# IRS Circular 230
# An Update

*by*

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This manual was written in early September 2005 and has not been updated for any developments after that date. The materials are provided to assist CPAs in complying with the requirements under Circular 230, but are not meant to be used as a substitute for studying the text of the regulations. Rather this manual is meant to assist CPAs in understanding the regulations in their own professional analysis.

# Presentation Contents

# 1 Circular 230 and the CPA

Circular 230 is the IRS's document that defines matters regarding the conduct of those practicing before the IRS. The document has been rewritten over the past few years. Initially all parts of the Circular except for the provisions dealing with "tax shelter opinions" which the IRS wanted to study further.

Practice before the IRS is defined at §10.2(d) of the Circular in the following manner:

> *(d) Practice before the Internal Revenue Service* comprehends all matters connected with a presentation to the Internal Revenue Service or any of its officers or employees relating to a taxpayer's rights, privileges, or liabilities under laws or regulations administered by the Internal Revenue Service. Such presentations include, but are not limited to, preparing and filing documents, corresponding and communicating with the Internal Revenue Service, and representing a client at conferences, hearings, and meetings.

Last year the IRS released the proposed revisions in this area, which touched off protest from the tax professional community. The IRS took comments under advisement, and in May issued the final regulations which went into effect in June. While some changes were made, for the most part the rules are still very similar to what was initially proposed, and the possible reach of the rules has caused concern in the professional community.

Today's presentation will deal with these changes, plus a brief overview of the major provisions in Subpart B & C of Circular 230 as they impact the CPA.

## 1.1 The CPA's Authority Before the IRS

The original licensing of a CPA is granted by the various states. Given that the IRS is a federal agency, the authority to practice before the IRS is governed by federal law—meaning that the state of Arizona cannot directly authorize a person to represent individuals before the IRS. Rather, federal law grants a presumptive right for a duly licensed CPA (among others) to represent individual taxpayers before the IRS, reserving the right to unilaterally remove that privilege from an individual if that person fails to comply with federal rules, regardless of whether the state licensing authority takes any action.

The authority to practice is granted by 5 USC §500(c) which states that:

> (c) An individual who is duly qualified to practice as a certified public accountant in a State may represent a person before the Internal Revenue Service of the Treasury Department on filing with that agency a written declaration that he is currently qualified as provided by this subsection and is authorized to represent the particular person in whose behalf he acts.

That authority is, however, not absolute. The right to regulate such practice is reserved by 5 USC §500(d)(2), which provides that this section "authorize or limit the discipline, including disbarment, of individuals who appear in a representative capacity before an agency..."

The authorization is found at 31 USC §330, which allows the Treasury to regulate conduct of those representing individuals before the agency, as well as the right to remove the right to practice for cause.

Three classes of individuals have the right to practice (others have more limited practice rights in specialized areas), two which are provided for under 5 USC §500 (attorneys and CPAs) and one which is open to any individual who demonstrates the necessary competency under 3 USC §330 (enrolled agents, or EAs).

It is important to note that a CPA who no longer possesses the right to practice as a CPA in any state will also automatically lose the right to practice before the IRS unless that CPA has independently qualified as an enrolled agent or the CPA is a licensed attorney. However, the IRS may still revoke the right to practice before the agency, and a CPA who is placed in such status will find that he/she cannot be "assisted" to continue practice by another licensed individual unless that individual wishes to risk his/her own right to practice before the IRS.[1] That is true even though the individual may still be a CPA licensed by the Arizona Board of Accountancy.[2]

So that means a CPA in tax practice must comply both the laws and regulations of the Arizona State Board of Accountancy and with the rules found for practice before the IRS in Circular 230—so the CPA must be knowledgeable of both. Violation of either set of rules can eliminate the CPA's right to continue in his/her position to represent clients before the IRS.

## 1.2 Other Standards

Though we won't cover them today, a CPA in tax practice should understand that various standards of the profession apply to tax practice. Arizona CPAs are governed generally under Chapter 6 of Title 32 of the Arizona Revised Statutes, which grants the state board of accountancy a number of powers, including the ability to impose restrictions on a CPA's tax practice as part of a disciplinary proceeding.[3]

The State Board of Accountancy's rules generally duplicate the rules found in the AICPA *Code of Professional Conduct* which would impose on the CPA a requirement that the CPA "not undertake any engagement for the performance of professional services which they cannot reasonably expect to complete with due professional competence..."[4] which would include tax engagements. As well, the Arizona rules specifically reference the AICPA standards on tax practice as representing a presumptive demonstration of the required due diligence in the conduct of their tax practice.[5]

1 Circular 230 §10.24

2 Note that Arizona State Board of Accountancy Rule R4-1-456(A)(1) nevertheless requires a CPA who is subject to revocation or suspension of the right to practice before the Internal Revenue Service to report that fact to the state board and it's reasonable to assume the State Board might decide to take its own action with regard to such conduct.

3 ARS §32-741 authorizes the board to take disciplinary action for various acts, including violations of the rules of the board. ARS §32-701(6) defines disciplinary action for purposes of the state accountancy law to include restrictions on tax practice—so the state board is authorized to impose such restrictions.

4 Arizona State Board of Accountancy Rule R4-1-455.01(A)

5 Arizona State Board of Accountancy Rule R4-1-455.01(G) which has an reference to the AICPA *Statement on Standards for Tax Services* under their prior designation as *Statements of Responsibilities in Tax Practice.* The AICPA renamed the standards when those standards were changed from advisory standards to enforceable standards against AICPA members. An interesting historical footnote is that, in fact, Arizona

### 1.3 Structure of Circular 230

Circular 230 itself can be found in complete form on the IRS website, generally listed as the first choice on the list of publications if you check on the "Forms and Publications" link on the main page found at http://www.irs.gov. As of the date these materials were written, the direct link to the Circular was http://www.irs.gov/pub/irs-pdf/pcir230.pdf, though the IRS is known to rearrange their links from time to time—so don't be surprised if it is not there.

The Circular is broken down into five subparts that deal with specific subject areas.

- Subpart A—Rules Governing Authority to Practice
- Subpart B—Duties and Restrictions Relating to Practice Before the IRS
- Subpart C—Sanctions for Violations of the Regulations
- Subpart D—Rules Applicable to Disciplinary Proceedings
- Subpart E—General Provisions

In today's presentation, we'll look Subpart B, concentrating first on those areas that were changed this year.

## 2 Circular 230 Subpart B

Recent changes to this portion of Circular 230 have gathered a lot of attention in the professional press and will be where today's presentation will concentrate. However, other provisions in this area are also potentially troublesome, and practitioners should consider all provisions found in this Subpart of the Circular to assure they are in compliance.

### 2.1 §10.33 Best Practices

The first of the June changes in Subpart B is the best practices provision found in §10.33 of Circular 230. While the IRS indicated when the regulations were published that these standards were not going to be considered as enforceable[6], many commentators believe this standard will still be an issue for civil litigation should a practitioner be accused of negligent practice. As well, most commentators believe this provision will eventually become mandatory unless action is taken by practitioners themselves to address these matters.

§10.33(a) provides a two pronged test for best practices. First, it indicates that compliance with all other parts of Circular 230 is part of the best practices standard. Second, the provision goes on to provide for four additional standards that should be met by the practitioner. Those four standards are as follows:

*Communicating clearly with the client regarding the terms of the engagement.* Under this standards, the adviser should determine the client's expected purpose for obtaining the advice and how it will be used by the client. As well, the adviser needs to establish a clear under-

CPAs, whether or not members of the AICPA, had to treat those standards as binding for years before the AICPA itself saw them as enforceable.

6 Circular 230 §10.52 (a)(1) makes clear this regulation is not subject to discipline even if willfully violated.

standing with the client of the scope and form of the service to be rendered. A clear engagement letter for all significant engagements, including those involving “simple” tax planning would go a long way towards establishing compliance with this standard.

As well, the lack of such a letter would create a situation where a client asserting malpractice might have an easier time persuading the court of his/her position—after all, under standards applicable to the professional, the professional had a clear responsibility to clearly communicate the terms of the engagement, so the lack of any documentation showing such communication to the client might be argued to, per se, show negligent performance by the professional.

*Evaluation of facts and the law*. The professional is responsible for certain performance standards regarding the facts that are important to the advice being given. The professional must

- Establish the facts;
- Determine which facts are relevant;
- Evaluate the reasonableness of any assumptions or representations;
- Relate applicable law, including potentially applicable judicial doctrines, to the relevant facts and
- Arrive at a conclusion based on the law and the facts

A key factor to note is that the professional cannot blindly rely on the client’s or a third party’s representations.

Again, this may pose some problems for professionals in malpractice claims, should the client assert that the CPA failed to live up to “reasonable level of care” that is contained in these standards when the CPA fails to challenge a fact that was relied upon in arriving at his/her conclusions.

*Advising the client.* The professional must advise the client of the import of the conclusions reached. The regulation specifically cites advising the client about the need to advise the client about whether he/she will be able to avoid accuracy-related penalties under the Internal Revenue Code if the taxpayer acts in reliance on this advice. As we’ll see, this relates back to another new standard.

*Fairness and Integrity*. This broad standard requires that professionals act fairly and with integrity in regard to practice before the Internal Revenue Service. Note that this standard doesn’t specify *who* must be the beneficiary of this fairness and integrity, suggesting that the standard applies to all parties (the client and the IRS) that the professional deals with in performance of services related to practice before the IRS.

*Responsibilities to ensure best practices are followed.* §10.33(b) provides that a tax advisor with responsibility for overseeing a firm’s practice of providing advice should take reasonable steps to ensure that the firm’s standards for all “members, associates and employees” are consistent with the best practices of this section. If a CPA is practicing in his/her own firm, the person with primary responsibility is simple to identify.

However, larger firms may find this more problematical—does the standards only cover a single person responsible for overseeing the entire firm’s tax advice practice? Does that put everyone else “off the hook” for this firm responsibility? Or does the existence of any responsibility for overseeing any other professional gain responsibility for the oversight of that portion of the practice and any applicability of best practices? And, in any event, remember that

CPAs are generally ethically required to adequately supervise the work of assistants in the performance of professional services.[7]

Firms may not be structured to centralize this "overall responsibility" for tax advice, especially since at least some tax advice might be provided both by a formal tax department and other departments within or associated with the firm—like a financial planning division. As well, small multi-member firms may not have a formal tax department, and responsibilities may not be formally divided between the partners.

CPAs not in public practice may also face a similar problem. While certain advice such CPAs provide was exempted from some of the more onerous provisions of the new revisions, such an exemption isn't provided in this area. So those who don't practice in a CPA firm should not assume that they have nothing to worry about—they may be held to a similar level of care and practice standards in their work.

Prudence suggests that every CPA involved, directly or indirectly, in the provision of tax advice should presume that he/she is a "responsible professional" in this regard for all others associated with the firm that he/she has any sort of supervisory authority over.

*Effective date*. The "best practices" provision had an effective date after June 20, 2005—so that means it is in effect as of today.

## 2.2 §10.35 "Covered Opinion" Requirements

This particular portion of the new revisions has generated by far the most commentary, and has lead to widespread use of boilerplate disclaimers by many of those directly and indirectly involved in tax practice—including professional organizations like the AICPA and large publishers like Thomson-RIA.[8]

### 2.2.1 Who is Covered by these Rules

Some may decide this is "no big deal" since the rules won't cover them—they aren't in a CPA firm and/or they don't do audit representation work or they don't issue formal opinions. Those individuals may be greatly underestimating the reach of these standards.

The general rule is found in §10.35(a) which provides that a "*practitioner* who provides a *covered opinion* shall comply with the standards of practice in this section." So the key questions are:

- Who is a practitioner?
- What is a covered opinion?

*Practitioners.* These provisions apply to practitioners, which are defined as *any individual* described in §10.2(e) of Circular 230.[9] That provision of Circular 230 gives us an-

7 ET §56.05 which provides that "due care requires a member to plan and supervise adequately any professional activity for which he or she is responsible."

8 The AICPA Tax Section's *E-Alerts* and RIA's recent analysis of the 2005 Energy and Transportation Acts have contained §10.35 "opt-out" language. As well, many law firms and CPA firms have taken to including similar language as part of the standard template for every e-mail the firm sends.

9 Circular 230 §10.35(b)(1)

other set of cross-references, providing that for its purposes, a practitioner means any individual described in §10.3(a), (b), (c) or (d).

Most relevant for our purposes is §10.3(b), which provides "any certified public accountant who is not currently under suspension or disbarment from practice before the Internal Revenue Service may practice before the Internal Revenue Service by filing with the Internal Revenue Service a written declaration that he or she is currently qualified as a certified public accountant and is authorized to represent the party or parties on whose behalf he or she acts."

At first glance, it might appear that if you haven't filed a "written declaration" with the IRS (such as by signing the IRS standard power of attorney) you wouldn't fall into this provision. However, recall that §10.35(b)(1) told us that §10.35 applied to any person *described*—and, arguably, any person eligible to make that declaration (even if no declaration has been made) is one described by §10.3(b). So that means any CPA licensed by any state who is not currently under suspension or disbarment with regard to the IRS is a practitioner.

As well, these changes were largely triggered by an IRS perception that questionable shelters were being marketed to individuals based on canned opinions endorsing the products in questions. Since, in most of those cases, the individual issuing the opinion was not at the time representing the taxpayer in a dispute with the IRS, to narrowing read the application of Circular 230 so that it only applied once a practitioner began representing a client before the IRS would render the whole set of rules virtually never applicable. At least to this author, it would be extremely unlikely that the IRS Office of Professional Responsibility would accept such a narrow reading on the applicability of these rules.

