ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK

COMMENTS ON CIRCULAR 230 REGULATIONS

AS REPORTED BY THE COMMITTEES ON ESTATE AND GIFT TAXATION, TAXATION OF BUSINESS ENTITIES, PERSONAL INCOME TAXATION AND TRUSTS, ESTATES AND SURROGATE'S COURTS

May 10, 2005

This report sets forth the comments of the Association of the Bar of the City of New York to the final regulations to Circular 230 that were published on December 20, 2004. Section I of this report introduces the issues and summarizes our recommendations. Section II discusses the provisions of the final regulations. Section III sets forth a detailed explanation of the recommendations summarized in Section I.

I. Introduction and Summary of Recommendations

On December 20, 2004 the U.S. Department of the Treasury ("Treasury") and the Internal Revenue Service (the "Service") published final regulations to Circular 230, which governs tax practice before the Service (the "New Regulations").[1] The New Regulations, which, for the most part, become effective on June 20, 2005, (i) set forth best practices for tax advisors providing advice relating to Federal tax issues and (ii) contain *standards* governing written tax advice to clients. Tax practitioners who violate the standards contained in the New Regulations are subject to censure, suspension, or disbarment from practice before the Service.[2]

The New Regulations, as drafted, reach far beyond the laudatory objective of targeting abusive tax shelter transactions, and so-called "cookie cutter" opinions that would sometimes be issued to support them. Rather, the New Regulations will almost certainly have a significant impact on how tax advisors communicate in writing (including by e-mail) on a daily basis with their clients by requiring most written tax advice to comply with the standards normally applicable to formal opinions of law.

There is substantial concern among the tax bar that the wide net cast by the New Regulations will restrict the normal flow of routine written tax advice from the lawyer to the client. As a result, some taxpayers will not obtain the timely and reasonably priced advice they have come to expect and, consequently, may unknowingly report the tax consequences of transactions on their tax returns improperly. This is hardly the outcome envisioned by the issuance of the New Regulations.

The New Regulations restrict the communication of competent written tax advice in a number of ways. First, written advice will be more costly and some clients will balk at receiving

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1 31 CFR part 10, reprinted as Treasury Department Circular 230.

2 The American Jobs Creation Act of 2004 (P.L. 108-357) (the "Jobs Act") also authorizes Treasury and the Service to impose a monetary penalty against practitioners who violate any provision of Circular 230. The New Regulations do not reflect this authorization.

written advice under this new effective fee structure. Fees will increase for several reasons. The obvious cause for the increase in fees relates to the cost of compliance with the new due diligence standards for covered opinions. Tax practitioners will need to devote substantially more time to the client's matter in order to meet these standards. Equally time consuming, perhaps, will be the time required to be spent by counsel in determining whether written advice concerning a transaction constitutes a covered opinion. The line drawing between a "significant" purpose and the "principal" purpose -- which may be necessary to determine one's obligations under the New Regulations -- is one that has bedeviled tax lawyers for years, but counsel will have to make that determination and others on almost every e-mail advice they plan to send out.[3]

Written tax advice will also be restricted under the New Regulations as a result of the increased amount of time that will be required to issue it. In our practices, we are frequently presented with situations where the client comes to us about to engage in a transaction and needs tax advice concerning that transaction that very day or week. Before written advice can be provided, however, the attorney would now need to undertake the analysis of whether, or to what extent, the advice is covered by the New Regulations. Oral tax advice may therefore become the norm in most situations. Oral tax advice, however, by its very nature, is more susceptible to imprecision and misunderstanding and increases the risk that the tax advice rendered will be incomplete or misapplied by the taxpayer.

Moreover, we are concerned that the likely consequence of the New Regulations on day-to-day tax practice (which generally does *not* involve abusive tax shelters) will be confusion and anxiety on the part of tax practitioners who will be faced with little guidance in how to go about conforming their conduct to the standards articulated in the New Regulations. Take, for example, the case of an estate planning lawyer who drafts a last will and testament (a "Will") for a client containing generation-skipping transfer tax ("GST" or "GST tax") provisions that relate to both (i) the authority of the executor and the trustee, as the case may be, to allocate GST tax exemption and sever the credit shelter trust, or the qualified terminable interest property ("QTIP") marital deduction trust, into separate GST exempt and nonexempt trusts and (ii) the operation of the GST exempt and nonexempt trusts ("Example 1"). There can be little doubt here that the principal purpose of the GST exempt trust and the related GST provisions under the client's Will is to minimize exposure to GST tax, which, in this case, is a tax avoidance purpose that Congress has specifically "blessed" under Sections 2632, 2642(a)(3) and 2652(a)(3).[4] It would appear, however, that *any* memorandum provided to the client discussing the purpose and operation of the GST exempt and nonexempt trusts under the client's Will could constitute a "covered opinion" under the New Regulations as it is written advice relating to a Federal tax issue arising from an *arrangement* (in this case, testamentary trusts[5] with GST provisions) the *principal purpose* of which is the avoidance of tax (here, the GST tax). Moreover, because the principal purpose (as distinguished from a "significant purpose") of the GST exempt trust is to

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[3] This point is discussed more fully in subsection C of section III of these comments.

[4] References to Sections are to sections of the Internal Revenue Code of 1986 (the "Code"), as amended, if preceded by "Treasury Regulations," to sections of the Treasury Regulations under the Code, or, if preceded by "Circular," to sections of the New Regulations.

[5] Treasury Regulations Section 301.7701-4(a) defines a trust as generally referring to "an *arrangement* created either by a will or by an inter vivos declaration whereby trustees take title to property for the purpose of protecting or conserving it for the beneficiaries under the ordinary rules applied in chancery or probate courts."

avoid GST tax, the practitioner, under the New Regulations, presumably (i) would *not* be able to avoid covered opinion status on the basis that no significant Federal tax issue is presented; (ii) would *not* be able to "elect out" of covered opinion status by prominently disclosing that the written advice was not intended or written by the practitioner to be used, and that it cannot be used by the taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer; and (iii) would *not* be able to provide a "limited scope opinion."

Varying the facts of this example, assuming that there were no separate memorandum and the practitioner merely delivered to his or her client a draft of this Will ("Example 2"), would the GST exempt trust provisions themselves constitute written advice thereby triggering the covered opinion requirements? The Will in this case could potentially be regarded as a writing that embodies the tax practitioner's advice to his or her client.[6] Further – and this would also apply to Example 1 in which a memorandum is provided to the client that explains the GST exempt trust provisions -- query to what extent (if any) the practitioner may be able to avail himself or herself of the exclusion from the definition of a covered opinion for "preliminary advice" on the basis that, under the circumstances, it is reasonable for the practitioner to believe that at some point in the future (perhaps 5, 10, 20 or 30 or more years down the road) a practitioner (perhaps even some other practitioner) will provide subsequent written advice to the client that satisfies the requirements for covered opinions.[7]

As a further variation on these facts, what if the entity, plan or arrangement that is the subject of the written tax advice is an irrevocable life insurance trust (an "ILIT") ("Example 3")? ILITs serve both tax and nontax objectives by (i) designating the manner in which the life insurance proceeds payable upon the settlor's death to the ILIT trustee are to be distributed to or for the benefit of the ILIT beneficiaries, (ii) providing an important source of liquidity for the payment of estate taxes, and (iii) saving (*i.e.*, avoiding) Federal estate and income taxes under Sections 2042 and 101 respectively. Does the tax avoidance component of the ILIT constitute the principal purpose, or merely a significant purpose, of this arrangement? Also, would the analysis be changed yet again if the ILIT also contains GST provisions as in Example 1 (as would generally be expected)? The New Regulations would leave the resolution of these ephemeral issues to the practitioner's judgment and subject the practitioner to discipline should the Service determine after the fact that the practitioner had made the wrong call.

Treasury officials have reacted to these and other concerns by encouraging tax practitioners "to submit detailed comments that would help identify advice that shouldn't be subject to burdensome restrictions."[8] This report sets forth the response to Treasury's requests

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[6] This point is discussed more fully in subsection B of section III of these comments.

