

CIRCULAR 230

“COVERED OPINIONS” - WHAT *ISN'T* COVERED?

OVERVIEW AND APPLICATION TO ESTATE PLANNING

Section of Real Property, Probate and Trust Law

Spring Symposia

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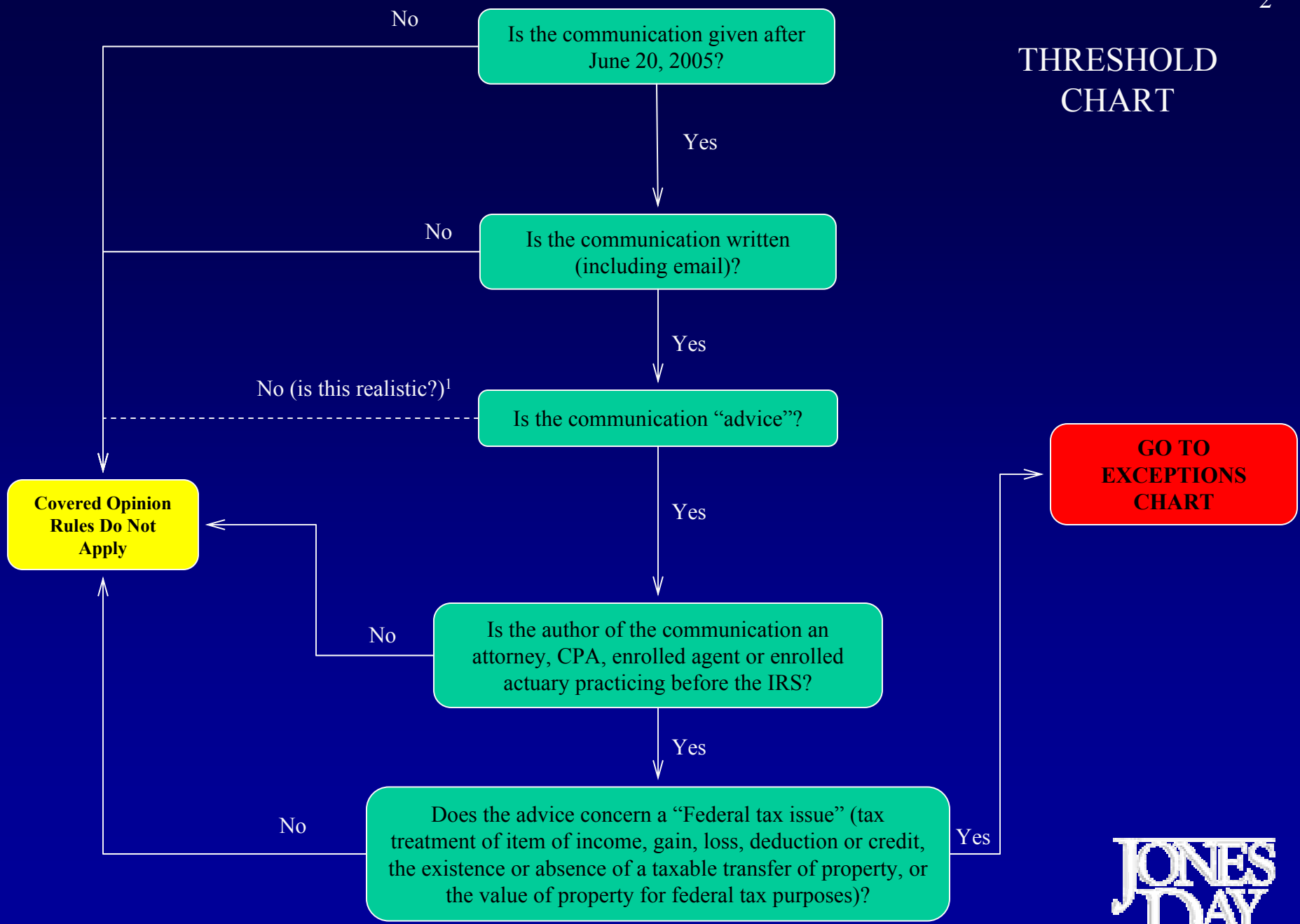
Atlanta

