February 12, 2004

Internal Revenue Service
CC:PA:LPD:PR (Reg 122379-02)
Room 5203
PO Box 7604
Ben Franklin Station
Washington, DC 20044

Re: Proposed Amendment to Circular 230

Dear Sirs:

The following comments on the proposed amendments to Circular 230, which were issued on December 30, 2003 (the "Amendments"), are submitted by the American College of Tax Counsel ("ACTC"). The ACTC commends the Service for issuing the proposed Amendments, and we are particularly supportive of the issuance of guidelines for the "best practices" that tax practitioners should adopt (although it needs to be made clear in Section 10.33 that these "best practices" are aspirational and not mandatory). We also support the proposed rules concerning marketed tax shelter opinions. As explained below, however, we are concerned about the definition of a "tax shelter opinion" in Section 10.35 and the rules concerning vicarious liability in Section 10.36 of the Amendments.[1]

The ACTC is a nonprofit professional association of tax lawyers in private practice, law school teaching and government service, who are recognized for their excellence in the field of taxation and for their substantial contributions and commitment to the profession. The College is comprised of tax lawyers from throughout the United States chosen by their peers in recognition of their outstanding reputation and service to the tax law and the tax bar.

[1] Our comments are limited to these two provisions in the Amendments; our silence concerning other aspects of the Amendments should not be viewed as either an endorsement or a rejection of such provisions.

The ACTC's Position Concerning Tax Shelters. The ACTC has long supported the Service's efforts to attack abusive tax shelters. In this regard, the ACTC supports the Service's recent regulatory initiatives to increase disclosure concerning potentially-abusive transactions as well as certain of the legislative proposals that would increase penalties on taxpayers who fail to make required disclosures and practitioners who fail to live up to their professional obligations.

The ACTC also believes that the tax shelter aspects of Circular 230 need to be overhauled. The current rules were adopted to address the tax shelters of the 1980s; these rules are often not relevant in a world in which tax shelters are based on derivatives, options and other exotic financial products. Proposed amendments were issued in 2001 (the "2001 Proposal"), but these rules were met with significant criticism and have not been finalized. We agree with the Service that an improvement of Circular 230 is long overdue, and we applaud the issuance of the Amendments in proposed form in order to seek comments concerning how Circular 230 should be improved and updated.

On the other hand, the ACTC also believes that the overwhelming majority of tax practitioners "play by the rules" and provide advice to their clients as to legal and proper ways to efficiently consummate legitimate business transactions. We are concerned that Circular 230 not be amended in a manner which will increase the burden on practitioners – or their clients – when tax-planning advice is provided in connection with routine business transactions.

The Definition of "Tax Shelter Opinions". The first issue that the ACTC wishes to address is the scope of the definition of a "tax shelter opinion" in Section 10.35 of the Amendments. Under the applicable provisions, a "tax shelter" is defined as any investment plan or arrangement, or any other plan or arrangement, a significant purpose of which is the avoidance or evasion of any tax imposed by the Code. A "tax shelter opinion" is written advice by a practitioner concerning the Federal tax aspect of any Federal tax issue relating to a tax shelter item. A narrow exclusion from the definition of a "tax shelter opinion" is provided for preliminary written advice, but only if the practitioner is expected to subsequently provide written advice to the taxpayer that satisfies the requirements for a tax shelter opinion. An exception is provided for certain limited scope opinions, but such opinions must expressly state that their scope is limited, and this exception does not avoid the application of Section 10.35(a) as to the matters covered by the limited scope opinion.

These definitions become applicable if a practitioner issues a "more likely than not tax shelter opinion," which is a tax shelter opinion that reaches a conclusion at a confidence level of at least more likely than not (that is, greater than 50 percent) that one or more material Federal tax issues would be resolved in the taxpayer's favor. In that case, the opinion that is issued by the practitioner must satisfy all of the requirements of Section 10.35(a).

If "tax avoidance" is synonymous with "tax minimization" (including recommending non-taxable alternatives to taxable transactions), these intersecting definitions is that they cover almost virtually everything that a tax practitioner routinely does. For example, suppose that a client sends an e-mail to her lawyer saying that she wants to sell her business that is conducted through an S corporation to a publicly-traded corporation. The tax lawyer sends a responsive e-mail that advises the client that, instead of engaging in a stock sale, the client should exchange the stock in her S corporation for stock of the publicly-traded corporation. The lawyers further tells her that this transaction is non-taxable, which is clearly the case. The lawyer has just furnished a "tax shelter opinion" to the client because the transaction has a significant purpose of tax avoidance and the advice is at a more likely than not (or higher) level of comfort. As a result, the e-mail would be required to satisfy the requirements of Section 10.35(a). This is an unreasonable burden on practitioners and a costly one for their clients.

