New York State Bar Association

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July 25, 2001

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Mr. David G. Harris
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Washington, D.C. 20024

Re: *New York State Bar Association Tax Section Report 995 on Proposed Modifications to Circular No. 230*

Dear Mr. McDonough, Commissioner Rossotti, Acting Chief Counsel Skillman, Assistant Secretary Weinberger and Mr. Harris:

FORMER CHAIRS OF SECTION:

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I am pleased to enclose New York State Bar Association Tax Section Report No. 995 commenting on the proposed revisions to Circular No. 230, released January 12, 2001.

We commend Treasury on the proposed revisions, believing them an important project well worth the resources and time devoted to the effort. We believe the proposed revisions would significantly improve Circular 230. One of the major revisions expands the rules governing tax shelter opinions to cover all opinions that provide a more likely than not or higher degree of assurance, whether or not the opinion is used to market the tax shelter. The current rules apply only to tax shelter opinions used in marketing a tax shelter. The revisions also would significantly amend the specific rules applicable to tax shelter opinions. We support these proposals to enhance the multi-prong attack on tax shelters, that we support.

The main points made in the attached Report may be summarized as follows:

1. Section 10.20: Information to be furnished

Section 10.20(a) should not be revised to require the practitioner to provide the Service with any information the practitioner or the client has regarding the identity of any person who may have possession or control of records or information the Service has requested. The proposal is vague and over-broad, may place an unreasonable burden on a practitioner who attempts in good-faith to fully comply and may conflict with ethical guidelines or violate disciplinary rules promulgated by other bodies governing professional conduct, such as the American Bar Association and governing state bars.

2. Section 10.21: Knowledge of client's omission

Section 10.21 should not be revised to require a practitioner, who learns that a client previously has made an error in or omission from a return or other document, to advise the client as to how the error may be corrected and the possible consequences of not correcting the error. Providing the mandated advice under these circumstances often would violate the practitioner's professional obligation to not provide advice the practitioner is not competent to provide.

While we think Circular 230 should not require the practitioner to provide advice regarding the error, we would not object if Circular 230

obligated the practitioner to advise the client that he or she should seek advice as to what should be done to correct the error and minimize any potential negative consequences.

3. Section 10.22: Diligence as to accuracy

Section 10.22 should be revised to (1) clarify the references to the "Internal Revenue Service" and the "Department of the Treasury" and to "Internal Revenue Service matters" and "matter[s] administered by the Internal Revenue Service;" and (2) incorporate into Section 10.22 the standard of due diligence as to factual accuracy set forth in the regulations under Code Sections 6694 and 6695. This confusion could be resolved by referring throughout Circular 230 to either the Service or Treasury Department and providing in the Section 0.2 definitions that the term refers to both the Internal Revenue Service and all other divisions of the Treasury Department.

4. Section 10.26: Notaries

Section 10.26 should be revised to remove the ban prohibiting practitioners from acting as notaries public in connection with matters for which they are employed as counsel, attorney or agent. This rule is unnecessary and unduly penalizes and inconveniences practitioners and taxpayers.

5. Section 10.27(b): Contingent fees

We applaud the changes contained in Proposed Section 10.27(b) regarding prohibitions on contingent fees and the definition of contingent fees. We suggest that Section 10.27(b) be revised to: (1) permit a contingent fee to be charged for *any* amended return or refund claim (by removing the requirement that the practitioner reasonably believe the amended return or refund claim will receive substantial review by the Service); (2) clarify that Section 10.27(b) does not prohibit charging a contingent fee for any other services not specifically addressed, such as representing a taxpayer in an audit or in filing a request for a private letter ruling; add a targeted anti-avoidance rule to prohibit specified abuses; (3) clarify that Section 10.27(b) applies without regard to whether the person paying the contingent fee to the practitioner is the actual "taxpayer;" (4) clarify that a fee would *not* be a "contingent fee" solely because it is based upon the amount of the tax liability or refund shown on a return or refund claim or because the practitioner employs a "value billing" method where the amount of the fee is based upon the practitioner's assessment of the

value of his or her work to the taxpayer, rather than upon the precise numbers of hours worked; and (5) add an anti-abuse rule to prevent practitioners from circumventing the prohibition on charging a contingent fee for preparing an original return by taking advantage of the right to charge a contingent fee in connection with an amended return, audit or assertion of a deficiency.

6. Section 10.28: Return of client's records

Proposed Section 10.28 should not be adopted because a practitioner should be able to exercise rights granted under state law to assert an attorney's lien on a client's records to enforce collection of an unpaid fee.

7. Section 10.29: Conflicting Interests

Section 10.29 should be clarified to: (1) specify that a "potential conflict" is limited to a divergence in the parties' economic interests the practitioner knows or has reason to know exists currently or is likely to develop in the near future; (2) provide guidance as to the extent and manner of the required disclosure of a conflict between two clients and the precise form and content of the waiver; (3) add illustrations of when representation of a client may be limited by a practitioner's own interests; and (4) describe how a practitioner could disclose the risks and reasonably determine that the representation will not be adversely affected.

8. Sections 10.33 and 10.35: Tax shelter opinions

We believe it would be extremely valuable if the rules on tax shelter opinions began by stating the guiding principles and goals of these sections. We also suggest the disciplinary provisions of Circular 230 specifically provide that these principles and goals be taken into account in determining whether a practitioner who has violated Circular 230 should be sanctioned and, if so, what the sanction should be.