[7] As has been suggested by others who have submitted comments to the Service, if the New Regulations intrude into the relationship between an attorney and his or her client or interfere with the legitimate expression of opinion as to the interpretation of the tax law to a degree that is more than is necessary to achieve legitimate tax enforcement goals, First Amendment issues are raised. See, generally, Jonathan G. Blattmachr, Mitchell M. Gans & Tracy L. Bentley, THE APPLICATION OF CIRCULAR 230 IN ESTATE PLANNING (THIS ARTICLE MAY NOT BE RELIED UPON FOR PENALTY PROTECTION), Tax Notes (April 4, 2005).

[8] GOVERNMENT URGES COMMON-SENSE APPROACH TO CIRCULAR 230 REGS., Tax Notes Today (February 10, 2005), describing remarks made by Eric Solomon, Deputy Assistant Secretary for Tax Policy, during a February 9, 2005 ABA-CLE Teleconference. See also TENSION MOUNTS OVER OPINION STANDARDS AS

for comments of the Association of the Bar of the City of New York. We believe it is possible to amend the New Regulations to facilitate the delivery of legitimate tax advice without compromising Treasury's and the Service's attempts to curb the proliferation of abusive tax shelters.[9]

As a preliminary matter, we join in the request of other professional associations that Treasury and the Service should promptly announce that they are postponing the June 20, 2005 effective date of the New Regulations while they consider the comments that they receive. Practitioners should not be forced to incur the significant expense of preparing for the effective date if the rules are likely to change in response to comments. Moreover, given the "critical role"[10] that tax practitioners play in the Federal tax system, we respectfully submit that if Treasury were to revise the New Regulations prior to the June 20, 2005 effective date,[11] the June 20, 2005 effective date *still* should be postponed for some reasonable period of time (i) to allow practitioners to comment fully on any such revised regulations and (ii) to give practitioners adequate time to prepare to apply these new rules.

Our recommendations are summarized immediately below and are explained in more detail in section III of these comments. Items A through J below contain our recommendations for crafting a more workable definition of "covered opinion," the term used in the New Regulations to identify the kinds of written advice required to comply with standards normally applicable to formal opinions of law. Items K and L set forth our recommendations concerning the rules applicable to covered opinions.[12] Item M points out a typographical error in a cross-reference appearing in the New Regulations. Item N sets forth our recommendation concerning the "best practices" provisions contained in Circular Section 10.33.

EFFECTIVE DATE DRAWS NEAR, Tax Notes Today (April 20, 2005), describing remarks made by Mr. Solomon during an April 19, 2005 meeting of the Pennsylvania Bar Institute.

9 The authors of this report wish to explicitly acknowledge the "Comments on Circular 230 Regulations" dated April 6, 2005, submitted by the American College of Trust and Estate Counsel (hereinafter the "ACTEC April 2005 Comments"). The authors of this report have drawn upon the well-articulated points and thorough analysis of the ACTEC April 2005 Comments in compiling this report. The following recommendations set forth in this report are substantially similar to the text of Recommendations A through G, respectively, of the ACTEC April 2005 Comments: Recommendations A, C, G, H, I, K and L.

10 CIRCULAR 230 REGS TO BE CLARIFIED BEFORE EFFECTIVE DATE, TREASURY SAYS, Tax Notes Today (May 5, 2005), reprinting letter from Eric Solomon, Deputy Assistant Secretary for Tax Policy, to Gary B. McDowell, dated May 3, 2005, stating, among other things, that Treasury intends to make clarifications to the New Regulations before they go into effect on June 20, 2005 that reflect some of the suggestions received from tax practitioners.

11 See id.

12 See, generally, Jonathan G. Blattmachr, Mitchell M. Gans & Tracy L. Bentley, THE APPLICATION OF CIRCULAR 230 IN ESTATE PLANNING (THIS ARTICLE MAY NOT BE RELIED UPON FOR PENALTY PROTECTION), Tax Notes (April 4, 2005), recommending certain changes to the New Regulations, some of which are similar to the recommendations made herein.

A. Clarify and Limit the Definition of Covered Opinion

We join in the view expressed by ACTEC in its April 2005 Comments that the definition of covered opinion should be limited to listed transactions, written advice concerning reportable transactions which have a significant purpose of avoiding Federal income tax ("Significant Purpose Reportable Transactions") and marketed opinions. We use the terms "listed transactions" and "reportable transactions" as they are used in Section 6662A.

If Treasury and the Service believe that this definition of covered opinion is too narrow, we believe it would be reasonable to add tax shelters as described in Section 6662(d) and as defined more fully in Treasury Regulations Section 1.6662-4(g)(2).

B. Define the Terms "Entity," "Plan" and "Arrangement" for Purposes of Determining Whether There is a Covered Opinion

If the recommendations set forth in paragraph A are not acceptable, we suggest that clarification be provided concerning the terms "entity," "plan" and "arrangement" for purposes of Circular Sections 10.35(b)(2)(i)(B) and 10.35(b)(2)(i)(C). Presumably, these terms are narrower in their scope than the term "transaction" and thus would not encompass tax advice concerning a particular transaction (such as a contemplated distribution, be it from a corporation, partnership or a trust), including tax advice that may be embodied in operative documents, so long as that transaction does not constitute (or form part of) an entity, plan or arrangement, the principal (or a significant, as the case may be) purpose of which is the evasion or avoidance of tax.

C. Eliminate the Distinction Between Principal Purpose and Significant Purpose Entities, Plans or Arrangements

Also assuming that the recommendations set forth in paragraph A are not acceptable, we suggest the removal of the distinction between (i) entities, plans or arrangements the *principal* purpose of which is tax avoidance and (ii) entities, plans or arrangements a *significant* purpose of which is tax avoidance ("Principal Purpose Entities, Plans or Arrangements" and "Significant Purpose Entities, Plans or Arrangements," respectively).

D. Clarify the Exclusion for Preliminary Advice

Circular Section 10.35(b)(2)(ii)(A) excludes from the definition of a covered opinion "[w]ritten advice provided to a client during the course of an engagement if a practitioner is reasonably expected to provide subsequent written advice to the client that satisfies the requirements of this section." Guidance is needed concerning the contours of this exclusion.

E. Provide Guidance Concerning the Distinction Between Significant and Incidental Purposes of Tax Avoidance

Guidance is needed to clarify what standards should apply for determining whether the tax avoidance purpose of an entity, plan or arrangement is significant, as opposed to merely incidental or tangential.

F. Exclude Tax Avoidance Techniques "Blessed" by Congress

The New Regulations should be revised to generally exclude written advice relating to tax avoidance techniques that have been "blessed" by Congress, as the objectives and policies underlying the New Regulations simply do not apply to them.

G. Exclude Written Advice That Concludes There Is Not a Reasonable Basis for Tax Treatment Favorable to the Taxpayer

The definition of covered opinion should be revised to exclude written advice that concludes there is *not* at least a reasonable basis for the tax treatment the taxpayer seeks to achieve in connection with a particular transaction. Clearly it is in the government's (and the client's) best interests to allow a practitioner to concisely advise a client that a proposed transaction is *not* effective to avoid tax.

H. Clarify the Definition of Marketed Opinion

The regulations should clarify and refocus the definition of "marketed opinion" so that the emphasis is less on the possible use of the opinion by a person other than the practitioner's client and more on its use to sell a transaction having a significant purpose of avoiding taxes.

I. Extend the Covered Opinion Standards Now Applicable to Significant Purpose Entities, Plans or Arrangements to all Covered Opinions

The requirements now applicable to "reliance opinions" that are issued in connection with Significant Purpose Entities, Plans or Arrangements should be extended to apply to all covered opinions. That is, practitioners (i) should be able to elect out of the covered opinion requirements for any particular writing by including in that writing a prominent disclosure that the writing cannot be used for the purpose of penalty protection, and (ii) should be able to provide limited scope opinions with respect to any type of transaction.

J. Clarify the SEC Exclusion

The exclusion for written advice included in documents filed with the Securities and Exchange Commission ("SEC") should be clarified, among other things, to include advice that is described, but not included in SEC documents.

