

## Written Tax Advice Will Now Come With Disclaimer

The next time you receive written federal tax advice from a tax advisor, either in print or by email, you may see the following disclaimer included in the tax advice:

*This tax advice was not intended or written to be used, and it cannot be used, by any taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer.*

Effective for tax advice rendered after June 20, 2005, this disclaimer is included among several “best practices” set forth in final Department of Treasury regulations governing practice by tax advisors before the Internal Revenue Service, referred to as Circular 230. Although Treasury’s introduction to these final regulations provide that “best practices” are not mandatory, it states the following, “Although best practices are solely aspirational, tax professionals are expected to observe these practices to preserve public confidence in the tax system.”

This Bulletin is intended to provide you with an explanation of this disclaimer and the kind of written tax advice in which it should be expected.

### Background

Section 6662 of the Internal Revenue Code (IRC) imposes a 20 percent taxpayer penalty on “any substantial understatement of income tax” and other underpayments of tax, including underpayments attributable to “negligence or disregard of rules or regulations.”

Generally, a substantial understatement of income tax exists where the amount of the tax understatement for the taxable year exceeds the greater of 10 percent of the amount of tax that should have been reported on the return, or \$5,000. However, in the case of a corporation other than an S corporation or a personal holding company, a substantial understatement of income tax exists where the amount of the tax understatement for the taxable year exceeds the lesser of 10 percent of the amount of tax that should have been reported on the return (or \$10,000, if greater) or \$1,000,000. For example, if a regular C corporation took an improper deduction that resulted in a decrease in tax from \$105,000, the correct amount, to \$90,000, a \$3,000 penalty (20 percent of \$15,000) may

be imposed. IRC Sec. 6664 provides an exception to the 20 percent underpayment penalty if the taxpayer can successfully demonstrate that there was reasonable cause for, and the taxpayer acted in good faith with respect to, the underpayment. A taxpayer’s reasonable reliance in good faith on the advice of a professional tax advisor may satisfy this reasonable cause exception.

Circular 230 was recently modified to establish higher standards that a tax advisor must meet in providing a client with written tax advice that the client can rely upon for penalty protection. Written tax advice that a taxpayer can rely upon for penalty protection is referred to in Circular 230 as a “covered opinion.” A covered opinion must conclude at a confidence level of “more likely than not” (greater than 50 percent likelihood) that the tax treatment described in the opinion will be sustained. It must be based upon facts the tax advisor used reasonable efforts to identify and upon any reasonable factual assumptions and representations. A covered opinion is required to describe the relevant

---

*Continued on back*

facts (including assumptions and representations), consider all relevant issues, apply the law to those facts, and provide a conclusion with respect to the law and the facts.

Based on all of the prerequisites and related costs for a covered opinion, taxpayers should anticipate that such an opinion will only be issued upon request.

Written tax advice that a taxpayer cannot rely upon for penalty protection is referred to in Circular 230 as “other written advice.” Other written advice does not provide a more likely than not conclusion and is not required by Circular 230 to meet the same high standards of a covered opinion.

### Reason for the Disclaimer on “Other Written Advice”

Included among the best practices described in final Circular 230 is “advising the client regarding the import of the conclusions reached, including, for example, whether a taxpayer may avoid accuracy-related penalties under the Internal Revenue Code if a taxpayer acts in reliance on the advice.” Accordingly, where a tax advisor has been engaged to provide written tax advice that is not a covered opinion, this best practice is satisfied by the inclusion of the subject disclaimer described above.

In the event of an IRS examination that includes the subject matter of

“other written advice,” the disclaimer does not mean that the authorities and reasoning included in the written tax advice cannot be used, or a copy of the written tax advice provided to the examining agent, to defend the tax treatment of such matter. However, if the IRS is not convinced and assesses tax and a penalty, “other written advice” provides no assurance that such penalty will not be upheld.

*Material discussed in this Bulletin is meant to provide general information and should not be acted on without obtaining professional advice appropriately tailored to your individual needs. If you need to discuss these or other tax issues, please call us at (503) 221-0336.*

©2005, Perkins & Company, P.C.



1211 SW Fifth Avenue  
Suite 1000  
Portland, Oregon 97204

