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CHAPTER 25

Tax Shelter Opinions: A Panel Discussion

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SYNOPSIS

§ 25.01 INTRODUCTION

MELVIN J. JACOBOWITZ: It's not true that the proposed rule amending Circular 230 was written specifically to fit in with this program. The procedure will be as follows: Ken Liles will first define the problem, the question of tax shelter opinions and the background leading up to the proposed rule; Gordon Henderson will discuss the rule and its implications; Harvey Dale will discuss alternatives to the rule; and then we'll go back and forth with some comments among the three members of the panel.

§ 25.02 DEFINING THE PROBLEMS

KENNETH H. LILES: The preceding articles have helped us a good bit by way of background on this problem. I saw a little comic strip not too long ago, Hagar the Horrible, who is one of my favorite comic strip characters. It shows Hagar standing there in the desert at night with his armor and his sword and shield and his horned helmet, with his aide at his side, and there's an Egyptian, obviously so judging from his attire and head gear, pointing to an object standing over there in the desert with some palm trees around it. It looks like a pyramid. And the Egyptian, pointing to it, says, "It is said to contain secret passages that hide undreamed of treasures in gold and silver and rare gemstones." "What's it called?" asks Hagar. And the Egyptian replies, "A tax shelter." Well, I guess the moral is you recognize one when you see it.

What I would like to do here briefly is to go back over the relevant formal ethical opinions of the ABA and its model Code of Professional Responsibility, and the "Guidelines to Tax Practice" developed by the Committee of the ABA Section of Taxation on Standards of Tax Practice, as to what they thought were good ethical standards for law firms to follow when engaged in writing opinions in areas that might be used to promote tax shelters. And then I'll briefly review Treasury's current Circular 230, so you'll have the proposed amendments to the Circular in context.

[1] ABA Formal Opinion 314

The first relevant ethical opinion of the ABA (Formal Opinion 314) came out in 1965, some fifteen years ago. There was a lot of controversy at the time in the ABA over this opinion and it went through considerable revision before it was finally issued. I remember that in the Tax Section there was quite a battle about it. This opinion deals with a lawyer advising his client who is preparing his tax return, which is, of course, after the events to be reported have occurred. The question was what duty is owed to the Internal Revenue Service. The authors of the opinion viewed this as an adversary situation and considered the attorney was in the position of an advocate. Commissioner Kurtz doesn't like to look at the relationships that way, but that's the way the ABA considered the taxpayer's relationship to the Service. Viewed thusly, the opinion states that a lawyer, in advising his client in the preparation of the client's tax returns, "may freely urge the statement of positions most favorable to the client just as long as there is [a] reasonable basis for those positions," in other words, anything more than something frivolous, however you define that term. Moreover, "where the lawyer believes there is a reasonable basis for a position that a particular transaction does not result in taxable income, or that certain expenditures are properly deductible as expenses, the lawyer has no duty to advise that riders be attached to the client's tax return explaining the circumstances surrounding the transaction or the expenditures."

This opinion's effects on tax returns has been one of the complaints the Service has had with the tax bar. I served on Commissioner Kurtz's Advisory Group last year, and we had a big discussion with the Commissioner and his Chief Counsel about the standards of tax returns. They said the ABA opinion aided in the so-called "audit lottery." The Service officials complained that taxpayers were encouraged by return preparers to take far-out positions knowing that the chances of detection were slim. The Commissioner wanted the standards of reporting raised substantially. He also wanted riders attached to returns where positions were taken in conflict with published Service positions. We disagreed. We took the position the Service could ask questions on the returns to obtain factual information, but should not be permitted to require taxpayers to put red flags on returns to alert the Service to audit the returns.

Next, I want to take a look with you at the current ABA Code of Professional Responsibility, which came out in 1970. This Code of Conduct, which is now the subject of proposed further revision, has some very pertinent provisions bearing on our subject today. Canon 7 differentiates between the duties of the attorney as an "adviser," and his position as an "advocate." When he is serving as an adviser, i.e., advising a client on a prospective transaction, it states that "a lawyer in appropriate circumstances *should* give his professional opinion as to what the ultimate decisions of the court would likely be" on the matter at hand, and should inform his client of the practical effect of such a decision. [Emphasis added.] It goes on to say the attorney should not knowingly assist his client to take an illegal or frivolous legal position, and, of course, the attorney should never encourage or aid his client to commit a criminal act, or counsel his client on how to violate the law or avoid punishment.

