

**AMERICAN BAR ASSOCIATION
SECTION OF TAXATION
COMMENTS REGARDING PROPOSED
AMENDMENTS TO THE REGULATIONS GOVERNING
PRACTICE BEFORE THE INTERNAL REVENUE SERVICE
(Title 31, Code of Federal Regulations, Subtitle A, Part 10)**

The views expressed herein are being presented on behalf of the Section of Taxation (the "Section"). These comments have not been approved by the Board of Governors or the House of Delegates of the American Bar Association and, should not be construed as representing the policy of the American Bar Association.

These comments were prepared by a task force of individual members of the Committee on Standards of Tax Practice and the Special Projects Committee of the Section of Taxation. Principal drafting responsibility was exercised by Bryan Skarlatos, Frederic L. Ballard, Jr., and B. John Williams. Substantive contributions were made by Ian M. Comisky, Denis Conlon, James P. Holden, George C. Howell, III, Mona Hymel, Chad Muller, Charles Pulaski, Cecil A. Ray, Les Shapiro, and David E. Watts. The Comments were reviewed by Walter J. Russell of the Section's Committee on Government Submissions, William M. Paul, Council Director for the Committee on Standards of Tax Practice, Paul J. Sax, Council Director for the Special Projects Committee, and Richard M. Lipton, Chair of the Section.

Although many of the members of the Section who participated in preparing these comments have clients who would be affected by the federal tax principles addressed by these comments or have advised clients on the application of such principles, and all would be affected in their capacity as practitioners, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make, or has a specific individual interest in making, a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these comments.

Contact People:

Richard M. Lipton
McDermott, Will & Emery
227 W. Monroe
Chicago, IL 60606
(312) 984-7627
rlipton@mwe.com

Bryan Skarlatos
Kostelantez & Fink, LLP
530 Fifth Avenue
New York, NY 11036
(212) 808-8100
(212) 808-8108
bskarlatos@kflaw.com

Frederic L. Ballard, Jr.
Ballard Spahr Andrews
& Ingersoll, LLP
601 Thirteenth Street, NW
Suite 1000 South
Washington, DC 20005
(202) 661-2210
(202) 661-2299
FLB@ballardspahr.com

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SECTION OF TAXATION
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General Comments.

The Section commends the Internal Revenue Service (the “Service”) for proposing amendments to the regulations governing practice before the Service (the “Proposed Amendments”). The existing regulations have not been thoroughly updated for many years. The Service has proposed many useful changes to the regulations. The Section strongly endorses the Service’s plan to thoroughly review, update and amend these regulations.

The Section has attempted through these comments to provide constructive commentary and criticism with respect to certain aspects of the Proposed Amendments. These comments do not address every aspect of the Proposed Amendments. Although the absence of a comment on any specific aspect of the Proposed Amendments does not constitute an endorsement of such a specific provision, the Section emphasizes that, subject to the specific comments below, the Proposed Amendments have our strong support. The Service is to be congratulated for undertaking this important effort.

From a procedural perspective, the Section notes that the published version of the Proposed Amendments shows the signature of the Deputy Commissioner of Internal Revenue and the Assistant Secretary (Tax Policy). In the past, changes to Circular 230, which contain Title 31 regulations, have been issued over the signature of the General Counsel of the Treasury. The Section encourages the continuation of this practice because it provides additional detachment and objectivity in the process.

One change that occurs throughout the Proposed Amendments is that the word “shall” has been replaced with the word “must” or “may.” The Section assumes that this change is intended to draw a distinction between mandatory conduct in some circumstances (“must”) and permissible conduct in other circumstances (“may”). If this substantive change is intended, we suggest that it would be appropriate to clarify this intent in the preamble when the Proposed Amendments are finalized.

Use of the defined term “practitioner” instead of repeatedly listing the types of professionals subject to Circular 230 is a welcome change that enhances the clarity of the regulations.

Section 10.7. Representing oneself; participating in rulemaking; limited practice; special appearances; and return preparation.

Section 10.7(c)(viii) provides that an individual who prepares and signs a taxpayer's return may represent the taxpayer before revenue agents, customer service representatives, and other similar employees of the Service. This provision allows a tax return preparer, who may not be a practitioner and who may not be subject to the regulations in Circular 230, to handle a taxpayer's examination. The Section does not believe that it is appropriate to allow a tax return preparer who has not demonstrated any knowledge of tax law or procedure to represent a taxpayer during an examination simply because the preparer has signed a return.

The Section is aware that taxpayers have complained that the practice of requiring a power of attorney before anyone can represent the taxpayer before the Service is too cumbersome for minor inquiries. Accordingly, the Section supports a recent amendment to Form 1040 that allows taxpayers to authorize their return preparer to exchange information with the Service by checking a box on the form. The Section believes that it is appropriate to allow return preparers to engage in the limited conduct of exchanging information if the taxpayer has authorized such activity. A corresponding amendment to this rule would be appropriate.

Section 10.20 Information to be furnished.

To the Internal Revenue Service. The Section believes that by deleting the exception for information requests that are "of doubtful legality," the Proposed Amendments to section 10.20(a) impose an obligation on practitioners that goes beyond a taxpayer's obligation to provide records or information under current law. Further, the Section believes that the requirement in section 10.20(a) that a practitioner must provide information regarding the identity of any person who may have possession or control of requested records or information should be deleted because that requirement can conflict with a taxpayer's constitutional rights under certain circumstances.

Section 10.20(a) of the Proposed Amendments seems to impose an absolute obligation on practitioners to submit records and information to the Service unless there is a reasonable basis to assert a privilege. The idea that a practitioner in all circumstances is required to provide specific information to an investigating agent is contrary to settled law, as is the implication that, if the practitioner does not volunteer such information under a claim of privilege, he must assert that privilege before the agent.

Section 10.20(a) in its present form is adequate. Further, the Service should disclaim any effort to elevate disagreements over the appropriateness of responses to requests for information to sanctionable behavior. Taxpayers have the right under the Code to receive a formal summons and to test the enforceability of the summons in the federal courts. *See* IRC §§ 7604, 7612. Any practitioner who believes in good faith and on reasonable grounds that requested information need not be produced must have the right to object to the request for such information. The Service must recognize that right.

