction is insignificant versus significant (in the following situation)?

> *A member is representing a taxpayer during a federal tax examination. The IRS has issued an information document request (IDR) for supporting information on certain deductions claimed on the return under examination. In the process of assembling the information to respond to the IDR, the member has determined a deduction claimed on the return was overstated. What should a member do when the member determines a taxpayer's overstated deduction is insignificant versus significant?*

1. *The member has determined the overstated deduction would have an "insignificant" effect on the taxpayer's tax liability. What should the member do?*

   Section 1.2 of SSTS No. 1 is not applicable to an item that has an insignificant effect on the taxpayer's tax liability. Section 10.21 of Circular 230 does not contain an exception for an insignificant effect. Thus, Section 10.21 requires the practitioner to advise the client of the facts and consequences of the error.

2. *The member has determined the overstated deduction would have a "significant" effect on the taxpayer's tax liability. What process should the member follow in determining what to do?*

   Both Section 1.2 of SSTS No. 1 and Section 10.21 of Circular 230 require the member to inform the taxpayer of the error and the consequences of such error. Paragraph 1.2.6 of section 1.2 indicates such advice may be given orally. Although paragraph 3.1.7 of SSTS No. 3 indicates that oral advice may serve a taxpayer's needs appropriately in routine matters or in well-defined areas, written communications are recommended in important, unusual, substantial dollar value or complicated transactions. The member should use professional judgment about the need to document oral advice. The member should also consider the provisions of Section 10.33 of Circular 230. For example, in evaluating how the advice should be communicated and documented, the member should consider the client's understanding of the form and scope of the advice or assistance to be rendered and the need to establish relevant facts, and the applicable law that support the member's conclusions. Additional guidance on a member's course of action and thought process are indicated in question 3 that follows.

3. *The member has determined the overstated deduction would have a "significant" effect on the taxpayer's tax liability. The taxpayer will not allow the member to disclose the overstated deduction to the taxing authority examiner. What should the member do?*

   It is the taxpayer's responsibility to decide whether to correct or disclose an error. If the taxpayer does not correct or disclose an error, the member should consider whether to withdraw from the engagement and whether to continue a professional or employment relationship with the taxpayer. The member's decision on representing the taxpayer should be based on professional judgment, the facts and circumstances, and other applicable standards. The member should specifically consider paragraph 1.2.14 of section 1.2 of SSTS No. 1 regarding the potential adverse effect of withdrawal. The member should consider consulting with legal counsel regarding the issue of withdrawal.

   There are several standards established in Circular 230 that may be relevant. Consider the member's responsibility under Section 10.34(b)(iii) regarding submission of a document that contains information that may be considered an intentional disregard of a rule or regulation. The member also has responsibility under Section 10.34(c) to inform the client regarding potential penalties that may apply and the possible opportunity to avoid such penalties by disclosure of the error. Section 10.51(a) of Circular 230 defines incompetence and disreputable conduct for which a practitioner may be sanctioned. Under this subsection, various examples of such conduct are listed, including paragraph (4): "Giving false or misleading information, or participating in any way in the giving of false or misleading information to the Department of the Treasury or any officer or employee thereof…."

How should a member prepare the current-year's return, which includes an incorrect net operating loss (NOL) carryforward, assuming the taxpayer does not want to amend the previous year's return because it would have no tax impact for that year (in the following situation)?

> *A member is assisting a taxpayer to prepare his federal income tax return. The taxpayer started a business that has lost money for several preceding years and has an NOL carryforward. The current year shows a small amount of profit. While reviewing the taxpayer's prior-year federal return, the member notices the taxpayer has erroneously expensed some loan costs that should have been amortized. Correcting the error would reduce the amount of the NOL, but the taxpayer would still be in a position with no net tax effect. When the member informed the taxpayer of the error, the taxpayer said he did not want to amend the previous year's return because it would have no tax impact for that year. How should the member prepare the current-year's return with respect to the loan costs previously expensed?*

In these circumstances, the member may decide that it is appropriate to continue the current engagement. In this case, the member's professional obligation is to prepare a correct return for the current year. It may be incorrect to continue currently deducting the loan costs. (Consider whether the deductions would be regarded as a "method of accounting" and, if so, whether pursuant to Regs. Sec. 1.446-1(e)(2)(i), the taxpayer is required to request and secure consent from the IRS before changing a method of accounting.)

