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Treasury Department Circular 230 and Final Regulations

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INTRODUCTION

Pursuant to 31 U.S.C. § 330, Treasury is authorized to issue regulations governing practice before the Internal Revenue Service ("IRS" or "Service"). The bulk of the regulations issued under this authority are contained in Circular 230 ("C230").

C230 defines "practice before the Service" and provides:

"PRACTICE BEFORE THE INTERNAL REVENUE SERVICE COMPREHENDS ALL MATTERS CONNECTED WITH PRESENTATION TO THE INTERNAL REVENUE SERVICE OR ANY OF ITS OFFICERS OR EMPLOYEES RELATING TO A TAXPAYER'S RIGHTS, PRIVILEGES, OR LIABILITIES UNDER LAWS OR REGULATIONS ADMINISTERED BY THE INTERNAL REVENUE SERVICE. SUCH PRESENTATIONS INCLUDE, BUT ARE NOT LIMITED TO, PREPARING AND FILING DOCUMENTS, CORRESPONDING AND COMMUNICATING WITH THE INTERNAL REVENUE SERVICE, AND REPRESENTING A CLIENT AT CONFERENCES, HEARINGS, AND MEETINGS."

C230 applies to attorneys, certified public accountants, enrolled agents, enrolled actuaries, and all other persons representing taxpayers before the Service (collectively "Tax Advisors"). It is broad in scope and generally covers:

- Rules relating to who may practice before the IRS;
- Duties and restrictions relating to practice before the IRS;
- Sanctions for rule violations; and
- Discipline of Tax Advisors.

On December 20, 2004, Treasury published final regulations ("Final Regulations") which amend C230 by:

- Adding aspirational "Best Practices" standards for Tax Advisors; and
- Setting forth new requirements for "Covered Opinions" and other "Written Advice" given by Tax Advisors.

Treasury recognizes the vital role Tax Advisors play in our federal tax system. It concluded the system is best served if the public has "confidence in the honesty and integrity of the professionals providing tax advice." This conclusion is difficult to debate.

Public confidence in the tax and accounting professions is undoubtedly currently not at its height. Highly publicized allegations of fraud and deception in accounting and tax practices involving public companies such as Enron, Global Crossing, ImClone, WorldCom, Qwest, Tyco, Lucent, HealthSouth, and Aldelphia, have played a significant role in tarnishing the tax and accounting professions. The collapse of Arthur Andersen placed an even darker cloud over these once honored professions.

To restore public confidence in our federal tax system, Treasury issued the Final Regulations which amend C230. These regulations (which are effective June 21, 2005) are specifically aimed at two goals:

- Deterring taxpayers from engaging in abusive transactions by limiting or eliminating their ability to avoid penalties via inappropriate reliance on advice of Tax Advisors; and

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2005 Tax Legislation Highlights

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2005 TAX LEGISLATION HIGHLIGHTS

There were many different tax bills passed in the last legislative session, many dealing with very limited circumstances. The following is an overview of the more important provisions that were passed, which effect a fair number of taxpayers.

SB 267 Tax Court Jurisdiction

A prior bill in 1997 inadvertently repealed the Tax Court's ability to make certain determinations regarding real market value of the property. Senate Bill 267 reinstates the repeal provision giving the Tax Court authority to determine on its own the real market value or the correct valuation of any property subject to special assessment. The Court has the ability to determine real market value on the basis of evidence before the court without regard to values pled by the parties.

SB 268 Small Claims Procedures

The Act repeals the statute that spells out the Tax Court's Small Claims Procedure. It addresses some of the confusing issues of the regular Magistrate Division process and Small Claims process. Provisions in the act also encourage the resolution of property tax appeals related to high-value, principal and secondary industrial properties appraised by the Department of Revenue. The Department of Revenue is required to consider these changes in adopting Administrative Rules related to appeals to the Tax Court of the value of principal or secondary industrial properties or centrally assessed properties in an effort to insure quick and efficient resolution of appeals. An example in ORS 305.403 now provides that an appeal process involving specially assessed value must include both the land and improvements of the principal and secondary industrial property and must be brought together in the same forum whether the forum is the Board of Property Tax Appeals or the Tax Court. Additional instruction is given in the act for Department responses to allegations and complaints.