Since, by definition, virtually every CPA is covered by these rules, the question of what is a covered opinion is a key matter.

### 2.2.2 Covered Opinion Definition

The issue of what is a covered opinion is, therefore, the crucial issue in these new rules. If the advice is deemed to be a covered opinion, then the CPA must comply with all the requirements of §10.35, but rather, if it is written advice, must comply with the less onerous rules at §10.37.

*Written advice.* The first key issue to note is that while the term "opinion" is used, the definition brings in all written advice *including electronic communications such as email and instant messaging.*[10] That means anything written, no matter how transmitted, be it handed to the client, sent via traditional mail, faxed, emailed or communicated via other electronic means is potentially a covered opinion. As well, the items does not have to be labeled as an opinion, nor be something that traditionally has been viewed as an opinion.

In normal use, I believe most practitioners would have thought an opinion was a formal document issued by an attorney covering the matter in detail. However, while this standard may end up forcing the practitioner to produce a document that looks like that, the

10 §10.35(b)(2)

initial communication that may trigger these standards may be something that was initially intended to be far less formal.

Some might conclude a CPA should simply stop putting anything in writing as a method of avoiding these rules. Based solely on avoiding these rules and the requirements associated with covered opinions, this would be effective. However, it's not method I'd recommend for two reasons. First, when communications are made only orally, in many cases the client will not remember the details of the advice or important limitations on the advice that would be made clear in written advice the client could refer to later. In that case, the chances increase that the client will manage to take actions that will subject the client to adverse tax results that would have been trivial to avoid had the client remembered the advice properly.

Second, if the client now files a malpractice claim against the CPA, in court you now have only the CPA's word on what was said compared to what the client claims he/she was told. Since it was the CPA's choice not to give the client documentation to refer to in order to assure all steps were carried out that were required, even that step might be argued to be a cause of the underlying problem even if the court were to believe the CPA's version of the conversation.

*Federal tax issue.* The next basic issue is that the communication must deal with a "federal tax issue" as defined by §10.35(b)(3).[11] To be *federal tax issue* the matter must be "a question concerning 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."[12] It is important to note that this is, on paper, a very broad standard as many items a CPA discuss with their clients or employers inherently impact something on that list—and so are potentially yanked into this standard.

The definition provision here goes on to discuss what becomes another important matter—what exactly makes a federal tax issue significant, as this will be a hugely important issue in determining if a communication falls into the class of communications that appears most likely to arguably "yank in" routine communications—that being the issue of what makes a federal tax issue significant.

The Circular provides that a federal tax issue is significant if "the Internal Revenue Service has a reasonable basis for a successful challenge and 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."[13] Areas of concern for that matter include at what level does the IRS have a "reasonable basis" for a challenge? Kip Dellinger, in an article that should have been published in *Tax Notes* by the time this class is held, notes that in the areas of avoiding penalties under §6662 for positions that had a reasonable basis of being sustained, we have traditionally worked from definitions that had a much less than 50% chance of being sustained (such as 15% to 20%).

The IRS has been silent on whether the same definition would apply in this case, though that does appear to be one argument that could be made, since it is certainly intellectually appealing to believe that a "reasonable basis" is a "reasonable basis" regardless of whether it is the IRS or the taxpayer asserting the position. As well, regardless of how

11 §10.35(b)(2)
12 §10.35(b)(3)
13 §10.35(b)(3)

this is interpreted, it seems to be clear that the IRS clearly is not saying they must have a greater than 50% chance of prevailing for the matter to be significant under these standards.

*Classes of written communication subject to the standards.* There are six specific types of communications that are covered by these standards. The six types of transactions are:

- A transaction that is the same as or substantially similar to a transaction that, at the time the advice is rendered, the Internal Revenue Service has determined to be a tax avoidance transaction and identified by published guidance as a *listed transaction* under 26 CFR 1.6011-4(b)(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; or
- 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 if the written advice--
    - Is a *reliance opinion*;
    - Is a *marketed opinion*;
    - Is subject to *conditions of confidentiality*; or
    - Is subject to *contractual protection*

Of the group listed above, two types of transactions will be of particular concern—those involving *listed transactions* and those involving *reliance opinions*.

You also should note that only listed transactions apply even if there is no “partnership or other entity, any investment plan or arrangement, or any other plan or arrangement” involved. That point may become crucial in interpreting these rules, and may actually serve to limit their applicability (or, perhaps not—it depends on your view of these rules).

In the Kip Dellinger article mentioned above, Kip argues that the proper interpretation is a realistically limited view of what is such a “partnership or other entity, any investment plan or arrangement, or any other plan or arrangement,” taken in the same light as practitioner have viewed that term in light of the tax shelter penalties under §6662. If you study that section, you’ll find that you cannot use “reasonable possibility” of success to escape the additional penalty for a substantial understatement of tax under IRC §6662 (d), by reference to a virtually identical definition under §6662(d)(2)(C)(ii).

Arguing for this view is the oft stated position of representatives of the IRS.[14] The IRS has indicated more than a little concern that they feel practitioners are “overreacting” to these rules and that they did not mean for “opt out” language (to be discussed below) to be attached to every routine communication with a client. In fact, they have expressed

14 Kip specifically references comments by IRS Chief Counsel Donald Korb, Director of the Office of Professional Responsibility Cono Namorato, and Assistant Director of OPR Steve Whitlock regarding the IRS view there be a “common sense” use of these definitions.

concern that the overuse of such opt-out language will serve to defeat the "consumer protection" aspect

Of course, arguing against this interpretation is the document that triggered Kip's article in the first place—an example used by the IRS in a national phone forum for practitioners going over these rules.

In that example, prepared by Carolyn Hinchman Gray of the IRS OPR, a transaction involving the purchase of an SUV by an operating and the applicability of Section 179 was evaluated for inclusion under these rules by presuming the basic transaction of whether or not the entity would buy the SUV was a "partnership or other entity, any investment plan or arrangement, or any other plan or arrangement" without even worrying about discussing that point, and the only issue was whether the IRS had a reasonable basis to challenge the professional's conclusions on whether or not the taxpayer qualified for the Section 179 deduction.[15]

### 2.2.3 Listed Transactions

The first category includes any transaction that is currently a listed transaction. A listed transaction is defined at Regulation §1.601-4(b)(2). That definition provides that:

> *Listed transactions.* A listed transaction is a transaction that is the same as or substantially similar to one of the types of transactions that the Internal Revenue Service (IRS) has determined to be a tax avoidance transaction

15 Here is the full example found in the notes for the *Powerpoint* presentation in a phone conference led by Kristen Hoiby, IRS Senior Tax Specialist in Seattle (with the problem comments underlined by me):

*Example: I received an e-mail question that I think does a good job of illustrating these rules. The question concerned an e-mail to a client suggesting the accelerated purchase of an SUV into 2004 in order to qualify for the higher bonus/179 deduction. So let's walk this through the decision tree: 1. It's an e-mail – therefore, its written advice. It is not a listed transaction and it does not have a principle purpose of tax avoidance and evasion because the SUV is being bought for the business. <u>Does it have a significant purpose of tax avoidance or evasion? Yes – it would reduce tax</u>. Is it a reliance opinion? It doesn't have the magic words "more likely than not" however, we did not want to create a semantics game where practitioners tried to come up with euphemisms for "more likely than not" therefore, we would probably see this as a "more likely than not" opinion. But, this is not a reliance opinion – <u>the reason being, it is not a significant federal tax issue</u>, one which the IRS has a reasonable basis for successfully challenging. What if, however, the client, in this example was a dentist, therefore, it would not be so clear cut that she was using the SUV in its business. <u>This would require you to make inquiries as to the use.</u> If she is a dentist on wheels, then probably the deduction is available and it is not a covered opinion. But if not, absent a disclaimer, <u>it would probably be a covered opinion</u>.*

A number of commentators, including myself, have been very concerned that the issue in question is seen to be a covered opinion in this example once the question of whether the dentist meets the business use test is introduced. Many have concluded that this would mean almost every communication relating to vehicle use would become a covered opinion unless the CPA did detailed research to determine the reliability of the client's assertion that there would be sufficient qualifying business use.

This particular example has been used by a number of IRS representatives multiple times in phone conferences, so the issue is not merely an isolated case of a single IRS employee being out of touch with how the agency as a whole views this matter—rather, it seems that someone has approved this view and it is being taught to those designated to lead the IRS presentations to those covered by these rules.

> and identified by notice, regulation, or other form of published guidance as a listed transaction.

While coverage of what is a listed transaction is a wholly separate course[16], there are a couple of key issues to note. First, the IRS has the right to change the items that are defined as listed transactions at any time. So an item that isn't a listed transaction could become one tomorrow. The updated listed is, for now, posted on the IRS website and can be found by searching for "listed transactions" from the main web page.

Second, note that *substantially similar* transactions are also treated as listed transactions. The regulation cited above makes it clear that you are to very broadly interpret the term substantially similar[17], so if a transaction has even a passing resemblance to a listed transaction you must treat it as a listed transaction.

Finally, it's important to note that under these rules any written communication about a listed transaction is going to be a covered opinion except for a "just say no" opinion. You cannot escape having to produce a covered opinion for a listed transaction that grants any level of assurance[18]

### 2.2.4 Principal Purpose Transactions

The second broad category of transactions are "principal purpose" transactions. A key issue is what defines a principal purpose, and the IRS has given guidance here in Circular 230 §10.35(b)(10) which provides:

16 I gave a lecture on this exact issue to the Arizona Forum for Improvement of Taxation that has been uploaded to my podcast website, including both the recorded audio from the presentation and a PDF file containing the slides shown during the presentation.

You can find the files at my podcast website at http://ezollars.libsyn.com and searching for the presentation posted on July 25, 2005 using the calendar at the left side of the page or by going directly to the entry at http://ezollars.libsyn.com/index.php?post_id=13878.

17 Regulation §1.6011-4(c)(4). In the podcast noted above, I described a number of transactions that either are clearly within the definition of listed transactions or are in danger of being seen as substantially similar transactions that clients of local accounting firms or for which controllers with small businesses could run into. I believe it is a very big mistake to assume that this is "only a large firm" problem—the potential for trouble exists for even very small clients.

In fact, some of the listed transactions only make sense in the context of a small business (such as those surrounding potentially abusive §412(i) plan insurance policies). General Motors is not likely to be terribly interested in aggressively funding a defined benefit pension plan, but anesthesiologist John Doe, MD with a one person professional practice would be in a position to benefit from such a structure.

18 Circular 230 §10.35(b)(4)(ii) only provides the "opt out" exception for reliance opinions. There is no similar provision for listed transactions. For these transactions the only way out is an opinion that provides no assurance of any sort to the taxpayer on the transaction (the "just say no" opinion) under the exception carved out by Circular 230 §10.35(b)(2)(ii)(E) for transactions under consideration by the client, or one of the other limited exceptions for advice to an employer solely to be used by the employer for its own tax position or preliminary advice when a full covered opinion is expected to be issued later.

> (10) *The principal purpose*. For purposes of this section, the principal purpose of a partnership or other entity, investment plan or arrangement, or other plan or arrangement is the avoidance or evasion of any tax imposed by the Internal Revenue Code if that purpose exceeds any other purpose. The principal purpose of a partnership or other entity, investment plan or arrangement, or other plan or arrangement is not to avoid or evade Federal tax if that partnership, entity, plan or arrangement has as its purpose the claiming of tax benefits in a manner consistent with the statute and Congressional purpose. A partnership, entity, plan or arrangement may have a significant purpose of avoidance or evasion even though it does not have the principal purpose of avoidance or evasion under this paragraph (b)(10).

Again, it's important to note that the "opt out" choice to avoid a covered opinion is not available for this type of transaction either.

As well, note that the IRS addresses both the "avoidance or evasion" of tax—implying that the conduct does not have to rise to the level of "evasion" as opposed to simple "avoidance" of tax. In practical terms, it appears that the IRS is equating "avoidance" with "reduction" in tax—so any transaction that reduces the taxpayer's tax bill would seem to be a transaction for the avoidance of tax.

This definition may prove especially troublesome for CPAs who perform business valuations in the context of the formation of family limited partnerships. The IRS litigating position in many such cases has been that the structure was availed of solely to obtain a discounted gift and, frankly, they likely have a persuasive case the the availability of discounts in the valuation of the gifted asset is the principal reason the partnership was formed in many cases—a case helped many times by letters from advisers suggesting the client look into this as a tax planning tool.

A valuation report, when analyzed under these rules, appears to be written advice to the client involving a federal tax issue (the value of the property under IRC §2512 for purposes of computing the tax imposed by IRC §2501) for a transaction that is under consideration. If it is a principal purpose transaction, then the CPA has no option under Circular 230 but to conform the written advice to the covered opinion standards.

### 2.2.5 Reliance Opinions

The most important category for most routine communications that may fall under these rules is the area of reliance opinions. A reliance opinion is defined at Circular 230 §10.35(b)(4)(i) as:

> (4) *Reliance opinion*--(i) Written advice is a reliance opinion if the advice concludes at a confidence level of at least more likely than not (a greater than 50 percent likelihood) that one or more significant Federal tax issues would be resolved in the taxpayer's favor.

So to be a reliance opinion, the written advice must meet two tests—it must involve a significant federal tax issue and it must conclude that the issue would, more likely than not, be resolved in the taxpayer's favor.

