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INTERNAL REVENUE SERVICE CIRCULAR 230: IMPLICATIONS FOR TAX ADVICE PROVIDED BY MORGAN LEWIS

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The U.S. Treasury and the Internal Revenue Service recently published regulations governing practice before the Internal Revenue Service, which are effective for written U.S. federal tax advice provided after June 20, 2005. These regulations are termed "Circular 230."

A Brief Summary of Circular 230

The effect of Circular 230 is far-reaching. Written tax advice that is considered a "covered opinion" must comply with numerous requirements. These provisions would require providers of U.S. federal tax advice to conduct extensive due diligence regarding the facts and assumptions underlying the transaction or arrangement (including assumptions as to future events and financial projections), and representations provided; to analyze not only applicable law but "potentially applicable judicial doctrines"; and generally not to assume the favorable resolution of any U.S. federal tax issue. Certain additional disclosures may be required to be made in connection with the tax advice.

In general, Circular 230 treats written tax advice, which may include an email, as a "covered opinion" if it concerns:

- a "listed transaction" (basically, a transaction identified on an Internal Revenue Service list of identified tax shelters) or a transaction that is substantially similar to a listed transaction;

- a partnership or other entity, an investment plan or arrangement, or any other plan or arrangement, the "principal purpose" of which is the avoidance or evasion of any U.S. federal tax; or

- a partnership or other entity, an investment plan or arrangement, or any other plan or arrangement, a "significant purpose" of which is the avoidance or evasion of any U.S. federal tax, and it is:
  - a "reliance opinion," which is tax advice at a "more likely than not" level;
  - a "marketed opinion," which is tax advice that is intended to be used or referred to by someone other than us in promoting, marketing or recommending a partnership or other entity, an investment plan or arrangement, or any other plan or arrangement, to one or more other taxpayers;
  - advice where we have imposed conditions of confidentiality; or
  - advice where some or all of our fee is contingent on the successful outcome of a U.S. federal tax matter, or refundable if not successful.

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The regulations provide that a transaction will not meet the "principal purpose" requirement if it is consistent with the applicable provision and congressional intent. However, even if consistent with the legislation and congressional intent, it may still be considered to have a "significant purpose."

Excluded from Circular 230 classification as a "covered opinion" are:

- transactions where the Internal Revenue Service does not have a "reasonable basis" for challenge;
- post-return advice; and
- "significant purpose" transactions which concern the qualification of a qualified plan or a state or local tax-exempt bond or are included in documents required to be filed with the Securities and Exchange Commission.

Probably the most important exclusions are those for "reliance opinions" and "marketed opinions." These exclusions will be applicable if the appropriate legends appear prominently in the tax advice. Both legends are intended to advise the recipient of the tax advice that he or she cannot rely on the advice for relief from penalties under the Internal Revenue Code. In addition, the legend for "marketed opinions" is intended to advise clients that they should consult their own independent tax advisors and that the advice was written in connection with marketing efforts.

What Does This Mean for Clients of Morgan Lewis?

Much of the day-to-day tax advice that we provide may be considered to be a "reliance opinion." For example, if we respond to an email requesting the percentage of stock required for a forward merger to be tax free by saying "generally 50%," that could be viewed as a "covered opinion" that does not comply with the Circular 230 rules. Similarly, saying "the payment should be deductible, but I need to know more," could also be viewed as a noncomplying "covered opinion."

Particularly troubling are emails that, when they contain tax advice, generally contain brief tax advice. We, like most if not all major law and accounting firms, will be including legends in emails that may contain tax advice. The purpose of the legend is to advise clients that they cannot rely on the tax advice for relief from any Internal Revenue Code penalties. It is also intended to obviate the need for the more extensive legend applicable to "marketed opinions," by indicating that the email is not intended to be used for marketing purposes.

The specific legend that we will be using is as follows:

> <u>IRS Circular 230 Disclosure</u>
> To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. federal tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein. For information about why we are required to include this legend in emails, please see [LINK].

The link will lead to this White Paper. We will also use this language as appropriate in memoranda and opinions.

We have also developed an additional legend that will be used where the tax advice is intended to be provided to another person. This language is as follows:

> <u>IRS Circular 230 Disclosure</u>
> To ensure compliance with the requirements imposed by the IRS, we inform you that any U.S. federal tax advice contained herein does not deal with a taxpayer's particular circumstances. Further, it was written in support of the promotion, marketing or recommending of the transaction described herein. This [memorandum/opinion] was not intended or written to be used, and cannot be used, for the purpose of avoiding penalties under the Internal Revenue Code. Taxpayers should consult their own tax advisors regarding the tax consequences to them of their own particular circumstances.

A variant of this legend will be used in disclosure documents.

We anticipate that there will be many instances where clients will want opinions without the disclaimer language. In those instances, we will work with our clients to determine whether we can conclude, after appropriate factual diligence, that either U.S. federal taxes were not a "significant purpose" of the transaction or that the Internal Revenue Service does not have a "reasonable basis" to challenge the transaction. In other instances, if desired, we would be able to provide an opinion that satisfies the extensive rules applicable to "covered opinions," which will require much more extensive factual due diligence efforts as well as an understanding of any assumptions and projections.

For more information on Circular 230, please contact any of the following partners:

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