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The Application of Circular 230 in Estate Planning

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THE APPLICATION OF CIRCULAR 230 IN ESTATE PLANNING (This Article May Not Be Relied on for Penalty Protection)

By Jonathan G. Blattmachr, Mitchell M. Gans, and Tracy L. Bentley

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The authors think that the new requirements under Circular 230 will likely have a substantial impact on estate-planning practice. Under the circular, written advice concerning a transaction that has tax avoidance as its principal purpose—or perhaps even its significant purpose in some cases—is a covered opinion that triggers various rules. Because so many estate-planning techniques are tax-driven, practitioners, the authors argue, may find themselves routinely subject to these rules unless they refuse to commit their advice to writing. Of the various rules the circular imposes, perhaps the most disquieting one, according to the authors, deals with clients seeking an opinion to protect against the assertion of the negligence penalty. Even though the client may only require the opinion to state that there is a reasonable basis for the claimed position, the new rules, if applicable, will require, in the authors' view, the practitioner to conclude that the position is more likely than not the correct one or to state in the opinion that it cannot be relied on for penalty protection purposes. In short, the authors conclude unless these rules are altered before their effective date, estate-planning practice is about to undergo a radical change.

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I. Introduction

Effective June 20, 2005, practice requirements for many individuals and firms that provide tax advice and practice before the IRS¹ will change. When providing written advice, practitioners will have to comply with revised Circular 230.² Failure to comply with the circular

¹"Practice before the IRS" includes the presentation before the IRS or any of its personnel relating to a taxpayer's rights, privileges, or liabilities under laws or regulations administered by the IRS. Circular 230, section 10.2(a). Attorneys, certified public accountants, enrolled agents, enrolled actuaries, individuals qualifying in accordance with Circular 230, section 10.5 or Circular 230, section 10.7, government officers and employees and state officers and employees are allowed to practice before the IRS. Circular 230, section 10.3.

²Under the American Jobs Creation Act of 2004 (P.L. 108-357), 31 U.S.C. 330 was amended to clarify that the Treasury Department may impose standards for written advice relating to any matter that is identified as having potential for tax avoidance or evasion and to authorize the IRS to impose monetary penalties

(Footnote continued on next page.)

may result in disbarment or suspension of practice before the IRS and a censure or fines.³ It may also serve as a predicate for professional liability. Because practitioners who do estate planning often provide written advice relating to federal tax issues, the circular may have a significant impact in the estate-planning community.

To deter taxpayers from engaging in inappropriate tax-driven transactions, a three-prong approach has evolved. Under the first prong, taxpayers who engage in those transactions are subject to penalties imposed by the code when the claimed tax treatment is denied. Under the second prong, taxpayers are required to affirmatively disclose so-called reportable or listed transactions. Under both of those prongs, taxpayers are the target. Under the third prong, unlike the first two, practitioners are the focus. They are made subject to sanction if they fail to comply with the ethics-type rules the Treasury Department has imposed in the circular. Given the common concern animating the three prongs of attack, one might expect that they would take a parallel approach. Surprisingly, however, the three prongs have a somewhat non-parallel structure. This article primarily discusses the recent ethics-type changes made by the Treasury Department in the circular.

Given the nature of our self-assessment tax system, Treasury's efforts to provide more effective enforcement should be applauded. To the extent Treasury is successful, the tax burden is more fairly distributed. Unfortunately, as will be explained, certain changes made in Circular 230 may, contrary to its intended purpose, actually reduce compliance. Some aspects of the circular, as revised, will chill the free flow of information between practitioner and client, resulting in uninformed clients taking return positions born out of self-interest rather than professionally informed analysis of the law. In short, in some respects, the changes might well be viewed as an overreaction that will prove to be problematic not only

against a practitioner who violates any provision of Circular 230. The final regulations that amended Circular 230 do not reflect those amendments to 31 U.S.C. 330.

³The censure, suspension, or disbarment may occur for willfully violating the circular or recklessly or through gross incompetence violating certain sections of it. Circular 230, section 10.52. The Jobs Act authorizes the Treasury Department and the IRS to impose a monetary penalty against a practitioner who violates any provision of Circular 230. The regulations promulgated under T.D. 9165 do not reflect that authorization. Sanctions under Circular 230 (for example, disbarment of practice before the IRS) apply in the event of willful, reckless, or grossly incompetent behavior by the practitioner. Unfortunately, the issue of whether the practitioner has been, for example, willful or reckless may be one of dispute and, because the consequences of disbarment, etc. could be so severe to the practitioner, many probably will err on the side of conservatism. In fact, the circular seems so broad and encompassing, even perhaps of routine matters, that it will probably retard the "free flow" of tax advice to clients. See Stratton, "Government Urges Common-Sense Approach to Circular 230 Regs," *Doc 2005-2719*, 2005 TNT 27-1 (Feb. 10, 2005), which might be read as an acknowledgement that the Treasury Department went perhaps too far in Circular 230 in curbing a practice of "sloppy" opinions related to tax shelters.

for practitioners and taxpayers but also for the Treasury Department — perhaps even raising constitutional questions.

II. Right to Regulate Practice Before the IRS

Federal statutory law (31 U.S.C. 330) has long permitted the Treasury Department to issue rules relating to practice before the IRS.⁴ Practice before the IRS encompasses all matters connected with presentation to the IRS or any of its personnel, relating to a taxpayer's rights, privileges, or liabilities under laws or regulations administered by the IRS. Those presentations include the preparation and filing of necessary documents, correspondence with and communications to the IRS, and the representation of a taxpayer at conferences, hearings and meetings.⁵

III. Background About Circular 230

The Treasury Department published regulations in Circular 230 (31 C.F.R. part 10). In 1984 the regulations were amended to provide standards for tax shelter opinions (49 F.R. 6719). In 2002 additional final regulations were issued incorporating only the non-tax-shelter related matters (67 F.R. 48760). On December 20, 2004, Treasury issued more final regulations amending Circular 230 (T.D. 9165), including the adoption of new section 10.35.

IV. Why Taxpayers May Be Provided Tax Opinions

Tax opinions are typically provided by two groups. First, some promoters who sell securities and investments provide a description of their tax effects. Failure to provide that information could constitute a material misrepresentation (or omission), resulting in liability under the securities laws. Also, if the investment is designed to confer tax benefits (for example, an exemption from taxation, taxation at a low rate, a deduction, a credit or a transfer that avoids gift, estate, generation-skipping, or other tax), a potential investor will want to fully understand the tax issues before deciding whether to acquire it.⁶

Second, practitioners provide their individual clients (that is, those who invest in the security, plan, or other financial arrangement) with advice about tax consequences of arrangements to help them avoid penalties that may be imposed if the reporting (or nonreporting) of the tax effects is incorrect. Also, sometimes, a taxpayer will simply want to understand the tax consequences of a contemplated transaction, whether viewed as beneficial

⁴"[I]t cannot be disputed that a Federal agency can regulate the conduct of attorneys who appear before it . . ." *New York State Bar Association v. Federal Trade Commission*, *American Bar Association v. Federal Trade Commission*, 276 F. Supp.2d 110, 136, n. 22 (2003).

⁵Circular 230, sections 10.2(a), 10.3.

⁶Even a charitable organization typically will want to know if the return on an investment is unrelated business taxable income under section 512 of the Internal Revenue Code of 1986, as amended. Section references are to the code or the regulations thereunder, except as otherwise noted.

or detrimental. For example, a taxpayer might want assurance that little or no gift tax will arise by creating a grantor retained annuity trust (GRAT) described in section 2702(b)(1) of the Internal Revenue Code of 1986, as amended. Another taxpayer might not expect the arrangement to produce a beneficial tax result but may simply want a full understanding of the transaction before undertaking it. A common example in estate planning might be to ask how much gift and generation-skipping transfer tax the individual will have to pay on a gift to a grandchild. As will be explained, the broad net that Circular 230 casts seems to be premised on the idea that, whenever tax results are a significant factor in the arrangement, the taxpayer expects advice that the effects will be beneficial — for example, the transfer will not be subject to any tax. That is not always true. Nonetheless, the circular can apparently apply, except with respect to reliance opinions (discussed below), regardless of whether the advice is “good” news, “bad” news, or just news to the taxpayer and regardless of the adviser’s level of confidence in the opinion.

V. Penalties: A Brief Summary

While the focus of this article is on the penalties Circular 230 imposes on practitioners, taxpayers who take incorrect positions on their returns may also be subject to penalties. Taxpayers seeking to avoid penalties will often secure professional opinion. In imposing standards on practitioners who provide those opinions, the Treasury Department has indirectly made it more difficult for taxpayers to use an “advice-of-counsel” defense when the IRS seeks to impose a penalty. Thus, before continuing with an examination of the circular, a brief summary of the accuracy-related penalty under 6662 would provide a useful backdrop.

Section 6662 imposes an “accuracy-related penalty” on an underpayment of tax if it is attributable to one or more of the following:

1. negligence or disregard of rules or regulations;⁷
2. substantial understatement of income tax;⁸
3. substantial valuation misstatement under chapter 1 of the code;⁹
4. substantial overstatement of pension liabilities;¹⁰ or
5. substantial estate or gift tax valuation understatement.¹¹

Also, recently enacted section 6662A imposes a penalty on underpayments of income tax attributable to reportable and listed transactions.¹²

In the transfer-tax context, the only penalties that are relevant are the penalty imposed on negligence or the

disregard of rules or regulations and the penalty imposed on the substantial estate or gift tax valuation understatement.¹³

As will be discussed, under section 6664, penalties can be avoided if it can be established that the taxpayer had reasonable cause and acted in good faith regarding the underpayment (except that, in the case of the section 6662A penalty, the taxpayer must also satisfy the more rigorous requirements specified in section 6664(d)).

Summary and conclusion about penalties. Tax rules are extremely complicated. If they are not correctly followed, penalties may be imposed. In some cases, the determination of whether a penalty is imposed is based on an objective factor (such as whether there is substantial authority for the position a taxpayer has taken). In others, it is based on a subjective factor (such as whether the taxpayer believed it was more-likely-than-not that the position would prevail). In certain circumstances, the penalty may be avoided by the reliance of an opinion of counsel or other tax professional. In addition, whether the penalty may be avoided or not, a taxpayer often wants to be informed about the correct federal tax treatment of an arrangement. Taxpayers turn to professionals for that advice. As will be explained, in many cases, how (or whether) a tax professional may provide that advice will be significantly altered by Circular 230.

