November 27, 2012

Mr. Steven T. Miller
Acting Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224, Internal Revenue Service

Re: Comments on Proposed Reg-138367-06 Relating to Practice Before the Internal Revenue Service

Dear Acting Commissioner Miller:

Enclosed are comments on proposed reg-138367-06 relating to practice before the Internal Revenue Service. These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association, and should not be construed as representing the policy of the American Bar Association.

Sincerely,

Rudolph R. Ramelli
Chair, Section of Taxation

Enclosure

cc: Mark J. Mazur, Assistant Secretary (Tax Policy), Department of the Treasury
    William J. Wilkins, Chief Counsel, Internal Revenue Service
    Emily S. McMahon, Deputy Assistant Secretary (Tax Policy), Department of Treasury
    Karen L. Hawkins, Director, Office of Professional Responsibility, Internal Revenue Service
    Deborah A. Butler, Associate Chief Counsel (Procedure and Administration), Internal Revenue Service
    Lisa Zarlenka, Tax Legislative Counsel, Office of Tax Policy, Department of Treasury
    Alexandra Minkovich, Attorney Advisor, Office of Tax Policy, Department of Treasury
    Matthew S. Cooper, Special Counsel, Office of the Associate Chief Counsel (Procedure and Administration), Internal Revenue Service
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ABA SECTION OF TAXATION COMMENTS ON
PROPOSED REG-138367-06 RELATING TO PRACTICE BEFORE THE
INTERNAL REVENUE SERVICE

These comments (“Comments”) are submitted on behalf of the American Bar Association Section of Taxation (the “Section”) and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal drafting responsibility for preparing these Comments was exercised by Michael Desmond on behalf of the Standards of Tax Practice Committee of the Section of Taxation. Substantive drafting contributions were made by Guinevere Moore and Pete Wilson on behalf of the Standards of Tax Practice Committee and by David Cholst on behalf of the Tax-Exempt Financing Committee. Additional comments were provided by Linda Beale, Diana Erbsen, Matthew Hicks, Rochelle Hodes, Monte Jackel and Michael Lang. The Comments were reviewed by Scott Michel, Gersham Goldstein and Eric Solomon.

Although the members of the Section of Taxation who participated in preparing these Comments have clients who may be affected by the federal tax principles addressed by these Comments or have advised clients on the application of such principles, and all would be affected in their capacity as practitioners, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make, or has a specific individual interest in making, a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these recommendations.

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Date:  November 27, 2012
INTRODUCTION

On September 14, 2012, the Treasury Department and Internal Revenue Service (the “Service”) announced their intention to amend the regulations governing practice before the Service, which appear in the Code of Federal Regulations and in pamphlet form as Treasury Department Circular No. 230 (“Circular 230”). Most significantly, the proposed regulations (referred to in these Comments as the “Proposed Amendments”) would eliminate from Circular 230 the covered opinion standards in current section 10.35 and would expand and enhance the existing standards under proposed section 10.37, making them applicable to all written tax advice. The Proposed Amendments would also withdraw prior proposed amendments to section 10.39 governing requirements for State or local bond opinions, subjecting those opinions to the same enhanced standards in proposed section 10.37. In addition, the Proposed Amendments would expand the procedures to ensure compliance in current section 10.36 by applying that section to all provisions of Circular 230. The Proposed Amendments would also add to Circular 230 a new section 10.35 setting forth standards regarding practitioner competence. Additional changes made by the Proposed Amendments are covered in the more detailed discussion below.

EXECUTIVE SUMMARY

The Section commends the Treasury Department and the Service for issuing the Proposed Amendments and, in particular, for proposing to eliminate the covered opinion standards in current section 10.35 and proposing to withdraw the standards for State or local bond opinions in previously proposed section 10.39. The covered opinion standards served an important purpose by focusing practitioner attention on written tax advice issued with respect to transactions that have the potential for improper tax avoidance. However, the complexity of the covered opinion standards as well as their broad application to routine transactions has come to outweigh their beneficial impact on practitioner conduct and taxpayer compliance.

Circular 230 plays an important role in regulating written advice practices, particularly in the context of transactions that have the potential for improper tax avoidance. It is important, however, that Circular 230 serve that role without unnecessarily burdensome standards that may not fit the particular facts and circumstances of an engagement. We commend the Treasury Department and the Service for recognizing in proposed section 10.37 that the proper format and structure for written advice is an all facts and circumstances inquiry that does not lend itself to formulaic rules. We do make some suggestions in these Comments on how the Proposed Amendments might be modified to clarify certain standards of practice, consistent with the broader objectives of Circular 230 and focusing in particular on the written advice standards in proposed section 10.37.

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Practitioners play a critical role in helping taxpayers understand the tax consequences of their transactions and in dissuading them from entering into transactions that fail to meet minimum standards of compliance. Practitioners’ written advice has, however, not always advanced these goals. Rather, it has sometimes served to facilitate noncompliance by encouraging taxpayers to take more aggressive return positions because of their misplaced belief that written tax advice necessarily provides penalty defense and other protections.

Although Circular 230 includes a general due diligence rule in section 10.22(a)(3) applicable to practitioner representations to their clients (including due diligence requirements with respect to the facts on which those representations are based), that rule gives no specific guidance on the due diligence requirements for written tax advice, nor does it articulate a higher standard for written tax advice rendered with respect to potentially abusive transactions. Accordingly, since 1984 Circular 230 has included separate due diligence standards in a series of rules governing written advice given with respect to potentially abusive transactions. Those targeted rules culminated in final regulations issued in December 2004 (the “Final Covered Opinion Regulations”) that included the covered opinion standards currently set forth in section 10.35. The attached Appendix summarizes the historical development of the covered opinion standards and the Section’s comments on those standards, tracing them back to the “tax shelter” rules in Circular 230 first promulgated in 1984.

Properly targeting due diligence standards for written tax advice has been an elusive goal, frustrated by definitional challenges over what constitutes a “tax shelter” or other potentially abusive transaction. Designing an appropriate rule is also made difficult by the complex and highly technical nature of tax law, which does not always lend itself to generally applicable standards. While many abusive tax transactions fail to satisfy applicable statutory rules, the Service must challenge others on case-specific applications of common law and statutory and regulatory anti-abuse rules. These rules often have subjective elements, the application of which is difficult to target \textit{ex ante} through a set of general practice standards. Efforts to draft a due diligence rule that considers these multiple subjective variables have been criticized as overly complex and both under- and over-inclusive.

After issuance of the Final Covered Opinion Regulations in 2004, practitioners were vocal in criticizing their complexity, their broad application to routine transactions, and the compliance burden they imposed. Senior Treasury Department and Service officials responded by saying that a pragmatic approach would be taken toward enforcement of the new rules, noting that in order for sanctions to be imposed for violation of the rules, the willfulness or reckless/gross incompetence standards in Circular 230 section 10.52 had to be met.\footnote{See Crystal Tandon, \textit{Korb Responds to Lawyers’ Circular 230 Hypotheticals}, Tax Notes Today, 2005 TNT 190-5 (Sept. 30, 2005) (“As a measure of comfort for those concerned about how the rules will be applied, Korb advised practitioners to look back at the penalty provisions under section 10.52 of Circular 230, which require a willful violation of the rules or recklessness.”).} In the seven years since promulgation of the Final Covered Opinion Regulations, there has been no public
disclosure of any disciplinary proceeding being brought against a practitioner under section 10.35. Representatives of the Service’s Office of Professional Responsibility (“OPR”) have, however, suggested that problematic written advice practices have been addressed under the general due diligence rules in section 10.22.4 Irrespective of their application (or the absence thereof) in practice, it cannot be disputed that the covered opinion standards have served an important role in focusing practitioner attention on the role advisors have played in facilitating abusive tax practices and, even without enforcement of the proscriptive rules in section 10.35, emphasizing that written advice must meet minimum due diligence requirements.

