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Tax Advisor-Client Privileges and Circular 230 Revisions

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Tax Advisor-Client Privileges and Circular 230 Revisions
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I. Tax Advisor-Client Privileges

A. Background

1. Attorney-Client Privilege

a. Classic "Wigmore" Definition: When (i) legal advice is sought (ii) from a legal advisor acting as such (iii) the communications relating to that advice (iv) made in confidence by the client (v) at the client's insistence are protected from disclosure (vi) by the client or advisor (vii) *unless* the privilege is waived.

b. Purpose: The attorney-client privilege is intended to facilitate sound and comprehensive legal advice by eliminating the incentive the client would otherwise have to not fully inform his attorney of the facts. *See Upjohn Co. v. United States*, 449 U.S. 383 (1981) ("Sound legal advice or advocacy depends on the attorney being fully informed by the client.").

c. Comment: The attorney-client privilege is predicated on confidentiality. If a client asks for legal analysis that is not confidential—*e.g.*, a brief that will be filed in court—that final analysis is certainly not privileged. Also, if a client shows ambiguity or indifference to the expectation of confidentiality, the communication may be found to not be privileged. At that point, it becomes critical to determine whether the disclosed communication was never privileged or whether the disclosure constituted a waiver of privilege. It is also important to note that an attorney, in contrast to a certified public accountant ("CPA"), has an ethical duty to keep client communications confidential. *See* ABA Model Rules of Professional Conduct, Rule 1.6.

2. Work Product

a. Fed. R. Civ. P. 26(b)(3) Description: Documents and tangible things prepared in anticipation of litigation or trial by or for a party or a party's representative are protected *unless* the other party demonstrates need of such items to prepare his case, or the other party is unable to obtain the substantial equivalent.

b. Purpose: The work product protection promotes uninhibited, thorough trial preparation to ensure that the other party does not

seek to win "on wits borrowed from the adversary." *Hickman v. Taylor*, 329 U.S. 495 (1947) (Jackson, J., concurring).

c. Comment: The work product protection is predicated on preventing the accrual of an unfair advantage to the party's opponent. As such, the work product protection is not necessarily waived if work product is disclosed to a third-party other than an opponent. Even if a waiver occurs, courts often define the scope of the waiver narrowly.

3. Tax Advisor Privilege

a. IRC § 7525: The communications that a taxpayer has with a federally authorized tax practitioner (*e.g.*, accountant, enrolled agent) that would be covered by the attorney-client privilege if they had been with an attorney are privileged, *but* only in civil tax proceedings (*e.g.*, not SEC or criminal tax proceedings), *and* not if the communications are made in connection with the promotion of a corporate tax shelter as defined in IRC § 6662.

b. Purpose: The tax advisor privilege provides that the right to privilege regarding tax advice before the Internal Revenue Service does not depend on the type of advisor.

c. Comment: Whether a communication is subject to the tax advisor privilege depends on whether the analogous elements of the privilege are met. For instance, the communication must be made in the course of seeking tax advice, not accounting advice or return preparation services. Similarly, the client must have a reasonable expectation of confidentiality, which can often be highly problematic if the tax advisor also acts as the client's CPA.

B. Modern Application of Privilege in Tax Cases

1. The *Kovel* Doctrine: The attorney-client privilege will not be waived if communications are made in front of a third-party expert who is serving as an interpreter to facilitate confidential communications between the client and the attorney. *See United States v. Kovel*, 296 F.2d 918 (2d Cir. 1961) (Friendly, J.).

a. Facts: Kovel was an accountant who was employed by a law firm, which was representing a client under investigation by a grand jury; the grand jury issued a subpoena demanding that Kovel appear and testify; Kovel refused to testify on the ground that he was employed by the law firm.

b. Holding: "[T]he presence of an accountant, whether hired by the lawyer or by the client, while the client is relating a complicated

tax story to the lawyer, ought not destroy the privilege, any more than would that of the linguist [serving as an interpreter]; the presence of the accounting is necessary, or at least highly useful, for the effective consultation between the client and the lawyer which the privilege is designed to permit." *Id.* at 922.

c. Comment: The so-called "*Kovel* doctrine" has been widely accepted and applied to experts other than accountants who act as interpreters to facilitate communications relating to a client's seeking of legal advice. However, the court in *Kovel* also made clear that, if what is sought is the advice of the accountant rather than the lawyer, no attorney-client privilege exists. *Id.* Attempts by parties to stretch the *Kovel* doctrine to different factual circumstances often fail. *See, e.g., United States v. Ackert*, 169 F.3d 136 (2d Cir. 1999) (holding that an investment banker who pitched a tax savings strategy to a potential corporate client was not acting as an interpreter under *Kovel*).