VI. Revisions to Circular 230

A. Reasons for the Revisions

In the background statement accompanying the issuance of the regulatory changes that were proposed to the circular in 2003, it was stated, in effect, that because the tax system’s effectiveness is based, in part, on the public’s confidence in tax advisers, changes in the rules for practice before the IRS need to change to “restore, promote and maintain” the public’s confidence in those advisers. The implication, of course, is that the public’s confidence in tax advisers had eroded and that the advisers must be more vigorously controlled by the federal government. Thus, even if a practitioner complies with ethics rules under state law, he or she may still be subject to sanction (including possible suspension or disbarment from practice before the IRS) under the circular.

B. Overview of the Revisions

There are three broad changes to Circular 230. The first is contained in section 10.33. That section sets forth what are labeled as “best practices.” Those are suggested or “aspirational” practices that Treasury believes tax practitioners should follow. Because they are not mandatory, a practitioner who fails to comply with them will not be subject to discipline under the circular. They will not be discussed in this article.¹⁴ Nevertheless, practitioners

⁷Section 6662(b)(1).

⁸Section 6662(b)(2).

⁹Section 6662(b)(3).

¹⁰Section 6662(b)(4).

¹¹Section 6662(b)(5).

¹²Also, the code imposes a fraud penalty (section 6663) and a penalty on the filing of frivolous income tax returns (section 6702).

¹³In addition to those penalties, the fraud penalty can also be imposed in the transfer tax context. See section 6663.

¹⁴[B]est practices include the following: (1) Communicating clearly with the client regarding the terms of the engagement; (2) Establishing the facts, determining which facts are relevant,

(Footnote continued on next page.)

may wish to ponder whether failure to follow those suggested practices could result in liability.¹⁵

The second change is to set forth minimum required practice rules regarding a written discussion of a federal tax matter. Those rules are contained in sections 10.35 and 10.37. The third set of changes are contained in sections 10.36 and 10.52, which set forth standards for a practitioner who has principal authority for overseeing a firm's federal tax practice (requiring efforts to ensure compliance with the circular).

C. Unrevised Section 10.34

Before turning to section 10.35, it seems appropriate to discuss section 10.34, which was not changed, as it provides a basis for comparison with the new provisions in section 10.35.

Under section 10.34, a practitioner may not sign a tax return as a preparer (or advise a client to take a position on a tax return) if the practitioner determines it contains a position that does not have a realistic possibility of being sustained on its merits or unless the practitioner determines that the position is not frivolous and is adequately disclosed to the IRS. A position is considered to have a realistic possibility of success if a reasonable and well informed analysis of the law and the facts by a person knowledgeable in the tax law would lead such a person to conclude that the position has approximately a one in three, or greater, likelihood of being sustained on its merits.¹⁶

D. New Section 10.35

Section 10.35 presents new requirements for certain written discussions of a federal tax matter. The new requirements are effective June 20, 2005. A writing apparently includes an e-mail or a fax.¹⁷ As indicated, failure to meet those practice standards may result in disciplinary action. The writings to which this section applies are referred to as "covered opinions." It is important to note the expansive scope of that concept and that it may apply to advice that practitioners would not ordinarily regard as a "formal" opinion.

evaluating the reasonableness of any assumptions or representations, relating the applicable law to the relevant facts, and arriving at a conclusion supported by the law and the facts; (3) Advising clients regarding the import of the conclusions reached; and (4) Acting fairly and with integrity in the practice before the IRS." Circular 230, section 10.33(a). "Tax advisors with responsibility for overseeing a firm's practice of providing advice concerning federal tax issues or of preparing or assisting in the preparation of submissions to the IRS should take reasonable steps to ensure that the firm's procedures for all members, associates, and employees are consistent with the best practices set forth in paragraph a of this section." Circular 230, section 10.33(b).

¹⁵"[P]roof of a violation of a rule or statute regulating the conduct of lawyers may be considered by a trier of fact as an aid in understanding and applying" the lawyer's duty of care. *Restatement of the Law Governing Lawyers* (3d) section 52(2)(c).

¹⁶See also section 6694 (imposing a similar standard).

¹⁷"Written advice (including electronic communications)" Circular 230, section 10.35(b)(2)(i).

A covered opinion is "written advice" by a practitioner concerning one or more federal tax issues arising in three areas: a listed transaction is involved; the principal purpose for entering into the transaction is tax avoidance; or where tax avoidance is a significant purpose and other elements are present. It seems that mere recitals of the provisions of the code (for example, "section 215 provides for a deduction for alimony paid") may constitute advice — arguably, the practitioner is advising as to what the code says. It is possible that what is really a transmittal message is written advice that must be tested to determine if it is a covered opinion. ("Dear Bridget: I am enclosing a draft of your irrevocable life insurance trust to which you will assign the policies insuring your life to attempt to have the proceeds excluded from your gross estate.") It may seem unlikely that a traditional estate-planning document, such as a will or a revocable trust, would be "written advice," but the possibility that it could perhaps be construed as such cannot be denied when the document contains clear tax statements. ("I direct that this my Will be construed and this trust for my spouse be administered to qualify for the estate tax marital deduction in my estate.")

Before turning to the categories of writings that constitute covered opinions, it is appropriate to note that there are two writings that are expressly excluded (with one exception)¹⁸ from being covered opinions.

Exclusion for preliminary advice. 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.¹⁹ It seems that it is appropriate to consider including in any such "exempt" writing a recital that it is intended to be preliminary advice; that it is expected that the adviser will provide subsequent written advice; and that such subsequent writing will comply with the covered opinion rules unless it is determined that such subsequent writing is not a covered opinion.

Exclusion for pension, bond and SEC document advice. The second broad exception, which does not apply to listed transactions or any arrangement the

¹⁸Section 811 of the Jobs Act added to the code new section 6707A, which imposes monetary penalties for failure to include on any return or statement any information required to be disclosed under section 6011 regarding a "reportable transaction." There are six categories of reportable transactions including listed transactions, certain confidential contracts, and certain contractual protection arrangements. See Treas. reg. sections 1.6011-4, 20.6011-4, 25.6011-4, 53.6011-4, 54.6011-4, and 56.6011-4. See IRS Notice 2005-11, 2005-7 IRB 493, *Doc 2005-1219*, 2005 TNT 13-10, relating to new penalty section 6707A. IRS Notice 2005-11 announces that the IRS will issue regulations under section 6707A. It is also appropriate to note that the act also enacted new section 6662A, which imposes new penalties for understatement of tax regarding any listed transaction and any other reportable transaction (if avoidance or evasion of income tax was a significant purpose of the other reportable transaction). IRS Notice 2005-12, 2005-7 IRB 494, *Doc 2005-1215*, 2005 TNT 13-9, announces that the IRS will issue regulations under section 6662A as well as under revised sections 6662 and 6664.

¹⁹Circular 230, section 10.35(b)(2)(ii)(A).

principal purpose of which is tax avoidance, applies to advice that concerns qualification of a qualified plan, a state or local bond opinion,²⁰ or is included in documents required to be filed with the Securities and Exchange Commission.²¹

1. Listed transactions. The first area of written advice that constitutes a covered opinion is one 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 has determined to be a tax avoidance transaction and identified by published guidance as a "listed transaction" under Treas. reg. section 1.6011-4(b)(2).²² An example of such a listed transaction is the one identified in IRS Notice 2000-44²³ (the so-called son-of-BOSS transaction). To date, no listed transaction seems directly to involve what probably would be viewed as a traditional estate-planning arrangement. But the list is constantly updated and practitioners should monitor those notices.

Apparently, even if the written advice concludes that the taxpayer would receive no benefit from the listed transaction (for example, the opinion concludes that the tax benefits that the listed transaction supposedly confers are not permitted under the code), the writing must comply with the covered opinion requirements. For example, a taxpayer requests a discussion of whether an arrangement he or she has entered is a listed transaction. The practitioner concludes that it is and that the taxpayer must make certain disclosures to avoid penalties. That written advice must apparently comply with the covered opinion practice requirement rules. That requirement regarding listed transactions may be contrasted with the definition of a reliance opinion (discussed below), which is one that, among other conditions, reaches a more-likely-than-not level of confidence that at least one so-called significant federal tax issue would be resolved in the taxpayer's favor. In other words, it seems that, even if the practitioner advises that all federal tax issues related to the listed transaction discussed in the writing will be resolved against the taxpayer, the writing must comply with the covered opinion rules.

It is also appropriate to note that the listed transaction writing is a covered opinion if it discusses one or more federal tax issues and, unlike the definition of a reliance opinion, the listed transaction writing is a covered opinion even if no federal tax issue discussed is "significant." Therefore, the "simple" written advice that the taxpayer should file IRS Form 8886 to report the listed transaction seems to be a covered opinion.

In other words, any written advice relating to a listed transaction, unless falling under the exclusion dealing with preliminary advice, must comply with the covered opinion rules.

2. Tax avoidance is the principal purpose of an arrangement. The second context in which written advice constitutes a covered opinion is where the advice relates to a federal tax issue arising from any partnership or other entity, any investment plan or arrangement, or any other plan or arrangement (an "arrangement"), the principal purpose of which is the avoidance or evasion²⁴ of any tax imposed by the code.²⁵ Similar to the rules regarding listed transactions, any writing about such an arrangement, apparently regardless of the level of confidence reached about the outcome of any federal tax issue, regardless of whether any federal tax issue discussed is significant, and regardless of whether any conclusion that any federal tax issue would be resolved in the taxpayer's "favor," is a covered opinion that must comply with the covered opinion rules contained in the circular (unless the preliminary-advice exclusion applies).