The Proposed Amendments are noteworthy in rejecting the long-standing effort to craft a targeted written advice rule in favor of a principles-based approach that is applicable irrespective of whether that advice relates to a potentially abusive transaction. We believe that the principles-based approach will, on balance, be more effective in enhancing tax compliance without inappropriately discouraging practical written tax advice or creating an unwarranted bias toward oral advice.

COMMENTS

I. Elimination of Covered Opinion Rules in Section 10.35 and Withdrawal of Proposed State or Local Bond Opinion Rules in Section 10.39; Modification of the Requirements for Other Written Tax Advice in Section 10.37

The Proposed Amendments would eliminate from Circular 230 the covered opinion standards in current section 10.35 and would also withdraw the standards applicable to State or local bond opinions in previously proposed section 10.39. These standards would be replaced by a more robust set of rules applicable to all written tax advice in the proposed modifications to section 10.37. Under proposed section 10.37, practitioners would be required to base all written advice on reasonable factual and legal assumptions (including assumptions as to future events), reasonably consider all relevant facts that the practitioner knows or should know, use reasonable efforts to identify and ascertain all relevant facts, not rely on input from the taxpayer or any other person if such reliance would be unreasonable and, in evaluating a Federal tax matter, not take audit risk into account. Unlike the current covered opinion standards, proposed section 10.37 does not prescribe the form of the written advice, but applies an all-facts-and-circumstances test (articulated in the proposed rule as a standard of review in proposed section 10.37(c)) that takes into consideration the scope of the engagement and the type and specificity of the advice sought.

A. Elimination of the Covered Opinion Rules in Section 10.35 and Withdrawal of the Proposed Amendments to Section 10.39 Governing Requirements for State or Local Bond Opinions

The Section strongly supports the proposal to eliminate the covered opinion rules in current section 10.35 and to expand and enhance section 10.37. We concur with the rationale for

4 Jeremiah Coder, IRS Moving Forward on Implementing Return Preparer Review Recommendations, Tax Notes Today, 2010 TNT 15-5 (Jan. 22, 2010) (quoting OPR Director Karen Hawkins as saying that “[s]ection 10.35 is the last place I’d go” for guidance on meeting the due diligence requirements under Circular 230 and that using section 10.35 is “way down on the priority list”).
these changes set forth in the preamble to the Proposed Amendments. We note also that the definitional complexity of the covered opinion rules makes it difficult to determine if those rules apply. Moreover, the rules have given rise to the burdensome and potentially misleading practice of including disclaimers on virtually all practitioner communications, even when those communications may not constitute covered opinions or even tax advice. Repeal of section 10.35 should eliminate this practice.

Consistent with our comments below supporting a principles-based approach applicable to all written tax advice, the Section also supports withdrawal of the proposed amendments to section 10.39 governing State or local bond opinions. Although State or local bond opinions do have unique elements, a principles-based approach applicable to all written tax advice should be adequate to address them. In addition, although there are valid arguments for treating State or local bond opinions differently from other written tax advice, the same type of argument can be made in other unique areas of tax law. To the extent that proposed section 10.39 suggests that separate rules can be drafted in each of these areas, its adoption would have set a precedent for unnecessary complexity in what should be a readily understandable set of practice rules applicable across all areas of tax law. Moreover, even in the relatively narrow context of State or local bond opinions, drafting targeted rules creates significant definitional problems, as described in greater detail in the Section’s prior comments on the proposed regulations. We believe that a single, principles-based rule is the better approach. We therefore support withdrawal of proposed section 10.39 and inclusion of State or local bond opinions under the enhanced rules of proposed section 10.37 governing all written tax advice.

B. Revision of the Requirements for Written Advice Generally Under Section 10.37

Current section 10.37 applies to all written tax advice not subject to the detailed covered opinion standards of current section 10.35 and imposes requirements on the substance of the written advice. Unlike the current covered opinion rules in section 10.35(c), it does not set forth requirements regarding the specific form of the written advice. The Section generally supports a written advice rule that goes beyond the general due diligence standards in section 10.22 and supports the principles-based approach taken in proposed section 10.37. That approach, if adopted in final regulations, will give practitioners a simpler and more comprehensible framework against which to measure their written advice practices. At the same time, the principles-based approach will give OPR a more effective enforcement tool, since violations of the general principles should be easier to establish than violations of the complex rules in current section 10.35.

5 ABA Tax Section, Comm. on Tax Exempt Financing, Comments Regarding the Proposed Section 10.39 of Circular 230 (July 21, 2006), reprinted in 2006 TNT 141-10; see also ABA Tax Section, Comm. on Tax Exempt Financing, Comments on Proposed Amendments to the Regulations Governing Practice Before the Internal Revenue Service Relating to Standards for State or Local Bond Opinions and Concerning Certain Related Guidance Projects Relating to Tax-Exempt Bonds (March 15, 2005), reprinted in 2005 TNT 56-15.
The written advice rules in proposed section 10.37 are in some sense implicit in the due diligence standards under section 10.22(a)(3) and their inclusion in a separate written advice standard does add some overlap and complexity to Circular 230. Nonetheless, we agree that it is appropriate to include this explicit statement of principles, given the inappropriate role that written advice has in the past played in encouraging certain potentially abusive transactions. We are concerned, however, that proposed section 10.37 may not give practitioners adequate guidance on the requirements for written tax advice and, by itself, may not give OPR an adequate tool for addressing problematic written advice practices. We therefore recommend that the Service consider publishing further guidance applying proposed section 10.37 to specific fact situations. The Section made a similar recommendation in comments provided in December 2005, after the current covered opinion rules went into effect. The Service has provided similar guidance in the past by publishing scenarios in the Internal Revenue Bulletin that are composites of matters that have come to the attention of OPR. Such guidance would better articulate specific practice standards applicable to written advice, improving the deterrent effect of the rule.

Published interpretations complementing proposed section 10.37 are also consistent with recent changes made to the rules governing publicity of proceedings in Circular 230 section 10.72(d), which were intended to improve transparency in the disciplinary process. In practice, however, those changes have been limited in their effectiveness by the relatively small number of cases that result in a published final report or decision. Providing examples illustrating application of the written advice standards would also be consistent with the inclusion of examples in regulations implementing the return preparer penalty under Code section 6694, which are directionally consistent with the written advice requirements in Circular 230.