HB 2124 Transfer of Experience Rating

The bill requires the Director of the Employment Department, when one employer transfers a trade or business to another employer, to determine tax rates of the employers based on transfer of unemployment experience attributable to the transferred trade or business. The new provision is effective January 1, 2006

HB 2950 Dependent Care Assistance

The bill provides that employer-provided dependent care assistance does not constitute wages for unemployment tax purposes to the extent the assistance qualifies under Internal Revenue Code Section 129(d), and does not exceed the federal earned income limitation of Section 129(b). The provision applies to unemployment insurance tax reporting periods beginning on or after January 1, 2006.

SB 323 Change in Definition of Independent Contractor

The bill changes the definition of an independent contractor for unemployment insurance and income tax purposes. The proposal was developed by a task force, but with the insistence by the Employment Department that the definition require the independent contractor have an independently established business. The rules have significantly changed for income tax years and withholding tax reporting periods beginning on or after January 1, 2006. Due to constraints in the length of this Newsletter, a later in depth Newsletter article on this bill will address the details of the changes to the definition of Independent Contractor.

HB 2449 Joint Tax Refunds

The bill allows the Department of Revenue to apportion refunds of tax reported on a joint return if an apportioned refund is requested by either spouse. The separate refunds are generally based on the income reported by each taxpayer's employer unless the parties submit alternative evidence. The new provision is effective 90 days after adjournment sine die.

HB 2452 Composite Returns for Pass-Through Entities

The bill authorizes pass-through entities to file composite tax returns on behalf of nonresident individuals, corporations or trusts. The bill requires tax withholdings at the highest marginal tax bracket for the taxpayer, based on the taxpayer's share of the taxable income of the pass-through entity. The provision is effective January 1, 2006.

SB 31 Federal Reconnect, Apportionment Factor, and More!

The bill is a hodgepodge of tax provisions, including a reconnection of Oregon's definition of taxable income to the federal definition of taxable income as of December 31, 2004, with a few exceptions. The bill does not connect to the qualified production activities subtraction permitted under Internal Revenue Code Section 199, nor does it tie to the tax exemption for federal subsidies of employers' prescription drug plans. Furthermore, if a taxpayer elects to deduct sales taxes on their federal return, the deduction is an "add-back" item on the Oregon return.

The bill provides for an ongoing "rolling reconnect" that allows for an automatic reconnect in future years to the definition of income tax as defined by the Internal Revenue Code. The bill also specifically includes a tie to the 2005 legislation that permitted early deductions for tsunami relief contributions.

Another provision of the Bill would increase the percentage of the federal earned income tax credit (EITC) that can be claimed on an Oregon return. The credit is refundable for five years beginning in 2006. Under the Bill, the Oregon EITC would increase from 5 percent to 6 percent of the federal amount in 2008.

Yet another provision of the bill would accelerate an increase in the sales factor of the corporate apportionment formula to 100 percent beginning July 1, 2005. The primary beneficiaries of the provision are corporations that manufacture products in Oregon and sell them to markets outside the state. Over the years, the Legislature has gradually increased the sales factor of the formula. Under current law, the sales factor is 80 percent, and payroll and property factors are 10 percent each. Under current law, the sales factor will increase to 90 percent on July 1, 2006, and 100 percent on July 1, 2008. The new bill would increase the sales factor to 100 percent immediately.

A new personal income tax credit is also added for volunteer emergency medical technicians who perform at least 20% of their total emergency medical technician services as a volunteer in rural areas.

Finally, the bill would increase the maximum amount of the research and development tax credit from $500,000 to $2 million in 2006. The research and development credit is 5 percent of eligible expense. The corporate income tax credit is nonrefundable but can be carried forward for up to five years.

SB 33 Delinquency Penalties

The bill extends the existing five percent delinquency penalty to amounts of under reported tax. The bill provides that the penalty is not imposed if tax and interest are fully paid within 30 days following issuance of a notice of deficiency. The provision takes effect on 91st day following adjournment sine die.

