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Circular 230 Redux: Questions of Validity and Compliance Strategies

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In this article, the authors revisit their prior article on Circular 230 (see *Tax Notes,* Apr. 4, 2005, p. 61), focusing in particular on the amendments Treasury adopted on May 18. They consider the meaning of an important, new safe harbor under which transactions that are consistent with the code and its purpose are subject to less rigorous standards. They go on to discuss strategies for making certain that the advice practitioners provide after June 20 will be in compliance with the circular. They also provide a decision tree that will enable practitioners to classify their written advice and thereby determine whether and how the circular applies. Finally, they suggest that because the circular adopts a system of rules that is not parallel to the penalty provisions in the code, it may be invalid as applied in estate planning and other contexts on First Amendment and statutory authority grounds.

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This article may not be relied on for penalty protection.

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Introduction

In a recent article published in *Tax Notes,*[1] we discussed the application of Circular 230 to estate planning. We made seven specific recommendations, hoping to make it more likely that the circular's underlying objectives would be achieved without imposing unnecessary burdens on practitioners or their clients. Several professional organizations also made suggestions to simplify the application of the circular and reduce its scope.[2] The Treasury Department on May 18 amended the final regulations. Unfortunately, most recommendations made were not adopted.[3] As a result, and as this article will discuss, the circular continues to represent a significant imposition on tax practitioners and their clients and almost certainly will increase the cost of the delivery of legal and other professional written advice on almost any federal tax issue.

In this article, we explore Treasury's revisions and then provide guidelines that we hope will be useful to

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[1]J. Blattmachr, M. Gans, and T. Bentley, ''The Application of Circular 230 in Estate Planning,'' *Tax Notes,* Apr. 4, 2005, p. 61.

[2]*See, for example,* ''American College of Trust and Estate Counsel Comments on Circular 230 Regulations,'' *Doc 2005-7566, 2005 TNT 71-30* (Apr. 14, 2005); ''Association of the Bar of the City of New York Comments on Circular 230 Regulations,'' *Doc 2005-11435, 2005 TNT 101-26* (May 13, 2005); ''New York State Bar Association, Tax Section, Report on Circular 230 Regulations,'' *Doc 2005-4484, 2005 TNT 43-56* (Mar. 7, 2005); ''Comments on Final Regulations Issued Under Circular 230 of the American Bar Association Section of Real Property, Probate and Trust Law,'' *Doc 2005-10167, 2005 TNT 90-23* (May 11, 2005).

[3]As will be discussed in detail below, probably the most important amendment made by the May 18 changes was a ''clarification'' of principal purpose by adopting a test set forth in Treas. reg. section 1.6662-4(g)(2)(ii). Although we mentioned this test in our April 4 article as a way to define principal purpose, we do not claim that the Treasury Department made the principal purpose change on account of our article.

practitioners in implementing the circular's requirements. Before doing so, however, we examine two arguments that we believe lead to the conclusion that the circular, at least in certain contexts, is invalid.

I. Constitutional and Statutory Questions

In our prior article, we suggested that, in the transfer-tax context, there was a lack of congruence between the circular and the penalty rules contained in the code. We went on to argue that, as a result, the circular violates the First Amendment. In this section, after rehearsing the lack-of-congruence analysis and the resulting First Amendment implications, we turn to an additional argument: that the Treasury Department, in creating that incongruence, exceeded the authority it has been given by Congress. We then raise the question whether professional organizations will undertake litigation to invalidate the circular insofar as it fails to maintain congruence with the code.

Under the circular, written advice concerning a principal purpose transaction constitutes a Covered Opinion. As such, the opinion must reach a more likely than not conclusion regarding any Significant Federal Tax Issue or it must state that it cannot be relied on by the taxpayer for penalty protection purposes regarding that issue.[4] Thus, for a principal purpose transaction, a practitioner may not give an opinion that there is a reasonable basis for the desired treatment of a Significant Federal Tax Issue without stating that the taxpayer may not rely on it in defending against the imposition of a penalty. Under the code, in contrast, a taxpayer can avoid penalties regarding certain tax issues, such as a transfer-tax issue, if the position is taken in good faith and based on reasonable cause.[5] Therefore, for transfer tax issues for example,[6] while a taxpayer may rely on professional advice that there is a reasonable basis for the claimed position to avoid a penalty,[7] the circular prevents the practitioner from issuing such an opinion unless it contains an advisory that reliance is not permitted.

This lack of congruence that the circular produces cannot be squared with the First Amendment. While the government can certainly require attorneys or other practitioners to make certain disclosures to their clients, it can do so only when there is an appropriate justification. In our earlier article, we based our First Amendment analysis, in part, on the Supreme Court decision in *Zauderer v. Office of Disciplinary Counsel of Supreme Court*.[8] In *Zauderer*, the state bar required lawyers who advertised contingency-fee services to include in the advertisement a disclosure to the effect that the client would remain responsible for certain costs if the lawsuit were to fail. In upholding the disclosure requirement over a First Amendment challenge, the Court explained that mandatory disclosure rules can be justified by the government's interest in preventing consumer deception.[9]

If, for example, the code permitted taxpayers to escape a penalty only if they first secured a more likely than not opinion, the circular could certainly require a practitioner to disclose that reliance on a reasonable basis opinion is not a valid defense against the imposition of a penalty. The justification for requiring the practitioner to make such a disclosure would be the government's concern about preventing taxpayers from being misled. Thus, when the circular and the code are congruent in that both require a more likely than not opinion, no First Amendment challenge could be asserted.[10] For some income-tax shelters the circular permissibly can require, as it does, a more likely than not opinion given that the code similarly requires the taxpayer subjectively to believe that to be the case to defeat the penalty.[11] However, in the transfer tax context for example, where a reasonable basis opinion can suffice for penalty-protection purposes, the government cannot defend the disclaimer that the circular mandates by pointing to a taxpayer-deception concern. In short, as suggested in our prior article, free discourse between practitioners and clients is unjustifiably undermined if the code permits taxpayers to assert a reasonable basis opinion as a defense while the circular, at the same

[4]*See* Circular 230, section 10.35(e)(4).

[5]*See* section 6664(c)(1) of the Internal Revenue Code of 1986 as amended (the code). Section references are to the code except where otherwise noted.

[6]For a discussion of the lack-of-congruence potential outside of the transfer tax context, see nn.60-71 and accompanying text in our earlier article.

[7]Treas. reg. section 1.6662-3(b) indicates that, if there is a reasonable basis for the position, the taxpayer is not negligent. It then references Treas. reg. section 1.6664-4, which provides that the negligence penalty can be defeated if the taxpayer had reasonable cause and was in good faith. Thus, if the taxpayer receives a reasonable basis opinion, that should provide a defense against the negligence penalty. Note, however, that Treas. reg. section 1.6664-4(c) provides that a professional opinion will not defeat a penalty if the taxpayer did not reasonably rely on it in good faith. *See Santa Monica Pictures LLC v. Commissioner,* T.C. Memo. 2005-104, *Doc 2005-10308, 2005 TNT 91-12* (imposing the substantial-understatement-of-income-tax penalty in a tax shelter context after rejecting the taxpayer's substantial authority argument because none of the opinions reached a more likely than not conclusion and then rejecting the taxpayer's section 6664 argument on the different ground that the taxpayer could not have reasonably relied in good faith on the legal opinions that had been secured). *See also U.S. v. Boyle,* 469 U.S. 241, 251 (1985) (indicating that, when the code is unclear, a taxpayer may avoid a penalty by showing reasonable cause through reliance on professional opinion).

(Footnote continued in next column.)

[8]471 U.S. 626 (1985).

[9]*See* 476 U.S. at 651-53.

[10]When government seeks to regulate speech when it could effectively address its concerns without doing so — for example, by amending the penalty provisions in the code — the constraint of the First Amendment becomes particularly critical. *See Thompson v. Western States Medical Ctr.,* 535 U.S. 357, 373 (2002). (''If the First Amendment means anything, it means that regulating speech must be a last — not first — resort. Yet here it seems to have been the first strategy the Government thought to try.'')

[11]*See* section 6664(d)(2)(C) (requiring the taxpayer, in the case of Listed and Reportable Transactions, reasonably to believe the position was more likely than not the correct one to defeat the penalty).

time, precludes practitioners from giving such advice in writing without including a disclaimer that renders the advice worthless.[12]

In any challenge to the validity of the circular, however, it is unlikely that the courts would find it necessary to resolve the First Amendment question. The courts seek to avoid a constitutional question whenever a case can be resolved on statutory grounds instead.[13] Indeed, when an agency adopts a regulation that raises constitutional questions, the courts will refuse to find that the agency had the authority to promulgate it absent a clear indication in the statute.[14] Thus, if the circular is challenged on the ground that it fails to maintain congruence with the code, the specter of constitutional invalidity would likely lead the court to conclude that the Treasury did not have the statutory authority to promulgate it. As will be discussed next, Congress did not indicate any intent — let alone a clear intent — to authorize the Treasury to use the circular as a vehicle to override the code.

In October 2004 Congress enacted the American Jobs Creation Act of 2004 (P.L. 108-357). In that legislation, Congress amended section 6664, somewhat altering the elements of the defense that taxpayers must establish to avoid some penalties (that is, the penalties imposed under sections 6662, 6662A, and 6663). The section, as amended, continues in essence a two-tier framework: For some tax shelters (now defined as Listed and Reportable Transactions, which are the subject of a penalty under new section 6662A), the taxpayer must establish a reasonable belief that the position was more likely than not the correct one. In all other cases (including, as a practical matter, all transfer tax cases),[15] a more likely than not standard is not imposed. Instead, the taxpayer merely must establish reasonable cause and good faith — which, as suggested, can be accomplished by reliance on a professional's reasonable basis opinion. In creating that framework, Congress could not have expressed itself more clearly. Indeed, as indicated, it continued the pattern under the preamendment version of the section, which similarly required a more likely than not standard for tax shelters and a less rigorous standard in other cases.