2. Waiver of the Attorney-Client Privilege: A investment promoter who discloses his attorney's tax opinion to potential third-party investors waives any attorney-client privilege that may have existed between the him and his attorney. *See United States v. Jones*, 696 F.2d 1069 (4th Cir. 1982).

a. Facts: Several investment promoters retained attorneys to provide tax opinions regarding investments in coal leases and included portions of the opinions in brochures and other promotional materials distributed to potential third-party investors; a grand jury issued several subpoenas seeking documents and testimony from the attorneys; the promoters intervened and sought to assert the attorney-client privilege.

b. Holding: Although expressing doubt that communications were made to obtain legal advice, the Fourth Circuit held that any asserted privilege was waived because the success of the promoters' business venture depended on convincing the potential investors that the claimed tax benefits would be sustained. *Id.* at 1073. The court held that any attorney-client privilege with respect to the opinions and communications made in the process of obtaining the opinions was waived. *Id.*

c. Comment: The court in *Jones* suggested that an investment promoter who is not seeking advice regarding his own tax consequences may not even be seeking legal advice in obtaining a tax opinion from his attorney. Although reasonable minds might differ about this suggested conclusion, the court's essential holding that the any possibly privilege that existed was waived seems

beyond question. The court's holding is consistent with the often stated axiom that the taxpayer cannot use the privilege as both a "sword and a shield." In other words, to the extent that the taxpayer affirmatively discloses legal advice to gain a benefit (*e.g.*, interest from an investor or an advice of counsel defense), the taxpayer will be required to disclose all communications relating to that advice to ensure that the taxpayer has not selectively disclosed only the favorable aspects of the advice received. *See In re Pioneer Hi-Bred International, Inc.*, 238 F.3d 1370 (Fed. Cir. 2001) (holding that a company that disclosed tax advice received from law firms in proxy statement related to a merger had waived the attorney-client privilege with respect to that advice).

3. Tax Accrual Workpapers: *United States v. Arthur Young & Co.*, 465 U.S. 805 (1984).

   a. Facts: A CPA firm was responsible for reviewing the taxpayer-corporation's financial statements as required by federal securities laws; in the course of the review, the CPA firm verified the statement of contingent tax liabilities, and in doing so prepared tax accrual workpapers relating to the evaluation of the reserves for such liabilities; the Service issued summonses to the CPA firm seeking all of its files, including the tax accrual workpapers; the taxpayer instructed the CPA firm not to respond.

   b. Holdings: Citing *Couch v. United States*, 409 U.S. 322, 335 (1973), the Supreme Court held that "no confidential accountant-client privilege exists." *Arthur Young*, 465 U.S. at 817. Further, the Court held that the work product doctrine announced in *Hickman v. Taylor, supra*, did not apply because of the differing roles of attorney and CPA. "By certifying the public reports that collectively depict a corporation's financial status, the independent auditor assumes a public responsibility transcending any employment relationship with the client." *Arthur Young*, 465 U.S. at 817–18.

   c. Comment: The Supreme Court in *Arthur Young* noted that guidelines issued by the Service during the course of the litigation provided that the examiner should seek tax accrual workpapers only in "unusual circumstances" and only as a "collateral source for factual data." *Id.* at 821 n. 17. That policy was basically unchanged until a recent administrative pronouncement discussed *infra*. It is also important to note that if a taxpayer's CPA firm reviews the legal memoranda concerning tax issues prepared by attorneys, those memoranda are not privileged. *United States v. El Paso Co.*, 682 F.2d 530 (1982).

