College of Tax Counsel Criticizes Sweep of Circular 230 Amendments

MAY 2, 2005

SUMMARY BY TAX ANALYSTS

Louis Mezzullo of the American College of Tax Counsel has criticized as overly broad the amendments to the Circular 230 regulations (T.D. 9165) covering standards for tax opinions, suggesting that they could restrict or prevent taxpayers from seeking advice from qualified tax advisers.

May 2, 2005

Honorable Eric Solomon
Acting Assistant Secretary of the Treasury
U.S. Department of Treasury
1500 Pennsylvania Avenue, NW
Room 3104
Washington, DC 20220

Honorable Donald L. Korb
Chief Counsel
Internal Revenue Service
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Room 3026
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RE: Circular 230

Dear Acting Assistant Secretary Solomon and Chief Counsel Korb:

I am pleased to submit the comments of the American College of Tax Counsel ("ACTC") with respect to the amendments to the regulations governing practice before the Internal Revenue Service that were published in December of last year (the "Amendments"). The ACTC is a professional association consisting of approximately 650 of the leading tax lawyers in the country who are selected on the basis of their professional reputations as well as demonstrated achievement in the areas of lecturing, writing, teaching and bar activities in the tax field.

We understand that the Amendments are intended to strengthen the Service's ability to attack abusive tax shelters and promote public confidence in the tax system. We support these goals. The ACTC has been in the forefront of the professional organizations in urging the Service to recognize and attack the abusive tax shelters that undermine the credibility of our tax system and the rule of law.

However, we believe that certain aspects of the Amendments are overly broad and will restrict or prevent taxpayers from seeking advice from qualified tax advisors. We believe that certain changes to the Amendments will better enable the Service to achieve its goals without materially altering the relationship between taxpayers and their legal advisors.

We are aware that the Service has already received, or will shortly receive, comments from other leading professional organizations concerning the Amendments. Significant commentary has also been published in the tax press, and we know that each of you (as well as Commissioner Everson) have been receiving comments and questions from practitioners at meetings held around the country. We applaud your willingness to receive comments and suggestions from the public concerning the Amendments.

We do not believe that it is necessary here to repeat all of the various issues and questions that have been raised by others. Instead, we focus below on the points that we believe are important "problems" that need to be addressed in order to make the Amendments more workable. Each of these points could be addressed, we believe, without undercutting the fundamental purpose of the Amendments.

We would be remiss if we did not note that many in the ACTC believe that the basic format of the Regulations -- regulating all tax advice in order to prevent a small minority from acting badly -- is inappropriate because it makes the many pay for the sins of the few. A strong argument can be made that the regulations should have taken a different approach and only applied in situations in which written advice was reasonably expected to be relied upon for penalty protection purposes. The following comments assume that the Service will not re-visit the basic assumptions underlying the regulations, although there are good arguments that the current proposal is overly broad in its application.

Principal Purpose Opinions. The Amendments create different rules for so-called "reliance opinions" and opinions concerning transaction with "the principal purpose of tax avoidance." We believe these rules should be unified.

In the case of reliance opinions, the Service recognized that it would be potentially expensive and unproductive for taxpayers and practitioners to have to comply with all of the rules applicable to "covered opinions" in Section 10.35 in situations in which (i) there is no significant Federal tax issue, or (ii) the opinion is not going to be relied upon for penalty-protection purposes. Therefore, the Amendments effectively permit a practitioner (and his or her client) to avoid the cost of compliance with all of the requirements of Section 10.35 applicable to "covered opinions" if either there is no significant Federal tax issue or the written advice contains the legend that such advice cannot be relied upon for penalty-protection purposes.

If the written advice involves a transaction with the principal purpose of tax avoidance, however, neither of these exceptions is available. All written advice where there is the principal purpose of tax avoidance must comply with the rules of Section 10.35 applicable to "covered opinions". This approach does not take into account, however, the fact that there are many situations in which tax avoidance is expressly sanctioned by Congress and, hence, the written advice is routine.