The question thus becomes whether Treasury had the authority to require in the circular that all written advice concerning a principal purpose transaction designed to provide penalty protection be accompanied by a more likely than not conclusion when Congress provided so unambiguously just a few months earlier that this standard would apply only in the limited category of certain tax shelters. While under the Supreme Court's *Chevron* doctrine,[16] the authority of an agency to issue regulations under a statute it administers is quite expansive,[17] it is not without limits.

In *Food and Drug Admin. v. Brown & Williamson Tobacco Corp.*,[18] the Food and Drug Administration sought to regulate tobacco products. Under the FDA's governing statute, any exercise of jurisdiction would have necessarily resulted in a complete ban given the health risks involved and the statutory requirement that the FDA remove from the marketplace unsafe products that fail to offer a therapeutic benefit. Despite the broad deference that agencies' regulations enjoy under *Chevron*, the Court held that the FDA lacked statutory authority to ban tobacco and therefore that the regulation was invalid. The Court first examined various pieces of legislation in which Congress had imposed regulations on tobacco (for example, regulations on labeling and advertising). From that, the Court inferred that Congress intended that tobacco would remain a legitimate product. Thus, the Court held, Congress made sufficiently clear in its tobacco-regulating legislation its intent to permit the product to remain viable, thereby leaving the FDA without the regulatory authority that would have inexorably led to a ban.[19] In the jargon of *Chevron*, when Congress unambiguously resolves an issue, the agency may not adopt a contrary approach.

Similarly, here, by repeatedly adopting a two-tier framework for penalties under which the rigorous more likely than not standard applies only in a limited category of cases, Congress made clear that in other cases taxpayers should be able to secure and rely on reasonable basis opinions supplied by professionals.[20] Yet the circular ignores that framework and precludes practitioners

[12]*See Conant v. Walters*, 309 F.3d 629, 636-37 (9th Cir. 2002) (discussing the First Amendment rights of doctor and patient to communicate freely with each other). *See also Legal Services Corp. v. Velazquez*, 531 U.S. 533 (2001). For a further discussion of *Conant* and the First Amendment issue, see our earlier article.

[13]*See, e.g., I.N.S. v. St. Cyr*, 533 U.S. 289 (2001) (resolving statutory ambiguity to avoid confronting the constitutional question).

[14]*See Solid Waste Agency of Northern Cook County v. U.S. Army Corp of Engineers*, 531 U.S. 159, 172 (2001) ("Where an administrative interpretation of a statute invokes the outer limits of Congress' power, we expect a clear indication that Congress intended that result.").

[15]As indicated in our prior article, estate planning transactions are currently not subject to the penalty under section 6662A (that is, they do not constitute a Reportable Transaction, and no estate planning transaction currently is considered a Listed Transaction).

[16]*Chevron U.S.A. Inc. v. Natural Resources Defense Council Inc.*, 467 U.S. 837 (1984).

[17]*See* Mitchell M. Gans, "Deference and the End of Tax Practice," 36 *Real Prop. Prob. & Tr. J.* 731 (2002).

[18]529 U.S. 120 (2000).

[19]For a further discussion of *Brown & Williamson*, see Gans, *supra* note 17.

[20]In *Brown & Williamson*, the Court emphasized that the FDA had conceded, before adopting the regulation at issue, that it did not have jurisdiction to regulate tobacco. The Court alluded to this concession to support its conclusion that Congress had intended to ratify the FDA's understanding and to continue the regulation of tobacco without giving the FDA authority to regulate (ban) it. *See* 529 U.S. at 157. Here, as well, the Treasury made clear to Congress its view of the law, adopting the two-tier framework in Treas. reg. section 1.6664-4. And, as in *Brown & Williamson*, Congress, in turn, in amending section 6664, sought to continue that framework.

from supplying this kind of written opinion on a Significant Federal Tax Issue in all principal purpose transactions. It would seem that the Treasury sought to do indirectly (through the circular) what it was unable to achieve directly (in Congress). However broad an agency's authority under *Chevron,* the Supreme Court's decision in *Brown & Williamson* makes clear that it does not extend that far.[21]

The circular stands on even weaker ground than the regulation in *Brown & Williamson.* Unlike the FDA's regulation, the circular raises constitutional questions. And, as suggested, in such a case, the courts are less willing to defer under *Chevron,* requiring the agency to demonstrate instead that Congress had a clear intent to confer the authority the agency claims. Given the penalty provisions Congress has embedded in the code, the Treasury's burden will be considerable should the circular be challenged.

The argument that the circular is invalid could be asserted in one of two ways. It could be raised as a defense by a practitioner charged with violating the circular. Or a professional organization could probably bring suit before any disciplinary violation is alleged, claiming that it is invalid on its face (as opposed to an argument that it is invalid as applied to a particular practitioner). While facial challenges can be problematic and perhaps difficult to sustain, the courts are particularly receptive when First Amendment issues are implicated.[22] In terms of bringing a facial challenge, it would seem that a professional organization representing practitioners who work, for example, in the estate planning area would make an excellent candidate to be a plaintiff given that the lack of congruence is particularly acute in this area.[23] Challenges designed to obtain judicial intervention before engaging in conduct that might be sanctionable are not unusual.[24] Given the risks involved in ignoring the circular and the costs that compliance will necessarily entail, it would seem likely that a professional organization will initiate such a challenge.

II. Brief Background About June 21 Changes

Broadly, the changes made in December and that become effective after June 20 relate to two areas. One area is contained in section 10.35 of the circular. It prescribes rules that must be followed in providing a written statement about a federal tax matter that constitutes a ''Covered Opinion.'' Any written statement about any federal tax issue should be tested to determine if it is a Covered Opinion and, if so, what kind it constitutes. The specific requirements prescribed for a Covered Opinion vary depending on the type of Covered Opinion involved. A written statement may constitute more than one type of Covered Opinion. Even if the written statement about a federal tax issue is not a Covered Opinion, so it need not comply with the requirements of section 10.35, the practitioner must comply with section 10.37 dealing with general requirements for written advice on federal tax issues that is not a Covered Opinion and section 10.34 dealing with return related advice (whether oral or in writing). A practitioner who recklessly, willfully, or by reason of gross incompetency fails to comply with Circular 230 may be suspended or disbarred from practice before the IRS, be publicly censured, or be fined. Practice before the IRS includes preparing and filing tax returns and representing a taxpayer in an examination of a return. Failure to comply might also serve as evidence in determining professional liability.

It is important to note that although section 10.35 of the circular refers to ''written *advice*,'' it covers much more than what probably most practitioners would regard as a ''formal'' opinion or advice regarding a federal tax issue. It seems to cover any written *statement* about a federal tax issue even if no conclusion is stated.[25]

A. Brief Overview of Section 10.35

A chart made part of our original article on the circular sets forth an overview of the changes made by section 10.35. A revised chart reflecting the changes just made is attached at the end of this article.

A Covered Opinion may be any written statement by a practitioner concerning one or more federal tax issues arising in three areas: (1) statements involving Listed Transactions; (2) statements relating to an arrangement the principal purpose of which is avoidance or evasion of federal tax; or (3) statements relating to arrangements a significant purpose of which is avoidance or evasion of federal tax. Certain written statements are excluded from constituting Covered Opinions. The May 18 changes add three new areas of exclusions. Also, the May 18 changes seek to provide guidance to determine if the principal purpose of the arrangement is the evasion or avoidance of federal tax. The May 18 amendments also ''relax'' what constitutes a ''prominently displayed'' disclaimer (which,

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[21]In the statute authorizing the Treasury to regulate practitioners, 31 USC 330, the Treasury is authorized to create standards applicable to the rendering of written advice concerning an entity or transaction having the potential for tax avoidance or tax evasion. *See* 31 USC 330(d). While that statute certainly gives the Treasury the authority to issue the circular, it does not give it the authority to render meaningless the two-tier framework that Congress recently decided to retain.

[22]*See, for example, U.S. v. Salerno,* 481 U.S. 739 (1987) (discussing the rigorous standards employed by the courts when a facial challenge is brought if the First Amendment is not implicated). It should be noted that the Supreme Court just recently decided to review the continuing viability of *Salerno. See Ayotte v. Planned Parenthood of Northern New England,* __ S. Ct. __, 2005 wl 483164 (May 23, 2005) (*granting cert.*). For a further discussion on the ripeness question, see *City of Auburn v. Qwest Corp.,* 260 F.3d 1160 (9th Cir. 2001).

[23]Such practitioners often give advice on principal purpose transactions, and, as suggested, the penalty applicable in the transfer tax context (the negligence penalty) can be defeated with a reasonable basis opinion.

[24]*See, e.g., New York State Bar Ass'n v. F.T.C.,* 276 F. Supp.2d 110 (D.D.C. 2003) (challenging the application of the privacy law by the FTC to lawyers).

[25]Note, for example, that a Covered Opinion is required, as a general rule, to reach a conclusion and not merely provide a discussion or recite the law. *See* Circular 230, section 10.35 (c)(3)(ii).

depending on the circumstances, may be required to avoid Covered Opinion status or to comply with the Covered Opinion rules).

B. The Circular as Revised

1. Excluded writings. Section 10.35 as promulgated in December excluded certain written statements from constituting Covered Opinions. The first exclusion is written advice provided during the course of an engagement if the practitioner is reasonably expected to provide subsequent written advice to the client that will satisfy the requirements for Covered Opinions.[26] The second broad exception, which does not apply to Listed Transactions or any arrangement the principal purpose of which is tax avoidance (or evasion), applies to advice that concerns qualification of a qualified plan, a state or local bond opinion,[27] or is included in documents required to be filed with the Securities and Exchange Commission.[28]

The May 18 changes add three new areas of exclusion: certain written advice after a tax return is filed;[29] certain advice provided to an employer by in-house counsel;[30] and certain written statements in which the practitioner concludes that a transaction is not appropriate or that one or more federal tax issues will not be resolved in the taxpayer's favor.[31] Although each of those new exclusions, as discussed below, is somewhat limited, none fails to apply by reason of relating to a Listed Transaction or a principal purpose transaction.

a. Written advice after the return is filed. A written statement is excluded when it is provided after the taxpayer has filed a tax return with the IRS if it is solely for use by the taxpayer and if the practitioner neither knows nor has reason to know that the advice will be used by the taxpayer to take a position on a tax 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 practitioner.