4. The "In Anticipation of Litigation" Requirement for Work Product: A tax memorandum written before a transaction occurs may qualify for the work product protection if it was prepared "because of" anticipated litigation. *See United States v. Adlman*, 68 F.3d 1495 (2d Cir. 1995); *United States v. Adlman*, 134 F.3d 1194 (2d Cir. 1998).

   a. Facts: Adlman was an attorney and the Vice President for Taxes at the taxpayer-corporation; the corporation was contemplating undertaking a transaction that would generate a $289 million loss for tax purposes; Adlman engaged an accountant at Arthur Andersen to write a memorandum evaluating statutes, regulations and cases, proposing theories and strategies for the taxpayer to adopt in response to a likely challenge by the Service, and making predictions about the likely outcome of litigation; during an examination, the Service issued a summons seeking the memorandum.

   b. Holdings: In the first opinion, the court held that the fact that the memorandum was produced before the transaction giving rise to the claimed loss occurred was not dispositive of whether the memorandum was prepared "in anticipation of litigation." 68 F.3d at 1501. In the second opinion, the court rejected the argument that the memorandum must have been prepared "primarily in anticipation of litigation" (a standard adopted in some circuits) to qualify for work product protection, and held that the memorandum can qualify for such protection if it was prepared "because of litigation." 134 F.3d at ___.

   c. Comment: The court in *Adlman II* indicated that the "because of" standard applied in that case "withholds protection from documents that are prepared in the ordinary course of business or that would have been created in essentially similar form irrespective of the [anticipated] litigation." *Id.* It is unclear from the court's opinion which types of tax memoranda or opinions might be viewed as prepared in the ordinary course of business and which might be viewed as meeting the "because of" standard.

5. Selective Waiver: Although one court of appeals has held that disclosure to one government agency does not waive the privilege, the vast majority of circuits hold that any disclosure to a third party waives the attorney-client privilege as to all third parties. *See, e.g., United States v. Massachusetts Institute of Technology*, 129 F.3d 681 (1st Cir. 1997) (discussing the cases and applying the majority rule).

   a. Facts: During an examination, the Service requested from MIT legal bills and minutes of board and committee meetings; MIT responded by providing redacted copies; after MIT refused to

supply the documents without redactions, the Service requested the same documents from the auditing arm of the Department of Defense, which had conducted an audit of defense contracts with MIT and had obtained the documents without redactions; the Defense Department declined to provide the documents, citing internal policy; the IRS then summoned the documents from MIT.

b. Holding: The court declined to adopt a rule that would permit selective disclosure to one agency without waiving the privilege to other third parties, stating that such an approach would require "a new set of difficult line-drawing exercises that would consume time and increase uncertainty." *Id.* at 685.

c. Comment: The only case to uphold the selective waiver rule was *Diversified Industries, Inc. v. Meredith*, 572 F.2d 596 (8th Cir. 1978) (en banc).

6. Dual-Purpose Documents: If a lawyer-accountant creates documents that serve both legal and accounting purposes, the attorney-client privilege and attorney work product protection do not apply. *See United States v. Frederick*, 182 F.3d 496 (7th Cir. 1999).

a. Facts: Frederick was an attorney and an accountant who prepared federal income tax returns for the taxpayer-couple and represented the taxpayers on audit; the Service summoned documents from Frederick and he withheld many on the grounds of attorney-client privilege and attorney work product; the documents included draft tax returns, worksheets reflecting financial data and calculations, and memos regarding compiling information to respond to the Service's requests for information.

b. Holding: The court resolved the privilege issue by focusing on whether the documents reflected "accountants' work" (*e.g.*, evaluating financial data and making tax calculations, or verifying numbers) or "attorneys' work" (*e.g.*, evaluating issues of statutory construction or case law). 182 F.3d at 502. Because there was no evidence that Frederick was doing attorneys' work, the court held that neither of the privileges apply. *Id.*

c. Comment: Although holding that no privilege existed, the court rejected the government's argument that there was no issue of privilege to the extent that the information was transmitted to a tax return preparer with the expectation of it being relayed to the Service. The court stated: "It cannot be assumed that everything transmitted to [Frederick] by the taxpayer was intended to assist him in his tax-preparation function . . . rather than in his legal-representation function." *Id.* at 500–01. The court also rejected

the government's argument that numerical information can never fall within the attorney-client or work product privileges. *Id.* at 501. Finally, although the tax advisor privilege under IRC § 7525 was not applicable to the documents at issue, the court noted that "[n]othing in the new statute suggests that these non-lawyer practitioners are entitled to privilege when they are doing other than lawyers' work." 182 F.2d at 502.