The nature of estate planning. Traditional estate planning certainly covers the transmission of property at death but deals with much more, including choice of guardians for minor children, selection of other fiduciaries, planning for successive management of a closely held business, burial instructions, marital arrangements, and retirement planning. Almost always, for individuals of significant means, it includes planning to reduce gift, estate, and generation-skipping transfer taxation. Indeed, everyday decisions, such as providing for the education or healthcare of descendants, involve tax considerations — from establishing educational accounts under section 529 to paying tuition for another directly to an educational institution so as to fall under the nontaxable transfer rule of section 2503(e) to avoid gift tax. The timing and form of a gift of \$11,000 to each descendant or other loved one in any calendar year may be motivated by a wish to have the transfer be protected from the gift tax (or perhaps the generation-skipping tax) through the application of the annual exclusion. Structuring of wills and trusts often is dictated primarily by tax considerations, such as having a trust contain terms so it may qualify for the marital deduction or making a bequest to use exactly the taxpayer's remaining estate tax exemption and in a manner so that the bequest will not be included in the gross estate for federal estate tax purposes of the taxpayer's surviving spouse or perhaps a descendant.

Is tax avoidance the principal purpose, within the meaning of the circular, of those kinds of typical estate-planning arrangements or transactions? The circular does not seem to provide any guidance on that question. One might, it seems, reasonably argue that tax avoidance is secondary to the paramount purpose in each of the posited cases. For example, it is certainly arguable that the tax motive in making an annual-exclusion gift is not as important as the desire to make a gift to the donee. But, perhaps, such an argument might be more difficult to maintain when an arrangement that is specifically

²⁰ Although those state and local bond opinions are excluded from the new Circular 230 rules, proposed regulations regarding those opinions have been issued. 31 C.F.R. Part 10 (Dec. 20, 2004).

²¹ Circular 230, section 10.35(b)(2)(ii)(B).

²² Circular 230, section 10.35(b)(2)(i)(A).

²³ Notice 2000-44, 2000-2 C.B. 255, Doc 2000-21236, 2000 TNT 157-7.

²⁴ Evasion of tax is a crime. Avoidance of tax is not. *United States v. Thompson/Center Arms Co.*, 504 U.S. 505, 511 n.4 (1992) (distinguished between evasion of tax and avoidance of tax).

²⁵ Circular 230, section 10.35(b)(2)(i)(B).

designed to avoid tax, such as a GRAT or a qualified personal residence trust (QPRT), is employed. In any case, because the consequences for a practitioner for failing to comply with the circular may be severe, many practitioners presumably will find it prudent to comply with the covered opinion rules in any case where it is even arguable that the tax motive is paramount. As will be suggested, that will complicate practice and result in increased fees for the client.

3. Tax avoidance is a significant purpose of certain arrangements. The third category is where the advice concerns one or more federal tax issues arising from any arrangement when a *significant purpose*²⁶ is the avoidance or evasion of any tax imposed by the code. In this category, the advice will constitute a covered opinion only if it falls within one (or more) of four subcategories:²⁷ “reliance opinions”; “marketed opinions”; advice that is subject to conditions of confidentiality; and advice that is subject to contractual protection. Those four subcategories are discussed below.

It seems likely that the IRS would be inclined to conclude that tax avoidance is a significant purpose (if not the principal purpose) in many common estate-planning vehicles (for example, a GRAT). Thus, even if an estate-planning practitioner feels comfortable concluding that tax avoidance is not the principal purpose for the transaction, he may nonetheless determine that tax avoidance is a significant purpose and therefore may have to consider whether the advice falls within one of the four subcategories.

a. Reliance opinions. A reliance opinion, the first subcategory, is written advice that concludes at a confidence level of “more-likely-than-not” (that is, a greater than 50 percent likelihood)²⁸ that one or more significant federal tax issues would be resolved in the taxpayer’s favor.

i. Federal tax issue. A federal tax issue is a question concerning the federal tax treatment of an item. It includes a question concerning “the existence or absence of a taxable transfer of property” or “the value of property for federal tax purposes.”²⁹ That would appear to extend to virtually the entire gamut of estate-planning transactions.

ii. Significant issue. A federal tax issue is significant if the IRS has a reasonable basis for a successful challenge³⁰ 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.³¹ It may be difficult for practitioners to determine whether the IRS has a reasonable basis for a successful challenge. Perhaps “everyday” advice such as assuring the taxpayer that a gift of \$11,000 of cash to a grandchild qualifies for the annual exclusion is not the type of issue for which the IRS would have a reasonable basis to challenge. But in rendering that advice, the practitioner perhaps should consider that the taxpayer may have made or might make other gifts to her grandchild that year. Given that birthday and holiday presents seem likely to be made, can the practitioner reasonably rely on the client’s statements in determining whether the issue is a significant one? With that consideration in mind, how confident can a practitioner be that the IRS has no reasonable basis for a successful challenge? As will be discussed in more detail below, a threshold for factual reliance must be complied with when delivering a covered opinion. But the circular does not explicitly require that the practitioner use any particular factual threshold when assessing whether the IRS would have a reasonable basis for challenge in the context of determining if a significant federal tax issue is at stake. Nevertheless, it seems prudent for practitioners to employ the higher factual-reliance standards for all purposes in applying the covered opinion rules.³²

In making the definition of “significant federal tax issue” turn on whether the IRS would have a reasonable basis for challenge, the circular fails to clarify how that test will be applied. While the definition would appear to create an objective standard — focusing on whether a disinterested party or practitioner would conclude that there was a reasonable basis for an IRS challenge — it would seem that practitioners holding a good-faith subjective belief that any IRS challenge would fail to satisfy the reasonable-basis standard should not be sanctioned.³³ Nonetheless, given the absence of guidance on the objective-subjective issue, it might be appropriate for practitioners to carefully scrutinize their analysis before concluding that the IRS would not have a successful basis

³¹Circular 230, section 10.35(b)(3).

³²Treas. reg. section 1.6694-1(e), which deals with the penalty imposed on the preparer of an income tax return, provides that practitioners may rely “in good faith without verification” on information supplied by the client. The preparer must, however, make appropriate inquiries of the client to ascertain whether the client is entitled to the tax treatment claimed. Thus, assuming the standard in this regulation were adopted for purposes of determining whether a significant federal tax issue was present, in the annual-exclusion example in the text, it would seem that the practitioner would be required to inquire about other gifts and would be permitted to accept the client’s response as accurate.

³³Treas. reg. section 1.6694-2(d), which deals with the penalty imposed on the preparer of an income tax return, adopts such an objective standard. The regulation goes on, however, to permit a practitioner to avoid the penalty, even if the objective standard is violated, based on a subjective good-faith showing (though the practitioner must also establish “reasonable cause”). See Treas. reg. section 1.6694-2(d).

²⁶In 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.

²⁷Circular 230, section 10.35(b)(2)(i)(B).

²⁸It seems certain that this means that the level of confidence is at least more likely than not. In other words, written advice cannot escape being a reliance opinion merely because the level of confidence is greater than more-likely-than-not.

²⁹Circular 230, section 10.35(b)(3).

³⁰It should be noted that this standard is phrased differently from the realistic possibility of success threshold (at least one chance in three) required for return preparers and signers under section 10.34, discussed above. No definition of the “reasonable basis for a successful challenge” is offered in the circular.

for challenge.³⁴ It might also be appropriate, when a practitioner does reach that conclusion, to explicitly so state in the written advice to provide a contemporaneous record of the practitioner's good-faith attempt to comply.

b. Exceptions to reliance opinions. In essence, there are two additional exceptions under which written advice that otherwise appears to be a reliance opinion might not be viewed as such. (The facts that the IRS has no reasonable basis for a successful challenge or that no significant federal tax issue is addressed may be viewed as the first and second exceptions.)

i. Confidence lower than more-likely-than-not. If the writing does not reach a level of confidence of more-likely-than-not that the significant federal tax issue will be resolved in the taxpayer's favor, it is not a reliance opinion. That exception may be of importance to estate planners and their clients.

As indicated above, taxpayers generally may face penalties relating to estate, gift, and generation-skipping transfer tax matters if they are negligent.³⁵ As long as the taxpayer has a reasonable basis for the position, as distinguished from the more rigorous more-likely-than-not-belief standard, the negligence penalty does not apply.³⁶ Hence, a client may be provided negligence penalty protection by receiving a written opinion concluding that the position is reasonable (as opposed to, for example, that it is more-likely-than-not). That means that compliance with the covered opinion rules is not mandatory for the adviser, unless compliance is required for another reason (for example, the principal purpose, and not just a significant purpose, of the arrangement is tax avoidance).

However, for several reasons, a client may be dissatisfied with an opinion not reaching at least a more-likely-than-not or greater level of confidence. For example, a client interested in creating a GRAT but unwilling to pay gift tax may seek a high-level assurance from the practitioner that the remainder has a "zeroed-out" value. In such a case, the client is not concerned about penalties but is rather concerned about the risk of tax liability. If the client asks the adviser to specify his or her level of confidence (and it is more-likely-than-not or higher) and tax avoidance is a significant factor for the GRAT arrangement, compliance with Circular 230 is required even though, apparently, that level of confidence was unnecessary to avoid penalty protection.³⁷

ii. Statement that it cannot be used for penalty pro-

tection. The second exception for falling outside the reliance opinion definition is where 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."³⁸ That approach will presumably be taken in many cases. However, the issue can become more complicated if, for example, the client wants a high-level assurance, as in the case of the zeroed-out GRAT, but also wants negligence-penalty protection. If the practitioner provides the client with a writing reaching a more-likely-than-not conclusion, the client will have penalty protection and will also have the high-level assurance the client desires (even though not necessary for penalty protection). However, the opinion will constitute a covered opinion, triggering all of the compliance requirements of Circular 230 and thereby causing increased cost to the client. Nonetheless, it appears that the client's objectives could be satisfied without causing the opinion to be a covered opinion by using two separate writings: one reaching a reasonable-basis conclusion and a second reaching a more-likely-than-not or even higher-level conclusion. The first is not a reliance opinion and therefore need not comply with the covered opinion rules (unless it must comply for some other reason) because it does not reach a more-likely-than-not conclusion — and all the taxpayer needs to avoid a negligence penalty is to have a reasonable-basis conclusion. The second writing may carry the prominently displayed notice that the writing cannot be relied on for penalty protection; if it does, it also will not be a reliance opinion so that it too need not comply with the covered opinion rules (unless it must do so for a reason other than being a reliance opinion). The taxpayer in theory does not need penalty protection from this second writing — the taxpayer received what he needed in that regard under the reasonable-basis writing. But the taxpayer will have received the practitioner's advice about what he believes is the actual threshold of likely outcome, which might be used by the taxpayer to bring an action against the practitioner if the advice turns out to be incorrect and the taxpayer is injured by incurring tax liability (even though no penalty may be imposed on account of the reasonable-basis letter).