If the taxpayer is not required to obtain the IRS's consent to make the change, the current-year return should be prepared as if the returns for the prior years had reflected the correct deductions.

FAQs for Statement on Standards for Tax Services No. 2, *Standards for Members Providing Tax Compliance Services, Including Tax Return Positions*

Section 2.2, Tax Return Questions

Reasonable Steps and Omitting Answers to Questions

Paragraph 2.2.2 of section 2.2 of SSTS No. 2 provides that a member should take reasonable steps to obtain from the taxpayer the information necessary to provide appropriate answers to all questions on a tax return before signing as preparer. In general, what is the meaning of " reasonable steps" for purposes of paragraph 2.2.2?

Reasonable steps would include the following:

- Exercises due professional care and diligence
- Obtains from the taxpayer sufficient relevant data to afford a reasonable basis for the member's conclusions and recommendations
- Follows up if the taxpayer has not provided the requested information

What should be considered by a member in determining if reasonable steps have been made to answer all questions on a return?

The member should review applicable technical and ethical standards, including the following:

- AICPA Code of Professional Conduct
- SSTSs and interpretations
- Circular 230, including Sections 10.22, 10.33, and 10.34
- IRC sections, including Sections 6662, 6664, 6694, and 6700
- IRS regulations and pronouncements
- State standards and rules, if applicable

A member has completed preparation of a return and has omitted an answer to a question. May the member submit the return to the client for filing?

Yes, if the member made reasonable efforts to obtain the information needed to answer the question. Paragraph 2.2.4 of section 2.2 of SSTS No. 2 provides guidance when a member should be satisfied that a reasonable effort has been made to provide appropriate answers to the questions on a return. Paragraph 2.2.5 of section 2.2 of SSTS No. 2 indicates reasonable grounds may exist for omitting an answer to a question applicable to a taxpayer.

A member prepares a return omitting an answer after having determined that the question is not applicable to the taxpayer. May the member submit the return to the client for filing?

Yes, if the member made reasonable efforts to obtain information needed to answer the question. Paragraph 2.2.3 of section 2.2 of SSTS No. 2 provides guidance when a member should be satisfied that a reasonable effort has been made to provide appropriate answers to the questions on a return.

FAQs for Statement on Standards for Tax Services No. 2, *Standards for Members Providing Tax Compliance Services, Including Tax Return Positions*

Section 2.3, Reliance on Information From Others

Pass-Through Basis

May a member rely on an S corporation's shareholder basis worksheet produced by a prior accountant in preparing the current-year's return (in the following situation)?

> *An S corporation has been in business for 10 years and is a new client of the member. The prior accountant's tax software produced a schedule that was provided to the corporation and shareholders entitled "Shareholder Basis Worksheet." May the member rely on this form for the basis of the shareholders in preparing the current-year's return?*

Yes, if, after reviewing prior returns and the worksheet that was prepared by the prior preparer's tax software, it appears to be reasonable and the member does due diligence by confirming that the prior preparer is competent.

May a member rely on an S corporation's basis worksheet produced from a firm's tax software when older year's substantiation isn't available (in the following situation)?

> *An S corporation has been in business for 15 years and has been a firm's client since inception. The CPA has a policy of destroying all Forms 1120S,* U.S. Income Tax Return for an S Corporation*, and working papers after 7 years. Neither the firm nor the corporation has copies of the first 8 years of tax returns. The firm's software produces a schedule entitled "Shareholder Basis Worksheet." The current tax period is the first year out of the last 7 in which it appears there may have been distributions in excess of basis. May a member rely on this basis worksheet?*

The member may rely on the worksheet if the numbers seem reasonable after examining the seven most recent returns and the worksheet calculations.