The actual words “more likely than not” or “greater than 50 likelihood” do not need to appear in the document—the IRS has made it clear they aren’t play semantic games here and will look at this to determine what a reasonable person might conclude as to the confidence level the CPA is giving.

What that means is that correspondence that answers client questions of the type “What will happen to my tax if I do X?” will generally be seen as giving that level of assurance unless the CPA goes out of his/her way to make clear that the answer provided does not meet the 50% test. In most real world cases, if a client asks what happens if I buy a new piece of equipment prior to year end, the CPA responds by saying that the client would be able to claim $X of depreciation on the asset and would expect to see a tax reduction of $Y based on the assumed marginal tax rate.

As noted earlier, the second part of this test involves whether the federal tax issue is “significant” which generally is going to boil down to whether it is large enough in amount to be a matter of concern. The IRS might reason, would the client have asked you in most cases if it wasn’t, knowing that he/she is likely going to pay for what he/she is being told? Similarly, would you have written out the answer unless you believed it was of more than passing importance?

Our final out before moving on is to see if the IRS has a reasonable chance of prevailing on a challenge. Note that if a transaction were to become an issue under examination at a later time, it seems likely that the IRS is not going to take the position that their challenge wasn’t reasonable. As well, the CPA has to based this evaluation solely on the merits of the position, and not look at the matter based on the odds that the transaction won’t be examined by the IRS, or even that on appeal the IRS is likely to abandon the matter[19].

However, a written communication can be excluded from the category of a reliance opinion if the communication carries “opt out” language—a clause that has generated a flurry of disclaimer notices attached to all types of correspondence from CPA and law firms since June 20. Circular 230 §10.35(b)(4)(ii) provides:

> (ii) For purposes of this section, written advice, other than advice described in paragraph (b)(2)(i)(A) of this section (concerning listed transactions) or paragraph (b)(2)(i)(B) of this section (concerning the principal purpose of avoidance or evasion), is not treated as a reliance opinion if the practitioner prominently discloses in the written advice that it 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.

Thus, many practitioners have been attaching disclaimers to virtually all correspondence that has language like this:

19 Circular 230 §10.35(c)(3)(iii). This may raise some interesting theoretical problems in cases where the IRS takes a taxpayer friendly position in documents that are not binding on them that can be arguably at odds with the law (such as the press release from then Commissioner Rosatti regarding the taxation of record breaking home run baseballs back in 1998—a release most commentators would agree was at odds with the law even we know the IRS isn’t about to challenge the treatment due to the public relations disaster they would incur).

> IRS rules require that I disclose to you that any advice contained in this letter[20] is not intended to be, and cannot be used, for the purpose of avoiding penalties imposed on you.

While the reaction is understandable, there are some additional issues to note. First, note that the restriction on penalty waiver is not restricted only to the tax shelter penalty provisions that have a "more likely than not" requirement attached to rely on an opinion. Rather, Circular 230's language, and that contained in most disclaimers, indicates that all penalty protection provided by the correspondence is voided.

In IRC Section 6662(d)(B) we find that a taxpayer can qualify for an exception to the substantial understatement penalty if the position advanced had substantial authority or the items was properly disclosed and the taxpayer had a reasonable basis for the tax treatment of the item, so long as the position did not involve a tax shelter as defined by IRC Section 6662(d)(C)[21]. Taxpayers are generally able to rely on the opinions of tax advisers in arriving at the conclusion they qualified for this exception.

Many commentators are more concerned about the real threat to CPAs is the potential exposure to malpractice claims in this area rather than any widespread action by the Office of Professional Responsibility against CPAs in run of the mill tax matters that don't involve what are traditionally viewed as tax shelters. That could include the CPA having to defend why he/she removed penalty protection from the taxpayer for the matter at hand or having to defend why a document did not contain the full disclosures required by the covered opinion standards if no disclaimer is used.

As well, CPAs must remember that the disclaimer is not a panacea that solves all problems in this area. Certain written communications cannot be "fixed" by opt-out language (listed and principal purpose transaction matters) and a document discussing those issues that contained the opt-out language could be argued to be evidence of the CPA's lack of professional competence in addition to subjecting that same CPA to potential disciplinary actions.

### 2.2.6 Marketed Opinions

The next category is for marketed opinions. This definition has generate some concern because a document might be shown by a client to a third party without the CPA's knowledge, perhaps even as a marketing tool to entice a third party to participate in a transaction.

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20 Or email, fax or memorandum, as appropriate.

21 As noted earlier, Kip Dellinger has pointed out the similarity of the definition found here and the definitions used in the new Circular 230. As he notes, if we are to interpret these terms as broadly as it seems many firms are doing, virtually every transaction would be a tax shelter and no taxpayer would ever be able to avail themselves of the exception noted above.

This suggests the interpretation should not be this broad, since proper statutory analysis would demand that, absent statutory clear language that requires finding that a section could have no applicability, it should be presumed that a proper interpretation of any ambiguity has to take into account that there should be cases where the penalty protection would be available—that is, every case of substantial understatement cannot be a tax shelter for the provision to ever be applicable.

Circular 230 §10.35(b)(5)(i) provides:

> Written advice 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).

The question of when a CPA has "reason to know" that a document would be used in enticing someone to enter a transaction would be a factual matter—but you might consider the following cases[22]:

- A CPA's client, who is a real estate agent, inquires about the rules impacting a proposed Section 1031 exchange of a rental property he owns. The CPA writes a letter outlining the rules to the agent, a letter that covers the general rules of a Section 1031 exchange. When a client of the real estate agent indicates he is concerned about the tax he'd have to pay if he sold his rental, the agent suggests a 1031 exchange and provides to the client the letter from his CPA that describes how this works.
- A CPA is reading an on line message board maintained by a professional organization where tax matters are discussed. The CPA responds to a question posted on the board involving how the tax law would impact a transaction. Another individual reading the board forwards that email to his client to help persuade the client to enter into a transaction that CPA has been pushing the client to enter into.
- A CPA, deciding this matter is one of general interest to CPAs, turns the response into a magazine article that is published in a professional tax journal. A subscriber to that journal copies the article and provides it to his client in support of a transaction the CPA wishes the client to engage in.
- A client asks a CPA to analyze a proposed purchase of a building that will be leased to his closely held corporation. The CPA provides this letter to the client, discussing various matters. The client has trouble rounding up the down payment and mentions the issue to an acquaintance. The acquaintance says he'd consider buying into the building as an investment. The client gives the acquaintance copies of all the information he has obtained to analyze this property, including a copy of the CPA's letter.
- The same facts except the CPA, knowing the client's financial position, believes it is unlikely the client will be able to pull of the purchase and, in fact, notes the same in his letter to the client.

The key problem is that a "reason to know" standard is, by its very design, not a "bright line" standard. The IRS's concern here is that they would have to prove that the CPA truly knew the document would be used in marketing, even though it seems apparent from the facts that this was the whole reason the CPA was contracted to give his views on the matter.

The IRS has established a second "opt out" rule to cover the marketed opinion case, with a separate disclaimer. Circular 230 §10.35(b)(5)(ii) provides:

22 Note that I am not saying all of these are marketed opinions and, in fact, I believe some aren't properly treated as such. But questions have been raised about such items.

> (ii) For purposes of this section, written advice, other than advice described in paragraph (b)(2)(i)(A) of this section (concerning listed transactions) or paragraph (b)(2)(i)(B) of this section (concerning the principal purpose of avoidance or evasion), is not treated as a marketed opinion if the practitioner prominently discloses in the written advice 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 opt out language has two additional requirements beyond the general one discussed for the reliance opinion. The second requirement that states the advice was written to support the marketing is especially problematical, since many are concerned with cases where the written advice is used by a third party where the CPA had not principally written the document with that view—but which the accountant arguably had "reason to know" might be used in that fashion.

The fact there are additional disclosures also means that *the standard disclaimers many firms are using will not be effective against claims that the item in question was a marketed opinion.* This may be doubly dangerous, since a party that later claims to have relied upon this opinion to his/her detriment could use this fact to show the CPA in question is "responsible" for his loss, since had the CPA properly complied with the covered opinion standards, he/she would not have entered into transaction.

### 2.2.7 Opinion Subject to Conditions of Confidentiality

If a "condition of confidentiality" applies to the transaction, again the covered opinion rules apply. A condition of confidentiality is defined in Circular 230 §10.35(b)(6), which provides:

> (6) *Conditions of confidentiality.* Written advice is subject to conditions of confidentiality if the practitioner imposes on one or more recipients of the written advice a limitation on disclosure of the tax treatment or tax structure of the transaction and the limitation on disclosure protects the confidentiality of that practitioner's tax strategies, regardless of whether the limitation on disclosure is legally binding. A claim that a transaction is proprietary or exclusive is not a limitation on disclosure if the practitioner confirms to all recipients of the written advice that there is no limitation on disclosure of the tax treatment or tax structure of the transaction that is the subject of the written advice.

This definition is similar to, though not completely identical to, the definition for reportable transactions under §1.6011-4.

The IRS in this case was taking aim at the various “proprietary” tax shelters that were marketed in the later 1990s and early years of this decade. In those cases, restrictive nondisclosure agreements were used as part of the package a potential client had to sign. Those promoting the transactions argued these agreements were necessary to protect their investment in developing these unique strategies.

The IRS took a different view, believing that they were designed to both restrict the ability of taxpayers to obtain independent advice about the transaction and to reduce the chance that the IRS would be made aware the specific transaction was taking place.

Given the reportable transaction rules, this type of device has seen much less use, since a taxpayer entering into such a transaction essentially has to violate the nondisclosure agreement to fall within the reportable transaction rules—and, with the addition last year by Congress of nasty monetary penalties on the mere failure to disclose a reportable transaction when required, I suspect they are not something likely to be seen any longer on any remotely legitimate transaction.

### 2.2.8 Contractual Protection

If the client is given “contractual protection” that also requires any written communication to comply with the covered opinion rules. Contractual protection is defined in Circular 230 §10.35(b)(7) which provides:

> (7) *Contractual protection.* Written advice is subject to contractual protection if the taxpayer has the right to a full or partial refund of fees paid to the practitioner (or a person who is a member of, associated with, or employed by the practitioner's firm) if all or a part of the intended tax consequences from the matters addressed in the written advice are not sustained, or if the fees paid to the practitioner (or a person who is a member of, associated with, or employed by the practitioner's firm) are contingent on the taxpayer's realization of tax benefits from the transaction. All the facts and circumstances relating to the matters addressed in the written advice will be considered when determining whether a fee is refundable or contingent, including the right to reimbursements of amounts that the parties to a transaction have not designated as fees or any agreement to provide services without reasonable compensation.

This is again similar to the rules on reportable transactions. Note that like those rules, this provision could be triggered “by accident” if a practitioner is not careful[23].

In this case, the IRS was concerned with “no risk” packages being marketed to taxpayers to entice the taxpayer to enter the transactions.

### 2.2.9 Excluded Communications

The IRS, in response to comments on the original proposed changes to this portion of Circular 230, did expand the list of excluded communications slightly. If a communication is one of these, the communication will not be subject to the covered opinion rules.

23 This topic is also covered in more detail in the podcast of the Arizona Forum for Improvement of Taxation referenced earlier.

Circular 230 §10.35(b)(2)(ii) provides the list of excluded communications, broken down into the following categories:

- **Preliminary advice**

> (A) Written 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;

This exception is a relatively narrow one, since it will only apply if the CPA expects to provide a covered opinion at a later date. The IRS will not likely be very receptive to a CPA who argues every document he wrote was one that meets this exception when no actual covered opinions are ever written by the practitioner.

- **Specific items of advice**

> (B) Written advice, other than advice described in paragraph (b)(2)(i)(A) of this section (concerning listed transactions) or paragraph (b)(2)(ii)(B) *[sic (i)]* of this section (concerning the principal purpose of avoidance or evasion) that—
>
> (1) Concerns the qualification of a qualified plan;
>
> (2) Is a State or local bond opinion; or
>
> (3) Is included in documents required to be filed with the Securities and Exchange Commission;

First, it is important to note that listed and principal purpose transactions cannot fall under this exception. So if one of those is in a document to be filed with the SEC or is the subject of an opinion of the qualification of a qualified plan, the covered opinion rules must still be adhered to.

Second, note that the qualified plan exception relates only to the qualification of the plan. A questions involving any other matter (including the validity of the amount of funding for a defined benefit plan, specific investments in the plan, etc.) would not fall into this exception.

The "state or local bond opinion" is defined at Circular 230 §10.35(b)(9). We will not generally be covering this definition in today's course, though if you deal in that area you need to get up to speed in this area.

- **Post-transaction advice**

> (C) Written advice prepared for and provided to a taxpayer, solely for use by that taxpayer, after the taxpayer has filed a tax return with the Internal Revenue Service reflecting the tax benefits of the transaction. The preceding sentence does not apply if the practitioner knows or has reason to know that the written advice will be relied upon by the taxpayer to take a position on a tax return (including for these purposes an amended return that claims tax benefits not reported on a previously filed return) filed after the date on which the advice is provided to the taxpayer;

This exception covers the case when a return has already been filed and the taxpayer asks the CPA to give advice about the tax treatment of that transaction. Since such an opinion, by definition, did not exist at the date the return was filed, the IRS seems to be saying the taxpayer would seem to be forestalled from claiming reliance on this opinion for the purposes of establishing reliance on a professional.

Note that if the CPA ends up recommending that an amended return be filed, knows that such a return will be filed on this matter or has reason to believe one will be filed, this exception is not available.

