

**CIRCULAR 230: ESTATE PLANNING ISSUES**

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### I. Introduction

- A. On December 20, 2004, the Internal Revenue Service (“IRS”) and the Treasury published final amendments to Circular 230 dealing with tax shelter opinions (now referred to as “covered opinions”), required procedures that must be followed by firms that issue such opinions to ensure compliance with the new rules, and so-called “best practices” that tax professionals should follow to preserve public confidence in the tax system. In addition, the IRS issued a proposed amendment to Circular 230 dealing with state and local bond opinions.
- B. In response to numerous comments from a number of professional organizations, the IRS and Treasury issued modifications to the final regulations of May 18, 2005, adding a definition of a principal purpose transaction, liberalizing the required format for disclosures, and adding three kinds of written advice to the kinds of advice that are not subject to the covered opinion requirements: post return advice, advice given to an employer by an employee, and so-called negative advice. In addition, the IRS issued additional guidance concerning the definition of state and local bond opinions on June 7, 2005.
- C. Circular 230, found in 31 CFR part 10, was initially issued in 1921. It contains rules governing the recognition of attorneys, certified public accountants, enrolled agents, and other persons representing taxpayers before the IRS (practitioners) and prescribes the duties and restrictions relating to practice before the IRS and sanctions for violating the regulations, as well as providing rules applicable to disciplinary proceedings.
- D. The IRS and the Treasury had published proposed regulations dealing with most of the issues covered in the final amendments on December 30, 2003. Notably, the proposed amendments referred to “tax shelter opinions,” while the final amendments refer to “covered opinions.” This subtle change in terminology is accompanied with what many perceive as a broadening of the kinds of opinions subject to detailed requirements.
  - 1. It is arguable that the final regulations do not significantly expand the scope of the types of opinion that must satisfy the covered opinion requirements.
  - 2. Under the proposed regulations, a practitioner providing a more likely than not tax shelter opinion or a marketed tax shelter opinion had to

comply with requirements similar to those contained in the final regulations for covered opinions.

- a. A tax shelter opinion was defined as written advice by a practitioner concerning the federal tax aspects of any federal tax issue relating to a tax shelter item or items.
  - b. A tax shelter item was defined as an item of income, gain, loss, deduction, or credit, the existence or absence of a taxable transfer of property, or the value of property.
  - c. A tax shelter was defined as any partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, a significant purpose of which was the avoidance or evasion of any tax imposed by the Internal Revenue Code.
3. As will be discussed below, under the final regulations, a reliance opinion or a marketed opinion would have been treated as a tax shelter opinion under the proposed regulations and, therefore, would have been subject to the requirements for a tax shelter opinion.
  4. Perhaps the significant change under the final regulations is the addition of the requirements dealing with "other written advice."
- E. In addition to sanctions, suspension, and disbarment, the American Jobs Creation Act of 2004 authorizes the Treasury and IRS to impose penalties against practitioners who violate any provision of Circular 230 and authorizes injunctions to prevent violations of Circular 230.
- F. A practitioner may be censured, suspended or disbarred from practice before the IRS for willfully violating Circular 230 (except the best practices provisions) or recklessly or through gross incompetence violating the covered opinion requirements, the other writing requirements or the compliance provisions.

## II. Covered Opinions

### A. Introduction.

1. A practitioner rendering a covered opinion must satisfy specific requirements to avoid being sanctioned, suspended or disbarred from practice before the IRS.
  - a. Formerly referred to as a tax shelter opinion, a covered opinion is written advice, including electronic communications, by a practitioner concerning one or more federal tax issues.
  - b. For this purpose, a practitioner includes an attorney, an accountant, and an enrolled agent.

B. Definition of a Covered Opinion.

1. Only written advice, including an email and, perhaps, a cell phone text message, on the following is treated as a covered opinion:
  - a. A transaction that is the same as or substantially similar to a transaction that, at the time the advice is rendered, the IRS has determined to be a listed tax avoidance transaction and identified by published guidance as a listed transaction under Treas. Reg. § 1.6011-4(b)(2) (referred to hereinafter as a “listed transaction opinion”);
  - b. Any partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, the principal purpose of which is the avoidance or evasion of any tax imposed by the Internal Revenue Code (referred to hereinafter as a “tax avoidance transaction” and written advice concerning the transaction is referred to hereinafter as a “tax avoidance opinion”); and
  - c. 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 any tax imposed by the Internal Revenue Code, if the written advice is:
    - (1) A reliance opinion;
    - (2) A marketed opinion;
    - (3) Subject to conditions of confidentiality; or
    - (4) Subject to contractual protection.
2. Excluded Advice. A covered opinion does not include:
  - a. Preliminary advice, which is written advice provided to a client during the course of an engagement if a practitioner is reasonably expected to provide subsequent written advice to the client that will satisfy the requirements of § 10.35.
  - b. Written advice that is not a listed transaction opinion or a tax avoidance opinion if it:
    - (1) Concerns a qualified plan;
    - (2) Is a state or local bond opinion; or