C. Recent Cases and an Administrative Pronouncement from the Tax Shelter Wars

1. Revisiting the Tax Accrual Workpapers Policy: In 2002, the IRS announced that it was revising the policy (referred to in *Arthur Young, supra*) concerning when revenue agents will request tax accrual or other financial audit workpapers relating to the tax reserve for deferred tax liabilities and to footnotes disclosing contingent tax liabilities appearing on audited financial statements. *See* Announcement 2002-63, 2002-27 I.R.B. 72. In particular, revenue agents may request tax accrual workpapers or other similar workpapers in the course of examining any tax return filed on or after July 1, 2002 that claims any tax benefit arising out of a transaction that the IRS has determined to be a listed transaction at the time of the request.

   a. General Rule If Disclosed: If the listed transaction was disclosed, the IRS will routinely request only tax accrual and other similar workpapers that relate to the transaction.

   b. Other Circumstances: All such workpapers, however, will be requested, in the event that either, (i) a listed transaction was not disclosed on a return claiming benefits from such a transaction, (ii) multiple listed transactions were claimed on a return (regardless of disclosure), or (ii) there are reported financial irregularities (such as those requiring a restatement of earnings) in connection with a return claiming tax benefits from a listed transaction.

   c. Comment: The Service has repeatedly indicated that it considers the changed policy regarding tax accrual workpapers to be a critical instrument in the war on tax shelters. However, as long as a taxpayer does not engage in a listed transaction, the new policy would not appear to be applicable. Of course, sometimes a taxpayer engages in a transaction that, though not a listed transaction at the time, becomes listed later. Also, if a taxpayer does engage in a listed transaction, the new policy can be avoided by claiming the tax benefits on an amended return.

2. Subject Matter Waiver of Attorney-Client Privilege: *Long-Term Capital Holdings v. United States*, 91 A.F.T.R.2d 2003-1139 (D. Conn. 2003).

   a. Facts: The taxpayer first engaged a law firm to determine the tax basis in certain property that would be contributed to a partnership; the taxpayer later engaged a different law firm to consider a subsequent transaction involving the same property; during an examination, the taxpayer turned over the basis opinion issued by the first law firm to the Service; the Service then argued that the disclosure of the first opinion constituted a subject matter waiver and required the second opinion to also be disclosed; the Service also argued that the taxpayer had waived the privilege by invoking the advice of counsel defense in response to the assertion of penalties, and that the disclosure to its accountant of the fact it received favorable advice from its attorneys waived the privilege.

   b. Holdings: The court held that the basis opinion was not privileged because the taxpayer did not intend to keep the opinion confidential but rather intended that the opinion would serve as part of the books and records that would be available for the Service to review. After an in camera review, the court also found that the subject matter of the basis opinion was distinct from the subject matter of the second opinion. Further, the court held that it was premature for the government to argue that the taxpayer was asserting the advice of counsel defense, and that, under the fairness doctrine, the only part of the second opinion that had been waived was the general conclusion (*i.e.*, that it was "more likely than not" that the loss could be taken) that was conveyed to the account.

   c. Comment: The court in *Long-Term Capital Holdings* correctly recognized that not all legal opinions are confidential and, therefore, intended to be privileged. It would be advantageous to make the fact that such an opinion is not confidential clear, however, so that the Service cannot argue that the disclosure of such an opinion constitutes a subject matter waiver. (This is an approach that is often taken whether a taxpayer's financial auditors demand written analysis from counsel.) The court also made clear that the fairness doctrine only applies where the extra-judicial disclosure of an attorney-client communication is "subsequently used by the client in a judicial proceeding." *see In re Von Bulow*, 828 F.2d 94, 102 (2d Cir. 1987). Under such circumstances, such disclosure "does not waive the privilege as to the undisclosed portions of the communication." *Id.* The fairness doctrine is likely to play an interesting role in future tax cases involving privilege disputes.