- **Advice to the taxpayer's employer**

> (D) Written advice provided to an employer by a practitioner in that practitioner's capacity as an employee of that employer solely for purposes of determining the tax liability of the employer;

Note that the advice is strictly limited to advice to the employer of the CPA, and solely to the extent it determines the tax liability of that employer. If the employer is a passthrough entity, it would appear that the advice would almost automatically fail since the advice would relate to the tax liability of the owner of the employer. As well, if taken literally, if the advice impacted a related entity (including a subsidiary, brother-sister or parent of the employer) the exception wouldn't be available. Controllers who believe this eliminates their exposure in this area may wish to rethink that conclusion.

- **Negative advice**

> (E) Written advice that does not resolve a Federal tax issue in the taxpayer's favor, unless the advice reaches a conclusion favorable to the taxpayer at any confidence level (e.g., not frivolous, realistic possibility of success, reasonable basis or substantial authority) with respect to that issue. If written advice concerns more than one Federal tax issue, the advice must comply with the requirements of paragraph (c) of this section with respect to any Federal tax issue not described in the preceding sentence.

This is the "just say no" exception. But note that written advice can only fall under this exception if it concludes there is no favorable conclusion that can be arrived at—including simply that the position is not frivolous. That means this exception is arguably limited only to positions that are frivolous if the CPA comments at all on the tax issues.

A CPA that availed him/herself of this exception might find some liability to the promoter who may claim he/she was unfairly slandered or from the client down the line if the position is later upheld in court. For these reasons, I expect this exception to be used only for items like tax protester schemes.

### 2.2.10 Covered Opinion Standards

If a CPA issues a covered opinion (either because he/she must or because he/she has not elected to use opt-out language), the opinion must meet certain specified standards that impact both the contents of the written advice and the procedures that must be performed. The performance rules are generally found at Circular 230 §10.35(c), special rules involving reliance on the work of others found at Circular 230 §10.35(d) and required disclosures to be contained in the opinion at Circular 230 §10.35(e).

- **Performance Standards**

An opinion a tax matter involves coming to a determination of both the facts of the transaction in question and application of the law to those facts. After that is done, a final conclusion is arrived at regarding how the tax law would apply to the transaction in question.

*Analysis of Factual Matters.* Specific performance standards related to the analysis of factual matters is found at Circular 230 §10.35(c)(1), which is divided into three provisions. These deal with identifying the relevant facts, the acceptance of assumptions and acceptance of representations (including client representations).

Below is an analysis of each requirement.

> (1) Factual matters.
>
> (i) The 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 facts are relevant. The opinion must identify and consider all facts that the practitioner determines to be relevant.

The CPA must identify all relevant facts that will have an impact on the tax treatment of the proposed transaction. The opinion must identify all facts the CPA determines to relevant and consider those facts. Viewed from the opposite direction (as a plaintiff's attorney might very well do), it would appear that a reader would be justified in assuming that any fact this is not discussed by the CPA in the opinion is not relevant to the ultimate resolution of the tax treatment.

> (ii) The practitioner must not base the opinion on any unreasonable factual assumptions (including assumptions as to future events). An unreasonable factual assumption includes a factual assumption that the practitioner knows or should know is incorrect or incomplete. For example, it is unreasonable to assume that a transaction has a business purpose or that a transaction is potentially profitable apart from tax benefits. A factual assumption includes reliance on a projection, financial forecast or appraisal. It is unreasonable for a practitioner to rely on a projection, financial forecast or appraisal if the practitioner knows or should know that the projection, financial forecast or appraisal is incorrect or incomplete or was prepared by a person lacking the skills or qualifications necessary to prepare such projection, financial forecast or appraisal. The opinion must identify in a separate section all factual assumptions relied upon by the practitioner.

The regulation does not prohibit the use of assumptions—in fact, for prospective transactions (which is going to be the norm) there is little choice but to make certain assumptions that underlie the conclusions reached. But the regulation does impose a requirement that the CPA must evaluate the reasonableness of any assumptions that are used.

By definition, an assumption that a transaction has a business purpose or is profitable aside from tax benefits is unreasonable. Rather, the CPA must reach a conclusion as to the existence of those conditions if they are relevant to the matter at hand. The IRS was concerned that some opinions in the tax shelter arena had effectively disclaimed any position on this matter, which quite often was the single major issue in dispute when an examination later took place.

The CPA cannot rely on a projection, financial forecast or appraisal if the CPA knows or should know that the person performing the projection, forecast or appraisal lacks the skills to prepare the items in question, or if the projection, forecast or appraisal is incorrect or incomplete.

The advice must disclose in a separate section all factual assumptions that the CPA relied upon in preparing the opinion.

> (iii) The practitioner must not base the opinion on any unreasonable factual representations, statements or findings of the taxpayer or any other person. An unreasonable factual representation includes a factual representation that the practitioner knows or should know is incorrect or incomplete. For example, a practitioner may not rely on a factual representation that a transaction has a business purpose if the representation does not include a specific description of the business purpose or the practitioner knows or should know that the representation is incorrect or incomplete. The opinion must identify in a separate section all factual representations, statements or findings of the taxpayer relied upon by the practitioner.

The CPA is also restricted from simply relying upon the representation of a party (including his/her client) if the CPA knows or should know the representation is false or incomplete.

Again the IRS emphasizes the special problems of business purpose, indicating that the CPA must obtain a specific description of the claimed business purpose and must also evaluate that description of that purpose with a “smell test”--that is, the CPA cannot rely on it if the CPA knows or should know that the representation is false or incomplete.

*Analysis of Law to Facts.* The next key set of standards require that the CPA relate the law to the facts determined above. These standards are found at Circular 230 §10.35(c)(2).

> (2) Relate law to facts.
>
> (i) The opinion must relate the applicable law (including potentially applicable judicial doctrines) to the relevant facts.

This general rule basically requires that the CPA must deal with the applicable law—that is, the advice cannot “skip” an analysis of some applicable provision of the law. Most likely this standard was aimed at a concern that a written document used to market a transaction might simply neglect to deal with potentially troublesome provisions of the law.

> (ii) The practitioner must not assume the favorable resolution of any significant Federal tax issue except as provided in paragraphs (c)(3)(v) and (d) of this section, or otherwise base an opinion on any unreasonable legal assumptions, representations, or conclusions.

Similar to the prohibition an unreasonably assuming away a factual matter, the CPA is prohibited generally from assuming a favorable resolution of any tax issue. Since the

CPA, as the one giving advice on the law, is generally assumed to be the person being relied upon to analyze the law, in this case an assumption is generally prohibited.

There are two exceptions to this rule. First, if a CPA complies with the requirements to issue a limited scope opinion under §10.35(c)(3)(v), the CPA can assume a positive resolution of the matters not covered by the limited scope opinion.

Second, if a CPA complies with the requirements to rely upon the opinion of others in accordance with §10.35(d) the CPA may rely on the conclusion in that opinion on the favorable resolution of the significant Federal tax issue.

> (iii) The opinion must not contain internally inconsistent legal analyses or conclusions.

Finally, an opinion must not be internally inconsistent—that is, it cannot come to a conclusion on one issue that is at odds with the conclusion that is arrived at for another issue, even if each of the analyses standing alone is arguably reasonable in its conclusion. The IRS has indicated that certain opinions in the tax shelter arena used such internally inconsistent positions on issues.

*Conclusion as to federal tax issues.* This provision brings together the analysis of the facts and the law to deal with a conclusion.

> (3) *Evaluation of significant Federal tax issues.*
>
> (i) In general. The opinion must consider all significant Federal tax issues except as provided in paragraphs (c)(3)(v) and (d) of this section.

As with the law, the CPA cannot skip an issue in a covered opinion except in the case of a limited scope opinion or when meeting the standard to rely on the opinion of another person.

> (ii) Conclusion as to each significant Federal tax issue. The opinion must provide the practitioner's conclusion as to the likelihood that the taxpayer will prevail on the merits with respect to each significant Federal tax issue considered in the opinion. If the practitioner is unable to reach a conclusion with respect to one or more of those issues, the opinion must state that the practitioner is unable to reach a conclusion with respect to those issues. The opinion must describe the reasons for the conclusions, including the facts and analysis supporting the conclusions, or describe the reasons that the practitioner is unable to reach a conclusion as to one or more issues. If the practitioner fails to reach a conclusion at a confidence level of at least more likely than not with respect to one or more significant Federal tax issues considered, the opinion must include the appropriate disclosure(s) required under paragraph (e) of this section.

A covered opinion must provide the CPA's conclusion as to the likelihood that the taxpayer will prevail on the merits with respect to each issue. If the CPA cannot reach a conclusion with regard to any issue, the opinion must directly state this fact.

The CPA must detail the facts and analysis supporting each conclusion or describe the reason why the CPA was unable to reach a conclusion with regard to any issue for which no conclusion is reached.

Special rules apply to any significant Federal tax issue where the CPA fails to reach a "more likely than not" conclusion on an issue[24] which would include those issues on which the CPA failed to reach a conclusion on. Note that the taxpayer must be notified that he/she cannot rely on the opinion to avoid penalties related to the Federal tax issue in question.

> (iii) Evaluation based on chances of success on the merits. In evaluating the significant Federal tax issues addressed in the opinion, the practitioner must not take into account the possibility that a tax return will not be audited, that an issue will not be raised on audit, or that an issue will be resolved through settlement if raised.

The opinion must limit the analysis of the chance of success based solely on the merits of the position, and cannot take into account the fact that the IRS is unlikely to examine the return, that the issue is not likely to be raised even if the return is examined or would be negotiated away in a settlement by the IRS at some point before going to court.

First, a "theoretical" (that is, not likely to be found in a real world case) example. For instance, let us assume that the CPA had reached a conclusion on an issue that if it was litigated in court the matter would be a close call, but ultimately it is more likely than not that the taxpayer would lose. However, absent the above limitation, the CPA might attempt to argue that since the risks of litigation would be considered by an appellate conferee in a case and weighted, the possibility of the appellate conferee conceding the issue is enough, along with the base possibility of prevailing, to make it more likely than not that the taxpayer would ultimately prevail. Under the standards the CPA could not reach a more likely than not conclusion in a covered opinion with these facts.

The IRS was more concerned that taxpayers were being given opinions that relied largely on detection risk, and that transactions were being designed specifically to "fly under the radar" and the opinions were relying on a relatively low audit rate.

Under these standards, a CPA would need to make a determination on the result presuming the case is fully litigated and before a court for a decision on the merits. No analysis can be used that presumes the case doesn't reach this point when giving the opinion.

> (iv) Marketed opinions. In the case of a marketed opinion, the opinion must provide the practitioner's conclusion that the taxpayer will prevail on the merits at a confidence level of at least more likely than not with respect to each significant Federal tax issue. If the practitioner is unable to reach a

24 Circular 230 §10.35(e)(4) gives the details, noted below:

*(4) Opinions that fail to reach a more likely than not conclusion. An opinion that does not reach a conclusion at a confidence level of at least more likely than not with respect to a significant Federal tax issue must prominently disclose that –*

*(i) The opinion does not reach a conclusion at a confidence level of at least more likely than not with respect to one or more significant Federal tax issues addressed by the opinion; and*

*(ii) With respect to those significant Federal tax issues, 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.*

> more likely than not conclusion with respect to each significant Federal tax issue, the practitioner must not provide the marketed opinion, but may provide written advice that satisfies the requirements in paragraph (b)(5)(ii) of this section.

A marketed opinion must reach a more likely than not conclusion with regard to each significant Federal tax issue or it cannot be issued except as a disclaimed marketed opinion that cannot be relied upon to avoid penalties at all.

- **Reliance on work of others and competence to provide opinion**

Special rules apply when the CPA relies on the work of others in arriving at the conclusions for a covered opinion.

> (d) Competence to provide opinion; reliance on opinions of others.
>
> (1) The practitioner must be knowledgeable in all of the aspects of Federal tax law relevant to the opinion being rendered, except that the practitioner may rely on the opinion of another practitioner with respect to one or more significant Federal tax issues, unless the practitioner knows or should know that the opinion of the other practitioner should not be relied on. If a practitioner relies on the opinion of another practitioner, the relying practitioner's opinion must identify the other opinion and set forth the conclusions reached in the other opinion.
>
> (2) The practitioner must be satisfied that the combined analysis of the opinions, taken as a whole, and the overall conclusion, if any, satisfy the requirements of this section.

The *AICPA Code of Professional Conduct* requires that a CPA possess or have the ability to obtain before completion of the engagement adequate technical competence to perform any engagement that he/she accepts[25]. The Circular 230 requirements effectively

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25 *AICPA Code of Professional Conduct* Ethics Interpretation 201-1 specifically provides:

*201-1 – Competence. A member's agreement to perform professional services implies that the member has the necessary competence to complete those professional services according to professional standards, applying his or her knowledge and skill with reasonable care and diligence, but the member does not assume a responsibility for infallibility of knowledge or judgment.*

*Competence to perform professional services involves both the technical qualifications of the member and the member's staff and the ability to supervise and evaluate the quality of the work performed. Competence relates both to knowledge of the profession's standards, techniques and the technical subject matter involved, and to the capability to exercise sound judgment in applying such knowledge in the performance of professional services.*

*The member may have the knowledge required to complete the services in accordance with professional standards prior to performance. In some cases, however, additional research or consultation with others may be necessary during the performance of the professional services. This does not ordinarily represent a lack of competence, but rather is a normal part of the performance of professional services.*

*However, if a member is unable to gain sufficient competence through these means, the member should suggest, in fairness to the client and the public, the engagement of someone competent to perform the needed professional service, either independently or as an associate.*

duplicate this requirement by specifically requiring that the CPA be knowledgeable in the aspects of Federal tax law relevant to the opinion.