1. The Regulations Should Elaborate on the Definition of “Written Advice”

Written tax advice is rendered by practitioners in many different forms and is often incorporated into documents evaluating broader questions of law or issued with respect to preliminary or abstract proposals and ideas. The specific context in which advice is delivered can range from short e-mail communications to detailed conceptual outlines or full-blown legal opinions, depending on the nature of the issue, the practitioner’s history and relationship with the client, and the taxpayer’s sophistication, resources and risk tolerance. The Proposed Amendments recognize these variables in providing that the standard of review applicable to

\[^6\] ABA Section of Taxation, Comments on the Final Circular 230 Regulations (May 11, 2005), reprinted in 2005 TNT 92-17.


\[^8\] See Preamble to T.D. 9359, 72 Fed. Reg. 54,548 (Sept. 26, 2007) (stating that modifications to the rules regarding publicity of reports and decisions of the Administrative Law Judge in Circular 230 disciplinary proceedings “will provide greater transparency to the disciplinary process”).

\[^9\] See Treas. Reg. § 1.6694-1(e)(3) (providing examples illustrating circumstances in which a tax return preparer’s reliance on information provided by the taxpayer, another preparer, or a third party is reasonable). The Securities and Exchange Commission’s no-action letter program provides another model for publishing interpretations of proposed section 10.37. See http://www.sec.gov/answers/noaction.htm.
section 10.37 will take all facts and circumstances into account. We support this approach and believe that it should provide appropriate flexibility to practitioners in determining how to evaluate transactions and advise their clients, mitigating the risk that proposed section 10.37 will create an improper incentive to render advice orally in order to avoid burdensome form requirements.\(^\text{10}\)

Because taxpayers are more likely to rely upon written advice to take a position on an uncertain issue of fact or law, we agree that such advice should be subject to detailed practice standards. We are concerned, however, that proposed section 10.37 could be construed too broadly to apply to \textit{any} written communication from a practitioner. We do not think that a detailed definition of “written advice” needs to be included in Circular 230 because any such definition runs the risk of being both under- and over-inclusive. There are, however, contexts in which we think it should be made clear that a practitioner’s written communications do not constitute “written advice” and therefore are not be covered by proposed section 10.37. These include general statements of law that are not directed to an identified taxpayer, such as client alerts and other generic statements about the tax law or academic and continuing education presentations. Government submissions and other advocacy documents that are subject to separate due diligence and candor requirements under sections 10.22(a) and 10.34 should similarly be excluded from the definition of “written tax advice” since these generally do not constitute representations that a taxpayer will rely on in taking a return position. It would be helpful if the final regulations clarified that not all written communications from a practitioner constitute “written advice” covered by proposed section 10.37.

We also recommend that the terminology in proposed section 10.37 be revised to retain the term “Federal tax issue” used in current section 10.37, rather than adopting the proposed new term “Federal tax matter.” A “Federal tax issue” is defined by current section 10.35(b)(3) as “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.” Although that definition could be expanded to make clear that it covers issues arising in Federal excise and other non-income tax contexts, in general it properly targets the written advice standard on substantive application of the tax law to issues deriving from a client’s particular circumstances. In contrast, although it is not defined in the proposed amendments to Circular 230, nor do those amendments explain the reason for the change, “Federal tax matter” appears to have a broader meaning where it is used elsewhere in Circular 230.\(^\text{11}\) We consider more appropriate a narrower rule applicable to advice given to a client or

\(^\text{10}\) Allowing flexibility for the form of the advice is also consistent with section 822(b) of the American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1587, where Congress confirmed the Treasury Department’s authority to impose standards applicable to the rendering of written advice with respect to any transaction that the Secretary “determines as having a potential for tax avoidance or evasion.”

\(^\text{11}\) See Circular 230 § 10.3(i) (prohibiting state officials whose duties involve “tax matters” from practicing before the Service if those duties could involve disclosure of information applicable to Federal tax matters); Circular 230 § 10.51(a)(4) (defining incompetence and disreputable conduct to include providing false or misleading information to the Treasury Department or other tribunal authorized to pass upon “Federal tax matters”). Other provisions in Circular 230 referencing “Federal tax related matters” also suggest a more expansive meaning. \textit{See, e.g.}, Circular 230 § 10.6(f)(1)(i)(A) (noting for continuing legal education requirements that “Federal tax
prospective client with respect to a “Federal tax issue” arising in respect of the client’s particular facts and circumstances.

2. Requirement to Relate Law to Facts

Current section 10.35(c) sets forth detailed requirements for the form that a covered opinion must follow. Those requirements are a primary source of concern with the covered opinion rules because they often force practitioners to include more factual or legal analysis in their opinions than the circumstances of the engagement might otherwise require, increasing the cost of written tax advice and imposing a burden that may not be commensurate with the benefit to compliance. Proposed section 10.37(c)(1) addresses this concern by eliminating any specific form requirement for written tax advice and applying instead an all facts and circumstances rule. Under that rule, the form of the advice is determined based on a number of factors including “the scope of the engagement and the type and specificity of the advice sought by the client.”

While the Proposed Amendments eliminate any specific form requirement for written tax advice, proposed section 10.37 does impose obligations on tax practitioners offering written tax advice. These obligations do not explicitly incorporate the concept in current section 10.35(c)(2) of relating the applicable law (including potentially applicable legal doctrines) to the facts. This requirement is, however, fairly read to be subsumed within proposed section 10.37(a)(2), which lists obligations applicable to practitioners providing written advice, and its requirement that the practitioner base all written tax advice on reasonable factual and legal assumptions.

The Section strongly supports the elimination of a specific form requirement from Circular 230. We recommend, however, that proposed section 10.37(a)(2) be amended to incorporate the concept of current section 10.35(c)(2)(i) requiring that the practitioner relate applicable law (including potentially applicable judicial doctrines) to the facts, but without requiring that this analysis be included in the form of the written tax advice. This could be reflected in a new section 10.37(a)(2)(vi), and would make explicit what is already implicit in proposed section 10.37, but without the burdensome form requirement in the current covered opinion rules. ¹²

In recent cases involving abusive tax transactions, it was common for written tax advice to include detailed (and often accurate) discussions of applicable law, but fail to apply the unique facts of each case to that law. Although the facts were often in the form of unreasonable assumptions and representations, the opinions were also deficient in not properly connecting those facts to the law. In order to prevent abuse, we believe that it is important that the

¹² For example, a practitioner providing an opinion regarding the Federal tax treatment of a State or local bond would be required to relate the law to the facts, but would not be required to include that analysis in the written tax advice itself or in any other writing. Rather, under the all facts and circumstances test in proposed section 10.37(c)(1), the form of the written tax advice could follow the “short form” opinion practice that market participants expect.
principles-based approach in proposed section 10.37 include an explicit requirement for the practitioner to relate applicable law (including judicial doctrines and other anti-abuse rules) to the facts as they are established under the articulated rules.

3. **Taking Audit Risk Into Account**

Proposed section 10.37(a)(2)(v) provides that a practitioner must not take into account in rendering written tax advice that the tax return will not be audited by the Service or, if audited, that the matter will not be raised. This language is less restrictive than the prohibition in current section 10.37, which also precludes a practitioner from taking into account whether an issue raised on audit will be resolved through settlement.

