

**Background**

Section 330 of title 31 of the United States Code authorizes the Secretary of the Treasury to regulate practice before the Treasury Department. The Secretary has published the regulations in Circular 230 (31 CFR part 10). On December 20, 2004, the Treasury Department and the IRS published in the **Federal Register** (T.D. 9165, 2005-4 I.R.B. 357 [69 FR 75839]) final regulations (Final Regulations) applicable to written advice that is rendered after June 20, 2005. Since publication of the Final Regulations, Treasury and the IRS have received a number of comments highlighting areas where the language of the Final Regulations might have consequences inconsistent with their intent. Upon consideration of those comments, the Treasury Department and the IRS have made revisions to the Final Regulations, as described below, to clarify the language of the Final Regulations.

**Explanation of Provisions***Written Advice Issued After a Tax Return is Filed*

Commentators have expressed concern that advice given after a tax return is filed, in particular advice given in the context of an IRS examination or litigation, might constitute a covered opinion within the meaning of the Final Regulations. In response to this concern, the definition of *excluded advice* in §10.35 is expanded to include written advice prepared for and provided to a taxpayer, solely for use by that taxpayer, after the taxpayer has filed a tax return reflecting the tax benefits of the transaction described in or referred to in the written advice. This exclusion does not apply if the practitioner knows or has reason to know that the taxpayer will rely upon the written advice to take a position on a return (including an amended return that claims tax benefits not reported on the original return) filed after the date on which the advice is provided to the taxpayer.

Commentators have also expressed concern that written advice provided by in-house counsel to the employer for purposes of determining the employer's tax liability could constitute a covered opinion and that the concept of a covered opinion in that context raises numerous issues. In response to these concerns, the definition of *excluded advice* in §10.35 is expanded to include advice provided to an employer by a practitioner in that practitioner's capacity as an employee of that employer solely for purposes of determining the tax liability of the employer. Written advice provided by in-house counsel that falls within the revised definition of *excluded advice* will continue to be subject to the requirements set forth in §10.37 for other written advice. The exclusion of written advice provided by in-house counsel from the covered opinion standards of §10.35 is in no way intended to affect other aspects of the relationship between in-house counsel and the employer, such as whether, and in what circumstances, the attorney-client privilege applies to communications involving in-house counsel, or the circumstances in which written advice provided by in-house counsel might be relevant to determining the employer's good faith and reasonable cause.

*Negative Advice*

Several commentators have suggested that negative advice, *i.e.*, advice concluding that a Federal tax issue will not be resolved in the taxpayer's favor, could constitute a covered opinion. This concern is most prevalent (1) in the context of written advice relating to a listed transaction or a transaction having the principal purpose of tax avoidance and (2) where written advice addresses more than one Federal tax issue and the advice concludes that one or more Federal tax issues will not be resolved in the taxpayer's favor.

Treasury and the IRS encourage practitioners to advise taxpayers that a transaction is not appropriate or that one or more Federal tax issues will not be resolved in the taxpayer's favor. Treasury and the IRS

**Section 330 (31 USC).—Best Practices for Tax Advisors**

*31 CFR 10.35: Requirements for covered opinions.*

**T.D. 9201****DEPARTMENT OF THE TREASURY  
Office of the Secretary  
31 CFR Part 10****Regulations Governing Practice Before the Internal Revenue Service**

AGENCY: Office of the Secretary, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations revising the regulations governing practice before the Internal Revenue Service (Circular 230). These regulations affect individuals who practice before the Internal Revenue Service. These regulations clarify the standards for covered opinions.

DATES: *Effective Date:* These regulations are effective May 19, 2005.

*Applicability Date:* For dates of applicability, see §10.35(g).

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are concerned, however, about written advice that could be construed as encouraging taxpayers to take aggressive positions on their tax returns, such as advice that concludes one or more Federal tax issues will not be resolved in the taxpayer's favor, but also reaches a conclusion favorable to the taxpayer at any confidence level (e.g., not frivolous, realistic possibility of success, reasonable basis or substantial authority) with respect to that issue(s). Consequently, the regulations are revised to provide that written advice that concludes that a Federal tax issue will not be resolved in the taxpayer's favor is not a covered opinion with respect to that issue, unless the written advice also reaches a conclusion favorable to the taxpayer at any confidence level (e.g., not frivolous, realistic possibility of success, reasonable basis or substantial authority) with respect to that issue. If written advice concerns more than one Federal tax issue, the advice must comply with the requirements of §10.35(c) with respect to any Federal tax issue that is not treated as excluded advice pursuant to the preceding sentence.

#### *Prominently Disclosed*

Commentators have raised questions about how to apply the definition of *prominently disclosed* under §10.35(b)(8). The prominent disclosure requirement is intended to ensure transparency between taxpayers and practitioners and to provide taxpayers with notice of any limitation on their ability to rely on written advice. To achieve these goals while minimizing the burden of compliance on practitioners, these regulations modify the definition of prominently disclosed.