HB 2454 Allocation Rules for Owners of Pass-Through Entities

The bill prescribes allocation formula for part-year resident and nonresident taxpayers that receive items of income, gain, loss, deduction, or credit from pass-through entities. The bill defines adjusted gross income of a part-year resident from Oregon sources as the sum of the following:

(a) For the portion of the year in which the taxpayer was a resident of Oregon, the taxpayer's entire adjusted gross income.

(b) For the portion of the year in which the taxpayer was a nonresident, the taxpayer's adjusted gross income derived from sources within Oregon.

(c) If losses, deductions, or credits are derived from a pass-through entity, the total amount of the item that is taken into account for federal adjusted gross income is multiplied by the ratio of the number of days the taxpayer was a resident of Oregon during the tax year of the entity, over the total number of days in the tax year of the entity.

(d) The total amount of the item that is taken into account for federal adjusted gross income and that is derived from or connected with sources within Oregon, is multiplied by the ratio of the number of days the taxpayer was a nonresident of Oregon during the tax year of the entity, over the total number of days in the tax year of the entity.

The new provision applies to tax years beginning on or after January 1, 2002, and other tax years for which returns are subject to appeal or to audit or adjustment by the Department of Revenue, or for which a claim of refund may be made. The new provision is effective 90 days after adjournment sine die.

HB 3350 Business Development Tax Incentives

The bill expands areas in which businesses may qualify for business development income tax exemption. Previously unemployment in the county had to be in the highest quartile of county unemployment rates in the state, and this has been changed to the top one-half. Similarly, the existing provisions required that the county per capita personal income be in the lowest third of county per capital incomes in the state, and this has been changed to the bottom one-half. The new provision applies to preliminary certifications issued under on or after January 1, 2006, and before January 1, 2011.

HB 2469 Allowance of Special Oregon QTIP Election

The bill expands the definition of a trust that qualifies for a special Oregon marital property election (QTIP election) for Oregon inheritance tax purposes. The bill will allow a trust that allows discretionary distributions of income and principal to qualify. Those individuals otherwise entitled to distributions from a trust may disclaim their interest, and a simplified procedure is included for allowing children to give up their right to any distributions from a trust, so that it can qualify for a state QTIP election.

Tax Humor

- "Only little people pay taxes." Leona Helmsley (attributed)
- "It is seldom given to mortal man to feel superior to a tax lawyer." Anthony C. Amsterdam
- "Sixty-four percent of women attorneys think that tax lawyers make undesirable dates." Daniel Dolan
- "I know all those people [i.e., tax evaders]. I have friendly, social, and criminal relations with the whole lot of them." Mark Twain
- "[A] tax lawyer is a person who is good with numbers but does not have enough personality to be an accountant." James D. Gordon III
- "[As Justice Potter Stewart said about pornography:] I can't define tax evasion, but I know it when I see it." Fred T. Goldberg Jr.

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Treasury Department Circular 230

- Preventing unscrupulous Tax Advisors and promoters from marketing abusive transactions and tax products to a large number of customers based upon an opinion that fails to adequately consider all the relevant facts.

Most Tax Advisors support these goals. In traditional fashion, however, Treasury used nuclear weaponry to combat the problem facing our federal tax system when a less lethal approach would have been adequate. Most Tax Advisors believe the Final Regulations will constrain all federal tax advice. Consequently, Treasury has been bombarded with written commentary from individual Tax Advisors, bar associations, accounting societies, law firms, accounting firms, securities dealers, industry groups, and other interested persons, complaining about the overbreadth of the Final Regulations. Many of the written comments presented (e.g., comments from the New York Bar Association, American Bar Association Tax Section, and American College of Trust and Estate Counsel) are much greater in length than the actual Final Regulations.