- (3) Is included in documents required to be filed with the Securities and Exchange Commission.
  - (a) It is unclear whether written advice contained in documents referred to or summarized in such filings is included in this exception.
- c. Written advice prepared for and provided to a taxpayer, solely for use by that taxpayer, after the taxpayer has filed a tax return with the IRS reflecting the tax benefits of the transaction (a post return opinion).
  - (1) This exclusion does not apply if the practitioner knows or has reason to know that the written advice will be relied upon by the taxpayer to take a position on a tax return (including for these purposes an amended return that claims tax benefits on a previously filed return) filed after the date on which the advice is provided to the taxpayer.
- d. Written advice provided to an employer by a practitioner in that practitioner's capacity as an employee of that employer solely for purposes of determining the tax liability of the employer.
  - (1) Hopefully, this exclusion will be expanded to cover employees of related entities and other relationships, such as a partner in a partnership, a member of a limited liability company, and fiduciaries and beneficiaries in the case of trusts and estates.
- e. Written advice that 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., not frivolous, realistic possibility of success, reasonable basis or substantial authority) with respect to that issue (a negative opinion).
  - (1) If the written advice concerns more than one federal tax issue, the advice must satisfy the covered opinion requirements with respect to any other federal tax issue that does not fall under this exclusion.

3. Principal Purpose.

- a. The modifications provided the following definition of principal purpose:

For purposes of [§ 10.35] the principal purpose of a partnership or other entity, investment plan or arrangement, or other plan or arrangement is the avoidance or evasion of any tax imposed by the

Internal Revenue Code if that purpose exceeds any other purpose. The principal purpose of a partnership or other entity, investment plan or arrangement, or other plan or arrangement is not to avoid or evade federal tax if that partnership, entity, plan or arrangement has as its purpose the claiming of tax benefits in a manner consistent with the statute and Congressional purpose. A partnership, entity, plan or arrangement may have a significant purpose of avoidance or evasion even though it does not have the principal purpose of avoidance or evasion [as defined for purposes of § 10.35].

- b. Despite the addition of a definition of principal purpose, in many cases it will be difficult to determine whether a transaction has as its principal purpose tax avoidance, and the conservative practitioner may decide to err on the side of caution by treating any transaction that involves significant tax savings as a tax avoidance transaction.
  - (1) This will be a heavy price to pay if the transaction turns out not to have been a tax avoidance transaction.

- 4. Whether written advice constitutes a covered opinion is significant for two reasons:
  - a. The detailed covered opinion requirements set forth below must be satisfied; and
  - b. The compliance procedures discussed below only refer to covered opinions.

C. Reliance Opinion.

- 1. Written advice is a reliance opinion if the advice concludes at a confidence level of more likely than not (a greater than 50% likelihood) that one or more significant federal tax issues would be resolved in the taxpayer's favor.
  - a. A federal tax issue 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.
  - b. An issue is only significant if the IRS has a reasonable basis for a successful challenge and the resolution of the challenge could have a significant impact, whether beneficial or adverse and under any reasonably foreseeable circumstances, on the overall federal tax treatment of the transactions or matters addressed in the opinion.

- c. Consequently, written advice dealing with federal tax issues that are not significant will not be treated as covered opinions, unless they are listed transaction opinions, tax avoidance opinions, marketed opinions, or opinions subject to conditions of confidentiality or contractual protection.
  2. An opinion, other than a listed transaction opinion, a tax avoidance opinion, a marketed opinion, or an opinion subject to contractual protection or conditions of confidentiality, will not be treated as a reliance opinion if the practitioner prominently discloses that the advice was not intended to be used and cannot be used by the taxpayer to avoid penalties that may be imposed on the taxpayer.
  3. Prominently disclosed. An item is prominently disclosed if it is readily apparent to a reader of the written advice.
    - a. Whether an item is readily apparent will depend on the facts and circumstances surrounding the written advice, including, but not limited to, the sophistication of the taxpayer and the length of the written advice.
    - b. At a minimum, to be prominently displayed an item must be set forth in a separate section (and not in a footnote) in a typeface that is the same size or larger than the typeface in any discussion of the facts or law in the written advice.
      - (1) Apparently, other items may be in larger typeface than the disclosure statement.

D. Other Types of Advice Treated as Covered Opinions.

1. A marketed opinion is advice that will be used by someone other than the practitioner, or a member or employee of the practitioner's firm, in promoting, marketing, or recommending the transaction to one or more taxpayers unless the advice prominently discloses that it was not intended to be used and cannot be used to avoid penalties and was written to support the promotion or marketing of the transaction and that the taxpayer should seek independent tax advice.
  - a. Hopefully, a marketed opinion will not include a situation where the practitioner is providing advice to an entity and the entity forwards the tax advice to its owners.
  - b. See the suggestion below for clarification about what constitutes a marketed opinion.
2. Written advice is subject to conditions of confidentiality if the practitioner imposes on one or more recipients of the advice a limitation on disclosure

to protect the confidentiality of the practitioner's tax strategies, but not if the practitioner simply claims that the transaction is proprietary or exclusive.

a. Hopefully, advice will not be treated as subject to confidentiality conditions simply because it contains a statement that the recipient is not to disclose the opinion to a third party, when the purpose of the restriction is to prevent the recipient from disclosing the opinion itself, not the strategy.

3. Written advice is subject to contractual protection if the taxpayer has the right to a full or partial refund of fees paid to the practitioner if all or a part of the intended tax consequences are not sustained or the fees paid are contingent on the taxpayer's realization of tax benefits.