Similarly, suppose that a taxpayer owns a building which he wishes to sell. He asks his tax lawyer for advice, and she sends an e-mail suggesting that the sale contract contain a provision allowing for a like-kind exchange. This e-mail further states that if an exchange is subsequently consummated, and assuming that the requirements for identification and acquisition of replacement property are satisfied, the exchange would be non-taxable. Again, this written advice would be a "tax shelter opinion" because it describes a transaction with a significant purpose of tax avoidance and the advice is provided at a more likely than not or greater level of comfort. Therefore, the e-mail would have to satisfy the requirements of Section 10.35(a).

The result in the two preceding examples occurs because of the broad definition of a "tax shelter" in the Amendments. Clients seek tax advice in order to comply with the tax law and pay tax that results under the transactional alternative that best achieves both their business and tax objectives. Virtually every piece of tax planning advice that is given by a tax practitioner has "a significant purpose of tax avoidance." If a "tax shelter opinion" is defined as any written advice concerning tax minimization possibilities, then most written advice provided by tax practitioners will be "tax shelter" opinions for purposes of Circular 230.

We do not believe that such an expansion of the scope of Circular 230 is appropriate. The 2001 Proposals contained the same definition of a "tax shelter," and that definition was severely criticized. The inclusion of this definition in the Amendments is likely to lead to similar criticism of the Amendments.

On the other hand, we are cognizant of the difficulty in defining a tax shelter in a manner that covers abusive transactions while not picking up routine and legitimate tax planning. We also are aware of the fact that the Service has decided to utilize the same definition of a "tax shelter" that was in the 2001 Proposals, notwithstanding the comments that were received in response to those proposals, because this definition ties into the definition used for penalty

purposes of Section 6662. Accordingly, we have assumed for purposes of these comments that this definition of a tax shelter will not be altered, although we would urge the Service to consider narrower formulations if it is able to do so. [2]

Limit the Definition of "Opinion". Assuming that the definition of a "tax shelter" is not going to be narrowed, the ACTC believes that the scope of the application of Circular 230 can appropriately be limited by providing that the only opinions subject to Section 10.35(a) of Circular 230 would be (i) marketed opinions, and (ii) opinions expressly issued for purposes of avoiding a penalty. The latter type of opinions, which are commonly referred to as "reliance opinions," would presumably state that they have been issued by a tax practitioner for purposes of establishing that a taxpayer reasonably believed that the tax treatment of the subject transaction was correct at a more likely than not (or higher) level of comfort. The regulations under Sections 6662 and 6664 could be amended to provide that a taxpayer could rely upon an opinion to avoid penalties only if the opinion bore such statement and complied with the requirements of Section 10.35(a).

This proposal is the opposite of the "limited scope opinion" approach taken in the Amendments. Under that approach, an opinion did not need to address all material tax issues, but only if the opinion expressly stated that the taxpayer could not rely upon the opinion to avoid penalties with respect to any material Federal tax issue(s) outside the limited scope of the opinion. This standard would require practitioners to include a "limited scope" statement in every piece of written advice provided to their clients, including routine tax planning e-mails of the type described above. We don't believe that it is appropriate for tax practitioners to have to include such a legend in every memorandum or e-mail that is sent to their clients. This exception will also increase the time and cost of providing routine tax planning advice, which we do not believe is appropriate.

Our proposal simply reverses the presumption in the Amendments by providing that Section 10.35(a) of Circular 230 does not apply to written advice unless the advice is a marketed opinion or a reliance opinion. Under our proposal, tax practitioners could continue to provide routine tax-planning advice to their clients without worrying about whether their written communications comply with the requirements of Section 10.35(a) of Circular 230. Clients will not have to pay for the increased costs of due diligence and compliance which would apply if Section 10.35(a) of Circular 230 applied, as the Amendments would require, to virtually every written communication between a tax advisor and her clients. Instead, these increased costs would be incurred only in situations in which the taxpayer wanted to be able to rely on the practitioner's opinion for penalty-avoidance purposes or in the case of marketed opinions. In

[2] We believe that the definition of a "tax shelter" could be linked to the definition of a "reportable transaction" in Section 6011 or, in the alternative, an "angel list" of excluded transactions could be developed by the Service.

such situations the increased costs of complying with Section 10.35(a) of Circular 230 will be known by the practitioner and the client, and the taxpayer's ability to rely upon the opinion for penalty-avoidance purposes will presumably be reflected in the cost of the services provided.