On April 25, 2005, speaking at a meeting of the Pennsylvania Bar Association, IRS Chief Counsel, Donald Korb, and Treasury Department Assistant Secretary of Regulatory Affairs & Acting Assistant Secretary for Tax Policy, Eric Solomon, stated that Treasury is listening to the loud and clear comments made by members of the federal tax community. Further, they said Treasury will attempt to modify and revise the regulations before the June 21, 2005 effective date. Cono Namorato, Director of the IRS Office of Professional Responsibility, made it clear in a speech he delivered to Tax Advisors on April 28, 2005, that there will be no extension of the effective date when he said: "I do fully expect that they will go into effect [as scheduled]." Most commentators believe, however, while Treasury may offer Tax Advisors some clarification, it will not significantly modify or revise the regulations. Director Namorato's recent public comments were consistent with this conclusion. He noted two areas where clarification will likely be offered, namely: the definition of transactions with a "principal purpose" of tax evasion or avoidance; and how "prominent disclosure" may be achieved in electronic communications. While Tax Advisors are concerned the IRS will broadly interpret the principal purpose rules under the Final Regulations to apply to most, if not all, federal tax advice, Director Namorato stated that Treasury only intends the "principal purpose rules" to cover "fringe behavior." It is likely the "principal purpose rules" will be clarified accordingly. With respect to the "prominent disclosure" requirement, Director Namorato stated: "The rule is designed to promote transparency between taxpayers and practitioners and provide taxpayers with a notice of any limitation on their ability to rely on written advice." He concluded that the disclosure rule will be clarified so Tax Advisors may follow it in an electronic environment.

On May 19, 2005, Treasury issued the anticipated amendments to the Final Regulations ("May 19 Amendments"). IRS Commissioner Mark Everson stated in a press release relative to the amendments that "[t]he guidance…provides useful clarification…These revisions respond to the concerns raised by practitioners without weakening the underlying standards."

While most commentators will not disagree that the May 19 Amendments do not weaken the Final Regulations, they will debate whether the amendments really respond to the many legitimate comments and concerns raised by the federal tax community. The Final Regulations, even after the May 19 Amendments, remain complex, overly broad, and virtually void of guidance relative to application of the new rules. Numerous potential traps exist for the unwary. Extreme caution is required.

Treasury did not include state and local bonds opinions within the scope of the Final Regulations. Rather, on the same date it published the Final Regulations, it published separate proposed regulations which amend C230 solely with respect to state and local bond opinions. As this article focuses solely on the Final Regulations, all discussion about state and local bond opinions has been intentionally omitted.

The American Jobs Creation Act of 2004 ("AJCA") was signed into law by the President on October 22, 2004. One of the provisions of the AJCA gives Treasury authority to impose standards for written advice relating to matters which have the potential for tax avoidance or evasion. In addition, it gives Treasury authority to impose monetary penalties against Tax Advisors who violate any provision of C230. Neither the Final Regulations nor the May 19 Amendments incorporate these provisions of the AJCA. Be aware—Treasury will likely publish additional regulations in the near future which will give the Service authority to impose monetary penalties against Tax Advisors and their firms for violating the standards contained in C230. Given a recent announcement by Treasury that it has computed the current level of federal tax avoidance to be in excess of $353 billion, it will surely use monetary penalties against Tax Advisors and their firms as a device to encourage tax compliance.

Tax Advisors must have a good understanding of C230, the Final Regulations and the May 19 Amendments. Given the stakes are so high, compliance with C230, as amended, requires the attention of Tax Advisors and their firms.

FINAL REGULATIONS

The Final Regulations are comprised of six components:

- Best Practices;
- Covered Opinions;
- Other Written Advice;
- Compliance Procedures;
- Advisory Committees; and
- Penalties.

A. Best Practices.

The Best Practices provisions of the Final Regulations amends § 10.33 of C230. The Best Practices provisions apply to all Tax Advisors. Nevertheless, they are only aspirational in nature. A Tax Advisor is not subject to disciplinary action by the Service solely for violating the Best Practices provisions of the Final Regulations. Be aware,

however, the Best Practices provisions do not alter or supplant other ethical standards applicable to Tax Advisors (e.g. Code of Professional Responsibility).