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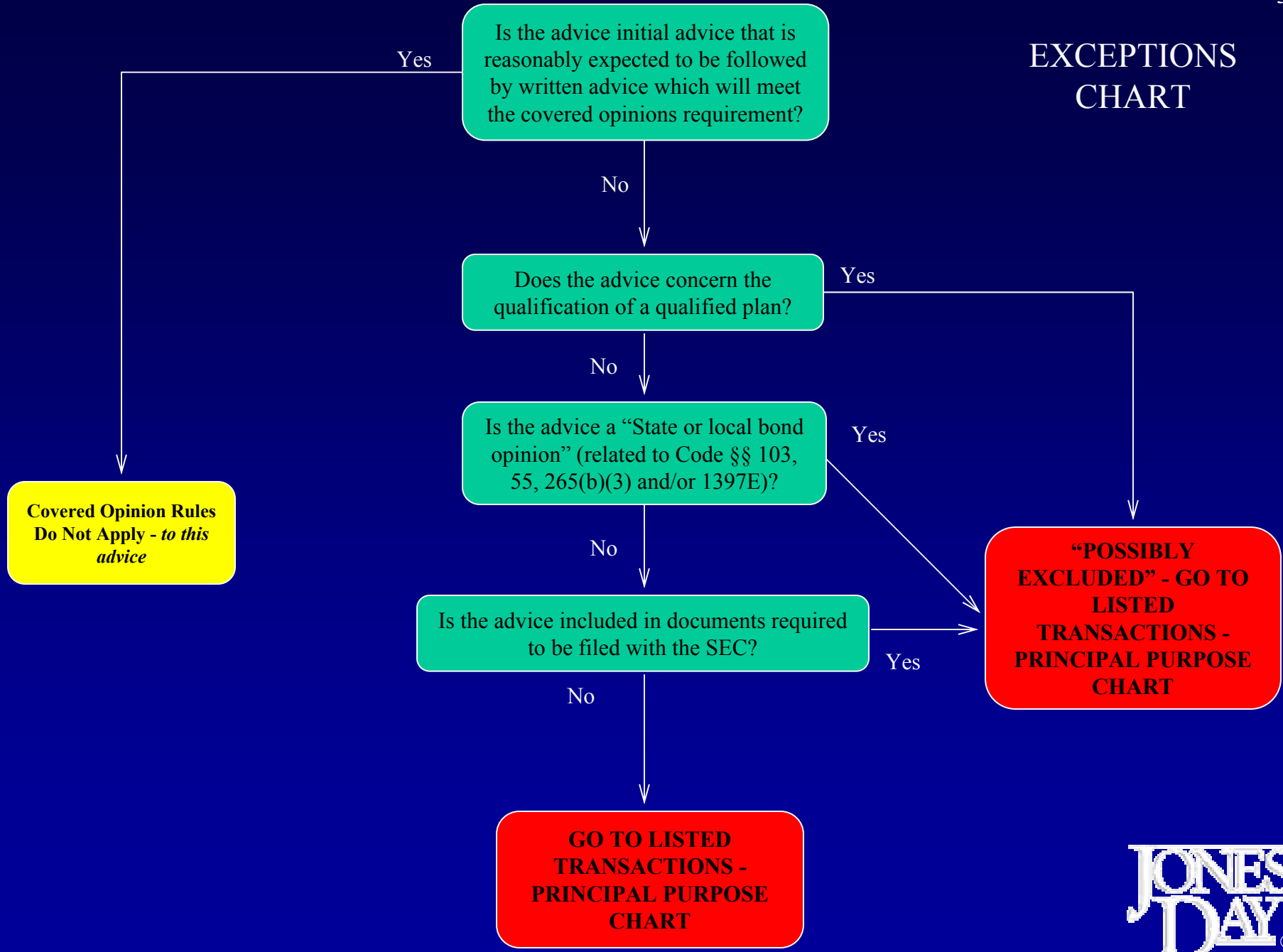
THRESHOLD CHART