With proper counseling, such a two-writing strategy might well be accepted by clients. However, there may be some downsides. First, the IRS may frown on practitioners who thread the needle to avoid complying with the covered opinion rules. Indeed, it might argue, analogizing to the step transaction doctrine, that the two opinions should be integrated. Second, a practitioner might be criticized by a client for not dotting all the i's and crossing all the t's of the covered opinion requirements even though the practitioner chose a route that did not require such compliance. The client may be advised by another practitioner that the IRS would be more reasonable in settling an issue, for example, if the practitioner providing the written advice had complied. Perhaps practitioners should ask the client what route he wants

³⁴The code itself, in an unrelated context, uses a similar test that focuses on the taxpayer's subjective belief as to whether the IRS would have a reasonable basis for a challenge. See section 6603(d)(3)(A).

³⁵See section 6662.

³⁶See Treas. reg. section 1.6662-3.

³⁷It is at least arguable that the "significant purpose" if not the "principal purpose" covered opinion rules should have been limited to circumstances (for example, tax shelters) when at least a more-likely-than-not level of confidence is required to avoid a penalty. In other words, written advice for estate, gift, and generation-skipping transfer tax matters could be offered without compliance with the covered opinion rules. But the Treasury Department concluded otherwise.

³⁸Circular 230, section 10.35(b)(4)(ii).

the adviser to follow in providing written advice. Complying with the covered opinion rules will result in higher fees to deliver the writing because the requirements are more stringent. Some clients will accept two letters when neither is a covered opinion.

All of the foregoing, of course, is based on the premise that the arrangement did not have tax avoidance as its principal purpose. With at least some estate-planning arrangements (for example, the creation of an irrevocable trust to acquire life insurance designed to allow subsequent premium payments to qualify for the gift tax annual exclusion through the grant to the beneficiaries of powers of withdrawal), it might be difficult to conclude with a high level of certainty that tax avoidance was not the principal purpose. Unfortunately, the circular provides no guidance on how the principal purpose of an arrangement is determined. It necessarily involves an examination of the taxpayer's subjective state of mind, an inquiry that is obviously fraught with difficulty.

c. Marketed opinions. Written advice is a marketed 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 his or her firm) in promoting, marketing, or recommending an arrangement to one or more taxpayers. Unless it relates to a listed transaction or to an arrangement the principal purpose of which is tax avoidance, a writing is not a marketed opinion, under an exception, if it prominently discloses in the written advice that: 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; the advice was written to support the promotion or marketing of the transaction(s) or matter(s) addressed in the written advice; and the taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax adviser.³⁹ In other words, if it is known or there is reason to know 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 avoidance⁴⁰ even if it contains the above disclosures.

The scope of what constitutes a marketed opinion seems very broad and may cover routine advice that a client may use in the conduct of its business. For example, a lawyer is engaged to write a statement to be included in a brochure about trusts to be distributed by a local bank or its customers, a brochure for a national brokerage firm about individual retirement accounts, or a brochure for a charity about ways to make gifts to the organization. In each case, the practitioner knows that the client will use the brochure in "promotion" and, because

some tax issue no doubt will be discussed, each presumably must contain the three prominently disclosed written "warnings." The words "written to support the promotion or marketing" of the ideas presented may not be conducive to the goal the institution wants to achieve by distributing the brochure but it seems that they must be present. It is uncertain whether a writing constitutes a marketed opinion if the lawyer merely prepares text that the client will put in its brochure with no attribution that it was prepared by the attorney. As indicated, a marketed opinion is written advice that "will be used or referred to by a person other than the practitioner . . . in promoting, marketing or recommending" an arrangement. One might conclude that "will be used" contemplates the use of the written advice even if it is attributed only to the "promoter" (and not the practitioner), such as where a charity sends its donors a brochure that explains deferred giving without identifying the practitioner. If that is so, would paraphrasing from the attorney's work, again without attribution to the lawyer, still make it a marketed opinion? On the other hand, it seems somewhat logical that the writing prepared by the practitioner is not a marketed opinion when the writing itself is not used in "promotion" and there is no reference to the lawyer (or the lawyer's firm). Indeed, if it is a marketed opinion, it must contain certain disclaimers. But the "end user" of the writing (for example, a charity preparing a brochure about deferred giving) may remove those disclaimers as it is not a practitioner. In fact, some charities in their brochures suggest that the donor seek advice from his or her own tax adviser. That alone, of course, would not be sufficient to meet the Circular 230 requirements for a marketed opinion — not only would other required "warnings" not be contained but it is doubtful it would be "prominently displayed." In any case, because of concern about not complying with the circular, many practitioners will choose to view even such a writing as a marketed opinion. It does not seem that the circular requires that the practitioner must prohibit the use of the writing by the "end user" (such as a charity). Nevertheless, given that the writing may constitute a marketed opinion if the practitioner has reason to know of its end use, it would seem prudent for any such writing to contain a prohibition of its use without the necessary disclosures.

It is possible that a marketed opinion even covers an article written about federal tax issues that is to be published in a commercial publication (such as *Tax Notes*) or distributed at a seminar sponsored by someone other than the practitioner (or his or her firm) attended by other tax practitioners.⁴¹ Although there seems to be an exception for the distributions of written advice by the practitioner (and his or her firm), there is none, it

³⁹The latter two requirements are repeated in Circular 230 section 10.35(e)(2) relating to certain required disclosures.

⁴⁰It is unclear whose principal purpose applies here, that of the promoter or that of the taxpayer to whom it is offered. In 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.

⁴¹It is uncertain whether a seminar attended by others but sponsored by the firm that has prepared a writing that will be distributed at the seminar makes the writing a marketed opinion. Presumably, the answer will turn on whether the firm reasonably knows that an attendee will use for or refer to the writing to someone else.

appears, for anyone else. Therefore, such an article written by a practitioner and published in a commercial publication or distributed at a conference may be a covered opinion unless it contains the prominently disclosed "disclaimers" and "warnings" discussed above, and does not address listed transactions or an arrangement the principal purpose of which is tax avoidance or evasion.⁴² As written, it may even cover e-mail responses on a listserv and possibly even e-mail or other correspondence between two practitioners in different firms working as cocounsel in a case. While the scope of the rule remains somewhat uncertain, if the government takes an expansive reading of it, "free speech" issues under the First Amendment of the Constitution may well arise. For example, if the IRS were to determine that publishing an article in a professional journal constituted a marketed opinion and that it violated the circular because of the failure to reach a more-likely-than-not conclusion, serious First Amendment issues would be raised. While the government can compel or prohibit disclosures to prevent fraud, it must appropriately tailor the regulation to its fraud-based concern to avoid a First Amendment violation.⁴³

"Prominently disclosed," for both marketed opinions and for written advice that otherwise would be a reliance opinion except for the "you cannot rely on this" warning, means bolded typeface that is larger than any other typeface used in the written advice. It is uncertain whether that means that the cover page of the brochure that might list the title of the topic and the sponsoring entity (for example, name of the bank or charity) must be in smaller type than the warning. Arguably, the title and sponsor's name are not part of the written advice but, if the title suggests any potential tax consequence, the IRS might conclude otherwise. Would the words "Ways to Support Our Organization" or "New York Estate Planning Council" have to be in smaller typeface than the warning? It does not seem that the warning need appear on every page of the marketing opinion but it is also unclear if it may be listed on a separate page at the end of the writing. Probably, a statement on the page preceding the written tax advice should be sufficient. In some cases, it may be appropriate for it to be contained at the top or bottom of every page. That way the practitioner should be "covered" if the "promoter" delivers, for example, one page of a multipage memorandum discussing the tax effects of the arrangement.

The ability to exclude a writing from the marketed opinion category by making the three disclosures may be important for additional reasons. One relates to the

ability of a practitioner to issue a limited scope opinion, as discussed in more detail below. A marketed opinion must address all significant federal tax issues. A limited scope opinion need not address all such issues. But a marketed opinion cannot be a limited scope opinion. Therefore, making the three disclosures in the writing and thereby avoiding marketed opinion status, the practitioner may issue a limited scope opinion that addresses only certain issues. For example, a brochure prepared for a charity about effective ways to give to the organization that constitutes a marketed opinion would have to cover not just the income tax effects of a donation but gift, estate, generation-skipping transfer tax issues, as well as possibly chapter 42 (private foundation tax rules that may apply to charitable lead trusts or charitable remainder trusts used to benefit even publicly-supported charities) and unrelated business taxable income provisions. However, if the brochure contained the three disclosures, it would not constitute a marketed opinion and could address only certain issues. Nevertheless, it seems appropriate to emphasize that this exclusion from being a marketed opinion does not apply to an arrangement that involves a listed transaction or where the principal purpose of it is tax avoidance (or evasion).

It should be noted that a marketed opinion need not reach any specified level of confidence to be a covered opinion.

d. Conditions of confidentiality. Written advice regarding one or more federal tax issues that is subject to conditions of confidentiality is a covered opinion. Such a condition of confidentiality will be present if the practitioner imposes on one or more recipients of the written advice a limitation on disclosure of the tax treatment or tax structure of the transaction and the limitation on disclosure protects the confidentiality of the practitioner's tax strategies, regardless of whether the limitation is legally binding. A claim that a transaction is proprietary or exclusive is not a limitation if the practitioner confirms to all recipients of the written advice that there is no limitation on disclosure of the tax treatment or tax structure of the transaction that is the subject of the written advice.

That is reminiscent of one of the parts of the reportable transactions regulation issued under section 6011.⁴⁴ There are six reportable transactions under those regulations, one of which is for a confidential transaction. Unlike the confidentiality transaction that is contained in the reportable transactions regulation, the confidentiality rule in Circular 230 is not limited to income tax transactions.