The Section has long supported a rule in Circular 230 prohibiting practitioners from basing their substantive evaluation of the merits of a position on an assessment of audit risk.\(^\text{13}\) For example, a position that is properly assessed at a reasonable basis level of authority cannot rise to substantial authority simply because the practitioner believes that the Service is unlikely to discover or audit the position. This prohibition is reflected in current section 10.37, which is targeted to the practitioner’s conduct in “evaluating a Federal tax issue.” Like other aspects of proposed section 10.37, we believe that the prohibition on taking audit selection into consideration in evaluating the merits of a position is implicit in the general due diligence requirements of section 10.22. We are concerned, however, that stating this rule only in the context of the written advice standards in proposed section 10.37 could lead some practitioners to reach the incorrect conclusion that it does not apply in the context of oral advice. While a more detailed statement in the regulation itself may not be needed, this point could be clarified in the preamble to the final regulations.

Proposed section 10.37 narrows the current audit risk rule by removing the prohibition on taking into account whether an issue might be resolved through settlement, if raised by the Service. We believe this change is appropriate. Proposed section 10.37 goes further, however, in changing the phrase “Federal tax issue” in the current regulations to “Federal tax matter.” This change could unnecessarily expand the prohibition beyond its intended scope. In this context, “a Federal tax matter” could be construed to include any discussion of the question of audit risk, divorced from a practitioner’s evaluation of the merits of a position. This broad construction could unnecessarily prohibit a practitioner from addressing legitimate client inquiries regarding audit risk, including negative advice regarding audit risk that is intended to discourage the taxpayer from entering into a potentially abusive transaction. This provides a further rationale for our earlier recommendation to retain the current section 10.37 term “Federal tax issue,” rather than using the term “Federal tax matter.”

4. **Heightened Scrutiny for “Marketed” Tax Shelter Transactions**

Section 10.37 currently provides that determinations as to whether a practitioner has complied with that section will be made on the basis of a “heightened standard of care” in the

\(^\text{13}\) See ABA Section of Taxation, Comments on the Final Circular 230 Regulations (May 11, 2005), reprinted in 2005 TNT 92-17.
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 . . . in promoting, marketing or recommending” a transaction a significant purpose of which is the avoidance or evasion of tax (i.e. a “marketed tax shelter opinion”). Section 10.37 does not provide any further explanation as what is meant by the heightened standard of care.

The Proposed Amendments also include special rules applicable to marketed tax shelter opinions, but change the language from a “heightened standard of care” to a “heightened standard of review.” The preamble to the Proposed Amendments does not explain the change, noting only that “the IRS will continue to apply a heightened standard of review.” The Section has previously commented that, when properly identified, marketed tax shelter opinions do raise significant compliance concerns and should be subject to a higher standard of care since the practitioner is, in this context, one or more steps removed from the taxpayer taking the ultimate return position.14 The new language stating that OPR will apply “heightened scrutiny” to such transactions raises several concerns.

First, the scope of the heightened standard of review rule is both under- and over-inclusive. The rule is potentially under-inclusive in that it does not by its terms apply to written advice that may present compliance concerns equal to or greater than those raised by marketed tax shelter opinions. For example, the rule does not apply to listed transactions, nor does it apply to return positions that are contrary to Treasury regulations or other published guidance. The rule is also over-inclusive in that it can be read to apply in a number of situations that present little or no potential for abuse. For example, as written, the heightened scrutiny rule could arguably apply to written advice to investors regarding the tax-free treatment of interest earned on State or local bonds under Code section 103, or to written statements given to potential donors regarding the deductibility of contributions to a tax-exempt organization. Saying that heightened scrutiny will apply in these under- and over-inclusive contexts could result in an ineffective rule that cannot be applied by practitioners or enforced by OPR. Irrespective of whether section 10.37 itself identifies any particular type or category of written advice for heightened scrutiny, OPR has (and should have) wide latitude in applying whatever standard of scrutiny or review it thinks appropriate under the unique facts of each case. Singling out written advice given with respect to marketed tax shelters is, therefore, unnecessary and we recommend that this provision be eliminated from proposed section 10.37. The final regulations could, however, state explicitly that OPR has broad discretion in determining the appropriate standard of review, irrespective of whether the underlying transaction is a marketed tax shelter or other potentially abusive transaction.

Finally, we remain concerned with any rule that is linked to the broad and largely undefined term “tax shelter.” That linkage is implicit in proposed section 10.37(c)(2) through its reference to marketed opinions given with respect to transactions that have “a significant purpose” of avoidance or evasion of tax. The Treasury Department and the Service have

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previously acknowledged the problems created by reference to this undefined term. Until further guidance is issued defining “tax shelter” or limiting the situations in which a transaction might be deemed to be a “significant purpose” transaction, we do not think that phrase should be incorporated into new rules and regulations.

5. **Reliance on Advice of Others**

The limitations in proposed section 10.37(b) regarding reliance on advice of others are more restrictive than the parallel provision under the general due diligence standards in section 10.22, although we do not think that they are unnecessarily burdensome. We recommend that the complementary rules in Circular 230 governing reliance on advice of others be made uniform in order to reduce complexity and eliminate any bias toward providing oral advice not covered by proposed section 10.37. Similarly, we recommend that the reliance rule in proposed section 10.37 be made consistent with the regulations under Treas. Reg. § 1.6694-2, which appear to allow for broader reliance by return preparers and impose less stringent due diligence requirements.

Although we support the concept of a separate reliance rule in section 10.37, proposed section 10.37(b)(3) raises a particular concern in its inconsistency with the general conflict of interest rules in Circular 230. Section 10.37(b)(3) would treat reliance on the advice of other practitioners as unreasonable if the practitioner knows or should know that the other practitioner has a conflict of interest. As a practical matter, many practitioners do have conflicts of interest. Such conflicts arise as a result of representation by the same firm of multiple clients that may have adverse interests, or as a result of the personal interest of the practitioner. Section 10.29 (and professional responsibility rules in general) specifically allows a practitioner to represent a client notwithstanding the conflict if certain conditions are met. Most importantly, such representations require the written informed consent of each affected client. When one or more clients provide informed consent, such consent does not remove the conflict. Rather, under section 10.29(b), the conflict continues to exist, but the practitioner may provide advice to the consenting client (or to another client to whom the conflict applies) assuming proper safeguards are complied with.

Clients routinely provide conflict waivers, yet proposed section 10.37 appears to deem reliance in this context unreasonable irrespective of whether the exception in section 10.29(b) would otherwise apply. Under the Proposed Amendments, a practitioner with a conflict of interest could represent a taxpayer directly if proper waivers were obtained, but would be prohibited from relying on another practitioner with a conflict of interest even though the other practitioner also obtained proper waivers. Section 10.37(b)(3) should be rewritten to clarify that it is not unreasonable for a practitioner to rely on advice given by another practitioner with a

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15 Notice 2009-5, 2009-1 C.B. 309. In Notice 2009-5, the Service noted that it was considering further guidance on the definition of “tax shelter” and explained that “[a] broad interpretation of tax shelter for purposes of section 6694 could be inconsistent with the 2008 Act's changes to section 6694 by requiring tax return preparers to comply with the general standard previously imposed under the 2007 Act (a reasonable belief that the position would more likely than not be sustained on the merits) rather than the new general standard under the 2008 Act (substantial authority).” See also Internal Revenue Manual 9.1.3.3.2.1 (broadly defining “avoidance” of tax to include the “shap[ing] of events to reduce or eliminate tax liability”).
conflict of interest as long as that advice complies with section 10.29(b). For example, proposed section 10.37(b)(3) could be revised to prohibit reliance only where “the practitioner knows or should know that the other practitioner has violated section 10.29 by providing the advice.”