Under Circular 230, the CPA can rely on the opinion of another practitioner unless the practitioner knows or should know that the opinion of the other practitioner should not be relied upon. However, note that *AICPA Statement on Standards for Tax Services* require that a CPA believe a position is warranted under the law. *SSTS No. 1*, paragraph 7 provides

> In order to meet the standards contained in paragraph 2, a member should in good faith believe that the tax return position is warranted in existing law or can be supported by a good-faith argument for an extension, modification, or reversal of existing law. For example, in reaching such a conclusion, a member may consider a well-reasoned construction of the applicable statute, well-reasoned articles or treatises, or pronouncements issued by the applicable taxing authority, regardless of whether such sources would be treated as authority under Internal Revenue Code section 6662 and the regulations thereunder.

*SSTS No. 8*, paragraph 3 effectively adopts the tax return position standard to advice given to the taxpayer. The upshot of this is that a CPA arguably has a responsibility to evaluate the competence of any other practitioner whose opinion is being relied upon, including analyzing that party's opinion to make sure the CPA is comfortable accepting that opinion. It is reasonable to assume that the IRS would likely interpret the "should know" standard using a similar test.

As well, the Circular makes clear that the CPA issuing the opinion is responsible for evaluating the overall conclusion.

- **Limited scope opinions**

The CPA can avoid issuing a covered opinion on all matters by using a limited scope opinion. The limited scope opinion provides protection to the taxpayer on only the matters covered in the opinion, but does not provide protection on any matter not considered.

There are significant rules that must be followed to make use of a limited scope opinion, and it is not available at all for certain types of transactions.

> (v) Limited scope opinions.
>
> (A) The practitioner may provide an opinion that considers less than all of the significant Federal tax issues 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 issue(s) addressed in the opinion;

Note that the taxpayer and the CPA must agree that this will be a limited scope opinion. The onus will be on the CPA to show that such an agreement was reached. As a practical matter, that likely means that the CPA will need to obtain a written engagement letter, signed by the client consenting to the receipt of a limited scope opinion that spells out the limitations of the opinion.

> (2) The opinion is not advice described in paragraph (b)(2)(i)(A) of this section (concerning listed transactions), paragraph (b)(2)(i)(B) of this section (concerning the principal purpose of avoidance or evasion) or paragraph (b)(5) of this section (a marketed opinion); and

Not surprisingly, this type of opinion cannot be used on a listed transaction, a principal purpose transaction or a marketed opinion. And, as previously discussed, the types of transactions that might be deemed to be listed or principal purpose may be larger than the CPA would at first assume to be the case[26].

> (3) The opinion includes the appropriate disclosure(s) required under paragraph (e) of this section.

The limited scope opinion must contain specific disclosures that note the limitations on the use of the opinion,[27] including the fact that other issues exist that could affect the ultimate Federal tax treatment that are not discussed in this document.

> (B) A practitioner may make reasonable assumptions regarding the favorable resolution of a Federal tax issue (an assumed issue) for purposes of providing an opinion on less than all of the significant Federal tax issues as provided in this paragraph (c)(3)(v). The opinion must identify in a separate section all issues for which the practitioner assumed a favorable resolution.

While a CPA can assume the favorable resolution of a significant Federal tax issue that is not be opined on in a limited scope opinion, the CPA must specifically identify those assumed favorable resolutions in a separate section of the opinion so that they are disclosed to the client.

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26 In particular, I would remind CPAs of the previous discussion related to family limited partnership transactions and the possibility that the IRS would always view the transaction as a principal purpose transaction for purposes of these rules.

27 Circular 230 §10.35(e)(3) provides:

*(3) Limited scope opinions. A limited scope opinion must prominently disclose 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.*

Presuming that a favorable resolution of those issues not considered would be required in order to obtain the benefit, the CPA is still "on the hook" in terms of identifying the relevant issues and alerting the client to the issue. This implied requirement could come back to haunt the CPA in civil litigation should a client receive an assessment based on a matter not discussed in the written communication.

## 2.3 §10.36 Procedures to Ensure Compliance

New §10.36 imposes requirements that the individual with the responsibility for oversight of the firm's tax advice practice take action to ensure compliance with the covered opinion rules by members of the firm. The individual can be held personally liable for violation of Circular 230 if the individual through "willfulness, recklessness, or gross incompetence" fails to take steps to insure compliance and a member of the firm violates the standards under §§10.35 or 10.39 or the practitioner knows or should know a member of the firm has engaged in a pattern of practice in violation of these provisions and does not take action to correct the situation.

In many small firms, there may not be a single individual designated to have this level of responsibility for the firm as a whole. If you are a CPA operating in such a firm and you have appear to have any sort of authority in the area of tax matters, you may be "at risk" for the actions of others in the firm, especially if you become aware of a potential problem.

## 2.4 §10.37 Other Written Advice

Advice that doesn't fall under the covered opinion rules is still subject to the general standards found in Circular 230 §10.37(a). That provision provides:

> (a) Requirements. A practitioner must not give written advice (including electronic communications) concerning one or more Federal tax issues if the practitioner bases the written advice on unreasonable factual or legal assumptions (including assumptions as to future events), unreasonably relies upon representations, statements, findings or agreements of the taxpayer or any other person, does not consider all relevant facts that the practitioner knows or should know, or, in evaluating a Federal tax issue, takes into account the possibility that a tax return will not be audited, that an issue will not be raised on audit, or that an issue will be resolved through settlement if raised. All facts and circumstances, including the scope of the engagement and the type and specificity of the advice sought by the client will be considered in determining whether a practitioner has failed to comply with this section. In the case of an opinion 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 to one or more taxpayers a partnership or other entity, investment plan or arrangement a significant purpose of which is the avoidance or evasion of any tax imposed by the Internal Revenue Code, the determination of whether a practitioner has failed to comply with this section will be made on the basis of a heightened standard of care because of the greater risk caused by the practitioner's lack of knowledge of the taxpayer's particular circumstances.

A CPA cannot issue written advice (including electronic advice, such as email) if any of the following apply:

- Advice is based on unreasonable factual or legal assumptions (including assumptions as to future events
- Unreasonably relies upon the representations, statements, findings or agreements of the client or another person
- Does not consider all facts the CPA knows or should know
- Takes into consideration the possibility that the return will not be audited, an issue will not be raised on audit or that an issue will be resolved through settlement if raised

The standard notes that a “facts and circumstances” test will be used to determine if the CPA complied with this provision, including the nature of the engagement and the type of advice sought. Arguably this suggests that the IRS will impose a stricter standard in the case where a taxpayer specifically engages a CPA to give advice on a proposed transaction vs. the case where the taxpayer asks a quick question in passing during an engagement primarily devoted to preparing the prior year’s tax return.

This may be another area where blanket use of the “opt out” language may prove troublesome. An opinion “tagged” with the opt out language may arguably indicate that the CPA believes that without that language the matter has risen to the level of a covered opinion. In that case, it would appear that the CPA would be subject to a higher expected standard of care under §10.37.

As well, it should be clear that getting “out from under” the covered opinion standards does not solve the problem entirely—the prohibition on basing advice on the expected outcome of the examination process prior to going to court still exists.

The IRS does make it clear that a heightened standard of care will be applied if the CPA knows or has reason to know that the advice will be used by someone other than the client the CPA is working with.

## 2.5 §10.29 Conflicts of Interest

A provision added in 2002 has been overlooked by many CPAs, but may be of importance. Circular 230 now requires a practitioner to obtain the consent of a client before representing the client if there is a conflict of interest. The provision notes:

> (a) Except as provided by paragraph (b) of this section, a practitioner shall not represent a client in his or her practice before the Internal Revenue Service if the representation involves a conflict of interest. A conflict of interest exists if:
>
> (1) The representation of one client will be directly adverse to another client; or
>
> (2) There is a significant risk that the representation of one or more clients will be materially limited by the practitioner's responsibilities to another client, a former client or a third person or by a personal interest of the practitioner.
>
> (b) Notwithstanding the existence of a conflict of interest under paragraph (a) of this section, the practitioner may represent a client if:

> (1) The practitioner reasonably believes that the practitioner will be able to provide competent and diligent representation to each affected client;
>
> (2) The representation is not prohibited by law;
>
> (3) Each affected client gives informed consent, confirmed in writing.
>
> (c) Copies of the written consents must be retained by the practitioner for at least 36 months from the date of the conclusion of the representation of the affected clients and the written consents must be provided to any officer or employee of the Internal Revenue Service on request.

# 3 Circular 230 Subpart C

Subpart C contains the teeth in Circular 230. Circular 230 §10.50(a) provides the general sanctions that can be imposed against a CPA and reads as follows:

> (a) *Authority to censure, suspend, or disbar*. The Secretary of the Treasury, or his or her delegate, after notice and an opportunity for a proceeding, may censure, suspend or disbar any practitioner from practice before the Internal Revenue Service if the practitioner is shown to be incompetent or disreputable, fails to comply with any regulation in this part, or with intent to defraud, willfully and knowingly misleads or threatens a client or prospective client. Censure is a public reprimand.

Incompetence and disreputable conduct is covered by §10.51, which gives a laundry list of banned conduct. One important provision is to note is found at §10.51(j) which prohibits "knowingly aiding and abetting another person to practice before the Internal Revenue Service during a period of suspension, disbarment, or ineligibility of such other person." This provision means that any person who is barred from practice before the IRS is "tainted" and cannot associate with anyone authorized to practice before the IRS (attorney, CPA or EA) without endangering that person's right to practice.

Violation of regulations is covered by §10.52, which provides the following:

> (a) Prohibited conduct. A practitioner may be censured, suspended or disbarred from practice before the Internal Revenue Service for any of the following:
>
> (1) Willfully violating any of the regulations (other than § 10.33) contained in this part; or
>
> (2) Recklessly or through gross incompetence (within the meaning of §10.51(l)) violating §§10.34, 10.35, 10.36 or 10.37.

That provides, effectively, a three tiered level of violations of Circular 230. §10.33 (the best practices provision) is put into the "no teeth" category for action by the Office of Professional Responsibility.

Regulations §§10.34 (standards for tax return positions), 10.35 (covered opinions), 10.36 (policing the covered opinion rules in the firm) and 10.37 (other written advice) are given special status—while for all other regulations (except for §10.33 noted above) the practitioner will be sanctioned only for willful violations, in these cases the practitioner can be cited based simply on recklessness or gross incompetence—that is, ignorance of the provision will not be an automatic excuse from sanctions for these provisions.

# 4 Written Advice Flowchart

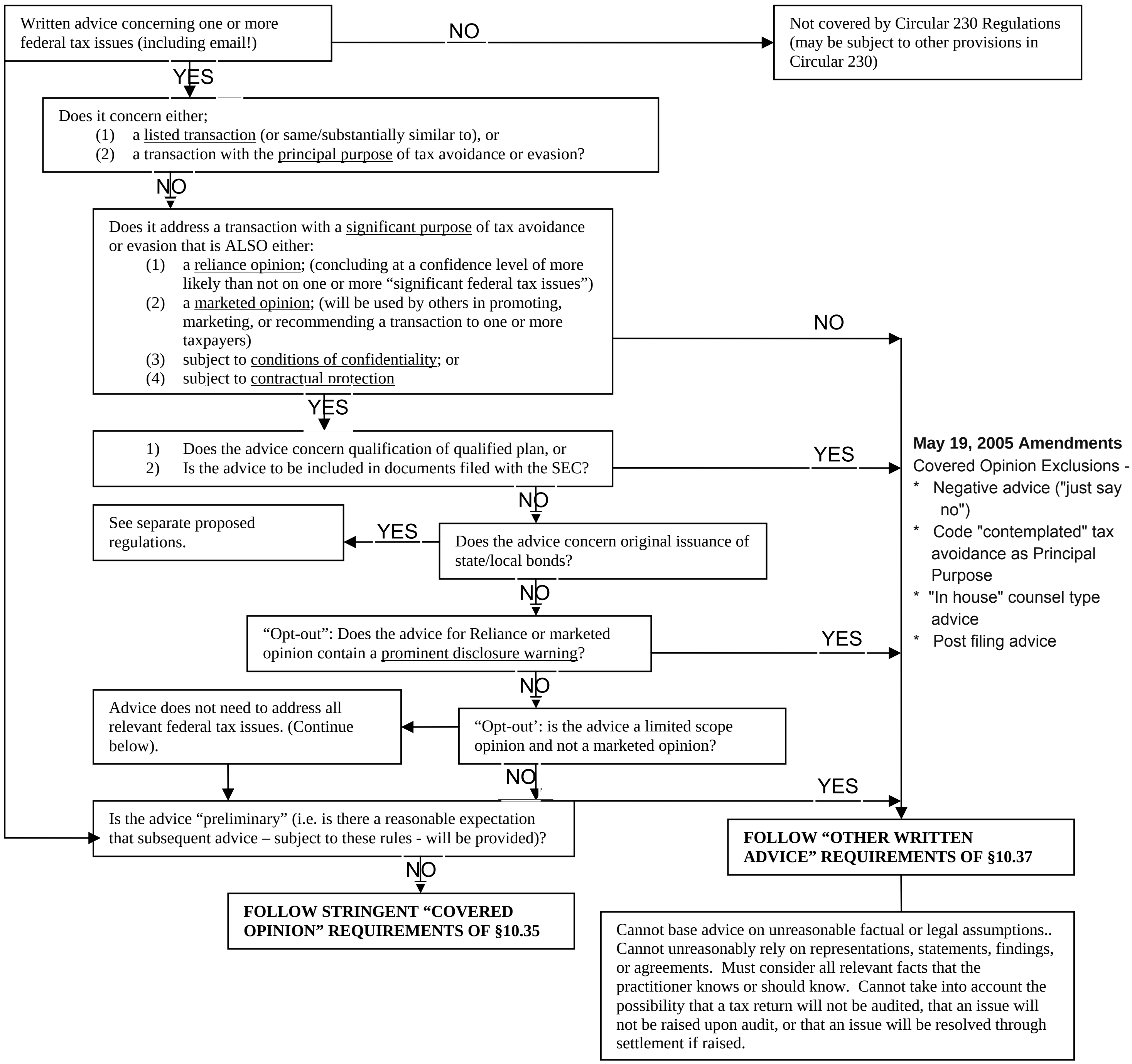
The chart on the next page was created by Kip Dellinger and made available on the California Society of CPA's Yahoo TaxTalk discussion group (http://groups.yahoo.com). Kip graciously consented to including this chart in the materials for this presentation.

