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Tax Law Update - New U.S. Treasury Tax Regulations Take Effect with Wide-ranging Implications

By Stephen A. Good

The U.S. Department of Treasury recently issued regulations known as "Circular 230" that apply not only to formal legal opinions concerning tax issues, but also any other written communication from an attorney or accountant to a client concerning federal tax matters. This includes e-mail. Consequently, the new regulations, which took effect June 21, 2005, promise to significantly impact client communications on federal tax issues.

When it issued Circular 230, the Department of Treasury said its objective was to "restore, promote and maintain the public's confidence in those individuals and firms" that provide tax advice. The failure by a tax practitioner, such as a tax lawyer or accountant, to comply with the requirements of Circular 230 may result in severe penalties. These include public censure, monetary fines and/or suspension or disbarment from practicing before the IRS. One nationally prominent tax practitioner and author observed the following in this regard:

[The Regulations] are an attempt by the [Internal Revenue] Service to balance concerns about overly aggressive advice provided by some practitioners who were involved in the promotion of abusive tax shelters on the one hand, and the potential imposition of burdensome requirements on the great majority of tax practitioners who never issued such opinions. In that light, the final Regulations can be viewed as a compromise, but one that leans more towards enforcement. Once again, the many will pay for the sins of a few.¹

Consequently, client experience when seeking counsel on federal tax matters will change in light of the new regulations. Tax lawyers and accountants agree that Circular 230 is likely to increase the cost of delivering written materials discussing tax issues to clients. Moreover, the costs of complying with the requirements imposed by Circular 230 are sufficiently burdensome that the cost of compliance will likely be justified only in instances where the client desires or requires the most formal tax opinion.

To illustrate, there are now detailed requirements tax practitioners must follow when providing a "covered opinion." The pertinent requirements include the following:

- the practitioner must make reasonable efforts to identify and ascertain all relevant facts and may not base the opinion on any "unreasonable factual assumption";
- the practitioner must relate the applicable law – including "any potentially applicable judicial doctrine" – to the relevant facts;
- with limited exceptions, the opinion must consider all "significant" federal tax issues and reach a conclusion as to the likelihood that the taxpayer will prevail on the merits on each such issue (or if a conclusion cannot be reached, the opinion must so state);

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¹ Lipton, Richard M., "The World Changes: Broad Sweep of New Tax Shelter Rules in AJCA and Circular 230 Affect Everyone," *Journal of Taxation* (March 2005).

- the practitioner must reach an “overall conclusion” as to the likelihood that the stated federal tax treatment of the arrangement or transaction is the proper treatment and set forth the reasons for that conclusion; and
- if any one of a number of conditions apply to the opinion, the practitioner must “prominently disclose” those conditions.

While there are several categories of covered opinions that generally do not apply to the tax practice maintained by Fennemore Craig, what constitutes a covered opinion is very broad. It may include any written communication or e-mail that (i) addresses a federal tax issue; (ii) reaches a conclusion favorable to the taxpayer at any confidence level; and (iii) is intended to be relied upon by the taxpayer to avoid penalties.

Tax practitioners can provide certain types of written communication on tax issues without complying with the extensive requirements of Circular 230 if the written communication includes a statement that the advice given may not be relied upon by the taxpayer to avoid penalties. Consequently, clients of Fennemore Craig can expect to see certain “reliance disclaimers” in various communications from the firm, including e-mail messages. It is anticipated that most written communications from Fennemore Craig attorneys that address federal tax issues will also include the “reliance disclaimer” unless there is an agreement between the firm and the client as to the need for an opinion that satisfies the requirements of Circular 230.

We intend to continue providing the highest quality legal services to our clients in a cost-effective manner within the framework of these challenging new rules. Please call us if you have any questions about Circular 230.

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