As noted, a claim that the transaction is proprietary or exclusive is not a limitation mandating the covered opinion rules must be followed if the practitioner confirms there is no limitation on disclosure. Circular 230 does not state that this confirmation must be contained in the written advice or even if it must be in writing. It seems that if the practitioner hopes to prevent the confidentiality rule from applying by specifying that there is no limit on disclosure, it would be preferable for it to be contained in the written advice itself.

⁴²It is even possible that an announcement of the conference with a description of federal tax topics that will be presented is a marketed opinion unless it contains the disclaimers and warnings and does not involve any listed transaction or any arrangement the principal purpose of which is tax avoidance or evasion.

⁴³See *Illinois ex rel. Madigan v. Telemarketing*, 538 U.S. 600 (2003) (upholding a fraud claim, over First Amendment argument, but reaffirming that certain government-compelled disclosures regarding charitable solicitation constituted a violation of the First Amendment).

⁴⁴Treas. reg. section 1.6011-4.

It is, perhaps, surprising that the confidentiality rule applies even if the federal tax issue is not significant and regardless of the level of confidence, if any, that is reached.

e. Contractual protection. Written advice that is subject to contractual protection is a covered opinion. Contractual protection means the taxpayer has the right to a full or partial refund of fees paid to the practitioner if all or part of the intended tax consequences from the matters addressed are not sustained, or if the fees are contingent on the taxpayer's realization of tax benefits from the transaction. This contractual protection provision is also reminiscent of the regulations on reportable transactions under section 6011.⁴⁵ The circular indicates that "any agreement to provide services without reasonable compensation" constitutes contractual protection, although it seems that would be the case only if the intended tax consequences are not sustained. It should be noted that in 2002, the Treasury Department addressed certain contingent fee issues.⁴⁶ And while these issues are beyond the scope of this article, it is worth noting that they are in some tension with the covered opinion rules in that they flatly prohibit the kind of contingent fee arrangement that, under the covered opinion rules, constitutes contractual protection.

VII. Requirements for Covered Opinions

The circular specifies four requirements with which a covered opinion must comply. Each has subparts. And other rules are also specified. So realistically the practitioner probably will have to deal with a dozen or so requirements for each covered opinion.

A. Factual Matters

A practitioner must use reasonable efforts to identify and ascertain the facts, which may relate to future events if a transaction is prospective or proposed, and to determine which of the facts are relevant. Apparently, whether the practitioner did or did not use reasonable efforts is an objective one. In other words, the fact that the practitioner honestly and perhaps even reasonably believed he had made reasonable efforts to identify and ascertain the facts may not be found to be compliance if it turns out the efforts were not reasonable. For example, a client wants advice whether transfers to the trust he proposes creating for his wife will qualify for the marital deduction. Reasonable efforts to identify the facts to issue the opinion, perhaps, must include determining if the wife is a U.S. citizen (as lifetime transfers to a spouse who is not a U.S. citizen do not qualify for the marital deduction⁴⁷). It is uncertain whether those efforts must also include an inquiry whether the wife might abandon her U.S. citizenship before any transfer is made or whether the property itself is a nondeductible interest. Would the practitioner also have to inquire as to whether the husband was imposing a condition on the transfer (for example, the

wife promises to bequeath the property on her death to his children) that could prevent it from qualifying for the gift tax marital deduction?

The practitioner must not base the opinion on any unreasonable factual assumption (including any with respect to future events). An unreasonable factual assumption is one the practitioner knows or should know is incorrect or incomplete. As an illustration, the circular states that it is unreasonable to assume that a transaction has a business purpose or is potentially profitable apart from tax benefits. The circular also states that it is unreasonable to rely on a projection, financial forecast of appraisal if the practitioner knows or should know it is incorrect, incomplete, or prepared by a person lacking the skills of qualifications necessary to complete it. Presumably that would permit a practitioner to specify that the sale of real estate to the taxpayer's child for the value determined by a qualified appraiser of such an interest is not a gift. But the exact wording may be important. For instance, stating, "It is our opinion that, if the value determined by the appraisal of your residence is correct, your sale of it for that price to your child will not constitute a taxable gift," may be acceptable but stating, "It is our opinion that, because you will be selling your home for its appraised value, you will not be making a taxable gift," may not be acceptable.

Similarly, the practitioner may not rely on any unreasonable factual representations, statement of findings of the taxpayer or any other person. As an illustration, the circular provides that the practitioner may not rely on a factual representation that a transaction has a business purpose if the representation does not include a specific description of the business purpose.

B. Relating the Law to the Facts

The practitioner, in rendering a covered opinion, must relate the applicable law to the facts. Applicable law includes "potentially applicable judicial doctrines." Although not specified, those may include the substance-over-form doctrine, the business purpose doctrine, the economic substance doctrine, the step transaction doctrine, and the reciprocal trust or reciprocal transfer doctrines.⁴⁸ Perhaps there are others. Unfortunately, those judicial or court-developed doctrines are not codified and therefore are uncertain in scope and content. It seems, to be on the "safe" side, that each covered opinion should discuss each doctrine. For example, although it does not seem that the business purpose doctrine is generally applicable to steps taken to reduce gift tax, a discussion that the doctrine should not apply (and specifying why that is so) probably should be contained in the advice.

The practitioner cannot assume any favorable resolution of any significant federal tax issue except with respect to certain limited scope opinions (discussed below) and in those circumstances (also discussed below) in which the practitioner is permitted to and does rely on the opinion of another practitioner, competent to give

⁴⁵*Id.*

⁴⁶T.D. 9021, Circular 230, section 10.27(b).

⁴⁷Section 2523(i).

⁴⁸See generally Jay A. Soled, "Use of Judicial Doctrines in Resolving Transfer Tax Controversies," 42 B.C. L. Rev. 587 (2001) (discussing the doctrine in the transfer tax context).

that advice. Apparently the practitioner may assume favorable resolution of any federal tax issue that is not significant (that is, the IRS has no reasonable basis for a successful challenge or its resolution could not have a significant effect on the overall federal tax treatment of the transactions or matters addressed in the opinion).⁴⁹ For example, a practitioner perhaps could assume, in discussing whether the property (for example, a patent⁵⁰) given to the individual's spouse who is a U.S. citizen is a nondeductible interest, that the form of the gift (for example, outright to the spouse) is consistent with the requirements for a transfer to qualify for the marital deduction.

The opinion must not contain internally inconsistent legal analyses or conclusions. For example, a conclusion that the actuarial value of the remainder interest in a charitable remainder was less than 10 percent seems inconsistent with a conclusion that the value of the remainder is deductible for income and gift tax purposes.⁵¹ It is not specified that the inconsistency must relate solely to federal tax issues. For example, a conclusion that the taxpayer's husband is not a citizen of the United States would seem inconsistent with a conclusion that a lifetime gift to the husband qualifies for the marital deduction even though the former conclusion is not one directly involving a tax issue.⁵²

C. Evaluation of the Significant Federal Tax Issues

The opinion must consider all significant federal tax issues (except as provided for limited scope opinions or for opinions that may and do rely on the opinion of another practitioner). It is interesting to note, as mentioned above, that written advice may constitute a covered opinion and therefore have to comply with those evaluation rules, even though it does not discuss any significant federal tax issue. Yet those covered opinions need to consider only the significant federal tax issues. In other words, as pointed out above, if the written advice relates to a listed transaction, it is a covered opinion, apparently regardless of whether the conclusions are favorable or unfavorable to the taxpayer and regardless of the level of confidence. However, section 10.35(c)(3) seems to require only that the writing address significant federal tax issues, which means, as mentioned above, the IRS has a reasonable basis for a successful challenge and its resolution could have significant effect, whether beneficial or adverse, on the overall federal tax treatment of the transactions or matters addressed in the opinion. So, if there is no significant federal tax issue, because for example, the practitioner concludes that the arrangement

involves a listed transaction, and it will almost certainly be resolved against the taxpayer and the taxpayer must report the transaction on Form 8886, the practitioner must comply with the covered opinion rules but need not provide any required conclusion.

In any event, for each significant federal tax issue considered in the opinion, the opinion must provide a conclusion as to the likelihood that the taxpayer will prevail on the merits. If the practitioner is unable to reach a conclusion as to one or more of those issues, the opinion must so state. The opinion must describe the reasons for the conclusions, including the facts and analysis, or describe the reasons the practitioner is unable to reach a conclusion as to one or more issues.

If the practitioner cannot reach a more-likely-than-not level of confidence regarding one or more significant federal tax issues considered, the opinion must disclose that and must disclose that "the opinion was not written, and cannot be used by the taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer."⁵³

D. Overall Conclusion

The opinion must provide the practitioner's overall conclusion as to the likelihood that the federal tax treatment of the arrangement is the proper treatment and the reasons for that conclusion.⁵⁴ In the case of a marketed opinion, however, the opinion must provide the practitioner's overall conclusion at a level of at least more-likely-than-not.⁵⁵ If the practitioner cannot reach that level of confidence for a marketed opinion, it seems that the opinion may not be issued without violating the circular. As indicated, the circular appears to make an important distinction between a marketed opinion and other covered opinions in this context.

E. Competency to Render the Opinion

The practitioner must be knowledgeable in all of the aspects of federal tax law relevant to the opinion rendered except he or she may rely on another's opinion regarding one or more significant federal tax issues, unless he or she knows or should know that the opinion of the other should not be relied on.⁵⁶ The opinion of another on which the practitioner relies must identify the other opinion and set forth the conclusions it reaches.

Limited scope opinions. The rules contained in the circular relating to limited scope opinions seem consistent with the legitimacy of the foregoing strategy of dividing the opinions into two writings, one issued at less than a more-likely-than-not level of confidence and one issued at that or a higher level. Section 10.35(c)(v) of the circular provides that a practitioner may provide an opinion that considers less than all of the significant federal tax issues if: (1) the practitioner and the taxpayer agree that the scope of the opinion and the taxpayer's potential reliance on the opinion for avoiding penalties that may be imposed are limited to the federal tax issues

⁴⁹Circular 230, section 10.35(c)(2)(ii) prohibits a practitioner from assuming "the favorable resolution of any *significant federal tax issue*" (emphasis added), implying that the practitioner may assume the favorable resolution of a federal tax issue that is not significant.