E. Requirements for Covered Opinions. A practitioner providing a covered opinion must comply with each of the following requirements.

1. Factual matters.

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.

(1) The opinion must identify and consider all facts that the practitioner determines to be relevant.

b. The practitioner must not base the opinion on any unreasonable factual assumptions (including assumptions as to future events).

(1) An unreasonable factual assumption includes a factual assumption that the practitioner knows or should know is incorrect or incomplete.

(a) For example, it is unreasonable to assume that a transaction has a business purpose or that a transaction is potentially profitable apart from tax benefits.

(2) A factual assumption includes reliance on a projection, financial forecast or appraisal.

(a) It is unreasonable for a practitioner to rely on a projection, financial forecast or appraisal if the practitioner knows or should know that the projection, financial forecast or appraisal is incorrect or incomplete or was prepared by a person



- b. Conclusion as to each significant federal tax issue.
- (1) The opinion 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.
  - (2) If the practitioner is unable to reach a conclusion with respect to one or more of those issues, the opinion must state that the practitioner is unable to reach a conclusion with respect to those issues.
  - (3) The opinion must describe the reasons for the conclusions, including the facts and analysis supporting the conclusions, or describe the reasons that the practitioner is unable to reach a conclusion as to one or more issues.
  - (4) If the practitioner fails to reach a conclusion at a confidence level of at least more likely than not with respect to one or more significant federal tax issues considered, the opinion must include the appropriate disclosures required.
- c. Evaluation based on chances of success on the merits. In evaluating the significant federal tax issues addressed in the opinion, the practitioner must not take into account the possibility that:
- (1) A tax return will not be audited;
  - (2) An issue will not be raised on audit; or
  - (3) An issue will be resolved through settlement if raised.
- d. Marketed opinions.
- (1) In the case of a marketed opinion, the opinion must provide the practitioner's 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.
  - (2) If the practitioner is unable to reach a more likely than not conclusion with respect to each significant federal tax issue, the practitioner must not provide the marketed opinion, but may provide written advice if it contains the appropriate disclosure.
- e. Limited scope opinions.

- (1) The practitioner may provide an opinion that considers less than all of the significant federal tax issues if:
  - (a) The practitioner and the taxpayer agree that the scope of the opinion and the taxpayer's potential reliance on the opinion for purposes of avoiding penalties that may be imposed on the taxpayer are limited to the federal tax issues addressed in the opinion;
  - (b) The opinion is not a listed transaction opinion, a tax avoidance opinion, or a marketed opinion; and
  - (c) The opinion includes the appropriate disclosure.
- (2) A practitioner may make reasonable assumptions regarding the favorable resolution of a federal tax issue (an assumed issue) for purposes of providing an opinion on less than all of the significant federal tax issues in a limited scope opinion.
  - (a) The opinion must identify in a separate section all issues for which the practitioner assumed a favorable resolution.

4. Overall conclusion.

- a. The opinion must provide the practitioner's overall conclusion as to the likelihood that the federal tax treatment of the transaction or matter that is the subject of the opinion is the proper treatment and the reasons for that conclusion.
- b. If the practitioner is unable to reach an overall conclusion, the opinion must state that the practitioner is unable to reach an overall conclusion and describe the reasons for the practitioner's inability to reach a conclusion.
- c. In the case of a marketed opinion, the opinion must provide the practitioner's overall conclusion that the federal tax treatment of the transaction or matter that is the subject of the opinion is the proper treatment at a confidence level of at least more likely than not.

5. Competence to provide opinion; reliance on opinions of others.

- a. The practitioner must be knowledgeable in all of the aspects of federal tax law relevant to the opinion being rendered, except that the practitioner may rely on the opinion of another practitioner

with respect to one or more significant federal tax issues, unless the practitioner knows or should know that the opinion of the other practitioner should not be relied on.

- b. If a practitioner relies on the opinion of another practitioner, the relying practitioner's opinion must identify the other opinion and set forth the conclusions reached in the other opinion.
- c. The practitioner must be satisfied that the combined analysis of the opinions, taken as a whole, and the overall conclusion, if any, satisfy the requirements of this section.

6. Required disclosures. A covered opinion must contain all of the following disclosures that apply:

a. Relationship between promoter and practitioner. An opinion must prominently disclose the existence of:

- (1) Any compensation arrangement, such as a referral fee or a fee-sharing arrangement, between the practitioner (or the practitioner's firm or any person who is a member of, associated with, or employed by the practitioner's firm) and any person (other than the client for whom the opinion is prepared) with respect to promoting, marketing or recommending the entity, plan, or arrangement (or a substantially similar arrangement) that is the subject of the opinion; or
- (2) Any referral agreement between the practitioner (or the practitioner's firm or any person who is a member of, associated with, or employed by the practitioner's firm) and a person (other than the client for whom the opinion is prepared) engaged in promoting, marketing or recommending the entity, plan, or arrangement (or a substantially similar arrangement) that is the subject of the opinion.

b. Marketed opinions. A marketed opinion must prominently disclose that:

- (1) The opinion was written to support the promotion or marketing of the transactions or matters addressed in the opinion; and
- (2) The taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor.