3. Attorney-Client Relationship and Scope of the Tax Advisor Privilege: *John Doe #1 v. Wachovia Corp.*, 268 F. Supp.2d 627 (W.D.N.C. 2003)

   a. Facts: A number of taxpayers were referred to a law firm by a financial institution; the law firm provided the taxpayers with a package containing a description of a proposed transaction and memorandum regarding the potential tax consequences; after the Service summoned the bank for documents related to the transactions, the taxpayers filed suit to prevent disclosure by asserting the attorney-client privilege and the tax advisor privilege under IRC § 7525.

   b. Holdings: The court held that no attorney-client relationship existed because the law firm merely sold a package to the taxpayers, who themselves never appeared to have so much as a conversation with an attorney at the law firm. 268 F.Supp.2d at 634. The court also held that the tax advisor privilege did not apply because the case did not constitute a civil tax proceeding (*i.e.*, the suit was between the taxpayers and the bank; the Service was not a party).

   c. Comment: This case is similar to the Fourth Circuit's previous decision in *Jones*, *supra*, in that the court refused to sustain a claim of privilege where tax opinions were used as a marketing device. It is also similar to the recently decided *United States v. KPMG LLP*, 316 F.Supp.2d 30 (D.D.C. 2004), in which the court rejected privilege assertions in similar circumstances, stating at one point: "In fact, when examined as a group, the letters appear to be nothing more than an orchestrated extension of KPMG's marketing machine." The court in *Wachovia* also pointed out a significant limitation on the tax advisor privilege—*i.e.*, that it does not apply outside civil tax proceedings. Interestingly, the court also found in the alternative that the tax advisor privilege would not apply because the tax opinions were distributed in connection with the promotion of tax shelters involving corporations (the proposed transaction involved the creation of a corporation), although the relevant statutory language could be read to require that the investor in such a tax shelter be a corporation. *See* IRC § 7525(b).

4. Identity Privilege and IRC § 7525: *United States. v. BDO Seidman*, 337 F.3d 802 (2003).

   a. Facts: The Service summonsed document relating to the accounting firm BDO Seidman's compliance with list-keeping and registration requirements for potentially abusive tax shelters under IRC §§ 6111 and 6112; the clients of BDO sought to intervene to assert the tax advisor privilege under IRC § 7525.

b. Holdings: The court held that the tax advisor privilege is no broader than the attorney-client privilege. 337 F.3d at 810. The court also held that the so-called "identity privilege," which is an exception to the general rule that the client's identity is not privileged, did not apply because the Service was unaware of the substantive content of the discussions between the clients and BDO. *Id.* at 812. Further, the court noted that the clients' participation in the potentially abusive tax shelters is information required to be disclosed under IRC §§ 6111 and 6112, and, therefore, the clients had no expectation of confidentiality in the communications regarding such participation with BDO. 337 F.3d at 812.

c. Comment: The court noted that the identity privilege applies only "in the rare circumstance when so much of an actual confidential communication has been disclosed already that merely identifying the client with effectively disclose the communication." *Id.* at 810. In the tax arena, the typical situation in which this arises is when a taxpayer has made a voluntary disclosure to avoid criminal prosecution.

II. Circular 230 Revisions and Heightened Focus on Enforcement

A. Background: Circular 230, 31 C.F.R., pt. 10, governs practice before the Internal Revenue Service. The ethics rules imposed on practicing attorneys by Circular 230 are in addition to those imposed by state bars and courts. This outline focuses only on selected rules.

1. Practitioner Definition: "Practitioner" is defined as attorneys, CPAs, enrolled agents or enrolled actuaries. 31 C.F.R., pt. 10, §§ 10.2(e) and 10.3(a)–(d).

2. Practice Definition: "Practice before" the Service is defined as "all matters connected with a presentation to the [Service] or any of its officers or employees relating to a taxpayer's rights, privileges, or liabilities under laws or regulations administered by the [Service]. Such presentations include, but are not limited to, preparing and filing documents, corresponding and communicating with the [Service], and representing a client at conferences, hearings, and meetings." 31 C.F.R., pt. 10, § 10.2(d). Traditionally, any representation that required the practitioner to provide an executed power of attorney to the relevant Service personnel was viewed as constituting practice before the Service.

3. General Reporting Standard for Return Positions: A practitioner may not advise with respect to a return position unless there is a realistic possibility (*i.e.*, a one-in-three chance) that the position will be sustained on the

merits, unless the position is not frivolous and the practitioner informs the client of the likelihood of penalties. 31 C.F.R., pt. 10, § 10.34(a).