The requirement of this exclusion that the advice be *solely* for the use by the taxpayer seems somewhat reminiscent of the definition of a Marketed Opinion, which is a written statement the practitioner knows or has reason to know the opinion will be used or referred to by a person other than the practitioner in promoting, marketing, or recommending an arrangement to one or more taxpayers. In any case, there seem to be at least two ways to construe the term ''solely'' in this context. One is that if the written statement ultimately is used by someone other than the client to whom it was rendered (for example, the client shares it with another who uses it), the exclusion does not apply (as it has failed the ''solely'' requirement) even if the practitioner did not know or have reason to know that the client would allow another to use it. That would be a harsh result as the practitioner would then be found to have failed to comply with the circular even though he or she had no reason to know it would be so used — even harsher than the Marketed Opinion rule. Perhaps the practitioner in such a case would easily defend not complying because he did not know or have reason to know another would use it.

Another construction of ''solely'' is that meeting this requirement turns on the practitioner's view or position that it is solely for the taxpayer's use. In other words, the ''solely'' requirement is based on the intention of the practitioner, not the intention of the taxpayer or the practitioner's expectation as to how the taxpayer will use the advice. This second construction of the term could provide a large exception to the Marketed Opinion requirements: The promoter files a return relating to a certain transaction and then seeks advice from the practitioner regarding the transaction. As long as the practitioner intends the advice to be solely for the taxpayer's use the written statement is not a Marketed Opinion, even if the practitioner has reason to know the taxpayer (or someone else to whom the taxpayer delivers a copy of the advice) will use it for marketing purposes.

A third possible meaning is that the written advice will be regarded as solely for the taxpayer's use unless the practitioner knows or has reason to know it will be used by another. Although that might be the most sensible meaning, the language in the exclusion does not support it — another part of the rule, as recited above, uses the ''knows or has reason to know'' requirement but the ''solely'' requirement does not. So it is somewhat troubling to read it into the latter.

It seems important for Treasury to clarify the meaning of ''solely'' as used in this exclusion.

As written, it seems that if the taxpayer claims tax benefits by filing an amended return, for example, on the *same* date[32] the written advice is delivered, the exclusion applies (provided the solely requirement is met). It seems doubtful that Treasury intended to provide such an exclusion from Covered Opinion status merely because the taxpayer took a position on the same day the written statement was delivered. Again, it may not seem prudent to rely on this exclusion if the practitioner knows or has reason to know the taxpayer will take a position on a tax return based on the advice when the tax return is filed on the same day that the written statement is delivered. Again, the Treasury should clarify this matter.

b. Written advice provided by taxpayer's in-house counsel. Written advice provided to an employer by a practitioner in the practitioner's capacity as an employee solely for purposes of determining the tax liability of the employer is excluded. The exclusion is, however, a limited one. It does not, for example, exclude a written statement made by an employee that is to be used to educate other employees of the employer (for example, an in-house trust counsel of a bank who prepares a memorandum about Circular 230) or for distribution to

[26]Circular 230, section 10.35(b)(2)(ii)(A).

[27]The IRS has issued interim guidance for Circular 230 compliance for opinions related to state and local bonds. *See* Notice 2005-47; 2005-26 IRB 1, *Doc 2005-12432, 2005 TNT 109-9*.

[28]Circular 230, section 10.35(b)(2)(ii)(B).

[29]Circular 230, section 10.35(b)(2)(ii)(C).

[30]Circular 230, section 10.35(b)(2)(ii)(D).

[31]Circular 230, section 10.35(b)(2)(ii)(E).

[32]The exclusion requires that the taxpayer not use the written advice to file another return (including an amended return) *after* the date of the written advice relating to the previously filed return.

others (for example, an in-house lawyer who prepares a brochure for her employer that is a charitable organization about how donors may contribute to the organization and that mentions tax consequences of the contribution).[33]

c. Negative written advice. The exclusion for written advice provided to a taxpayer that concludes that a transaction is not appropriate or that one or more federal tax issues will not be resolved in the taxpayer's favor applies only if the statement does not reach a conclusion that suggests at any level of confidence that the taxpayer might prevail. For example, the negative advice exclusion does not apply if the practitioner concludes that the treatment in favor of the taxpayer is not frivolous, that the taxpayer has a realistic possibility of success, that there is a reasonable basis for taking the position, or that there is substantial authority for the position. In other words, merely because the practitioner reaches a confidence level lower than more likely than not that the taxpayer would prevail does not allow the negative advice exclusion to apply if the practitioner advises, for example, that taking the position would be nonfrivolous.

2. Prominent disclosure. A written statement may avoid being a Covered Opinion by reason of constituting a Reliance Opinion (a written statement about a Significant Federal Tax Issue[34] relating to an arrangement a significant purpose of which is tax avoidance or evasion) if it ''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.''[35]

Written advice is a Marketed Opinion and therefore is a Covered Opinion if the practitioner knows or has reason to know that it will be used or referred to by a person other than the practitioner (or someone affiliated with her firm) in promoting, marketing, or recommending an arrangement to one or more taxpayers. Unless it relates to a Listed Transaction or to a principal purpose transaction, a writing is not a Marketed Opinion, however, if it prominently discloses in the written advice that: (1) the advice was not intended or written by the practitioner to be used, and that it cannot be used by any taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer; (2) the advice was written to support the promotion or marketing of the transaction(s) or matter(s) addressed in the written advice; and (3) the taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax adviser.[36] In other words, if it is known that others will refer to or use the opinion in promoting an arrangement, it is a Marketed Opinion if it relates to a Listed Transaction or its principal purpose is tax avoidance (or evasion)[37] even if it contains the three ''you cannot rely'' disclaimers.

The May 18 changes relax the requirement that any prominent disclosure be in bold typeface larger than any other contained in the written statement. The changes provide that an item is prominently disclosed if it is readily apparent to a reader of the advice. However, the change is qualified in that the determination of whether an item is ''readily apparent'' to the reader will depend on the facts and circumstances surrounding the advice, including, but not limited to, the sophistication of the taxpayer and the length of the written advice. As is discussed in more detail below, it may be that practitioners should place the disclosure at the beginning of the written statement. In any case, at a minimum, the disclosure must be set forth in a separate section (and not a footnote alone) in a typeface at least as large as the typeface of any discussion of the facts or law in the written statement.

That is a welcome practical change, because it would appear to permit the name of the practitioner's firm and, perhaps, the title of the written statement to be larger than the tax advice itself.

3. Definition of principal purpose. The most onerous rules under the circular apply to written statements relating to Listed Transactions and principal purpose transactions. As originally promulgated in December, the circular provided no guidance as to how a practitioner should determine the principal purpose of an arrangement. The May 18 changes do provide some guidance. First, Treasury considered the possibility that the transaction might have multiple motivations. Under the change, the principal purpose of the transaction is the one that exceeds (presumably in importance) the other purposes. Second, in a potentially much more important change, Treasury has created a new safe harbor, which we now examine.

[33]The circular's apparent scope is so broad that merely describing a particular tax arrangement without explicitly stating any tax result (for example, ''[s]ome individuals may wish to consider creating a trust for his or her own benefit the remainder of which will pass to our organization on the death of the individual'') might be regarded as making a written statement about a federal tax issue because there is an implication of a federal tax effect (for example, a deduction for the value of the remainder created for charity).

[34]A federal tax issue is a question concerning the federal tax treatment of an item of income, gain, loss, deduction, or credit, the existence or absence of a taxable transfer of property, or the value of property for federal tax purposes. 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 under any reasonably foreseeable circumstance, on the overall federal tax treatment of the transaction(s) or matter(s) addressed in the writing. In other words, in addition to tax avoidance being a significant *purpose* of the arrangement, a federal tax *issue* must be significant for the writing to constitute a Reliance Opinion (and the level of confidence the practitioner reaches on a Significant Federal Tax Issue must be at least more likely than not).

[35]Circular 230, section 10.35(b)(4)(ii).

[36]The latter two requirements are repeated in section 10.35(e)(2) of the circular relating to certain required disclosures.

[37]It is unclear whose principal purpose applies here, that of the promoter or that of the taxpayer to whom the arrangement is offered. It the context in which it appears (that is, determining if it is a Marketed Opinion), it seems to be that of the promoter. Otherwise, it could be the principal purpose of one taxpayer but not of another, making it a Marketed Opinion regarding the first and not the second.

Before the amendment, as suggested in our earlier article, written advice concerning noncontroversial transactions would have constituted a Covered Opinion if the taxpayer's principal purpose was tax avoidance or evasion.[38] For example, under the preamendment version of the circular, if a practitioner had recommended an annual-exclusion gift, any written advice about the transaction would have been subject to the Covered Opinion rules if, as seems somewhat likely, the taxpayer's principal purpose was tax avoidance. Apparently, recognizing that it would be inefficient to apply the rules when the code contemplates the tax benefit in question, Treasury has now added a clarification to the term "principal purpose" that is designed to narrow the rules' focus. In effect, the clarification creates a safe harbor: If a transaction has as its purpose the "claiming of tax benefits in a manner consistent with the statute and Congressional purpose," it will not be treated as a principal purpose transaction.[39] Thus, it would seem that, for an annual-exclusion gift motivated solely by a tax avoidance purpose, written advice will not be subject to the principal-purpose rules, as amended, because Congress intended to permit the exclusion.[40]

While the safe harbor is a welcome development, questions will inevitably arise about its application when the meaning of a code provision is unsettled. On one hand, it would seem that, if the IRS has conceded the issue in published guidance (for example, in a revenue ruling), the Treasury should be precluded from arguing that an outcome favoring the taxpayer is not consistent with the terms of the statute and its underlying purpose.[41] On the other hand, when the IRS has not made such a concession, the analysis becomes more difficult. If, for example, the IRS has issued a series of taxpayer-friendly private letter rulings[42] — but there is no decision or published guidance on the issue — can a practitioner take the view that the series of rulings is tantamount to a published revenue ruling in applying the safe harbor? Or if federal courts of appeal of different circuits are split about the meaning of a provision, can a practitioner rely on language in the favorable decision to the effect that the code contemplates the benefit in question? Or what if the circuit in which the taxpayer resides has rejected the IRS's position while other circuits have adopted it? In short, while it would seem that practitioners should be able to treat an IRS concession in published guidance as a definitive resolution of the code's meaning,[43] the scope of the safe harbor remains unclear when the issue is unsettled.