- c. Limited scope opinions. A limited scope opinion must prominently disclose that:
    - (1) The opinion is limited to the one or more federal tax issues addressed in the opinion;
    - (2) Additional issues may exist that could affect the federal tax treatment of the transaction or matter that is the subject of the opinion and the opinion does not consider or provide a conclusion with respect to any additional issues; and
    - (3) With respect to any significant federal tax issues outside the limited scope of the opinion, the opinion was not written, and cannot be used by the taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer.
  
  - d. Opinions that fail to reach a more likely than not conclusion. An opinion that does not reach a conclusion at a confidence level of at least more likely than not with respect to a significant federal tax issue must prominently disclose that:
    - (1) The opinion does not reach a conclusion at a confidence level of at least more likely than not with respect to one or more significant federal tax issues addressed by the opinion; and
    - (2) With respect to those significant federal tax issues, the opinion was not written, and cannot be used by the taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer.
  
  - e. Advice regarding required disclosures. In the case of any disclosure required under this section, the practitioner may not provide advice to any person that is contrary to or inconsistent with the required disclosure.
    - (1) In this case, advice presumably includes oral advice.
7. Effect of opinion that meets these standards. An opinion that meets these requirements satisfies the practitioner's responsibilities under Circular 230, but the persuasiveness of the opinion with regard to the tax issues in question and the taxpayer's good faith reliance on the opinion will be determined separately under applicable provisions of the law and regulations.

### III. Other Written Advice and Compliance

A. A practitioner who provides written advice that is not a covered opinion is subject to the following requirements:

1. A practitioner must not give written advice (including electronic communications) concerning one or more federal tax issues if the practitioner bases the written advice on unreasonable factual or legal assumptions (including assumptions as to future events), unreasonably relies upon representations, statements, findings or agreements of the taxpayer or any other person, does not consider all relevant facts that the practitioner 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 settlement if raised.
2. All facts and circumstances, including the scope of the engagement and the type and specificity of the advice sought by the client will be considered in determining whether a practitioner has failed to comply with this section.
3. In the case of an opinion the practitioner knows or has reason to know will be used or referred to by a person other than the practitioner (or a person who is a member of, associated with, or employed by the practitioner's firm) in promoting, marketing or recommending to one or more taxpayers a partnership or other entity, investment plan or arrangement a significant purpose of which is the avoidance or evasion of any tax imposed by the Internal Revenue Code, the determination of whether a practitioner has failed to comply with this requirement will be made on the basis of a heightened standard of care because of the greater risk caused by the practitioner's lack of knowledge of the taxpayer's particular circumstances.
  - a. This should be an indication that the final amendments contemplate written advice may be relied on by others without it being treated as a marketed opinion (and therefore a covered opinion), where, for example, an employer provides tax information prepared by a practitioner to its employees with regard to the tax treatment of certain employee benefits.

B. Compliance.

1. The amendments retain the procedures in the proposed regulations designed to ensure compliance.
2. Any practitioner who has or shares principal authority or 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 the requirements for covered opinions.

3. A practitioner will be subject to discipline for failing to comply with these requirements if:
  - a. The practitioner through willfulness, recklessness or gross incompetence does not take reasonable steps to ensure that the firm has adequate procedures to comply with the requirements for covered opinions, and one or more individuals who are members of, associated with, or employed by, the firm are, or have, engaged in a pattern or practice, in connection with their practice with the firm, of failing to comply with those requirements; or
  - b. The practitioner knows or should know that one or more individuals who are members of, associated with, or employed by, the firm are, or have, engaged in a pattern or practice, in connection with their practice with the firm, that does not comply with the requirements for covered opinions and the practitioner, through willfulness, recklessness or gross incompetence, fails to take prompt action to correct the non-compliance.

#### IV. Best Practices

##### A. Best Practices for Tax Advisors.

1. Tax advisors (a broader term than practitioners) should provide clients with the highest quality of representation concerning federal tax issues by adhering to best practices in providing advice and in preparing or assisting in the preparation of a submission to the IRS.
2. In addition to compliance with the standards of practice provided elsewhere in the final amendments, best practices include the following:
  - a. Communicating clearly with the client regarding the terms of the engagement.
    - (1) For example, the advisor should determine the client's expected purpose for and use of the advice and should have a clear understanding with the client regarding the form and scope of advice or assistance to be rendered.
  - b. Establishing the facts, determining which facts are relevant, evaluating the reasonableness of any assumptions or representations, relating the applicable law (including potentially applicable judicial doctrines) to the relevant facts and arriving at a conclusion supported by the law and the facts.

- c. Advising the client regarding the import of the conclusions reached, including, for example, whether a taxpayer may avoid accuracy-related penalties under the Internal Revenue Code if a taxpayer acts in reliance on the advice.
- d. Acting fairly and with integrity in practice before the IRS.

B. Procedures to Ensure Best Practices for Tax Advisors.

- 1. Tax advisors with responsibility for overseeing a firm's practice of providing advice concerning federal tax issues or preparing or assisting in the preparation of submissions to the IRS 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 above.

V. Effective Dates and Creation of Advisory Committees

A. Effective Dates.

- 1. The effective date for the amendments to Circular 230 is 180 days after the publication of the amendments in the Federal Register (June 20, 2005), except for the creation of advisory committees, which is effective as of the date of publication (December 20, 2004).