With respect to the lawyer's position as an advocate, the Code of Conduct echoes ABA Opinion 314:

> The Advocate may urge any permissible construction of the law favorable to his client, without regard to his professional opinion as to the likelihood that the construction will ultimately prevail. His conduct is within the bounds of the law . . . if the position taken is supported by the law or is supportable by a good faith argument for an extension, modification, or reversal of the law.

An attorney can be punished under these standards only if he *knowingly* does a wrong. For example, the lawyer shall not *knowingly* make a false statement of law or fact. A lawyer shall not counsel or assist his client in conduct that the lawyer *knows* to be *illegal* or *fraudulent*. In sum, these rules deal mainly with attorney-client relationships, and they provide that the attorney is obligated to render his opinion, when he is acting as advisor, even if it be a "negative opinion." Finally, the attorney is subject to discipline only if he *knowingly* violates the rules.

[2] ABA Formal Opinion 335

The ABA came along in 1974 with an opinion which gets closer to the present problem. ABA Formal Opinion 335 deals with a situation involving a third party relationship. It deals with a security lawyer writing opinions as a basis for transactions involving sales of unregistered securities. And it says such a lawyer "should make adequate preparation including inquiry into the relevant facts"; but, "while he should not accept as true that which he does not reasonably believe to be true, he does not have the responsibility to 'audit' the affairs of his client or to assume, without reasonable cause, that the client's statement of the facts cannot be relied upon." Now, "[t]he steps reasonably required of the lawyer in making his investigation must be commensurate with circumstances under which he is called upon to render the opinion." But "he must bear in mind that his responsibility is to render to the client his *considered, independent*"—these are important words—"opinion whether, having made at least inquiries . . . the claimed exemption *is or is not* available under the law." [Emphasis added.] Now, you'll notice here that although the lawyer has a duty to investigate the facts, if he has reason to believe they are inaccurate, he's not the auditor of the facts; and based upon this investigation, the lawyer must give his opinion on the ultimate legal outcome, whether *positive* or *negative*. In other words, the attorney must, if the circumstances call for it, issue a "negative opinion."

[3] Recommendations for Guidelines

The ABA Section of Taxation has a standing Committee on Standards of Tax Practice, which is staffed by senior attorneys who have gained considerable recognition in the Section; they're supposed to be outstanding leaders of the tax bar. This Committee came out in 1978 with recommended "Guidelines to Tax Practice." That is to say, the Committee published a set of ethical standards which they recommended law firms adopt in their tax practice. These rules get close to the area we are concerned with in this panel discussion. They state that firms should "counsel against any tax plans that are bound to fail if all the facts become known to the Service"; nor should the firm "participate in transactions entirely lacking economic substance and intended solely to conceal or mislead." More specifically, the firm should "not assist in the offering of a 'tax shelter' program unless [the firm concludes] there is a 'substantial likelihood' that the tax consequences will be resolved in favor of the taxpayer." They don't indicate what "substantial likelihood" means, but it is obviously greater than the mere "reasonable basis" rule of the Code of Conduct. These, then, are high ethical standards that are suggested.

By way of justification, they go on to say that, even though the firm may have disclosed in its legal opinion "all the risks and possible adverse tax consequences of a tax shelter program, the fact that [the firm] gave an opinion [on the tax aspects] may be taken by the public as [an] *endorsement* of the [tax shelter] program." [Emphasis added.] They go on to add they think firms would be smart, generally, to counsel against "borderline" plans, because obviously borders frequently may shift in the future as the tax law develops in controversial areas involving tax shelters.

As you will see, the Treasury has used these suggested guidelines as a springboard, so to speak, to help justify what they would make a mandatory penal provision.

