

Circular 230 Regs 'Federalize' Tax Practice, Treasury Told

by Sheryl Stratton

Treasury officials heard their first public feedback on the new Circular 230 regs during a January 13 Tax Management lunch hosted by the Silverstein and Mullens law firm in Washington.

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Treasury officials heard their first public feedback on the new Circular 230 regs during a January 13 Tax Management lunch hosted by the Silverstein and Mullens law firm in Washington. Early indications are that while the new rules succeed in targeting abusive transactions, they also interfere with the lawyer-client relationship.

Striking Balances

On December 20, 2004, Treasury and the IRS issued the long-awaited Circular 230 regulations (T.D. 9165) addressing opinion standards for tax professionals who provide advice on federal tax issues or submissions to the IRS. (For T.D. 9165, see *Doc 2004-23933* [PDF] or *2004 TNT 244-4* (.).) Largely effective 180 days after December 20, 2004, the final regs adopt, with revisions, proposed REG-122379-02, issued in late 2003. (For REG-122379-02, see *Doc 2003-27199* [PDF] or *2004 TNT 1-13* (.).)

The regs set best practice standards only for those practicing before the IRS and provide mandatory rules for practitioners who provide "covered" opinions. The regs define covered opinions and explain the requirements for covered opinions, disclosures, and other written advice. They do not, however, reflect changes made to practice standards by the American Jobs Creation Act of 2004 (P.L. 108-357).

Eric Solomon, Treasury acting deputy assistant secretary for tax policy, said the comments received on the proposed regs were "extremely helpful."

The biggest challenge in drafting the final regs was trying to strike the balance between creating a baseline for practitioner standards, while at the same time minimizing burdens on everyday advice, Solomon said. The regs try to target the kinds of advice that give the government the most cause for concern, while trying to minimize any effect on the practitioner-client relationship, he explained.

Covered opinions are listed transactions, transactions with the principal purpose of tax avoidance, and transactions with a significant purpose of tax avoidance but have other characteristics, Solomon said. Regarding advice for which there is significant purpose of tax avoidance, the regs try to create transparency concerning the relationship between the practitioner and client, he explained. The rules generally permit the taxpayer/client to rely on a "reliance" opinion, he said, defining it as one that determines a transaction that has a significant purpose of tax avoidance is more likely than not to be upheld. However, if there is a statement on the opinion that the advice cannot be used for penalty protection, it will not be treated as a reliance opinion, he said.

Federalizing Relationships

The final regs bring tax practice to the point where the complexity for practicing has exceeded the complexity of the code itself, declared Jeffrey H. Paravano, with Cleveland-based Baker & Hostetler.

While he agreed that the tax advice "market" is in need of additional oversight, Paravano, a former Treasury official, said the question is how to balance that need with the need of compliant taxpayers to engage in routine commerce with as few material restrictions as possible.

The balance struck in the Circular 230 regs seems perfect as the rules apply to aggressive, highly structured, and promoted tax products, Paravano said. But the Circular 230 rules seem to be a fairly intrusive example of federalizing the practice of law in which sophisticated clients engaged in routine transactions call asking specific, limited questions, he said.

Paravano said his clients have substantial in-house capability and are not interested in paying for more than limited technical advice. The problem is that even though the advice covers only a limited number of issues, the client fully expects the advice to be correct, and fully expects to rely on the advice for penalty protection, he said.

The limited scope provision requiring specific, targeted advice to appear below bold text stating that the advice cannot be used for purposes of avoiding penalties suggests that the advice may not be correct, Paravano pointed out. "It will not be acceptable either to clients or practitioners." The result is that practitioners must either use the limited scope "red herring" or decide that the IRS has

no reasonable basis for challenging the issue, he said. But given the complexity of the code, concluding that the IRS has no reasonable basis to challenge any issue is fraught with danger, he said.

Even when a tax attorney delivers a complete opinion that fully complies with the rules, if a client later sends an e-mail asking whether the advice would still apply if a specific fact changes, it appears that the tax adviser would not be permitted under the new rules to simply respond yes or no, according to Paravano. Instead, the changed fact would need to be reworked through the entire process and a new lengthy opinion would need to be delivered, he said. If the client is not interested in paying for that, the adviser would need to absorb those costs, he noted.

Similarly, several practitioners present shared their views that smaller business clients will not understand the limited scope caveat and will be annoyed by it. The broad rules will have an effect on everyday transactions, they said, and make it extremely difficult to render tax advice on ordinary transactions.

Paravano pressed for some kind of fee threshold above which the rules would be triggered.

Staying Tuned

Tax administrators recognize that the standards will have an effect on the way practitioners give advice, responded Jonathan Ackerman, an attorney-adviser with Treasury's Office of Tax Policy. The delayed effective date is intended to give them enough time to adjust to the procedures, he said.

Treasury needs to monitor how the regs are in the implementation phase, Ackerman said. "We are sincerely concerned about what effects the rules will have on the marketplace."

There has been a surprising lack of feedback to date, Ackerman said. With the upcoming American Bar Association Section of Taxation meeting in San Diego, the government is expecting to hear more, he added.

Treasury wants to know how the standards are working in practice, Ackerman emphasized, encouraging practitioners to submit comments. "It is extremely important" for the government to know how the rules are being applied, he said.

The new rules reflect the government's effort to balance the need for minimum standards at all levels of tax practice with the legitimate concerns expressed in response to the two prior sets of proposed regs, said Julian Kim, now with Latham & Watkins in Washington.

The final regs are going to create a sea change in practice, according to Kim, who worked on the last set of proposed Circular 230 regs. The new regs are going to create a high level of awareness across the board, he noted, as they are but one of several significant steps that will be taking place over the next 12 to 18 months.

Significant changes were made in the 2004 legislation dealing with penalties and opinion standards, Kim said. The preamble of the final regs states that Treasury will be coordinating the new law with the final regs, he said. There will have to be separate reg projects under section 6664 on the use of opinions for reliance purposes and on the new penalties for reportable transactions, he said.

But people should not lose sight of why the regs were needed in the first place, Kim added.

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