REPORT
TO AMEND 31 C.F.R. PART 10,
TREASURY DEPARTMENT CIRCULAR 230,
TO DEAL WITH “MORE LIKELY THAN NOT” OPINIONS
RELATING TO TAX SHELTER ITEMS OF CORPORATIONS

This Report with proposed amendments to Circular 230 has not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, accordingly, should not be construed as representing the position of the Association.

Date: 12/6/1999

REPORT

Treasury Department Circular 230, set forth at 31 C.F.R. part 10, provides rules for persons who practice before the Internal Revenue Service. Section 10.33 of Circular 230 deals with tax shelter opinions that are designed to be included or described in tax shelter offering materials that are publicly distributed. The rules in section 10.33 do not apply specifically to practitioners who provide "more likely than not" opinions to corporate taxpayers directly for possible use as legal justification in the event of an accuracy-related penalty assertion with respect to a "tax shelter item" as that term is defined in Treas. Reg. §1.6662-4(g)(3). We recommend the addition of a new section 10.35 to fill this gap. The text of the proposed amendment to Circular 230 is attached.

New section 10.35 would provide minimum standards for practitioners who are asked to furnish their corporate clients with "more likely than not" opinions under section 6664(c) and Treas. Reg. § 1.6664-4(e) for the purpose of establishing the reasonable cause and good faith defense to an accuracy-related penalty by providing legal justification for the tax treatment of a tax shelter item. Because the possible application of section 6664 necessarily arises in audit proceedings before the IRS, Circular 230 should provide rules of practice with respect to such "more likely than not" opinions.

New section 10.35 provides that a practitioner providing a more likely than not opinion to establish a taxpayer's legal justification for the tax treatment of a corporate tax shelter item is required to evaluate and take account of all relevant facts; to relate the applicable law to those facts; to consider, to the extent relevant and appropriate, both the substance and the purpose of the plan or arrangement; to identify and discuss all material tax issues; to identify and discuss the relevance and persuasiveness of the legal authority pertinent to the facts and material tax issues; and to contain a reasoned analysis of whether applicable authority supports the position taken by the taxpayer. The opinion must conclude unambiguously that there is a greater than 50-percent likelihood that the tax treatment of the tax shelter item would be upheld if challenged by the IRS.

The opinion must not be based on any unreasonable factual or legal assumptions. Assuming, rather than determining through reasonable inquiry, that a material fact exists would be considered unreasonable. Assuming, rather than analyzing and concluding, that a material legal issue would be resolved favorably would also be considered unreasonable. By way of example, it would be unreasonable for a practitioner merely to assume the existence of a business purpose for a transaction if business purpose is a material fact. It would also be unreasonable for a practitioner who establishes the existence of a business purpose to assume, rather than to analyze and conclude, that such a business purpose supports the transaction in question.

Except as provided below, a practitioner providing an opinion described in new section 10.35 must be knowledgeable in the relevant aspects of the Federal tax law at the time the opinion is rendered. The practitioner may not rely on an analysis of the Federal tax law prepared by
another person with respect to any aspect of the taxpayer’s treatment of the same tax shelter item, unless the practitioner is not sufficiently knowledgeable to render an informed opinion on a particular aspect of the Federal tax law. In such a case, the practitioner may rely on an analysis prepared by another practitioner who is knowledgeable with respect to that particular aspect of the law. For example, a practitioner giving advice as to the effect of a transaction in which the taxpayer will purchase an interest in a securitization trust holding a municipal bond may rely on the opinion of bond counsel that interest on the bond is exempt from Federal income tax under section 103.

A more likely than not opinion provided with respect to a corporate tax shelter item that does not state that it is being provided as legal justification for the treatment of such item on a tax return shall be presumed not to have been intended for such purpose. The Section of Taxation recommends that the Treasury Department consider the addition of a similar presumption to the regulations under §6664.

This recommendation is made in a policy environment of increased attention to corporate tax shelter activities. See Treasury Department, White Paper, The Problem of Corporate Tax Shelters: Discussion, Analysis, Legislative Proposals, released July 1, 1999; Joint Committee on Taxation, Staff Penalty and Interest Study, released July 22, 1999. The Section believes there is a consensus among practitioners that the practice of giving more likely than not opinions that are intended to provide legal justification for the tax treatment of corporate tax shelter items should be addressed as a matter of proper practice as a supplement to continuing reform of underlying substantive law. See, e.g., James P. Holden, 1999 Griswold Lecture before the American College of Tax Counsel, Dealing with the Aggressive Corporate Tax Shelter Problem, 52 Tax Lawyer 369 (1999), making many points similar to this report and a recommendation from which the proposed amendment draws heavily.