6. Coordination of the Proposed Written Advice Standards Applicable to Practitioners and the Accuracy-Related Penalty Rules Applicable to Taxpayers

We understand that Treasury and the Service are considering amendments to the section 6664 reasonable cause regulations to coordinate those regulations with proposed section 10.37. The Section has supported such coordination in the past and we continue to support coordination of these provisions. We are also concerned, however, that taxpayers not be held responsible for practice standard shortcomings in their advisors’ work that they did not know of, or have reason to know of. We look forward to commenting on any proposal by the Treasury Department and the Service to coordinate the accuracy-related penalty rules with Circular 230.

II. Addition of General Competence Standards in New Section 10.35

Proposed section 10.35 provides that a practitioner must possess the necessary competence to engage in practice before the Service, which includes the required knowledge, skill, thoroughness, and preparation necessary for the matter for which the practitioner is engaged. The Section supports the adoption of an affirmative obligation of competence in Circular 230.

Competence necessarily includes diligence: A practitioner must not handle a matter before the Service without adequate preparation that is reasonable under the circumstances. Competent representation and diligence requires appropriate application by the practitioner of that legal knowledge, skill and training, reasonable thoroughness in the study and analysis of the law and facts, and reasonable attentiveness to the responsibilities owed to the client. In order to maintain the level of competence needed to effectively assist a client in a matter, it may be necessary for a practitioner to engage in continuing study and education. Consistent with (1) existing provisions in the preparer penalty rules under Treas. Reg. § 1.6694-1(e), (2) current section 10.22, (3) language in proposed section 10.37, and (4) the recommended caveats for accepting employment below, the competence standards under proposed section 10.35 should explicitly acknowledge that those standards can generally be met through reasonable reliance on other practitioners or third parties. Given the complexity of the Internal Revenue Code, practitioners frequently encounter situations in which multiple practitioners, each having particular expertise, will assist a taxpayer with a federal tax matter. While no single practitioner may be personally competent to address all federal tax issues in the representation, reasonable reliance on the expertise of another practitioner would address the objectives of proposed section 10.35.

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Proposed section 10.35 should also recognize the practical reality of targeted advice that responds to a specific taxpayer inquiry, but may not answer the ultimate question regarding the proper tax treatment of an item. For example, a taxpayer may inquire of a practitioner with expertise in the area of charitable contributions about the treatment of a deduction under Code section 170 reported on a Schedule K-1 issued by a partnership or subchapter S corporation. That practitioner could provide competent advice regarding the deduction generally and application of the percentage limitations in Code section 170(b). However, the practitioner may not be asked about, nor be competent to answer, questions regarding basis limitations, at risk rules or application of the passive activity loss rules under Code section 469. In this and myriad other contexts, the practitioner should not be deemed incompetent with respect to issues that the practitioner was not asked to address, nor reasonably should be expected to have addressed.17

We also believe that practitioners would benefit from the enumeration of a nonexclusive list of factors to be considered in evaluating whether the competence requirements have been satisfied. If not set forth in the regulations themselves, such a list could be included in other published guidance.18 In determining whether a matter is beyond a practitioner’s ability to provide competent representation, relevant factors could include (1) the scope of the engagement or matter at issue, (2) the role of the practitioner in the matter, (3) whether there were procedures in place to ensure appropriate supervision (if relevant), (4) the relative complexity and specialized nature of the matter, (5) the practitioner’s general experience with the issue in question, (6) the preparation and study the practitioner will be able to give the matter, and (7) whether it is feasible either to refer the matter to or associate a practitioner of established competence for the tax issue in question. The guidance could also state that a practitioner can satisfy the obligation of competence by engaging in further study and investigation unless the time required to acquire the additional knowledge necessary will result in unusual delay or expense to the client.19 Proposed section 10.35 should state explicitly that these competence considerations must be taken into account by a practitioner before agreeing to a representation.

The competence standards should also recognize the practical reality of a de minimis rule, where the burden and cost to achieve full knowledge of an issue may greatly outweigh any compliance benefit.20 For example, a small business may be eligible for the domestic

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17 If, for example, the practitioner was the “signing tax return preparer” under Treas. Reg. § 301.7701-15(b)(1) with primary responsibility for the overall substantive accuracy of the return, subject to any de minimis rule, it would not be acceptable (and the practitioner would not be competent) if the practitioner did not consider these issues or obtain appropriate input from another practitioner with relevant expertise and experience.

18 See, for example, Notice 2007-39, 2007-1 C.B. 1243, which provides guidance on the factors OPR will evaluate in determining whether to impose monetary penalties under section 10.50(c).

19 This is consistent with comment 2 to ABA Model Rule 1.1, which states that “[a] lawyer can provide adequate representation in a wholly novel field through necessary study.” The comment further recognizes that “representation can also be provided through the association of a lawyer of established competence in the field in question.”

20 The Treasury Department and IRS recognized the wisdom of a de minimis rule in Treas. Reg. § 301.7701-15(b)(3)(ii)(A), which carves out of the “substantial portion” test that would otherwise make an individual a nonsigning tax return preparer items that do not rise above established threshold amounts. The materiality of an
manufacturing deduction under section 199, but it appears that the amount of that deduction will be negligible. This should not require that a practitioner hired to advise on and prepare a Form 1120-S income tax return for the business become fully informed on the many details and nuances of section 199, nor should it require the taxpayer to hire another practitioner. In this and other similar contexts, the practitioner should not be deemed incompetent with respect to issues that the practitioner was neither asked to, nor reasonably should be expected to, address.

Proposed section 10.52 does not provide a sanction for practitioners who recklessly or through gross indifference violate the competence standards in proposed section 10.35. We believe that it would be extremely difficult, if not impossible, for OPR to establish that a practitioner “willfully” violated proposed section 10.35.21 A recklessness/gross indifference standard may, therefore, be more appropriate in this context. Accordingly, we recommend consideration of this prohibited conduct standard for sanctioning section 10.35 violations.

III. Procedures to Ensure Compliance with Circular 230 under Modified Section 10.36

Current section 10.36 imposes a requirement on the managers of a firm’s tax practice to have procedures in place to ensure compliance with the covered opinion standards in section 10.35 and to ensure compliance with a firm’s practice of preparing tax returns, claims for refund or other documents for submission to the Service. A similar oversight rule is provided under the tax return preparer penalty rules in Treas. Reg. § 1.6694-2(a)(2) and Notice 2007-39. Proposed section 10.36 would expand the oversight responsibility to require that any practitioner who has or shares principal authority and responsibility for overseeing a firm’s practice before the Service to take reasonable steps to ensure that the firm has adequate procedures in place for all members, associates and employees to comply with applicable provisions of Circular 230. Proposed section 10.36 subjects practitioners with oversight responsibility to discipline for certain failures to ensure that adequate procedures are in place.

We support the proposal to expand the scope of section 10.36. The proposal would conform Circular 230 more closely to ABA Model Rule 5.1, which imposes requirements on law firm partners, managers and supervisory lawyers, and to ABA Model Rule 5.3, which governs assistance from non-lawyers. The proposal could, however, be limited in its scope to the practice standards in Subpart B of Circular 230, rather than the entire part.22 We also have the following more technical comments and recommendations on proposed section 10.36:

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21 See Decision on Appeal, Director, Office of Professional Responsibility v. Leonard Fein, Complaint No. 2006-33 (Oct. 17, 2008), reprinted in 2011 TNT 208-08. In Fein, the Appellate Authority noted the absence of a definition of “willfulness” under Circular 230 and adopted case precedents interpreting that term from the criminal tax provisions of the Internal Revenue Code.

