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New York State Bar Association

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March 3, 2005

Mr. Eric Solomon
Acting Deputy Assistant Secretary (Tax Policy)
Department of the Treasury
Room 3104 MT
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

The Honorable Mark W. Everson
Commissioner
Internal Revenue Service
Room 3000 IR
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Dear Acting Assistant Secretary Solomon and Commissioner Everson:

I am pleased to submit the New York State Bar Association Tax Section's Report No. 1081 on regulations governing practice before the Internal Revenue Service (the "Service") that were published in December of last year (the "December Circular 230 Regulations"). The December Circular 230 Regulations are intended to bolster the Treasury's efforts to combat tax shelters and enhance public confidence in the honesty and integrity of tax professionals. As you know, we strongly support these objectives.

In the report on this subject that we submitted in March of last year in response to prior proposed regulations (our "Prior Report"), we recommended an approach (the "opt-in" approach) under which a taxpayer could rely on written advice as reasonable cause and good faith for taking a tax position (and thus mitigate the risk of imposition of penalties if the IRS disagreed with the substantive position) if, but only if, the advice contained a legend stating that it was intended for this purpose. (We assumed the IRS

would revise the regulations under Section 6664 to make this clear and would broadly publicize these revisions.) Written advice would have to include a detailed and comprehensive analysis meeting all of the requirements of Section 10.35 of the relevant regulations if, but only if, it contained such a legend.

We noted in our Prior Report, however, that a significant minority of us favored an "opt-out" approach under which *all* written advice would have to include a detailed and comprehensive analysis complying with the rules of Section 10.35, unless it contained a legend warning taxpayers that it did *not* provide penalty protection. The December Circular 230 Regulations have generally adopted such an "opt-out" approach, and we appreciate your consideration of ours' and others' views in providing this "opt-out" alternative.

Upon deeper reflection, however, and for the reasons set out below, we now firmly believe that such an "opt-out" approach is neither desirable nor practical when applied to most forms of ongoing written communications that taxpayers receive from tax advisors (other than "marketed opinions" and advice with respect to "listed transactions"). We therefore reiterate our recommendation that you adopt an "opt-in" approach, but we reverse ourselves with respect to any impression we may have left that we think an "opt-out" approach would be a feasible general alternative. With all due apologies, we hope that you will carefully consider our reasoning, because our views in this regard are nearly unanimous. If you find our reasoning persuasive, we hope you will consider switching to an "opt-in" approach and apply an "opt-out" approach solely to marketing opinions and advice with respect to listed transactions.

If you are not prepared to switch to an "opt-in" approach generally, we hope you will at least carefully consider the concerns expressed in this report and modify the December Circular 230 Regulations to deal more adequately with routine ongoing written communications and advice. While the current regulations are targeted at tax shelter advice, most written tax advice does not fit that mold. Taxpayers seek tax advice in a myriad of circumstances, often to enhance compliance with the tax law. Many of us advise sophisticated tax professionals in large departments of major corporations. Others of us advise individuals on the potential tax consequences of various personal transactions, including the purchase and sale of homes, the structuring or acceptance of deferred compensation arrangements, marriage and divorce, and the transmission of assets to members of their families during life and at death. In either case, our advice is rarely presented in the form of a single detailed memorandum with respect to a specific transaction that a client is considering entering into. Often it is provided in response to abstract legal questions concerning business, personal and structural circumstances that do not involve any proposed transaction. Sometimes it discusses the effect that various transactions might have on a client's tax position, but the transactions that are discussed rarely materialize

or materialize in entirely different forms. Moreover, we give all types of written advice at all stages of client decision making, ranging from quick e-mails to short memos to extensive memos to formal opinions to powerpoint presentations. We think the December Circular 230 Regulations as currently drafted are ill-suited to this vast bulk of tax practice. They would impede the ability of taxpayers to receive timely tax advice, and by effectively forcing practitioners to stamp a meaningless boilerplate on almost all written communications, they might ultimately undermine the objectives of Circular 230 as well.

We likewise hope you will rethink your position on advice with respect to transactions the principal purpose of which is tax avoidance. Under the December Circular 230 Regulations, there is no ability to opt-out of covered opinion status for such advice, nor may limited scope opinions be given with respect to such transactions. We do not think it is desirable or appropriate to *forbid* a lawyer from giving any written advice (other than a full-scale covered opinion) with respect to a transaction the principal purpose of which is tax avoidance. A client may want to know, for example, whether the *Castle Harbour* loss-generating transaction (or the *Cottage Savings* loss-generating transaction) that appears to have been blessed by a lower court really works, and it may be appropriate for a lawyer to respond "it depends" and to describe in writing the circumstances in which it might work (*e.g.*, if the taxpayer has a good business purpose) and how they relate to the client's circumstances without generating a lengthy opinion based on facts which must necessarily be invented because actual facts do not exist and the transaction is not likely to occur.

In any case, we do not think the distinction between "a significant purpose" and "the principal purpose" is coherent enough to bear the weight that the December Circular 230 Regulations place upon it. Is tax avoidance the principal purpose of the issuance of the contingent convertible debt obligations described in Rev. Rul. 2002-31? Moreover, the distinctions that the December Circular 230 Regulations already make among covered opinions, reliance opinions, marketed opinions and general advice are sufficiently complex. A further distinction between "a significant purpose" and "the principal purpose" would introduce a degree of analytic complexity into the calculus of a lawyer's obligations that would serve to obscure, rather than implement, the simple objectives of these regulations.

We recognize your concern about the opportunity that an opt-in system might provide to unscrupulous advisors to mislead taxpayers into thinking they had received an opinion that they had not in fact received. We also recognize that listed transactions are the most aggressive types of transactions and should be subject to special rules. We therefore recommend an exception to the opt-in system for marketed opinions (properly defined, as further discussed in our report) and for advice with respect to listed

transactions. Advice with respect to these transactions would have to comply with the requirements of Section 10.35 unless it effectively warned taxpayers that it did not provide penalty protection and that it might not reflect an unbiased view.

We appreciate your consideration of our recommendations, and we would be delighted to discuss them with you further. Please do not hesitate to call us or to request that we come down and visit you.

Respectfully submitted,

David P. Hariton
Chair

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