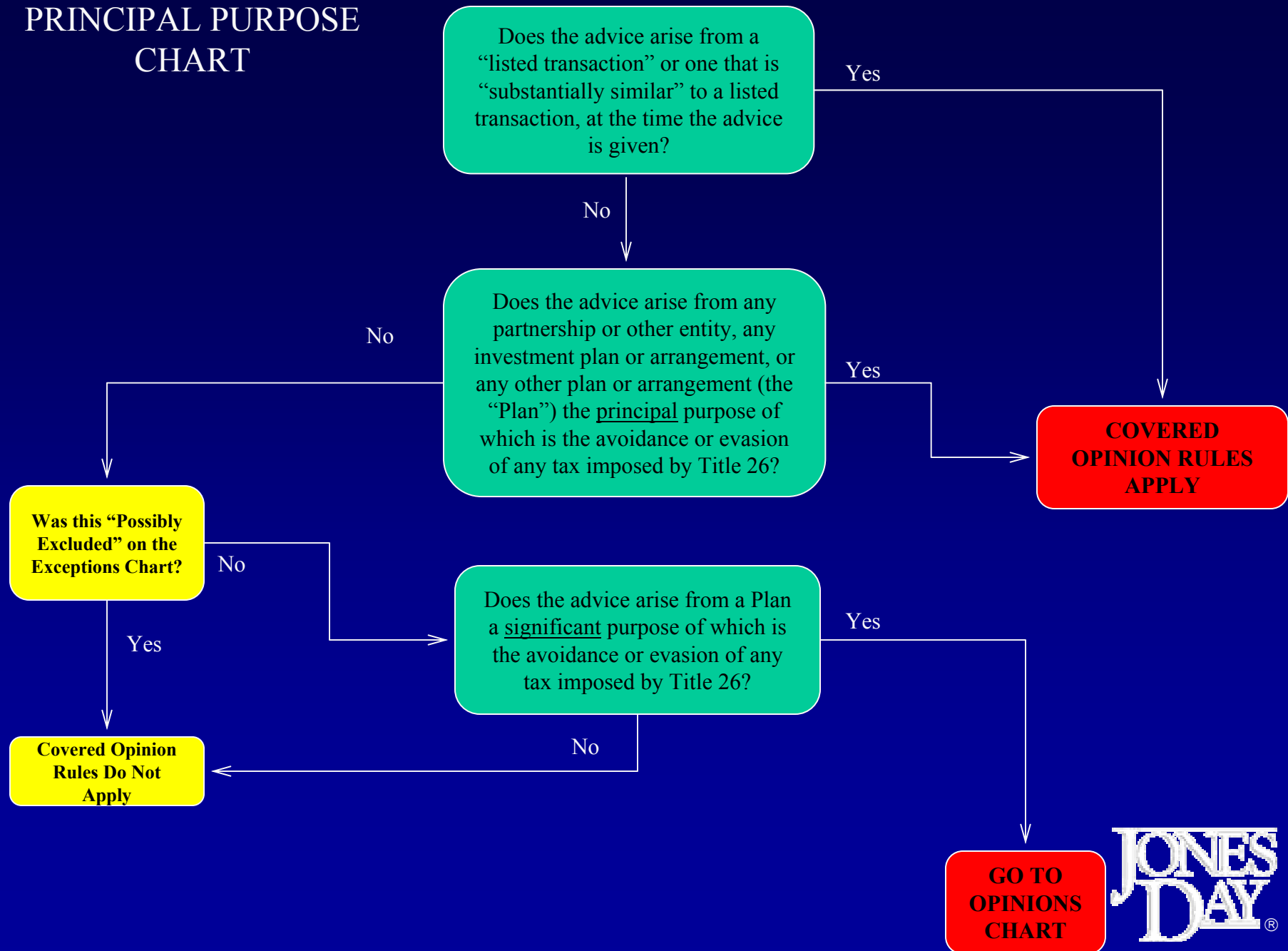
¹ Note that an argument that the communication is not "advice" could have unintended consequences, such as on the attorney-client privilege.