In addition, the Section believes that the portion of the Proposed Amendment to section 10.20(a) which states that the practitioner “must provide any information that either the practitioner or the practitioner’s client has regarding the identity of any person who may have possession or control of requested records or information,” should be deleted. This portion of the Proposed Amendments fails to adequately recognize that information regarding the identity of the person who may have possession or control of requested records or information may be subject to claims of privilege. Thus, the provision may force a practitioner into a choice between allegedly misleading an agent by silence or providing a lead to potentially incriminatory information, in violation of the client’s rights and privileges.

To the Director of Practice. The Proposed Amendment to section 10.20(b) similarly deletes the provision in the current rule that permits a practitioner to not supply information or testimony to the Director of Practice if the practitioner believes in good faith and on reasonable grounds that the request is of doubtful legality. For the reasons set forth above, the Section believes that the current provision should not be changed.

Section 10.21. Knowledge of client's omission.

The Section supports the expansion of this provision so that it applies to any document submitted under the revenue laws as opposed to only those documents required to be submitted under the revenue laws.

The Section supports the additional requirement that a practitioner who knows of the fact of a noncompliance, error or omission must advise the client regarding the manner in which corrective action can be taken and the possible consequences of not taking corrective action. However, the Section believes that a practitioner should also be required to advise the client of the possible consequences of taking corrective action as well. There may be circumstances in which it would violate a practitioner’s duty of competence to fail to advise a client of the consequences of taking such corrective action.

Further, there may be circumstances in which it is not appropriate for a practitioner to advise a client regarding the possible consequences of taking or not taking corrective action. These circumstances may arise if the practitioner is not sufficiently experienced, has a conflict of interest, or for some other reason. Accordingly, the Section suggests that this provision should include a phrase directing that, when appropriate, a practitioner must advise the client to consult with another practitioner who is competent and disinterested for purposes of advising a client regarding the possible consequences of taking or not taking corrective action.

Section 10.22 Diligence as to accuracy.

The Section supports the clarification of the phrase "due diligence" in the context of a practitioner who relies on others. This clarification recognizes the realities of practice in a firm or other organization.

In addition, there should be a cross-reference to section 10.34(a)(3) which provides that, to the extent that a practitioner acts in accordance with the principles set forth in section 10.34(a)(3), the practitioner will be presumed to have exercised due diligence for purposes of section 10.22 when advising a client to take a position on a return or when preparing or signing a return as a preparer. This cross-reference will clarify the meaning of due diligence when a practitioner relies on information provided by a client.

Section 10.28. Return of client's records.

The Section is concerned that the imposition of an obligation on a practitioner to return all of a clients' records upon request, regardless of a dispute over fees, may conflict with ethical and common law rules that vary from state to state. This provision should not be included in Circular 230.

Further, the obligation set forth in section 10.28 to return all documents is excessively broad because a practitioner may have possession of client records relating to both tax and non-tax matters. For example, a practitioner may have possession of a client's corporate or real estate records relating to a corporate or real estate transaction. It is not appropriate for Circular 230 to attempt to regulate a practitioner's conduct with respect to such non-tax matters. Accordingly, the obligation imposed by this provision should be limited to "tax-related" records.

Finally, there is an issue of whether a tax return prepared by the practitioner is a record of the client or a record of the practitioner. The Section believes that the tax return should be considered a record of the practitioner because it is created by, and reflects the work of, the practitioner. Of course, the client's records on which the return is based belong to the client and, in the event of a dispute, the client can simply use those records to have a another return prepared by another practitioner. The Section believes that section 10.28 should specify that the tax return is not a record of the client.

Section 10.29. Conflicting Interests.

With two exceptions, the Section applauds the substance of section 10.29, as proposed. Our first substantive concern is with the requirement that waivers of potential conflicts of interest under section 10.29(a)(2) must be in writing. This requirement does not appear in Model Rule 1.7(a) of the A.B.A. Model Rules of Professional Conduct and may lead to a substantial degree of inadvertent non-compliance. The Section also notes that this written consent requirement only appears to apply to potential conflicts of interest between multiple parties who are represented by the practitioner. By its terms, proposed section 10.29(c) does not require a written consent in cases in which the potential conflict is between the interests of the represented party and the practitioner's own interests. The Section recommends that this provision be amended to permit a written or oral waiver of a potential conflict of interest.

Our second concern is with the use in the Proposed Amendment of the term "potential conflict of interest" in section 10.29(a). This term is not defined and, conceivably, may be substantially more inclusive than the term "conflicting interests" which appears in the

current version of section 10.29 and in the preamble to the Proposed Amendments. By contrast, Model Rule 1.7(a) of the A.B.A. Model Rules of Professional Conduct, which proposed section 10.29(a) resembles in some respects, does not require an attorney to secure informed consent unless the representation of a client will be “directly adverse” to another client. The Section submits that this is the appropriate standard for determining whether conflicting interests are significant enough to require a waiver of the conflict.

Proposed section 10.29(c) implies that a “potential conflict” may exist if the representation of a party may be “materially limited” by the practitioner’s own interest. However, it is unclear whether the term “potential conflict” in section 10.29(c) is intended to be the equivalent of a “potential conflict of interest” for purposes of section 10.29(a). Section 10.29(a) of the Proposed Amendments should be clarified to expressly provide that a “potential conflict of interest” exists for purposes of section 10.29(a) only where a practitioner’s representation of one party may be materially limited by the interests of another represented party. Even in this case, however, the formulation used in Model Rule 1.7(a) may be preferable. Certainly, situations may arise in which the competing economic interests of one represented party may be materially impacted by the outcome of the practitioner’s representation before the Internal Revenue Service of another represented party. Such circumstances do not require the practitioner to secure the informed consent of both parties under Model Rule 1.7(a). However, even if clarified as set forth above, the broader term “potential conflict of interest” may not be so limited. Consequently, the Section recommends that the term “potential conflict of interest” in section 10.29(a) should either be changed to “conflicting interests” as defined in Model Rule 1.7(a) or, alternatively, defined or otherwise limited to refer only to situations in which the objectives of the practitioner’s representation of one party before the Internal Revenue Service would be directly adverse to the interests of the other party. Such a change would obviate the need for any clarification of the meaning of the phrase “potential conflict” in section 10.29(c).

