The New Circular 230 Regulations—Best Practices or Scarlet Letter?

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I. INTRODUCTION

Treasury and the IRS adopted new rules governing the practice of tax law ("Circular 230 Regulations") effective June 21, 2005. Most lawyers and clients now see the following legend (the "Circular 230 Legend") more often than they see the most aggressive advertisements:

> *IRS Circular 230 Disclosure:*
>
> *To ensure compliance with requirements imposed by the IRS in Circular 230, we inform you that, unless we expressly state otherwise in this communication (including any attachments), any tax advice contained in this communication is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or other matter addressed herein.*

Presumably, the Circular 230 Legend was intended by the IRS to be a scarlet letter; a shameful warning sign to be attached to written tax advice where (i) the IRS has a "reasonable basis" to challenge the advice, and (ii) the tax practitioner has failed to conform to rigid—and, for clients, very expensive—opinion standards. Instead, the Circular 230 Legend has quickly developed *two* distinct meanings—one for highly tax-sophisticated clients and a different one for less tax-sophisticated clients.

In the tax-sophisticated world, the Circular 230 Legend—like Hester's scarlet letter "A" in Hawthorne's classic novel—quickly transformed from a badge of shame disguised as a decoration (Chapter 2) to being interpreted as "able" (Chapter 13). Even business lawyers and litigators, many of whom know very little about the tax law and rarely give tax advice, are including the Circular 230 Legend on all of their e-mails—even e-mails in which they do nothing more than invite a friend to lunch. In this world, where it generally would not be "reasonable in light of all of the facts and circumstances, including the experience, knowledge and education of the taxpayer"[1] to rely for penalty protection on less formal advice from a tax professional, the Circular 230 Legend and other IRS mandated legends such as the Limited Scope Legend (discussed below) are white noise—they tell the client what they already know. The closest non-tax example would be the warning on the outside of a McDonald's coffee cup stating that the contents are hot.

In the less tax-sophisticated world—which dwarfs the tax-sophisticated world—the Circular 230 Legend is what it is—a scarlet letter with all the baggage. It applies a false label that suggests there is something "wrong" with the advice. While a number of tax professionals seem to be deserving of punishment far worse than the requirement that they attach a scarlet letter to their every written word, most of the tax bar has not promoted abusive schemes and are entitled to be treated with some semblance of human dignity as they assist taxpayers attempting to comply with complex laws. For the many reasons described below, we believe the Circular

[1] Reg. § 1-6664-4(b), (c). Unless specifically stated otherwise, references to the Tax Code or to any Section are to the Internal Revenue Code of 1986, as amended through July of 2005, and references to regulations are to regulations issued under the Tax Code.

230 Regulations are overbroad in their general application to all reliance opinions and should be rewritten to more carefully target situations where there is a significant risk of tax shelter activity.

Part II of this article accepts both the need for strict tax practice standards and the IRS's broad authority to promulgate those standards. Part III suggests that the regulations are overbroad and not appropriately targeted to abuses or situations where there is a significant risk of tax shelter activity. Part IV of this article suggests a more targeted approach. Part V explains the broad application and mechanics of the new Circular 230 rules.[2] Exhibit A contains a flowchart summarizing application of the new Circular 230 rules. A copy of Baker & Hostetler LLP's firm policy—intended to assist other firms with their Circular 230 and tax shelter compliance—is attached as Exhibit B. These practice area standards also incorporate policies intended to assist firm compliance with recently enacted provisions of The American Jobs Creation Act of 2004, P.L. 108-357 (the "Jobs Act"). A model tax opinion intended to assist with Circular 230 compliance in a variety of situations is attached as Exhibit C.[3]

II. ADMITTED NEED FOR STANDARDS; IRS AUTHORITY TO PROMULGATE RULES

The proliferation of technical tax shelters in recent years and the behavior of certain tax professionals who turned a blind eye to obvious shortcomings of certain strategies amply demonstrates that the "market" relating to tax advice is in need of additional oversight. We therefore accept the need for heightened, even onerous, opinion standards for situations where there is a significant risk of tax shelter activity. The question is how to balance that need with the need of generally compliant advisors and their clients to engage in routine commerce with as few burdensome restrictions as possible.

Nor do we quarrel with the IRS's authority to promulgate tax opinion rules applicable to individuals and firms that practice before the IRS. Section 822 of the Jobs Act gives the IRS authority to censure and impose monetary penalties on individuals and firms "practicing before the Department of Treasury," and provides at Section 822(d):

> Nothing . . . shall be construed to limit the authority of the Secretary to impose standards applicable to the rendering of written advice . . . which is of a type the Secretary determines as having a potential for tax avoidance or evasion.

We would like to point out, however, that (i) in the same Jobs Act where Congress granted the IRS this authority, Congress deliberately targeted its burdensome opinion standards to situations where there is a risk of shelter activity,[4] and (ii) if the Tax Code were not so needlessly complex, the ability to take advantage of incongruities in the Tax Code would diminish. Overtreating a

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[2] Special thanks to Baker & Hostetler LLP summer associate Jeffrey D. Dobosh for his assistance with this section.

[3] Special thanks to Robert G. Woodward of King & Spalding LLP for his thoughtful writing and comments regarding tax opinions on a panel we recently shared at the Texas Federal Tax Institute. *See* Robert G. Woodward, "Tax Opinions,"21st Annual Texas Federal Tax Institute, June 9, 2005, Tab 9. Exhibit B is based upon portions of Mr. Woodward's article.

[4] *See* discussion of disqualified advisors and disqualified opinions at Section IV.B.6., *infra*.

symptom imposes significant unfairness and does less to solve the problem compared to a more carefully tailored approach.

We wonder whether the IRS has exceeded its statutory grant of authority by imposing heightened standards on all tax advice (i.e., generally all reliance opinions), when the authorizing legislation requires the IRS to target situations "having a potential for tax avoidance or evasion."

III. NEW REGULATIONS ARE OVERBROAD AND MISS THE MARK

A. Rules Penalize Small Businesses and Unsophisticated Taxpayers

Tax professionals at large corporations and sophisticated taxpayers are able to digest complex tax advice; take the time to understand the cases and rulings on which the advice is based; and form their own more-likely-than-not reasonable belief regarding the appropriate tax treatment of a transaction—which will protect those taxpayers from penalties. Small businesses and taxpayers not schooled in tax law generally will not be willing or able to pay the very high costs associated with a full-blown, covered opinion and lack the training and tax-sophistication to form their own more-likely-than-not reasonable belief in gray areas of the tax law. Smaller amounts at risk do not necessarily translate into less complex tax issues. Small businesses and individuals therefore will be subject to penalties more frequently because they will be able to rely less frequently on the advice of professionals. The new Circular 230 Regulations seem to violate notions of fairness in this regard. The cautionary advice of Shakespeare—"The first thing we do, let's kill all the [tax] lawyers"—has effectively occurred with promulgation of the new Circular 230 Regulations. Those rules make reliable tax advice for individuals and small businesses unaffordable and therefore generally unavailable. Effective tax counsel in gray areas now is out of reach for the masses—even in situations where there is no significant risk of shelter activity.

B. Threshold Standard Is Unworkable in Practice

Advice that does not address a "significant federal tax issue" often will not be subject to the intrusive requirements of Section 10.35 of Circular 230 because many of the types of covered opinions require the presence of a "significant federal tax issue." The Circular 230 Regulations define a "significant federal tax issue" 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 where the IRS has a "reasonable basis" for a successful challenge. The "no reasonable basis to deny tax benefits" standard proved completely ineffective in the Clinton-era tax shelter regulations. Those regulations and their vague standards were abandoned in favor of bright-line rules. That the IRS would adopt in Circular 230 a standard that has proven in the shelter disclosure area to be ineffective is problematic—even more so because the standard for enforcement in the Circular 230 Regulations is reckless. Vague standards coupled with penalties also violate notions of fairness—i.e., penalties are not appropriate in gray areas where the rules are not clear.

C. Legends Arguably Incorrect

The new standards, which require legends stating that the advice may not be relied upon for penalty protection in certain cases, is arguably incorrect until the IRS changes the penalty regulations. Those regulations generally allow taxpayers to reasonably rely on advice of professionals, and look to the diligence, sophistication and experience of the taxpayer in determining whether reliance is reasonable.[5] Until the penalty regulations are changed, compliance by the advisor with Circular 230 arguably provides erroneous advice to clients regarding applicable rules for penalty avoidance. For the tax advisor wondering whether to follow state ethics rules and provide correct advice, or federal practice rules and provide potentially misleading advice, the new rules create a bit of a quandary.

D. "No-Penalty Protection" Legend Is Misleading

Requiring specific, targeted advice to appear below bold text stating that the advice cannot be used for purposes of avoiding penalties suggests that the advice may not be correct. The mandatory legending seems (1) unfair to the attorney, whose livelihood depends on charging for specific, limited tax advice, and (2) unfair to the client, who should be permitted to ask specific questions regarding complexity in the Tax Code and rely on limited professional advice without paying for more than they need to conduct their business in a reasonable fashion. The Circular 230 "Limited Scope" opinion rules are not sufficiently flexible to provide relief in these situations.

E. Not a "Best Practice"

Circular 230 was written by the IRS with a view toward fostering "best practices." No other state or federal body charged with setting practice standards during the past two centuries, however, has promulgated anything even remotely similar to the broad, detailed and invasive rules contained in the new Circular 230 Regulations. The Circular 230 rules seem most similar to SEC rules that apply to an issuer selling a security. Treating all tax advice as the sale of a tax shelter (which admittedly is not unlike the sale of a security) is like the SEC treating all corporate advice like the sale of a security. The IRS seems to be over-treating a symptom—admittedly a serious symptom that needs to be addressed—because they have less ability to eliminate the source of the problem—complexity in the Tax Code. Interfering so severely with the attorney-client relationship in situations that do not seem to present any potential for abuse creates enormous burdens and does less to solve the problem compared to a more carefully tailored approach.

F. Rules Are Overbroad and Violate Federalism

The "balance" struck in the Circular 230 Regulations seems perfect as the rules apply to aggressive, highly structured and promoted tax shelters. They seem, however, almost like

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[5] *See* Treas. Reg. § 1.6664-4. In addition, in certain cases under current penalty rules, a taxpayer *may* rely on an opinion expressed at a lower level of confidence and obtain penalty protection. The Circular 230 rules require that an opinion that fails to reach a "more-likely-than-not" level of confidence on any issue prominently disclose that the opinion was not written and cannot be used by the taxpayer for penalty protection. *See* Circular 230 at 10.35(e)(4).

something out of a comic book as they apply to routine tax advice—that is, curious and entertaining to everyone—everyone except tax advisors and their clients.