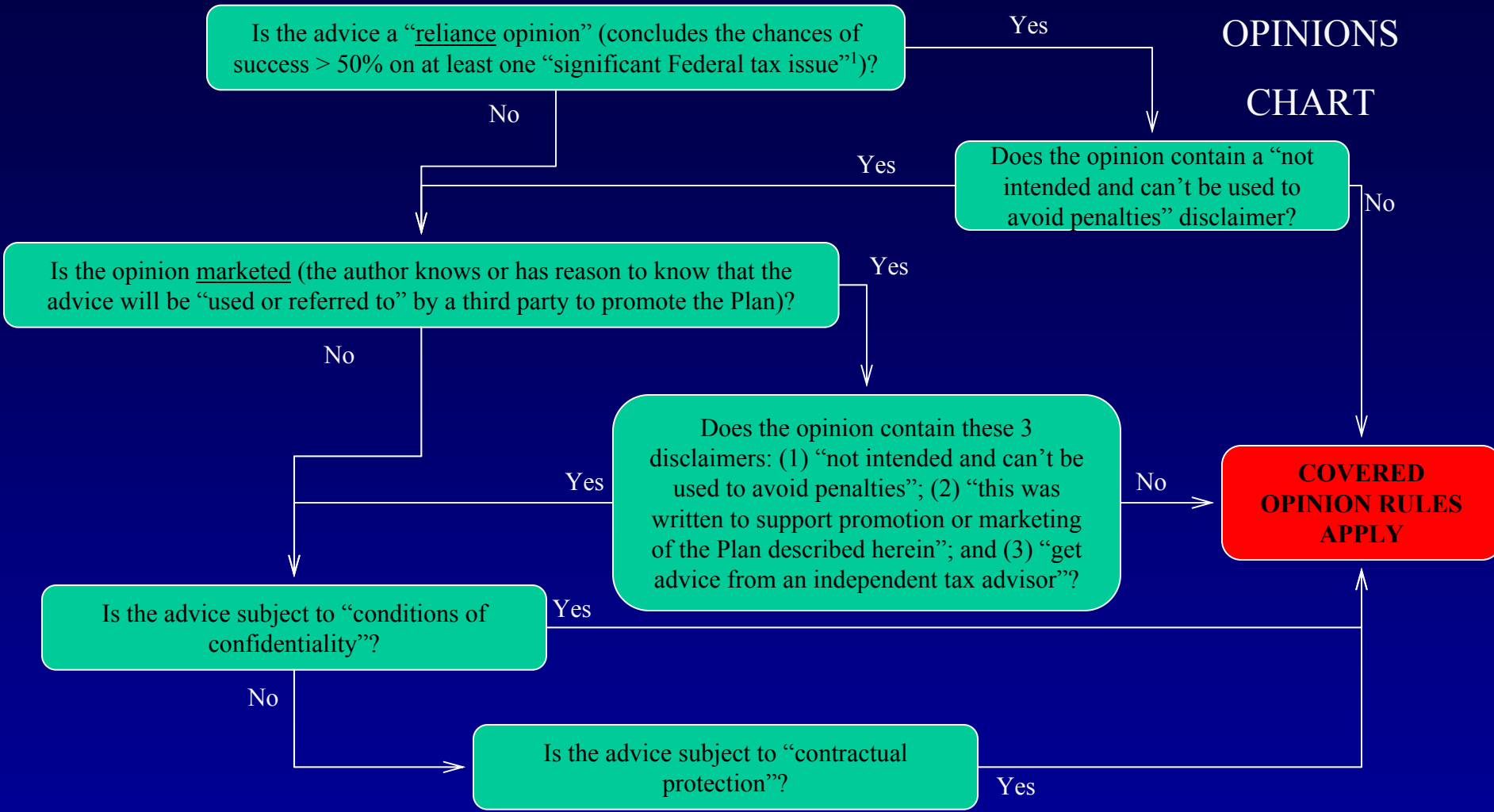
EXCEPTIONS CHART



LISTED TRANSACTIONS- PRINCIPAL PURPOSE CHART



OPINIONS CHART



¹“Significant Federal tax issue” is a “Federal tax issue” with respect to which the IRS has a reasonable basis for a successful challenge and its resolution would have a significant impact, whether beneficial or adverse and under any reasonably foreseeable circumstance, on the overall Federal tax treatment of the transaction(s) or matter(s) in the opinion.



COVERED OPINIONS

- Must meet factual requirements
- Must relate the law to facts
- Must consider all “significant Federal tax issues” (unless a limited scope opinion, and not a marketed opinion)
- Must reach an overall conclusion
- Must contain certain disclosures
- Author must be competent

COVERED OPINIONS - FACTS

- Actual facts. Must use reasonable efforts to identify and ascertain the facts, which may relate to future events if the transaction is prospective or proposed, and determine which facts are relevant. The opinion must identify and consider all facts determined to be relevant
- Assumptions. Must not base the opinion on unreasonable factual assumptions (including reliance on projection, financial forecast or appraisal), including as to future events.
 - “Know or should know” standard. (Is it reasonable to assume all clients will make GRAT annuity payments or interest payments on notes?)
 - It is unreasonable to assume a business purpose, or that a transaction is profitable apart from tax benefits, or to make an assumption on a material valuation issue
 - Must identify, in a separate section, all assumptions
- Representations. Same rule as assumptions, including that representations relied upon must be identified in a separate section.

COVERED OPINIONS - RELATE LAW TO FACTS

- Must relate the applicable law (*including potentially applicable judicial doctrines*) to the relevant facts
- Must not assume a favorable resolution of any “significant Federal tax issue”¹ unless
 - the “limited scope opinion” requirements are met, or
 - the author relies upon another competent practitioner’s opinion, identifies the other opinion and sets forth in the author’s opinion the conclusions of the other practitioner
