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**Using Disclosure Statements to  
Proactively Manage Tax Controversies**

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## I. Introduction

The considerable gray area in tax law sometimes requires taxpayers to take tax reporting positions that are not certain to be sustained if reviewed by the tax authorities. With \$80 billion in additional funding provided to the Internal Revenue Service (“IRS”) under the Inflation Reduction Act of 2022 (the “Act”),<sup>1</sup> taxpayers with uncertain reporting positions need tools to protect against penalties and audit risk.<sup>1</sup> Tools available to manage uncertain tax positions include private letter rulings, pre-filing agreements, tax opinion letters, and tax insurance. Surprisingly, however, tax practitioners often overlook the simplest tool to manage tax-related risk: adequately disclosing the uncertain position to the tax authority. Disclosure is cost-effective, and it can mitigate against many common penalties as well as start the clock on the statute of limitations for assessment.

This article focuses on the use of disclosure statements in modern tax practice. It discusses: ethical and professional duties tax professionals owe to clients and the IRS concerning mandatory and elective tax disclosures; circumstances in which disclosure of an item or a tax reporting position is required by the internal revenue laws; situations in which disclosure of an uncertain tax reporting position, while not mandated by the internal revenue laws, is still advisable to manage penalties or statutes of limitation; and the reasons a well-crafted tax disclosure is sometimes preferred to a private letter ruling, a pre-filing agreement, a tax opinion letter, or tax insurance.

## II. Ethical and Professional Duties Concerning Tax Disclosures

### A. Tax Return Preparers

#### 1. Generally

Irrespective of whether disclosures are required or elective, tax professionals are subject to ethical and professional rules that dictate their obligations to clients concerning these disclosures. Tax returns involving an item or a position to be disclosed on the tax return are typically prepared by one or more signing or nonsigning tax return preparers who are subject to the requirements of title 31 of the Code of Federal Regulations (“Circular 230”). The class of persons subject to Circular 230 is broad, including:

- A signing tax return preparer, which is the individual tax return preparer who has the primary responsibility for the overall substantive accuracy of the preparation of the tax return or claim for refund; and
- A nonsigning tax return preparer, which generally includes any tax return preparer who is not a signing tax return preparer but who prepares all or a substantial portion of a tax return or claim for refund by, for example, rendering tax advice on a

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<sup>1</sup> Inflation Reduction Act of 2022, H.R. 5376, Part 3 of Title I, Subtitle A (Aug. 7, 2022). The Act provides for roughly \$80 billion in additional funding for the IRS over approximately ten years, including more than \$45 billion for civil and criminal tax enforcement. *Id.* at § 10301.

position that is directly relevant to the determination of the existence, characterization, or amount of any entry on a tax return or claim for refund.<sup>2</sup>

Tax professionals may be surprised to find they are nonsigning tax return preparers, even if they advised on a single, but significant, aspect of a tax return or claim for refund. To be sure, Treasury Regulations provide numerous examples of signing and nonsigning tax return preparers under the Code. Among the persons specified as nonsigning tax return preparers are individuals who provide written or oral advice to a taxpayer (or to another tax return preparer) when that advice leads to a position or entry that constitutes a substantial portion of the tax return or claim for refund.<sup>3</sup> Furthermore, a person who furnishes to a taxpayer or other tax return preparer sufficient information and advice so completion of the return or claim for refund is largely a mechanical or clerical matter is considered a tax return preparer, even though that person does not actually place or review placement of information on the return.<sup>4</sup> Under these authorities, a nonsigning tax return preparer (and therefore a tax return preparer under the Code) specifically includes a lawyer who renders advice directly relevant to the determination of an entry on a taxpayer's tax return.<sup>5</sup>

It is against this background that a tax professional who advises a taxpayer on a position making up a portion of a tax return can unwittingly be subject to the requirements of Circular 230, including numerous affirmative obligations concerning tax disclosures.

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<sup>2</sup> See Circular 230 § 10.2(a)(8) (defining a tax return preparer by cross-reference to Code Section 7701(a)(36) and Treasury Regulations Section 301.7701-15). Code Section 7701(a)(36)(A), in turn, generally defines a tax return preparer as any person who prepares for compensation, or who employs one or more persons to prepare for compensation, all or a substantial portion of any tax return or claim for refund. See also Reg. § 301.7701-15(a). As noted, a tax return preparer includes: (1) a signing tax return preparer, which is the individual tax return preparer who has the primary responsibility for the overall substantive accuracy of the preparation of the tax return or claim for refund; and (2) a nonsigning tax return preparer, which generally includes any tax return preparer who is not a signing tax return preparer but who prepares all or a substantial portion of a tax return or claim for refund by, for example, rendering tax advice on a position that is directly relevant to the determination of the existence, characterization, or amount of any entry on a tax return or claim for refund. Compare Reg. § 301.7701-15(b)(1) (defining a signing tax return preparer), with Reg. § 301.7701-15(b)(2)(i) (defining a nonsigning tax return preparer), and Reg. § 301.7701-15(b)(3) (defining when it is appropriate to treat a nonsigning tax return preparer as a tax return preparer).

<sup>3</sup> Reg. § 301.7701-15(b)(2).

<sup>4</sup> Reg. § 301.7701-15(c).

<sup>5</sup> See Reg. § 301.7701-15(b)(2)(ii), Ex. 1. The example and related conclusion is as follows:

Attorney A, an attorney in a law firm, provides legal advice to a large corporate taxpayer regarding a completed corporate transaction. The advice provided by A is directly relevant to the determination of an entry on the taxpayer's return, and this advice leads to a position(s) or entry that constitutes a substantial portion of the return. A, however, does not prepare any other portion of the taxpayer's return and is not the signing tax return preparer of this return. A is considered a nonsigning tax return preparer.

*Id.*

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