Regulation of the practice of law has been a state function for more than two centuries. Federal regulation in the form of clear rules targeted at potential abuse is one thing. To require heightened standards for essentially all written tax advice as Circular 230 does, however, is another. The IRS has exercised its new Jobs Act authority to "impose standards applicable to rendering tax advice . . . which is of a type the Secretary determines as having a potential for tax avoidance or evasion" by imposing burdens on tax attorneys and their clients that go way beyond any comparable burden imposed on attorneys or clients outside of the tax area. The "reckless" standard that the IRS states should provide comfort is of little solace to (1) a practitioner who may lose her livelihood, or (2) a client who may lose her job because her only choices are to (a) buy more tax advice than she wants to buy, or (b) subject her employer to potential penalties. The new rules are so broad that they seem to completely abdicate state regulation of the practice of tax law. The question is not whether the IRS has the authority to regulate in this manner, but whether it should exercise its authority by promulgating such broad rules. Should tax lawyers, unlike all other lawyers, be subject to rules that require all advice that is not copied out of a Master Tax Guide to be stamped with a scarlet letter?

While no one wants to stand in the IRS's way of shutting down the promotion of abusive tax shelters, the Bush administration has a very good track record of tailoring regulation to specific abuses. The extreme burden these regulations put on generally compliant tax advisors and their clients suggests that the IRS, even though well-intentioned, has missed the mark here by a wide margin. Like the initial tax shelter regulations issued in 2000 and the overbroad confidentiality filter issued in 2002, the initial Circular 230 Regulations seem to be in need of a significant overhaul.

The carve-outs, or angel-list, that will be necessary to allow the regulations to be enforced according to their terms would be so extensive that it would be more prudent to re-target the general rules. Statements by government officials that tax advisors should take comfort in the fact that the Circular 230 rules will be enforced in a "reasonable" rather than a literal manner are appreciated but also create a certain amount of horror in the minds of tax practitioners who feel compelled to attempt to comply with the laws as written. If a regulation cannot be or will not be enforced pursuant to its terms, the regulation should be changed.

IV. A MORE TARGETED APPROACH

A. Need for Oversight; Need for Clear Lines Before Applying Penalties

The Tax Code is hopelessly complex—making the Tax Code difficult to comply with and also creating opportunity for technical tax shelters—i.e., tax benefit strategies that comply with the language of the tax law but may or may not be consistent with the underlying purposes of the tax law. The challenge for taxpayers, their advisors, the IRS, and, ultimately, the courts, with respect to every tax avoidance transaction is to determine if it involves tax planning permitted by the Code or whether instead it was concocted or engineered to take advantage of complexity to obtain tax benefits not contemplated by a reasonable application of the language and purpose of a statute or regulation.

As noted earlier in this article, there is no question that tax advisors need to behave both professionally and ethically when giving tax advice.[6] We also believe that oversight and enforcement by the IRS against tax practitioners is an important component of combating abusive schemes. It is equally clear, however, and deeply embedded in the law, both within the tax area and outside the tax area, that penalties are not appropriate in gray areas where the law is not clear. Taxpayers confronted with complexity and unclear laws generally should be permitted to seek advice, to take reasonable return positions, and to explain to the IRS the positions they are taking without subjecting themselves to potential penalties. If the IRS makes seeking professional advice of little-perceived value even in situations not involving shelters, compliance with the tax law will worsen rather than improve.

B. Recent Steps Taken Outside of Circular 230

A number of statutory and regulatory changes in recent years obviate the need for a sledgehammer approach in Circular 230. The clarity and effectiveness of these recent changes so starkly contrast with the overbroad and vague approach taken in the Circular 230 Regulations that the Circular 230 Regulations seem out of sync.

1. "Web of Disclosure"

The Bush Administration Treasury Department worked with Congress and the IRS for several years to create clear rules and a coherent "web of disclosure" for potentially abusive tax avoidance transactions—requiring (i) taxpayers to report certain transactions under Section 6011, (ii) material advisors to report ("Register") those same transactions under Section 6111, and (iii) material advisors to maintain customer lists under Section 6112. The vagueness, inconsistencies and complexity that previously made application and enforcement of those provisions impractical have been eliminated.

2. New Material Advisor Disclosure Rules

The Jobs Act repealed the Section 6111 registration rules and replaced them with a requirement that each "material advisor" with respect to a reportable transaction is required to file a new information return providing information identifying and describing the transaction, any potential tax benefits expected to result therefrom, and any other information Treasury may require.[7]

A "material advisor" is any person who makes a tax statement and provides material aid, assistance or advice in connection with various types of activities, including "organizing, managing, promoting, selling, implementing, insuring or carrying out" a reportable transaction and earns a certain amount of fees.[8]

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6 *See Report: The Role of Professional Firms in the U.S. Tax Shelter Industry*, United States Senate Permanent Subcommittee on Investigations, February 8, 2005.
7 § 6111(a); Notice 2004-80, 2004-50 I.R.B. 963. *See also*, Notice 2005-12 (February 24, 2005).
8 § 6111(a).

The fee threshold is $50,000 when substantially all the benefits from the reportable transaction are provided to natural persons and $250,000 in the case of reportable transactions involving corporate or other nonindividual taxpayers.[9] As for Section 6112, fees are aggregated on a transaction-by-transaction basis and all fees earned by a firm must be considered together (i.e., tax and non-tax).

Until further guidance is issued, a material advisor will be treated as becoming a material advisor under Section 6111 when all of the following events have occurred: (1) the material advisor makes a tax statement, (2) the material advisor receives, or expects to receive, the minimum fee amounts, and (3) the transaction is entered into by the taxpayer. Material advisors, including those who cease to provide services prior to the time the transaction is entered into, must make reasonable and good faith efforts to determine whether the taxpayer entered into the transaction.[10]

Notice 2004-80, 2004-50 I.R.B. 963, provides interim rules implementing the requirements of Section 6111 until regulations are issued. Under Notice 2004-80, each material advisor with respect to a reportable transaction must file a return on Form 8264, Application for Registration of a Tax Shelter, within 30 days after the date on which the person becomes a material advisor. Notice 2005-12 relaxed this rule by providing that, until further guidance is issued, a material advisor will meet its return filing obligation if the Form 8264 is filed by the last day of the month that follows the end of the calendar quarter in which the advisor became a material advisor.

In general, amended Section 6111 applies to any reportable transaction for which advice was provided after date of enactment of the Jobs Act (October 22, 2004).[11]

There are significant penalties for failure to file Form 8264. Failure to file triggers a $50,000 penalty if it relates to a reportable transaction other than a Listed Transaction and a $200,000, or possibly greater, penalty in the case of a Listed Transaction.[12] There is no possibility for waiver of these penalties since they apply to Listed Transactions and only very limited ability to waive those related to other types of reportable transactions.[13]

There is one important exception from reporting with respect to transactions triggering the book/tax filter. If an advisor does not make a statement about the book or accounting treatment of the transaction, and only provides tax advice, then the advisor will not be a material

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[9] § 6111(b). Note that existing regulations under § 6112 lower the threshold to $25,000 for corporate Listed Transactions and $10,000 for noncorporate Listed Transactions.

[10] Notice 2005-12 IRB 1 (February 24, 2005).

[11] Notice 2005-12 states that "[f]or purposes of the disclosure required by section 6111, disclosure is required for reportable transactions with respect to which a material advisor makes a tax statement (other than post-filing advice. . .) after October 22, 2004, regardless of whether any portion of the fee was received before October 22, 2004, or whether the transaction was entered into before October 22, 2004."

[12] The penalty with respect to failure to disclose a Listed Transaction can be 50% of the fees derived by the material advisor if greater than $200,000; or 75% if the material advisor intentionally disregarded the filing requirement. § 6707.

[13] § 6707(c) referencing § 6707A(d).

advisor with respect to such book/tax difference.[14] From the taxpayer's perspective, if a taxpayer adequately reports a book/tax difference from a transaction on Schedule M-3, Schedule M-3 disclosure constitutes Section 6011 reportable transaction disclosure and no separate Form 8886 need be filed.

3. Section 7525 Practitioner Privilege Effectively Repealed by Congress

The Jobs Act effectively repealed the Section 7525 tax practitioner privilege in all situations involving tax planning. New Section 7252(b) provides that the tax practitioner privilege shall not apply to any written communication which is in connection with the promotion of the direct or indirect participation in any tax shelter (as defined in Section 6662(d)(2)(C)(ii)). For these purposes, a tax shelter means any partnership, entity, plan or arrangement if a significant purpose is the avoidance or evasion of federal income tax.

4. Confidentiality and Contingent Fees Both Require Disclosure; Attorneys Not Bound by Confidentiality Regarding Interpretations of Law

The web of disclosure rules and regulations include provisions requiring disclosure by taxpayers and Registration by material advisors of any transaction where fees are contingent on tax benefits or an advisor imposes confidentiality over the advisor's tax strategy.[15] Confidentiality also is a lesser threat because the law is clear that it is unethical for any attorney to seek to obtain agreement from any other attorney to keep interpretations of law confidential. Further, any attorney signing such a confidentiality agreement creates a conflict between the attorney's duty to his present client, and the attorney's duty to avoid conflicts of interest with future clients who are entitled to the attorney's full professional knowledge and skill. Any confidentiality agreement regarding the application of legal principles that limits an attorney's ability to practice law also is an impermissible restriction on an attorney's right to practice law and would be unenforceable as a violation of state legal ethics rules. *See, e.g.*, Illinois State Bar Association Advisory Opinion on Professional Conduct 00-01 (October 2000) (conflict arises with respect to future clients when an attorney agrees not to disclose ideas to reduce other clients' tax liabilities). *Cf.* Illinois Ethics Rule 5.6 ("No employment agreement provision or settlement agreement provision may impermissibly restrict an attorney's right to practice law.").