B. Advisory Committees.

- 1. To promote and maintain the public's confidence in tax advisors, the Director of the Office of Professional Responsibility is authorized to establish one or more advisory committees composed of at least five individuals authorized to practice before the IRS.
- 2. The Director should ensure that membership of an advisory committee is balanced among those who practice as attorneys, accountants, and enrolled agents.
- 3. Under procedures prescribed by the Director, an advisory committee may review and make general recommendations regarding professional standards or best practices for tax advisors, including whether hypothetical conduct would give rise to a violation of the requirements for covered opinions and the compliance provisions.

VI. Need for Additional Clarification

A. In General.

- 1. The amendments to Circular 230 dealing with covered opinions and other written tax advice, as well as compliance procedures and best practices, are unnecessary with regard to the practices of the vast majority of

practitioners to achieve the purposes expressed in the preamble to the final amendments.

2. However, all responsible tax professionals would agree that, because of the abuses of a small minority, rules regarding certain types of tax advice have become necessary to preserve the integrity of the system.
3. Nevertheless, it is equally important that the new rules do not stifle needed tax advice required by taxpayers on a daily basis with regard to a myriad of issues, particularly when such advice is not meant to protect the taxpayer from any penalties.
  - a. For example, an overly-broad reading of the definition of a tax avoidance opinion, requiring written tax advice to satisfy the covered opinion requirements and precluding any ability to opt out with appropriate disclosure, would considerably increase the cost of providing every-day written tax advice.
  - b. In addition, a restrictive definition of preliminary advice, requiring for many types of every-day written tax advice either a comprehensive discussion of all significant federal tax issues or a disclosure, would also add considerable cost or, in the case of the disclosure, confusion on the part of the recipient of the advice.
  - c. Finally, an overly-broad definition of a tax avoidance opinion coupled with a restrictive definition of preliminary tax advice would encourage practitioners to return to giving oral advice rather than using emails, a result that would be inefficient and, because the recipient would not have the advice in writing, could lead to misinterpretation of the advice.
4. It is with these goals in mind that the following additional clarifications to the rules should be made in some form that practitioners and the government can both rely on.

B. Covered Opinions.

1. A tax avoidance transaction (the primary purpose of the transaction is tax avoidance) should be limited to a transaction in which the intended result of the transaction is the reduction in the tax liability of one or more taxpayers without any substantial change in the economic circumstances of the taxpayer or taxpayers other than the reduction in tax liability. Tax liability includes liability for income, gift, estate, and generation skipping taxes. Economic circumstances include changes to the net worth of the taxpayer before and after the transaction, disregarding any reduction in tax liability as a result of the transaction, and transfers of assets between or among family members and trusts or business entities owned by family members.

2. A tax avoidance transaction does not include structuring a transaction in a form that results in a lower tax liability for one or more participants in the transaction than would occur if another form were used that would accomplish the same non-tax economic results.
3. In determining whether written tax advice concerning a transaction is subject to the covered opinion requirements, all components of the transaction should be considered as a whole and not individually.
4. A marketed opinion is written tax advice that the practitioner knows or has reason to know will be used by the recipient to solicit participation in the transaction discussed in the written advice by one or more persons who have no relationship with the recipient. The relationship described in the previous sentence includes an employer-employee relationship and an owner and entity relationship. In addition, the relationship includes parties involved in the transaction other than a person whose only involvement is investing in the transaction as a new passive investor (as opposed to an existing passive investor).

C. Preliminary Advice.

1. Preliminary advice includes written advice in response to an inquiry about one or more tax issues that does not include a discussion of the overall tax consequences of the proposed or hypothetical transaction. A response to an inquiry will be treated as preliminary advice if (1) the response clearly states that the response only covers the specific question or questions raised in the inquiry and is not advice as to the overall tax consequences of a proposed or hypothetical transaction or (2) it is clear from the context of the response that it is not advice as to the overall tax consequences of a proposed or hypothetical transaction
2. If a practitioner gives written advice that would be treated as preliminary advice if a covered opinion were to be rendered at a later date and the transaction does not take place, the earlier written advice need not satisfy the requirements of a covered opinion or other written tax advice.

D. Other Issues.

1. Although a practitioner may not assume a business purpose with respect to a transaction, the practitioner may point out that a business purpose is required to achieve the intended tax benefits regardless of the existence of evidence that there is, in fact, a business purpose for the transaction.
2. Although a statement in written tax advice is prohibited if it addresses the likelihood that the return disclosing the transaction would be audited or that the tax issues involved would be raised on such an audit, the practitioner may discuss the likelihood of a favorable result if the issue is raised on audit.

## VII. Issues for Estate Planning Practitioners

### A. Observations Regarding Covered Opinions and Other Written Advice.

1. Preliminary advice is not treated as a covered opinion if the practitioner is reasonably expected to provide subsequent written advice to the client that will satisfy the requirements of a covered opinion.
2. The written advice required for a covered opinion must deal with a federal tax issue – defined as 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. Does this mean advice about the tax status of an entity such as an S corporation is not a covered opinion but could be other written advice?
3. Not all written advice dealing with federal tax issues will be treated as covered opinions, except for listed transaction opinions and tax avoidance opinions, as well as marketed opinions and opinions subject to conditions of confidentiality or contractual protections. For example, the IRS may not have a reasonable basis for a successful challenge or the resolution of a challenge may not have a significant impact on the overall federal tax treatment of the transactions or matters addressed in the opinion.
4. Standard written communication with clients, not just formal legal opinions, may be subject to some of the requirements. Email falls within the written advice definition. Many IT formatting and other issues arise with email communications.
5. Malpractice concerns may dictate compliance with the best practice standards even though they are not mandatory.
6. Because most estate planning work typically involves a principal purpose other than tax avoidance, practitioners may inadvertently overlook the Circular 230 rules when advising on intrafamily transactions and aggressive techniques.
7. Most written communications not involving a listed or tax avoidance transaction will not be treated as covered opinions because the communications likely will not rise to the level of a reliance opinion.
8. Avoiding covered opinion status is important if the advice will not include a complete analysis of all significant tax issues.
9. A limited scope opinion may be appropriate in many situations.