K. Revise the Type of Disclosure Required to Elect Out of Covered Opinion Treatment

The disclosure requirements of Circular Sections 10.35(b)(2)(ii) and (b)(8), which enable practitioners to elect out of the rules governing covered opinions in certain circumstances, should be modified so that they are less disruptive to the attorney-client relationship and more practical in view of modern methods of attorney-client communication, such as e-mail.

L. Modify the Disclosure Requirements Applicable to Opinions Concerning a Significant Federal Tax Issue When a More Likely Than Not Conclusion Is Unnecessary to Avoid Penalties

The disclosure requirement of Circular Section 10.35(e)(4) should be revised to allow clients to rely on opinions failing to reach a "more likely than not" conclusion in situations where the Code does not in fact require a more likely than not conclusion to avoid penalties.

M. Correct Typographical Error in Cross-Reference

Circular Section 10.35(b)(2)(ii)(B) contains a typographical error in that the cross-reference in that paragraph to Circular Section 10.35(b)(2)**(ii)**(B) instead should be to Circular Section 10.35(b)(2)**(i)**(B).

N. Amend the Best Practices Provisions

Circular Section 10.33, which contains an aspirational statement of "best practices" that applies to both written and oral tax advice, should be amended to the extent that it suggests that it is *always* a "best practice" for a tax practitioner to advise his or her client whether the client may avoid accuracy-related penalties under the Code if the taxpayer acts in reliance on the advice.

II. Description of the New Regulations' Requirements for Written Advice Constituting a Covered Opinion

A. In General

Circular Section 10.35 is the heart of the New Regulations. It requires any written advice concerning one or more Federal tax issues constituting a covered opinion to comply with a set of standards similar to those that many tax practitioners would follow if they were delivering formal opinions. Practitioners would be unlikely to comply with these standards if they were delivering informal tax advice in letter, memorandum or e-mail form. This is particularly so if the communication merely describes the expected tax consequences of common documents, arrangements, and transactions such as wills, trust agreements, partnership and limited liability agreements, and prenuptial and marital settlement agreements. Even when practitioners usually

would follow standards similar to those set forth in Circular Section 10.35, their standards almost certainly would vary to some extent from those set forth in the section.[13]

B. Covered Opinion

A covered opinion is any written advice (including e-mails) concerning one or more Federal tax issues arising from:[14]

1. A transaction that, at the time the advice is rendered, is a listed transaction under Treasury Regulations Section 1.6011-4(b)(2) or a transaction that is the same as or substantially similar to a listed transaction.

2. "Any partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, the principal purpose of which is the avoidance or evasion of any tax imposed by the Internal Revenue Code" (a "Principal Purpose Entity, Plan or Arrangement").

3. "Any partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, a significant purpose of which is the avoidance or evasion of any tax imposed by the Internal Revenue Code" (a "Significant Purpose Entity, Plan or Arrangement"), but only if the written advice is:

    a. a reliance opinion;

    b. a marketed opinion;

    c. subject to conditions of confidentiality; or

    d. subject to contractual protection.

The New Regulations do not provide any guidance for determining whether an entity, plan, or arrangement has a principal or significant purpose of avoiding a tax imposed by the Code. Nor do they provide any exception for Principal Purpose Entities, Plans or Arrangements or Significant Purpose Entities, Plans or Arrangements that rely on exclusions, deductions or other tax benefits clearly provided by the Code.[15]

The New Regulations exclude certain preliminary advice from the definition of a covered opinion. Specifically, "[a] covered opinion does not include . . . [w]ritten advice provided to a client during the course of an engagement if a practitioner is reasonably expected to provide subsequent written advice to the client that satisfies the requirements of [Circular Section 10.35]."[16]

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[13] ACTEC April 2005 Comments at 5.

[14] A particular writing may fall into more than one category of covered opinion.

[15] ACTEC April 2005 Comments at 6.

[16] Circular Section 10.35(b)(2)(ii)(A).

In addition, a covered opinion does not include written advice, other than advice concerning listed transactions or advice concerning Principal Purpose Entities, Plans or Arrangements, that (1) concerns the qualification of a qualified plan; (2) is a State or local bond opinion; or (3) is included in a document required to be filed with the Securities and Exchange Commission.[17]

A Federal tax issue is any issue that concerns the Federal tax treatment of an item of income, gain, loss, deduction or credit, the existence or absence of a taxable transfer of property, or the value of property for Federal tax purposes.[18]

A reliance opinion is written advice concerning a Significant Purpose Entity, Plan or Arrangement that concludes there is a greater than 50 percent likelihood that a significant Federal tax issue would be resolved in the taxpayer's favor unless the written advice prominently discloses that it cannot be used by the taxpayer for the purpose of avoiding penalties. For this purpose, a significant Federal tax issue is any issue as to which the Service "has a reasonable basis for a successful challenge [where] its resolution could have a significant impact, whether beneficial or adverse and under any reasonably foreseeable circumstance, on the overall Federal tax treatment of the transaction(s) or matter(s) addressed in the opinion."[19] If the written advice merely concludes that there is a reasonable basis that a significant Federal tax issue would be resolved in the taxpayer's favor, the advice is not a covered opinion.

In order to satisfy the prominent disclosure requirement, as it applies to reliance opinions, marketed opinions and limited scope opinions, the disclosure must appear in a separate section at the beginning of the written advice and must be in bold typeface that is larger than any other typeface used in the written advice. One inconsistency in the New Regulations is that the written advice must prominently disclose that it cannot be relied upon for penalty protection even if a taxpayer who engages in the transaction discussed in the writing does not need a more likely than not opinion to avoid penalties.[20]

A marketed opinion is written advice concerning a Significant Purpose Entity, Plan or Arrangement that the practitioner "knows or has reason to know . . . will be used or referred to by a person other than the practitioner (or a person who is a member of, associated with, or employed by the practitioner's firm) in promoting, marketing or recommending a partnership or other entity, investment plan or arrangement to one or more taxpayers"[21] unless the advice prominently discloses that it cannot be used by the taxpayer for the purpose of avoiding penalties, that it was written to support the marketing of the transaction or matter described, and

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17 Circular Section 10.35(b)(2)(ii)(B).

18 This definition of "Federal tax issue" apparently excludes issues relating to various Federal taxes such as employment taxes and certain Federal excise taxes that are imposed without reference to income, gain, loss deduction or credit, the existence or absence of a taxable transfer of property, or the value of property for Federal tax purposes. See ACTEC April 2005 Comments at 6 n.10.

19 Circular Section 10.35(b)(3).

20 ACTEC April 2005 Comments at 7.

21 Circular Section 10.35(b)(5)(i).

that the taxpayer should seek tax advice from an independent tax advisor.[22] The prominent disclosure exception does not apply to advice that relates to a listed transaction or a Principal Purpose Entity, Plan or Arrangement. As a result, any written advice with respect to a listed transaction or Principal Purpose Entity, Plan or Arrangement will be a marketed opinion if the practitioner delivering the advice knows or has reason to know it will be used by a person other than the practitioner or a person associated with her firm in recommending an entity, plan or arrangement to one or more taxpayers.

Written advice concerning a Significant Purpose Entity, Plan or Arrangement is subject to conditions of confidentiality if the practitioner providing the advice imposes on one or more recipients a limitation on disclosure of the tax treatment or structure of the transaction, and the limitation protects the confidentiality of such practitioner's tax strategies.

Written advice concerning a Significant Purpose Entity, Plan or Arrangement is subject to contractual protection if the practitioner (or a person associated with her firm) is obligated to fully or partially refund fees if the intended tax results are not sustained or if the collection of fees is contingent on the taxpayer's enjoying the predicted tax benefits from the transaction.