5. Disqualified Advisors and Disqualified Opinions; Need for Independent Controversy Counsel

The Jobs Act provides a statutory basis for disqualifying certain advisors and opinions.[16] Reliance will not be respected in the case any reportable transaction if the opinion giver is a "disqualified tax adviser" or the opinion is a "disqualified tax opinion." As defined by § 6664(d)(3)(B)(ii), a disqualified tax adviser: (1) is a material adviser (within the meaning of § 6111(b)(1)) that participates in the organization, management, promotion, or sale of the transaction, (2) is compensated directly or indirectly by a material advisor regarding the transaction, (3) has a fee arrangement wholly or partly contingent on the intended tax benefits of

[14] Notice 2004-80, 2004-50 I.R.B. 963.
[15] Reg. § 1.6011-4; § 6111.
[16] Pub. L. 108-357, § 812(c)(1), 118 Stat. 1418 (2004) (codified at 26 U.S.C. § 6664(d)).

the transaction being sustained, or (4) has a "disqualifying financial interest" in the transaction, as determined under regulations.[17] Notice 2005-12, Jan. 19, 2005, in the context of the "disqualified advisor" rules, states that a material advisor "participates" in the "organization" of a transaction if the advisor (1) devises, creates, investigates or initiates the transaction or tax strategy; (2) devises the business or financial plans for the transaction or tax strategy; (3) carries out those plans through negotiations or transactions with others; or (4) performs acts relating to the development or establishment of the transaction. A material advisor participates in the "management" of the transaction if the advisor is involved in the decision-making process regarding any business activity with respect to the transaction. Notice 2005-12 provides that an advisor will not be treated as participating if his or her only involvement is rendering an opinion regarding the tax consequences of the transaction. In the course of preparing an opinion, an advisor is permitted to suggest modifications to the transaction, but not "material" modifications that assist the taxpayer in obtaining the anticipated tax benefits. This interim guidance seems inconsistent with the legislative history of the disqualified advisor provisions of the Act, which provides in footnote 475 of the Conference Report that the statutory language was not intended to disqualify independent tax counsel. Independent counsel often will offer advice on strengthening compliance with federal tax rules; putting an advisor in the position of either (i) harming her client by tolerating less than optimal tax planning, or (ii) harming her client by disqualifying her advice from reliance for penalty protection seems both untenable and flatly inconsistent with Congressional intent.

Reliance will also be barred if the opinion is a disqualified tax opinion, i.e., an opinion that: (1) is based on unreasonable factual or legal assumptions (including future events), (2) unreasonably relies on representations, statements, findings, or agreements of the taxpayer or any other person, (3) does not identify and consider all relevant facts, or (4) does not meet any other requirements that Treasury may prescribe.[18]

Two recent cases serve as reminders of the requirements present in current law concerning the reasonable belief and good faith defense. First, the Connecticut District Court in *Long Term Capital Holdings*,[19] imposed penalties and chastised the taxpayer and its accounting and law firms in connection with a loss generation transaction. The court held that Long Term Capital Holdings did not have reasonable good faith reliance on its law firm's opinion regarding the tax consequences of the loss generation transaction because the opinion was not issued until nine months after the partnership had filed its tax return in which it claimed the losses, reasonably diligent analysis of all facts and circumstances would have revealed some of the firm's assumptions to be unreasonable and unsupportable, there was no citation to relevant

[17] *See* discussion supra at VII. It should be noted that case law has been clear for some time that taxpayers are not permitted to rely on a tax opinion from a promoter of the product. *See Illes v. Comm'r*, 982 F.2d 163, 166 (6th Cir. 1992) ("nor can taxpayer's asserted reliance on his accountant be viewed as reasonable, since [the accountant] was not a disinterested source"); *Goldman v. Comm'r*, 39 F.3d 402 (2d Cir. 1994) ("Appellants cannot reasonably rely for professional advice on someone they know to be burdened with an inherent conflict of interest"); and *Neonatology Assocs. v. Comm'r* (3d Cir. 7/29/02) (negligence penalty not avoided where taxpayer failed to "assess that the professional himself does not suffer from a conflict of interest") (*citing* Regs. § 1.6664-4(c), *Ellwest Stereo Theaters, Inc. v. Comm'r*, 70 T.C.M. CCH 1655, and *Zfass v. Comm'r*, 118 F.3d 184, 189 (4th Cir. 1997)).

[18] § 6664(d)(3)(B)(iii). These rules may be conformed to the new Circular 230 Regulations once the Circular 230 Regulations are straightened out.

[19] *Long Term Capital Holdings v. United States*, 330 F. Supp. 2d 122 (D. Conn. 2004).

Second Circuit law in the opinion, there was little legal analysis of the economic substance of the transaction, only one partner read the opinion, and the taxpayer's accounting firm deliberately attempted to conceal the transaction by netting offsetting M-1 disclosures.[20]

Long Term Capital Holdings also highlights the substantial risk a taxpayer subjects itself to any time it hires persons who sold a given tax strategy (to the taxpayer or to others) to assist with IRS Appeals or litigation. Taxpayers interested in maximizing their chances of success must not be burdened by counsel with conflicts regarding their prior work setting up the transaction or transaction type. Even if such counsel assists behind the scenes (as was the case in *Long Term Capital*) and is not counsel of record, there is a significant risk that any controversy or litigation will become, in part, about the professionals who set up the transactions. Taxpayers need counsel that is worried only about the merits of the taxpayer's tax liability (and perhaps even take advantage of such prior failings of counsel to protect the taxpayer's tax treatment), not a firm that merely keeps the taxpayer's interests in mind while also attempting to minimize its own exposure or any soft spots in its prior diligence (with respect to the taxpayer's transaction or transactions set up for others). Retaining transaction counsel with respect to any tax controversy always has been risky; after the *Long Term Capital* decision, the needless exposure created by hiring such counsel is crystal clear and must be avoided.

Second, the Fifth Circuit in *InterTan*[21] upheld a $1 million Section 6662(a) accuracy-related penalty on a 1993 understatement attributable to foreign tax credits ("FTCs") regardless of whether the transaction was a tax shelter. The Tax Court had previously held that InterTan failed to adequately disclose a circular preferred stock transaction with a Canadian subsidiary designed to generate FTCs. Furthermore, InterTan could not avoid any portion of the accuracy-related penalty based on reasonable cause or good faith because it did not provide its advisors with all the necessary information and did not follow its tax advisor's advice in completing the transaction. InterTan failed to inform its tax advisors of a loan guarantee and assignment agreement, failed to vary dollar amounts involved in various steps of the transaction, and completed the transaction in just two days—more quickly than its tax advisors were comfortable with.

C. Suggestions for a More Targeted Approach—Follow The Jobs Act More Closely; Replace Broad Reliance Opinion Subfilter With Shelter Indicia

As noted above, under the Jobs Act taxpayers who engage in a reportable transaction are prohibited from relying for penalty protection on a disqualified advisor or disqualified opinion. While enacting severe substantive distinctions regarding how a transaction is treated for penalty purposes based on objective disclosure filters that may or may not be indicia of shelter activity seems ill-advised, what's done is done. At least the lines drawn are clear lines and are not inconsistent with the related disclosure rules. The question for Treasury and the IRS is, What *more* should be done under the IRS's Circular 230 authority?

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[20] *See also*, *Santa Monica Pictures, LLC v. Comm'r*, 89 T.C.M. (CCH) 1157 (2005) (rejecting the taxpayer's substantial authority argument because the taxpayer could not have reasonably relied in good faith on the legal opinions that had been secured and imposing the § 6662 (a)(2) substantial understatement of income tax penalty in a tax shelter context).

[21] *InterTan, Inc. v. Commissioner*, 87 T.C.M. (CCH) 767 (2004) *aff'd*, 117 Fed. Appx. 348 (5th Cir. 2004).

Treasury spent a number of years forcing consistency between the rules and regulations under Sections 6011, 6111 and 6112. Congress assisted with that effort and decided that tax opinions where the Section 6011 objective filters were triggered also should conform to higher standards. The new Circular 230 rules jump completely off track by imposing burdens on essentially all written advice. The Circular 230 rules are broader in some respects than the new legislative and regulatory rules and more narrow in other respects. Repeal of the final Circular 230 rules and issuance of Circular 230 Regulations consistent with the disqualified advisor and disqualified opinion provisions of the Jobs Act, including its legislative history, would be a good first step. As written, the decision tree (see Exhibit A) for Circular 230 compliance resembles a schematic of the space shuttle. Figuring out how to practice tax law now seems as difficult as the Tax Code itself.

If the foregoing is viewed by the IRS as insufficient, the IRS might adopt a bright-line rule that the heightened standards and legends in the Circular 230 rules must be used any time certain reportable transactions are at issue plus: (i) any time the advisor is a material advisor and fees are charged on any basis other than standard hourly rates for time spent on the matter, or (ii) any time the advice is a "marketed opinion." Replacing the broad reliance opinion subfilter (from the "significant purpose plus" rules) with this more narrow approach would go a long way toward providing needed relief. This would more closely target the substantial burden of the new regulations on the situations where heightened standards may be needed and allow advisors and clients struggling with application of the Tax Code outside the shelter area to do so without being burdened by complex and confusing rules that do not seem appropriate where there is little potential for abuse.

V. APPLICATION OF FINAL CIRCULAR 230 RULES

A. Overview

The Treasury Department first published proposed amendments to the Circular 230 Regulations attempting to modify standards for certain tax shelter opinions on December 30, 2003.[22] After a public hearing on February 19, 2004, and consideration of the public comments, final regulations were issued in December 2004,[23] and amended in May 2005.[24] These final regulations under Circular 230 are effective beginning June 21, 2005. They provide mandatory requirements for "covered opinions" and new practice standards for all other written tax advice.

The final Circular 230 Regulations contain six broad categories of provisions:

(1) aspirational "best practices,"

(2) new standards and requirements for "covered opinions,"

(3) procedures to ensure the new requirements are being complied with,

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[22] 68 Fed. Reg. 75,186 (December 30, 2003).
[23] 69 Fed. Reg. 75,839 (December 20, 2004) (codified at 31 C.F.R. §§ 10.33, 10.35, 10.36, 10.37, 10.38, and 10.52).
[24] 70 Fed. Reg. 28,824 (May 19, 2005) (codified at 31 C.F.R. § 10.35).

(4) new standards and requirements for all written advice,

(5) new sanctions, and

(6) advisory committees.