[4] Circular 230

This brings me to Treasury Circular 230. I think it is important to start with the statutory authority underlying the Circular. The basic authority is a statute[1] enacted in 1884. The genesis of this statute lay in the Civil War. Federal soldiers had a right to seek compensation from the Treasury Department for their horses lost or destroyed in that conflict. Treasury was concerned about the qualifications of the agents filing these claims and the inflated size and suspicious nature of a lot of the claims. It seems the Treasury

1 31 U.S.C. § 1026.

was being asked to pay race horse prices for a lot of worthless plow horses. To remedy the problem the statute gave the Treasury the authority to regulate practitioners before it. Thus, the statute was designed to accomplish two things, principally to protect the poor claimant against being misrepresented by a charlatan, and incidentally to protect the revenue. The proposed amendments to Circular 230 have been attacked on the ground that their statutory basis is being misused in that the proposed amendments are motivated by a desire to protect the revenue, but I think there is a legitimate justification under the statute.

The statute is in two parts. First, it provides that the Treasury Secretary may prescribe rules and regulations governing the recognition of agents and attorneys representing claimants before his Department, and may require such persons, before being recognized as representatives, to show they are of "good character" and "in good repute" and possess the "necessary qualifications" to enable them to render such claimants a valuable service, and otherwise "competent" to advise and assist such claimants in the presentation of their cases. Second, the statute provides that such Secretary may, after due notice and opportunity for hearing, suspend and disbar from further practice before his Department, any such person, including an attorney, shown to be "incompetent," "disreputable," or who "refuses" to comply with said rules and regulations, or who, with "intent" to defraud in any manner, "willfully" and "knowingly" shall deceive, mislead, or threaten any claimant or prospective claimant.

The existing Circular 230 tracks the wording of this statute very accurately and faithfully. In Section 10.22, governing "Diligence as to Accuracy," provision is made that each attorney shall exercise due diligence in preparing or assisting in the preparation of, and filing returns, documents, etc., relating to Internal Revenue Service matters; in determining the correctness of oral or written representations made by him to the Department; and in determining the correctness of oral and written representations made by him to clients, that is in his opinions to clients, on Service matters. The provision dealing with suspension and disbarment (Section

10.50) tracks the statute in providing that the Secretary of the Treasury, after due notice and opportunity for hearing, may suspend or disbar from practice any attorney shown to be "incompetent," "disreputable," or who "refuses" to comply with the rules and regulations. The term "disreputable conduct" is defined (Section 10.51) to include giving "false" or "misleading" information or participating in any way in giving false or misleading information to Treasury, "knowing" such information to be false or misleading; "willfully" failing to make a Federal tax return in violation of the revenue laws, or evading or attempting to evade, or participating in any way in evading or attempting to evade any Federal tax or payment, or "knowingly" counseling, or suggesting to a client an illegal plan to evade Federal taxes, or concealing assets to evade such taxes. Finally, Section 10.52, governing "violation" of the regulations, provides that any attorney may be disbarred or suspended from practice before the Service for "willful" violation of these rules. It is significant that only willful violations will result in suspension or disbarrment from practice before Treasury and the Service.

This brings me to the problem, as the Government perceives it, with policing tax shelter opinions of attorneys. Beginning in the mid-70s, there was a great explosion in tax shelter promotions of ever increasing questionability. The Commissioner and his Chief Counsel and the General Counsel of the Treasury, had tried various approaches to combat this trend—such as increased partnership audits, stepped up litigation and publication of revenue rulings pinpointed against new tax shelter schemes. The Commissioner, Chief Counsel of the Service and General Counsel of Treasury strongly urged the organized bar to amend its rules of professional conduct and standards of tax practice to help head off so-called "abusive" tax shelters. Statistics were cited to show how abusive tax shelter programs have proliferated, and they claimed five billion in adjustments have already been identified. Of course, this presents a serious threat to the revenue. They fear, if not checked, this development will undermine public confidence in the fairness of the tax system, will overburden the audit process, and ultimately swamp the courts. If you have been following recent developments, you already know the Tax Court is making great efforts to develop new rules to bring some order into this exploding area of litigation before the Court.

The thing the Treasury and Service officials appear most concerned about is the use of tax attorneys' opinions to help promote abusive tax shelter programs. The investors may view the attorney's willingness to provide a tax opinion as an "endorsement" of the tax shelter and as a protection from fraud or negligence charges in the event the taxpayer's return happens to be picked up on audit. So they're trying to put the monkey on the back of the attorneys to help get it off theirs.