Section 10.30. Solicitation.

The Proposed Amendments to section 10.30(a) expand the prohibition of deceptive solicitation practices to cover private, as well as public, solicitations. This provision uses the terms “public communications” and “private solicitations.” This language implies that the drafters may have intended to create a distinction between a “communication” and a “solicitation.” The Section does not believe that any such distinction was intended. Therefore, the regulation could be revised to read “A practitioner may not, with respect to any Internal Revenue Service matter, in any way use or participate in the use of any form of public or private communication containing a false, fraudulent, or coercive statement or claim; ...” This language makes clear that false statements, both public and private, are prohibited. Alternatively, if the drafters did intend to create a distinction between a “communication” and a “solicitation,” the rules need to be clarified.

This provision also specifies terms that may or may not be used in describing a practitioner’s professional designation as an enrolled agent. The proposed regulations add the term “licensed” to the list of prohibited descriptions. The Section disagrees with prohibiting the use of this term. While the Section appreciates the need to protect taxpayers from misleading

designations, the term “licensed” does accurately describe the process one undertakes to become an enrolled agent. Webster’s defines “license” as “a permission granted by competent authority to engage in a business or occupation....” For example, those who wish to be enrolled agents must satisfy admission criteria including continuing education. They must file an application for enrollment along with a fee to the Director of Practice and, ultimately, be granted permission by the Director of Practice to practice before the Service. An individual must possess a valid enrollment card that includes periodic renewals (an accompanying fee) to practice before the Service. These elaborate procedures appear very much to be a licensing procedure even if not called such under the regulations. For these reasons, the designation “licensed” would not be any more misleading, false or harmful to prospective clients than the term “enrolled.” Thus, the designation “licensed” should not be prohibited.

Section 10.30(c) of the proposed regulations lists the acceptable modes of communicating fee information. Given the rapid pace of technological advances in communication methods, the regulation could be stated more broadly to anticipate such changes. The language could be modified as follows: “Fee information may be communicated in any available medium, including professional lists, telephone directories, print media, mailings, electronic mail, facsimile, hand delivered flyers, radio, television, and any other method.” Furthermore, the requirement that copies of these communications be retained by the practitioner could also be broadened to anticipate communication media not yet available.

Section 10.33. Tax shelter opinions used by third parties to market tax shelters.

Summary of Principal Comments

Section 10.33 of the Proposed Amendments provides requirements for a tax shelter opinion that does not conclude that the tax treatment of a tax shelter item is more likely than not the proper treatment. Section 10.33(c)(2) defines a “tax shelter” broadly by reference to section 6662(d)(2)(C)(iii) of the Code. Section 10.33(c)(4) defines a “tax shelter opinion,” for purposes of section 10.33, in a manner that limits the definition to advice that the practitioner knows or has reason to believe will be used or referred to by a person other than the practitioner in promoting, marketing, or recommending a tax shelter to one or more taxpayers. As explained in more detail below, section 10.35(c)(4) of the Proposed Amendments, which addresses tax shelters for which a practitioner is providing a “more likely than not” opinion, uses a much more expansive definition of “tax shelter opinion” than section 10.33(c)(4). The definition in section 10.35(c)(4) does not restrict a “tax shelter opinion” to opinions marketed to third parties.

The Section believes that the definition of “tax shelter” in sections 10.33(c)(2) and 10.35(c)(2) of the Proposed Amendments is inappropriately broad. The definition of “tax shelter” would preferably be limited to transactions the principal (rather than “a significant”) purpose of which is the avoidance or evasion of federal income tax. In the alternative, a lengthy list of excluded transactions would need to be added to the definition of a “tax shelter.” If the definition of “tax shelter” is limited in such fashion, then the definition of “tax shelter opinion”

in section 10.33(c)(4) should be expanded to cover all opinions that are used, or that are provided by practitioners involved, in the marketing or promotion of the related tax shelter.¹

Section 10.33 imposes various requirements on both the substance of the opinion and its form, for example a requirement that the opinion must disclose on the first page that it does not conclude that the tax treatment is more likely than not the proper treatment and is not intended to establish reasonable belief, reasonable cause or good faith for penalty purposes. Although some of the individuals who participated in the preparation of these comments believe that these formal requirements may intrude excessively into the professional relationship between the practitioner and the client and that reliance on a general requirement of fair disclosure would be preferable, the Section believes that the specific requirements as to form in section 10.33 will simplify the matter for both practitioners and clients. Again, this divergence of views is ameliorated if the definition of “tax shelter” is appropriately limited.

The Section recommends that sections 10.33 and 10.35 be better coordinated and that uniform definitions be employed to the extent possible so as to avoid confusion and unintentional noncompliance.

Detailed Comments

Heading and cross-references. The heading to section 10.33 reflects its origin in the present regulations by referring to “tax shelter opinions used by third parties to market tax shelters.” Consideration could be given to having the heading include a reference to “tax shelter opinions below a ‘more likely than not’ standard.” Use of this language would clarify the relationship between section 10.33 and section 10.35 which deals with opinions that are at a “more likely than not” or higher level of confidence. In any event, the introductory language for each section could cross-refer to the other so that a reader of either would realize there are two separate rules.

10.33(a)(1) through (3): facts, law, and analysis. These provisions set forth the requirements for a section 10.33 opinion in respect of factual matters, relating the applicable law to the relevant facts, and analysis of material Federal tax issues. They are similar to the equivalent provisions in section 10.35, dealing with opinions that the tax treatment of a tax shelter item is more likely than not the proper treatment, except for one important difference. That difference is that section 10.35(a)(1)(ii)(C) specifically requires that a section 10.35 opinion may not use a factual assumption that a transaction has a business reason, is profitable, or complies with a material valuation issue. There is no counterpart prohibition in section 10.33.