4. Standards for Tax Shelter Marketing Opinions: In the 1980s, Circular 230 was amended to provide standards for practitioner issuing "marketing" opinions for tax shelters. These standards were designed to aid in combating the tax shelters that proliferated during that time. Those tax shelters typically involved promoters who marketed partnership interests to individual investors, who sought deduction or credits that could shelter as much unrelated income as possible with as little investment as possible. The tax shelter marketing opinion standards are still in force. *See* 31 C.F.R., pt. 10, § 10.33.

B. Recent History and Developments

1. 2001 Proposed Revisions: In February 2001, Treasury issued proposed revisions to Circular 230 that would have, among other things, added standards for practitioners issuing "more likely than not" opinions. These standards of practice were designed to aid in combating corporate and individual tax shelters that have been proliferating in more recent years. Comments on the proposed regulations were received, but the proposed regulations were never finalized.

2. 2003 Proposed Revisions: On December 29, 2003, Treasury issued new proposed revisions to Circular 230. *See* 68 Fed. Reg. 75,186. As discussed further below, the new proposed regulations focus on four areas:

   a. Describing "best practices" for all practitioners

   b. Provide standards applicable to marketed tax shelter opinions and more likely than not tax shelter opinions

   c. Provide procedures for ensuring compliance with the standards applicable to tax shelter opinions

   d. Provide for advisory committees to the Office of Professional Responsibility

3. Recent Appointment: On the same day, the Service also announced that a new Director of the Office of Professional Responsibility was being appointed, Cono Namorato. His prior experience includes white-collar criminal defense work, and public service as the Deputy Assistant Attorney General for Criminal Tax.

C. 2003 Proposed Revisions to Circular 230: The following is a summary of selected provisions of the 2003 proposed revisions to Circular 230. *See* 68 Fed. Reg. 75,186.

1. Best Practices: The best practices standards proposed apply to all practitioners in providing clients representation. These standards include:

   a. Communicating clearly regarding the terms of the engagement and the form and scope of the advice rendered;

   b. Establishing the relevant facts, including the reasonableness of any assumption or representations;

   c. Relating applicable law, including judicial doctrines, to the relevant facts;

   d. Arriving at a conclusion supported by the law and facts;

   e. Advising the clients of the import of the conclusions;

   f. Acting fairly and with integrity in practice before the IRS.

2. Scope of Tax Shelter Opinions: The tax shelter opinions standards apply to both marketed and more likely than not tax shelter opinions.

   a. The applicable definition of a tax shelter is the definition under the accuracy related penalty. See Sec. 6662. Because the accuracy related penalty defines a tax shelter broadly as any transaction that involves a significant purpose to avoid tax, many commentators have criticized as unworkable and unwarranted the wide scope of the proposed tax shelter opinion standards.

   b. "Marketed tax shelter opinions" are those used by third persons in promoting, marketing, or recommending the tax shelter to one or more taxpayers.

   c. "More likely than not tax shelter opinions" are opinions that reach a conclusion that there is at least a greater than 50 percent chance that one or more material federal tax issues would be resolved in the taxpayer's favor.

   d. Preliminary advice provided pursuant to an engagement in which the practitioner is expected to later provide an opinion that satisfies the more likely than not tax shelter opinion standards is excluded.

3. Tax Shelter Opinion Standards: Under the tax shelter opinion standards:

   a. Practitioners must use reasonable efforts to identify and ascertain the facts (including future events) that are relevant. The opinion must identify and consider all relevant facts and not rely on any unreasonable factual assumptions or representations.

   b. Practitioners must relate the applicable law (including judicial doctrines) to the relevant facts and not rely on any unreasonable legal assumptions, representations or conclusions.

   c. Practitioners must generally consider all material federal tax issues and reach a conclusion with respect to each issue. If the practitioner considers less than all material federal tax issues, certain requirements must be met.

   d. Practitioners must provide an overall conclusion as to the tax shelter item (or items) and the reasons for that conclusion, or state that the practitioner is unable to reach such a conclusion and describe the reasons.

   e. Practitioners must be knowledgeable in all of the aspects of federal tax law relevant to the opinion being rendered. If not, the practitioner may rely on the opinion of another practitioner with respect to these issues unless the practitioner knows or should know that such opinion should not be relied on.