A limited scope opinion is "an opinion that considers less than all of the significant Federal tax issues."[23] A limited scope opinion may only be provided if:

(1) the practitioner and the taxpayer agree that the scope of the opinion and the taxpayer's potential reliance on the opinion for purposes of avoiding penalties that may be imposed on the taxpayer are limited to the Federal tax issues addressed in the opinion;

(2) the opinion is not advice concerning listed transactions, Principal Purpose Entities, Plans or Arrangements or a marketed opinion; and

(3) the opinion prominently discloses that (i) the opinion is limited to the one or more Federal tax issues addressed in the opinion; (ii) additional issues may exist that could affect the Federal tax treatment of the transaction or matter that is the subject of the opinion and the opinion does not consider or provide a conclusion with respect to any additional issues; and (iii) with respect to any significant Federal tax issues outside the limited scope of the opinion, the opinion was not written, and cannot be used by the taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer.

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[22] The New Regulations require that the prominent disclosure state that the advice was written to support the "promotion or marketing" of the transaction even if the advice was written merely to recommend a particular transaction to a client and members of that client's family. See ACTEC April 2005 Comments at 7 n.11.

[23] Circular Section 10.35(c)(3)(v).

C. Requirements for Covered Opinions

The New Regulations specify four requirements with which a covered opinion must comply. Each requirement has subparts. Other rules are specified as well. Realistically, the practitioner will have to deal with a dozen or so requirements for most covered opinions.

1. Factual Matters. A practitioner must use reasonable efforts to identify and ascertain the facts, which may relate to future events if a transaction is prospective or proposed, and to determine which of the facts are relevant. The practitioner must not base the opinion on any unreasonable factual assumption (including any assumptions with respect to future events). An unreasonable factual assumption is one that the practitioner knows or should know is incorrect or incomplete. As an example of this, the New Regulations provide that "it is unreasonable to assume that a transaction has a business purpose or that a transaction is potentially profitable apart from tax benefits."[24] Similarly, the practitioner may not rely on any unreasonable factual representations, statements or findings of the taxpayer or any other person. Apparently, whether the practitioner did or did not use reasonable efforts is an objective standard but the scope of the required efforts a practitioner must make to ascertain the facts is unclear. In other words, the fact that the practitioner honestly, and perhaps even reasonably, believed she had made reasonable efforts to identify and ascertain the facts may not be found to be in compliance if it turns out the efforts were not reasonable.[25]

2. Relate Law to Facts. The practitioner, in rendering a covered opinion, must relate the applicable law to the facts. Applicable law includes "potentially applicable judicial doctrines." Although not specified, these may include the substance over form doctrine, the business purpose doctrine, the economic substance doctrine, the step transaction doctrine, and the reciprocal trust or reciprocal transfer doctrines.[26]

The practitioner cannot assume any favorable resolution of any significant Federal tax issue except (i) with respect to certain "limited scope opinions" and (ii) in those circumstances where the practitioner is permitted to and does rely on the opinion of another practitioner who is competent to give such advice. Apparently, the practitioner may assume a favorable resolution of any Federal tax issue that is not significant (that is, the Service has no reasonable basis for a successful challenge or the resolution of the challenge could not have a significant impact on the overall Federal tax treatment of the transactions or matters addressed in the opinion). [27] In addition, the opinion must not contain internally inconsistent legal analyses or conclusions.[28]

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[24] Circular Section 10.35(c)(ii).

[25] ACTEC April 2005 Comments at 8.

[26] Id.

[27] Id. at 8-9.

[28] A tax opinion will sometimes be based upon two or more alternative grounds, either of which provides the basis for the legal conclusion, and this should not of itself cause the opinion to be regarded as containing internally inconsistent legal analyses. For example, a tax opinion that concludes that a particular entity will not be subject to entity-level taxation might reach that conclusion on the grounds that the entity is properly regarded for Federal income tax purposes as *either* (i) a grantor trust *or* (ii) a partnership that is not a publicly-traded partnership. The fact that the entity cannot be treated as both a grantor trust and a partnership at the same time should not render the opinion internally inconsistent inasmuch as either tax treatment would be fully consistent with the overall legal

For example, a conclusion that the actuarial value of the remainder interest in a charitable remainder trust is less than ten percent is inconsistent with a conclusion that the value of the remainder is deductible for income and gift tax purposes.[29]

3. Evaluation of Significant Federal Tax Issues. A covered opinion must consider all significant Federal tax issues and analyze the likelihood that the taxpayer will prevail on the merits with respect to each such issue. (As described above, exceptions to this requirement exist for limited scope opinions and in circumstances where the practitioner relies on the opinion of another practitioner.) Written advice may constitute a covered opinion and, therefore, be required to comply with these evaluation rules, even though it does not discuss any significant Federal tax issue.[30]

4. Overall Conclusion. The opinion must provide the practitioner's overall conclusion as to the likelihood that the Federal tax treatment of the arrangement is the proper treatment and the reasons for that conclusion.

In the case of a marketed opinion, the opinion must provide the practitioner's overall conclusion at a confidence level of at least more likely than not. If the practitioner cannot reach that level of confidence with respect to a marketed opinion, the opinion may not be issued without violating the New Regulations. In this regard, the New Regulations appear to make an important distinction between marketed opinions and other covered opinions.[31]

In the case of other opinions, if the practitioner cannot reach a confidence level of at least more likely than not, the written advice must prominently disclose, among other required disclosures, that the client may not use the advice for the purpose of avoiding penalties. This rule is applicable whether or not the type of transaction discussed requires a more likely than not level of confidence in order for the taxpayer to avoid penalties.[32]

III. Explanation of Recommendations

A. Clarify and Limit the Definition of Covered Opinion

We join in the view expressed by ACTEC in its April 2005 Comments that the definition of covered opinion should be coordinated with those areas where Congress and the Service have indicated that taxpayers will be subject to elevated scrutiny.[33] Under current law, taxpayers are subject to heightened scrutiny with respect to their participation in transactions identified in the Treasury Regulations under Section 6011 ("Reportable Transactions"). Reportable Transactions

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conclusion of no entity-level taxation. Clarification, accordingly, should be provided that the use of two or more alternative grounds to reach a legal conclusion does not, of itself, constitute an internally inconsistent legal analysis.

[29] In order to constitute a qualified charitable remainder trust under Section 664, the actuarial value of the remainder interest must be at least ten percent of the net fair market value of such property as of the date such property is contributed to the trust. See Section 664(d)(2)(D).

[30] ACTEC April 2005 Comments at 9.

[31] Id.

[32] Id. at 9-10.

[33] Id. at 10-11.

include listed transactions, confidential transactions, transactions with contractual protection, loss transactions, transactions with a significant book-tax difference, and transactions involving a brief asset holding period. Taxpayers must disclose Reportable Transactions on Form 8886 in order to avoid monetary penalties imposed by Section 6707A. Of course, not all Reportable Transactions have tax avoidance as a purpose, a fact reflected in the new penalty provisions of the Jobs Act.[34] New Section 6662A, which is aimed at "combating abusive tax avoidance transactions,"[35] imposes an accuracy-related penalty on listed transactions and on other Reportable Transactions that have a significant purpose of avoiding Federal income tax (referred to in these comments as "Significant Purpose Reportable Transactions"). New Section 6664(d) also contains special rules for transactions falling into these categories.

We believe that the transactions described in Section 6662A provide a good basis for identifying the types of written advice that should be subject to heightened covered opinion standards under the New Regulations. Accordingly, we join in ACTEC's recommendation that the New Regulations treat written advice as a covered opinion if the advice (i) concerns a listed transaction, (ii) concerns a Significant Purpose Reportable Transaction or (iii) is a marketed opinion (as discussed separately in subsection H of this section III).[36]

ACTEC's proposed definition will reach written advice relating to transactions of particular concern to Congress and the Service and will also promote the goals of a unified enforcement policy and simplification of the tax laws. The Service's efforts to stem abuses by subjecting tax practitioners to elevated standards with respect to their preparation of certain written advice will be coordinated with efforts to stem abuses by subjecting taxpayers to elevated standards with respect to their participation in certain transactions. ACTEC's proposed definition also will enable the New Regulations to benefit from the interpretive guidance that has been and will be issued by Treasury to help taxpayers comply with their obligations in respect of Reportable Transactions,[37] although it would also require practitioners to make a subjective determination as to whether a Reportable Transaction has tax avoidance as a significant purpose.[38]

The portion of ACTEC's proposed definition of covered opinion relating to Significant Purpose Reportable Transactions is limited to transactions that affect Federal income tax liability. That is, this portion of the definition does not encompass transactions involving other taxes, such as estate, gift, employment or excise tax. This result flows from the fact that, other

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[34] For example, an offering memorandum for interests in an operating or investment partnership will customarily contain a summary of the tax considerations relevant to a purchase of the partnership interests. Offering memoranda are frequently marked "confidential," not because of any tax strategies that the partnership will pursue, but simply to protect the partnership's operational and investment strategies. Id. at 10 n.17.