10.33(a)(3) and (a)(4): “typical investors”. Section 10.33(a)(3), dealing with analysis of material Federal tax issues, is based generally on the tax liability of a “typical

¹ As described below, if our suggested modification to the definition of “tax shelter” is not adopted, then the definition of “tax shelter opinion” in section 10.35(c)(4) should be restricted as described below in our comments relating to section 10.35.

investor.” Contrasting language referring to “the taxpayer” appears in section 10.35. The Section assumes that this difference in language reflects the differing definitions of “tax shelter opinion” in these two provisions. In order to avoid confusion, a definition of “typical investor” should be provided in section 10.33.

10.33(a)(5): overall conclusion; required disclosures. Section 10.33(a)(5) requires that (1) an opinion must clearly state that the practitioner is unable to reach an overall conclusion (if that is the case), (2) the failure to reach a “more likely than not” overall conclusion or to reach any overall conclusion must be clearly and prominently disclosed on the first page, and (3) the opinion must clearly and prominently disclose on the first page that the opinion was not written for the purpose of establishing a taxpayer’s reasonable belief, reasonable cause, or good faith for purposes of cited penalty provisions in section 6662 and 6664. Although some of the individuals who assisted in the preparation of these comments believe that the formal requirements may intrude excessively into the professional relationship between practitioner and client and may raise a question as to authority for the regulation,² the Section believes that these proposals will add uniformity and certainty. The Section strongly agrees with the goal of furthering disclosure of the limited nature of the opinion.

10.33(c)(2): definition of tax shelter. The Section’s most significant concern about the Proposed Amendment to section 10.33 is the definition of a “tax shelter.” Section 10.33(c)(2) defines tax shelter by reference to section 6662(d)(2)(C)(iii) of the Code, imposing the accuracy-related penalty. The same definition appears in section 10.35, relating to “more likely than not” opinions, except that in section 10.35 there is a specific exclusion for municipal bonds and qualified retirement plans.

The Section agrees that the definition of a “tax shelter” in section 10.33(c)(2) of the current regulations is outdated. The Section further believes that Section 10.33 should use the same definition of “tax shelter” as section 10.35. However, the Section believes that the definition set forth in section 6662(d)(2)(C)(iii) of the Code is overly broad for use in the Circular 230 context because it encompasses transactions “a significant” purpose of which is tax avoidance. Using that definition would draw in numerous transactions that should not be viewed as “tax shelters” for Circular 230 purposes. Because many routine business transactions are structured in a manner in which tax avoidance is a “significant” purpose, adoption of the statutory definition of a “tax shelter” in section 6662(d)(2)(C)(iii) would extend the rules of Circular 230 to many (if not most) tax opinions furnished in connection with routine business transactions. Such an expansion of the impact of Circular 230 is unwarranted and would unduly intrude on the practitioner-client relationship.

The Section recommends that a “tax shelter” be defined for purposes of Circular 230 by reference to the language utilized in section 6662(d)(2)(C)(iii) prior to its amendment in

² These members would prefer a general requirement of fair disclosure without specific formal requirements, on the theory that practitioners should be able to put their advice into a form that meets the needs of the particular client. However, if, as the Section recommends, the definition of a “tax shelter” is appropriately limited, most of the objections to this proposal are rendered moot.

1997. Specifically, the Section believes that a “tax shelter” should be limited to situations in which the principal purpose is the avoidance or evasion of federal income tax. In this regard, the regulations that were issued prior to 1997 under section 6662(d)(2)(C)(iii) (section 1.6662-4(g)(2)(ii)) provide a useful frame of reference. These regulations elaborate the substantive standards of “principal purpose” (the pre-1997 standard before the statutory change to “significant purpose”) and “avoidance or evasion” of tax so as to exclude arrangements with a purpose of claiming exclusions from income, accelerated deductions or other tax benefits in a manner consistent with the Code and Congressional purpose.

The section 6662 regulations contain a number of examples covered by this exclusion, including purchasing or holding a tax-exempt municipal bond or establishing a qualified retirement plan and also several other specific tax-advantaged transactions. If the Service does not accept the Section’s proposed definition of a “tax shelter,” the Section recommends, in the alternative, that numerous routine transactions that have a significant purpose of tax avoidance be excluded from the definition of a “tax shelter.” The list of exclusions should include:

- Transactions generating tax credits under Code section 29 or 42.
- The failure of a partnership to make a Code section 754 election.
- Other transactions expressly permitted by the partnership anti-abuse regulations in Treasury regulations section 1.701-2.
- Choice of entity or checking the box.
- Transactions permitted by the Supreme Court’s decision in *Cottage Savings*.
- Partnership redemptions that use property rather than cash.
- Like-kind exchanges that are part of a sale of an asset.
- Substituting debt for equity or choosing to issue debt instead of equity.
- Transferring insurance operations to a subsidiary.
- Corporate reorganizations.
- Qualified stock option plans.

These exclusion examples would be in addition to the list already set out in section 1.6662-4(g).

The above list is indicative of the problems that the Section believes are inherent in the definition of “tax shelter” in section 10.33(c)(2) of the Proposed Amendments. Many routine business transactions, including (for example) a like-kind exchange or using a partnership rather than a corporation to make an investment, have a significant purpose of the avoidance of

federal income tax. Furnishing a written opinion to a client concerning such routine business transactions should not require a practitioner to address all of the matters required by sections 10.33 and 10.35 of Circular 230.

10.33(c)(4): definition of tax shelter opinion. Section 10.33(c)(4) defines tax shelter opinion for purposes of section 10.33 as, in general, an opinion that will be used by a promoter in marketing a tax shelter. By doing so, section 10.33(c)(4) in effect creates an exception to section 10.33 for opinions delivered directly to a taxpayer. There is no analogous exception under section 10.35(c)(4) for “more likely than not” opinions.

While section 10.35 applies to opinions that potentially can be used by taxpayers to obtain penalty protection under sections 6662(d)(2)(C)(i)(II) and 6664(c)(1) of the Code, the opinions covered by section 10.33 cannot be used for such purposes. Accordingly, the Section feels that it is appropriate to limit the scope of section 10.33 to opinions that are used by a promoter in marketing a tax shelter, particularly if the broad definition of “tax shelter” contained in the Proposed Amendments is ultimately adopted. To remove that limitation would unduly impinge on the practitioner-client relationship and, in many cases, would cause sophisticated taxpayers, many of whom have their own in-house tax professionals, to pay for more analysis and advice from outside tax advisors than they want.