FAQs for Statement on Standards for Tax Services No. 2, *Standards for Members Providing Tax Compliance Services, Including Tax Return Positions*

Section 2.4, Use of Estimates

Casualty Losses of Real and Personal Property

For purposes of a casualty loss determination regarding a taxpayer's primary residence, may a member accept a taxpayer's estimate for improvements when receipts are missing during the period of ownership (in the following situation)?

> *A taxpayer's residence was destroyed by a fire and the taxpayer has to prepare a list of improvements and a computation of basis of the residence for both insurance and casualty loss purposes. The taxpayer has owned the residence for many years and does not have receipts for all improvements made during the period of ownership. The member has reviewed the taxpayer's list of improvements and estimate of basis and considers them reasonable. May the member accept the taxpayer's estimate for the improvements made by the taxpayer when receipts are missing during the period of ownership in determining any casualty loss on the fire? Disclosure is required under paragraph 2.4.7 of section 2.4 of SSTS No. 2. The member should also consider other applicable rules, including the rules of the taxing jurisdiction.*

The member may accept a taxpayer's estimate of basis in the residence because it is not practical to obtain exact data and when the member considers the taxpayer's estimate reasonable based on the facts and circumstances known to the member. The member should use professional judgment about whether disclosure is required under paragraph 2.4.7 of section 2.4 of SSTS No. 2. The member should also consider other applicable rules, including the rules of the taxing jurisdiction.

May a member accept an insurance company's estimate for the fair market value in determining any loss on personal property destroyed in a fire (in the following situation)?

> *A taxpayer's residence was partially destroyed by a fire and the taxpayer is preparing a computation of basis for the personal property lost in the fire. The taxpayer does not have receipts for all personal property in the residence and must estimate the date acquired, cost, and fair market value (FMV) for much of the personal property. The taxpayer develops an insurance claim submission by walking through the property with an insurance adjuster from the taxpayer's insurer. In addition to the taxpayer's written estimates, the taxpayer furnished the member with the sworn proof of claim submitted to the insurance company with all personal property items lost and a copy of the taxpayer's insurance policy. May the member accept the insurance company's estimate for the FMV in determining any loss on the personal property destroyed in the fire?*

The member should be able to accept the insurance company's estimate because the insurance adjuster would want to pay only what the property is worth and is disinterested in the tax effect.

May a member accept a taxpayer's estimates in preparing a return (in the following situation)?

> *A husband and wife sell their residence and have a substantial gain. They have owned the residence for a number of years and have done extensive improvements during the time they owned the residence. The taxpayers do not have receipts for all the improvements, but they have furnished the member with a list of improvements and estimated costs of these improvements. In addition to the taxpayer's list of improvements, the taxpayers have furnished the member with pictures of the residence taken in previous years showing improvements, a copy of the insurance policy documents from previous municipal code inspections, and filings with the state for real estate taxes. May the member accept the taxpayers' estimates in preparing the return?*

It seems reasonable to use the taxpayers' estimates.

FAQs for Statement on Standards for Tax Services No. 2, *Standards for Members Providing Tax Compliance Services, Including Tax Return Positions*

Section 2.4, Use of Estimates

Earnings and Profits

Would it be reasonable to use retained earnings shown on a financial statement as an estimate of cumulative earnings and profits for years that have missing tax returns (in the following situation)?

> *Company A will be making a distribution to shareholders and must determine its earnings and profits in order to determine the amount of the distribution that is dividend income and enable shareholders' treatment of the distribution with respect to capital gain or return of capital, or both. The company has been in existence longer than 10 years and has never made any type of distribution and has never calculated its earnings and profits. Copies of tax returns for the past 5 years are available, and financial statement information is available for all years of the company's existence. Although the company has made diligent efforts to obtain the missing tax returns, it has been unable to do so. It is not practical to obtain the missing information by any reasonable means. There have not been any Forms 5452,* Corporate Report of Nondividend Distributions*, prepared, which would reflect the earnings and profits on a yearly basis.*
>
> *The company has indicated these financial statement amounts could be used in preparing estimates for earnings and profits for the tax years for which tax returns are not available. The member has reviewed this information and believes it is reasonable to use as an estimate for earnings and profits purposes. Would it be reasonable to use financial statement retained earnings for the years when returns are missing as an estimate of cumulative earnings and profits for those years?*

Yes. The member may use the taxpayer's estimate of the earnings and profits based on the financial statement retained earnings because the member has determined the estimates are reasonable based on the facts and circumstances known to the member and the member has exercised professional judgment.