The preamble indicates that the safe harbor is borrowed from the exception in Treas. reg. section 1.6662-4(g)(2)(ii). Perhaps, therefore, a better understanding of the contours of the safe harbor can be obtained by examining it through the prism of that regulation. Under section 6662, a taxpayer who invests in a tax shelter must satisfy a more rigorous standard to avoid the substantial understatement penalty. The regulation defines the term "tax shelter" with reference to the taxpayer's principal purpose in entering into the transaction.[44] In the language borrowed by the circular, the regulation goes on to provide that a transaction will not be treated as a tax shelter if the transaction has as its purpose the claiming of "tax benefits in a manner consistent with the statute and Congressional purpose." Although the regulation provides no further clarification as to the meaning of that phrase, it does contain a list of examples of qualifying transactions or elections: investments in tax-exempt bonds designed to qualify for the exclusion under section 103; investments designed to produce accelerated depreciation deductions under section 168; investments designed to produce percentage depletion deductions under section 613 and 613A; investments designed to

[38]If a significant purpose were tax avoidance, Reliance Opinion status would be avoided if the written statement addressed no Significant Federal Tax Issue.

[39]Where a taxpayer literally complies with a code provision, the IRS may nonetheless argue that permitting the tax benefit sought would be inconsistent with Congress's purpose. *See Gregory v. Helvering,* 293 U.S. 465 (1935); *see also Santa Monica Pictures LLC, v. Commissioner, supra* note 7. In creating two prongs — requiring consistency with the statute and with Congress's purpose — the new definition may be understood as seeking to reflect the substantive rule that derives from *Gregory.* Not citing *Gregory,* however, the preamble indicates, as will be discussed, that the definition was borrowed from Treas. reg. section 1.6662-4, which creates a similar exception from the definition of a tax shelter (taxpayers who invest in tax shelters and who seek to avoid penalties are subjected to a heightened standard).

[40]Even though, under the clarification, it will not be treated as a principal purpose transaction, it may nonetheless be subject to the rules under a significant-purpose analysis. In other words, if, as is likely, tax avoidance is a significant purpose, the advice could nonetheless be subject to the rules. For example, if the advice reaches a more likely than not conclusion on any Significant Federal Tax Issue, it would be a Covered Opinion in that a significant purpose transaction is subject to the rules if the advice were to reach such a conclusion. It seems unlikely, however, that the Covered Opinion rules would be applicable in this context given the noncontroversial nature of the annual exclusion (that is, a noncontroversial issue is not a Significant Federal Tax Issue). *See* Circular 230, section 10.35(b)(3).

[41]The Tax Court has held that, as long as a taxpayer-friendly revenue ruling has not been revoked, it will not permit the IRS to make a contrary argument. *See Rauenhorst v. Commissioner,* 119 T.C. 157, *Doc 2002-22803, 2002 TNT 195-13* (2002); *Baker v. Commissioner,* 122 T.C. 143, *Doc 2004-3555, 2004 TNT 34-9* (2004); *Dover v. Commissioner,* 122 T.C. 324, *Doc 2004-9660, 2004 TNT 88-15* (2004).

[42]Neither a private letter ruling nor a National Office technical advice memorandum may be cited or used as precedent. Section 61101(k)(3). On the other hand, it may constitute substantial authority for purposes of section 6662. *See* Treas. reg. section 1.6662-4(d).

[43]All of the examples provided in Treas. reg. section 1.6662-4 are of the clear-cut variety.

[44]The statute no longer uses the principal-purpose test, but rather a significant-purpose test as indicated in our prior article. The regulation has not yet been conformed to that code change.

produce a deduction for intangible drilling expenses under section 263(c)); establishment of a qualified retirement plan in accordance with sections 401-409; or subchapter S elections.

Given the nature of the items included in that list, one might reasonably infer that only transactions that the code explicitly validates can qualify. One might further infer that, because the circular borrows the concept from the regulation, that limited interpretation of the regulation should apply with equal force in the context of the circular's safe harbor. In other words, transactions will qualify for the safe harbor under this view only if the code explicitly validates the tax benefit in question. Thus, as suggested, an annual-exclusion gift would qualify for the safe harbor because the code explicitly validates the exclusion.

Even assuming that this limited interpretation of the safe harbor is correct, questions still remain. Consider, for example, the application of the safe harbor in the case of a grantor retained annuity trust (GRAT). Section 2702 explicitly authorizes the use of a GRAT. It would seem, therefore, that advice concerning a GRAT would fall under the safe harbor. But what if the GRAT is structured so that the value of the remainder is zeroed-out? The IRS has indicated that, in its view, Congress did not contemplate that taxpayers would be permitted to zero out a GRAT.[45] The question thus becomes whether, in the context of a tax benefit the code explicitly authorizes, the safe harbor can be rendered inapplicable because an unsettled issue is implicated.

As another example, consider an annual-exclusion gift of a limited partnership interest. What if, as in *Hackl*,[46] under the partnership agreement, a sale of the gifted interest by the donee would not confer full partnership status on the purchaser (for example, the purchaser would become a mere assignee)? Would the safe harbor apply on the rationale that the taxpayer was seeking to qualify for a code-authorized benefit, the annual exclusion? Or is it rendered unavailable by the decision in *Hackl* — or, on the premise that *Hackl* was wrongly decided, by the unsettled nature of the issue?

That question, in turn, raises a question about the meaning of the tax shelter regulation itself. Consider, for example, a taxpayer who acquires an asset to secure the benefits of accelerated depreciation (a benefit explicitly referenced in Treas. reg. section 1.6662-4). Assume the taxpayer uses a depreciable life of, say, 10 years but the federal court ultimately concludes that the taxpayer should have used a 15-year life. Will the taxpayer be subjected to the more rigorous tax shelter standard on the penalty question because the deduction was not, under the court's holding, permissible? Or will the taxpayer be able to argue that, even though it was not able to sustain its position on the substantive issue, the transaction was not a tax shelter for purposes of the penalty analysis, because accelerated depreciation is a code-authorized benefit? If the taxpayer in that example is held to the tax shelter standard because of the defeat on the substantive issue, the regulation's exception for code-authorized transactions has no meaning.[47] In other words, if taxpayers who lose on the substantive issue cannot take advantage of the exception, no taxpayer will be able to do so inasmuch as penalties are not imposed on taxpayers who prevail. Thus, to avoid rendering the exception meaningless, it must be understood as applying when, in the context of a transaction involving a code-authorized benefit, the taxpayer fails to prevail.

By a parity of logic, the safe harbor clarification just added to the circular should apply in the context of the zeroed-out GRAT and partnership-gift examples. In both cases, the transaction involves a code-authorized benefit. The possibility that the taxpayer might not prevail in either case should not render the safe harbor unavailable — just as a failure to prevail in the depreciation example should not render the tax shelter regulation's exception inapplicable.

While, as suggested, it would seem appropriate to interpret the safe harbor against the backdrop of the regulation's exception, it is entirely plausible that the safe harbor was drafted without any intent to make the two concepts mirror each other. It is even possible, moreover, that no thought was given to the problematic way in which the exception is drafted. After all, no clarification is provided concerning the exception in the preamble to the proposed or final regulations under section 6662. Thus, while it is hoped that the conclusions reached in the zeroed-out GRAT and partnership-gift examples appear sound, practitioners may well find it difficult to rely on that reading without further clarification from the Treasury. Indeed, given the nature of the comments that inspired the safe harbor — suggesting that compliance with the rules would be unnecessary in the case of a code-authorized benefit even if tax avoidance is the taxpayer's principal purpose — it may well be that Treasury intended that it would apply only when the issue is entirely noncontroversial (for example, advice that a client make an annual-exclusion cash gift).[48]

Even when the IRS has conceded the issue in published guidance, factual issues may make it difficult for the practitioner to comfortably invoke the safe harbor. For example, while the IRS has conceded that a *Crummey* power creates a present interest,[49] the annual exclusion

[45]*See* TAM 200245053, *Doc 2002-25023, 2002 TNT 218-69* (indicating that the preamble to the regulations under section 2702 contemplate that a GRAT cannot be zeroed-out).

[46]*Hackl v. Commissioner,* 335 F.3d 664, *Doc 2003-16504, 2003 TNT 135-8* (7th Cir. 2003).

[47]In our prior article, we suggested this possibility. *See* n.65 of that article.

[48]But, of course, if the intent was to limit the safe harbor to noncontroversial issues, the amendment adds very little to the preamendment version of the Covered Opinion rules. For, under the preamended version, in the case of a Covered Opinion, only Significant Federal Tax Issues needed to be addressed. And because a noncontroversial issue would seem to include a Significant Federal Tax Issue, there was no need to address noncontroversial issues under the preamendment version of the rules — suggesting that a safe harbor that creates an exception to the Covered Opinion rules only when the issues are noncontroversial is not very meaningful.

[49]*See, e.g.,* Rev. Rul. 85-24, 1985-1 C.B. 329.

will be denied if the court finds that there was an understanding that the power-holder would not exercise the power.[50] Thus, even though the courts have not been particularly receptive to the IRS's argument that an understanding had been reached with the power-holder,[51] it might be challenging for a practitioner to invoke the safe harbor when it is nearly certain that the power will not be exercised.[52] In other words, given the critical nature of the factual question and the difficulty in assuming that the power may be exercised, the safe harbor may be of little assistance in this context.