Even though these provisions are only aspirational in nature, there is reason to pause for cause. It is likely the plaintiffs' bar will use these standards as additional ammunition in pursuing claims against Tax Advisors. Given the Best Practices standards are contained in C230, legal authority governing the activities of Tax Advisors, it is probable that the Best Practices provisions of the Final Regulations will become a standard of care for Tax Advisors.

The Best Practices provisions are generally aimed at inspiring Tax Advisors to provide their clients with the highest quality representation concerning federal tax matters. Specifically, the provisions provide that Tax Advisors should:

- Communicate clearly with clients regarding the terms of engagement, and the form and scope of advice to be rendered;
- Establish the relevant facts and evaluate the reason ableness of any assumptions or representations;
- Relate applicable law, including potentially applicable judicial decisions and doctrines, to the relevant facts;
- Arrive at conclusions only supported by the law and the facts;
- Advise clients regarding the import of the conclusions reached; and
- Act fairly and with integrity in practice before the Service.

Tax Advisors responsible for overseeing their firm's tax practice are required to take reasonable steps to ensure that their firm's procedures for all members, associates, and employees are consistent with the Best Practices provisions of the Final Regulations. Again, while there is no discipline for violating the Best Practices provisions of the Final Regulations, it is likely plaintiffs' attorneys will assert failure to comply therewith causes the Tax Advisor(s) and his/her firm to fall the below community standard of care. Caution is advised.

The Best Practices provisions of the Final Regulations do not replace the practice standards set forth in C230. These practices were inserted in the Final Regulations to expand C230. Again, a good understanding of C230 by all Tax Advisors is necessary for practicing federal tax law today.

B. Covered Opinions.

A "Covered Opinion" is "Written Advice" given by a Tax Advisor concerning federal tax issue(s) arising from one of three types of matters:

- Listed Transactions: A transaction listed (or a substantially similar transaction) under T. Reg. § 1.6011-4(b)(2).
- Principal Purpose Transactions: Any partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, a principal purpose of which is the avoidance or evasion of federal tax.
- Tax Avoidance Transactions: Any partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, a significant purpose of which is the avoidance or evasion of federal tax, if the Written Advice constitutes:
  - A "Reliance Opinion";
  - A "Marketed Opinion";
  - Written Advice subject to a "Confidentiality Condition"; or
  - Written Advice subject to a "Contractual Protection."

The May 19 Amendments provide that a principal purpose to avoid or evade any tax exists if that purpose exceeds any other purpose of the partnership or other entity, investment plan or arrangement, or other plan or arrangement. The purpose of claiming tax benefits in a manner consistent with statute and Congressional intent, however, is not a principal purpose of tax avoidance or evasion. Be aware, even though the purpose of a plan or transaction does not rise to the level of being a principal purpose of tax avoidance or evasion, it still may be classified as being a significant purpose of tax avoidance or evasion.

Unfortunately, neither the Final Regulations nor the May 19 Amendments contain any further guidance or examples as to what constitutes a principal or significant purpose of tax avoidance or evasion. The concepts remain vague and will likely be areas subject to debate.

A Covered Opinion does not include:

- Preliminary Written Advice if the Tax Advisor expects to later provide compliant advice; and
- Written Advice which does not constitute an opinion relative to a Listed Transaction or a Principal Purpose Transaction, and which concerns qualification of a qualified retirement plan, state or local bond opinion, or part of an SEC filing;
- Written Advice (as a result of the May 19 Amendments) provided to an employer by a Tax Advisor in such person's capacity as an employee of the employer solely for purposes of determining the tax liability of the employer;
- Written Advice (as a result of the May 19 Amendments) prepared for and provided to a taxpayer, solely for use by the taxpayer, after the taxpayer has filed a tax return with the IRS reflecting the tax benefits of a transaction referred to in the Written Advice, provided however, this exclusion is inapplicable if the Tax Advisor knows or has reason to know the taxpayer will rely upon the advice to take a position on a return, including an amended return, that claims tax benefits not reported on the original return, filed after delivery of the advice; and
- Written Advice (as a result of the May 19 Amendments) that does not resolve a federal tax issue in the taxpayer's favor (with respect to such issue only if more than one federal tax issue is addressed), unless the advice reaches a conclusion favorable to the taxpayer at any level of confidence

(e.g. not frivolous, realistic possibility of success, rea sonable basis or substantial authority).