22 Subpart C and Subpart D of Circular 230, for example, contain procedures for sanctions and disciplinary proceedings that would have no direct relevance under a rule to ensure compliance.
• The proposed rule is unclear regarding the person within a firm who has or shares relevant responsibility. We recommend that it be revised to state that there must be at least one person within a firm with such responsibility.  

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• The proposed rule only applies to subject a firm manager to sanctions if that manager is a “practitioner” within the meaning of section 10.2(a)(5). Consistent with the recent expansion of Circular 230 section 10.8(c) to non-practitioners in certain circumstances, we recommend that proposed section 10.36 be expanded to include non-practitioners with responsibility for management of a firm’s tax practice. Because the sanction provisions in section 10.50 are premised on culpable conduct of a practitioner, however, any expansion of section 10.36 to cover non-practitioners should be accompanied by a revision to section 10.50 to clarify how sanctions would be imposed on a firm manager who is not a practitioner.  

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• The proposed rule should be revised to clarify that oversight responsibility includes proper staffing of any engagement covered by Circular 230 to ensure that relevant standards of competence are met or, if they cannot be met, that the firm does not represent the taxpayer in connection with the matter. This would complement the competence standards in proposed section 10.35 and help to ensure that firm management does not put undue pressure on subordinates to agree to perform work that the firm and its practitioners are not competent to handle.  

• The rule should make clear that there may be situations in which a manager is subject to discipline in the practitioner’s capacity as a manager or supervisor even if there is no subordinate practitioner who is subject to discipline. For example, there may be situations in which no specific individual is aware that a firm has a conflict of interest in representing a taxpayer because the manager failed to implement proper conflict procedures. Similarly, it is not uncommon for an individual practitioner to disagree with the position ultimately taken by the firm, or to believe that the firm was not competent to advise with respect to the position. 25  

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In this context, supervisory sanctions may be appropriate although

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23  See ABA Section of Taxation, Comments on Proposed Rulemaking Circular 230 (Feb. 12, 2004) (recommending that the procedures to ensure compliance apply broadly to any practitioner with supervisory responsibility and not be limited to persons with “principal” responsibility, i.e., of “first importance”), reprinted in 2004 TNT 32-28.

24  The Section has previously raised concerns with subjecting non-practitioners to discipline under Circular 230. See ABA Section of Taxation, Comments on the Final Circular 230 Regulations (May 11, 2005), reprinted in 2005 TNT 92-17.

25  Although beyond the scope of these Comments, this situation can present unique conflict of interest concerns where expressions of the individual practitioner’s concerns with a position taken by the firm or the representation itself may not be in the taxpayer’s interest.
subordinate sanctions are not. Under this recommendation, proposed section 10.36 would differ from the somewhat analogous rules under section 10.50(c)(1)(ii), which require the imposition of monetary sanctions on an individual practitioner as a prerequisite to imposing monetary sanctions on a firm.

- Proposed section 10.36 imposes supervisory responsibility only with respect to “members, associates and employees.” It is increasingly common for practitioner firms to utilize contractual relationships with third parties to deliver tax advice and other work governed by Circular 230. Proposed section 10.36 should be expanded to cover these arrangements, both to ensure proper oversight of contractors and to ensure that firms who handle all work in house are treated the same as firms that outsource some aspect of their tax practice. The standard applicable to contract parties should, however, include a provision allowing a supervisor to rely on a reasonable inquiry to the contracting party that the contracting party itself has proper supervisory procedures in place.

- Although proposed section 10.36 requires a firm’s tax practice management to have compliance procedures in place, there appears to be no consequence under the rule if such procedures exist but practice management fails to take adequate steps to ensure that they are followed. In contrast, Treas. Reg. §§ 1.6694-2(a)(2) and -3(a)(2) allow for the imposition of preparer penalties against an employer firm (although not a supervisor) if it disregards review procedures through willfulness, recklessness, or gross indifferencer. We recommend that proposed section 10.36 be clarified to reference having procedures in place and taking appropriate steps to be sure that those procedures are properly followed and implemented.

IV. Procedures for Expedited Suspension Under Modified Sections 10.81 and 10.82

Under current section 10.82, practitioners are subject to expedited suspension procedures in the case of certain identified conduct considered to be evidence of a high level of disregard for the tax system. In 2006, the Treasury Department and the Service proposed regulations expanding the conduct subject to expedited suspension to include certain failures by a practitioner to pay tax or file returns. That aspect of the 2006 proposed regulations has never been finalized. The Proposed Amendments modify the prior proposed amendments to eliminate the failure to pay tax from the expedited suspension procedures and to impose heightened requirements for expedited suspension only with respect to certain failures to file tax returns. More specifically, proposed section 10.82 would permit the use of expedited procedures in the case of a practitioner who fails to file required annual Federal returns for four of the five years immediately preceding the institution of an expedited disciplinary proceeding, or who fails to file returns due more frequently than annually during five of the seven filing periods preceding institution of such a proceeding.

It cannot be disputed that any practitioner who willfully fails to satisfy their basic tax filing requirements presents a threat to the tax system. This is reflected in section 10.51(a)(6), which defines a willful failure to file as incompetent and disreputable conduct. There is also no
question that such a practitioner can and should be subject to the normal disciplinary proceedings available under Circular 230. By limiting its scope to a failure to file returns and not including a failure to pay tax, proposed section 10.82 reflects an appropriate narrowing of the previously proposed rule.

Proposed section 10.82 continues to raise concerns, however, by deeming certain failures to file to be “willful” without regard to the practitioner’s culpability in failing to meet applicable filing requirements or any prior determination regarding such culpability. For example, there could be legitimate disputes between a practitioner and the Service as to whether a practitioner met the annual filing threshold, triggering a filing requirement. Yet proposed section 10.82 would deem that practitioner to have acted “willfully” in failing to file. More problematic are disputes regarding non-income tax returns required to be filed on an annual or more frequent basis. For example, it may not be uncommon for the Service to take the position that a practitioner who retained seasonal assistance from temporary workers should have treated them as employees, rather than independent contractors, triggering a requirement to file annual Form 940 and quarterly Form 941 employment tax returns. Even though the practitioner may have had a good-faith basis for not filing employment tax returns, proposed section 10.82 would deem that practitioner to have acted willfully in failing to file and thus be subject to expedited suspension. There are undoubtedly many other situations in which a practitioner may believe in good faith that an annual or more frequent return is not required to be filed, yet in these circumstances proposed section 10.82 would put their ability to practice at risk on an expedited suspension basis.26

We recognize that there are few scenarios in which a practitioner would have a good faith basis for believing that the practitioner was not required to file an annual income tax return. Balancing this against the serious threat to the tax system presented by non-filing practitioners, we recommend limiting the expedited suspension in proposed section 10.82 to practitioners who fail to file income tax returns for four out of the five preceding tax periods.