One possible “loophole” that the Service should consider closing is the limitation in section 10.33(c)(4) that causes section 10.33 to apply only to opinions used by “a person other than the practitioner” in marketing a tax shelter. That limitation allows a practitioner to engage in tax shelter marketing to a large number of potential investors using his or her opinion as a promotional device without such opinion being subject to section 10.33. Assuming that the Section’s recommendation regarding narrowing the definition of “tax shelter” is adopted, we believe that the tax shelter opinion definition should be expanded to cover an opinion provided by a practitioner who participates in the promotion or marketing of a tax shelter.³

This expansion, however, must be carefully crafted to avoid impinging on the ability of a practitioner who is not involved in promoting or marketing a tax shelter to provide limited advice to a client regarding the tax shelter in a one-on-one setting (assuming that the advice given is not subject to section 10.35). Specifically, we recommend that the first sentence of section 10.33(c)(4) be revised to read as follows:

- (4) A tax shelter opinion, as the term is used in this section, is written advice by a practitioner concerning the Federal tax aspects of a tax shelter item or items (i) that a practitioner knows or has reason to believe will be used or referred to by a person other than the practitioner (or a person who is a member of, associated with, or

³ If the definition of a “tax shelter” in section 10.33(c)(2) is not limited, then the “promotion” or “recommendation” of a tax shelter could include advice given by a practitioner to a client in connection with a routine business transaction that has a significant purpose of tax avoidance. For that reason, we believe that the expansion of the definition of “tax shelter opinion” in section 10.33(c)(4) is dependent upon a narrowing of the definition of “tax shelter” in section 10.33(c)(2).

employed by the practitioner's firm or company) in promoting, marketing, or recommending the tax shelter to one or more taxpayers or (ii) where the practitioner (or a person who is a member of, associated with, or employed by the practitioner's firm or company) has participated or is participating in promoting, marketing, or recommending the tax shelter to one or more taxpayers, in each case irrespective of whether such promotional, marketing, or similar activities are conducted privately or publicly.⁴

Finally, both section 10.33(c)(4) and section 10.35(c)(4) appear to draw a distinction between “preparing” and “reviewing” portions of tax shelter offering materials in situations where neither the practitioner nor his firm is referred to in the offering materials or the related sales promotion efforts. The practitioner apparently is treated as providing a tax shelter opinion in the former case, but not the latter. The distinction between preparing and reviewing the tax consequences section or sections of offering materials is blurry at best and is a tenuous basis for deciding whether a tax shelter opinion has been given. The exception appropriately focuses on the key indicia of a tax shelter opinion, namely, whether the practitioner's name, firm, or advice is referred to in the offering materials. Consequently, the Section recommends that the exception contained in the last sentence of sections 10.33(c)(4) and 10.35(c)(4) be expanded to cover both preparation and review activities, so long as the other requirements for the exception are met.

10.33(c)(5): material Federal tax issues: “significant effect” test. Section 10.33 requires that a practitioner must ascertain that all material Federal tax issues have been considered. The definition of material Federal tax issue in section 10.33(c)(5) includes generally any Federal tax issue the resolution of which could have a “significant impact” on a taxpayer under any reasonably foreseeable circumstance. In order to avoid the question of whether a large dollar item is significant to a very large taxpayer, this definition could be rephrased to include any issue the resolution of which could have a significant impact on the taxpayer either in terms of foreseeable percentage of total tax liability or absolute amount of tax liability.

Section 10.35. More likely than not tax shelter opinions.

Summary of Principal Comments

⁴ Some of the individuals involved in the preparation of these comments believe that, if the definition of a “tax shelter” were appropriately limited, further simplification of Circular 230 could be achieved by using the definition of “tax shelter opinion” in section 10.35(c)(4) for purposes of section 10.33 as well. These individuals believe that complete disclosure should be made with respect to all written advice concerning tax shelters, even if such advice does not provide penalty protection to the taxpayer, so that taxpayers understand that the proposed transaction involves a tax shelter. However, the definition of a “tax shelter opinion” in section 10.33(c)(4) of the Proposed Amendments should not be expanded unless the definition of a “tax shelter” in proposed section 10.33(c)(2) is appropriately limited.

Section 10.35 provides requirements for a tax shelter opinion that concludes that the tax treatment of a tax shelter item is the proper treatment on a “more likely than not” basis or any higher level of confidence. Section 10.35 uniformly applies to opinions issued to both individuals and corporations, regardless of whether or not such opinions are used for marketing or promoting the related tax shelter and whether or not such opinions are intended to provide penalty protection. Similar to section 10.33, relating to third-party opinions that are below the “more likely than not” level, section 10.35 imposes various requirements on the substance of the opinion. Section 10.35 requires that the conclusion as to whether the “more likely than not” standard is met be unambiguous. Section 10.35(c)(2) defines a “tax shelter” by reference to the definition in the accuracy-related penalty provisions of section 6662, with specific exclusions for municipal bonds and qualified retirement plans. Section 10.35(c)(4) defines a “tax shelter opinion” to include any written advice given by a practitioner to a client with respect to the federal income tax aspects of a tax shelter.

Section 10.35 as proposed presents significant issues as to its coverage -- both in terms of uncertainty and potential overbreadth. A practitioner should be able to tell with greater clarity when the heightened standards of section 10.35 apply; and such heightened standards ought to apply to a narrower category of advice than is suggested in the Proposed Amendments.

In October of 1999, the Section submitted a report recommending heightened standards for opinions provided to corporate taxpayers “for the stated purpose of establishing the legal justification of a corporate taxpayer under 26 C.F.R. 6664-4(e)(2) for the tax treatment of a ‘tax shelter item,’ as defined in 26 C.F.R. 1.6662-4(g)(3).” The definition of “tax shelter” that was invoked by the cross-reference to section 1.6662-4(g)(3) in the October 1999 report was the narrower one -- based on the “principal purpose” test -- that is recommended above in our comments relating to section 10.33. The definition of a “tax shelter opinion” in proposed section 10.35(c)(4) includes all forms of written advice concerning the Federal tax aspects of a tax shelter item or items, whether or not for the stated purpose of penalty protection, whenever such advice expresses a more likely than not or higher standard of opinion. In addition, section 10.35(c)(2) incorporates the broader “significant purpose” definition of a tax shelter. For the reasons discussed below, these two definitions together would cause section 10.35 to apply to an overly broad category of practitioner advice.