Most tax professionals have thrown up their hands and generally try to avoid the complex, detailed Circular 230 rules that frequently do not match the market for tax advice by including the Circular 230 Legend on everything they write. The most noticeable changes to everyday tax practice imposed by the Circular 230 Regulations include:

(1) the extension of formal opinion standards to informal communication like e-mail;

(2) the requirement that discussions of facts, assumptions, representations, etc., always need to be included in the face of the delivered work product;

(3) some heightened standard of factual due diligence (particularly with respect to business purpose and economic substance representations); and

(4) a prohibition against issuing limited scope opinions that would be considered marketed opinions under the new rules, and the requirement that limited scope opinions be comprehensive within their limited scope and legended regarding potential penalty protection.

The most difficult problem when attempting to apply the new regulations is determining whether or not written advice is a "covered opinion" subject to the new standards. The rules that apply to a covered opinion once it is identified also are overly detailed and often out of step with market demands relating to the buying and selling of tax advice. The flowchart attached as Exhibit A is designed to assist with the calculus of determining when written advice is a covered opinion. This narrative similarly outlines a "decision tree" approach to application of the new rules.

B. Types of Covered Opinions

A covered opinion is written advice, including electronic communication, on one or more federal tax issues arising from (1) a "listed" transaction, (2) a plan or arrangement, the principal purpose of which is the avoidance or evasion of federal tax, or (3) a plan or arrangement, a significant purpose of which is the avoidance or evasion of federal tax, if the written advice is: (a) a reliance opinion, (b) a marketed opinion, (c) subject to conditions of confidentiality or (d) subject to contractual protection.[25] An advisor's first inquiry therefore should be whether the advice must be provided in writing.[26] If so, the second inquiry should be whether the advice will deal with a "federal tax issue." A federal tax issue is a question concerning the treatment of an

[25] 69 Fed. Reg. 75,842 (codified at 31 C.F.R. § 10.35(b)(2)(i)).

[26] Since clients often remember what they want to hear and may forget important caveats delivered orally, tax advisors who switch to providing more oral advice likely will need to contend with malpractice issues.

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.[27]

1. Exclusions From Covered Opinion Rules

Assuming the tax practitioner has determined that written advice concerning a federal tax issue is to be provided, he or she should then check to see if one of four exceptions applies.

The definition of "covered opinion" specifically excludes written advice that is:

(1) Preliminary (but only in those rare cases where the tax practitioner reasonably expects to provide subsequent written advice to the client that otherwise satisfies the covered opinion requirements);

(2) Post-filing advice (prepared for and provided to a taxpayer, solely for use by that taxpayer, after the taxpayer has filed a return reflecting the benefits of the transaction, unless 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 return, including 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);

(3) Negative advice (determined on an issue-by-issue basis, 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);

(4) In-house advice from an employee to her employer.[28] This exemption is to be interpreted broadly according to public statements by IRS and Treasury personnel so that in-house personnel may engage in both tax planning and tax compliance for members of their employer group of companies in cases where outside investors are not sought as part of the transaction.[29]

At first blush, the preliminary exception looks to be a welcome safe haven. Often advice is in fact "preliminary" or informal, and generally taxpayers could not expect to reasonably rely on informal advice for penalty protection. In order to use the preliminary exception under the new rules, however, the practitioner must "reasonably expect" to provide covered opinion advice. The significant caveat effectively converts this potential carve-out into a mirage.

Covered opinions also do not include written advice concerning the qualification of a qualified plan, documents required to be filed with the SEC,[30] or written advice subject to a Prominent Disclosure Exception (described below). Certain types of opinions involved with the

[27] *Id*. at 75,842 (codified at 31 C.F.R. § 10.35(b)(3)).
[28] *Id*. at 75,842 (codified at 31 C.F.R. § 10.35(b)(2)(ii)(A) and 70 Fed. Reg. 28,824 (codified at 31 C.F.R. § 10.35(b)(2)(ii)).
[29] *See, e.g.*, statement by Michael Desmond, Treasury Deputy Tax Legislative Counsel, 2005 TNT 116-4 (June 17, 2005).
[30] 69 Fed. Reg. 75,842 (codified at 31 C.F.R. § 10.35(b)(2)(ii)(B)).

original issuance of state and local bonds are dealt with in separate proposed regulations (i.e., they are not treated as covered opinions).[31]

2. Listed Transactions, Principal Purpose Transactions, and Significant Purpose "Plus" Transactions

If the writing does not meet one of the above exceptions, then the author must consider whether it falls into one of three broad types of writings considered "Covered Opinions." In general, there are three types of Covered Opinions:

(1) Listed Transactions: Written advice concerning a transaction that is expected to obtain the same or similar types of tax benefits and that is either factually similar or based on the same or similar strategy as a transaction that has been identified as abusive by the IRS under Treasury Regulations Section 1.6011-4(b)(2);[32]

(2) Principal Purpose Transactions: Written advice concerning a transaction with the principal purpose of tax avoidance or evasion. To be considered "the principal purpose," the purpose of avoidance or evasion must exceed any other purpose. Furthermore, the principal purpose is not to avoid or evade federal tax if the partnership, entity, plan or arrangement has as its purpose the claiming of tax benefits in a manner consistent with the statute and Congressional purpose.[33]

A transaction may have a significant purpose of tax avoidance or evasion even though it does not have the principal purpose of avoidance or evasion.[34]

(3) Significant Purpose "Plus" Transactions: Written advice concerning a transaction with a significant purpose of tax avoidance or evasion which also is either:

(a) A "Reliance Opinion": Advice that concludes at a confidence level of 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. This is the subfilter that makes the Circular 230 rules incredibly broad in their application. Other subfilters discussed in this section are reasonably targeted as situations where shelter activity is a significant risk.

A "significant federal tax issue" is defined 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 where the IRS 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 transactions or matters addressed in the opinion. The regulations do not define "a significant purpose" of avoidance. The "old" regulations under the now-repealed tax shelter registration rules of Section 6111 provided that a transaction would be considered to

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[31] *See* Reg. 159824-04 (proposed regulations issued Dec. 20, 2004).
[32] *Id.* at 75,842 (codified at 31 C.F.R. § 10.35(b)(2)(i)(A)).
[33] *Id.* at 75,842 (codified at 31 C.F.R. § 10.35(b)(2)(i)(B)).
[34] 70 Fed. Reg. 28,824 (codified at 31 C.F.R. § 10.35(b)(10)).

have a significant purpose of tax avoidance if it was "structured to produce tax benefits that constitute an important part of the intended results of the arrangement"—though there were safe harbors that excepted the transaction from the old regime if it was entered into in the ordinary course of business consistent with commercial practice." "Avoidance" includes deferral—so that, for example, both Section 1031 like-kind exchanges and Section 368 merger transactions should be considered significant purpose transactions.

The fact that the carve-out for transactions consistent with Congressional intent which applies to principal purpose transactions does not also apply to significant purpose transactions makes little sense.

(b) A "Marketed Opinion": Advice that the practitioner knows or has reason to know will be used or referred to by a person other than the practitioner (or a person who is a member or associated with the practitioner's firm) in promoting, marketing or recommending a partnership or other entity, investment plan, or arrangement to one or more taxpayers.

The second part of the Circular 230 Legend was designed to try to stop advice from morphing into a Marketed Opinion.

(c) Subject to Conditions of Confidentiality: Advice where a practitioner imposes on one or more recipients 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 such limitation is legally binding.

(d) Subject to Contractual Protection: Advice where the taxpayer has the right to a full or partial refund of fees paid to the practitioner if all or part of the intended tax consequences from the matters addressed are not sustained, or if the fees paid to the practitioner are contingent on the taxpayer's realization of tax benefits from the transaction.[35]

C. Prominent Disclosure Exceptions

If the advice would be considered one of the Significant Purpose types of Covered Opinions, one of the Prominent Disclosure Exceptions may apply to take the advice out of the scope of the Covered Opinion rules—if acceptable to the client. The new regulations include the following Prominent Disclosure Exceptions to the Covered Opinion rules:

(1) Written advice (other than on Listed or Principal Purpose transactions) will not be considered 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—i.e., the now famous Circular 230 Legend.[36]

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[35] 69 Fed. Reg. 75,842 (codified at 31 C.F.R. § 10.35(b)(2)(i)(C)).
[36] *Id*. at 75,842 (codified at 31 C.F.R. § 10.35(b)(4)).

(2) Written advice (other than on Listed or Principal Purpose transactions) will not be considered 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;

(b) the advice was written to support the promotion or marketing of the transaction or matters addressed by the written advice;[37] and

(c) the taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor.[38]

(3) To be effective these disclosures must be "readily apparent" to a reader. At a minimum they must be set forth in the written advice as a separate section (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.[39]

D. Covered Opinion Procedures

Assuming a determination is made that the advice is a Covered Opinion and no Prominent Disclosure Exception is available, the resulting Covered Opinion will be subject to heightened factual and legal due diligence standards as well as additional disclosure requirements. In general, the practitioner must consider all relevant facts, relate the law to the facts, evaluate the significant federal tax issues, and provide a conclusion.[40] In considering the relevant facts, Circular 230 mandates the following required factual due diligence for Covered Opinions:

(1) 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 relevant facts.

(2) The practitioner must not base the opinion on any unreasonable factual assumptions. It is unreasonable to assume business purpose or that a transaction will be profitable apart from its tax effects. The opinion must identify in a separate section all factual assumptions relied upon by the practitioner.

(3) The practitioner must not base the opinion on any unreasonable factual representations, statements, findings or agreements, including those concerning business purpose (e.g., a representation concerning business purpose must include a specific description). The

[37] In private placement memoranda and other offering documents, the industry standard is to state that the advice was "written in connection with promotion by the issuer . . ." to avoid issuer securities law liability for the tax practitioner and her law firm.
[38] *Id*. at 75,842 (codified at 31 C.F.R. § 10.35(b)(5)(ii)).
[39] *Id*. at 75,843 (codified at 31 C.F.R. § 10.35(b)(8)).
[40] *Id*. at 75,843 (codified at 31 C.F.R. § 10.35(c)).

opinion must identify in a separate section all factual representations, statements or findings of the taxpayer relied upon by the practitioner.[41]

Circular 230 also mandates the following legal due diligence with respect to covered opinions:

(1) The practitioner must relate the applicable law (including potentially applicable judicial doctrines) to the relevant facts.