- a. For example, in the case of an FLP, the opinion may exclude any advice as to valuation discounts or the possible application of I.R.C. § 2036.
10. Compliance with best practices should reduce the likelihood of a violation of the mandatory provisions of Circular 230.
  11. Best practices should be followed by paralegals and other staff as well as by the lawyers.
  12. Oral advice is not subject to the covered opinion rules, but cell phone text messages may be. What about written advice after a transaction or tax reporting that was based on oral advice?
  13. All should be familiar with the 30 or so listed transactions in order to avoid advising on a transaction that is substantially similar to a listed one.
  14. Non lawyers in the firm can create problems. For example, a paralegal or fiduciary accountant may be sending an email to a trust or estate beneficiary regarding the lawyer's determination of how to handle a difficult issue.
  15. The final regulations to Circular 230 may be to our practice what Sarbanes-Oxley is to the practice of our corporate partners.
- B. Estate Planning Techniques Potentially Affected. Most estate planning and estate administration techniques, elections, and transactions involve tax advice. Depending on the facts and circumstances, advice regarding many of the following, as well as other standard transactions, could be subject to some portion of Circular 230 after the effective date of the final regulations:
1. Creation of *Crummey* life insurance trust
  2. Formation of FLP or LLC
  3. S election or check-the-box tax status
  4. Creation of "defective" grantor trust
  5. Sale to grantor trust
  6. Allocation of GST exemption
  7. GRATs and QPRTs
  8. Charitable remainder trusts
  9. 529 plans

10. Intrafamily sales
11. AFR loans
12. Stock redemptions in family corporations
13. Assets included and excluded from the gross estate
14. 2032 alternate valuation
15. QTIP election
16. Issuance of *Graegin* note
17. Determination of basis
18. *Mellinger* discount
19. Treating capital gains as part of DNI

#### VIII. Analyzing a Transaction under Circular 230

##### A. Introduction.

1. The following list of questions is designed to assist the practitioner in determining whether written tax advice is subject to the covered opinion requirements under the final amendments to Circular 230.
2. Keep in mind that how certain terms are defined will have an impact on whether written advice will be subject to the covered opinion requirements.
3. As mentioned above, it is hoped that the IRS will issue additional guidance on the definitions of a tax avoidance transaction, marketed opinion, and preliminary advice.

##### B. Questions.

1. Answer the following questions to determine whether or not advice is subject to the required opinion requirements.

2. Questions:

- a. Is the advice in writing, including an email and, perhaps, a cell phone text message? If the answer is no, the advice is not subject to the covered opinion requirements. If the answer is yes, go to question b.
- b. Is the written advice preliminary advice? If the answer is yes, the written advice is not subject to the covered opinion requirements. If the answer is no, go to question c.
- c. Does the written advice concern a federal tax issue, which 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? If the answer is no, the written advice is not subject to the covered opinion requirements. If the answer is yes, go to question d.
- d. Does the written advice concern a listed transaction as defined under Treas. Reg. Section 1.6011-4(b)(2) (or a substantially similar transaction)? If the answer is yes, the written advice must satisfy the covered opinion requirements. If the answer is no, go to question e.
- e. Does the written advice concern any partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, the principal purpose of which is the avoidance or evasion of any tax imposed by the Internal Revenue Code (a tax avoidance transaction)? If the answer is yes, the written advice must satisfy the covered opinion requirements. If the answer is no, go to question f.
- f. Does the written advice concern a qualified plan? If the answer is yes, the written advice is not subject to the covered opinion requirements. If the answer is no, go to question g.
- g. Is the written advice a state or local bond opinion? If the answer is yes, the written advice will be subject to requirements similar to those that apply to a covered opinion once the proposed regulations are finalized. If the answer is no, go to question h.
- h. Is the written advice included in documents required to be filed with the Securities and Exchange Commission? If the answer is yes, the written advice is not subject to the covered opinion requirements. If the answer is no, go to question i.