⁵⁰See, e.g., Treas. reg. section 20.2056(b)-1(b) (second sentence).

⁵¹To constitute a "qualified" charitable remainder trust under section 664, the actuarial value of the remainder must be at least 10 percent. Section 664(d)(1)(D).

⁵²See note 47 *supra*.

⁵³Circular 230, section 10.35(e)(4).

⁵⁴Circular 230, section 10.35(c)(4)(i).

⁵⁵Circular 230, section 10.35(b)(4)(ii).

⁵⁶Circular 230, section 10.35(c)(1).

that are addressed in the writing, (2) the opinion does not involve a listed transaction or an arrangement the principal purpose of which is tax avoidance, and is not a marketed opinion, and (3) the opinion includes certain required disclosures (discussed below).

The practitioner, in issuing a limited scope opinion, may make reasonable assumptions about the favorable resolution of a federal tax issue but must identify, in a separate section of the opinion, all issues for which the practitioner assumed a favorable resolution. It probably would be appropriate for the opinion to contain a heading for that part of the writing stating something like "Assumptions About Favorable Resolution of Certain Federal Tax Issues."

F. Required Disclosure on Promoter Relationship

Each covered opinion must prominently disclose (that is, specify in bolded typeface larger than any other typeface used in the writing) any compensation arrangement (such as a referral fee or fee-sharing) or referral agreement between the practitioner (or the practitioner's firm) and any person (other than the client for whom the opinion is prepared) engaged in promoting, marketing, or recommending the arrangement (or a substantially similar one) that is the subject of the opinion.

The scope of the promoter relationship rule is uncertain. For example, an attorney occasionally refers individuals to an insurance sales representative who, in turn, typically recommends that the customer engage that attorney to draft an irrevocable trust to acquire the policy. The sales representative occasionally refers other customers who are acquiring policies to that same attorney if the representative concludes that the customer should seek legal advice in structuring the acquisition of a life policy and is not otherwise adequately represented on legal matters. If the attorney prepares a covered opinion regarding a federal tax matter for the trust and/or the policy of insurance, must the lawyer include the required disclosure for the sales representative because it is a promoter-practitioner relationship that Circular 230 covers? The answer is not certain. But prudence again may suggest that the referral arrangement be disclosed. It seems also appropriate to mention that there is no fee-sharing between them.

G. A Few Points About Form of Covered Opinions

It also seems appropriate in issuing a covered opinion to state that it is a covered opinion and perhaps to state why (for example, it involves a listed transaction). It may also be appropriate in one section of the opinion or in appropriate parts to state what Circular 230 requires the opinion to contain. For example, in the section involving assumptions about favorable resolution of certain federal tax issues in a limited scope opinion, it may be appropriate to make a statement to the following effect: "This, as stated earlier, is a limited scope opinion within the meaning of Circular 230. The circular permits a practitioner to make reasonable assumptions about the favorable resolutions of one or more federal tax issues in reaching conclusions on a tax issue addressed in the opinion. In reaching certain opinions herein, we make those assumptions. The circular requires that we set forth those as-

sumptions in a separate section of our opinion letter. In this section of this letter, we will set forth those assumptions."

H. Compliance Does Not Mean Good Faith

An opinion that meets the requirements of section 10.35 does not affect the persuasiveness of the opinion or the taxpayer's good faith in relying on it, both of which will be determined separately under applicable provisions of the law and the regulations.⁵⁷

I. A Word About the Impact on Tax Practitioners

The Treasury decision says 100,000 practitioners will be affected by the changes to the circular. It estimates the annual burden per disclosing practitioner varies from 5 to 10 minutes with an estimated average of 8 minutes. As this article indicates, that estimate may well understate the time for compliance with the circular. It appears as though it will involve dozens if not hundreds of hours each year for each practitioner.

J. Requirements for Other Written Advice

Requirements for written advice that is not a covered opinion is contained in a new section 10.37. Section 10.37 provides that a practitioner may not give written advice concerning one or more federal tax issues if the practitioner: bases it on unreasonable factual or legal assumptions; unreasonably relies on representations, statements, findings, or agreements of the taxpayer or another person; fails to consider all relevant facts; or takes into account the possibility that a tax return will not be audited, that an issue will not be raised on audit, or that an issue will be settled.⁵⁸ In determining if the practitioner has complied with section 10.37, a heightened standard of care will be applied by the IRS if the practitioner knows or has reason to know that the advice will be used or referred to by a person other than the practitioner (or those affiliated with his firm) in promoting, marketing, or recommending the arrangement involved to other taxpayers.⁵⁹

VIII. A Critique

In 1982, in enacting the penalty on the substantial understatement of income tax, Congress introduced the more-likely-than-not standard.⁶⁰ The conference committee indicated that it was appropriate to hold taxpayers investing in tax shelters who sought to avoid the penalty to a higher standard.⁶¹ Under the legislation, such a taxpayer could avoid the penalty if: substantial authority supported the taxpayer's claimed position and the taxpayer believed the position was more likely than not the correct one. The term "tax shelter" was defined with reference to the taxpayer's subjective motivation. If the

⁵⁷Circular 230, section 10.35(f).

⁵⁸Circular 230, section 10.37(a).

⁵⁹*Id.*

⁶⁰See Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. 97-248, section 323, 96 Stat. 324 (1982).

⁶¹See H.R. Conf. Rep. 97-760, 1347 ("The Conferees believe that if the principal purpose of a transaction is the reduction of tax, it is not unreasonable to hold participants to a higher standard than ordinary taxpayers.").

principal purpose for entering into the transaction was tax avoidance, the transaction was viewed as a tax shelter and the more-likely-than-not standard applied. While, over the ensuing years, the definition of a tax shelter has undergone a modest change (now focusing on whether the taxpayer had tax avoidance as a significant purpose) and the requirements for avoiding the penalty have also been modified, the more-likely-than-not standard remains intact.⁶²

⁶²In 1994 section 6662 was amended in terms of the application of the substantial understatement penalty in the case of a corporate tax shelter. See Uruguay Round Agreements Act, Pub. L. No. 103-465, section 744, 108 Stat. 4809 (1994). Before that amendment, under section 6662(d), corporate and individual taxpayers investing in a tax shelter could automatically avoid the penalty if two conditions were satisfied: there was substantial authority supporting the claimed position and the taxpayer believed that the claimed treatment was more likely than not correct. Under the amendment, corporate taxpayers could no longer qualify for relief under section 6662(d). As a result, the question arose whether corporate taxpayers investing in a shelter could avoid the penalty (and, if so, under what circumstances) under section 6664(c). The Treasury Department responded by modifying Treas. reg. section 1.6664-4 to provide that, in the case of a corporate tax shelter, the penalty could be avoided under section 6664(c) if the taxpayer satisfied the two preamendment conditions under section 6662(d). See proposed regulations preamble, 60 F.R. 406-01 (Jan. 4, 1995). Unlike the preamendment provision, however, under the regulation as modified, the penalty could still be imposed, even if the conditions were satisfied, if the taxpayer failed to act with reasonable cause and in good faith. In other words, under the modification, the existence of substantial authority and the taxpayer's more-likely-than-not belief are relevant factors but do not necessarily result in elimination of the penalty. In making that modification, the Treasury Department indicated that no inferences were to be drawn concerning individual taxpayers investing in a tax shelter. See *id.* In 2004 section 6662 was amended yet again. See Jobs Act section 812(d), 118 Stat. 1418 (2004). Under the 2004 amendment, no taxpayer investing in a tax shelter (neither individual nor corporate taxpayers) can qualify for automatic avoidance of the newly imposed penalty under section 6662A. Instead, taxpayers (individuals and corporations) must satisfy the section's more stringent requirements (including a more-likely-than-not belief) to qualify for automatic protection. Because section 6662A targets only listed and reportable transactions, however, the standards for avoiding the penalty are unclear when an individual taxpayer has invested in a tax shelter that is neither a listed nor a reportable transaction. Given the modification the Treasury Department made to the regulations under section 6664 in response to the 1994 amendment, it seems likely that the Treasury Department will again amend Treas. reg. section 1.6664-4 to provide that an individual investing in a tax shelter that is not within the scope of section 6662A may, like a corporation investing in a tax shelter, avoid the penalty section 6662 penalty if the more-likely-than-not and substantial-authority standards are satisfied and the taxpayer acted with reasonable cause and in good faith.

Parenthetically, it should be noted that, while section 6662 now requires that the taxpayer have a significant tax avoidance motive for entering into the transaction if it is to be characterized as a tax shelter, as originally enacted in 1982, the section contained a principal-purpose test instead. That change was made in 1997. See Taxpayer Relief Act of 1997, Pub. L. 105-34, section 1028(c)(2), 111 Stat. 788 (1997).

In defining the term "tax shelter," the regulations create an exception, presumably in recognition of the substantive notion that the code contemplates certain tax benefits even when the taxpayer enters into the transaction for the sole purpose of securing the benefit.⁶³ Under the exception, a transaction that produces benefits that the code contemplates is not a tax shelter and is therefore not subject to the more-likely-than-not standard, without regard to the taxpayer's motive in undertaking the transaction.⁶⁴ Thus, in the case of such a transaction, a taxpayer need not satisfy the more-likely-than-not standard to avoid the substantial understatement penalty, even if the transaction is driven entirely by a tax avoidance motive.⁶⁵

Circular 230 was designed to assist the government in enforcing the penalties under section 6662. Before the circular, a taxpayer investing in a tax shelter could secure a more-likely-than-not opinion from a practitioner to create immunity from the penalties under the section.⁶⁶ Practitioners asked to provide such an opinion would in many cases do so without fear of liability or other consequence, for if all the possible arguments the government might make were considered, the judgment involved in assessing the likelihood of success would not seem to be actionable malpractice. Under the circular, however, the government could perhaps take the position that a practitioner providing such an opinion may be sanctioned if it is determined there was an insufficient basis to warrant a more-likely-than-not conclusion.