V. Requirement that Practitioners Refrain from Negotiating Taxpayer Checks Under Modified Section 10.31

The Proposed Amendments update current section 10.31 to clarify that it applies to electronic deposits and is not limited to the negotiation of a paper check. This is an appropriate change and conforms the provision in Circular 230 more closely to the parallel prohibition under Code section 6695(f) and Treas. Reg. § 1.6695-1(f).

We recommend, however, that the language of proposed section 10.31 be revised to track the more detailed provisions in Treas. Reg. § 1.6695-1(f). For example, Treas. Reg. § 1.6695-26

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26 In a related context, the term “tax return” has been defined expansively to encompass virtually any submission made to the Service. Notice 2011-6. 2011-3 I.R.B. 315 (“The IRS hereby specifies that all tax returns, claims for refund, or other tax forms submitted to the IRS are considered tax returns or claims for refund for purposes of section 1.6109-2 unless otherwise provided by the IRS.”). While this expansive definition is not referenced in proposed section 10.82, it does raise the potential for a broad range of circumstances in which a repeated failure to file a “return” (or an examination agent’s unproven assertion of such a failure) is deemed to be willful conduct irrespective of the practitioner’s good faith basis for not filing or making a submission.
1(f) prohibits a practitioner from negotiating a taxpayer’s check only if the practitioner “was a
tax return preparer of the return or claim for refund which gave rise to the refund.” This
language permits a practitioner acting as the representative of a trust or decedent’s estate who
was not a preparer of the trust’s Form 1041 income tax return or the decedent’s final year Form
1040 income tax return to negotiate a refund check. Under proposed section 10.31, however,
that practitioner would be prohibited from negotiating the check, potentially imposing a burden
on trust or estate administration. Likewise Treas. Reg. § 1.6695-1(f)(2) enumerates several
regulatory exceptions to the prohibition on a tax return preparer negotiating a taxpayer’s check.
While the merits of those exceptions are beyond the scope of these comments, proposed section
10.31 should be consistent in its application.

VI. Clarification of OPR’s Oversight of Practitioner Discipline

The Proposed Amendments would modify section 10.1 to provide that OPR “shall have
exclusive responsibility for [practitioner] discipline, including disciplinary proceedings and
sanctions.” This language alleviates a concern regarding OPR’s authority that arose with earlier
amendments to Circular 230 and the promulgation of IRS Delegation Order 25-15 (July 16,
Office to perform certain tax administration functions, including receiving and processing
complaints regarding preparer or practitioner misconduct, initiating preliminary investigations,
and referring complaints to OPR or other investigatory functions within the Department of
Treasury.

Although we support the proposed change to section 10.1, we remain concerned
regarding the investigatory role of the Return Preparer Office, even if its investigations are
preliminary. We recommend that the provision be modified to make clear that the Return
Preparer Office’s authority to conduct preliminary investigations is limited to the investigation of
(i) registered tax return preparers within the meaning of section 10.3(f) or (ii) persons who may
be tax return preparers within the meaning of Code § 7701(a)(36), Treas. Reg. § 301.7701-15, or
Treas. Reg. § 1.6109-2, but who have failed to register with the Return Preparer Office as
required by Treas. Reg. § 1.6109-2. The Return Preparer Office, like any other function of the
Service, should be allowed to receive and process complaints regarding any practitioner or other
individual. It is not appropriate, however, for the Return Preparer Office to conduct
investigations (including preliminary investigations) into allegations of misconduct made against
attorneys, certified public accountants, enrolled agents, enrolled actuaries or enrolled retirement
plan agents who are not otherwise subject to oversight by that office.

CONCLUSION

The covered opinion standards in section 10.35 have served an important function in
educating practitioners and taxpayers alike on the role that written tax advice plays in ensuring
better compliance with the tax law and in discouraging taxpayers from entering into transactions
that do not meet minimum confidence standards. The burden imposed by the complexity and
over-breadth of the covered opinion standards has, however, come to outweigh their beneficial
effect. Accordingly, we strongly support the proposal to replace the targeted rules in section
10.35 and the proposed rules in 10.39 with a principles-based approach.
In supporting the principles-based approach, our comments are intended to clarify aspects of proposed section 10.37 to ensure that it is consistent with other provisions both in Circular 230 and in other relevant areas of the tax law. These clarifications will, we believe, make the rule easier to understand and apply. That, in turn, will provide OPR with a more effective tool to address problematic written advice practices in the future, helping to ensure that written advice does not again encourage, rather than discourage, potentially abusive transactions.

In commenting on other provisions in the Proposed Amendments, we also generally support the changes being proposed. Our comments on those changes are, similarly, intended to provide greater clarity and consistency, ensuring that practitioners have meaningful guidance on the standards of practice they should follow, and ensuring that OPR can effectively sanction practitioners who fail to meet those standards under the applicable prohibited conduct standards in section 10.52.
APPENDIX

The Proposed Amendments, if adopted as final, would repeal the covered opinion standards in section 10.35 and would withdraw the standards for State or local bond opinions in previously proposed section 10.39. In making these proposals, the Proposed Amendments reject long-standing efforts to draft a due diligence rule for written tax advice targeted on potentially abusive transactions in favor of a principles-based approach applicable to all written tax advice. To place our comments on this aspect of the Proposed Amendments in context, we include in this Appendix a summary of the evolution of the targeted written advice rules in Circular 230 and the Section’s prior comments on those rules.

A. “Tax Shelter” Rules in Circular 230

In 1984 the Treasury Department and the Service first finalized “tax shelter” standards in Circular 230 that targeted the syndicated individual tax shelters prevalent at the time.27 It was thought that the targeted tax shelter rules were appropriate because written advice was being used to encourage, rather than regulate, taxpayer participation in aggressive tax transactions. The tax shelter standards promulgated in 1984 were patterned after American Bar Association (ABA) Formal Opinion 346 (1982) and were aimed at tax opinions that were intended to be included or described in tax shelter offering materials prepared for the purpose of soliciting investments in transactions designed to produce significant tax benefits. The 1984 tax shelter rules were limited to income tax and adopted a definition of “tax shelter” that was linked to purported tax benefits (in the form of deductions or credits) in excess of the taxpayer’s investment in the transaction.28

For opinions rendered with respect to a defined “tax shelter,” the 1984 standards required that the practitioner rendering the opinion (1) make an inquiry as to all relevant facts, (2) be satisfied that all material facts were described accurately and completely in the offering materials, and (3) assure that any representations as to future activities were clearly identified, reasonable, and complete. The 1984 tax shelter standards also required that the practitioner relate the law to the facts of the transaction and, when addressing issues based on anticipated future conduct or activities, clearly identify what facts were assumed. In addition, the practitioner was obligated to ascertain that all material federal tax issues had been considered and that any material issues raising the reasonable possibility of a challenge by the Service were fully and fairly addressed. Finally, the 1984 standards required that the practitioner, where possible, render an opinion as to whether it was “more likely than not” that the taxpayer would prevail on the merits of each material tax issue if there was a reasonable possibility of challenge by the Service.


28 This definition generally tracked Code section 6111(c) as enacted by the Deficit Reduction Act of 1984, 98 Stat.691, Pub. L. No. 98-369, § 141(a), which defined “tax shelter” by reference to a “tax shelter ratio” of tax benefits to “investment base.”
The 1984 tax shelter standards were effective in focusing practitioner attention on written advice standards applicable to transactions with a high potential for improper tax avoidance. However, the syndicated tax shelters that they targeted soon fell into disfavor as a result of substantive changes in the tax law enacted by the Tax Reform Act of 1986, and thereafter the 1984 standards were not widely used as a tool to combat abusive opinion practices.