[35] H.R. Rep. 108-548, pt. 1.

[36] ACTEC April 2005 Comments at 11.

[37] See, for example, Revenue Procedure 2003-25, which provides a list of book-tax differences that are not to be taken into account in determining whether a transaction is reportable under Treasury Regulations Section 1.6011-4.

[38] ACTEC April 2005 Comments at 11-12.

than with respect to listed transactions, the accuracy-related penalty rules of Section 6662A are themselves limited to transactions that affect Federal income tax.[39]

We believe that limiting the definition of covered opinion in a manner that is consistent with Section 6662A makes good sense. A significant goal of the New Regulations "is to reach, with explicit provisions, the advice that provides penalty protection . . . ."[40] Accordingly, as currently drafted, the New Regulations provide that an opinion failing to reach a more likely than not conclusion must prominently disclose that it cannot be used for the purpose of avoiding penalties.[41] The more likely than not standard, however, is relevant under current law only to certain transactions resulting in understatements of Federal income tax.[42] Penalties related to other tax matters can generally be avoided based on less stringent standards.[43] Accordingly, we believe that it is appropriate that the definition of covered opinion be more expansive with respect to those transactions affecting income tax liability.

The portions of ACTEC's proposed definition of covered opinion concerning marketed opinions and listed transactions are not limited to transactions affecting Federal income tax liability. Marketed opinions are discussed in subsection H of this section III. Written advice can be a marketed opinion regardless of the type of Federal tax involved in the transaction discussed in the advice. We join in ACTEC's recommendation to retain marketed opinions within the definition of covered opinion because of the historical role such opinions have played in the propagation of abusive tax shelters. Similarly, we join in ACTEC's recommendation to retain advice concerning listed transactions within the definition of covered opinion because the transactions so listed are of particular concern to the Service.[44]

We also join in ACTEC's position that, should Treasury and the Service conclude that ACTEC's proposed definition of covered opinion is too narrow, it would be reasonable to add tax shelters as described in Section 6662(d) and as defined more fully in Treasury Regulations Section 1.6662-4(g)(2).[45] As described above, the drafters of the New Regulations appear to be concerned with ensuring that clients who need to be able to show reliance on "more likely than not" opinions issued by tax advisors to avoid the substantial understatement of income tax penalties of Section 6662 with respect to tax shelters will not mistakenly rely on written advice that does not meet the requirements of Treasury Regulations Section 1.6662-4(g)(4)(i)(B). Although inclusion of advice with respect to tax shelters would introduce additional uncertainty into the definition of covered opinion by requiring practitioners to determine whether particular

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39 See Section 6662A(b)(2).

40 IRS OFFICIAL CLARIFIES ADVICE SUBJECT TO CIRCULAR 230 RULE CHANGES, Tax Notes Today (May 2, 2005), reporting remarks made by Stephen A. Whitlock, Deputy Director of the IRS Office of Professional Responsibility, on April 29, 2005 at a course on tax controversies in New Orleans, Louisiana sponsored by the American Law Institute and the American Bar Association.

41 Circular Section 10.35(e)(4).

42 See Section 6664(d).

43 For example, underpayments attributable to negligence or disregard of rules or regulations can be avoided based on a "reasonable basis" standard. See Section 6662(b)(l) and Treasury Regulations Section 1.6662-3(b)(3).

44 ACTEC April 2005 Comments at 13.

45 Id. at 13-14.

transactions satisfy the subjective standards of the definition of tax shelter, the regulations provide guidance that could be used in making this determination.[46]

B. Define the Terms "Entity," "Plan" and "Arrangement" for Purposes of Determining Whether There is a Covered Opinion

The New Regulations do not define the terms "entity," "plan" and "arrangement" for purposes of Circular Section 10.35(b)(2)(i)(B) and 10.35(b)(2)(i)(C). Presumably, these terms are narrower in their scope than the term "transaction" and thus would not encompass tax advice concerning a particular transaction (such as a contemplated distribution, be it from a corporation, partnership or a trust) so long as that transaction did not constitute (or form part of) an entity, plan or arrangement, the principal purpose (or a significant purpose, as the case may be) of which was the evasion or avoidance of tax. Accordingly, guidance is needed on the meaning of these terms.

In addition, as illustrated in Example 2 in section 1 of these comments, the New Regulations fail to address whether an operative document that arguably embodies a tax practitioner's advice – such as a Will that contains GST exempt trust provisions, or tax provisions contained in partnership agreements or corporate merger agreements – could potentially be regarded as a covered opinion of itself. Accordingly, we recommend that the New Regulations be clarified to provide that an operative document prepared by a practitioner that relates to routine estate planning or business transactions will not constitute a covered opinion absent overriding circumstances.

C. Eliminate the Distinction Between Principal Purpose and Significant Purpose Entities, Plans or Arrangements

If the definition of covered opinion proposed in subsection A of this section III is not acceptable, we suggest the modification of the definition to eliminate the distinction between Principal Purpose Entities, Plans or Arrangements and Significant Purpose Entities, Plans or Arrangements so that all written advice with respect to Principal Purpose Entities, Plans or Arrangements will be subject to the same criteria now used for determining whether written advice regarding a Significant Purpose Entity, Plan or Arrangement constitutes a covered opinion.

The treatment of written advice under the New Regulations is substantially different depending upon whether tax avoidance constitutes *the principal purpose*, rather than *a significant purpose*, of an entity, plan or arrangement. Any written advice concerning one or more Federal tax issues arising from a Principal Purpose Entity, Plan or Arrangement is automatically subject to the covered opinion requirements. There is no opportunity to elect out of the requirements.

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[46] We also join in the request for confirmation, as suggested by various commentators, that tax professionals who are employees of a taxpayer corporation (such as a corporation's tax director, tax counsel, or other tax professional) will generally *not* be subject to the New Regulations to the extent that they do not practice before the Internal Revenue Service. See Arthur L. Bailey & Alexis A. MacIvor, NEW CIRCULAR 230 REGULATIONS IMPOSE STRICT STANDARDS FOR TAX PRACTITIONERS at 349-50, Tax Notes (April 18, 2005).

In contrast, written advice with respect to one or more Federal tax issues arising from a Significant Purpose Entity, Plan or Arrangement will constitute a covered opinion only if the written advice is a reliance opinion, a marketed opinion, is subject to conditions of confidentiality or is subject to contractual protection. In addition, written advice with respect to a Significant Purpose Entity, Plan or Arrangement that otherwise pertains to a reliance opinion or to certain marketed opinions will not constitute a covered opinion if it includes a prominent disclosure that it is not to be relied upon for penalty protection. Furthermore, in the case of reliance opinions, such written advice will not constitute a covered opinion unless it concludes at a confidence level of at least more likely than not that one or more significant Federal tax issues will be decided in the taxpayer's favor.

Despite this substantial difference in treatment, the distinction between a Principal Purpose Entity, Plan or Arrangement and a Significant Purpose Entity, Plan or Arrangement is far from clear. In many instances, it will be difficult for a practitioner to determine into which of the two categories a particular entity, plan or arrangement fits. And yet, if the practitioner erroneously determines that a particular arrangement constitutes a Significant Purpose Entity, Plan or Arrangement rather than a Principal Purpose Entity, Plan or Arrangement, she could be subject to severe sanctions. As a result, a practitioner who has any doubts is likely to treat the arrangement as a Principal Purpose Entity, Plan or Arrangement out of an abundance of caution, thus subjecting both herself and her clients to additional burdens that may be expensive and unnecessary and beyond the intended scope of the New Regulations.[47]

Moreover, given the uncertainty surrounding the exclusion for preliminary advice as further discussed below in subsection D of this section III, it may be imprudent in certain instances for a practitioner to provide *any* written advice until the practitioner has satisfied him or herself through reasonable diligence that the transaction at issue does not constitute part of a Principal Purpose Entity, Plan or Arrangement. Indeed, there may well be instances where the practitioner, notwithstanding the exercise of due diligence, will not be provided with sufficient facts to determine whether the written advice relates to a Principal Purpose Entity, Plan or Arrangement.