For example, the shareholder of a closely-held C corporation might approach her tax advisor and ask how her overall tax burden could be reduced; the advisor would likely suggest making an S election. This election would have the principal purpose of tax avoidance, yet no one would question the availability of the election (assuming that the other requirements to make an election are satisfied). The same analysis would apply to many of the elections that are expressly provided in the Code, including the "check the box" election, accounting method elections, hedging elections, etc.

We do not believe that it is necessary to have separate rules for "the principal purpose" transactions and other situations in which a taxpayer will receive a reliance opinion. The Amendments could be simplified – and this problem solved – if the per se application of Section 10.35 were limited to listed transactions or substantially similar transactions. Any investment, plan or arrangement with the principal purpose of tax avoidance (but not a listed transaction) would be subject to Section 10.35's rules applicable to "covered opinions" unless (i) there was no significant Federal tax issue (which would usually be the case if the taxpayer was simply making an election) or (ii) the written advice was not being relied upon for penalty protection purposes.

Form of Disclaimer for Reliance Opinions. The Amendments provide that the "disclaimer" that must be borne by written advice in order to avoid treatment as a reliance opinion subject to Section 10.35 must be "prominently disclosed," which means that it must be (i) at the top of the written advice and (ii) in bolded typeface larger than any other typeface used in the written advice. We believe that this requirement is not practical, particularly given that "written advice" includes every e-mail and fax sent by a tax practitioner that contains advice as to how a taxpayer might reduce his, her or its tax burden.

To eliminate this potential problem while maintaining the Service's goal of notifying taxpayers that the written advice may not be relied upon for penalty-protection purposes, we recommend that the definition of "prominently disclosed" be amended to provide that a statement is prominently disclosed if it is made in such a manner that a reasonable person would be aware of such statement. A boldface statement in typeface the same as (or larger than) other typeface in the written advice, at either the top or bottom of the written advice, would be presumed to be "prominently disclosed".

Application to In-House Counsel. It is unclear whether the requirements in Section 10.35 would apply to in-house corporate counsel with respect to advice given to their employer corporation. We recommend a clarification that the Amendments do not apply in such situations.

Preliminary Advice. The exception in the Amendments for "preliminary advice" applies only if the practitioner is reasonably expected to provide written advice is subsequently provided that complies with the requirements of Section 10.35. However, in the course of planning a transaction, a practitioner (and the client) may not know whether or not "final" written advice will be provided.

There are many situations in which the problem may arise. For example, in many instances, a client will indicate that the client does not want any further written advice with respect to a transaction (because the client wants to reduce costs and perceives no significant tax risk). If the practitioner has previously provided advice that the practitioner believed was "preliminary," must the practitioner insist on providing a written opinion that satisfies Section 10.35? In addition, a practitioner may explain how a transaction could be structured, but the transaction may not be consummated for economic reasons that the practitioner foresaw. The practitioner only expected to provide subsequent written advice if the transaction goes forward, but the practitioner had doubts about that possibility. Is it a "reasonable expectation" that subsequent advice will be provided if the practitioner is unsure that the transaction will occur?

Again, we think there is a reasonable way to address this situation. Instead of requiring that preliminary advice complies with Section 10.35, a practitioner should be able to provide preliminary written advice concerning a significant federal tax issue if is it prominently disclosed on such written advice that it may not be relied upon for penalty-protection purposes. Practitioners would be able to adopt procedures to comply with the rules concerning "preliminary advice" by making them a sub-category of the general procedures concerning advice that is not subject to the covered opinion rules of Section 10.35. Separate rules for "preliminary" advice would then not be needed.

Less than "More Likely Than Not" Advice. The Amendments do not specifically address how written advice should be provided to a taxpayer at less than a "more likely than not" level of comfort. Sections 10.35 and 10.37 should be clarified to provide that written advice at a lower standard (including any so-called "negative opinion" or any other opinion that cannot be relied upon for penalty protection) is subject to Section 10.37 but not Section 10.35.

