

New Circular 230 Requirements

I. Overview

Effective June 21, 2005, the Treasury Department has revised the standards of practice before the Internal Revenue Service (“IRS”) relating to the rendering of certain written tax advice (so-called “covered opinions”). The following briefly summarizes some of the most significant aspects of these new rules (generally referred to as “Circular 230”).

As discussed below, where tax practitioners render written advice that constitutes a “covered opinion,” the written advice must comply with certain specified standards set forth in Circular 230. In many cases these additional requirements do not apply, however, where the written advice contains certain disclaimers as described further below. Circular 230 potentially may apply to any written memoranda, letters and opinions, as well as e-mails, that consider federal tax issues.

II. “Covered Opinions”

A. General Definition. A covered opinion includes any written tax advice (including electronic communications) that concerns one or more federal tax issues arising from certain specified transactions. A “federal tax issue” for this purpose is a question concerning the federal tax treatment of an item of income, gain, loss, deduction or credit, the existence or absence of a taxable transfer of property, or the value of property for federal tax purposes. The specified transactions are:

- (1) *Listed Transactions* - a transaction that has been identified as abusive by the IRS;
- (2) *Principal Purpose Transactions* - a transaction with the principal purpose of tax avoidance or evasion; and
- (3) *Significant Purpose Transactions* - a transaction with a significant purpose of tax avoidance or evasion where the written tax advice falls into any of the below categories (subsections (a) through (d)).
 - (a) A “*Reliance Opinion*.” Advice that concludes at a confidence level of at least more likely than not (a greater than 50 percent likelihood) that one or more significant federal tax issues would be resolved in the taxpayer’s favor.
 1. *Significant Federal Tax Issue.* A federal tax issue is “significant” where the IRS has a reasonable basis for a successful challenge and resolution of the issue could have a significant impact, whether beneficial or adverse and under any reasonably foreseeable circumstance, on the overall federal tax treatment of the related transactions or matters.
 2. *Disclosure Exception to Reliance Opinion.* Written advice is not a reliance opinion if it prominently discloses that the advice is not intended or written to be used, and it cannot be used by the taxpayer, for purposes of avoiding tax penalties under the Internal Revenue Code that may be imposed on the taxpayer.
 3. *Prominent Disclosure.* The above disclosure language (as well as the “marketed opinion” disclosures and other required disclosures described below) must be “prominent.” Circular 230 provides that for this purpose the disclosure language may be part of the body of the written advice, so long as it is set off by itself, readily apparent to the reader of the advice and not contained in a footnote. It may be the same or larger typeface than the rest of the covered opinion.

- (b) A “*Marketed Opinion*.” Advice that the practitioner knows or has reason to know will be used or referred to by another person in promoting, marketing or recommending a partnership or other entity, investment plan or arrangement to one or more taxpayers.
 - 1. *Special Requirements*. A marketed opinion must satisfy certain special requirements in addition to those that apply generally to all covered opinions, as described further in Section III.B.
 - 2. *Disclosure Exception to Marketed Opinion*. Written advice is not a marketed opinion if it prominently discloses all of the following:
 - (a) the advice was not intended or written to be used, and it cannot be used, by any taxpayer for the purpose of avoiding penalties;
 - (b) the advice was written to support the promotion or marketing of the transaction or matters addressed by the written advice; and
 - (c) the taxpayer should seek advice based on the taxpayer’s particular circumstances from an independent tax advisor.
- (c) *Subject to Conditions of Confidentiality*. Advice where a practitioner imposes on one or more recipients a limitation on disclosure of the tax treatment or tax structure of the transaction and the limitation on disclosure protects the confidentiality of that practitioner’s tax strategies, regardless of whether such limitation is legally binding.
- (d) *Subject to Contractual Protection*. Advice where the taxpayer has the right to a full or partial refund of fees paid to the practitioner if all or part of the intended tax consequences from the matters addressed in the advice are not sustained, or if the fees paid to the practitioner are contingent on the taxpayer’s realization of tax benefits from the transaction.