(2) The practitioner must not assume the favorable resolution of any significant federal tax issue or otherwise base an opinion on any unreasonable legal assumptions, representations, or conclusions.

(3) The opinion must not contain internally inconsistent legal analyses or conclusions.[42]

(4) The opinion must consider all significant federal tax issues.

(5) 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, the opinion must so state. The opinion must describe the reasons for the conclusions, including the facts and analysis supporting the conclusions (or describe the reasons why unable to reach a conclusion).

(6) In evaluating the chances of success on the merits of the significant federal tax issues discussed, 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.[43]

(7) The opinion must provide an 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 so state and describe the reasons for such inability.[44]

(8) The practitioner must be knowledgeable in all of the aspects of federal tax law relevant to the opinion being rendered unless relying on the opinion of another qualified practitioner. If the practitioner relies on the opinion of another, the relying practitioner's opinion must identify the other opinion and set forth the conclusions reached in the other opinion.[45]

Finally, a covered opinion must contain all of the following disclosures that apply (Required Disclosures):

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[41] *Id*. at 75,843 (codified at 31 C.F.R. § 10.35(c)(1)).
[42] *Id*. at 75,843 (codified at 31 C.F.R. § 10.35(c)(2)).
[43] *Id*. at 75,843 (codified at 31 C.F.R. § 10.35(c)(3)).
[44] *Id*. at 75,843 (codified at 31 C.F.R. § 10.35(c)(4)).
[45] *Id*. at 75,843 (codified at 31 C.F.R. § 10.35(d)).

(1) Any relationship (including a compensation arrangement, such as a referral or fee sharing agreement, or referral agreement) between the practitioner and any person (other than the client for whom the opinion is being 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.[46]

(2) 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 result and that, with respect to such issues, the opinion was not written, and cannot be used by the taxpayer, for the purpose of avoiding penalties.[47]

E. Special Rules

1. Limited Scope Opinions

The new regulations permit Limited Scope Opinions (opinions that address less than all the significant federal tax issues). A Limited Scope Opinion must still meet all the Covered Opinion requirements discussed above with respect to the issue or issues that are addressed in the advice. This severely reduces the practicality of the Limited Scope alternative.

The special Limited Scope Opinion rules are:

(1) A practitioner may provide a Limited Scope Opinion (other than concerning a Listed or Principal Purpose transaction or a Marketed Opinion) if the practitioner and the client agree that the scope of the opinion and the client's potential reliance on the opinion for purposes of avoiding penalties are limited to the federal tax issues addressed in the opinion.

(2) In the case of a Limited Scope Opinion, the practitioner may make reasonable assumptions regarding the favorable resolution of a federal tax issue. The opinion must identify in a separate section all issues for which the lawyer assumed a favorable resolution.

(3) A Limited Scope Opinion must prominently disclose that:

(a) the opinion is limited to the one or more federal tax issues addressed in the opinion;

(b) 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 such issues; and

(c) 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 client, for the purpose of avoiding penalties.[48]

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[46] *Id*. at 75,844 (codified at 31 C.F.R. § 10.35(e)(1)).
[47] *Id*. at 75,844 (codified at 31 C.F.R. § 10.35(e)(4)).
[48] *Id*. at 75,844 (codified at 31 C.F.R. § 10.35(e)(3)).

It is important to note that the Limited Scope alternative cannot be used for Marketed Opinions. This restriction has real economic consequences in a variety of everyday business settings because of the broad definition of Marketed Opinions.

2. Marketed Opinions

Marketed Opinions (written advice 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 plan or investment) are subject to the following special rules:

(1) A Marketed Opinion must reach a conclusion that the client 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 a practitioner is unable to reach such a confidence level, he or she must not provide a Marketed Opinion (but may provide written advice subject to the Prominent Disclosure Exception outlined above).[49]

(2) A Marketed Opinion must provide an overall conclusion that the federal tax treatment of the transaction or matter is the proper treatment at a confidence level of at least more likely than not.[50]

(3) A Marketed Opinion must prominently disclose that the opinion was written to support the promotion or marketing of the transaction or matter addressed in the opinion, and that the taxpayer should seek advice from an independent tax advisor.[51]

Note that private placement memoranda would be among the types of materials that would be considered Marketed Opinions (including all promotional materials not required to be filed with the SEC, for example).

F. Other Written Advice Requirements

The new regulations provide certain standards that must be applied to any written advice that is not a covered opinion (whether or not, for example, it is a tax shelter or involves a listed transaction issue). When preparing any written advice (include e-mails and routine communications) concerning one or more federal tax issues, a practitioner:

(1) Must not base such advice on unreasonable factual or legal assumptions (including as to future events). It is unreasonable, for example, to assume that a transaction has a business purpose or will be profitable apart from its tax effects.

(2) Must not unreasonably rely upon representations, statements, findings or agreements, including those concerning business purpose. To be reasonably relied upon, a representation concerning business purpose must include a specific description.

(3) Must consider all relevant facts that the lawyer knows or should know.

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[49] *Id*. at 75,843 (codified at 31 C.F.R. § 10.35(c)(3)(iv)).
[50] *Id*. at 75,843 (codified at 31 C.F.R. § 10.35(c)(4)).
[51] *Id*. at 75,844 (codified at 31 C.F.R. § 10.35(e)(2)).

(4) Must not, when evaluating a client's chances of success on the merits as to a federal tax issue, 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.[52]

The standard for other written advice is subjective. The practitioner should consider all relevant facts and circumstances, including the scope of the engagement and the type and specificity of the advice sought by the client in determining whether he or she has complied with this standard. For example, if the practitioner knows that the advice will be used or referred to by someone else 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, she should use a heightened standard of care.

G. Procedures to Ensure Compliance; Law Firm Compliance

Finally, the new regulations provide procedures to ensure compliance.[53] The threshold for triggering disciplinary action is fairly high. The regulations provide for discipline including censure and suspension or disbarment from practice before the IRS.[54] The Jobs Act authorizes monetary penalties against a practitioner who violates Circular 230.[55] The sanctions will be imposed only for reckless or grossly incompetent violations. For example, a practitioner will be subject to discipline if through willfulness, recklessness or gross incompetence they do not take reasonable steps to ensure compliance, and one or more individuals who are members of, associated with or employed by the firm engage in a pattern or practice of failing to comply with the covered opinion requirements—or if the persons with principal authority for tax practice know or should know that individuals have engaged in a pattern or practice and through willfulness, recklessness or gross incompetence fail to take prompt action to correct the noncompliance. Law firm procedures adapted from Baker & Hostetler LLP's policies as of July 2005 are attached as Exhibit B. These procedures are intended to comply with both Circular 230 and recent Jobs Act requirements. A form tax opinion template is attached as Exhibit C.

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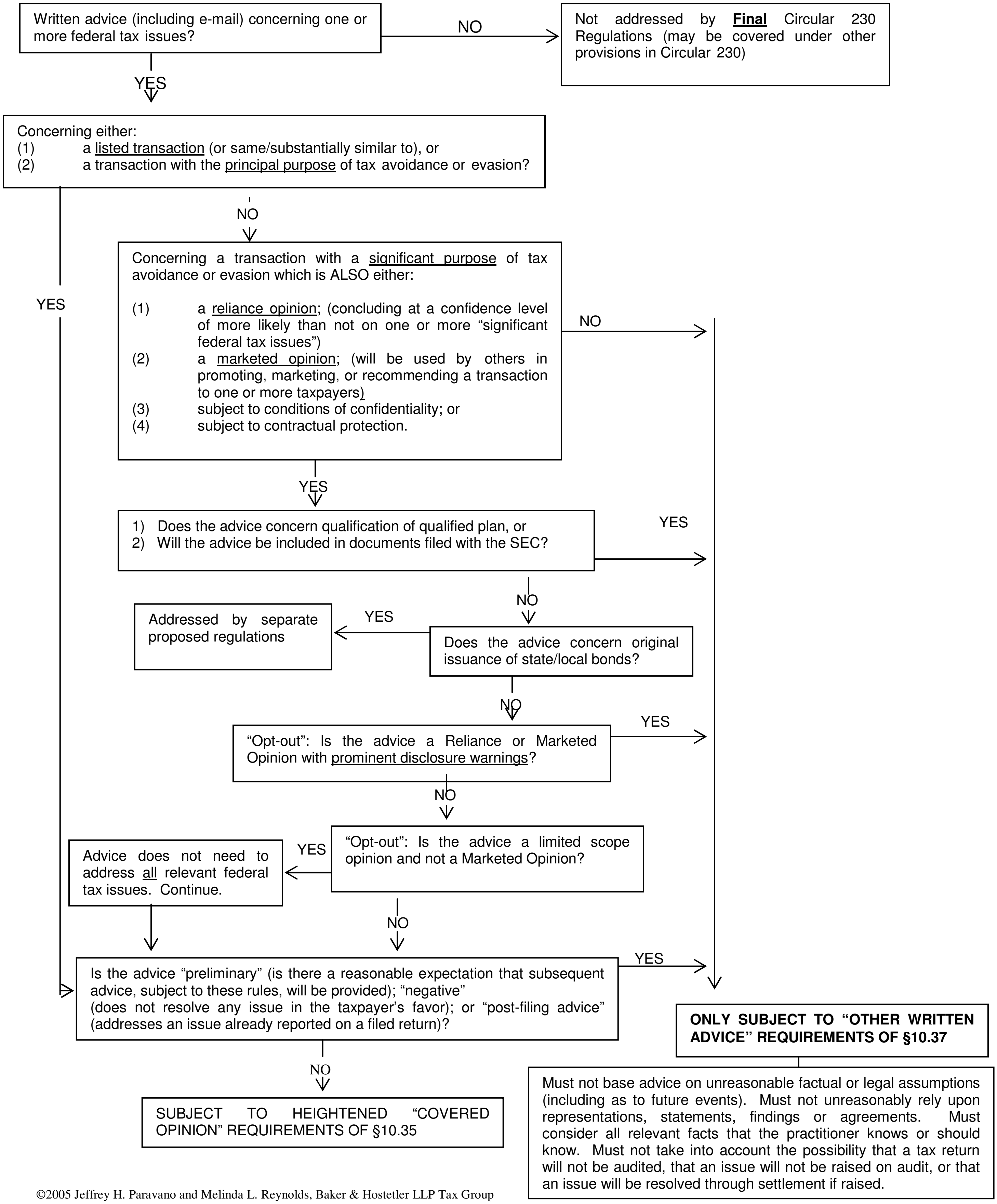
52 *Id*. at 75,844 to 75,845 (codified at 31 C.F.R. § 10.37(a)).
53 *Id*. at 75,844 (codified at 31 C.F.R. § 10.36).
54 *Id*. at 75,845 (codified at 31 C.F.R. § 10.52).
55 Pub. L. 108-357, § 822(a)(1), 118 Stat. 1418 (2004) (codified at 31 U.S.C. § 330(b)).