May the member prepare the necessary filings for the taxpayer to report distributions when the taxpayer will not make any effort to obtain the missing information (in the following situation)?

> *Same facts as question 1, except the taxpayer will not make any effort to obtain missing information to determine the earnings and profits and the tax consequences of the distributions to the shareholders. The taxpayer also is not willing to treat the distributions as ordinary dividends due to the absence of any information to the contrary. May the member prepare the necessary filings for the taxpayer to report the distributions?*

No. The member may not prepare the necessary filings for the taxpayer because the taxpayer has not made reasonable efforts to obtain information necessary to estimate the earnings and profits to make the determination of the tax effect of the distributions.

FAQs for Statement on Standards for Tax Services No. 2, *Standards for Members Providing Tax Compliance Services, Including Tax Return Positions*

Section 2.4, Use of Estimates

Home Office

A taxpayer has accurate records regarding her actual home office expenses. Is an estimate of the business portion of her principal residence provided by the taxpayer reasonable (in the following situation)?

> *A taxpayer uses her home office regularly and exclusively as her principal place of business. The taxpayer does not have a survey of her home but has measured the floor space of the room used as an office and has furnished the member with the total floor space in her home. The taxpayer estimates that the home office occupies 300 square feet of 2,400 total square feet of the home. In addition, the taxpayer has accurate records of the actual expenses paid for her home. Is the estimate prepared by the taxpayer reasonable?*

The taxpayer's estimate appears to be reasonable and meets the criteria under section 2.4 of SSTS No. 2.

A taxpayer doesn't have accurate records regarding her home office and the member thinks the taxpayer's estimates aren't reasonable. Should the member use the taxpayer's estimates (in the following situation)?

> *A taxpayer uses her home office regularly and exclusively as her principal place of business. The taxpayer communicates to the member that she does not have a record of the actual expenses paid for the home office, but she provides the member with an estimate of her expenses for the entire home without separating them into the proper categories needed for reporting on her tax return. The taxpayer has also provided the member with an estimate of the home office square footage and total square footage, which the member considers not reasonable. Is the estimate provided by the taxpayer reasonable?*

The taxpayer's estimate is not reasonable and does not meet the criteria under paragraph 2.4.2 of section 2.4 of SSTS No. 2. The estimates furnished by the taxpayer are not reasonable based on the facts and circumstances known to the member.

Statement on Standards for Tax Services No. 3, *Standards for Members Providing Tax Consulting Services*

Communication and Documentation

Background

SSTS No. 3, *Standards for Members Providing Tax Consulting Services*, offers guidance to members for communicating tax advice to taxpayers on federal, state, local, and international tax matters. Tax advice is a broad topic and includes the application of tax law (statutes, regulations, case law, and other issued guidance of a specific jurisdiction) to the specific facts and circumstances of a transaction, ongoing operations and activities, or taxpayer planning situations. Both compliance and planning engagements are included.

When providing advice on federal tax matters, members should also consult requirements in Section 10.37 of Circular 230 for written advice. This section provides members with a detailed explanation of the applicable rules and considerations for written advice in federal tax matters and the process a member should use in providing both written and oral advice. In addition, members should consult paragraph 3.1.8 of SSTS No. 3 when deciding on the form of written advice to taxpayers.

FAQs

What form and content should a member use to communicate the tax consequences of a property sale when written advice is requested by a taxpayer versus when it is not requested by a taxpayer (in the following situation)?

