

July 31, 2000

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

Jonathan Talisman, Esq.  
Acting Assistant Secretary (Tax Policy)  
Treasury Department, Room 1330 MT  
1500 Pennsylvania Avenue, N.W.  
Washington, D.C. 20220

Re: Revisions to Circular No. 230

Dear Commissioner Rossotti and Mr. Talisman:

I am pleased to enclose a report of the New York State Bar Association Tax Section<sup>1</sup> responding to the request of the Department of the Treasury and the Internal Revenue Service for comments relating to possible revisions to Circular No. 230 dealing with standards of practice applicable to tax shelter transactions (REG-111835-99). Our comments relate, in particular, to the standards of practice that govern the rendering of opinions by tax advisors in connection with tax shelter transactions.

As a preliminary matter, the Tax Section is on record as supporting a “strict liability” standard for the imposition of penalties in

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<sup>1</sup> The principal drafter of the enclosed report was Steven C. Todrys, a former Chair of the Tax Section.

connection with underpayments attributable to tax shelter transactions. Adopting strict liability would eliminate taxpayers' reliance on opinions ("reasonable cause opinions") of tax advisors as a basis for invoking the "reasonable cause" exception currently available as a defense to accuracy-related penalties. The elimination of the demand for reasonable cause opinions would substantially reduce the need to adopt standards of practice governing tax shelter opinions.

Nonetheless, assuming that the reasonable cause exception is retained, we believe that the standards of practice for reasonable cause opinions should conform to the substantive law requirements for the exception, and that the substantive requirements should be strengthened. In particular:

1. A reasonable cause opinion should state that it is being provided for purposes of the reasonable cause exception.
2. A reasonable cause opinion should address and opine on the applicability of judicial, statutory and regulatory doctrines that could apply to the tax shelter transaction, such as the business purpose, step transaction, economic substance, substance over form, clear reflection of income and sham transaction doctrines.
3. The practitioner rendering a reasonable cause opinion should undertake an adequate factual inquiry (which may rely, in proper cases, on certificates of the taxpayer), including an inquiry into the business purpose and non-tax economic consequences of the proposed transaction.

We also address standards for opinions and memoranda that tax advisors may provide promoters as marketing material for tax shelters ("marketing opinions"). Marketing opinions differ from reasonable cause opinions in that they (i) are not directed to a particular taxpayer and, therefore, cannot address the facts and circumstances applicable to that taxpayer and (ii) are often limited to specific technical legal issues. As a

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result, it is more difficult to develop standards of practice that should apply to marketing opinions. We recommend:

1. A marketing opinion should state that a taxpayer cannot rely on it for purposes of the reasonable cause exception.
2. A marketing opinion should address all material tax aspects of the proposed transaction, including the judicial, statutory and regulatory doctrines that are required to be addressed in a reasonable cause opinion (as noted above).
3. A marketing opinion should be based on a detailed set of hypothetical facts upon which the tax advisor would be willing to opine favorably.

We also discuss certain issues relating to contingent fees, confidentiality and sanctions.

We continue to believe that abusive tax shelter activity can be addressed only through material economic disincentives, such as meaningful penalties, and that it is not likely that changes in the standards of practice under Circular No. 230 will have a significant impact on tax shelter activity. However, raising the standards for opinion practice would help to reinforce the obligation that practitioners have to assess fully and objectively the tax consequences of tax shelter transactions, thereby making it less likely that taxpayers will enter into (or that promoters will market) transactions whose legal basis is weak.

Sincerely,

Robert H. Scarborough

Enclosure

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cc: Eric Solomon, Esq.  
Acting Deputy Assistant Secretary (Tax Policy)  
Treasury Department

Joseph M. Mikrut, Esq.  
Tax Legislative Counsel  
Treasury Department

The Hon. Stuart L. Brown  
Chief Counsel  
Internal Revenue Service

Richard W. Skillman, Esq.  
Deputy Chief Counsel – Technical  
Internal Revenue Service

Patrick W. McDonough, Esq.  
Director of Practice  
Internal Revenue Service

Michael E. Shaheen, Esq.  
Special Counsel to the Commissioner  
Internal Revenue Service

CC:DOM:CORP:R (REG-111835-99)  
Internal Revenue Service