The chart helps in navigating the various tests that written advice is subjected to under the Circular 230 standards.

# Circular 230 Written Advice Flowchart

Prepared by Kip Dellinger, CPA (8/17/05)

**Federal tax issue** = 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. ***Significant*** means the IRS has a reasonable basis for a successful challenge of the treatment and it will have a significant impact on the overall tax treatment of the transaction(s) or matter(s) addressed in the opinion.




Code Section 6662(d)(2)(C0 REDUCTION NOT TO APPLY TO <u>TAX SHELTERS</u> (emphasis supplied)

(i) IN GENERAL – Subparagraph (B) shall not apply to any item attributable to tax shelter

(ii) TAX SHELTER – For purposes of clause (i), the term "tax shelter means –

(I) a partnership or other entity,

(II) any investment plan or arrangement, or

(III) any other plan or arrangement,

If a significant purpose of such partnership, entity, plan, or arrangement is the avoidance or evasion of Federal income tax.

***<u>Identical to the wording used in Section 10.35 of Circular 230 (except word "income")</u>***

# 5 Circular 230 Subpart B

The following pages contains Circular 230 subpart B as it was modified effective June 20, 2005.

(2) Limitations. (i) An individual who is under suspension or disbarment from practice before the Internal Revenue Service may not engage in limited practice before the Internal Revenue Service under paragraph (c)(1) of this section.

(ii) The Director, after notice and opportunity for a conference, may deny eligibility to engage in limited practice before the Internal Revenue Service under paragraph (c)(1) of this section to any individual who has engaged in conduct that would justify censuring, suspending, or disbarring a practitioner from practice before the Internal Revenue Service.

(iii) An individual who represents a taxpayer under the authority of paragraph (c)(1) of this section is subject, to the extent of his or her authority, to such rules of general applicability regarding standards of conduct and other matters as the Director of Practice prescribes.

*(d) Special appearances.* The Director of Practice may, subject to such conditions as he or she deems appropriate, authorize an individual who is not otherwise eligible to practice before the Internal Revenue Service to represent another person in a particular matter.

*(e) Preparing tax returns and furnishing information.* Any individual may prepare a tax return, appear as a witness for the taxpayer before the Internal Revenue Service, or furnish information at the request of the Internal Revenue Service or any of its officers or employees.

*(f) Fiduciaries.* For purposes of this part, a fiduciary (i.e., a trustee, receiver, guardian, personal representative, administrator, or executor) is considered to be the taxpayer and not a representative of the taxpayer.

**§ 10.8 Customhouse brokers.**

Nothing contained in the regulations in this part will affect or limit the right of a customhouse broker, licensed as such by the Commissioner of Customs in accordance with the regulations prescribed therefore, in any customs district in which he or she is so licensed, at a relevant local office of the Internal Revenue Service or before the National Office of the Internal Revenue Service, to act as a representative in respect to any matters relating specifically to the importation or exportation of merchandise under the customs or internal revenue laws, for any person for whom he or she has acted as a customhouse broker.

- Par. 3. In part 10, subpart B is amended by revising §§ 10.20 through 10.32 and revising § 10.34.

## Subpart B -- Duties and Restrictions Relating to Practice Before the Internal Revenue Service

**§ 10.20 Information to be furnished**

*(a) To the Internal Revenue Service*

(1) A practitioner must, on a proper and lawful request by a duly authorized officer or employee of the Internal Revenue Service, promptly submit records or information in any matter before the Internal Revenue Service unless the practitioner believes in good faith and on reasonable grounds that the records or information are privileged.

(2) Where the requested records or information are not in the possession of, or subject to the control of, the

practitioner or the practitioner's client, the practitioner must promptly notify the requesting Internal Revenue Service officer or employee and the practitioner must provide any information that the practitioner has regarding the identity of any person who the practitioner believes may have possession or control of the requested records or information. The practitioner must make reasonable inquiry of his or her client regarding the identity of any person who may have possession or control of the requested records or information, but the practitioner is not required to make inquiry of any other person or independently verify any information provided by the practitioner's client regarding the identity of such persons.

*(b)* *To the Director of Practice.* When a proper and lawful request is made by the Director of Practice, a practitioner must provide the Director of Practice with any information the practitioner has concerning an inquiry by the Director of Practice into an alleged violation of the regulations in this part by any person, and to testify regarding this information in any proceeding instituted under this part, unless the practitioner believes in good faith and on reasonable grounds that the information is privileged.

*(c)* *Interference with a proper and lawful request for records or information.* A practitioner may not interfere, or attempt to interfere, with any proper and lawful effort by the Internal Revenue Service, its officers or employees, or the Director of Practice, or his or her employees, to obtain any record or information unless the practitioner believes in good faith and on reasonable grounds that the record or information is privileged.

**§ 10.21 Knowledge of client's omission.**

A practitioner who, having been retained by a client with respect to a matter administered by the Internal Revenue Service, knows that the client has not complied with the revenue laws of the United States or has made an error in or omission from any return, document, affidavit, or other paper which the client submitted or executed under the revenue laws of the United States, must advise the client promptly of the fact of such noncompliance, error, or omission. The practitioner must advise the client of the consequences as provided under the Code and regulations of such noncompliance, error, or omission.

**§ 10.22 Diligence as to accuracy.**

*(a)* *In general.* A practitioner must exercise due diligence--

(1) In preparing or assisting in the preparation of, approving, and filing tax returns, documents, affidavits, and other papers relating to Internal Revenue Service matters;

(2) In determining the correctness of oral or written representations made by the practitioner to the Department of the Treasury; and

(3) In determining the correctness of oral or written representations made by the practitioner to clients with reference to any matter administered by the Internal Revenue Service.

*(b)* *Reliance on others.* Except as provided in §§ 10.33 and 10.34, a practitioner will be presumed to have exercised due diligence for purposes of this section if the practitioner relies on the work product of another person and the practitioner used reasonable care in

engaging, supervising, training, and evaluating the person, taking proper account of the nature of the relationship between the practitioner and the person.

**§ 10.23 Prompt disposition of pending matters.**

A practitioner may not unreasonably delay the prompt disposition of any matter before the Internal Revenue Service.

**§ 10.24 Assistance from or to disbarred or suspended persons and former Internal Revenue Service employees.**

A practitioner may not, knowingly and directly or indirectly:

(a) Accept assistance from or assist any person who is under disbarment or suspension from practice before the Internal Revenue Service if the assistance relates to a matter or matters constituting practice before the Internal Revenue Service.

(b) Accept assistance from any former government employee where the provisions of § 10.25 or any Federal law would be violated.

**§ 10.25 Practice by former Government employees, their partners and their associates.**

*(a) Definitions.* For purposes of this section--

(1) Assist means to act in such a way as to advise, furnish information to, or otherwise aid another person, directly or indirectly.

(2) Government employee is an officer or employee of the United States or any agency of the United States, including a special government employee as defined in 18 U.S.C. 202(a), or of the District of Columbia, or of any State, or a member of Congress or of any State legislature.

(3) Member of a firm is a sole practitioner or an employee or associate thereof, or a partner, stockholder, associate, affiliate or employee of a partnership, joint venture, corporation, professional association or other affiliation of two or more practitioners who represent nongovernmental parties.

(4) Practitioner includes any individual described in paragraph (f) of § 10.2.

(5) Official responsibility means the direct administrative or operating authority, whether intermediate or final, and either exercisable alone or with others, and either personally or through subordinates, to approve, disapprove, or otherwise direct Government action, with or without knowledge of the action.

(6) Participate or participation means substantial involvement as a Government employee by making decisions, or preparing or reviewing documents with or without the right to exercise a judgment of approval or disapproval, or participating in conferences or investigations, or rendering advice of a substantial nature.

(7) Rule includes Treasury Regulations, whether issued or under preparation for issuance as Notices of Proposed Rule Making or as Treasury Decisions; revenue rulings; and revenue procedures published in the Internal Revenue Bulletin. Rule does not include a transaction as defined in paragraph (a)(8) of this section.

(8) Transaction means any decision, determination, finding, letter ruling, technical advice, Chief Counsel advice, or contract or the approval or

disapproval thereof, relating to a particular factual situation or situations involving a specific party or parties whose rights, privileges, or liabilities under laws or regulations administered by the Internal Revenue Service, or other legal rights, are determined or immediately affected therein and to which the United States is a party or in which it has a direct and substantial interest, whether or not the same taxable periods are involved. Transaction does not include rule as defined in paragraph (a)(7) of this section.

*(b) General rules.*

(1) No former Government employee may, subsequent to his or her Government employment, represent anyone in any matter administered by the Internal Revenue Service if the representation would violate 18 U.S.C. 207 or any other laws of the United States.

(2) No former Government employee who participated in a transaction may, subsequent to his or her Government employment, represent or knowingly assist, in that transaction, any person who is or was a specific party to that transaction.

(3) A former Government employee who within a period of one year prior to the termination of Government employment had official responsibility for a transaction may not, within two years after his or her Government employment is ended, represent or knowingly assist in that transaction any person who is or was a specific party to that transaction.

(4) No former Government employee may, within one year after his or her Government employment is ended, appear before any employee of the Treasury Department in connection with the publication, withdrawal, amendment, modification, or interpretation of a rule in the development of which the former Government employee participated or for which, within a period of one year prior to the termination of his or her Government employment, he or she had official responsibility. This paragraph (b)(4) does not, however, preclude such former employee from appearing on his or her own behalf or from representing a taxpayer before the Internal Revenue Service in connection with a transaction involving the application or interpretation of such a rule with respect to that transaction, provided that such former employee does not utilize or disclose any confidential information acquired by the former employee in the development of the rule.

*(c) Firm representation.*

(1) No member of a firm of which a former Government employee is a member may represent or knowingly assist a person who was or is a specific party in any transaction with respect to which the restrictions of paragraph (b)(2) or (3) of this section apply to the former Government employee, in that transaction, unless the firm isolates the former Government employee in such a way to ensure that the former Government employee cannot assist in the representation.

(2) When isolation of a former Government employee is required under paragraph (c)(1) of this section, a statement affirming the fact of such isolation must be executed under oath by the former Government employee and by another member of the firm acting on behalf of the firm. The statement must clearly identify the firm, the former Government employee, and the transaction(s) requiring isolation and it must be filed with the Director of Practice (and at such other place(s)

directed by the Director of Practice) and in such other place and in the manner prescribed by rule or regulation.

*(d) Pending representation.* Practice by former Government employees, their partners and associates with respect to representation in specific matters where actual representation commenced before July 26, 2002, is governed by the regulations set forth at 31 CFR Part 10 revised as of July 1, 2002. The burden of showing that representation commenced before July 26, 2002, lies with the former Government employees, and their partners and associates.

**§ 10.26 Notaries.**

A practitioner may not take acknowledgments, administer oaths, certify papers, or perform any official act as a notary public with respect to any matter administered by the Internal Revenue Service and for which he or she is employed as counsel, attorney, or agent, or in which he or she may be in any way interested.

**§ 10.27 Fees.**

*(a) Generally.* A practitioner may not charge an unconscionable fee for representing a client in a matter before the Internal Revenue Service.

*(b) Contingent fees.*

(1) For purposes of this section, a contingent fee is any fee that is based, in whole or in part, on whether or not a position taken on a tax return or other filing avoids challenge by the Internal Revenue Service or is sustained either by the Internal Revenue Service or in litigation. A contingent fee includes any fee arrangement in which the practitioner will reimburse the client for all or a portion of the client's fee in the event that a position taken on a tax return or other filing is challenged by the Internal Revenue Service or is not sustained, whether pursuant to an indemnity agreement, a guarantee, rescission rights, or any other arrangement with a similar effect.

(2) A practitioner may not charge a contingent fee for preparing an original tax return or for any advice rendered in connection with a position taken or to be taken on an original tax return.

(3) A contingent fee may be charged for preparation of or advice in connection with an amended tax return or a claim for refund (other than a claim for refund made on an original tax return), but only if the practitioner reasonably anticipates at the time the fee arrangement is entered into that the amended tax return or refund claim will receive substantive review by the Internal Revenue Service.

**§ 10.28 Return of client's records.**

(a) In general, a practitioner must, at the request of a client, promptly return any and all records of the client that are necessary for the client to comply with his or her Federal tax obligations. The practitioner may retain copies of the records returned to a client. The existence of a dispute over fees generally does not relieve the practitioner of his or her responsibility under this section. Nevertheless, if applicable state law allows or permits the retention of a client's records by a practitioner in the case of a dispute over fees for services rendered, the practitioner need only return those records that must be attached to the taxpayer's return. The practitioner, however, must provide the client with reasonable access to review and copy any additional records of the client retained by the practitioner under state law that are necessary for the client to comply with his or her Federal tax obligations.