The Section’s earlier suggestion that coverage be limited to formal, “stated purpose” penalty-protection opinions was based in part on the desire for predictability of coverage. The earlier suggestion also assumed no change to existing section 10.33. In light of the significant changes made by the Proposed Amendments, these comments recommend a narrower definition of “tax shelter” as an alternative approach for obtaining greater certainty and appropriate breadth in the coverage of sections 10.33 and 10.35. However, even if the coverage of proposed section 10.33 is not narrowed as recommended in our comments above, we recommend that section 10.35 use a significantly narrower and clearer definition of covered opinions. This objective could be accomplished either through using a narrower definition of “tax shelter” in section 10.35(c)(2) or through the Section’s original suggestion of covering only opinions provided for the “stated purpose” of penalty protection (and possibly opinions used in marketing a tax shelter). Either approach is consistent with our October 1999 report.

Detailed Comments

10.35(a): general; cross references. The introductory material should include cross-references to section 10.33. In addition, the Service should consider clarifying the application of section 10.35 to an opinion where the practitioner provides a “more likely than not” level comfort with respect to certain aspects of the tax treatment of a tax shelter item, but not others. For example, assume that a practitioner’s written opinion provides a “more likely than not” level of comfort with respect to the ability to recognize, and the timing of, a loss produced by a tax shelter, but provides a lesser level of opinion with respect to the character of the loss. In that case, it seems logical that the requirements of section 10.35 would apply to the recognition and timing portion of the opinion, but not the character portion (although section 10.33 might apply to the character portion).

10.35(a)(4): evaluation of material Federal tax issues. Section 10.35(a)(4) has references to investors. To avoid confusion, we again recommend that a definition of “investor” be provided.

10.35(c)(2): definition of tax shelter. Section 10.35(c)(2) defines tax shelter by reference to the statutory definition in section 6662(d)(2)(C)(iii) of the Code, with exclusions for municipal bonds and qualified retirement plans. For the reasons set forth in detail above with respect to section 10.33(c)(2), the Section believes that this definition is inappropriately broad. For purposes of Circular 230, “tax shelters” should preferably be limited to transactions the principal purpose of which is the avoidance or evasion of federal income tax. In the alternative, a lengthy list of excluded transactions should be added to the definition of a “tax shelter.”

10.35(c)(4): definition of tax shelter opinion. Section 10.35(c)(4) does not limit the definition of “tax shelter opinion” to opinions that are used in marketing a tax shelter or prepared for penalty protection. For the reasons set forth in detail above with respect to section 10.33(c)(4), the Section believes that the more expansive definition of “tax shelter opinion” in section 10.35(c)(4) is appropriate if, but only if, the definition of a “tax shelter” is appropriately limited. Otherwise, because section 10.35(c)(4) encompasses any written advice provided to a taxpayer with respect to a “tax shelter,” a practitioner would be required to provide a full-blown opinion complying with Circular 230 if the practitioner is advising a client with respect to a transaction in which the taxpayer has a significant purpose of tax avoidance.

The scope of this problem in the Proposed Amendments cannot be overstated. Practitioners routinely furnish clients with written advice, usually at a “more likely than not” or higher level of assurance, concerning routine business transactions. Although these transactions are not principally tax motivated, such transactions are usually structured so as to minimize the federal income tax consequences thereof, i.e., the transactions have a “significant purpose” of tax avoidance. If the definitions in section 10.35 of the Proposed Amendments are not altered, many routine business transactions will be swept within the ambit of this provision. Every like-kind exchange would be subject to this rule; every transfer of assets to a partnership (instead of a taxable sale) would arguably be subject to this rule; every tax-free reorganization could be within

the broad scope of this rule; even the utilization of a partnership instead of a corporation to conduct a new business would be subject to this rule. The list is virtually endless.

This problem arises not because of the definition of “tax shelter opinion” in section 10.35(c)(4) but, rather, because of the overly-broad definition of a “tax shelter” in section 10.35(c)(2). The Section agrees that a practitioner who provides written advice to a taxpayer with respect to a “tax shelter” (as appropriately defined) should be required to address all material issues concerning that tax shelter. However, if the definition of a “tax shelter” is not appropriately limited, then the requirements of Circular 230 should apply only to opinions used for tax shelter marketing or promotion or prepared to provide penalty protection in order to avoid unduly intruding on the practitioner-client relationship.

Accordingly, if the definition of “tax shelter” were appropriately limited, then the Section believes that it would be appropriate to use the currently proposed definition of “tax shelter opinion” in section 10.35(c)(4). Otherwise, the Section recommends that the definition of “tax shelter opinion” be modified so that it is limited to opinions used for marketing (presumably using the same language as in section 10.33(c)(4) (modified as suggested above in our comments regarding section 10.33)) or prepared for the “stated purpose” of penalty protection (presumably using the language suggested in our October 1999 report). Also, see our comment on the corresponding provision in section 10.33 regarding the need to eliminate the distinction between “preparation” and “review” in the last sentence of section 10.35(c)(4).

10.35(c)(5): material Federal tax issues. See our comment on the counterpart provision of section 10.33.

Section 10.36. Procedures to ensure compliance.

Section 10.36 requires a practitioner who practices in a firm to take reasonable steps, consistent with his or her authority and responsibility for the firm’s practice, to make certain that the firm has adequate procedures for purposes of ensuring compliance with the sections on opinions and return preparation. The Section is concerned that the phrases “make certain” and “ensuring compliance” may imply a higher level of responsibility than is intended, in view of the limitations on the Director’s authority in subsections (a) and (b). This problem could be relieved by replacing “make certain” with “confirm” and “ensuring compliance” with “complying.”