The Section recommends the amendment of Circular 230 by adoption of the following amendments:

**DRAFT OF PROPOSED AMENDMENTS TO CIRCULAR 230**

Add a new § 10.35 to read as follows:

§ 10.35. "More likely than not" opinions. - (a) Application of section This section prescribes minimum standards for a practitioner who provides a "more likely than not" opinion for the stated purpose of establishing the legal justification of a corporate taxpayer under 26 C.F.R. 1.6664-4(e)(2) for the tax treatment of a "tax shelter item," as defined in 26 C.F.R. 1.6662-4(g)(3). This section also necessarily applies to opinions prepared for such a purpose that express a higher level of confidence than "more likely than not."

(b) Requirements for "more likely than not" opinion. A practitioner who provides an opinion to a corporate client for the stated purpose of establishing that, at the time a return is filed, the client reasonably believed that the tax treatment of a tax shelter item as reflected on the client’s return was more likely than not the proper treatment, must, as of the time the opinion is rendered and subject to paragraph (b)(9), be knowledgeable in the relevant aspects of Federal tax law and must comply in good faith with each of the following requirements:

(1) Evaluate all relevant facts. The practitioner must make inquiry as to all relevant facts and circumstances and be satisfied that the opinion takes account of all such facts and circumstances. The opinion should not be based, directly or indirectly, on any unreasonable factual assumptions (e.g., an assumption of a fact that is material to the analysis, such as an assumption that the transaction had a business purpose or an assumption with respect to the
profitability of the transaction apart from tax benefits, or an assumption of a fact made by a valuation expert in connection with an appraisal).

(2) Reliance on representations. The practitioner may, where the circumstances indicate that it would be reasonable to do so taking into account the practitioner's prior experience with the client, rely upon factual representations by persons that the practitioner considers to be responsible and knowledgeable. If the information so represented appears to be incorrect, incomplete or inconsistent in any material respect, the practitioner must make further inquiry.

(3) Relate law to facts. The opinion must relate the applicable law to the relevant facts.

(4) Consider substance and purpose. The opinion must take into account, to the extent relevant and appropriate under applicable law, both the substance and the purpose of the entity, plan or arrangement that gives rise to the tax shelter item in question.

(5) Identify all material tax issues. The opinion must identify and discuss all material tax issues unless the opinion is provided solely with respect to a specific tax issue, as described by paragraph (b)(9).

(6) Evaluate authorities. The opinion must identify and discuss the relevance and persuasiveness of the legal authority pertinent to the facts and material tax issues.

(7) Analysis. The opinion must contain a reasoned analysis of whether applicable authority supports the position taken by the taxpayer. Such analysis shall be made in the manner described in 26 C.F.R. 1.6662-4(d)(3). The opinion must not assume the favorable resolution of any legal issue material to the analysis.

(8) More likely than not assessment. The opinion must unambiguously conclude that there is a greater than 50-percent likelihood that the tax treatment of the item would be upheld on the merits if challenged.

(9) Reliance on analysis of others. A more likely than not opinion may not rely on an analysis of the Federal tax law prepared by another person that relates directly or indirectly to any aspect of the taxpayer’s treatment of the same tax shelter item, unless such analysis is limited to a specific tax issue (e.g., whether interest on a municipal bond is exempt from Federal income tax under section 103) with respect to which the practitioner is not sufficiently knowledgeable to render an informed opinion. In such a case, the practitioner may rely on the analysis of another practitioner who is sufficiently knowledgeable regarding such issue, but the practitioner must ensure that the combined analysis, taken as a whole, satisfies the requirements of this section.

(c) Presumption. A more likely than not opinion provided with respect to a corporate tax shelter item that does not state that it is for the purpose of providing the taxpayer with legal justification for the treatment of such item on a tax return shall be presumed not to have been intended for such purpose.

(d) Effect of opinion that meets these standards. An opinion of a practitioner that meets the above requirements will satisfy the practitioner's responsibilities under this section. 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 separately determined under applicable provisions of the law and regulations.

Amend § 10.52(b) as follows:

A practitioner may be disbarred or suspended from practice before the Internal Revenue Service for any of the following: * * *

(b) Recklessly or through gross incompetence (within the meaning of § 10.51(j)) violating § 10.33, § 10.34 or § 10.35 of this part.