In the circular, the government — whether wittingly or unwittingly — seeks to bootstrap itself. Under existing regulations, individuals investing in a tax shelter who rely on a professional opinion may be able to avoid penalties under section 6662 if they reasonably believe in good faith that the position taken on the return is correct.⁶⁷ Although the regulations require a more-likely-than-not opinion for penalty protection for corporations investing in a tax shelter, they are silent in the case of an individuals. Therefore, an opinion stating that there is a reasonable basis for the position may suffice to avoid

⁶³See *In re C.M. Holdings, Inc.*, 301 F.3d 96, Doc 2002-19191, 2002 TNT 161-10 (3d Cir. 2002) (citing *Sacks v. Commissioner*, 69 F.3d 982, Doc 95-10132, 95 TNT 218-13 (9th Cir. 1995), and discussing the conclusion in *Sacks* that some tax benefits are contemplated in the code and are therefore permitted without regard to the taxpayer's motive).

⁶⁴See Treas. reg. section 1.6662-4(g)(2)(ii).

⁶⁵Curiously, there does not appear to be a context in which the qualification could have any application. If the tax benefit the taxpayer seeks is one that the code contemplates, there will be no understatement and therefore no possibility that the penalty could apply. On the other hand, if the court should conclude that the code does not contemplate the benefit, the qualification cannot, by its terms, apply. In short, it would seem that the qualification can apply only when the taxpayer prevails on the substantive issue, thus rendering the qualification meaningless.

⁶⁶A taxpayer armed with such an opinion may not necessarily prevail on the penalty issue. See *Long Term Capital Holdings*, 330 F. Supp.2d 122, Doc 2004-17390, 2004 TNT 169-15 (D.C. Conn. 2004).

⁶⁷See Treas. reg. section 1.6664-4.

penalty when an individual taxpayer is involved. The preamble to the proposed regulations cautions against drawing an inference that the lower standard applies to individual tax shelters, acknowledging that the applicable standard for an opinion concerning those taxpayers remains uncertain.⁶⁸ Nonetheless, it is difficult to read the regulation as making the more stringent standard applicable to individuals given that it imposes this standard on corporations and then fails to articulate any standard for individuals. Under the circular, in contrast, practitioners are precluded from providing an opinion at a confidence level of less than more-likely-than-not unless the opinion states the taxpayer may not rely on it for penalty protection (assuming a "significant federal tax issue" is involved).⁶⁹ Thus, while, under existing regulations, an individual investing in a tax shelter might be able to avoid penalties on the strength of a professional opinion using a reasonable-basis-of-success standard,⁷⁰ the circular now precludes practitioners from using this standard in a covered opinion, unless the opinion explicitly negates the taxpayer's ability to claim reliance on it for penalty protection purposes.

In the wealth transfer tax context, the circular may effect an even more problematic bootstrap. While the substantial understatement penalty applies only to income tax deficiencies, the negligence penalty applies for both transfer tax and income tax purposes. Thus, in the transfer tax context, the negligence penalty, not the substantial understatement penalty, is the focus of concern. Unlike the substantial understatement provisions, the negligence penalty provisions nowhere impose a more-likely-than-not standard on a taxpayer seeking to defeat the penalty on the basis of professional opinion. Given the penalty structure, a practitioner giving transfer tax advice who is concerned about providing negligence penalty protection (but obviously not substantial understatement penalty protection) might well choose to use the reasonable-basis-of-success standard in framing the opinion.⁷¹ Under the circular, however, such an opinion would be impermissible if it were a covered opinion, because, as indicated, a covered opinion dealing with a significant federal tax issue must use the more stringent standard or advise the taxpayer that reliance on the opinion for penalty protection purposes is not appropriate. In short, the circular imposes in that context a

standard on practitioners that is not congruent with the standard that the penalty provisions impose on taxpayers.

The circular's negligence penalty bootstrap is particularly problematic for practitioners who work in the estate-planning area. Many common estate-planning transactions may be viewed as having tax avoidance as their principal purpose, which will force estate-planning practitioners to conclude that the advice they give must be based on the more-likely-than-not standard — at least when a significant federal tax issue is involved. That difficulty stems from the circular's focus on the taxpayer's subjective state of mind in entering into the transaction or arrangement. While such a focus may make sense in the income tax context given the crucial relevance of motive under the sham and economic substance doctrines and the suspect nature of these tax-driven transactions under these doctrines,⁷² it makes no sense in the transfer tax context. Indeed, the courts have repeatedly held that, for transfer tax purposes, a tax avoidance motive is irrelevant.⁷³ In short, there is no justification for making a tax avoidance motive a relevant consideration in the transfer tax context.

In creating a "disconnect" between the penalty provisions and the standards applicable to practitioners, the circular interferes with the free flow of information between practitioner and client. If, for example, a practitioner giving transfer tax advice when the client's principal purpose is tax avoidance sincerely believes that there is a reasonable basis for the taxpayer's position, she may not give written advice to that effect unless the taxpayer is also advised that reliance on the opinion for penalty protection is not permissible. Even though such a reasonable basis opinion could protect the client from a negligence penalty, the practitioner is precluded from providing it without the disclaimer. In requiring the practitioner to state that the client may not rely on the advice, the circular's interference with the communication may infringe on the First Amendment. The government cannot, consistent with the First Amendment, force a practitioner to make a disclosure when communicating with clients unless the communication would otherwise be misleading or deceptive.⁷⁴ Because a reasonable basis opinion would not otherwise be misleading, there appears to be no satisfactory justification for First Amendment purposes for compelling the practitioner to include the disclaimer. Moreover, the disclaimer might arguably be viewed as an impermissible restraint on speech. An absolute prohibition on the giving of accurate advice

⁶⁸See 60 F.R. 406-01, 1995-1 C.B. 947 (Jan. 4, 1995).

⁶⁹See Circular 230, section 10.35(d)(4).

⁷⁰Note that section 6694, which imposes a penalty on practitioners, contains a "realistic possibility" of success standard. Thus, while the code contemplates that lower standard, the circular now imposes the higher more-likely-than-not standard.

⁷¹Treas. reg. section 1.6662-3 defines negligence in objective terms. When a taxpayer fails to establish that the position taken on the return is objectively reasonable, however, the taxpayer may still be able to avoid the penalty by making a subjective showing that the position was taken in good faith and with reasonable cause. See Treas. reg. section 1.6664-4. In that latter context, it would appear that a taxpayer could succeed by showing reliance on a professional's reasonable basis opinion.

⁷²See, e.g., *ACM Partnership v. Commissioner*, 157 F.3d 231, Doc 98-31128, 98 TNT 202-7 (3d Cir. 1998).

⁷³See, e.g., *Cristofani v. Commissioner*, 97 T.C. 74 (1991); *Gulig v. Commissioner*, 293 F.3d 279, Doc 2002-14498, 2002 TNT 118-10 (2002) (affirming the Tax Court on this issue); *Knight v. Commissioner*, 115 T.C. 506, Doc 2000-31015, 2000 TNT 232-11 (2000).

⁷⁴See *Zauderer v. Office of Disciplinary Counsel of Supreme Court of Ohio*, 471 U.S. 626 (1985) (holding that a bar rule requiring an attorney who advertised to include a disclosure about certain risks inherent in contingency-fee representation was not a violation of the First Amendment because of the state's concern about consumer fraud or deception).

could not withstand constitutional attack.⁷⁵ And requiring the practitioner to state, in effect, that the advice is not reliable for penalty protection purposes could possibly be treated as tantamount to such a prohibition.⁷⁶ To be sure, the code could be amended to provide that a more-likely-than-not opinion is necessary to avoid the negligence penalty (or to provide that professional opinion can never serve as a basis for defeating the penalty). But to seek to accomplish indirectly, as the circular does, the same objective by interfering with the practitioner's right to provide accurate information when other alternatives are available that would be less intrusive in terms of speech rights seems constitutionally suspect.⁷⁷

Constitutional questions aside, the circular may prove to be counterproductive as a matter of policy. It may, in other words, chill communications between practitioners and clients and thereby lead to unanticipated consequences — indeed consequences contrary to those the circular was intended to achieve. To the extent that the circular causes practitioners to refrain from giving written advice, clients may be more inclined to assume that the law favors the treatment they seek. If that occurs, the circular will have succeeded in encouraging, rather than discouraging, aggressive reporting.

Parenthetically, even in the income tax context, the use of the taxpayer's motive as a critical determinant under the circular may not be salutary. Courts have had difficulty in grappling with the application of the sham and economic substance doctrines because they are based, at

least in part, on the taxpayer's subjective state of mind.⁷⁸ In making the sanctions that practitioners face turn on their client's subjective purpose, the circular appears not only to impose an unreasonably onerous burden on practitioners but also exposes them to the possibility of a severe consequence should they guess wrong in assessing the client's purpose.⁷⁹

However the circular may be amended insofar as income tax advice is concerned, it should certainly be amended to create an exception for opinions relating to transfer tax issues. In other words, an opinion or advice relating exclusively to a transfer tax issue that uses a reasonable-possibility-of-success standard should be permitted without any requirement that it defeat the taxpayer's ability to rely on it for penalty protection purposes. Making that distinction between income tax and transfer tax issues is not unconventional. Indeed, in the somewhat related context of so-called reportable transactions, a similar distinction is made: While a taxpayer who enters into a reportable transaction must disclose it, no such requirement is imposed in the estate and gift tax context.⁸⁰ Moreover, as indicated, when the code contemplates the particular tax benefit, the regulations under section 6662 exclude the transaction from the definition of the term "tax shelter" — thus obviating a more-likely-than-not opinion — even though it is driven by a tax avoidance motive. Because, in the transfer tax context, tax-driven planning is almost universally contemplated by the code (for example, an *inter vivos* gift results in excluding postgift appreciation from the donor's gross estate), an estate-planning exception should be permitted by a parity of logic. Creating that exception would also be valuable in terms of efficiency. That is, practitioners should not be required to bear the burden — and taxpayers should not be required to bear the concomitant cost — of complying with the covered opinion rules in the circular simply because a common estate-planning

⁷⁵See *Conant v. Walters*, 309 F.3d 629 (9th Cir. 2002) (holding that it was a violation of the First Amendment for the government to prohibit a physician from recommending the use of marijuana to a patient).