In light of the lack of certainty flowing from having both a principal purpose and a significant purpose test, we believe the New Regulations will be fairer and easier to administer if only the significant purpose test is retained.[48]

D. Clarify the Exclusion for Preliminary Advice

Circular Section 10.35(b)(2)(ii)(A) excludes from the definition of covered opinion "[w]ritten advice provided to a client during the course of an engagement if a practitioner is reasonably expected to provide subsequent written advice to the client that satisfies the requirements of this section." The following issues require guidance:

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[47] See ACTEC April 2005 Comments at 14-15. Sole practitioners, in particular, are likely to be harmed by the New Regulations given the heightened sensitivity of their client base to professional fees relating to routine tax advice.

[48] Id. at 15.

1) Must the practitioner who is referenced in this exclusion be the same practitioner who is rendering the preliminary advice? Because this exclusion refers to "*a* practitioner" (as opposed to "*the* practitioner"), the answer to this question presumably would be "no."

2) What does it mean for the subsequent written advice to satisfy "the requirements of this section?" Does that require the practitioner providing the written advice to have a reasonable expectation that a covered opinion will ultimately be rendered? Or will this exclusion for preliminary advice also be available if the practitioner has a reasonable expectation that, at some point in the future, a practitioner will "elect out" of the requirement for issuing a covered opinion as permitted by Circular Section 10.35?

3) How far into the future can the practitioner look in evaluating whether subsequent written advice satisfying Circular Section 10.35 is likely to be issued? Returning to the factual scenario presented in Example 1 in section 1 of these comments which concerns GST trust provisions contained within a Will, can the practitioner take into account the likelihood that the subsequent written advice may be provided to the executor of the client's Will many years (if not decades) in the future?

E. Provide Guidance Concerning the Distinction Between Significant and Incidental Purposes of Tax Avoidance

Guidance is also needed to determine when a tax avoidance purpose of an entity, plan or arrangement has risen to the level of being "significant." In many instances, the tax attributes of an entity, plan or arrangement, although important to the taxpayer, are perhaps better regarded as "incidental" to non-tax business objectives. Guidance accordingly is needed on this distinction.

In addition, if the New Regulations retain the distinction between Principal Purpose Entities, Plans or Arrangements and Significant Purpose Entities, Plans or Arrangements with the former, among other things, continuing to be ineligible to elect out of covered opinion status, clarification should be provided that a practitioner's providing of "tangential" tax advice, that is unrelated to the Federal tax issues arising from the Principal Purpose Entity, Plan or Arrangement, will not constitute a covered opinion absent some other factor. For example, if a practitioner's client is an unrelated third-party lender that is providing a loan to a partnership, both the client and the practitioner may not have any reason to know -- or even to suspect -- that the borrower is a Principal Purpose Entity, Plan or Arrangement as a result of tax planning unrelated to the third-party financing. However, because Circular Section 10.35(b)(2)(i) defines a covered opinion to include written advice by a practitioner concerning one or more Federal tax issues arising from a Principal Purpose Entity, Plan or Arrangement, the practitioner's written advice arguably may constitute a covered opinion, and the practitioner would not have the opportunity to elect out of covered opinion status through appropriate disclosures. In such circumstances, the practitioner's tax advice should not constitute a covered opinion (unless it is a covered opinion for some other reason), and guidance should be provided to that effect.

F. Exclude Tax Avoidance Techniques "Blessed" by Congress

The New Regulations effectively blur the distinction between tax evasion and tax avoidance[49] as they relate to Principal Purpose Entities, Plans or Arrangements and Significant Purpose Entities, Plans or Arrangements. The removal of this distinction is especially problematic in the context of tax avoidance techniques that have been "blessed" by Congress, as the objectives and policies underlying the New Regulations simply do not apply to them.

The following entities, plans or arrangements are but a few of the numerous tax avoidance techniques that have been specifically approved by Congress or Treasury as to which written advice, under the language of the New Regulations, could be construed to constitute a covered opinion:

> A corporation for which a S Corporation election pursuant to Section 1362 is contemplated
>
> An entity treated as a disregarded entity
>
> Qualified personal residence trusts ("QPRTs") (as defined under Treasury Regulations Section 25.2702-5(c))
>
> Grantor retained annuity trusts ("GRATs") (as structured to meet the requirements of Section 2702(b)(1) and Treasury Regulations Section 25.2702-3)

The New Regulations should accordingly be clarified to provide that the use of a tax avoidance technique that has been expressly authorized by the Internal Revenue Code or the Treasury Regulations, or by the Internal Revenue Service in an administrative pronouncement, will not, of itself, cause there to be a Federal tax issue that could serve as a predicate for either a Principal Purpose Entity, Plan or Arrangement or a Significant Purpose Entity, Plan or Arrangement.

G. Exclude Written Advice That Concludes There Is Not a Reasonable Basis for Tax Treatment Favorable to the Taxpayer

The definition of covered opinion should be revised to exclude written advice that concludes there is *not* a reasonable basis for the tax treatment the taxpayer seeks to achieve in connection with a particular transaction. Clearly it is in the government's (and the client's) best interests to allow a practitioner to concisely advise a client that a proposed transaction is *not* effective to avoid tax.

Read literally, the New Regulations seem to provide that covered opinions include written advice concerning one or more Federal tax issues arising from any listed transaction, any Principal Purpose Entity, Plan or Arrangement or any Significant Purpose Entity, Plan or Arrangement even though the advice provided to the taxpayer is (i) that favorable tax treatment

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[49] We note that the distinction between tax *evasion* and tax *avoidance* – which the New Regulations effectively treat as a mere difference in semantics -- is, in fact, an extremely important distinction for substantive law purposes.

will probably be denied or (ii) that the taxpayer must report the transaction and that penalties may be imposed on the taxpayer for failure to do so.

Comments of Treasury officials suggest that such a literal construction of the New Regulations was not intended.[50] Imposing covered opinion requirements for such "negative" advice may reduce compliance with the tax law. Accordingly, we recommend that the New Regulations be revised to exclude written advice that concludes that there is not a reasonable basis that tax benefits from an arrangement will be allowed.[51]

H. Clarify the Definition of Marketed Opinion

The term "marketed opinion" should be defined differently. The current definition, which is set forth in paragraph (b)(5) of Circular Section 10.35, provides as follows:

> (5) Marketed opinion - (i) Written advice [concerning a Significant Purpose Entity, Plan or Arrangement] is a marketed opinion if the practitioner knows or has reason to know that the written advice will be used or referred to by a person other than the practitioner (or a person who is a member of, associated with, or employed by the practitioner's firm) in promoting, marketing or recommending a partnership or other entity, investment plan or arrangement to one or more taxpayer(s).

This definition is not broad enough to reach all of the material it should reach, such as self-marketed opinions. At the same time, a literal application of its terms could catch articles and outlines written for publication in periodicals and for distribution at seminars, e-mail exchanges on "list-serves" and "blogs" and other informal discussions among professionals, material describing non-controversial tax techniques that appear in brochures, and written advice shared among related taxpayers.[52]

Take, for example, the case of a tax practitioner who, at the request of a charitable client, prepares a written piece about a standard tax and estate planning strategy, such as a charitable remainder trust, for inclusion in the client's planned giving brochure.[53] Because the brochure is intended to be used by the charity to promote or recommend an arrangement a significant purpose of which is the avoidance of tax, the practitioner's contribution appears to be captured by the definition of marketed opinion. This type of educational material should not be discouraged. Most important, the writing will not address any significant Federal tax issue, as such term is defined in the New Regulations. Indeed, the consequences of the use of charitable remainder trusts are comprehensively set forth in Treasury Regulations. This type of material

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[50] See IRS OFFICIAL CLARIFIES ADVICE SUBJECT TO CIRCULAR 230 RULE CHANGES, Tax Notes Today (May 2, 2005), reporting remarks made by Stephen A. Whitlock, Deputy Director of the IRS Office of Professional Responsibility, on April 29, 2005 at a course on tax controversies in New Orleans, Louisiana sponsored by the American Law Institute and the American Bar Association.