The proposed definition of "tax shelter opinion" definition is problematic because it seems to encompass *any written advice* addressing any aspect of an actual or contemplated tax shelter. We propose four solutions to this problem and, after evaluating the benefits and detriments of each, we recommend you adopt what we call the "Opt-in Statement" approach, whereby Section 10.35 will apply to any written advice, unless the advice includes a statement that it is not intended to be used for penalty protection purposes.

We also recommend clarifying when, if ever, a marketing opinion may provide penalty protection under Code Sections 6662 and 6664; requiring a Section 10.35 opinion that will not qualify for penalty protection to include a statement to that effect (like that required in Section 10.33 opinions by Proposed Section 10.33(a)(5)(iii)); and requiring a Section 10.35 marketing opinion to state on its first page that whether the conclusions reached in the opinion will apply to any specific taxpayer will depend upon the facts and circumstances of the specific taxpayer. If it will be the case that an opinion must comply with Section 10.35 to provide a taxpayer with a reasonable cause/good faith defense, a Section 10.35 opinion should also be required to state that.

We recommend you clarify: (1) Section 10.33 does not apply where a practitioner does not know or have reason to believe (after adequate inquiry) that the practitioner's review of the offering materials will be referred to in the marketing of the transaction; (2) what the practitioner's obligations are with respect to insuring that any opinion covered by Section 10.33 is described accurately and completely in the marketing of the transaction and how those obligations may be satisfied; (3) what the practitioner's obligations are if the practitioner's firm is referred to in the offering materials because it provided non-tax advice on the transaction; and (4) what the practitioner's obligations are if he or she learns after marketing has been completed that his or her tax advice has been misrepresented. Also, Section 10.33 should cover opinions used for marketing, even where marketing is done by the person who issued the opinion or a member of the same firm.

We suggest a modified definition of a "tax shelter item" and a "material Federal tax issue" and that you clarify certain aspects of the requirements relating to the substantive analysis that must be included in the tax opinion, including whether an opinion subject to Section 10.33 or 10.35 must address all aspects of all tax shelter items of the taxpayer generated by the tax shelter.

Both 10.33 and 10.35 opinions should be required to briefly describe the tax shelter disclosure, registration and list-keeping requirements under the Code Section 6011, 6111 and 6112 regulations and to discuss whether those requirements apply to the transaction, but should not be required to reach an overall conclusion.

A tax shelter opinion subject to Section 10.33 or 10.35 should be required to list all relevant agreements and other documents reviewed by the practitioner.

Proposed Sections 10.33 and 10.35 also should be clarified to clarify that an opinion may discuss alternative theories for one or more of its conclusions, provided the requirements of Section 10.33 or 10.35 have been satisfied relying on one consistent theory. Similarly, if material facts are uncertain and more than one factual scenario is reasonably possible, an opinion should be allowed to include analysis and conclusions as to each reasonable factual scenario.

9. Reliance on Opinions of Others

We suggest the rules allowing a practitioner to rely, in part, upon an opinion of another practitioner be clarified.

10. Format and Clarity of Regulations

We recommend Proposed Sections 10.33 and 10.35 be combined into a single section because the majority of the two sections are identical and it will be easier for practitioners to become familiar with and apply the rules if they can refer to one set of rules applicable to all Section 10.33 and 10.35 opinions and then to separate sub-rules for each of the two sections where applicable.

11. Effective Date of Proposed Sections 10.33 and 10.35.

It is not clear whether Proposed Sections 10.33 and 10.35 are intended to apply only to opinions issued after the regulations are finalized, or whether they also would apply to marketing opinions issued before that date but used in marketing after that date. We believe the rules should apply only to opinions issued after that date.

12. Sanctions for Violations and Rules for Disciplinary Proceedings

We believe there are a number of apparent inconsistencies and potential problems in the Proposed Rules relating to sanctions for violations and the rules for disciplinary proceedings, Sections 10.50 through Section 10.82. While recognize these provisions are, for the most part, taken from the current version of Circular 230 with few changes, we believe the enforcement provisions to be an extremely important and often overlooked aspect of Circular 230 and that revising them will, among other things, increase voluntary compliance.

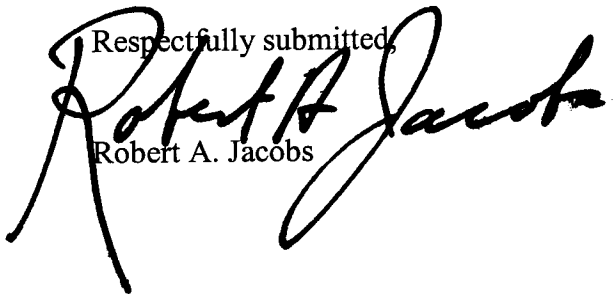
Our recommendations include: (1) clarifying under Sections 10.50, 10.51 and 10.52 what conduct subjects a practitioner to sanctions; (2)

clarifying what a "reprimand" under Section 10.60 is and addressing the due process issues raised by the current lack of any procedural rules with respect to reprimand; (3) publicizing descriptions of sanctions issued and the behavior that gave rise to the sanctions (this will provide practitioners with tangible evidence and a periodic reminder that violations will have unfavorable consequences and will assist practitioners in developing a clearer understanding of the types of conduct that are improper); and (4) adding some general guidelines or standards as to what types of behavior warrant which sanction and what the general terms of the sanction should be (so that there is some consistency in the enforcement of Circular 230 and some guidance to ALJ's in ruling on violations of Circular 230).

13. <u>Confidentiality Agreements</u>

Confidentiality agreements should not be addressed in Circular 230 because these agreements raises issues that are within the venue of the bodies governing the professions.

Respectfully submitted,



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