EXHIBIT A

CIRCULAR 230 WRITTEN ADVICE FLOWCHART



Final Circular 230 Regulations

Key Definitions/Provisions

"Substantially similar" to a Listed Transaction: A transaction expected to obtain the same or similar types of tax benefits and that is either factually similar or based on the same or similar tax strategy as a transaction that has been identified as abusive by the IRS.

Reliance Opinion: Written advice is a "reliance opinion" if the advice concludes at a confidence level of more likely than not ("MLTN") (a greater than 50 percent likelihood) that one or more "significant federal tax issues" would be resolved in the taxpayer's favor.

Significant Federal Tax Issue: 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. A federal tax issue is "significant" if the IRS 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 transactions or matters addressed in the opinion.

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 or associated with the practitioner's firm) in promoting, marketing or recommending a partnership or other entity, investment plan or arrangement to one or more taxpayers.

Conditions of Confidentiality: 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 such limitation is legally binding.

Contractual Protection: Taxpayer has the right to a full or partial refund of fees paid to the practitioner if all or part of the intended tax consequences from the matters addressed are not sustained, or if the fees paid to the practitioner are contingent on the taxpayer's realization of tax benefits from the transaction.

Prominent Disclosure: Must be set forth in written advice (1) as a separate section (not a footnote) and (2) in a typeface that is at least the same size as that used in any discussion of facts or law in the written advice.

Prominent Disclosure Warnings (Exclusions): Written advice (other than on Listed or Principal Purpose transactions) will not be considered 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.

Written advice (other than on Listed or Principal Purpose transactions) will not be considered 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;
b. the advice was written to support the promotion or marketing of the transaction or matters addressed by the written advice; and

c. the taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor.

Requirements for Covered Opinions:

(1) Factual Due Diligence: Identify and consider all relevant facts.

- (a) No unreasonable factual assumptions (including business purpose and profitability aside from tax benefits); Identify in separate section all factual assumptions
- (b) No unreasonable factual representations (including regarding business purpose unless includes specific description); Identify in separate section all factual representations

(2) Legal Due Diligence

- (a) Relate applicable law to facts (including "potentially applicable judicial doctrines")
- (b) Must not assume favorable resolution of any significant federal tax issue; no unreasonable legal assumption, representation, conclusion; no internally inconsistent legal analyses or conclusions.
- (c) Consider all significant tax issues and reach a conclusion as to merits on each
  - (i) Exceptions for limited scope opinions or opinions relying on opinion of another
  - (ii) Failure to reach MLTN requires disclosure; cannot do Marketed Opinion
  - (iii) Cannot consider audit lottery or settlement possibilities
- (d) Overall conclusion

(3) Disclosures

- (a) Relationship between promoter and practitioner
- (b) Marketed Opinion
- (c) Limited Scope
- (d) Failure to reach MLTN

EXHIBIT B

LAW FIRM TAX PRACTICE AREA STANDARDS (REVISED JULY 2005)*

I. Standards For All Written Tax Advice

A. Standards. When preparing written advice (including e-mail communications) concerning one or more federal tax issues, a [Law Firm] lawyer:

1. Must not base such advice on unreasonable factual or legal assumptions (including as to future events). It is unreasonable to assume that a transaction has a business purpose or will be profitable apart from its tax effects.

2. Must not unreasonably rely upon representations, statements, findings or agreements, including those concerning business purpose. To be reasonably relied upon, a representation concerning business purpose must include a specific description.

3. Must consider all relevant facts that the lawyer knows or should know.

4. Must not, when evaluating a client's chances of success on the merits as to a federal tax issue, 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.

B. Compliance. The [Law Firm] lawyer should consider all relevant facts and circumstances, including the scope of the engagement and the type and specificity of the advice sought by the client, in determining whether he or she has complied with this standard. If the lawyer knows that the advice will be used or referred to by someone outside the 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, he or she should use a heightened standard of care in making this determination.

C. Prohibitions.

1. Confidentiality of Tax Strategies. A [Law Firm] lawyer should not use any language in providing written advice that could be construed as restricting a client's ability to obtain independent review of [Law Firm]-developed tax strategies (including the tax structure or tax consequences)

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* The practice area standards in this Exhibit are not copyrighted and may be adopted in whole or in part by any firm without attribution.

of a proposed transaction. An example of acceptable language would be as follows:

The advice contained herein is intended solely for the use of [client/recipient] and may not be relied upon by third parties; however, [client/recipient] is free to share the tax advice contained herein with third parties without limitation.

2. "<u>Book" Effect of Tax Advice</u>. A [Law Firm] lawyer should refrain from making any statements concerning the financial reporting or "book" treatment of any transaction proposed or reviewed by [Law Firm].

D. "<u>Material Advisor" Referral Requirement</u>. If the subject of the written advice provided by a [Law Firm] lawyer is, or will be, described by any one of the categories below, the [Law Firm] lawyer must contact immediately the practice team leader of the Tax Shelter Compliance Team:

1. The tax savings described in the advice provided are greater than any other economic benefit received by the client as a result of the transaction or the tax advice recommends a transaction with significant tax benefits and the fees for such advice will exceed $25,000.

2. Any communication with the client provides that [Law Firm] tax strategies will be kept confidential (despite I, C, 1 above).

3. [Law Firm] or other advisors' fees will be contingent on the realization of tax benefits or there is a right to full or partial refund of fees paid if intended tax consequences of the transaction are not realized.

4. The transaction generates a book/tax difference in excess of $10 million.

5. The client realizes a sale or exchange loss equal to or in excess of $2 million (noncorporate entities/persons) or $10 million (corporations).

6. The client expects to claim a tax credit greater than $250,000 based on an asset held for less than 45 days.

II. <u>Standards For Covered Opinions</u>

In addition to the standards for all written tax advice, written advice described in one of the following three categories is considered a Covered Opinion subject to the Covered Opinion Procedures outlined below UNLESS IT IS:

Preliminary (the lawyer reasonably expects to provide subsequent written advice to the client that otherwise satisfies the standards of this policy);

Post-filing advice (written advice prepared for and provided to a taxpayer, solely for use by that taxpayer, after the taxpayer has filed a return reflecting the benefits of the transaction, unless 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 return (including 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);

Negative (written advice, determined on an issue-by-issue basis, 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);

Subject to a Prominent Disclosure Exception (described below).

> [The Circular 230 Written Advice Flowchart attached to this article as Exhibit A may be helpful in determining whether written advice should be considered a Covered Opinion.]

A. <u>Types of Covered Opinions</u>.

1. <u>Listed Transactions</u>. Written advice concerning a transaction that is expected to obtain the same or similar types of tax benefits and that is either factually similar or based on the same or similar tax strategy as a transaction that has been identified as abusive by the IRS (a "Listed Transaction").

2. <u>Principal Purpose Transactions</u>. Written advice concerning a transaction with the principal purpose of tax avoidance or evasion (a "Principal Purpose Transaction."

    a. To be considered "the principal purpose," the purpose of avoidance or evasion must exceed any other purpose.

    b. The principal purpose is not to avoid or evade federal tax if the partnership, entity, plan or arrangement has as its purpose the claiming of tax benefits in a manner consistent with the statute and Congressional purpose.

3. <u>Significant Purpose Transactions</u>. Written advice concerning a transaction with a significant purpose of tax avoidance or evasion which is also either:

    a. <u>A "Reliance Opinion</u>." Advice that concludes at a confidence level of 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, where a "significant federal tax issue" is defined 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 where the IRS 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 transactions or matters addressed in the opinion.

b. <u>A "Marketed Opinion</u>." Advice that the practitioner knows or has reason to know will be used or referred to by a person other than the practitioner (or a person who is a member or associated with the practitioner's firm) in promoting, marketing or recommending a partnership or other entity, investment plan or arrangement to one or more taxpayers.

c. <u>Subject to Conditions of Confidentiality</u>. Advice where a practitioner imposes on one or more recipients 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 such limitation is legally binding.

d. <u>Subject to Contractual Protection</u>. Advice where the taxpayer has the right to a full or partial refund of fees paid to the practitioner if all or part of the intended tax consequences from the matters addressed are not sustained, or if the fees paid to the practitioner are contingent on the taxpayer's realization of tax benefits from the transaction.

e. <u>Exceptions</u>. Unless such advice (i) concerns the qualification of a qualified plan, (ii) concerns state or local bonds, or (iii) will be included in documents to be filed with the SEC.

B. <u>Prominent Disclosure Exceptions</u>.

1. Written advice (other than on Listed or Principal Purpose transactions) will not be considered 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.

2. Written advice (other than on Listed or Principal Purpose transactions) will not be considered 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;

b. the advice was written to support the promotion or marketing of the transaction or matters addressed by the written advice; and

c. the taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor.

3. To be effective these disclosures must be readily apparent to a reader. At a minimum they must be set forth in the written advice:

a. as a separate section (not in a footnote); and

b. 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.

C. <u>Covered Opinion Procedures</u>.

Covered Opinions are subject to heightened factual and legal due diligence standards as well as additional disclosure requirements.

1. <u>Required Factual Due Diligence for Covered Opinions</u>.

a. The lawyer 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 relevant facts.

b. The lawyer must not base the opinion on any unreasonable factual assumptions. It is unreasonable to assume business purpose or that a transaction will be profitable apart from its tax effects. The opinion must identify in a separate section all factual assumptions relied upon by the lawyer.

c. The lawyer must not base the opinion on any unreasonable factual representations, statements, findings or agreements, including those concerning business purpose (e.g., a representation concerning business purpose must include a specific description). The opinion must identify in a separate section all factual representations, statements or findings of the taxpayer relied upon by the lawyer.