[51] ACTEC April 2005 Comments at 15-16.

[52] Id. at 16-17.

[53] This example is taken from the ACTEC April 2005 Comments, at page 18.

would be protected from marketed opinion status if the definition were modified to exclude any written advice that does not address a significant Federal tax issue.[54]

This problem also arises in the context of business transactions. There is a wide scope of business dealings that involve "recommending" that do not fall within the type of tax shelter promotion that is the intended target of the New Regulations. Business partners frequently "recommend" transactions to each other without any intention of becoming tax shelter promoters. Tax advice that one party has received may be proffered to another as a way of encouraging the second party to agree to a business transaction. Likewise, a corporation may share tax advice that it has received with its shareholders in recommending a transaction. Further, tax advice provided to a client may be shared between parties to a joint venture, acquisition or other corporate reorganization. Certainly, these circumstances should all be excluded from the covered opinion requirements.[55]

The New Regulations offer a way of electing out of marketed opinion status. Circular Section 10.35(b)(5)(ii) provides that written advice (other than advice concerning a listed transaction or a Principal Purpose Entity, Plan or Arrangement) is a not a marketed opinion if it prominently discloses that --

> (A) The advice was not intended or written by the practitioner to be used, and that it cannot be used by any taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer;
>
> (B) The advice was written to support the promotion or marketing of the transaction(s) or matter(s) addressed by the written advice; and
>
> (C) The taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor.

This provision is not an appropriate alternative to narrowing the definition as it would serve no useful purpose.

We join in the position taken by ACTEC in its April 2005 Comments that the term "marketed opinion" should be defined to reach only opinions used to promote and market the sale of tax-driven transactions and that it should reach such opinions whether or not a third party is involved in marketing the transaction. It should not reach opinions that are shared by one individual with another without the expectation, in the case of the practitioner who prepared the opinion, of receiving a fee in excess of her normal hourly rate or, in the case of the individual for whom the opinion was prepared, of receiving a fee if a taxpayer with whom the opinion is shared decides to engage in the transaction. This approach would more appropriately address the concerns of the Service.[56]

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[54] Id. at 18.

[55] See New York State Bar Association Tax Section Report on Circular 230 Regulations, dated March 3, 2005 (the "NYSBA Tax Section March 2005 Report"), at recommendation entitled "Marketed Opinions."

[56] ACTEC April 2005 Comments at 19.

We suggest consideration be given to using the following definition that is substantially similar to that set forth on page 19 of the ACTEC April 2005 Comments:

(5) *Marketed opinion* - (i) Written advice is a *marketed opinion* if it concerns one or more significant Federal tax issues arising in connection with an entity, plan or arrangement described in the opinion and -

(A) the practitioner who prepares such advice (or a person who is a member of, associated with, or employed by the practitioner's firm) distributes the advice to the practitioner's clients or to persons with whom the practitioner wishes to establish a client relationship with the expectation that, if a distributee engages in the entity, plan or arrangement described in the advice, the practitioner will receive a fee in excess of the normal hourly charge or other normal method of calculating fees;[57] or

(B) the practitioner who prepares such advice (or a person who is a member of, associated with, or employed by the practitioner's firm) distributes it to another person with the expectation that the distributee will use the advice to promote or market the entity, plan or arrangement to third parties from whom the distributee will collect a fee if such third party engages in the entity, plan or arrangement.

If the definition is narrowed in this manner, we believe it would be appropriate to maintain the current method of electing out of marketed opinion status by the use of the disclosure described above.

I. Extend the Covered Opinion Standards Now Applicable to Significant Purpose Entities, Plans or Arrangements to all Covered Opinions

The requirements now applicable under the New Regulations to "reliance opinions" that are issued in connection with Significant Purpose Entities, Plans or Arrangements should be extended to apply to all covered opinions. As a result, the requirements with respect to reliance opinions would apply to any entity, plan or arrangement that may have risen to the level of a Principal Purpose Entity, Plan or Arrangement as well as to those that constitute Significant Purpose Entities, Plans or Arrangements. Similarly, written advice with respect to a listed transaction or written advice that constitutes a marketed opinion, is subject to conditions of confidentiality, or is subject to contractual protection, including advice with respect to an entity, plan or arrangement that may be characterized as a Principal Purpose Entity, Plan or Arrangement under the New Regulations as written, would be subject to the rules that, as written, apply only to Significant Purpose Entities, Plans or Arrangements. We do not believe that such treatment would frustrate the goals of the New Regulations.[58]

Including Principal Purpose Entities, Plans or Arrangements in the Significant Purpose Entity, Plan or Arrangement category will enable practitioners to "elect out" of all covered opinion requirements if they provide appropriate disclosures. It will also enable practitioners to

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[57] An alternative approach would be to use as a benchmark the threshold amount for determining whether a person is a material advisor as set forth in Section 6111(b). See ACTEC April 2005 Comments at 19 n.29.

[58] See ACTEC April 2005 Comments at 20.

give limited scope opinions with respect to such entities, plans or arrangements. We believe practitioners should be able to elect out of the covered opinion requirements and provide limited scope opinions without first having to make the otherwise irrelevant determination that tax avoidance is only a significant purpose of the entity, plan or arrangement, not its principal purpose.[59]

Under the New Regulations, written advice concerning a Significant Purpose Entity, Plan or Arrangement is a covered opinion by reason of the type of advice it contains[60] only if it addresses a significant Federal tax issue; that is, an issue as to which the Service has a reasonable basis for a successful challenge and the resolution of which could have a significant impact, whether beneficial or adverse, on the overall Federal tax treatment of the transaction or matters addressed in the opinion. Presumably, any entity, plan or arrangement specifically sanctioned by the Code or the Treasury Regulations would not give rise to a significant Federal tax issue because the Service would not have a reasonable basis for a successful challenge.[61] Therefore, written advice with respect to such an entity, plan or arrangement should not be required to meet the requirements of a covered opinion.[62]

J. Clarify the SEC Exclusion

The New Regulations exclude from the definition of a covered opinion written advice, other than advice concerning listed transactions or Principal Purpose Entities, Plans or Arrangements, that "[i]s included in documents required to be filed with the Securities and Exchange Commission" [63] (the "SEC Exclusion"). We believe that the SEC Exclusion should be revised in the following two (2) ways:[64]

First, we recommend that the SEC Exclusion be expanded to encompass not only written advice that is "included" in documents required to be filed with the SEC, but also written advice that is "described" or "summarized" in any document filed with the SEC. For example, parties to a corporate merger may agree in the merger agreement that tax opinions addressed to the target and the acquiror will serve as closing conditions to the merger. The parties may describe in the proxy statement filed with the SEC that such opinions are anticipated to be provided,[65] but may not include a copy of the opinions themselves in any SEC filing. Because the conclusions

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59 See id.

60 Written advice also can be classified as a covered opinion based on the type of opinion, *i.e.*, a marketed opinion or an opinion subject to conditions of confidentiality or contractual protection, without reference to the type of advice it contains.

61 See ACTEC April 2005 Comments at 20.

62 Id. This point is further discussed in subsection F to this section III.

63 Circular Section 10.35(b)(2)(ii)(B).

64 See NYSBA Tax Section March 2005 Report, at recommendation entitled "SEC Exclusion."

65 This overlaps with the need for Treasury to clarify the exclusion for preliminary advice, as discussed in subsection D to this section III.

of the anticipated opinion will be included in such a filing, the tax opinions should be excluded from the definition of a covered opinion.[66]

Second, because of the difficulty involved in determining whether tax avoidance constitutes the principal purpose, or a significant purpose, of an entity, plan or arrangement (as discussed in subsection C to this section III above), the SEC Exclusion should cover Principal Purpose Entities, Plans or Arrangements as well as Significant Purpose Entities, Plans or Arrangements.