The concept of "reliance opinions" does not mean that taxpayers will automatically be subject to penalties if they do not receive an opinion that conforms to Section 10.35(a). Section 6664 provides that a taxpayer may avoid a penalty with respect to a tax shelter (as broadly defined in Section 6662) if the taxpayer reasonably believed that the treatment of the item was more likely than not correct. The taxpayer would be able to indicate the basis for her position concerning the questioned item and all of the reasons why the taxpayer believes that her treatment was correct. The taxpayer would not, however, be able to submit the written advice received from the practitioner for purposes of avoiding a penalty under Section 6662. This is a reasonable compromise, in that the client can still establish that she had a reasonable basis for her position, but an opinion can be utilized to meet this burden only if the opinion satisfies the requirements of Circular 230.

Vicarious Liability under Section 10.36. The second issue that we wish to raise concerns the possibility that Section 10.36 in the Amendments would impose vicarious liability on tax practitioners for the actions of others in connection with the issuance of tax shelter opinions. We do not believe that vicarious liability is appropriate, particularly if the definition of tax shelter opinions in Section 10.35 remains unchanged.

Section 10.36(a) provides that 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 Service 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 Section 10.33. We support this goal. We anticipate that most practitioners will take reasonable steps to incorporate the best practices set forth in Section 10.33, and we expect that their firms will likewise take reasonable steps in that regard.

Our concern focuses on Section 10.36(b), which provides that any practitioner who has (or the practitioners who have or share) principal authority and responsibility for overseeing a firm's practice of providing advice concerning Federal tax issues must take reasonable steps to ensure that the firm has adequate procedures in effect for all members, associates and employees for purposes of complying with Section 10.35. A practitioner who fails to meet this requirement could be subject to discipline under Circular 230. Section 10.36(b) elaborates that discipline can apply if the practitioner through willfulness, recklessness or gross incompetence does not take reasonable steps to ensure that the firm has adequate procedures to comply with Section 10.35, and one or more practitioners in the firm are, or have, engaged in a pattern or practice that fails to comply with Section 10.35, or if the practitioner knows or has reason to know that one or more individuals who are practitioners in the firm are, or have, engaged in a practice that does

not comply with Section 10.35 and the practitioner, through willfulness, recklessness or gross incompetence fails to take prompt action to correct the noncompliance.

As discussed above, Section 10.35 in the form currently proposed will apply to virtually every written communication authored by a tax practitioner. Thus, the impact of Section 10.36 would be that the partners who manage or supervise a firm's tax practice (which practice arguably could include all of the lawyers in the firm who at any time provide tax advice to their clients) would be personally subject to discipline unless every written communication complied with the requirements of proposed Section 10.35 of Circular 230. Moreover, even if some steps were taken to comply with the requirements of proposed Section 10.35 of Circular 230, the Amendments do not provide any guidance as to whether such steps had been "adequate." Section 10.36 in the Amendments could be read to authorize disciplinary action against the partners in a law firm if its memoranda, letters and e-mails did not conform to Section 10.35(a) because the firm might not have taken adequate steps to prevent such "tax shelter opinions" from being issued.

We believe that vicarious liability is inappropriate – each practitioner should be responsible for his or her own actions, but the actions of one practitioner should not result in disciplinary action against another practitioner. We do not think that this problem can be resolved solely by limiting the scope of the definition of a "tax shelter opinion" as discussed above, although this step would certainly lessen the problem. In the end, we believe that Section 10.36(a) should be retained but the vicarious liability rules in Section 10.36(b) should be deleted. Alternatively, the rules concerning vicarious liability should be narrowed so as to apply only in the most egregious situations, and "safe harbor" procedures which can be adopted by a law firm to avoid vicarious liability should be added to Section 10.36.

Conclusion. The ACTC strongly supports the Service's efforts to improve and update Circular 230. We hope that the foregoing comments will be taken as constructive criticism, because we support the issuance of final rules as soon as practicable. We believe that the changes discussed above will make Circular 230 into a more reasonable set of rules for governing the actions of all tax practitioners.

Sincerely,

Louis Mezzullo
Chair, ACTC