(b) For purposes of this section--Records of the client include all documents or written or electronic materials provided to the practitioner, or obtained by the practitioner in the course of the practitioner's representation of the client, that preexisted the retention of the practitioner by the client. The term also includes materials that were prepared by the client or a third party (not including an employee or agent of the practitioner) at any time and provided to the practitioner with respect to the subject matter of the representation. The term also includes any return, claim for refund, schedule, affidavit, appraisal or any other document prepared by the practitioner, or his or her employee or agent, that was presented to the client with respect to a prior representation if such document is necessary for the taxpayer to comply with his or her current Federal tax obligations. The term does not include any return, claim for refund, schedule, affidavit, appraisal or any other document prepared by the practitioner or the practitioner's firm, employees or agents if the practitioner is withholding such document pending the client's performance of its contractual obligation to pay fees with respect to such document.

**§ 10.29 Conflicting interests.**

(a) Except as provided by paragraph (b) of this section, a practitioner shall not represent a client in his or her practice before the Internal Revenue Service if the representation involves a conflict of interest. A conflict of interest exists if:

(1) The representation of one client will be directly adverse to another client; or

(2) There is a significant risk that the representation of one or more clients will be materially limited by the practitioner's responsibilities to another client, a former client or a third person or by a personal interest of the practitioner.

(b) Notwithstanding the existence of a conflict of interest under paragraph (a) of this section, the practitioner may represent a client if:

(1) The practitioner reasonably believes that the practitioner will be able to provide competent and diligent representation to each affected client;

(2) The representation is not prohibited by law;

(3) Each affected client gives informed consent, confirmed in writing.

(c) Copies of the written consents must be retained by the practitioner for at least 36 months from the date of the conclusion of the representation of the affected clients and the written consents must be provided to any officer or employee of the Internal Revenue Service on request.

(Approved by the Office of Management and Budget under Control No. 1545-1726)

**§ 10.30 Solicitation.**

*(a) Advertising and solicitation restrictions.*

(1) A practitioner may not, with respect to any Internal Revenue Service matter, in any way use or participate in the use of any form of public communication or private solicitation containing a false, fraudulent, or coercive statement or claim; or a

misleading or deceptive statement or claim. Enrolled agents, in describing their professional designation, may not utilize the term of art "certified" or imply an employer/employee relationship with the Internal Revenue Service. Examples of acceptable descriptions are "enrolled to represent taxpayers before the Internal Revenue Service," "enrolled to practice before the Internal Revenue Service," and "admitted to practice before the Internal Revenue Service."

(2) A practitioner may not make, directly or indirectly, an uninvited written or oral solicitation of employment in matters related to the Internal Revenue Service if the solicitation violates Federal or State law or other applicable rule, e.g., attorneys are precluded from making a solicitation that is prohibited by conduct rules applicable to all attorneys in their State(s) of licensure. Any lawful solicitation made by or on behalf of a practitioner eligible to practice before the Internal Revenue Service must, nevertheless, clearly identify the solicitation as such and, if applicable, identify the source of the information used in choosing the recipient.

*(b) Fee information.*

(1)(i) A practitioner may publish the availability of a written schedule of fees and disseminate the following fee information--

(A) Fixed fees for specific routine services.

(B) Hourly rates.

(C) Range of fees for particular services.

(D) Fee charged for an initial consultation.

(ii) Any statement of fee information concerning matters in which costs may be incurred must include a statement disclosing whether clients will be responsible for such costs.

(2) A practitioner may charge no more than the rate(s) published under paragraph (b)(1) of this section for at least 30 calendar days after the last date on which the schedule of fees was published.

*(c) Communication of fee information.* Fee information may be communicated in professional lists, telephone directories, print media, mailings, and electronic mail, facsimile, hand delivered flyers, radio, television, and any other method. The method chosen, however, must not cause the communication to become untruthful, deceptive, or otherwise in violation of this part. A practitioner may not persist in attempting to contact a prospective client if the prospective client has made it known to the practitioner that he or she does not desire to be solicited. In the case of radio and television broadcasting, the broadcast must be recorded and the practitioner must retain a recording of the actual transmission. In the case of direct mail and e-commerce communications, the practitioner must retain a copy of the actual communication, along with a list or other description of persons to whom the communication was mailed or otherwise distributed. The copy must be retained by the practitioner for a period of at least 36 months from the date of the last transmission or use.

*(d) Improper associations.* A practitioner may not, in matters related to the Internal Revenue Service, assist, or accept assistance from, any person or entity who, to the knowledge of the practitioner, obtains clients or otherwise practices in a manner forbidden under this section.

(Approved by the Office of Management and Budget under Control No. 1545-1726)

**§ 10.31 Negotiation of taxpayer checks**.

A practitioner who prepares tax returns may not endorse or otherwise negotiate any check issued to a client by the government in respect of a Federal tax liability.

**§ 10.32 Practice of law.**

Nothing in the regulations in this part may be construed as authorizing persons not members of the bar to practice law.

-Par.2 Section 10.33 is revised to read as follows:

**§ 10.33 Best practices for tax advisors.**

*(a) Best practices.* Tax advisors should provide clients with the highest quality representation concerning Federal tax issues by adhering to best practices in providing advice and in preparing or assisting in the preparation of a submission to the Internal Revenue Service. In addition to compliance with the standards of practice provided elsewhere in this part, best practices include the following:

(1) Communicating clearly with the client regarding the terms of the engagement. For example, the advisor should determine the client's expected purpose for and use of the advice and should have a clear understanding with the client regarding the form and scope of the advice or assistance to be rendered.

(2) Establishing the facts, determining which facts are relevant, evaluating the reasonableness of any assumptions or representations, relating the applicable law (including potentially applicable judicial doctrines) to the relevant facts, and arriving at a conclusion supported by the law and the facts.

(3) Advising the client regarding the import of the conclusions reached, including, for example, whether a taxpayer may avoid accuracy-related penalties under the Internal Revenue Code if a taxpayer acts in reliance on the advice.

(4) Acting fairly and with integrity in practice before the Internal Revenue Service.

*(b) Procedures to ensure best practices for tax advisors.* 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 set forth in paragraph (a) of this section.

*(c) Applicability date.* This section is effective after June 20, 2005.

**§ 10.34 Standards for advising with respect to tax return positions and for preparing or signing returns.**

*(a) Realistic possibility standard.* A practitioner may not sign a tax return as a preparer if the practitioner determines that the tax return contains a position that does not have a realistic possibility of being sustained on its merits (the realistic possibility standard) unless the position is not frivolous and is adequately disclosed to the Internal

Revenue Service. A practitioner may not advise a client to take a position on a tax return, or prepare the portion of a tax return on which a position is taken, unless--

(1) The practitioner determines that the position satisfies the realistic possibility standard; or

(2) The position is not frivolous and the practitioner advises the client of any opportunity to avoid the accuracy-related penalty in section 6662 of the Internal Revenue Code by adequately disclosing the position and of the requirements for adequate disclosure.

*(b) Advising clients on potential penalties.* A practitioner advising a client to take a position on a tax return, or preparing or signing a tax return as a preparer, must inform the client of the penalties reasonably likely to apply to the client with respect to the position advised, prepared, or reported. The practitioner also must inform the client of any opportunity to avoid any such penalty by disclosure, if relevant, and of the requirements for adequate disclosure. This paragraph (b) applies even if the practitioner is not subject to a penalty with respect to the position.

*(c) Relying on information furnished by clients.* A practitioner advising a client to take a position on a tax return, or preparing or signing a tax return as a preparer, generally may rely in good faith without verification upon information furnished by the client. The practitioner may not, however, ignore the implications of information furnished to, or actually known by, the practitioner, and must make reasonable inquiries if the information as furnished appears to be incorrect, inconsistent with an important fact or another factual assumption, or incomplete.

*(d) Definitions.* For purposes of this section--

(1) Realistic possibility. A position is considered to have a realistic possibility of being sustained on its merits if a reasonable and well informed analysis of the law and the facts by a person knowledgeable in the tax law would lead such a person to conclude that the position has approximately a one in three, or greater, likelihood of being sustained on its merits. The authorities described in 26 CFR 1.6662-4(d)(3)(iii), or any successor provision, of the substantial understatement penalty regulations may be taken into account for purposes of this analysis. The possibility that a tax return will not be audited, that an issue will not be raised on audit, or that an issue will be settled may not be taken into account.

(2) Frivolous. A position is frivolous if it is patently improper.

-Par. 3. Sections 10.35, 10.36, 10.37 and 10.38 are added to subpart B to read as follows:

**§ 10.35 Requirements for covered opinions.**

(a) A practitioner who provides a covered opinion shall comply with the standards of practice in this section.

(b) *Definitions.* For purposes of this subpart--

(1) *A practitioner* includes any individual described in §10.2(e).

(2) *Covered opinion* -- (i) *In general.* A *covered opinion* is written advice (including electronic communications) by a practitioner concerning one or more Federal tax issues arising from --

(A) A transaction that is the same as or substantially similar to a transaction that, at the time the advice is rendered, the Internal Revenue Service has determined to be a tax avoidance transaction and identified by published guidance as a listed transaction under 26 CFR 1.6011-4(b)(2);

(B) 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; or

(C) 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 if the written advice--

(1) Is a *reliance opinion;*

(2) Is a *marketed opinion*;

(3) Is subject to *conditions of confidentiality;* or

(4) Is subject to *contractual protection.*

*(ii)* *<u>Excluded advice</u>.* A *covered opinion* does not include--

(A) Written 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;

(B) Written advice, other than advice described in paragraph (b) (2) (i) (A) of this section (concerning listed transactions) or paragraph (b) (2) (i) (B) of this section (concerning the principal purpose of avoidance or evasion) that--

(1) Concerns the qualification of a qualified plan;

(2) Is a *State or local bond opinion;* or

(3) Is included in documents required to be filed with the Securities and Exchange Commission.

(C) Written advice prepared for and provided to a taxpayer, solely for use by that taxpayer, after the taxpayer has filed a tax return with the Internal Revenue Service reflecting the tax benefits of the transaction. The preceding sentence does not apply if the practitioner knows or has reason to know that the written advice will be relied upon by the taxpayer to take a position on a tax return (including for these purposes an amended return that claims tax benefits not reported on a previously filed return) filed after the date on which the advice is provided to the taxpayer;

(D) Written advice provided to an employer by a practitioner in that practitioner's capacity as an employee of that employer solely for purposes of determining the tax liability of the employer; or

(E) Written advice that does not resolve a Federal tax issue in the taxpayer's favor, unless the advice reaches a conclusion favorable to the taxpayer at any confidence level (e.g., not frivolous, realistic possibility of success, reasonable basis or substantial authority) with respect to that issue. If written advice concerns more than one Federal tax issue, the advice must comply with the requirements of paragraph (c) of this section with respect to any Federal tax issue not described in the preceding sentence.

(3) <u>A Federal tax issue</u> is a question concerning 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. For purposes of this subpart, a *Federal tax issue* is significant if the Internal

Revenue Service has a reasonable basis for a successful challenge and 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.

*(4)* *__Reliance opinion__*--(i) Written advice is a *reliance opinion* if the advice concludes at a confidence level of at least more likely than not a greater than 50 percent likelihood) that one or more significant Federal tax issues would be resolved in the taxpayer's favor.

(ii) For purposes of this section, written advice, other than advice described in paragraph (b)(2)(i)(A) of this section (concerning listed transactions) or paragraph (b)(2)(i)(B) of this section (concerning the principal purpose of avoidance or evasion), is not treated as a *reliance opinion* if the practitioner prominently discloses in the written advice that it 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.

(5) *__Marketed opinion__*--(i) Written advice 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).

(ii) For purposes of this section, written advice, other than advice described in paragraph (b)(2)(i)(A) of this section (concerning listed transactions) or paragraph (b)(2)(i)(B) of this section (concerning the principal purpose of avoidance or evasion), is not treated as a *marketed opinion* if the practitioner prominently discloses in the written advice 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.

(6) *__Conditions of confidentiality.__* Written advice is subject to *conditions of confidentiality* if the practitioner imposes on one or more recipients of the written advice a limitation on disclosure of the tax treatment or tax structure of the transaction and the limitation on disclosure protects the confidentiality of that practitioner's tax strategies, regardless of whether the limitation on disclosure is legally binding. A claim that a transaction is proprietary or exclusive is not a limitation on disclosure if the practitioner confirms to all recipients of the written advice that there is no limitation on disclosure of the tax treatment or tax structure of the transaction that is the subject of the written advice.

*(7)* *__Contractual protection.__* Written advice is subject to *contractual protection* if the taxpayer has the right to a full or partial refund of fees paid to the practitioner (or a person who is a member of, associated with, or employed by the practitioner's firm) if

all or a part of the intended tax consequences from the matters addressed in the written advice are not sustained, or if the fees paid to the practitioner (or a person who is a member of, associated with, or employed by the practitioner's firm) are contingent on the taxpayer's realization of tax benefits from the transaction. All the facts and circumstances relating to the matters addressed in the written advice will be considered when determining whether a fee is refundable or contingent, including the right to reimbursements of amounts that the parties to a transaction have not designated as fees or any agreement to provide services without reasonable compensation.