> *A member had a tax planning meeting with a taxpayer. The taxpayer indicated that he recently sold depreciable real property and would like the member to review the transaction and provide written advice on the potential tax consequences. The taxpayer does not believe he should have a tax issue because the sales price is very close to the acquisition cost. The member knows the property has been depreciated yearly, the client has a low basis in the property sold due to depreciation claimed on previous income tax returns, and there are other considerations, including the taxpayer's other income, alternative minimum tax, and state and local tax, that could affect the amount of tax due by the taxpayer. What form and content should the member use to communicate the potential tax consequences of the property sale when written advice is requested by the taxpayer versus when it is not requested by the taxpayer?*

1. *What form and content should the member use to communicate the potential tax consequences of the property sale when written advice is requested by the taxpayer?*

   The taxpayer appears to not understand the relationship between depreciation expense claimed on previous years' tax returns and the gain computation at the time of the sale. The member may consider providing the taxpayer with an oral explanation during their conversation so that the taxpayer is not surprised by the results or overlooks it when the written advice is provided.

   There is no required format for tax advice under SSTS No. 3 or Circular 230. Paragraph 3.1.8 of SSTS No. 3 provides factors to be considered when deciding on the format. One such factor is "the tax sophistication of the taxpayer." Because it seems the taxpayer does not understand the tax issues associated with the transaction, the written advice should provide a sufficient explanation so that a person without tax sophistication can understand how the tax law applies to the person's situation.

With respect to content, the member should exercise professional judgment and consider the following issues associated with the sale:

- Taxpayer's other income
- Explanation of depreciation rules and adjusted basis of the property sold
- State and local tax issues
- Possible alternative minimum and net investment income taxes, passive losses and carryovers, and other carryover items
- Possible alternatives, if any (for example, a tax-free exchange)
- Possible federal, state, and local penalty provisions
- Other relevant issues depending on the taxpayer's tax situation and financial knowledge
- Other considerations for issues addressed in SSTS Nos. 1, 2, and 4.

  Paragraph 3.1.4 of SSTS No. 3 provides that, when providing tax advice, a member should assume that the tax advice will affect the manner in which the matter is reported or disclosed on the taxpayer's return, and the member should therefore consider the potential penalty consequences of the issues on which the advice is provided. Accordingly, the member should consider including information on potential penalties that could be associated with the transaction.

Additional information that should be considered includes the following:

- The advice reflects professional judgment based on the member's understanding of the facts and the law existing as of the date the advice is rendered.
- Subsequent developments could affect previously rendered professional advice.

  The member has no obligation to communicate subsequent developments that could affect previously rendered professional advice unless by specific agreement.

2. *What form and content should the member use to communicate the potential tax consequences of the property sale when written advice is not requested by the taxpayer?*

   The member should explain the gain to be reported for tax purposes and other tax implications of the sale which the taxpayer may not have anticipated. The member may counsel the taxpayer that the taxpayer would benefit from written tax advice (which would further clarify the tax implications of the sale).

   When the taxpayer requests oral advice only, it is recommended that the member contemporaneously document the advice in written form in the taxpayer's file.

When the need for outside consultation is required, what steps should a member take to communicate the need for outside expertise to a taxpayer, and how should a member evaluate and document the outside professional advice received (in the following situation)?

A taxpayer has invested a substantial amount of money in the rehabilitation of a building with the intention of qualifying for rehabilitation and other available tax credits. The taxpayer is also interested in maximizing depreciation deductions. The taxpayer has engaged a member to prepare the applicable returns reflecting these items. The member has determined that outside professional advice will be needed to determine depreciation lives of the building components and the tax benefits of the expenditures. What steps should the member take to communicate the need for outside expertise and how should the member evaluate and document the outside professional advice received?

1. *What steps should the member take to communicate the need for outside expertise?*

   The member should communicate to the taxpayer that the member does not have the experience and expertise to determine the information necessary to prepare the returns. Therefore, the member recommends obtaining additional professional advice.

2. *How should the member evaluate and document the outside professional advice received?*

   The member should evaluate the advice from the outside professional adviser using professional judgment. Regs. Sec. 1.6694-2(e)(5) provides factors to consider when relying on the advice of others, including whether the advice was reasonable on its face and the qualifications of the outside adviser. The member should also review Section 10.22(b) of Circular 230 and applicable reporting and disclosure standards in the IRC and regulations and the jurisdictions where the returns will be filed.

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