2. <u>Required Legal Due Diligence for Covered Opinions</u>.

a. The lawyer must relate the applicable law (including potentially applicable judicial doctrines) to the relevant facts.

b. The lawyer must not assume the favorable resolution of any significant federal tax issue or otherwise base an opinion on any unreasonable legal assumptions, representations, or conclusions.

c. The opinion must not contain internally inconsistent legal analyses or conclusions.

d. The opinion must consider all significant federal tax issues.

e. The opinion must provide the lawyer'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 lawyer is unable to reach a conclusion, the opinion must so state. The opinion must describe the reasons for the conclusions; including the facts and analysis supporting the conclusions (or describe the reasons why unable to reach a conclusion).

f. In evaluating the chances of success on the merits of the significant federal tax issues discussed, the lawyer 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.

g. The opinion must provide an 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 lawyer is unable to reach an overall conclusion, the opinion must so state and describe the reasons for such inability.

h. The lawyer must be knowledgeable in all of the aspects of federal tax law relevant to the opinion being rendered unless relying on the opinion of another qualified practitioner. If the lawyer relies on the opinion of another, the relying lawyer's opinion must identify the other opinion and set forth the conclusions reached in the other opinion.

3. <u>Required Disclosures</u>.

A Covered Opinion must contain all of the following disclosures that apply:

a. Any relationship (including a compensation arrangement, such as a referral fee or fee-sharing agreement, or referral agreement) between the lawyer or any other [Law Firm] lawyer and any person (other than the client for whom the opinion is being 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.

b. 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 result and that, with respect to such issues, the opinion was not written, and cannot be used by the taxpayer, for the purpose of avoiding penalties.

D. Special Rules for Limited Scope Opinions.

1. A lawyer may provide an opinion (other than concerning a Listed or Principal Purpose transaction or a Marketed Opinion) that considers less than all of the significant federal tax issues (a "Limited Scope" Opinion) if the lawyer and the client agree that the scope of the opinion and the client's potential reliance on the opinion for purposes of avoiding penalties are limited to the federal tax issues addressed in the opinion.

2. In the case of a Limited Scope Opinion, the lawyer may make reasonable assumptions regarding the favorable resolution of a federal tax issue. The opinion must identify in a separate section all issues for which the lawyer assumed a favorable resolution.

3. A Limited Scope Opinion must prominently disclose that:

a. the opinion is limited to the one or more federal tax issues addressed in the opinion;

b. 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 such issues; and

c. 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 client, for the purpose of avoiding penalties.

E. Special Rules for Marketed Opinions.

1. A Marketed Opinion must reach a conclusion that the client 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 a lawyer is unable to reach such a confidence level, he or she must not provide a Marketed Opinion (but may provide written advice subject to the Prominent Disclosure Exception outlined above).

2. A Marketed Opinion also must provide an overall conclusion that the federal tax treatment of the transaction or matter is the proper treatment at a confidence level of at least more likely than not.

3. A Marketed Opinion must prominently disclose that:

   a. the opinion was written to support the promotion or marketing of the transaction or matter addressed in the opinion; and

   b. the taxpayer should seek advice from an independent tax advisor.

III. <u>Covered Opinion and Written Advice Review</u>

A. All Covered Opinions should be considered material Legal Opinions subject to review and approval by an Opinion Reviewer as provided in the [Law Firm] Legal Opinion Policy.

B. Other written advice (including electronic communications) concerning one or more federal tax issues may be considered a material Legal Opinion subject to review and approval by an Opinion Reviewer as provided in the [Law Firm] Legal Opinion Policy, depending on the materiality of such advice, as outlined in the [Law Firm] Legal Opinion Policy. In determining materiality, additional relevant considerations may include whether such advice addresses any significant federal tax issues (as defined herein) and/or is likely to be used by the client for penalty protection.

C. Signing Partners and Opinion Reviewers should consider using the attached Opinion Review Checklist to document the review process.

D. In order to clarify the status of all written advice, including e-mail, concerning federal tax issues as either subject to, or exempt from, Circular 230 rules, [Law Firm] lawyers must use the following disclosures when appropriate. In general, unless written advice, including e-mail, bears one of these legends, or otherwise is clearly not a Covered Opinion, it should be considered a Covered Opinion and subject to review and approval under the [Law Firm] Legal Opinion Policy. The prefatory phrase "pursuant to Circular 230" or "pursuant to 31 CFR Part 10" may be added at the option of the [Law Firm] lawyer where appropriate in order to highlight to the recipient client the disclosure requirement.

1. Preliminary Advice.

Unless specifically provided otherwise, this advice is preliminary and based solely on facts provided to date.

2. Limited Scope (may not be used for Principal Purpose or Listed Transaction Advice or Marketed Opinions).

NOTE: THE LIMITED SCOPE DISCLOSURE DOES NOT EXEMPT THE ADVICE THAT IS THE SUBJECT OF THE COMMUNICATION FROM THE APPLICATION OF CIRCULAR 230 REQUIREMENTS.

Any conclusions presented are limited to the federal tax issues discussed herein. Additional issues may exist that could affect the federal tax treatment of the matter that is the subject of this advice and this advice does not consider or provide a conclusion with respect to such issues. With respect to issues outside the limited scope of this advice, this advice was not written and may not be used as penalty protection.

3. No Significant Federal Tax Issue.

In our opinion the IRS has no reasonable basis for a successful challenge of any of the conclusions concerning federal tax issues discussed herein.

4. No “More Likely Than Not” Conclusion.

You have not requested and this advice does not present a conclusion concerning a federal tax issue at a confidence level of, or exceeding, “more likely than not” (a fifty-percent likelihood).

Alternative:

We inform you under 31 CFR Part 10, the advice contained herein does not present a conclusion concerning a federal tax issue at a confidence level at least equal to “more likely than not.”

5. No Penalty Protection “Opt-Out” for Reliance Opinions (may not be used for Principal Purpose or Listed Transaction Advice).

This advice was not intended or written to be used, and cannot be used, for the purpose of avoiding any federal tax penalties that may be imposed.

Recommend Alternative:

IRS Circular 230 Disclosure:

To ensure compliance with requirements imposed by the IRS in Circular 230, we inform you that, unless we expressly state otherwise in this communication (including any attachments), any tax advice contained in this communication is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing, *or recommending to another party any transaction or other matter addressed herein.*

6. No Penalty Protection "Opt-Out" for Marketed Opinions (may not be used for Principal Purpose or Listed Transaction Advice).

This advice was not intended or written to be used, and cannot be used, by any taxpayer for the purpose of avoiding penalties. This advice was written in connection with the promotion or marketing by the Issuer and Placement Agent of [the investment]. Taxpayers should seek advice based on the their particular circumstances from an independent tax advisor.

Alternative for use specifically in context of private placement memoranda:

The tax discussion in this memorandum ("Tax Discussion") is general in nature and is not intended to be a tax opinion or tax advice. The Tax Discussion was written exclusively in connection with the promotion and marketing by the Issuer and Placement Agent of [the investment]. Specific tax consequences may vary widely depending on a particular investor's individual circumstances. The Tax Discussion may not be relied upon for the purpose of avoiding penalties that may be asserted by the Internal Revenue Service against an investor. Every potential investor in the [investment] is urged to consult, and must depend upon, their own tax advisors concerning the tax consequences of an investment in connection with their own tax situation and potential and proposed changes in applicable law, including the application of state and local, foreign and other tax considerations.

7. Negative Advice.

This advice does not resolve any federal tax issue in the taxpayer's favor. In our opinion there is no basis for filing a federal income tax return based upon the position described herein.

8. Post Return Filing Advice.

This advice has been prepared for and provided to the taxpayer solely for use by such taxpayer after a return reflecting the benefits of the transaction has been filed. This advice will not be relied upon for a position on a return (including an amended return claiming tax benefits not reported on a previously filed return) filed after the date of this advice.

[Law Firm]

Opinion Review Checklist

THIS IS AN OPTIONAL FORM TO DOCUMENT THE REVIEW PROCESS FOR A MATERIAL LEGAL OPINION (WHETHER OR NOT A COVERED OPINION) AS DESCRIBED IN THE TAX PRACTICE AREA STANDARD SUPPLEMENT TO THE [LAW FIRM] LEGAL OPINION POLICY.

To be completed by Signing Partner:

Date: ____________________
Signing Partner/Office: ____
Author of Opinion/Office if different from Signing Partner: ____________________

Client Name: ____
Client Matter Number: ______________________________
Client Contact Name: ______________________________

Brief description of federal tax issues discussed in opinion:

____
____
____
____
____

Confidence Level Expressed:

____

Do you believe that this is a Covered Opinion? If not, why not? Specifically note the disclosure warning used, if applicable.

____
____

If not a Covered Opinion, do you believe that the client nevertheless intends to use the opinion for penalty protection?

____
____
____
____

To be completed by Opinion Reviewer:

Do you believe that this is a Covered Opinion? If not, why?

____
____
____

If you have determined that the advice being reviewed is a Covered Opinion, confirm that all procedures provided for in the Tax Practice Area Supplement to the [Law Firm] Legal Opinion Policy have been complied with; **specifically, consider the following in your review and initial; note any issues for follow-up and how cleared**:

_____	Confirm that all relevant facts been identified and considered.
_____	Confirm that all relevant facts are separately presented within the opinion.
_____	Confirm that the opinion is not based on any unreasonable factual assumptions, in particular business purpose or profitability apart from tax effects.
_____	Confirm that all factual assumptions are identified in a separate section within the opinion.
_____	Confirm that the opinion is not based on any unreasonable factual representations, statements, findings or agreements. In particular, representations concerning business purpose must be specific.
_____	Confirm that all factual representations are identified in a separate section within the opinion.
_____	Confirm that all applicable law (including potentially applicable judicial doctrines) has been related to the relevant facts.
_____	Confirm that the opinion does not assume the favorable resolution of any significant federal tax issue or is otherwise based on any unreasonable legal assumptions, representations, or conclusions.
_____	Confirm that the opinion does not contain internally inconsistent legal analyses or conclusions.
_____	Confirm that the opinion considers all significant federal tax issues.