- Must not contain internally inconsistent analyses

¹“Significant Federal tax issue” is a Federal tax issue with respect to which the IRS has a reasonable basis for a successful challenge and its resolution would have a significant impact, whether beneficial or adverse and under any reasonably foreseeable circumstance, on the overall Federal tax treatment of the transaction(s) or matter(s) in the opinion



COVERED OPINIONS - ISSUES

- Must consider all “significant Federal tax issues” unless
 - the “limited scope opinion” requirements are met, or
 - the author relies upon another competent practitioner’s opinion, identifies the opinion and sets forth in the author’s opinion the conclusions of the other practitioner
- Must provide a conclusion as to the likelihood that the taxpayer will prevail on the merits with respect to each significant Federal tax issue, and if not, the opinion must so state.
- Must describe the reasons for the conclusions, including facts and analysis of support, or describe why a conclusion cannot be reached
- If a conclusion is less than or equal to 50% for one or more “significant Federal tax issues,” the opinion must prominently disclose:
 - one or more issues in the opinion are not MLTN or higher, and
 - the taxpayer cannot rely on the opinions for penalty protection on those issues
- Must not take into account the chances of audit
- “Marketed opinion” must either be MLTN on all significant tax issues, or have the “this is not a marketed opinion” disclaimer

LIMITED SCOPE OPINIONS

- A practitioner may provide an opinion on less than all of the significant Federal tax issues (and may make reasonable assumptions regarding the favorable resolution of other Federal tax issues) if:
 - The taxpayer and the practitioner agree to limit the scope and the taxpayer's reliance on the opinion for penalty protection to one or more Federal tax issues addressed in the opinion
 - The advice does arise out of either a listed transaction or a "principal purpose" transaction
 - The opinion is not a marketed opinion
 - The opinion identifies in a separate section issues assumed
 - The opinion must include the limited scope opinion disclosures