K. Revise the Type of Disclosure Required to Elect Out of Covered Opinion Treatment

We endorse the position set forth by ACTEC in Recommendation F of its April 2005 Comments that the New Regulations should be revised to moderate the intrusiveness, potential offensiveness, and impracticality of the disclosure now required to avoid treating written advice concerning a Significant Purpose Entity, Plan or Arrangement as a covered opinion.[67]

Circular Sections 10.35(b)(2)(ii) and (b)(8) require that the written advice contain a statement that the advice is not intended to be used to avoid tax penalties and that the statement be set forth in a separate section at the beginning of the written advice in a bold typeface larger than any other typeface used in the written advice.

As stated by ACTEC in its April 2005 Comments, one of the concerns about the New Regulations most strenuously expressed by practitioners is the disruptive and unprofessional nature of such a banner on otherwise routine attorney-client correspondence. Such a banner is likely to alarm clients, particularly those who are unsophisticated, and generally undermine the attorney-client relationship by interfering with the communication of legal and tax information. There is no compelling reason related to the administration of the tax laws for such disruption of this time-honored relationship. Moreover, in some media such as e-mail, it might be impossible or excessively burdensome to comply with these requirements of location and typeface.[68]

At a minimum, the requirement that the necessary disclosure be "prominently disclosed" or disclosed in any particular place in the writing should be deleted from the New Regulations. Any disclosure with the mandated content anywhere in the text of the written advice would serve the purpose of negating reasonable reliance. If Treasury and the Service are concerned about disclosure that is buried in an unusually long and tedious letter, that case could be addressed (as ACTEC has suggested) by requiring the disclosure to be included on the first page if the document has a total of more than, say, 25 pages. Such a long document would not be casual correspondence, and it would not be disruptive or unprofessional for it to have a summary at the beginning, which could include the necessary disclaimer. In contrast, the banner mandated by

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[66] In addition, as further discussed in subsection H to this section III, we recommend that the New Regulations be revised so that a tax opinion provided to the target or acquiror would not constitute a marketed opinion.

[67] ACTEC April 2005 Comments at 21-22.

[68] Id. at 21-22.

the "prominently disclosed" requirement will always be both disruptive and unprofessional and will degrade the legal profession for no good purpose.[69]

In addition, a moderate approach to any disclosure requirement would permit it to be satisfied with a general disclaimer, for example in an engagement letter. If an appropriately important piece of correspondence from the practitioner to the client (particularly one that the client acknowledges in writing) clearly states that the client is not to use any written advice from the practitioner for the purpose of avoiding tax penalties unless the written advice explicitly states that it may be so used, then the purpose of the New Regulations would appear to be served. We do not believe, however, that the general disclaimer approach would be appropriate for a marketed opinion.[70]

It is understandable that Treasury and the Service would be concerned about the taxpayer who would argue that it was reasonable to rely on a practitioner's written advice despite a technical defect in the analysis that an ordinary layperson could not be expected to discern. The foregoing recommendations address that concern. If these recommendations are not thought to be enough, then Treasury and the Service could consider (as also suggested by ACTEC) including such warnings in the tax returns themselves, or in the instructions. One approach might be to place such warnings in the signature field, like the "penalties of perjury" reference. Such warnings could be in whatever typeface the Service chose to use.[71]

L. Modify the Disclosure Requirements Applicable to Opinions Concerning a Significant Federal Tax Issue When a More Likely Than Not Conclusion Is Unnecessary to Avoid Penalties

If the term covered opinion is ultimately defined to include written advice concerning entities, plans or arrangements for which a "more likely than not" opinion is not required to avoid penalties (as is the case based on the definition of "covered opinion" currently in the New Regulations), we recommend that Circular Sections 10.35(b)(4)(ii) and 10.35(e)(4)(ii) be modified to allow taxpayers to continue to rely on opinions, whether or not they are covered opinions, on issues that require only a reasonable basis level of confidence to avoid penalties.[72]

Under the New Regulations, a covered opinion is an opinion regarding a Significant Purpose Entity, Plan or Arrangement if it is a reliance opinion. Circular Section 10.35(b)(4) defines a reliance opinion as an opinion that reaches a confidence level of more likely than not on one or more significant Federal tax issues, unless the opinion prominently discloses that it cannot be used to avoid penalties that may be imposed on the taxpayer. The disclosure required by Circular Section 10.35(b)(4)(ii) should be modified to say that the opinion may not be relied on to avoid those penalties that require a more likely than not opinion to avoid penalties.[73]

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69 Id. at 22.

70 Id.

71 Id.

72 Id. at 22-23.

73 Id. at 23.

Similarly, a covered opinion that does not reach a more likely than not level of confidence with respect to any significant Federal tax issue is required to prominently disclose this fact and to state that with respect to those issues the opinion cannot be used to avoid penalties. If an issue with respect to which the opinion concludes that there is a reasonable basis but not a more likely than not level of confidence requires only a reasonable basis opinion in order to avoid penalties, the client should be allowed to rely on the reasonable basis opinion to avoid such penalties. In fact, any advice to the contrary is inconsistent with the tax law. We therefore endorse the position taken by ACTEC in its April 2005 Comments that this problem can be corrected by amending Circular Section 10.35(e)(4)(ii) to say that "With respect to those significant Federal tax issues *which require a more likely than not opinion in order to avoid penalties*, the opinion was not written, and cannot be used by the taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer."[74] Notwithstanding this suggested change, this entire discussion serves to underscore the convoluted nature of the New Regulations which will leave clients totally bewildered and adrift.

M. Correct Typographical Error in Cross-Reference

Circular Section 10.35(b)(2)(ii)(B) contains a typographical error in that the cross-reference in that paragraph to Circular Section 10.35(b)(2)**(ii)**(B) instead should be to Circular Section 10.35(b)(2)**(i)**(B), which pertains to entities, plans or arrangements the principal purpose of which is tax avoidance or evasion.

N. Amend the Best Practices Provisions

Finally, we are concerned that certain language contained in Circular Section 10.33, which sets forth "best practices for tax advisors," is overbroad. The best practices provisions of the New Regulations apply to both written and oral communications with clients.[75] Although the preamble to the New Regulations states that these best practices are "solely aspirational," the preamble further provides that "tax professionals are expected to observe these practices to preserve public confidence in the tax system." Thus, it appears likely that a plaintiff's litigation attorney, in a malpractice action, would point to these best practices as establishing the applicable standard of care for the tax professional in advising his or her client.

The third "best practice" calls for the tax practitioner to "advis[e] 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."[76] The New Regulations further provide that tax advisors with responsibility for overseeing a firm's practice of providing advice concerning Federal tax issues or of preparing or assisting in the preparation of submissions to the Internal Revenue Service should take reasonable steps to ensure that the firm's procedures for all members, associates, and employees are consistent with the best practices.

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74 Id. at 24.

75 The best practices provisions become effective on June 20, 2005.

76 Circular Section 10.33(a)(3).

We are concerned that the example provided in Circular Section 10.33(a)(3) – which indicates that it is a "best practice" for a practitioner to advise the client whether a taxpayer may avoid accuracy-related penalties under the Internal Revenue Code if a taxpayer acts in reliance on the advice -- will often be impractical to apply. Although we certainly agree that it is good practice for a practitioner to state whether the advice may be relied upon to provide penalty protection, it may be impractical to do so in certain instances, such as where the tax advice is rendered orally or is preliminary in nature. Accordingly, we recommend revising the example contained in Circular Section 10.33(a)(3) as follows:

> *"for example, with respect to written advice that is not preliminary in nature, whether a taxpayer may avoid accuracy-related penalties under the Internal Revenue Code if a taxpayer acts in reliance on such advice"*

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