#### *Transactions with The Principal Purpose of Tax Avoidance or Evasion*

Commentators have asked for clarification of the term *the principal purpose* of tax avoidance or evasion and in particular have asked whether the definition in 26 CFR 1.6662-4(g)(2)(i) and (ii) is incorporated into §10.35. In response, these regulations define the principal purpose in §10.35(b)(10) similar to the definition in 26 CFR 1.6662-4(g)(2)(ii). This definition also provides that a transaction can be a listed transaction or can have a significant purpose of tax avoidance even if it lacks the principal purpose of tax avoid-

ance. Practitioners must evaluate transactions under the rules in §10.35(b)(2)(i)(A) and (C), even if those transactions are not covered by §10.35(b)(2)(i)(B) because they do not have the principal purpose of avoidance or evasion within the meaning of §10.35(b)(10) of these regulations.

#### **Special Analyses**

This final rule clarifies and narrows the application of final regulations published in the **Federal Register** on December 20, 2004 (69 FR 75839). Accordingly, pursuant to 5 U.S.C. 553(b)(B), there is good cause to issue this final rule without prior notice and opportunity for public comment, because such would be contrary to the public interest. For these same reasons, and because the previously published final regulations apply to written advice rendered after June 20, 2005, under 5 U.S.C. 553(d)(1) and (3) a delayed effective date is not required. This final rule is not a significant regulatory action for purposes of Executive Order 12866. Accordingly, a regulatory impact analysis is not required. Because no notice of proposed rulemaking is required, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply.

#### **Drafting Information**

The principal author of the regulations is Heather L. Dostaler of the Office of the Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division.

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#### **Adoption of Amendments to the Regulations**

Accordingly, 31 CFR part 10 is amended as follows:

#### **PART 10 — PRACTICE BEFORE THE INTERNAL REVENUE SERVICE**

Paragraph 1. The authority citation for 31 CFR part 10 continues to read as follows:

[Authority: Sec. 3, 23 Stat. 258, secs. 2-12, 60 Stat. 237 *et. seq.*; 5 U.S.C. 301, 500, 551-559; 31 U.S.C. 330, 118 Stat. 1418; Reorg. Plan No. 26 of 1950, 15 FR 4935, 64 Stat. 1280, 3 CFR, 1949-1953 Comp., P. 1017.]

Par. 2. Section 10.35 is amended by:

1. Revising paragraph (b)(2)(ii).
2. Revising paragraph (b)(8).
3. Adding paragraph (b)(10).

The additions and revisions read as follows:

#### *§10.35 Requirements for covered opinions.*

\* \* \* \* \*

- (b) \* \* \*
- (2) \* \* \*

(ii) *Excluded advice.* A covered opinion does not include—

(A) Written advice provided to a client during the course of an engagement if a practitioner is reasonably expected to provide subsequent written advice to the client that satisfies the requirements of this section;

(B) Written advice, other than advice described in paragraph (b)(2)(i)(A) of this section (concerning listed transactions) or paragraph (b)(2)(i)(B) of this section (concerning the principal purpose of avoidance or evasion) that—

- (1) Concerns the qualification of a qualified plan;
- (2) Is a *State or local bond opinion*; or
- (3) Is included in documents required to be filed with the Securities and Exchange Commission;

(C) Written advice prepared for and provided to a taxpayer, solely for use by that taxpayer, after the taxpayer has filed a tax return with the Internal Revenue Service reflecting the tax benefits of the transaction. The preceding sentence does not apply if the practitioner knows or has reason to know that the written advice will be relied upon by the taxpayer to take a position on a tax return (including for these purposes an amended return that claims tax benefits not reported on a previously filed return) filed after the date on which the advice is provided to the taxpayer;

(D) Written advice provided to an employer by a practitioner in that practitioner's capacity as an employee of that employer solely for purposes of determining the tax liability of the employer; or

(E) Written advice that does not resolve a Federal tax issue in the taxpayer's favor, unless the advice reaches a conclusion favorable to the taxpayer at any confidence level (e.g., not frivolous, realistic possibility of success, reasonable basis or substantial authority) with respect to that issue.

If written advice concerns more than one Federal tax issue, the advice must comply with the requirements of paragraph (c) of this section with respect to any Federal tax issue not described in the preceding sentence.

\* \* \* \* \*

(8) *Prominently disclosed.* An item is prominently disclosed if it is readily apparent to a reader of the written advice. Whether an item is readily apparent will depend on the facts and circumstances surrounding the written advice including, but not limited to, the sophistication of the taxpayer and the length of the written advice. At a minimum, to be prominently disclosed an item must be set forth in a separate section (and not in a footnote) in a typeface that is the same size or larger than the typeface of any discussion of the facts or law in the written advice.

\* \* \* \* \*

(10) *The principal purpose.* For purposes of this section, the principal purpose of a partnership or other entity, investment plan or arrangement, or other plan or arrangement is the avoidance or evasion of any tax imposed by the Internal Revenue Code if that purpose exceeds any other purpose. The principal purpose of a partnership or other entity, investment plan or arrangement, or other plan or arrangement is not to avoid or evade Federal tax if that partnership, entity, plan or arrangement has as its purpose the claiming of tax benefits in a manner consistent with the statute and Congressional purpose. A partnership, entity, plan or arrangement may have a significant purpose of avoidance or evasion even though it does not have the principal purpose of avoidance or evasion under this paragraph (b)(10).

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Mark E. Matthews,  
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Services and Enforcement,  
Internal Revenue Service.*

Approved May 12, 2005.

James W. Carroll,  
*Acting General Counsel,  
Department of the Treasury.*