COVERED OPINIONS - OVERALL CONCLUSION

- Opinion must provide author's overall conclusion as to the likelihood that the treatment in the opinion is the proper treatment, and the reasons therefor
- If the author cannot reach an overall conclusion, the opinion must so state and describe the reasons why
- An author of a "marketed opinion" must reach an overall conclusion of at least MLTN

REQUIRED DISCLOSURES

- Appearance and location. All disclosures must be in a separate section, at the beginning of the written advice, in bold, in a larger typeface than any other typeface
- All covered opinions must disclose
 - Any compensation arrangement, such as a referral fee or fee-sharing arrangement, between the practitioner or the firm and any other person (apart from the client) with respect to the promoting, marketing or recommending of the entity, plan or arrangement discussed in the opinion, or
 - Any referral agreement between the practitioner or the firm and a person (other than the client) engaged in promoting, marketing or recommending the entity, plan or arrangement discussed in the opinion
 - If the opinion does not reach MLTN level on one or more significant Federal tax issues,
 - the fact that it does not reach MLTN level on one or more issues, and
 - with respect to those issues, the opinion was not written, and cannot be used to avoid penalties

REQUIRED DISCLOSURES - CONT'D

- Marketed opinions must disclose
 - that the opinion was written to support the promotion or marketing of the matters or transactions described in the opinion
 - that the taxpayer should seek advice from an independent tax advisor
- Limited scope opinions must disclose
 - that the opinion is limited to such issues
 - that additional issues may exist that could affect the Federal tax treatment of the matters in the opinion and that the opinion does not consider or provide a conclusion with respect to any additional issues and
 - with respect to any significant Federal tax issues outside of the limited opinion, the opinion was not written, and cannot be used to avoid penalties

COMPETENCY

- Author must be knowledgeable in all of the aspects of Federal tax law relevant to the opinion being rendered, except
 - the author may rely upon another competent practitioner's opinion, if the author identifies the other opinion and sets forth in the opinion the conclusions of the other practitioner,
 - unless the author knows or should know that the opinion of the other practitioner should not be relied on
- Overall satisfaction -
 - The author must be satisfied that the combined analysis of the opinions, taken as a whole, and the overall conclusion, if any, satisfy the requirements of section 10.35 (the covered opinions rule) of Circular 230

ESTATE PLANNING - ARE THESE COVERED OPINIONS?

- A letter to a client regarding the tax and non-tax benefits of a prospective FLP?
- An outline of the structure of a defective grantor trust (“DGT”) and possible installment sale?
- An email to a client regarding the use of a GRAT?
- A letter advising client to create bypass trust in a Will or revocable trust?

LETTER REGARDING FLP

- Threshold Chart. Letter probably includes some discussion of a “Federal tax issue”
 - The absence of a taxable event, for income and gift tax purposes, upon the funding of the FLP,
 - The income tax treatment of the FLP, and/or
 - The possible valuation discounts of interests in the FLP.
- Exceptions Chart. None should apply (“initial advice” is not much of an exception).
- Principal Purpose Chart - Listed transactions.
 - Most likely not arising from listed transaction. Query whether contributing options to an FLP would be “substantially similar to” Notice 2003-47 (the contribution of compensatory options to a partnership)?
 - Potential argument by the IRS that FLP has tax avoidance as the *principal* purpose. (If argument is successful, all covered opinion requirements must be met - disclaimers will not relieve you of the obligations.)
 - If avoidance is not the principal purpose, the IRS could argue that tax avoidance is a *significant* purpose.