4. Required Disclosures: The tax shelter opinion standards also require certain disclosures at the beginning of marketed tax shelter opinions, limited scope opinions, and opinions that fail to reach a conclusion at a confidence level of at least more likely than not.

   a. Practitioners must disclose if there is compensation arrangement with respect to the promotion, marketing or recommending of a tax shelter, or if there is a referral agreement between the practitioner and any person engaged in marketing the tax shelter.

   b. Practitioners must disclose that a marketed opinion may not be sufficient for purposes of avoiding the accuracy related penalty, and that taxpayers should seek advice from their own advisors.

   c. Practitioners must disclose in a limited scope opinion that additional issues may exist that could affect the federal tax treatment of the tax shelter, and that such an opinion cannot be used for accuracy related penalty purposes.

   d. Practitioners must disclose in an opinion that fails to reach a more likely than not opinion with respect to any material federal tax

issue that the opinion cannot be used for accuracy related penalty purposes.

5. Procedures to Ensure Compliance: The procedures to ensure compliance provide standards to ensure compliance within a practitioner's firm with the best practices and tax shelter opinions provisions of Circular 230.

   a. Practitioners with responsibility for overseeing a firm's practice before the IRS should take reasonable steps that the firm has adequate procedures in effect to ensure that all members, associates and employees comply with the best practices standards.

   b. Practitioners with 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 to ensure that all members, associates and employees comply with the tax shelter opinion standards. A practitioner will be subject to discipline under this section if:

      i. The practitioner through willfulness, recklessness or gross incompetence does not take such reasonable steps, and one or more members, associates or employees are, or have, engaged in a pattern of practice of failing to comply with the tax shelter opinion standards.

      ii. The practitioner knows or has reason to know that any members, associates or employees have engaged in practice that does not comply with those standards, and the practitioner, through willfulness, recklessness, or gross incompetence, fails to take prompt action to correct the noncompliance.

6. Advisory Committees on the Integrity of Tax Professionals: The Director of the Office of Professional Responsibility may establish one or more advisory committees composed of at least five individuals authorized to practice before the IRS to review and make recommendations regarding professional standards and whether a practitioner may have violated the best practices or tax shelter opinion standards.

D. 2004 Proposed Legislation Regarding Treasury Department Authorization: There have been anecdotal reports through the years to the effect that, whenever the Director of Practice charged practitioners with violating the Circular 230 opinion standards, the administrative law judge would dismiss the cases on ground that writing opinions did not constitute "practice before" the Service. To remedy this

problem, and provide further explicit authorization to regulate practice before the Service, Congress has recently proposed legislation.

1. The statute that authorizes the issuance of Circular 230 grants authority to the Secretary of the Treasury to "regulate the practice of representatives of persons before the Department of the Treasury." 31 U.S.C. § 330(a).

2. The proposed legislation would amend the statute to provide that "[n]othing in this section or in any other provision of law shall be construed to limit the authority of the Secretary of the Treasury to impose standards applicable to the rendering of written advice with respect to any entity, transaction plan or arrangement, or other plan or arrangement, which is of a type which the Secretary determines as having a potential for tax avoidance or evasion." H.R. 4520, 108th Cong., 2d Sess., § 622(b); *see also* S. 1637, 108th Cong., 2d Sess., § 414(b).

3. In addition, the proposed legislation would also explicitly provide authorization for the Secretary to censure a practitioner, and to impose a monetary penalty on a practitioner, or the practitioner's firm if it knew or should have known of the improper conduct. H.R. 4520, 108th Cong., 2d Sess., § 622(a) *see also* S. 1637, 108th Cong., 2d Sess., § 414(a). The penalty would be limited to an amount that does not exceed the gross income derived from the improper conduct. H.R. 4520, 108th Cong., 2d Sess., § 622(a); *see also* S. 1637, 108th Cong., 2d Sess., § 414(a).

E. Recent Case Implicating Circular 230 Issues: In *Long-Term Capital Holdings v. United States*, 2004 U.S. Dist. LEXIS 17,159 (August 27, 2004), the court held that the taxpayer was not entitled to a claimed loss and that, for several reasons, the taxpayer was not entitled to rely on a "should" opinion from a law firm as a defense to penalties. In doing so, the court concluded, among other things, that the opinion was not written as of the date that the tax return was filed (*i.e.*, the law firm provided only an oral opinion at that time, which was later followed up by a written opinion), and that the opinion did not meet the minimal standards required for an advice of counsel defense under IRC § 6664. It seems likely that the court would not have found that the opinion met the new standards (not yet applicable) under the proposed revisions to Circular 230.