It would seem that if a practitioner relies on the safe harbor, he should not be sanctioned if, after the advice is rendered, the Supreme Court adopts the taxpayer's position, as the tax benefit would have been claimed in a manner consistent with the code and congressional purpose. Similarly, a practitioner should not be sanctioned for relying on the safe harbor when a postadvice revenue ruling favorable to the taxpayer is issued. Conversely, a postadvice Supreme Court decision adopting the IRS view may preclude the practitioner from invoking the safe harbor in the disciplinary context because it has turned out that the tax benefit was not claimed in a manner consistent with the code and congressional purpose. As a consequence, conservative practitioners will likely not rely on the safe harbor in any case where the issue is unsettled.

Nonetheless — and this is perhaps the most critical point — if a practitioner relies on the safe harbor in a context in which the issue is not entirely settled but is definitively settled against the taxpayer by some postadvice decision (for example, a Supreme Court decision), the practitioner may be able to avoid sanctions by establishing a lack of willfulness, recklessness, or gross incompetence.[53] For example, assume that, at the time the advice is given, there are a series of private letter rulings that uniformly adopt the taxpayer's position and that, based on those rulings, the practitioner invokes the safe harbor. As suggested, a postadvice definitive decision would appear to preclude the practitioner from invoking the definition in a disciplinary proceeding. On those facts, however, a finding that the practitioner was willful, reckless, or grossly incompetent would seem difficult, if not impossible, to sustain.[54] Still, it would be helpful if the circular were amended to make certain that a practitioner who relies on existing decisions (or even a private letter ruling or the literal provisions of the code or a regulation) should not be subject to sanction if that decision is ultimately overturned or not followed.

III. Statements May Fall Into Multiple Categories

It seems very important to recognize that a written statement may fall under an exception for one Covered Opinion category (for example, it is not a Reliance Opinion because it contains a prominently disclosed "you may not rely on this for penalty protection") but may nonetheless be a Covered Opinion in another category (for example, it is a Marketed Opinion). Therefore, testing to determine if the written statement falls within the scope of section 10.35 of the circular generally should include all potential categories of Covered Opinion. If it does fall into more than one, the practitioner should attempt to comply with the "most strict" requirements of the circular.

A. Suggested Steps to Comply With the Circular

We hope that some of the suggested steps set forth below will be viewed as practical. If a large number of practitioners adopts them, any practitioner who follows them may be in a stronger position to demonstrate that the practitioner was not reckless, willful, or grossly incompetent if it is later determined that the written

[50]*See Estate of Cristofani v. Commissioner,* 97 T.C. 74 (1991), *acq. in result* 1996-29 IRB 4, *Doc 96-19970, 96 TNT 137-13.*

[51]*See Estate of Kohlsaat v. Commissioner,* T.C. Memo. 1997-212, *Doc 97-12671, 97 TNT 89-12.*

[52]*Cf. Long Term Capital Holdings v. U.S.,* 330 F. Supp.2d 122, 94 AFTR2d 2004-5666, *Doc 2004-17390, 2004 TNT 169-15* (D.C. Conn. 2004) (applying a penalty after finding, on the facts, the taxpayer could not establish the necessary profit motive); *Santa Monica Pictures, LLC v. Commissioner, supra* note 7 (adopting a similar analysis).

[53]Section 10.52 of the circular does not provide a definition of the term "willful." Presumably, it will be given content based on an analogy to its counterpart concept in the criminal tax evasion context. *See, e.g., Cheek v. U.S.,* 498 U.S. 192 (1991) (defining the term to mean a violation of a known legal duty and indicating that a subjective good-faith belief, even if objectively unreasonable, will preclude a finding of willfulness). However, section 10.51 of the circular, which is cross-referenced, does define the terms "reckless" and "gross incompetence." The definition of reckless in section 10.51 appears to make community standards a relevant determinant (inquiring whether the conduct was "an extreme departure from the standards of ordinary care that a practitioner should observe"). *See also* Treas. reg. section 1.6662-3(b)(2) (providing that a disregard of a rule or regulation "is reckless if the taxpayer makes little or no effort to determine whether a rule or regulation exists, under circumstances which demonstrate a substantial deviation from the standard of conduct that a reasonable person would observe"). And while the definition of gross incompetence does not as explicitly reference the community standard, it would nonetheless seem to be an implicit benchmark (gross incompetence "includes conduct that reflects gross indifference, preparation which is grossly inadequate under the circumstances, and a consistent failure to perform obligations to the client"). The section explicitly contemplates that, in applying those definitions, a pattern of misconduct will weigh against the practitioner — implying perhaps that, conversely, an isolated violation will be viewed as an innocent one not warranting sanction. Finally, it should be noted that the definitions in section 10.51 appear to be drafted, in large part, with a narrow focus: Practitioners who give misleading advice (that is, advice that affirmatively misrepresents or omits material information). It does not, in other words, focus specifically on the kind of violation addressed in the text: when practitioners erroneously conclude that their advice does not violate the rules contained in the circular.

(Footnote continued in next column.)

[54]Given that private letter rulings may constitute substantial authority for purposes of section 6662, *see* Treas. reg. section 1.6662-4(d), a postadvice decision that rejects the approach taken in the private letter rulings should not render the practitioner culpable.

statement does not comply with the circular, as the practitioner probably will be found to have conformed to the community standard.

1. Advise clients the circular is coming. Some practitioners will find it appropriate to advise clients in writing about the circular, that it will change how written statements must be prepared, and that it may increase the cost of written work relating to any federal tax matter. A short letter or memorandum might contain something like the following:

> On June 21, 2005, new Circular 230 will become effective. The circular was issued by the United States Treasury Department. It sets forth rules that tax practitioners, including lawyers and certified public accountants, must follow in providing written statements about certain federal tax issues. A federal tax issue is a question concerning the federal tax treatment of an item of income, gain, loss, deduction, or credit, the existence or absence of a taxable transfer of property (such as whether a transfer to another is subject to federal gift tax), or the value of property for federal tax purposes. The circular covers much more than formal legal opinions and may apply to any writing relating to any Internal Revenue Code matter, including e-mail messages. Practitioners who fail to comply with the circular may be suspended or disbarred from practice before the Internal Revenue Service (such as filing a return or participating in the audit of a United States tax return), be publicly censured, or be fined. Unfortunately, we and many others anticipate that the circular may increase the cost of delivering certain written material to taxpayers. The circular requires that certain written statements contain disclaimers or warnings and you will see new statements in some messages from us, including e-mail messages. All responsible tax practitioners will follow the requirements of the circular. It is our intention to continue to deliver the highest quality services to you and in a cost efficient manner. Please call us if you have any question about how the circular may affect our representation of you.

It is also recommended that you mention the circular to any new client and ''warn'' the client that any written engagement letter will contain a statement about it.

2. E-mail disclaimers. Consider having a statement permanently embedded at the beginning of each e-mail message stating something like ''Please review the 'Disclaimers' contained toward the end of this message before reading this message.'' The disclaimer messages could appear before the now standard ''confidentiality'' message contained at the end of virtually all e-mail messages sent by professionals and may state something like ''Unless expressly stated otherwise above, (1) nothing contained in this message was intended or written to be used, can be used by any taxpayer, or may be relied on or used by any taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer under the Internal Revenue Code of 1986, as amended, (2) any written statement contained in this message relating to any federal tax transaction or matter may not be used by any person to support the promotion or marketing of or to recommend any federal tax transaction(s) or matter(s) addressed in this message, and (3) any taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax adviser with respect to any federal tax transaction or matter contained in this message. No one, without our express prior written permission, may use any part of this letter/memorandum in promoting, marketing, or recommending an arrangement relating to any federal tax issue to one or more taxpayers. It may not be shared with any other person without our prior written consent other than as required by law or by ethical rules. This prohibition on sharing this letter/memorandum does not preclude you from sharing with others the federal tax nature of any transaction discussed herein or the fact that you may have consummated such transaction.''

Although the foregoing will not necessarily ensure compliance in all cases with the circular, it may reduce the risk of being charged with knowing or having reason to know that it will be used or referred to by a person in promoting, marketing, or recommending an arrangement to one or more taxpayers and therefore may reduce the risk of the e-mail constituting a Marketed Opinion. Obviously, if the practitioner knows or suspects that the written statement is a Marketed Opinion, the suggested e-mail disclaimer alone will not be sufficient to have prevented the practitioner from violating section 10.35 of the circular.

In any case, as indicated, if you intend the addressee to be able to rely on the e-mail, you should so expressly state.

3. Certain potential Marketed Opinions. In any written statement that discusses any federal tax issue and that the practitioner does not intend to be a Marketed Opinion, add a statement to the effect that '' No one, without our express prior written permission, may use any part of this letter/memorandum in promoting, marketing, or recommending an arrangement relating to any federal tax issue. Furthermore, it may not be shared with any other person without our prior written consent other than as required by law or by ethical rules. However, this prohibition on sharing this letter/memorandum does not preclude you from sharing with others the nature of this transaction or the fact that you consummated it.''[55]

Such a statement should help demonstrate that the drafter of the written statement did not know or have reason to know that someone would use it in promoting, marketing, or recommending any federal tax transaction or matter contained in the statement to any other taxpayer.

4. Use a decision-tree approach. The rules of the circular are complex. It is recommended that practitioners use a

[55]We suggest that this last sentence be included to prevent this advice from being viewed as a Covered Opinion on the grounds that it is confidential. *See* Circular 230, section 10.35(b)(6). It is ironic that to avoid Covered Opinion status, the practitioner will be required, as a practical matter, to inform clients that they have the right to disclose the nature of the strategy to others.

decision-tree approach when reviewing a writing to determine if it is a Covered Opinion and, if so, what kind or kinds. For example, the first question should probably be something like, ''Does the writing discuss any federal tax issue?'' If not, the circular's Covered Opinion rules should not apply. But if the answer is ''yes,'' ask, ''Does the writing relate solely to preliminary advice?'' If it does, it's excluded from being a Covered Opinion. If it does not, ask, ''Does the writing relate to the qualification of a qualified plan, state and local bonds, or matters involving SEC disclosure?'' If so ask, ''Does the arrangement involve a Listed Transaction or, if not, is the principal purpose of the arrangement tax avoidance or evasion?'' And so on.