B. Exclusions. Covered opinions generally do not include written advice that:

- (1) Concerns qualification of a qualified plan;
- (2) Is a state or local bond opinion;
- (3) Is included in documents required to be filed with the SEC;
- (4) Is provided to a taxpayer after the taxpayer has filed the tax return that reflects the tax benefits of the transaction (unless the tax practitioner knows or has reason to know that the taxpayer will rely on the advice to take a position on a return, including an amended return, filed after the advice is provided);
- (5) Does not resolve a federal tax issue in the taxpayer’s favor unless the advice reaches a conclusion favorable to the taxpayer at any confidence level (e.g., reasonable basis); or
- (6) Is preliminary advice, where it is reasonably expected that subsequent written advice will be provided that otherwise satisfies the applicable Circular 230 requirements.

III. Covered Opinion Procedures

A. Requirements for Covered Opinions. Under Circular 230, covered opinions must comply with a number of specific requirements, including heightened factual and legal diligence standards as well as additional disclosure requirements.

(1) *Required Factual Diligence for Covered Opinions*

- (a) The practitioner must use reasonable efforts to identify and ascertain the facts (which may relate to future events

if a transaction is prospective or proposed) and to determine which facts are relevant. The covered opinion must identify and consider all relevant facts.

- (b) The practitioner must not base the covered opinion on any unreasonable factual assumptions. It is unreasonable to assume that a transaction has a business purpose or will be profitable apart from its tax effects. The covered opinion must identify in a separate section all factual assumptions relied upon by the practitioner.
- (c) The practitioner must not base the opinion on any unreasonable factual representations, statements or findings of any person, including those concerning business purpose (e.g., a representation concerning business purpose must include a specific description). The covered opinion must identify in a separate section all factual representations, statements or findings of the taxpayer relied upon by the practitioner.

(2) *Required Legal Diligence for Covered Opinions*

- (a) The covered opinion must consider all significant federal tax issues and the practitioner must not assume the favorable resolution of any significant federal tax issue (but see the discussion of limited scope opinions below).
- (b) The covered opinion generally must provide the practitioner's conclusion as to the likelihood that the taxpayer will prevail on the merits with respect to each significant federal tax issue considered in the opinion and explain the reasons for the conclusion. If the practitioner is unable to reach a conclusion with respect to any issue, the opinion must state this and explain why no conclusion was reached.
- (c) In evaluating the chances of success on the merits of the significant federal tax issues discussed, the practitioner must not take 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 settlement if raised.
- (d) The covered opinion must provide an overall conclusion as to the likelihood that the federal tax treatment of the transaction or matter that is the subject of the covered opinion is the proper treatment and the reasons for that conclusion. If the practitioner is unable to reach an overall conclusion, the covered opinion must so state and describe the reasons for such inability.

B. Marketed Opinion Requirements. In addition to the above requirements, marketed opinions must also comply with certain other special requirements described below.

- (1) *Required Disclosure.* A marketed opinion must prominently disclose that:
 - (a) the opinion was written to support the promotion or marketing of the transaction or matters addressed in the opinion; and
 - (b) the taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor.
- (2) *Likelihood of Success.* A marketed opinion must also reach a conclusion that the taxpayer will prevail on the merits at a confidence level of at least more likely than not with respect to each significant federal tax issue.

C. Special Rules for Limited Scope Opinions

- (1) A practitioner may provide a covered opinion (other than one concerning a listed or principal purpose transaction or a marketed opinion) that considers less than all of the significant federal tax issues (a "limited scope opinion") if the practitioner and the client agree that the scope of the covered opinion and the client's potential reliance on the covered opinion for purposes of avoiding penalties are limited to the federal tax issues addressed in the covered opinion.

(2) In the case of a limited scope opinion, the practitioner may make reasonable assumptions regarding the favorable resolution of a federal tax issue. The opinion must identify in a separate section all issues for which the practitioner assumed a favorable resolution. The opinion must prominently disclose that it is a limited scope opinion.

D. Special Disclosures. Certain special disclosures are required for covered opinions (i) that do not reach a conclusion at a confidence level of at least more likely than not with respect to a significant federal tax issue; or (ii) where certain compensation or fee arrangements related to the opinion are in place.