Further, this section does not provide necessary guidance as to what constitutes “adequate procedures in effect for purposes of ensuring compliance with section 10.33, 10.34 and 10.35”. The Service might provide interim guidance by reference to Regs. 1.6694-2(d)(1) through (5) and Rev. Proc. 80-40, which provide comparable guidance applicable to imposition of the return preparer penalty, including exceptions involving good faith errors arising from complex and technical provisions of the Code, the frequency and materiality of errors, the establishment of normal office practices, systems and review procedures to avoid compliance errors, and reliance on third parties.

Section 10.50. Sanctions.

The Section generally supports the expansion of the types of sanctions available to the Service under the Proposed Amendments. The Section believes that a “censure” sanction is an appropriate remedy in certain circumstances, and for that reason the Section endorses the concept of the addition of this potential sanction. However, it is unclear whether Congress has given the Secretary or the Director of Practice authority to create such a sanction. This is especially problematic because a censure is a public sanction that could implicate a practitioner’s due process rights.

Section 10.50(a) is an authorizing regulation pursuant to which the Secretary of the Treasury delegates to the Director of Practice the same authority to sanction practitioners that is granted to the Secretary by Congress in 31 U.S.C. §330(b). Section 330(b) of Title 31 gives the Secretary authority to suspend or disbar practitioners for incompetence, disreputable conduct, violating Circular 230 or misleading or threatening a client. Section 10.50(a) of Circular 230, as currently written, tracks the language of 31 U.S.C. §330(b) almost word for word. However, the proposed amendment to section 10.50(a) grants to the Director of Practice an additional power to censure practitioners that was not given to the Secretary by Congress in 31 U.S.C. §330.

Although the Section endorses the concept of “censure” as a sanction that is imposed by the Director of Practice, the Section believes that statutory authority must exist before the Treasury may delegate that power. The Section urges the Service to obtain statutory authority for this proposed sanction. If and when such statutory authority exists, the Section will strongly support the addition of this sanction.⁵

In addition, the proposed amendments to section 10.50(a) change the word “refuses” to the word “fails” when describing the conduct of a practitioner who violates the regulations. The Section believes that this change should not be made because the change in

⁵ Some members of the Section have questioned whether the Director of Practice has the necessary authority to regulate many of the types of conduct addressed throughout Circular 230, including the proposed expanded definition of “tax shelter opinion” in section 10.35(c)(4). The reasoning behind this position is that 31 U.S.C. §330 authorizes the Secretary to regulate the practice of representatives before the Service. Practice before the Service is limited by section 10.2(e) of Circular 230 to any matter in which a practitioner makes a presentation to the Service, which typically requires the submission of a power of attorney. Many of the provisions of Circular 230, such as sections 10.33, 10.34, or 10.35, do not involve the submission of a power of attorney. The conduct addressed in these and possibly other sections of Circular 230 might be viewed as outside the scope of jurisdiction granted to the Secretary and, derivatively, to the Director of Practice, by 31 U.S.C. §330. These members suggest that additional statutory authority could be sought from Congress to permit the Director of Practice to regulate this type of conduct.

After careful consideration, the Section has adopted a position contrary to this view. The Section believes sufficient authorization is present in the power of the Secretary to suspend or disbar practitioners for violations of regulations prescribed by the Secretary under 31 U.S.C. §330. The Section notes that section 10.2(e) of Circular 230 defines practice before the Service to include “all matters connected with a presentation to the Service.” (Emphasis added.) The Section considers most, if not all, of the conduct addressed in Circular 230 to be conduct connected with a presentation to the Service. Thus, such conduct constitutes practice before the Service that is subject to regulation by the Secretary. Section 10.2(e) could itself be amended to confirm this rationale by including the conduct in question within the regulatory definition of practice before the Service. Alternatively, if the Service seeks statutory authority for the proposed “censure” sanction, which the Section recommends, it might also be appropriate for the Service to obtain a clarification from Congress concerning the scope of the Service’s authority under Circular 230.

phraseology could be interpreted to change the standard for sanctions that is currently set forth in section 10.52. Section 10.52 currently requires that a violation occur through gross incompetence, recklessness, or willfulness. However, changing the word “refuses” to the word “fails” could be interpreted to lower the standard for sanctions to a mere negligent or inadvertent failure to comply with the regulations. Lowering the standard for sanctions to negligence or inadvertence is not only inadvisable for many reasons, but also contrary to the express standards set forth in section 10.52. The change in phraseology contained in the proposed amendments to this section will lead to confusion and should be eliminated.

Section 10.53 Receipt of information concerning practitioner.

The Section supports the re-write of what is now subsection (a) because it eliminates a redundancy in the current version of subsection (a) by requiring simply that any officer or employee of the Service who has reason to believe a violation has occurred must make a written report of such violation to the Director.

The proposed amendments to subsection (b) could be re-written to enhance the clarity of the provision. As currently drafted, amended subsection (b) permits people other than officers or employees of the Service to report an alleged violation and then requires any officer or employee who receives such a report to make a written report to the Director. There does not seem to be any need for the provision to contain a permissive phrase simply allowing other people to report violations to Service employees or officers. Further, the requirement that an employee or officer who receives such a report must make a written report to the Director is redundant because subsection (a) already requires any officer or employee who has reason to believe of a violation to make a written report. If an officer or employee receives a credible report of an alleged violation from another person, it seems logical that the report would provide the officer or employee with reason to believe, within the meaning of subsection (a), that such a violation has occurred, thereby creating an obligation to make a written report. If it is necessary to emphasize that information received from another person can constitute reason to believe that a violation has occurred, then the provision could be re-written as follows:

(b) Information from other persons. An officer or employee of the Internal Revenue Service who receives credible information from another person indicating that the provision of this part may have been violated has reason to believe that such a violation has occurred and must make a written report to the Director.