We hope that the chart attached to this report may serve as a general guide in determining if the circular applies and, if it does, why.

5. Approach Listed Transactions with caution. Do not discuss in writing any Listed Transaction (or principal purpose transaction) without careful compliance with the circular's rules. Remember that true ''negative'' advice is an exception to the application of section 10.35. But even in that case, other sections of the circular (for example, section 10.37) may apply. Of course, the practitioner needs to know what the Listed Transactions are. For a cumulative list of Listed Transactions, see IRS Notice 2004-67, 2004-41 IRB 600, *Doc 2004-19024, 2004 TNT 187-8*, for the list through the date that notice was issued. For more recent transactions, see http://www.irs.gov/businesses/corporations. Click on ''Abusive Tax Shelters and Transactions.'' Then click on ''Listed Abusive Tax Shelters and Transactions.'' The list is frequently updated.

6. Obtain a representation of principal purpose in some cases. In some cases, it will be appropriate to obtain a statement from the taxpayer as to the principal purpose of the arrangement. Although the circular does not contain an explicit discussion about when a practitioner may rely on factual representations in determining whether the written statement will constitute a Covered Opinion or the type of that opinion, it is likely that the practitioner may not rely on an unreasonable or unfounded representation for those purposes.[56]

7. Determine if the tax benefits are claimed in a manner consistent with the code and congressional purpose. It may greatly reduce the cost of compliance with the circular if the principal purpose of the arrangement is not tax avoidance and is not a Listed Transaction — for example, the practitioner may then issue a Limited Scope Opinion. A practitioner generally can objectively determine if the arrangement is a Listed Transaction. Although the determination of principal purpose for an arrangement normally could be viewed as making a subjective determination, the circular, as now amended, provides that the principal purpose of the arrangement will not be tax avoidance if the tax benefits are claimed in a manner consistent with the code and congressional purpose. This new test to determine if the principal purpose is tax avoidance should be considered (as long as a Listed Transaction is not involved) so compliance with the circular can be simplified.

8. Drafting guidelines to comply with section 10.35. Consider the following approach in drafting a written statement that may constitute a Covered Opinion.

a. Comply with the strictest standard. It may be critical to realize that a written statement may constitute more than one type of Covered Opinion. If so, ensure compliance with the most ''strict'' rules (for example, those for Marketed Opinions that prohibit an overall conclusion at a confidence level of less than more likely than not).[57]

b. Include an introductory statement about the circular. Consider beginning any written statement that will constitute a Covered Opinion with an introductory statement that it is a Covered Opinion. That introductory statement might be as follows: ''This letter/memorandum constitutes a Covered Opinion within the meaning of Circular 230. The circular was promulgated by the United States Treasury Department and requires that certain written statements issued by a tax practitioner, called Covered Opinions, contain certain material and requires a specific manner of presentation. Important terms contained in the circular and used herein are defined at the end of this letter/memorandum. This letter/memorandum is drafted in a manner designed to comply with the circular.''

c. Have a separate definitions section. Circular 230 contains many unique or special terms, such as Covered Opinion, Significant Federal Tax Issue, Listed Transaction, Principal Purpose, and Marketed Opinion. It may be that each written statement that deals with the circular will be easier to prepare and will be easier to read if these definitions are contained in a separate section of the written statement entitled something like ''Definition of Terms Relating to Circular 230.'' This section may become standard practice similar to setting forth definitions in forms for articles of incorporation or for partnership agreements in a separate ''Definitions'' section.

d. State the type of Covered Opinion or why the writing is not a Covered Opinion and the reason for that conclusion. State the type or types of Covered Opinion(s) the writing constitutes or why it is not a Covered Opinion.[58]

[56]*See* Circular 230, section 10.37.

[57]Of course, even if the written statement is not a Marketed Opinion, the practitioner may not be able to reach a more likely than not conclusion.

[58]It may be that some practitioners would find that adding this type of ''gobbly-gook'' will be confusing for a client and is neither necessary nor appropriate to be contained in the letter and that the conclusion reached as to why the written statement is not a Covered Opinion, or the type of Covered Opinion, etc., should be recorded in a separate internal memorandum. However, there may be two reasons to place those matters in the written statement to the client. First, if the IRS reads the letter, it

(Footnote continued on next page.)

For example, if it is determined that the written statement is a Reliance Opinion, consider setting forth the reasoning for that conclusion, such as: ''*Type of Covered Opinion.* We have determined that no federal tax issue discussed in this letter relates to a Listed Transaction. We have also determined that the tax benefits discussed in this letter are being claimed in accordance with provisions of the Internal Revenue Code and the underlying Congressional purpose and, therefore, we believe the principal purpose of the arrangement is not tax avoidance (or evasion). We have determined that a significant purpose of the arrangement discussed in this letter 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 we discuss below. We are not aware and believe we have no reason to think that this letter will be used to promote, market, or recommend to another taxpayer any federal tax transaction or matter discussed herein. Accordingly, we have determined that this letter may constitute a Reliance Opinion but no other type of Covered Opinion. Therefore, we have prepared this letter in a manner that we believe complies with requirements of Circular 230 with respect to Reliance Opinions.''

Similarly, if the written statement that would constitute a Reliance Opinion is not one because it does not reach a confidence level of at least more likely than not, it should so state. Such a statement might be something like: ''Although a significant purpose of the arrangement discussed herein may be tax avoidance, we have determined that this letter does not constitute a Reliance Opinion because we do not set forth a conclusion that it is at least more likely than not that the tax treatment would be sustained.'' If the reason the written statement is not a Reliance Opinion is because no Significant Federal Tax Issue is involved, it seems appropriate to so state.

If the arrangement does not involve a Listed Transaction and its principal purpose is not tax avoidance and the Covered Opinion is intended to be a Limited Scope Opinion, a statement must be made to the effect that ''This writing is intended to constitute a Limited Scope Opinion.'' As mentioned above, explanations of significant terms (for example, a Reliance Opinion or Limited Scope Opinion) may be set forth in the section entitled ''Definition of Terms Relating to Circular 230'' of the letter/memorandum.[59]

e. Use separate headings for separate sections. Consider having each part of the Covered Opinion broken down by headings — for example, ''Facts,'' ''Application of the Law to the Facts,'' ''Overall Conclusions,'' ''Promoter Relationship,'' ''Reliance on the Opinion of Another,'' and so forth as required by the circular. That should increase the chances of compliance at least with the form of the Covered Opinion rules and help to demonstrate that the practitioner was not willful, reckless, or grossly incompetent if some ''technical'' violation of the circular is found to have occurred.

f. Recite the origin of facts. Recite in the facts section the source of the facts. In some cases, that might be ''You have represented to us that the following facts apply to the arrangement. We have relied on your representations in preparing this letter/memorandum. If any of the facts are incorrect or incomplete, our discussion and conclusion may be different than those set forth below. You have agreed that we are under no obligation and we expressly disavow any obligation to advise you if we learn that the facts are not as you have represented to us.'' However, keep in mind that you may not rely on unreasonable facts.

g. Recite the state of the law. Although not required or suggested by the circular but apparently standard practice at many sophisticated firms, it seems appropriate to consider stating expressly — perhaps in the introductory section — that the written statement is prepared under the current state of the law. Such a statement might be something like ''We have prepared this letter/memorandum under what we believe to be the current state of the law. You have agreed that we are under no obligation and we expressly disavow any obligation to advise you with respect to any development or other change in the law that would affect the discussion or any conclusion contained in this letter/memorandum.''

h. State whether the written statement is intended to be relied on. It seems appropriate to state whether you know if the client is intending to rely on the written statement for purposes of tax penalty protection or otherwise or is not intending to so rely. For example, if the client is not intending to rely on it for tax penalty protection, something like the following might be contained in the written statement and might be set forth in a separate section with the separate heading entitled, perhaps, ''*No Reliance Intended*. You have advised us that you understand that nothing contained in this letter/memorandum may be used or relied on by you (or any other taxpayer) for purposes of penalty protection under the Internal Revenue Code.'' However, if the client will be relying on it, the separate heading and statement might be something like: ''*Reliance for Penalty Protection*. We are sending you this letter/memorandum and understand that you will be relying on it to avoid certain potential penalties that might otherwise be imposed by the Internal Revenue Code with respect to one or more matters discussed herein. Our opinion is not binding on the Internal Revenue Service, any court, or any other

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is likely that the IRS can reasonably conclude that the practitioner was not willful, etc. regarding some Circular 230 offense. Second, some practitioners may neglect to prepare the internal memo on account of time, etc.

[59]Of course, additional disclosures are required for Limited Scope Opinions. *See* Circular 230, section 10.35(c)(3)(v).

person or entity. We are providing this letter/memorandum solely for your use. We cannot assure you and do not guarantee that it will prevent the imposition of any penalty that might be imposed by the Internal Revenue Code.''

In addition, if the written statement is intended to protect the client from one or more tax penalties, it may well be appropriate to have a separate section of the written statement discuss the potential penalties and how they may be avoided (for example, good faith and a reasonable basis for taking the position or substantial authority). As indicated in our April 4 article, the avoidance of some penalties appears to be based on a wholly objective standard (for example, in some cases, whether there is substantial authority) while others are based, at least in part, on a reasonable belief or reasonably following the advice of a professional. In all cases, it seems, the client's chances will be increased if the client can demonstrate reasonable reliance on professional advice and, therefore, a discussion about potential penalties and why the practitioner concludes they should not apply seems appropriate to consider reciting in the written statement.[60]

9. Obtain a second opinion/private ruling in some cases. It may be appropriate in some cases to seek the opinion of another tax practitioner as to whether the circular applies and/or whether the written statement prepared complies with the circular. Seeking and following expert advice should go far in demonstrating that the practitioner was not willful, reckless, or grossly incompetent. In cases of substantial doubt, the practitioner might consider inquiring whether the IRS would issue a private letter ruling and, if it will, obtaining one. One circumstance in which a ruling might be sought may be when a practitioner is preparing a Marketed Opinion for a client — for example, a brochure for a bank about Roth IRAs. The circular requires that all Significant Federal Tax Issues be discussed. It may not be possible for the practitioner to reach an overall conclusion that is at least a more likely than not level of confidence because some Significant Federal Tax Issue is uncertain and could cause the arrangement to fail to provide the tax benefit sought by a Roth IRA. (It is appropriate to emphasize that all Significant Federal Tax Issues must be discussed except for a Limited Scope Opinion; a Marketed Opinion cannot be rendered as a Limited Scope Opinion.) It may be that the IRS will provide practical guidance in such a case that will allow the practitioner to issue the Marketed Opinion without running afoul of the circular. In any case, once a private letter ruling is obtained, it would seem virtually certain that the IRS would be precluded from contending that the practitioner violated the circular.