What a Practitioner "Should Know". One of the major problems in Section 10.37 is that a practitioner is required to take into account all relevant facts that the practitioner knows or "should know." The latter part of this requirement is vague in its application and creates a significant potential problem for practitioners, who could be subject to discipline if, in hindsight, the practitioner had "reason to know" or "should have known" about facts that were not presented to the practitioner by the client.

We believe that either (i) the "should know" aspect of Section 10.37 should be deleted from Section 10.37 or (ii) in the alternative, Section 10.37 should be clarified (either directly and/or through the addition of examples) to indicate that a practitioner will not be subject to discipline if the practitioner reasonably relies upon representations, statements or facts provided to the practitioner by the client. Practitioners should not be required to independently verify that the facts and statements provided by a client are correct if they appear to be reasonable.

Marketed Opinions. The Amendments expressly prohibit a marketed opinion that is of limited scope, although other types of limited-scope opinions are allowed. There does not appear to be any basis for this restriction if the marketed limited-scope opinion were to satisfy all of the requirements that apply to both marketed opinions and the requirements for limited-scope opinions. We believe that this is an unnecessary restriction on the ability of clients to receive and utilize, and practitioners to provide, limited-scope opinions that may be referred to by clients in marketing products or services that have favorable tax treatment. For example, a marketed limited-scope opinion with respect to the treatment of charitable donations would be impermissible under this rule, as would a marketed limited-scope opinion concerning a like-kind exchange; we do not see any policy reason why such marketed limited-scope opinions should not be allowed.

We also think that a clarification is needed that outlines and articles that are either published or distributed as part of a continuing professional education program are not "marketed opinions". A rule that requires a disclaimer on articles and outlines would not be reasonable.

We also recommend a clarification that an opinion issued to shareholders in connection with a tax-free reorganization is not a "marketed opinion" -- any other conclusion would, again, be unreasonable.

Alternative Theories. The Amendment provides that written advice that is subject to Section 10.35 may not contain "internally inconsistent legal analyses or conclusions," but it does not recognize that a practitioner will often provide advice based on alternative theories of the law or views of the facts. (For example, if the facts are viewed as "X" the transaction would be treated as follows, and even if the facts were viewed as "not X", the result would be the same because of "Y".) This type of "alternative reasoning" is quite standard, and the Amendments should be clarified to permit this type of written advice.

Written Advice Concerning Tax Disputes. Section 10.35 should be clarified that it does not apply to any written advice provided to a taxpayer after a transaction has closed or been implemented with respect to any audit, examination, appeals or litigation concerning the transaction. In addition, although a practitioner may not base advice on the possibility that a return may not be audited or that an issue may not be raised on audit, a practitioner should be able to discuss in writing with a client the audit practices of the Service and the client's ability to contest or appeal an adverse determination by the Service.

Procedures under Section 10.36. We understand that the Service has decided not to publish "model procedures" under Section 10.36 because the standards applicable to a large, multi-national firm might be inappropriate for a two-person local firm. We understand and appreciate that concern. However, it would be helpful if the Service were to adopt a "safe harbor" or rule that a practitioner who has principal authority and responsibility for overseeing a firm's tax practice will not be subject to discipline if the firm adopts procedures that are reasonably designed to ensure compliance with Circular 230 and that all tax practitioners within the firm are regularly alerted to, and reminded of their requirement to comply with, these procedures. In a large firm, the head of the tax practice cannot ensure compliance as a practical matter, but he or she can make certain that rules are adopted and that all tax practitioners and others in the firm who may reasonably be expected to give written advice about federal tax issues are aware of the rules that should be obeyed.

Effective Date. Although some believe that the effective date of the Regulations should be postponed, we believe that the Service has provided a reasonable transition period if significant additional changes are not made. On the other hand, if the Service decides to make changes to the Regulations in response to public comments and if those changes are significant, then an additional 30-, 60- or 90-day postponement of the effective date might be appropriate, depending on the nature and scope of the changes made.

Sincerely,

Louis Mezzullo
Chair
American College of Tax Counsel

cc: Honorable Mark Everson
Nicholas DeNovio