Further, the Section believes that practitioners should be notified when they are reported for possible violations of Circular 230. Even in cases in which the Director of Practice determines that no further action is warranted, but decides to retain the report in case additional reports are received regarding the same practitioner, due process considerations entitle the practitioner to notice and an opportunity to respond contemporaneously, before memories dim or relevant documents are lost or discarded. Indeed, in appropriate circumstances, the Director of Practice might even request the practitioner to submit a response in a “no action” case for just these reasons. However, the Section also recognizes that the resources available to the Director of Practice are limited. For these reasons, the Section believes that notification of a practitioner

of reported violation is not warranted if the Director of Practice concludes that no further action should be taken.

Consistent with these considerations, the Section recommends that a sentence be added to the end of section 10.53 which provides as follows:

In any case in which the Director of Practice receives any such report, the Director shall either (1) determine that the report warrants no further action and immediately destroy the report and all documentation or records relating thereto or (2) notify the practitioner of the nature of the claimed violation and, if appropriate, request the practitioner to submit a preliminary response.

Subpart D. Rules Applicable To Disciplinary Proceedings.

Circular 230 fails to prescribe any standard of proof for the Administrative Law Judge to apply in making determinations. The gravity of disciplinary charges warrants that the Director of Practice be held to a standard of proof higher than preponderance of the evidence. As is common in other disciplinary proceedings, a determination that a respondent has violated standards of conduct should be made only upon a showing by “clear and convincing evidence.” See In re Medrano, 956 F.2d 101 (5th Cir. 1992); Calvert v. California State Bar, 819 P.2d 424 (Cal. 1991); In re Jenkins, 816 P.2d 335 (Idaho 1991).

Further, Circular 230 does not contain any provisions for discovery by a practitioner who is involved in a disciplinary proceeding. The proposed amendments to section 10.64(b) realistically contemplate the circumstances in which a practitioner is not fully aware of the allegations against him or her. Although section 10.20(b) enunciates a practitioner's duty to produce information requested by the Director of Practice, Circular 230 provides no rules for governing a respondent's access to information held by the Director or others on which the Director based a determination of a violation under section 10.60.

A respondent should be entitled to obtain all evidence against him or her. Section 10.20(b) requires a practitioner to produce information to the Director. This requirement should be balanced with a provision for disclosure by the Director of Practice to the practitioner. Subpart D of Circular 230 should explicitly state that no evidence may be admitted in the proceeding for censure, suspension or disbarment (or disqualification of an appraiser) that has not been first produced to the respondent. The new provision should also provide a time frame, e.g., 30 days after the answer has been filed, within which the evidence must be produced. Production should be comprehensive and made without specific request for it.

Finally, Circular 230 does not prescribe any limitation on the period within which the Director must bring charges. A violation of the standards of conduct should be determined and prosecuted within a reasonable period of time after the conduct has been discovered. For example, the Director of Practice could be required to determine that a violation of the standards of Circular 230 has occurred for purposes of section 10.60 within one year of learning of the occurrence. Further, the Director of Practice could be required to institute a proceeding pursuant

to section 10.62 within a specific period, for example, 90 days of the determination, absent a consent to extend the period by the practitioner.

Section 10.60. Institution of Proceedings.

Section 10.60(a) provides for a public censure. See our comments to section 10.50 for comments regarding the Director's authority to impose this new sanction. A censure should not be imposed without administrative due process or a practitioner's offer of consent to the censure. Apparently the censure would not affect a practitioner's eligibility to practice before the IRS. As stated above, the Section supports this proposal. It is consistent with what a number of state bars provide and could prove beneficial to a practitioner who would prefer a censure to a much more harsh suspension. The fact that it is public also works to the benefit to the tax system in situations where an appropriate disposition of a matter should be something more than a private reprimand but not serious enough for a suspension. However, as discussed above, the Section believes that statutory authorization for this proposed new sanction should be obtained.

Section 10.61. Conferences.

The proposed amendment to section 10.61(b) provides the opportunity for a practitioner to offer his or her consent to a voluntary censure, suspension or disbarment. The current regulations do not. The section 10.61(b) heading should be changed to include the word "disbarment." In addition, the same section provides for a practitioner to offer his or her consent to voluntary censure, suspension or disbarment or to "resign, as the case may be." The resignation portion appears deficient in two respects. First, it does not contemplate an offer of resignation, although any proposed resignation must be accepted by the Service, which implies that a practitioner can only offer to resign. Second, the proposal uses the phrase "as the case may be." This is a perplexing phrase and may indicate that resignation is available to all practitioners when, in fact, it only should be available to enrolled agents and enrolled actuaries. Both problems can be clarified by modest changes to the language.

Section 10.72. Evidence.

The proposed amendments to section 10.72 modifies the rule of admissible evidence seemingly to give the Administrative Law Judge discretion to receive evidence that is not relevant. ("However, the Administrative Law Judge 'may' exclude evidence that is irrelevant."). Using "may exclude" instead of "shall exclude" is inconsistent with section 10.70(b)(5). It is not clear why irrelevant evidence should be received in a sanctions proceeding. Further, section 10.72 permits hearsay to be received as evidence.

The "shall" standard of the currently effective Circular 230 should be adhered to. There is little sense in permitting irrelevant evidence into the record. Admission of irrelevant evidence is prejudicial to a respondent because in these circumstances the Administrative Law Judge has not ruled on evidence he or she believes needs to be rebutted by the respondent. Thus, the accused has no way of knowing what evidence the Administrative Law Judge thinks is relevant to the charges against the respondent, complicating the presentation of the defense and, at best, wasting time and resources.

The admission of hearsay to prove a violation of the rules of conduct also seems to lack a sound basis and is particularly unsound when the proceeding has at stake the livelihood of the respondent. The hearsay rules are designed to limit the admission of untrustworthy evidence and should be adopted in some form that assures a respondent a fair hearing and entitlement to confront accusers and cross-examine witnesses. For example, an affidavit is hearsay. The rules as drafted could preclude a respondent from cross-examining a witness who testified by way of an affidavit. Admitting hearsay could deprive the respondent of due process.

Section 10.77. Appeal to Secretary.

Section 10.77 provides that “notice of appeal must include exceptions to the decision of the Administrative Law Judge and supporting reasons for such exceptions.” A “notice of appeal” should be a procedural step, not a substantive one. Although supporting reasons for the appeal obviously should be disclosed early in the process, inclusion of such information in a notice of appeal should not be required.