LETTER REGARDING FLP (CONT'D)

- Opinions Chart. The letter may meet the “more likely than not” (“MLTN”) standard
 - “The contribution to the FLP of the diversified portfolio *should* not result in income to you and should not be a gift upon formation.”
 - Words such as “should,” “likely,” “will” and “would” are probably greater than 50% chance of success. (Should you ever use “will” in any correspondence?)
 - The letter *could* include a disclaimer, but how will clients react? (Remember, the disclaimer will not be sufficient to relieve you of meeting the covered opinion requirements if the advice arises from either a listed transaction or a “principal purpose” transaction.) Even with a disclaimer, an opinion might be considered “marketed”.
- Best arguments that covered opinion rules do not apply
 - Any tax avoidance purpose is not the principal purpose. (Who wants to pin their defense on an argument based on a client’s purpose?)
 - The “Federal tax issues” discussed in the letter are not “*significant* Federal tax issues” because the IRS does not have a reasonable basis for a successful challenge of the conclusions therein. (How high does one’s comfort level have to be to meet this standard? 80%? 90%?)

OUTLINE REGARDING DGT AND INSTALLMENT SALE

- Threshold Chart. Outline probably includes some discussion of a “Federal tax issue”
 - The absence of a taxable event, for income and gift tax purposes, upon the sale to the DGT
 - The income tax treatment of the DGT
 - How to “turn-off” grantor trust status to *avoid* (“did I say that out loud?”) a large future gain
- Exceptions Chart. N/A
- Principal Purpose Chart - Listed transactions.
 - Not arising from listed transaction.
 - Potential argument by IRS that DGT structure has tax avoidance as the principal purpose, either based on defective status (“you wanted to sell part of your business to your daughter as part of the succession plan; the DGT structure accomplishes that goal without any tax liability”), or as a way to avoid transfer taxes on increases in value in excess of the AFR (a weak argument).
 - If avoidance is not the principal purpose, the IRS might argue that tax avoidance is a significant purpose.

OUTLINE REGARDING DGT AND INSTALLMENT SALE (CONT'D)

- Opinions Chart. The outline may meet the MLTN standard
 - “The appreciation in value of the gifted assets should escape inclusion in your estate.” “The sale to the DGT should not be a gift or taxable event for income tax purposes.”
 - Words such as “should,” “likely,” “will” and “would” are probably greater than 50%.
 - The outline *could* include a disclaimer, but how will clients react?
- Best arguments that covered opinion rules do not apply. Probably harder to make these arguments than with FLP:
 - Any tax avoidance purpose is not the principal purpose.
 - The “Federal tax issues” discussed in the outline are not “significant Federal tax issues.”

EMAIL REGARDING GRAT

- Threshold Chart. Email probably includes some discussion of a “Federal tax issue” - income tax treatment of GRAT, appreciation above Code § 7520 passes gift-tax free, etc.
- Exceptions Chart. N/A
- Principal Purpose Chart - Listed transactions.
 - Not arising from listed transaction
 - “Avoidance” purposes should be harder, if not impossible, for the IRS to make given the statutory authority supporting the use of the GRAT. Also, what tax is avoided? A possible future estate tax?
- Opinions Chart. Same as with FLP and installment sale to DGT.
- Best arguments that covered opinion rules do not apply. Probably easiest to make these arguments with a GRAT:
 - Any tax avoidance purpose is not the principal purpose.
 - The “Federal tax issues” discussed in the letter are not “significant Federal tax issues.” If properly structured, should the IRS have a reasonable basis to challenge a GRAT?

ISSUES FOR DISCUSSION

- Is this much ado about nothing?
- Do the covered opinion rules apply to post-transaction advice? Do the rules apply to advice given in tax controversies? (The three filters do not appear to place a time period on when the transaction occurs, just when the advice is given.)
- What if after June 20, 2005 you re-send to a client a memorandum (or email or PowerPoint) which was prepared prior to June 20, 2005? (“I lost that outline on how the GRAT works. Can you please send me another copy?”)
- The rules are important, because disbarment could cause you to be fired from your firm. See 10.24(a): “A practitioner may not, knowingly and directly or indirectly... accept assistance from or assist any person who is under disbarment or suspension from practice before the [IRS]....”
- What does “avoid” mean? *See* Treas. Reg. § 1.6662-4(g)(2)(ii).
- Are the new rules just an indirect way for the IRS to reduce defenses to penalties? If a client does not receive a written version of the advice you give, how can she prove reliance upon your advice?