10. Oral advice with an internal memo. In some cases, the cost of complying with the circular will be so substantial, compared to the issue involved, that it will be appropriate to provide only oral advice to the client and then prepare an internal written record of what was stated. It seems nearly certain that a taxpayer who can avoid a penalty by relying on the advice of a practitioner may do so whether the advice is written or oral (although it might be anticipated that the IRS may contend that a taxpayer should not be able reasonably to rely on oral advice). Because, in the case of oral advice, no written statement will be delivered to a taxpayer, it will not have to comply with any parts of the circular (other than section 10.34).[61] In such a case, it may be appropriate to advise the client why the advice will not be in writing and, to be able to prove the oral advice was given to the client, prepare an internal memo that recites the oral advice given. The recording of the advice probably should not be set forth in diary entries because those are often given to the client in connection with billing matters and those diary entries might therefore have to comply with the circular because they are a written statement delivered to the client.

11. Consider forming a Circular 230 committee. Although it will not be practical for solo and many small-firm practitioners, larger firms may wish to consider forming a committee that will develop expertise and be able to advise about compliance with the circular. At some firms the committee may review written statements (such as formal opinion letters) to ensure compliance with the circular. That review presumably would include the form of the written statement (for example, noting that all facts are contained in one section of the writing) and substance of the circular (for example, if the writing does not reach a more likely than not level of confidence, ensure it states why it does not).

12. Provide an opinion at a lower level of confidence when only that lower level is needed for penalty protection. As stated in our prior article, a taxpayer may avoid penalties in some cases even though the level of confidence reached by the adviser is lower than more likely than not, such as when the issue involves an estate, gift, or generation-skipping transfer tax matter when only a reasonable basis is needed (nonnegligence). When the practitioner concludes that the written statement would be only a Reliance Opinion and involves a tax issue for which a more likely than not opinion is not needed to provide penalty protection, the practitioner can avoid compliance with section 10.35 (although section 10.37 would still apply) by rendering an opinion at the lower standard needed to avoid penalties.[62] Because

[60]*See* note 61 below, dealing with return-related advice.

[61]Under section 10.34 of the circular, practitioners who give return-related advice must satisfy at least one of two rules: (1) the practitioner determines that the position to be taken by the taxpayer on the return has a realistic possibility of being sustained on the merits, or (2) the position is not frivolous and the practitioner advises the taxpayer on the possibility of avoiding the accuracy-related penalty in section 6662 through adequate disclosure and the requirements for adequate disclosure.

[62]Because a more-likely-than-not opinion can be inferred from the use of words like ''should,'' ''would,'' or ''is likely to be,'' practitioners should avoid using such words when giving an opinion at a lower standard then more-likely-than-not. Alternatively, practitioners may include an express statement that no advice given is intended or should be construed to render a more-likely-than-not level of confidence.

the cost of complying with section 10.35 may be significant, issuing the opinion at the lower threshold may be acceptable to certain clients but it may be appropriate to state so expressly in the written statement. That will provide the client with the necessary penalty protection and yet not have to comply with section 10.35 of the circular.[63]

IV. Conclusion

The May 18 amendments to Circular 230 provide three new areas of exclusion: written advice after the tax return is filed; written advice provided by in-house counsel solely about the employer's tax return; and negative written advice. Although each of those is quite limited in scope, they will be helpful to practitioners in certain cases. The more significant amendment relates to a clarification of the meaning of ''principal purpose,'' which provides that an arrangement's principal purpose is not tax avoidance (or evasion) if the tax benefits are claimed in a manner consistent with the code and congressional purpose. Although the meaning of the clarification is far from clear and may apply only if the tax position claimed is sustained, it probably means that it will be difficult to successfully charge a practitioner with willful, reckless, or grossly incompetent failure to comply with the circular when the practitioner was not unreasonable — though wrong — in concluding that the tax benefit is consistent with the statute and congressional purpose. In other words, we believe that conforming to the community standard in reaching such a conclusion will make it difficult, if not impossible, for a fact-finder to conclude that the practitioner was willful, reckless, or grossly incompetent. Being able to avoid principal purpose status is important because it may allow the practitioner to provide the written advice under the less onerous Reliance Opinion standard (or avoid Covered Opinion status entirely if no Significant Federal Tax Issue is involved or the practitioner does not provide a more likely than not opinion). Finally, the circular, as drafted, would appear to be invalid, at least as applied in certain contexts. We anticipate that one or more professional organizations may challenge the circular on the grounds suggested. (Chart begins on p. 1547; decision tree is found on p. 1550.)

[63]The standards under section 10.37 are not substantively different from those in section 10.35 in many respects although the ''formalities'' are less rigid.

Required Compliance With Circular 230, Section 10.35 for 'Covered Opinions'

	Type of Covered Opinion	Exception for Preliminary Advice	Exception for Advice on Qualified Plan Qualification, State and Local Bonds, Matters Involving SEC Disclosure	Exception for Advice After Return Filed	Exception for In-House Advice Relating Solely to the Employer's Return	Exception for Negative Advice	Exception if Tax Benefit Claimed in Manner Consistent With Code and Congressional Purpose	Exception if Not a Significant Federal Tax Issue (IRS Has No Reasonable Basis for Successful Challenge)	Exception if Confidence Level = or <50%	Exception if Disclosure Permitted	Exception if 'No Penalty Protection' Disclaimer	Disclosure of Relationship With Promoter Required	Confidence Level Must Be > 50%	Limited Scope Opinion Allowed
1.	Listed Trans-actions Sec. 10.35 (b)(2)(i)(A)	Yes Sec. 10.35(b) (2)(ii)(A)	No	Yes Sec. 10.35(b)(2) (ii)(C)	Yes Sec. 10.35(b) (2)(ii)(D)	Yes Sec. 10.35(b) (2)(ii)(E)	No	No	No	No	No	Yes Sec. 10.35 (e)(1)	Yes, as to Significant Fed Tax Issue (or "No Penalty Protection" Disclaimer Required, except for Marketed Opinions Where All Levels of Confidence Must be >50%) Sec. 10.35(e)(4)	No
2.	Principal Purpose of Arrange-ment Is Tax Avoidance/ Evasion Sec. 10.35(b) (2)(i)(B)	Yes Sec. 10.35(b) (2)(ii)(A)	No	Yes Sec. 10.35 (b)(2)(ii)(C)	Yes Sec. 10.35(b) (2)(ii)(D)	Yes Sec. 10.35(b) (2)(ii)(E)	Yes Sec. 10.35(b) (10)	No	No	No	No	Yes Sec. 10.35 (e)(1)	Yes, as to Significant Fed Tax Issue (or "No Penalty Protection" Disclaimer Required, except for Marketed Opinions Where All Levels of Confidence Must be >50%) Sec. 10.35(e)(4)	No

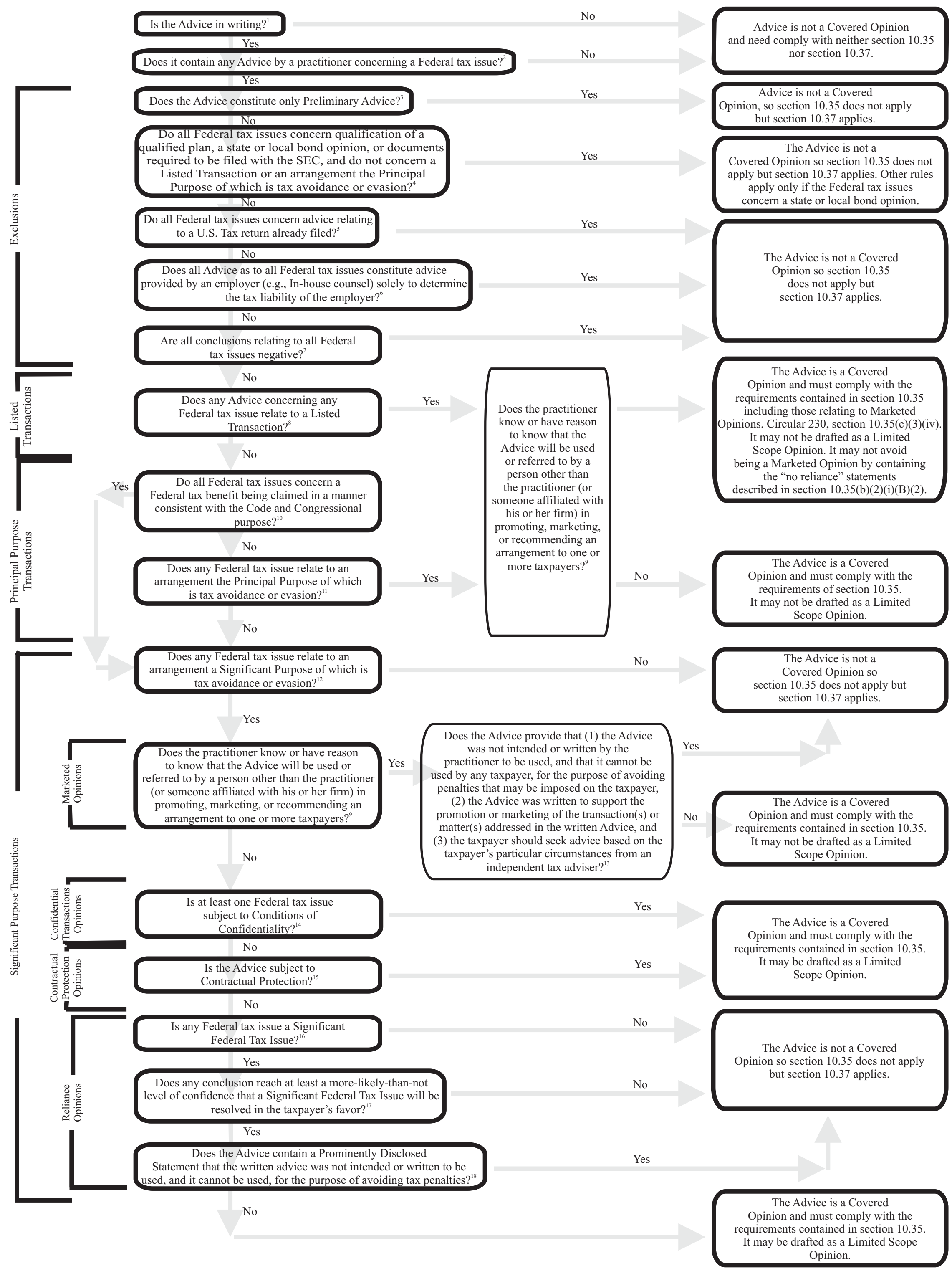
Required Compliance With Circular 230, Section 10.35 for 'Covered Opinions'