- i. Is the written advice post return advice? If the answer is yes, the written advice is not subject to the covered opinion requirements. If the answer is no, go to question j.
  - j. Is the written advice given by an employee to an employer with respect to the employer's tax liability? If the answer is yes, the written advice is not subject to the covered opinion requirements. If the answer is no, go to question k.
  - k. Is the written advice a negative opinion? If the answer is yes, the written advice is not subject to the covered opinion requirements. If the answer is no, go to question l.
  - l. Does the written advice concern 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 any tax imposed by the Internal Revenue Code? If the answer is no, the written advice is not subject to the covered opinion requirements. If the answer is yes, go to question m.
  - m. Is the written advice a marketed opinion? If the answer is yes, the written advice must satisfy the covered opinion requirements unless there is a disclosure. If the answer is no, go to question n.
  - n. Is the written advice an opinion subject to conditions of confidentiality or contractual protection? If the answer is yes, the written advice must satisfy the covered opinion requirements. If the answer is no, go to question o.
  - o. Does the written advice conclude at a confidence level of more likely than not (a greater than 50% likelihood) that one or more significant federal tax issues would be resolved in the taxpayer's favor? If the answer is no, the written advice is not subject to the covered opinion requirements. If the answer is yes, the written advice is a reliance opinion and must satisfy the covered opinion requirements unless there is a disclosure.
    - (1) A federal tax issue is only significant if the IRS has a reasonable basis for a successful challenge and the resolution of the challenge could have a significant impact, whether beneficial or adverse and under any reasonably foreseeable circumstances, on the overall federal tax treatment of the transactions or matters addressed in the opinion.
3. Written tax advice that is not subject to the covered opinion requirements must satisfy the other written advice requirements.

C. Limited Scope Opinions.

1. A limited scope opinion, which requires a disclosure, is one way to reduce the cost of providing tax advice.
2. However, under the Regulations, a limited scope opinion may not be provided with regard to a listed transaction opinion, a tax avoidance opinion, or a marketed opinion.

D. Permitted and Required Disclosures.

1. A reliance opinion is not subject to the covered opinion requirements if it discloses that the written advice is not intended or written by the practitioner to be used, and that it cannot be used by the taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer.
2. A marketed opinion that does not concern a listed transaction or a tax avoidance transaction is not subject to the covered opinion requirements if it discloses that:
  - a. The advice was not intended or written by the practitioner to be used, and that it cannot be used by any taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer;
  - b. The advice was written to support the promotion or marketing of the transaction(s) or matter(s) addressed by the written advice; and
  - c. The taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor.
3. A covered opinion must disclose the existence of any compensation arrangement or any referral agreement between the practitioner and a promoter of the transaction.
4. A marketed opinion that is subject to the covered opinion requirements must disclose that:
  - a. The opinion was written to support the promotion or the marketing of the transaction(s) or matter(s) addressed in the opinion; and
  - b. The taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax adviser.
5. A limited scope opinion subject to the covered opinion requirements must disclose that:
  - a. The opinion is limited to one or more federal tax issues addressed in the opinion;

- b. Additional issues may exist that could affect the federal tax treatment of the transaction or a matter that is the subject to the opinion and the opinion does not consider or provide a conclusion with respect to any addition issues; and
  - c. With respect to any significant federal tax issues outside the limited scope of the opinion, the opinion was not written, and cannot be used by the taxpayer, for the purpose of avoiding penalties which may be imposed by the taxpayer.
6. A covered opinion that fails to reach a more likely than not conclusion with respect to one or more significant federal tax issues must disclose that:
- a. The opinion does not reach a conclusion at a confidence level of at least more likely than not with respect to one or more significant federal tax issues addressed by the opinion; and
  - b. With respect to those significant tax issues, the opinion was not written, and cannot be used by the taxpayer for the purpose of avoiding penalties that may be imposed by the taxpayer.

E. Covered Opinion Requirements.

- 1. Factual Matters.
  - a. The practitioner must identify in separate sections all factual assumptions and all factual representations, statements, or findings of the taxpayer, relied on by the practitioner.
  - b. The practitioner may not rely on either unreasonable factual assumptions or unreasonable factual representations, statements, or findings of the taxpayer.
- 2. The practitioner must relate the law to the facts.
- 3. The opinion must consider all significant federal tax issues unless the practitioner is providing a limited scope opinion or is relying on the opinion of others.
- 4. The opinion 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.
  - a. If the practitioner is unable to reach a conclusion with respect to one ore more of those issues, the opinion must state that the practitioner is unable to reach a conclusion with respect to those issues.

- b. The reasons for the conclusion must be stated.
5. The opinion must provide the practitioner's overall conclusion as to the likelihood that the federal tax treatment of the transaction or matter that is the subject of the opinion is the proper treatment and the reasons for that conclusion.
  - a. If the opinion is a marketed opinion, the opinion must reach a more likely than not conclusion.
  - b. If the practitioner is unable to reach an overall conclusion, the opinion must so state and describe the reason.

#### IX. Estate Planning Hypothetical

1. You receive a telephone call from an existing client inquiring about the tax benefits of using a family limited partnership ("FLP"). You spend one-half hour discussing the transfer tax savings that may be achieved through a FLP because of the lack of control, lack of marketability, and other discounts that may apply to the valuation of an interest in such entities.
2. The client calls you the next day and asks that you send him a letter spelling out the tax benefits of an FLP that you discussed with him on the telephone the day before. The client has not expressed any specific intention of creating an FLP.
3. After receiving the letter, the client calls you back and tells you that he has several parcels of undeveloped property that he is thinking about transferring to an FLP. He intends to have the property developed for residential use in the near future. He asks you for your advice concerning the tax consequences of transferring the real estate to the FLP.
4. The client calls you back the next day and asks you to send him a letter concerning your discussion the day before about the tax consequences of transferring the property to the FLP.
5. The client calls you the next day and tells you that he would like to have his wife as a general partner and his three children as initial limited partners in the FLP and asks you the tax consequences if they each contribute a small amount of cash to the FLP in exchange for limited partnership interests. You discuss with him the investment company rules under Internal Revenue Code ("IRC") § 721 and other issues that may arise in connection with the formation of the proposed limited partnership.
6. The client calls you back the next day and asks you to send him a letter describing all of the potential tax consequences with respect to the formation of the FLP and possible gifts of limited partnership interests to his three children.
7. The client calls you a week later and asks you to prepare the limited partnership agreement for the FLP, the deeds transferring the unimproved property to the FLP, and

any other documents you feel necessary to form the partnership. You prepare a draft of a limited partnership agreement and send it to him.