_____	Confirm that the opinion provides a 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 author has been unable to reach a conclusion, confirm that the opinion states this. The opinion must describe the reasons for the conclusions; including the facts and analysis supporting the conclusions (or describe the reasons why unable to reach a conclusion).
_____	Confirm that, in evaluating the chances of success on the merits of the significant federal tax issues discussed, the opinion does 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.
_____	Confirm that the opinion provides an 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 opinion does not reach an overall conclusion, the opinion must so state and describe the reasons for such inability.
_____	Confirm that the Signing Partner or other author is sufficiently knowledgeable about all of the aspects of federal tax law relevant to the opinion being rendered (unless relying on the opinion of another qualified practitioner). (If the Signing Partner or author has relied on the opinion of another, the relying lawyer's opinion must identify the other opinion and set forth the conclusions reached in the other opinion.)
_____	Confirm that all required disclosures as described in the Tax Practice Area Standards supplement to the Legal Opinion Policy have been properly reflected in the opinion.

If you have determined that the advice being reviewed is not a Covered Opinion, specifically consider the following in your review and initial; note any issues for follow-up and how cleared:

_____	Confirm that the advice is not based on unreasonable factual or legal assumptions (including as to future events). Specifically address business purpose or profitability apart from tax effects.
_____	Confirm that the advice does not unreasonably rely upon representations, statements, findings or agreements, including those concerning business purpose. (To be reasonably relied upon, a representation concerning business purpose must include a specific description.)
_____	Confirm that the advice considers all relevant facts that the lawyer knows or should know.
_____	Confirm that the advice does 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.

EXHIBIT C*

FORM OF TAX OPINION

[LETTERHEAD]

[DATE]

DRAFT OF COVERED OPINION TEMPLATE

PRIVILEGED AND CONFIDENTIAL
ATTORNEY-CLIENT COMMUNICATION/ATTORNEY WORK PRODUCT

[NAME and ADDRESS OF CLIENT]

RE: *[MATTER OR TRANSACTION NAME]*

Ladies and Gentlemen:

You [alternative: add "on behalf of the parties listed on Exhibit A attached" if applicable], have requested our opinion[s] concerning the United States federal income tax consequences of [transaction or matter].

[Brief description of transaction or matter.]

Our opinion*[s]* is*/[are]* based upon our interpretation of relevant provisions of the Internal Revenue Code of 1986, as amended through the date of this opinion (the "Code" or "IRC"), *[other statutory authority; treaties],* Treasury Regulations, reported judicial opinions, published administrative rulings, procedures, and interpretations, all of which are subject to change prospectively or retroactively, which changes might alter our opinion.

Circular 230

Treasury and the IRS have promulgated rules at 31 CFR Part 10, the so-called Circular 230 rules, that govern practice before the IRS, including providing certain forms of written tax advice termed Covered Opinions. The Circular 230 rules require that Covered Opinions (a) adhere to certain standards of factual and legal due diligence, (b) be presented in a certain format, and (c) contain certain information. We have concluded that this advice constitutes a Covered Opinion within the meaning of Circular 230 and this advice is drafted in a manner designed to comply with Circular 230.

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* Special thanks to Robert G. Woodward of King & Spalding LLP. *See* Robert G. Woodward, "Tax Opinions," 21st Annual Texas Federal Tax Institute, June 9, 2005, Tab 9. This exhibit is based upon portions of Mr. Woodward's article.

TYPES OF COVERED OPINIONS; CHOOSE ONE:
ALL ASSUME NOT LISTED OR PRINCIPAL PURPOSE

RELIANCE OPINION; NOT MARKETED; LIMITED SCOPE

We have concluded that this advice should be considered a Covered Opinion because it should be considered a Reliance Opinion. We have determined that no federal tax issue discussed in this advice relates to a Listed Transaction (one that has been identified by, or is substantially similar to one that has been identified by, the IRS and Treasury as abusive). We have determined that the tax benefits discussed in this letter likely are being claimed in accordance with provisions of the Code and the underlying Congressional purpose and, therefore believe that the principal purpose of the transactions as outlined are not tax avoidance. We have also determined, however, that a significant purpose of the transactions may be tax avoidance, and, as set forth below, we have reached a more-likely-than-not conclusion with respect to one or more significant federal tax issues that we discuss below. We have therefore determined that this advice constitutes a Reliance Opinion.

We have concluded further that this advice is not a Marketed Opinion under Circular 230 and therefore may be issued as a Limited Scope Opinion. A Marketed Opinion is written advice that 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 the partnership or other entity, investment plan, or arrangement to one or more taxpayers. *[Explain; e.g., because this advice is directed to the partners/investors and will not be used to promote or recommend participation in the transaction/matter, it should not be considered a Marketed Opinion.]*

As described at Section IV below, our opinions presented herein are limited to those federal tax issues that we have previously agreed upon. Circular 230 allows for such Limited Scope Opinions, which, for example, may make reasonable assumptions about the favorable resolution of issues, provided that they are not, among other things, Marketed Opinions.

RELIANCE OPINION; MARKETED OPINION

We have concluded that this advice should be considered a Covered Opinion because it should be considered a Reliance Opinion. We have determined that no federal tax issue discussed in this advice relates to a Listed Transaction (one that has been identified by, or is substantially similar to one that has been identified by, the IRS and Treasury as abusive). We have determined that the tax benefits discussed in this letter likely are being claimed in accordance with provisions of the Code and the underlying Congressional purpose and, therefore believe that the principal purpose of the transactions as outlined are not tax avoidance. We have also determined, however, that a significant purpose of the transactions may be tax avoidance, and, as set forth below, we have reached a more-likely-than-not conclusion with respect to one or more significant federal tax issues that we discuss below. We have therefore determined that this advice constitutes a Reliance Opinion.

Because we understand that you may use this advice to promote, market, or recommend tax matters addressed herein, we also have concluded that this advice should be considered a Marketed Opinion.

RELIANCE OPINION; MARKETED OPINION OPT OUT; LIMITED SCOPE

We have concluded that this advice should be considered a Covered Opinion because it should be considered a Reliance Opinion. We have determined that no federal tax issue discussed in this advice relates to a Listed Transaction (one that has been identified by, or is substantially similar to one that has been identified by, the IRS and Treasury as abusive). We have determined that the tax benefits discussed in this letter likely are being claimed in accordance with provisions of the Code and the underlying Congressional purpose and, therefore believe that the principal purpose of the transactions as outlined are not tax avoidance. We have also determined, however, that a significant purpose of the transactions may be tax avoidance, and, as set forth below, we have reached a more-likely-than-not conclusion with respect to one or more significant federal tax issues that we discuss below. We have therefore determined that this advice constitutes a Reliance Opinion.

Because we understand that you may use this advice to promote, market, or recommend tax matters addressed herein, we also have concluded that this advice should be considered a Marketed Opinion.

Marketed Opinion Disclaimer

In order to avoid this characterization and so that we may issue a Limited Scope Opinion, as we have previously agreed, we state that this advice:

(1) 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;

(2) was written to support the promotion or marketing of the transaction or matters addressed by the written advice; and

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

As described at Section IV below, our opinions presented herein are limited to those federal tax issues that we have previously agreed upon. Circular 230 allows for such Limited Scope Opinions, which, for example, may make reasonable assumptions about the favorable resolution of issues, provided that they are not, among other things, Marketed Opinions.

I. Information Relied Upon

In rendering our opinion, we have relied with your consent on the facts, representations, assumptions, and documents set forth below. Please review the facts, representations, assumptions and document listing carefully. Any inaccuracy in these facts, representations, assumptions or documents, or the existence of other facts made relevant by our legal analysis, could alter our opinions.

A. Facts

[INSERT DESCRIPTION OF RELEVANT FACTS—INCLUDING AS TO FUTURE EVENTS.]

B. Representations

In rendering this opinion, we have relied upon the representations set forth in the letter to us from *[client]* dated *[date]* which is attached as Exhibit C.

[REPRESENTATIONS CONCERNING BUSINESS PURPOSE AND PRE-TAX PROFIT MUST BE SPECIFIC AND REVIEWED FOR REASONABLENESS.]

C. Assumptions

In rendering this opinion, we have relied upon the factual assumptions:

[INSERT LIST OF FACTUAL ASSUMPTIONS—INCLUDING FAVORABLE RESOLUTIONS OF ISSUES; NO UNREASONABLE ASSUMPTIONS]

D. Documents

In rendering this opinion, we have examined and relied upon the following documents:

[INSERT LIST OF DOCUMENTS]

E. Reliance on the Opinion of Another

[IF APPLICABLE.]

II. Discussion

[MAKE SURE THERE IS RATIONALE FOR EACH OF THE CONCLUSIONS PRESENTED; APPLY LAW TO FACTS; NO ASSUMPTIONS AS TO FAVORABLE RESOLUTION UNLESS LIMITED SCOPE; FOLLOW GUIDELINES IN POLICY.]

III. Summary of Opinions

Based on the facts, representations, assumptions and documents reviewed as set forth above, and for the reasons set forth above, it is therefore our opinion:

[MAKE SURE EACH CONCLUSION IS AT CONSISTENT LEVEL OF CONFIDENCE AND IN ORDER PRESENTED IN DISCUSSION.]

[MAY HAVE PREFERENCE TO HAVE THIS SECTION BEFORE DISCUSSION….]

IV. **Limited Scope Opinion**

Our opinions are limited to the United States federal income tax consequences of the matters described herein. Additional issues may exist that could affect the federal tax treatment of the transactions or matters addressed above and our opinions do not consider or provide a conclusion with respect to any such additional issues. Our opinions are not written, and cannot be used, to avoid tax penalties with respect to any federal tax issues not addressed above.

V. **Reliance Limitations**

This opinion is delivered solely to *[client or as above, with reference to Exhibit A]* with respect to the matters set forth herein.

We understand that you will be relying on this advice to avoid certain potential penalties that might otherwise be imposed by the IRS with respect to on or matters discussed herein. We also understand that no tax ruling will be sought from the IRS with respect to any of the tax consequences discussed herein, and there is no assurance that such a ruling, if sought, would be issued by the IRS. Our conclusions represent our opinion as to the outcome of litigation in which the legal positions of both the IRS and the taxpayer are fully developed. Unlike an income tax ruling, an opinion of counsel has no binding effect or official status of any kind, and no assurance can be given that the conclusions reached in this opinion would be sustained by a court if contested by the IRS. We cannot assure you, nor guarantee, that this advice will prevent the imposition of penalties.

This opinion may not be relied upon by any other party or for any other purpose whatsoever without our prior written consent. You are, however, free to share the tax advice contained herein with third parties without limitation.

Very truly yours,

[Law Firm]