Type of Covered Opinion	Exception for Preliminary Advice	Exception for Advice on Qualified Plan Qualification, State and Local Bonds, Matters Involving SEC Disclosure	Exception for Advice After Return Filed	Exception for In-House Advice Relating Solely to the Employer's Return	Exception for Negative Advice	Exception if Tax Benefit Claimed in Manner Consistent With Code and Congressional Purpose	Exception if Not a Significant Federal Tax Issue (IRS Has No Reasonable Basis for Successful Challenge)	Exception if Confidence Level = or <50%	Exception if Disclosure Permitted	Exception if 'No Penalty Protection' Disclaimer	Disclosure of Relationship With Promoter Required	Confidence Level Must Be > 50%	Limited Scope Opinion Allowed
3. A Significant Purpose of Arrange-ment Is Tax Avoidance/ Evasion:													
a. Reliance Opinion Sec. 10.35(b) (2)(i) (C)(1)	Yes Sec. 10.35(b) (2)(ii)(A)	Yes Sec. 10.35(b) (2)(ii)(B)	Yes Sec. 10.35(b) (2)(ii)(C)	Yes Sec. 10.35(b) (2)(ii)(D)	Yes Sec. 10.35(b) (2)(ii)(E)	No	Yes Sec. 10.35(b) (4)(i)	Yes Sec. 10.35(b) (4)(i)	No	Yes Sec. 10.35(b) (4)(ii)	Yes Sec. 10.35(e)(1)	Yes, as to Significant Fed Tax Issue (or "No Penalty Protection" Disclaimer Required, except for Marketed Opinions Where All Levels of Confidence Must be >50%) Sec. 10.35(e)(4)	Yes Sec. 10.35(c)(v)
b. Marketed Opinion Sec. 10.35(b) (2)(i) (C)(2)	Yes Sec. 10.35(b) (2)(ii)(A)	Yes Sec. 10.35(b) (2)(ii)(B)	Yes Sec. 10.35(b) (2)(ii)(C)	Yes Sec. 10.35(b) (2)(ii)(D)	Yes Sec. 10.35(b) (2)(ii)(E)	No	No	No	No	Yes (with Other Statements) Sec. 10.35(b) (5)(ii)	Yes Sec. 10.35 (e)(1)	Yes, as to Significant Fed Tax issue (Or "No Penalty Protection" (Independent Advice Disclaimers Required Sec. 10.35(e)(4)	No

Required Compliance With Circular 230, Section 10.35 for 'Covered Opinions'

Type of Covered Opinion	Exception for Preliminary Advice	Exception for Advice on Qualified Plan Qualification, State and Local Bonds, Matters Involving SEC Disclosure	Exception for Advice After Return Filed	Exception for In-House Advice Relating Solely to the Employer's Return	Exception for Negative Advice	Exception if Tax Benefit Claimed in Manner Consistent With Code and Congressional Purpose	Exception if Not a Significant Federal Tax Issue (IRS Has No Reasonable Basis for Successful Challenge)	Exception if Confidence Level = or <50%	Exception if Disclosure Permitted	Exception if 'No Penalty Protection' Disclaimer	Disclosure of Relationship With Promoter Required	Confidence Level Must Be > 50%	Limited Scope Opinion Allowed
c. Disclosure Limited Sec. 10.35(b)(2)(i)(C)(3)	Yes Sec. 10.35(b)(2)(ii)(A)	Yes Sec. 10.35(b)(2)(ii)(B)	Yes Sec. 10.35(b)(2)(ii)(C)	Yes Sec. 10.35(b)(2)(ii)(D)	Yes Sec. 10.35(b)(2)(ii)(E)	No	No	No	Yes Sec. 10.35(b)(6)	No	Yes Sec. 10.35(e)(1)	Yes, as to Significant Fed Tax issue (Or "No Penalty Protection" Independent Advice Disclaimer Required) Sec. 10.35(e)(4)	Yes Sec. 10.35(c)(v)
d. Contractual Protection Sec. 10.35(b)(2)(i)(C)(4)	Yes Sec. 10.35(b)(2)(ii)(A)	Yes Sec. 10.35(b)(2)(ii)(B)	Yes Sec. 10.35(b)(2)(ii)(C)	Yes Sec. 10.35(b)(2)(ii)(D)	Yes Sec. 10.35(b)(2)(ii)(E)	No	No	No	No	No	Yes Sec. 10.35(e)(1)	Yes, as to Significant Fed Tax issue (Or "No Penalty Protection" Disclaimer Required, except for Marketed Opinions Where All Levels of Confidence Must be >50%) Sec. 10.35(e)(4)	Yes Sec. 10.35(c)(v)

THIS DECISION TREE MAY NOT BE USED FOR PENALTY PROTECTION
DECISION TREE FOR POTENTIAL APPLICATION OF CIRCULAR 230, SECTION 10.35



[1]Writings include e-mail messages and faxes. Circular 230, section 10.35(b)(2)(i). The Circular consistently uses, without definition, the term ''Advice'' which may include any written statement concerning a federal tax issue.

[2]A federal tax issue is a question concerning the federal tax treatment of an item of income, gain, loss, deduction, or credit, the existence or absence of a taxable transfer of property, or the value of property for federal tax purposes. Circular 230, section 10.35(b)(3).

[3]The exclusion for preliminary advice is for written advice provided during the course of an engagement if the practitioner is reasonably expected to provide subsequent written advice to the client that will satisfy the requirements for Covered Opinions. Circular 230, section 10.35(b)(2)(ii)(A).

[4]Circular 230, section 10.35(b)(2)(ii)(B).

[5]This exclusion applies only when the written advice is provided after the taxpayer has filed a tax return with the IRS if it is solely for use by the taxpayer and if the practitioner neither knows nor has reason to know that the advice will be used by the taxpayer to take a position on a tax 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 practitioner. Circular 230, section 10.35(b)(2)(ii)(C).

[6]Circular 230, section 10.35(b)(2)(ii)(D).

[7]This exclusion applies only if the advice does not reach a conclusion that suggests at any level of confidence that the taxpayer might prevail. For example, the negative advice exclusion does not apply if the practitioner concludes that the treatment in favor of the taxpayer is not frivolous. Circular 230, section 10.35(b)(2)(ii)(E).

[8]A Covered Opinion includes advice arising from a transaction that is the same as or substantially similar to a transaction that, at the time the advice is rendered, the IRS had determined to be a tax avoidance transaction and identified by published guidance as a ''Lisited Transaction'' under Treas. reg. section 1.6011-4(b)(2). Circular 230, section 10.35(b)(2)(i)(A). For a list of Listed Transactions, see IRS Notice 2004-67 for the list through the date that the notice was issued and, for more recent transactions, see http://www.irs.gov/businesses/corporations.

[9]A Marketed Opinion is one that the practitioner knows or has reason to know will be used or referred to by another to promote, etc., an arrangement to a taxpayer. Circular 230, section 10.35(b)(5)(i).

[10]If a tax benefit is claimed in a manner consistent with the statute and congressional purpose, the principal purpose of the arrangement is neither tax avoidance nor tax evasion. Circular 230, section 10.35(b)(10). Therefore, the written advice need not comply with the rules under section 10.35 of the circular related to principal purpose arrangements.

[11]If it cannot be determined that the tax benefit is claimed in a manner consistent with the statute and congressional purpose, the written advice need not comply with the rules under section 10.35 of the Circular related to Principal Purpose arrangements if the taxpayer's principal purpose is not tax avoidance or evasion. Circular 230, section 10.35(b)(2)(i)(B).

[12]Circular 230, section 10.35(b).

[13]Circular 230, section 10.35(b)(5)(i).

[14]Circular 230, section 10.35(b)(2)(i)(C)(3). Conditions of Confidentiality are defined in section 10.35(b)(6).

[15]Circular 230, section 10.35(b)(2)(i)(C)(4). Contractual protection is defined in section 10.35(b)(7).

[16]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 transaction(s) or matter(s) addressed in the opinion. Circular 230, section 10.35(b)(3).

[17]Circular 230, section 10.35(b)(4)(i).

[18]Circular 230, section 10.35(b)(4)(ii). The full statement is ''For purposes of this section, written advice, other than advice described in paragraph (b)(2)(i)(A) of this section (concerning listed transactions) or paragraph (b)(2)(i)(B) of this section (concerning the principal purpose of avoidance or evasion), is not treated as a reliance opinion if the practitioner prominently discloses in the written advice that it was not intended or written by the practitioner to be used, and that it cannot be used by the taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer.''