⁷⁶Circular 230, section 10.37 (as well as section 10.35) prohibits the practitioner from referencing in writing the possibility that a return will not be audited. It would seem that this prohibition is a limited one designed to prevent the practitioner from taking this possibility into account in assessing the strength of the legal arguments. Others, however, may read it as a categorical prohibition: No reference may be made, under this view, to the audit issue in any writing given to the client. If the former reading is correct, there would appear to be no constitutional implications. Under the penalty provisions, a taxpayer cannot use her belief that audit was unlikely to defeat a penalty. See section 6664(d)(3)(A)(ii). It would therefore seem appropriate for the circular to prevent practitioners from leading their clients to believe that the audit issue is a relevant one in the penalty context. See *Illinois ex rel. Madigan v. Telemarketing*, 538 U.S. 600 (2003) (indicating that the prevention of fraud or deception is a sufficient justification to warrant government regulation). On the other hand, if the latter reading is the correct one, practitioners are in effect precluded from giving their clients accurate information. This kind of prohibition may indeed raise constitutional questions. See *Conant v. Walters*, 309 F.3d 629 (9th Cir. 2002) (holding invalid a direction preventing a physician from recommending the use of marijuana).

⁷⁷See, e.g., *Illinois ex rel. Madigan v. Telemarketing*, 538 U.S. 600 (2003) (requiring, for First Amendment purposes, that the intrusion on speech rights be as narrow as possible); but see *Zauderer*, 471 U.S. at 651, n.14 (suggesting that the requirement that the least restrictive regulation be used to avoid a First Amendment defect is not applicable in the context of a government-required disclosure).

⁷⁸See, e.g., *ACM Partnership*, 157 F.3d 231, at 247-248, n.31 (3d Cir. 1998) (indicating that, despite the conclusion reached about the taxpayer's subjective state of mind, the taxpayer might nonetheless be able to avoid the sham doctrine through an objective showing).

⁷⁹While regulations that are ambiguous may be interpreted in favor of the government if the government's proffered resolution is a reasonable one, see *Auer v. Robbins*, 519 U.S. 452 (1997); Mitchell M. Gans, "Deference and the End of Tax Practice," 36 *Real Prop. Prob. & Tr. J.* 731 (2002), one would assume that such an approach would be unreasonable in the context of interpreting ethics-type rules that impose sanctions. Cf. *United States v. Thompson/Center Arms Co.*, 504 U.S. 505, 517-518, and n. 10 (1992) (applying a rule of lenity). Indeed, in section 10.52, any suspension, disbarment, or censure requires a finding of willfulness or recklessness. Nonetheless, it would seem that the circular should be amended to clarify that, in the case of doubt or ambiguity in the circular, the practitioner should not be sanctioned.

⁸⁰See T.D. 9046 (distinguishing in the preamble to regulations under section 6011 between reportable and listed transactions and making the disclosure requirement for reportable transactions applicable for income tax purposes but not for estate and gift tax purposes).

concept like a "QTIP" (qualified terminable interest property) trust or the gift tax annual exclusion is used. In the income tax context, on the other hand, where there is a legitimate concern about taxpayers engaging in tax-driven, aggressive transactions, the benefits of the circular's more stringent standards may be worth the cost.

IX. Summary and Conclusions

The recent changes to Circular 230 may have a profound effect on tax practice, including estate-planning advice that involves any federal tax issue that is reduced to writing. If the practitioner issues a covered opinion, compliance with new section 10.35 of the circular must be met or the practitioner faces possible suspension or disbarment of practice before the IRS, censure, or fines. It is uncertain whether all arrangements involving the avoidance of estate, gift, or generation-skipping transfer tax will be regarded as having tax avoidance as the principal purpose or a significant purpose. It may be difficult to maintain that such an arrangement does not have at least a significant tax avoidance purpose. The distinction between arrangements the principal purpose of which is tax avoidance and those having only a significant tax avoidance purpose is important for several reasons, including being able to avoid having written advice constitute a covered opinion or to permit it to constitute a limited purpose opinion. Even a brochure prepared for clients in use of their businesses or other activities (explaining, for example, an IRA or the tax benefits of a charitable contribution) may be a covered opinion because, at least in some cases, they will be marketed opinions, requiring special disclaimers.

X. Seven Specific Suggested Changes to the Circular

We recommend that the circular be revised in the following ways. First, any estate, gift, and generation-skipping transfer tax arrangement should be excluded from section 10.35 of Circular 230 unless it is a listed transaction. That exclusion should apply even though there may be, as there almost always is, some income tax ramification of an estate-planning arrangement.

Second, reliance by a practitioner (the first practitioner) on the written advice of another practitioner (the second practitioner) that the written advice the first practitioner proposes to send to a client of the first practitioner falls outside of the scope of Circular 230 or complies with it should constitute presumptive evidence that the first practitioner was not willful, reckless, or grossly incompetent under section 10.52 of Circular 230 (dealing with censure, suspension, or disbarment of those who fail to comply with the circular), which presumption could be overcome only by clear and convincing evidence to the contrary.

Third, Treasury should give thought to the possibility of restating the standards of practice contained in the circular without making the taxpayer's subjective state of mind a relevant determinant. If Treasury should reject that suggestion, the circular should be revised to provide guidelines that would assist in determining whether an arrangement has tax avoidance as its principal purpose or has tax avoidance as a significant purpose.

Fourth, the circular should be clarified to provide that a written statement given to a client is not a marketed opinion if the client makes no attribution to the practitioner (or the practitioner's firm).

Fifth, the circular should be clarified to provide that published articles or other written material distributed to professionals or laypersons at a conference is expressly excluded from the requirements of the circular, even if listed transactions or arrangements of which the principal purpose or a significant purpose is tax avoidance are described in the publication.

Sixth, when under the code a penalty can be avoided on the basis of a professional opinion stated at a confidence level of less than more-likely-than-not, the circular should not preclude the practitioner from providing the client with an opinion that would permit the penalty to be avoided.

Seventh, the circular should be amended to provide that, if any of its provisions are found to be ambiguous or uncertain in their meaning, a construction favoring the practitioner should be adopted.

Required Compliance With Circular 230, Section 10.35 for 'Covered Opinions'												
Type of Covered Opinion		Exception for Advice on Qualified Plan Qualification State and Local Bonds, Matters Involving SEC Disclosure	Exception for Preliminary Advice	Exception if Not a Significant Federal Tax Issue	Exception if Confidence Level <= 50 %	Exception if Disclosure Permitted	Exception if No Penalty Protection Disclaimer	Relationship With Promoter Required	Confidence Level Must Be >50 %	Exception for Limited Scope Opinion	Limited Scope Opinion Allowed	Exception if IRS Has No Reasonable Basis for Successful Challenge
1.	Listed Transactions Section 10.35(b)(2)(i)(A)	Yes Section 10.35(b)(2)(ii)(B)	Yes Section 10.35(b)(2)(ii)(A)	No	No	No	No	Yes Section 10.35(e)(1)	Yes to Significant Fed Tax Issue (or No Reliance Statement Required) Section 10.35(e)(4)	No	No	No
2.	Principal Purpose of Arrangement Is Tax Avoidance/ Evasion Section 10.35(b)(2)(i)(B)	Yes Section 10.35(b)(2)(ii)(B)	Yes Section 10.35(b)(2)(ii)(A)	No	No	No	No	Yes Section 10.35(e)(1)	Yes to Significant Fed Tax Issue (Or No Reliance Statement Required) Section 10.35(e)(4)	No	No	No
3.	A Significant Purpose of Arrangement Is Tax Avoidance/ Evasion:											
	a. Reliance Opinion Section 10.35(b)(2)(i)(B)(1)	Yes Section 10.35(b)(2)(ii)(B)	Yes Section 10.35(b)(2)(ii)(A)	Yes Section 10.35(b)(4)(i)	Yes Section 10.35(b)(4)(i)	No	Yes Section 10.35(b)(4)(ii)	Yes Section 10.35(e)(1)				

Required Compliance With Circular 230, Section 10.35 for 'Covered Opinions'												
Type of Covered Opinion		Exception for Advice on Qualified Plan Qualification State and Local Bonds, Matters Involving SEC Disclosure	Exception for Preliminary Advice	Exception if Not a Significant Federal Tax Issue	Exception if Confidence Level <= 50%	Exception if Disclosure Permitted	Exception if No Penalty Protection Disclaimer	Relationship With Promoter Required	Confidence Level Must Be >50%	Exception for Limited Scope Opinion	Limited Scope Opinion Allowed	Exception if IRS Has No Reasonable Basis for Successful Challenge
	b. Market Opinion	Yes	Yes	No	No	No	Yes (With Other Statements)	Yes	Yes to Significant Fed Tax Issue (or No Reliance Statement Required) Section 10.35(e)(4)	No	Yes	No
	Section 10.35(b)(2)(i)(B)(2)	Section 10.35(b)(2)(ii)(B)	Section 10.35(b)(2)(ii)(A)				Section 10.35(b)(5)(ii)	Section 10.35(e)(i)			Section 10.35(c)(v)	
	c. Disclosure Limited	Yes	Yes	No	No	Yes	No	Yes	Yes to Significant Fed Tax Issue (or No Reliance Statement Required) Section 10.35(e)(4)	No	Yes	No
	Section 10.35(b)(2)(i)(B)(2)	Section 10.35(b)(2)(ii)(B)	Section 10.35(b)(2)(ii)(A)			Section 10.35(b)(6)		Section 10.35(e)(1)			Section 10.35(c)(v)	
	d. Contractual Protection	Yes	Yes	No	No	Yes	No	Yes	Yes to Significant Fed Tax Issue (or No Reliance Statement Required) Section 10.35(e)(4)	No	Yes	No
	Section 10.35(b)(2)(i)(B)(4)	Section 10.35(b)(2)(ii)(B)	Section 10.35(b)(2)(ii)(A)			Section 10.35(b)(6)					Section 10.35(c)(v)	
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