Be aware-Written Advice includes all written communications, whether delivered by facsimile, snail-mail, hand-delivery or e-mail.

Written Advice constitutes a Reliance Opinion if it concludes at a confidence level of more likely than not (greater than 50%) that one or more **significant** federal tax issues will be resolved in the taxpayer's favor. These opinions are commonly called "penalty protection opinions." **Be aware—**There is an exception to the rule. Written Advice does not constitute a Reliance Opinion if:

- It does not relate to a Listed Transaction;
- It does not relate to a Principal Purpose Transaction; and
- **The Tax Advisor "prominently discloses" in the Written Advice that it was not intended to be used and cannot be used for avoiding penalties.**

The Final Regulations provide that "prominent disclosure" exists if a statement is set forth in a separate section at the beginning of the Written Advice in a boldface type which is larger than all of the other typeface contained therein. As a result of the concerns raised by members of the federal tax community about the difficulty of complying with this requirement, especially in an electronic environment, Treasury in the May 19 Amendments revised the definition of "prominent disclosure." The amendments provide that an item is prominently disclosed if it is "readily apparent" to a reader of the Written Advice. Whether a disclosure is prominent is a question of facts and circumstances, including the sophistication of the reader and the length of the Written Advice. At a minimum, a disclosure must be set forth in a separate section of the Written Advice (not in a footnote) and must be set forth in a typeface that is the same size or larger than the remaining typeface contained in the written document. Unfortunately, the Final Regulations and the May 19 Amendments are void of any further guidance on the issue of "prominent disclosure." The May 19 Amendments do, however, eliminate the requirement that Tax Advisors place the disclosure at the top of the Written Advice and the corresponding client relations issues. Further, the May 19 Amendments remove the quandary of manipulating typeface in an electronic environment. Nevertheless, because of the remaining vagueness as to what actually constitutes prominent disclosure, uncertainty continues to exist.

Written Advice is a "Marketed Opinion" if the Tax Advisor knows it will be used by someone to market or promote a transaction. An exception to the rule exists. Written Advice which otherwise constitutes a Marketed Opinion will not be considered a Marketed Opinion if three criteria are met, namely:

- It does not relate to a Listed Transaction;
- It does not relate to a Principal Purpose Transaction; and
- **The Tax Advisor "prominently discloses" in the Written Advice that it was not intended to be used and cannot be used for avoiding penalties; it was written to support promotion of the transaction or matter; and the taxpayer should seek independent tax advice.**

Written Advice is subject to a "Confidentiality Condition" if the Tax Advisor imposes on the recipient limitations on the disclosure of the tax treatment or structure regardless of whether the limitation is legally binding. To avoid classification as Written Advice subject to a Confidentiality Condition, Tax Advisors should clearly recite in the Written Advice that there is no limitation on disclosure of the tax treatment or structure.

Written Advice is subject to "Contractual Protection" if the taxpayer or client has the right to a full or partial refund of fees if all or part of the intended tax result is not sustained, or if fees are contingent upon success of reaching the intended tax result. To avoid classification as Written Advice subject to Contractual Protection, Tax Advisors should clearly recite in the Written Advice that no fee arrangement is based, in whole or in part, upon successfully attaining the intended tax result.

1. Requirements For Covered Opinions

A Tax Advisor providing a Covered Opinion must comply with each of the following requirements:

- Use reasonable efforts to identify and ascertain all rel evant facts;
- Contain no unreasonable representations, statements, or findings provided by the taxpayer;
- Clearly identify all factual assumptions, representa tions, statements or findings relied upon by the Tax Advisor;
- Relate all applicable law to the relevant facts;
- Contain no assumptions as to the favorable resolu tion of any significant federal tax issue;
- Contain no internally inconsistent legal analysis or conclusions;
- Consider all significant federal tax issues;
- Contain the Tax Advisor's conclusion as to the likeli hood of success on each significant federal tax issue or the reason(s) such conclusion(s) could not be reached;
- If less than a more likely than not conclusion is given, a disclosure must be made that the advice can not be used or relied upon for penalty protection;
- Cannot take into account in reaching conclusions that a tax return will not be audited, an issue will not be raised on audit, or that an issue would likely be compromised on audit;
- In the case of a Marketed Opinion, must provide the conclusion that the taxpayer will prevail on the mer its at a confidence level of at least more likely than not with respect to each significant federal tax issue; and
- Must "prominently disclose" disclose the existence of referral fees or fee sharing for promoting, marketing or recommending transactions, or any referral agree ment with a person promoting, marketing or recom mending transactions.

2. Limited Scope Opinions.

A "Limited Scope Opinion" exists if the Tax Advisor covers less than all of the significant federal tax issues. By definition, it is not a Covered Opinion. Under the Final Regulations, a Tax Advisor may only provide a Limited Scope Opinion if three criteria are met, namely:

- The taxpayer and Tax Advisor agree that the scope and the taxpayers' reliance on the opinion for penalty protection are limited to the federal tax issues actually covered in the opinion;
- The opinion does not constitute advice relative to a Listed Transaction, a Principal Purpose Transaction or a Marketed Opinion; and
- The opinion "prominently discloses" that it is limited to one or more issues addressed; that additional issues may exist that could affect federal tax treat ment of the transactions or matters; and with respect to those additional issues not covered, the opinion cannot provide penalty protection.

C. Other Written Advice.

A Tax Advisor may not give Written Advice concerning one or more federal tax issues if he or she bases the Written Advice on unreasonable factual or legal assumptions; unreasonably relies on representations, statements, findings or agreements of the taxpayer or any other person; does not consider all relevant facts that the Tax Advisor knows or should know; or, in evaluating a federal tax issue, 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 resolved through compromise if it is raised on audit. If the Tax Advisor knows or should know the advice will be used in promoting or marketing a partnership or other entity, investment plan or an arrangement a significant purpose of which is the avoidance or evasion of any federal tax, the determination of whether the Tax Advisor has failed to comply with these standards will be made on the basis of a heightened standard of care. The Final Regulations, however, do not define or clarify the level of care which will be used in such circumstances.

D. Procedures to Ensure Compliance.

To ensure compliance, the Final Regulations require that the Tax Advisors who have or share the principal authority for overseeing a firm's federal tax practice must take reasonable steps to ensure the firm has adequate procedures in effect to comply therewith. Any Tax Advisor holding such a leadership role may be subject to discipline (other than for violations of the Best Practices provisions) if:

- Through willfulness, recklessness or gross incompe tence does not take reasonable steps to ensure that the firm has adequate procedures in place to comply with the Final Regulations, or allows a pattern of practice within the firm of failing to comply with the Final Regulations; or
- Knows or should know that one or more individuals in the firm have engaged in a pattern of practice that does not comply with the Final Regulations and through willfulness, recklessness or gross incompe tence, fails to take prompt correction action.
- For the leader(s) of a firm's federal tax practice, it is imperative that steps are immediately taken to effec tuate the implementation of proper procedures and policies designed to ensure compliance with C230 and the Final Regulations. The following steps are recommended by the leader(s) of a firm's federal tax practice:
- Disseminate a written summary of the Final Regulations and May 19 Amendments to all Tax Advisors, others in the firm who may be involved in the rendering of federal tax advice, and the members of management of the firm;
- Conduct meetings to communicate the requirements created by the Final Regulations and the May 19 Amendments to all Tax Advisors, others in the firm who may be involved in the rendering of federal tax advice, and the members of management of the firm;
- Establish and implement policies for compliance with the Final Regulations and the May 19 Amendments;
- Create mandatory disclosure statements for electronic communications;
- Consider amending the firm's business intake proce dures and protocols;
- Consider amending the firm's form of engagement letter;
- Create in-house education programs to ensure con tinuing awareness; and
- Establish and implement a monitoring mechanism to ensure continuing compliance with the Final Regulations and the May 19 Amendments.

