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Guest Article

Circular 230 Modifications Go Into Effect

By Jeffrey A. Baskies

The December 2004 and May 2005 modifications and clarifications to Circular 230 became effective on June 20, 2005. Circular 230, which establishes the standards of practice before the Internal Revenue Service, was first published in 1921. As a result of perceived tax shelter abuses, the IRS has significantly revised its standards of practice. Unfortunately, in an effort to deal with undoubtedly real problems, the Service may have thrown legitimate estate planning advice out with the bath water.

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While most of the provisions of Circular 230 seem easily avoided by the average attorney offering ordinary tax advice, there are concerns that certain advice (regarding tax savings techniques as ordinary as Irrevocable Life Insurance Trusts, QPRTs, GRATs and sales to grantor defective trusts) may be subject to the restrictions of Circular 230. Bottom line: if you offer any tax or estate planning advice to clients, you need to familiarize yourself with Circular 230.

Dramatic Impact

If you regularly offer tax opinions you must read Circular 230 in its entirety, as it will dramatically impact your practice.

For those of us who offer tax and estate planning services, but don't often provide opinion letters, I suggest an article by Steve Akers of Bessemer Trust entitled "IRS Guidance Regarding Circular 230 - Effect on Estate Planning Practitioners" published by Leimberg Services. It offers a very detailed summary of the December 2004 final regulations and the May 2005 revisions to those regulations. This article will try to summarize the key issues in a shorter format, but cannot replace your own diligence in investigating the new requirements.

First, note that Circular 230 has both aspirational best practices applicable to all tax advisers (found in Sect. 10.33) and mandatory practices and standards for "covered opinions" (more below). The aspirational best practices are important, but it's the mandatory practices that create the real headaches, as failure to comply can lead to sanctions including: penalties, censure,

suspension or disbarment from practicing before the IRS.

Second, note that the mandatory standards apply to *written advice*. Things you say to a client in a meeting will not be held against you. But any advice you put in writing may come back to bite you. Further, note that written advice specifically includes written electronic communications - which covers e-mail.

Third, the mandatory standards apply to written advice regarding "covered opinions." (Sect. 10.35). The original drafts of Circular 230 talked in terms of written advice regarding "tax shelters," but the final version addresses "covered opinions," which is intentionally more open-ended.

Fourth, "covered opinions" are defined as written advice concerning one or more "federal tax issues" (which is broad enough to include estate planning) arising from:

- A listed transaction - which is a transaction listed by the IRS and identified as a forbidden tax shelter.

- A plan or arrangement where avoidance or evasion of tax is the principal purpose of the transaction (a principal purpose is generally defined as a plan where tax savings exceeds any other purpose).

As Akers notes in his article, the revised rules (May 18, 2005) seem to clarify that discussions about standard planning techniques such as credit shelter trusts, charitable trusts, etc. would not be subject to the principal purpose test as they are principally for wealth transfer planning. However, some commentators are questioning whether discussions of GRATs, ILITs, FLPs and other techniques that are not specifically mentioned in the regulations might be subject to this test. For example, as Akers notes, in one ILIT case (*Christophani*), the IRS argued that Crummey powers should be ignored as their principal purpose was tax avoidance. And in several FLP cases (*Bongard* and *Bigelow*), the IRS argued that discounts should be ignored because the principal purpose of the FLP was avoiding or reducing transfer taxes.

Because of this uncertainty in the estate planning community, we must hope that the IRS provides some clarification. In my opinion, the more logical argument is that most estate planning is principally done in the context of wealth transfer - albeit in a form designed to be optimally tax efficient. However, if an opinion does qualify as "principal purpose" advice, then it is a covered opinion requiring all the things enumerated below, and you cannot avoid these elements by offering a disclaimer notice.

- A plan or arrangement where avoidance or evasion of tax is a significant purpose and the written advice is:

(a) a marketed opinion (I assume most of us are not offering opinions to folks to go out and market them);

(b) subject to conditions of confidentiality (I assume we don't often make clients sign these);

(c) subject to contractual protection - if, for example, the taxpayer has a right to a refund if the intended tax consequences are not achieved or if fees are contingent on realization of a tax benefit from the transaction. This provision might be relevant to some of us who have based fees on issues like successful audits of estate tax returns; or

(d) a reliance opinion, which is written advice that concludes at a confidence level of "at least more likely than not" that one or more significant tax issues would be resolved in the taxpayer's favor. However, written advice will not be treated as a reliance opinion if it has a "prominently disclosed" disclaimer that it was not written to be used and cannot be used for the purpose of

avoiding penalties. This disclaimer is a very important concept and something all estate planners should consider adopting (see discussion below). But the disclaimer *only* frees you from the requirements for covered opinions *if* it relates to a reliance opinion.