8. Several days later he calls you and tells you that the agreement is satisfactory, whereupon you prepare a final partnership agreement, a certificate of limited partnership, and deeds transferring the property to the limited partnership. Note that the limited partnership agreement you drafted reflects the fact that his wife and children are putting up small amounts of cash and that his wife is receiving a 1% general partnership interest and his children are each receiving a 1% limited partnership interest. You also advise him to obtain an appraisal of the real estate and of an interest in the entity. He tells you he will use the current assessed value for the real estate and will assume a 45% discount for valuing a limited partnership interest in the partnership.
9. After the limited partnership agreement has been signed by all five of the initial partners, the certificate of limited partnership has been recorded, and the deeds transferring the property to the FLP have been recorded, you prepare a binder that contains all of the relevant documents, including your earlier letters to the client and you send it to the client for his records.
10. A month later, the client calls you and tells you he is now ready to make gifts of interests in the FLP to his three children and asks you to prepare the deeds of gift to carry out his intentions.
11. Several months later the client calls you and tells you that he wishes to transfer additional interests in the FLP to his children, but does not want to make any more taxable gifts and asks you if you have any suggestions. You discuss with him the possibility of using a sale to a grantor trust or a transfer to a grantor retained annuity trust ("GRAT") as a way of avoiding additional taxable gifts and as a way of retaining income from the transferred assets for a limited period of time.
12. The client calls you back the next day and asks you to send him a letter describing the tax consequences of a GRAT.
13. A week later the client calls and asks you to prepare a trust agreement for the GRAT and the deeds of gift necessary to transfer interests in the FLP to the GRAT.
14. A month later the client calls and asks you to send him a letter describing the tax consequences of a sale to a grantor trust.
15. Two weeks after you send the letter describing the sale to a grantor trust technique, the client calls you and asks you to prepare three grantor trusts, one for each of his children, and the other documents necessary to carry out the sales, including the purchase agreements and installment notes.
16. Several months later, the client calls you and tells you that he and his wife would like to come in to review their current estate plan. In preparation for the meeting, he asks you to send him a letter detailing his current estate plan, which includes the transactions described above as well as several other items that you have prepared for him in the past.

These include an irrevocable life insurance trust that was set up several years ago to hold a last-to-die policy insuring him and his wife, trusts set up for each of his five grandchildren to take advantage of the generation skipping transfer tax annual exclusion, and wills and trusts for him and his wife that take advantage of the maximum marital deduction when the first spouse dies and provides for the funding of a generation skipping transfer trust at the death of the survivor using the generation skipping transfer tax exemptions of both spouses through the use of a reverse QTIP trust.

X. Suggested Disclosure Statement for Preliminary Advice

The following is a suggested statement that would be inserted as a separate paragraph in emails and letters that a practitioner intended to be preliminary advice:

This [email/letter] is not intended to be advice that can be relied on to avoid any penalties that the Internal Revenue Service may assert because of a successful challenge to any position taken on a tax return. If we determine that a covered opinion, as that term is defined in Treasury Regulations dealing with written tax advice, is required, or is desired to avoid penalties, at your request we will provide you with a covered opinion.

Note that the statement refers to “information” rather than “advice” and contemplates that there will be one of seven possible results, assuming the opinion is not a marketed opinion or an opinion subject to conditions of confidentiality or contractual protection:

1. The contemplated transaction does not occur and there is no need to determine whether a covered opinion is necessary.
2. It is determined that the transaction is either a listed transaction or a tax avoidance transaction and a covered opinion is required.
3. It is determined that the transaction is a significant purpose transaction and there is at least one significant federal tax issue involved, and a more-likely-than-not opinion is desired by the client; therefore a covered opinion is required.
  - a. A limited scope opinion may be appropriate.
4. It is determined that the transaction is a significant purpose transaction and there is at least one significant federal tax issue involved, and a more-likely-than-not opinion is not desired by the client; therefore a covered opinion is not required, but a disclosure statement is required if the opinion would be a more-likely-than-not opinion.
5. It is determined that the transaction is a significant purpose transaction and there is at least one significant federal tax issue involved, and a more-likely-than-not opinion is not desired by the client and the opinion is not a

more-likely-than-not opinion; therefore a covered opinion is not required and no disclosure statement is necessary.

6. It is determined that the transaction is a significant purpose transaction and there is no significant federal tax issue involved; therefore a covered opinion is not required and no disclosure statement is necessary.
7. It is determined that the transaction is not a significant purpose transaction; therefore a covered opinion is not required and no disclosure statement is necessary.

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