By placing such a burden upon the leader(s) of a firm's federal tax practice, it is clear Treasury recognizes that a firm's culture influences its tax practices. This burden should not be taken lightly. Waiting for the Service to knock on your door is ill-advised.

E. Establishment of Advisory Committees.

In order to promote and maintain the public's confidence in our tax system, the Director of the Office of Professional Responsibility is given the authority to establish one or more advisory committees composed of at least five individuals authorized to practice before the Service. These committees are to contain an equal mix of attorneys, accountants, and enrolled agents. The committees may review and make general recommendations regarding professional standards or Best Practices. Participation by a broad cross-section of the federal tax community will help maintain balance in the practice standards.

F. Penalties.

The Final Regulations provide that a Tax Advisor may be censored, suspended or disbarred from practice before the Service for any of the following:

- Willfully violating any of the provisions contained in the Final Regulations (other than the Best Practices provisions); or
- Recklessly or through gross incompetence violating any of the provisions contained in the Final Regulations (other than the Best Practices provisions).

As a result of the AJCA, as stated above, it is likely the Treasury will soon issue regulations which contain monetary penalties. The penalties which relate to abusive tax shelters and strategies/products are expected to be significant.

SUMMARY OF DISCLOSURE REQUIREMENTS UNDER FINAL REGULATIONS

All Covered Opinions must contain certain disclosures. As stated above, all disclosures must be prominently displayed in the Written Advice. This means they must be located in a separate section of the written document and printed in a typeface that is the same size or larger than all other print in the document. The "prominent disclosure" must:

- Set forth any compensation arrangement or referral arrangement between the Tax Advisor and any promoter of the transaction or matter;
- In Marketed Opinions, set forth that the Tax Advisor prepared the opinion to support the promotion or marketing of the transaction or matter and that the taxpayer should seek independent tax advice;
- In Limited Scope Opinions, set forth that the opin ion is limited to the federal tax issues expressly addressed in the opinion, that other issues may exist which could affect the federal tax treatment of the transaction or matter, that the opinion does not provide a conclusion to any other issues, and that it was not written and cannot be used, to avoid penalties with respect to any significant fed eral tax issues outside the limited scope of the opinion; and
- For opinions not reaching at least a more likely than not conclusion with respect to a federal tax issue, must disclose that it does not reach such level, and with respect to the issues not reaching such level that it was not written to and cannot be used to avoid penalties.

Tax Advisors cannot provide any advice to a person which is contrary to or inconsistent with these disclosures. This prohibition likely extends not only to written communications, but also to oral communications.

CONCLUSION

A real urgency exists for Tax Advisors and their firms to gain a good understanding of C230, as amended by the Final Regulations and the May 19 Amendments, and implement policies to ensure compliance therewith. In light of the possibility of censorship, suspension or disbarment from practice before the IRS, the stakes are high. Once Treasury adopts monetary penalties for noncompliance with C230, emerging from authority created by the AJCA, the stakes will reach even higher levels.

The Service's new arsenal is strong. As a practical matter, C230, as amended by the Final Regulations and the May 19 Amendments, greatly limits, or possibly eliminates, the ability of Tax Advisors to issue and mass market written tax opinions concerning Listed Transactions or Principal Purpose Transactions. The regulations are so broad they surely extend well beyond such abusive transactions. Consequently, the important issue facing Tax Advisors is how much farther do the regulations really reach? Extending the regulations to the broadest application would unduly restrain the ability of Tax Advisors to render federal tax advice. Representatives of Treasury have publicly commented in the last several weeks that this is not their intent. Unfortunately, the May 19 Amendments do not do a very good job of reflecting such an intent. Until Tax Advisors receive significant clarification, uncertainty about the application of C230 will continue to exist, which in turn will likely hinder the ability of Tax Advisors and their firms to render federal tax advice. Further, the application of C230 will surely increase the cost to taxpayers for tax services. Regardless of the Service's true ability to effectively enforce the regulations, Tax Advisors need to take the Final Regulations and the May 19 Amendments seriously, and strive to comply therewith.

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