Unless the commentators warning that estate planning advice falls under the principal purpose test are right, the most important issue for most of us will likely be reliance opinions. While most planners rarely bother to say that an opinion in a writing is "more likely than not" to work, there is a general concern among many practitioners that written advice that summarizes the tax effects of a transaction might be deemed to implicitly carry a "more likely than not" conclusion.

Given this concern, and in an effort not to have to comply with the mandatory requirements for covered opinions, estate planners should consider adopting a standard disclaimer to apply to written advice - e-mails and letters. To comply, the disclaimer must be "prominently disclosed." Prominent disclosure previously meant it had to be at the beginning and in larger type, but now is interpreted as meaning the disclaimer must be in a separate section - not in a footnote - and in the same size or larger typeface than the rest of the advice. There's an open question as to whether putting the disclaimer at the end of an e-mail is equivalent to a footnote and thus not sufficient.

What Goes Into A Covered Opinion

For a covered opinion where a disclaimer won't suffice, Sect. 10.35 provides strict standards that the writing must meet, including:

- You must use reasonable efforts to ascertain the facts - you can't just rely on the client;

- You cannot base your opinion on any unreasonable factual assumptions or representations;

- Your opinion must outline the applicable law (including all potentially applicable judicial doctrines) and may not assume the favorable resolution of any significant tax issue (except for limited scope opinions - these are discussed more fully in the regulations and in the Akers outline, if you are interested);

- You must evaluate all "significant federal tax issues" and reach a conclusion based on the facts and the law as to the likelihood that the taxpayer will prevail on the merits with respect to each issue;

- If there is any issue where you cannot say the client is more likely than not to prevail, then you must state that and have a banner in your written advice saying that the opinion could not reach "more likely than not" on all issues; and

- Your evaluation of "significant federal tax issues" must not consider the possibility that a return will not be audited, that an issue will not be raised on audit, or, if it is, that the issue will likely be settled.

Assuming you don't want to do all of these things for all of your writings to clients, it is important not to give covered opinions.

General Standard For Written Advice

There is also a provision that sets forth general standards for all written advice even if it's not a covered opinion (Sect. 10.37), which has not received much attention - perhaps because it is not completely new. But in all cases, you cannot provide written advice if you: (1) base it on unreasonable factual or legal assumptions; (2) unreasonably rely on representations of the taxpayer or others; (3) fail to consider relevant facts (that's a hard one because you may not realize what you failed to consider); or (4) take into account the possibility that a tax return won't

be audited, that an issue won't be raised on audit or that it will be settled. This applies to all written advice, so you may not in any written communications refer to the "audit lottery" or any sort of settlement considerations.

Suggestions For Planners

You need determine whether the advice you are giving is "principal purpose" in nature, and if so, how you will comply with the rules for covered opinions. Remember that if you are giving written advice subject to the principal purpose test, you cannot avoid the covered opinion requirements by a disclaimer.

Given that disclaimers only work for reliance opinions, it is important that you know when you are giving reliance opinions and if you want to disclaim reliance thereon. It may seem weird to tell clients they cannot rely on your advice - what are they paying for then? - but unless you disclaim, you are offering a "covered opinion" and must comply with all that goes with that, which could require quadrupling your fee! In addition, while clients cannot rely on a disclaimed opinion to avoid penalties, they may still rely on your opinions for professional malpractice purposes.

Since it is possible that the opinions we offer could be perceived as reliance opinions without that being our intention, consider some standard language in planning letters and e-mails. Here's a suggestion:

Notice: Please note the opinions expressed herein are not intended or written to constitute either a "covered opinion" or a "reliance opinion" under applicable Treasury Regulations or Circular 230 governing practice before the IRS. The opinions expressed herein are not intended or written to be used, and may not be used or relied upon by the recipient, for the purpose of avoiding penalties that may be imposed by the Internal Revenue Service.

It is also arguably possible a paralegal or secretary could wind up transmitting tax advice ("Dear client, Jeff said he wanted me to modify the form 706 as follows because..."). As a result, you may want to consider including disclaimer notices in correspondences they create as well.

A final note - any opinions herein are not intended or written to be used, nor may they be relied upon by the readers, to avoid penalties being imposed by the IRS! But if you have ideas on how to deal with Circular 230 and disclaimers in particular, please feel free to e-mail me and offer your ideas and comments.

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