(8) Prominently disclosed. An item is *prominently disclosed* if it is readily apparent to a reader of the written advice. Whether an item is readily apparent will depend on the facts and circumstances surrounding the written advice including, but not limited to, the sophistication of the taxpayer and the length of the written advice. At a minimum, to be prominently disclosed an item must be set forth in a separate section (and not in a footnote) in a typeface that is the same size or larger than the typeface of any discussion of the facts or law in the written advice.

(9) State or local bond opinion. A *State or local bond opinion* is written advice with respect to a *Federal tax issue* included in any materials delivered to a purchaser of a State or local bond in connection with the issuance of the bond in a public or private offering, including an official statement (if one is prepared), that concerns only the excludability of interest on a State or local bond from gross income under section 103 of the Internal Revenue Code, the application of section 55 of the Internal Revenue Code to a State or local bond, the status of a State or local bond as a qualified tax-exempt obligation under section 265 (b)(3) of the Internal Revenue Code, the status of a State or local bond as a qualified zone academy bond under section 1397E of the Internal Revenue Code, or any combination of the above.

(10) The principal purpose. For purposes of this section, the principal purpose of a partnership or other entity, investment plan or arrangement, or other plan or arrangement is the avoidance or evasion of any tax imposed by the Internal Revenue Code if that purpose exceeds any other purpose. The principal purpose of a partnership or other entity, investment plan or arrangement, or other plan or arrangement is not to avoid or evade Federal tax if that partnership, entity, plan or arrangement has as its purpose the claiming of tax benefits in a manner consistent with the statute and Congressional purpose. A partnership, entity, plan or arrangement may have a significant purpose of avoidance or evasion even though it does not have the principal purpose of avoidance or evasion under this paragraph (b)(10).

(C) Requirements for covered opinions. A practitioner providing a *covered opinion* must comply with each of the following requirements.

(1) Factual matters. (i) The 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 facts are relevant. The opinion must identify and consider all facts that the practitioner determines to be relevant.

(ii) The practitioner must not base the opinion on any unreasonable factual assumptions (including assumptions as to future events). An unreasonable factual assumption includes a factual assumption that the practitioner knows or should know is incorrect or incomplete. For example, it is unreasonable to assume that a transaction has a business purpose or that a transaction is potentially profitable apart from tax benefits. A factual assumption includes reliance on a projection, financial forecast or appraisal. It is unreasonable for a practitioner to rely on a projection, financial forecast or appraisal if the practitioner knows or should know that the projection, financial forecast or appraisal is incorrect or incomplete or was prepared by a person lacking the skills or qualifications necessary to prepare such projection, financial forecast or appraisal. The opinion must identify in a separate section all factual assumptions relied upon by the practitioner.

(iii) The practitioner must not base the opinion on any unreasonable factual representations, statements or findings or of the taxpayer or any other person. An unreasonable factual representation includes a factual representation that the practitioner knows or should know is incorrect or incomplete. For example, a practitioner may not rely on a factual representation that a transaction has a business purpose if the representation does not include a specific description of the business purpose or the practitioner knows or should know that the representation is incorrect or incomplete. The opinion must identify in a separate section all factual representations, statements or finds of the taxpayer relied upon by the practitioner.

(2) *Relate law to facts*. (i) The opinion must relate the applicable law (including potentially applicable judicial doctrines) to the relevant facts.

(ii) The practitioner must not assume the favorable resolution of any significant Federal tax issue except as provided in paragraphs (c)(3)(v) and (d) of this section, or otherwise base an opinion on any unreasonable legal assumptions, representations, or conclusions.

(iii) The opinion must not contain internally inconsistent legal analyses or conclusions.

(3) *Evaluation of significant Federal tax issues*--(i) *In general*. The opinion must consider all significant Federal tax issues except as provided in paragraphs (c)(3)(v) and (d) of this section.

(ii) *Conclusion as to each significant Federal tax issues*. The opinion must provide the practitioner's conclusion as to the likelihood that the taxpayer will prevail on the merits with respect to each significant Federal tax issue considered in the opinion. If the practitioner is unable to reach a conclusion with respect to one or more of those issues, the opinion must state that the practitioner is unable to reach a conclusion with respect to those issues. The opinion must describe the reasons for the conclusions, including the facts and analysis supporting the conclusions, or describe the reasons that the practitioner is unable to reach a conclusion as to one or more issues. If the practitioner fails to reach a conclusion at the confidence level of at least more likely than not with respect to one or more significant Federal tax issues considered, the opinion must include the appropriate disclosure(s) required under paragraph (e) of this section.

(iii) *Evaluation based on chances of success on the merits*. In evaluating the significant Federal tax issues addressed in the opinion, the practitioner must not take into account the possibility that a tax return will not be audited, that an issue will not be raised on audit, or that an issue will be resolved through settlement if raised.

(iv) _Marketed opinions_. In the case of a *marketed opinion*, the opinion must provide the practitioner's conclusion that the taxpayer will prevail on the merits at a confidence level of at least more likely than not with respect to each significant Federal tax issue. If the practitioner is unable to reach a more likely than not conclusion with respect to each significant Federal tax issue, the practitioner must not provide the marketed opinion, but may provide written advice that satisfies the requirements in paragraph (b)(5)(ii) of this section.

(v) _Limited scope opinions_. (A) The practitioner may provide an opinion that considers less than all of the significant Federal tax issues 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 issue(s) addressed in the opinion;

(2) The opinion is not advice described in paragraph (b)(2)(i)(A) of this section (concerning listed transactions), paragraph (b)(2)(i)(B) of this section (concerning the principal purpose of avoidance or evasion) or paragraph (b)(5) of this section (a *marketed opinion*); and

(3) The opinion includes the appropriate disclosure(s) required under paragraph (e) of this section.

(B) A practitioner may make reasonable assumptions regarding the favorable resolution of a Federal tax issue (as assumed issue) for purposes of providing an opinion on less than all of the significant Federal tax issues as provided in this paragraph (c)(3)(v). The opinion must identify in a separate section all issues for which the practitioner assumed a favorable resolution.

(4) _Overall conclusion_. (i) The opinion must provide the practitioner's overall conclusion as to the likelihood that the Federal tax treatment of the transaction or matter that is the subject of the opinion is the proper treatment and the reasons for that conclusion. If the practitioner is unable to reach an overall conclusion, the opinion must state that the practitioner is unable to reach and overall conclusion and describe the reasons for the practitioner's inability to reach a conclusion.

(ii) In the case of a *marketed opinion*, the opinion must provide the practitioner's overall conclusion that the Federal tax treatment of the transaction or matter that is the subject of the opinion is the proper treatment at a confidence level of at least more likely than not.

(d) _Competence to provide opinion; reliance on opinions of others_. (1) The practitioner must be knowledgeable in all of the aspects of Federal tax law relevant to the opinion being rendered, except that the practitioner may rely on the opinion of another practitioner with respect to one or more significant Federal tax issues, unless the practitioner knows or should know that the opinion of the other practitioner should not be relied on. If a practitioner relies on the opinion of another practitioner, the relying practitioner's opinion must identify the other opinion and set forth the conclusions reached in the other opinion.

(2) The practitioner must be satisfied that the combined analysis of the opinions, taken as a whole, and the overall conclusion, if any, satisfy the requirements of this section.

(e) *Required disclosures*. A covered opinion must contain all of the following disclosures that apply--

(1) *Relationship between promoter and practitioner*. An opinion must prominently disclose the existence of--

(i) Any compensation arrangement, such as a referral fee or a fee-sharing arrangement, between the practitioner (or the practitioner's firm or any person who is a member of, associated with, or employed by the practitioner's firm) and any person (other than the client for whom the opinion is prepared) with respect to promoting, marketing or recommending the entity, plan, or arrangement (or a substantially similar arrangement) that is the subject of the opinion; or

(ii) Any referral agreement between the practitioner (or the practitioner's firm or any person who is a member of, associated with, or employed by the practitioner's firm) and a person (other than the client for whom the opinion is prepared) engaged in promoting, marketing or recommending the entity, plan, or arrangement (or a substantially similar arrangement) that is the subject of the opinion.

(2) *Marketed opinions*. A *marketed opinion* must prominently disclose that--

(i) The opinion was written to support the promotion or marketing of the transaction(s) or matter(s) addressed in the opinion; and

(ii) The taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor.

(3) *Limited scope opinions*. A limited scope opinion must prominently disclose 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.

(4) *Opinions that fail to reach a more likely than not conclusion*. An opinion that does not reach a conclusion at a confidence level of at least more likely than not with respect to a significant Federal tax issue must prominently disclose that --

(i) The opinion does not reach a conclusion at a confidence level of at least more likely than not with respect to one or more significant Federal tax issues addressed by the opinion; and

(ii) With respect to those significant Federal tax issues, 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.

(5) *Advice regarding required disclosures*. In the case of any disclosure required under this section, the practitioner may not provide advice to any person that is contrary to or inconsistent with the required disclosure.

(f) *Effect of opinion that meets these standards*--(1) *In general*. An opinion that meets the requirements of this section satisfies the practitioner's responsibilities under this section, but the persuasiveness of the opinion with regard to the tax issues in question and the taxpayer's good faith reliance on the opinion will be determined separately under applicable provisions of the law and regulations.

(2) *Standards for other written advice*. A practitioner who provides written advice that is not a covered opinion for purposes of this section is subject to the requirements of §10.37.

(g) *Effective date*. This section applies to written advice that is rendered after June 20, 2005.

**§10.36 Procedures to ensure compliance.**

**(**a) *Requirements for covered opinions*. Any practitioner who has (or practitioners who have or share) principal authority and responsibility for overseeing a firm's practice of providing advice concerning Federal tax issues must take reasonable steps to ensure that the firm has adequate procedures in effect for all members, associates, and employees for purposes of complying with §10.35. Any such practitioner will be subject to discipline for failing to comply with the requirements of this paragraph if--

(1) The practitioner through willfulness, recklessness, or gross incompetence does not take reasonable steps to ensure that the firm has adequate procedures to comply with §10.35, and one or more individuals who are members of, associated with, or employed by, the firm are, or have engaged in a pattern or practice, in connection with their practice with the firm, of failing to comply with §10.35; or

(2) The practitioner knows or should know that one or more individuals who are members of, associated with, or employed by, the firm are, or have, engaged in a pattern or practice, in connection with their practice with the firm, that does not comply with §10.35 and the practitioner, through willfulness, recklessness, or gross incompetence, fails to take prompt action to correct the noncompliance.

(b) *Effective date*. This section is applicable after June 20, 2005.

**§10.37 Requirements for other written advice.**

(a) *Requirements*. A practitioner must not give written advice (including electronic communications) concerning one or more Federal tax issues if the practitioner bases the written advice on unreasonable factual or legal assumptions (including assumptions as to future events), unreasonably relies upon representations, statements, findings or agreements of the taxpayer or any other person, does not consider all relevant facts that the practitioner knows or should know, or, in evaluating a Federal tax issue, takes into account the possibility that a tax return will not be audited, that an issue will not be raised on audit, or that an issue will be resolved through settlement if raised. All facts and circumstances, including the scope of the engagement and the type and specificity of the advice sought by the client will be considered in determining whether a practitioner has failed to comply with this section. In the case of an opinion 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 to one or more taxpayers a partnership or other entity, investment plan or arrangement a significant purpose of which is the avoidance or evasion of any tax imposed by the Internal Revenue Code, the determination of whether a practitioner has failed to comply with this section will be made on the basis of a heightened standard of care because of the greater risk caused by the practitioner's lack of knowledge of the taxpayer's particular circumstances.

(b) *Effective date.* This section applies to written advice that is rendered after June 20, 2005.

**§10.38 Establishment of advisory committees.**

(a) *Advisory committees.* To promote and maintain the public's confidence in tax advisors, the Director of the Office of Professional Responsibility is authorized to establish one or more advisory committees composed of at least five individuals authorized to practice before the Internal Revenue Service. The Director should ensure that membership of an advisory committee is balanced among those who practice as attorneys, accountants, and enrolled agents. Under procedures prescribed by the Director, an advisory committee may review and make general recommendations regarding professional standards or best practices for tax advisors, including whether hypothetical conduct would give rise to a violation of §§10.35 or 10.36.

(b) *Effective date.* This section applies after December 20, 2004.

## Subpart C--Sanctions for Violation of the Regulations

**§10.50 Sanctions**.

*(a) <u>Authority to censure, suspend, or disbar.</u>* The Secretary of the Treasury, or his or her delegate, after notice and an opportunity for a proceeding, may censure, suspend or disbar any practitioner from practice before the Internal Revenue Service if the practitioner is shown to be incompetent or disreputable, fails to comply with any regulation in this part, or with intent to defraud, willfully and knowingly misleads or threatens a client or prospective client. Censure is a public reprimand.

*(b) <u>Authority to disqualify.</u>* The Secretary of the Treasury, or his or her delegate, after due notice and opportunity for hearing, may disqualify any appraiser with respect to whom a penalty has been assessed under section 6701(a) of the Internal Revenue Code.

(1) If any appraiser is disqualified pursuant to this subpart C, such appraiser is barred from presenting evidence or testimony in any administrative proceeding before the Department of Treasury or the Internal Revenue Service, unless and until authorized to do so by the Director of Practice pursuant to §10.81, regardless of whether such evidence or testimony would pertain to an appraisal made prior to or after such date.

(2) Any appraisal made by a disqualified appraiser after the effective date of disqualification will not have any probative effect in any administrative proceeding before the Department of the Treasury or the Internal Revenue Service. An appraisal otherwise barred