B. Development of the Covered Opinion Standards in Current Section 10.35

In the late 1990s, the problem seen twenty years earlier of written tax advice playing a role in encouraging taxpayers to take aggressive tax positions reappeared in the context of “technical” tax shelters. In broad terms, these transactions were characterized by their technical compliance with applicable provisions of the Code, but were subject to challenge by the Service on application of economic substance, substance-over-form and other anti-abuse rules. The existing tax shelter standards in Circular 230 adopted in 1984 were not well suited to these transactions and, in all events, had fallen into disuse. The 1984 standards were, therefore, not effective in discouraging certain practitioners from issuing opinions and other written tax advice with respect to this new generation of potentially abusive transactions.

The Treasury Department and the Service recognized, and most practitioners agreed, that a better targeted written advice rule was needed to address the growing problem of technical tax shelters. As part of a broader effort to overhaul Circular 230, in 2000 Treasury and the Service issued an advance notice of proposed rulemaking (“ANPRM”) soliciting input on various provisions in Circular 230, including targeted “tax shelter” rules. This began a four-year effort that culminated in promulgation of the covered opinion standards in current section 10.35 to replace the tax shelter standards adopted in 1984.

January 2001 Proposed Tax Shelter Regulations. Taking into consideration comments received in response to the ANPRM, on January 12, 2001, the Treasury Department and the Service published proposed regulations (the “2001 Proposed Regulations”) addressing numerous aspects of Circular 230, including opinion standards with respect to tax shelters. The 2001 Proposed Regulations defined “tax shelter” by reference to the “significant purpose” of tax avoidance definition then set forth in Code section 6662(d)(2)(C)(iii), with certain enumerated exceptions. Under the 2001 Proposed Regulations, two separate rules would impose heightened standards on any “tax shelter” opinion that (1) reached a conclusion that it was more likely than not that the proposed tax treatment was proper, or (2) the practitioner knew would be used to market the transaction to third parties.

In April 2001, the Section submitted extensive comments on the 2001 Proposed Regulations.

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31 Section 6662(d)(2)(C)(iii) has since been renumbered as section 6662(d)(2)(C)(ii).
Regulations, including comments on the provisions dealing with “tax shelter” opinions. The comments expressed concern over definitional uncertainties as to when the heightened standards would apply. In particular, the comments expressed concern with the broad “significant purpose of tax avoidance” definition of tax shelter, suggesting that a narrower “principal purpose” definition be used instead.

In August 2001, the Section submitted further comments on the 2001 Proposed Regulations. Those comments recommended that Treasury and the Service combine the rule that dealt with more likely than not tax shelters with the separate rule that applied to marketed tax shelters. The August 2001 comments also recommended that the definition of “tax shelter” be linked to a set of three alternative tests that would better target transactions with the potential for improper tax avoidance, rather than using the broad “significant purpose” definition in section 6662(d). The Section supplemented its August 2001 comments in a letter to the Treasury Department dated April 24, 2002. The supplemental letter recommended, among other things, that the targeted written advice rules eliminate use of the pejorative term “tax shelter” and that “significant purpose” transactions not be covered by the targeted rules because of concern that those rules would apply too broadly to a wide range of non-abusive tax planning.

December 2003 Re-Proposed Tax Shelter Regulation. Responding to comments submitted in connection with the ANPRM and the 2001 Proposed Regulations, the Treasury Department and the Service published final regulations in July 2002 making changes to numerous aspects of Circular 230. Those final regulations carved out the provisions in the 2001 Proposed Regulations dealing with tax shelters. In December 2003, another set of proposed Circular 230 regulations was issued (the “2003 Re-Proposed Regulations”) focused again on targeted tax shelter opinion standards. The standards for tax shelter opinions set forth in the 2003 Re-Proposed Regulations differed from the 2001 Proposed Regulations in several important respects. Most significantly, the Re-Proposed Regulations combined and modified the standards applicable to more likely than not and marketed tax shelter opinions in order to reduce the definitional complexity of the rules and to provide greater uniformity in their application. The 2003 Re-Proposed Regulations retained the broad “significant purpose” definition of “tax shelter,” but created additional targeted exceptions, including an exception for preliminary advice expected to be followed by a more detailed written opinion. The 2003 Re-Proposed Regulations also included a new provision allowing “limited scope” opinions that explicitly stated that they were not addressing all significant Federal tax issues raised.

The 2003 Re-Proposed Regulations generally retained the detailed requirements set forth in

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32 ABA Section of Taxation, Comments Regarding Proposed Amendments to the Regulations Governing Practice Before the Internal Revenue Service (April 23, 2001), reprinted in 2001 TNT 86-47.


in the 2001 Proposed Regulations applicable to more likely than not and marketed tax shelter opinions, but added additional rules requiring practitioners to make specific disclosures, including disclosures related to conflicts of interest and the taxpayer’s ability to rely on an opinion for penalty defense purposes.

In February 2004, the Section submitted comments on the December 2003 Re-Proposed Regulations. In those comments, the Section recommended that the detailed standards applicable to tax shelter transactions be limited in their application to formal written opinions, so that they would not discourage taxpayers from seeking written advice generally, which could unduly burden and disrupt traditional tax planning and have a negative effect on compliance. Beyond that general observation, the Section generally supported the targeted tax shelter rules in the 2003 Re-Proposed Regulations, making several suggestions on ways in which the rules could be clarified.

In final regulations issue in December 2004 (the “Final Covered Opinion Regulations”), the Treasury Department and Service finalized the 2003 Re-Proposed Regulations with changes based on comments received.36 The Final Covered Opinion Regulations took effect six months later, for written advice rendered after June 20, 2005. Consistent with the Section’s recommendation, the regulations narrowed the categories of transactions to which detailed opinion standards and disclosure requirements applied by replacing the significant purpose of tax avoidance (“tax shelter”) definition with a series of filters that incorporated common elements of what were thought to be potentially abusive transactions. The filters were incorporated into the definition of a “covered opinion” and included “listed transactions,” certain “principal purpose” transactions, and “significant purpose” transactions. The significant purpose filter was limited, however, to transactions that also met the definition of a “reliance opinion” (i.e., an opinion reaching a “more likely than not” conclusion with respect to a “significant Federal tax issue”) or a “marketed opinion,” or opinions providing for confidentiality of the tax advice or contractual protection with respect to the tax advice.

Recognizing the definitional complexity of the covered opinion rules and the burdensome form requirements that applied if written advice fell within the scope of the rules, in certain circumstances, the Final Covered Opinion Regulations allowed for an “opt out” if appropriate reference was made to the fact that the advice could not be relied upon for purposes of penalty protection. The Final Covered Opinion Regulations also included an exception for State or local bond opinions, which were addressed separately by another set of proposed regulations issued on December 20, 2004.37

For all written tax advice not subject to the covered opinion rules in section 10.35, new section 10.37 of the final regulations set forth a default rule. The standards for all other written


tax advice in section 10.37 tracked in many respects the covered opinion rules, but without the
detailed documentation requirement or a mandate for the specific form that the written advice
had to follow.