The Treasury cites a number of types of opinions which they find objectionable. First, is the fraudulent opinion, one that is intentionally false or incompetent, or which knowingly or recklessly misstates law or facts. (It seems to me pretty clear that no amendment of Circulr 230 is needed to deal with such cases.) Next, is the "don't-bother-me-with-the-facts" opinion, which says, in effect, "Assuming the facts are so and so," even though the attorney may have reason to believe they're not so; and then there is the "nonopinion," which may be an extensive document based on a hypothetical situation, which never comes to a conclusion or is a "partial" opinion which may address some but not all of the really critical tax issues. Last, they find objectionable any "reasonable basis" opinion, i.e., an opinion which states there is a reasonable basis for claiming the tax advantages being promoted but does not state what the chances of prevailing may be. (Well, maybe this is because the counselor really can't predict what the conclusion would likely be.) Or an opinion that says, "Yes, you have a reasonable basis; but, if audited, it will be challenged, in which event, you probably will lose." The government people find such reasonable basis opinions objectionable because the person out there investing really may not believe that caveat or will go on anyway and invest and take his chances, because he really has little to lose, since he gets use of the government's tax money at low interest rates, and he secures a protective opinion on which he thinks he can safely rely to insulate him from fraud or negligence penalties. So an adventurous investor may decide to take his chances with the "audit lottery" anyway, although it seems to me that is really becoming more of a dangerous Russian roulette game, at least where limited partnership abusive tax shelter programs are involved.

What remedy, then, does Treasury propose by way of amendment to Circular 230 to deal with tax shelter opinions of the sort with which they say they are concerned? First, the proposed amendments provide that a practitioner who provides a "tax shelter opinion" shall exercise "due diligence" in three respects. Please note this requirement would cover tax opinions on *all* tax shelters, not just on the "abusive" ones. The differentiation between them is that the "abusive" one is where there is no significant economic purpose or substance to the transaction other than generation of expected tax benefits; whereas a "tax shelter" is defined as a sale, offering, syndication, promotion, investment or other transaction in which the claimed benefits are "likely to be perceived" by the taxpayer (whoever he is) as the "principal reason" for participation. This is, of course, a broad and imprecise definition. For this purpose, an "opinion" is defined as written advice relating to the federal tax law which the practitioner providing the advice knows or reasonably should know will be referred to, or included in the offering materials distributed to the parties out there, who are not then his clients, in connection with promotion of the tax shelter. The promoter hopes that the tax opinion will help him sell the deal. For example, he can point to it and say "Here is this reputable law firm's opinion which says this is all right, and you'll get all these tax benefits." That's why the proposed amendments to Circular 230 are directed against attorneys' tax opinions.

Turning now to the proposed amendment to the "due diligence standards." The practitioner who provides a tax shelter opinion would have to exercise due diligence to assure that the opinion on the offering material "fully and fairly discloses" those *facts* which bear "significantly" on "each important" federal tax aspect; and that the opinion fully and fairly describes and, unless inappropriate under good professional practice (which they claim will be only rare circumstances), "states a conclusion" as to the "likely legal outcome" with respect to "each important" tax aspect. As an exception, a "partial opinion" can be given where other opinions cover the other tax aspects. In addition, the tax practitioner must exercise due diligence that his opinion is "accurately and clearly" described in any discussion of the tax aspects appearing in any offering materials. So you would have to police the use of your opinion.

As if this were not enough, a practitioner would be allowed to render an opinion—after all of those due diligence requirements are satisfied—only if the opinion concludes that "more likely than not," the "bulk" of the tax benefits on the basis of which the shelter has been promoted are allowable under the tax law. The preamble to the proposals states that "bulk" means substantially more than 50 percent. Thus, you would not be allowed to render an opinion at all unless it's going to be a "positive" one, so you could not issue a "negative opinion" or a "reasonable basis" opinion, even though your best professional judgment called for such a restricted opinion to be rendered.

Furthermore, the proposals would amend the definition of "disreputable conduct" to include giving an "intentionally or recklessly misleading" opinion, or a "pattern" of providing "incompetent" opinions on questions arising under the federal tax laws. Note this rule would cover *all* tax opinions not just those dealing with tax shelters, much less "abusive" ones.

Finally, a tax practitioner could be suspended or disbarred from practice before Treasury, including the Service, for violating these new rules, whether or not such conduct is "willful." In other words, the word "willful" would be read out of the statute under which these rules are justified. Apparently, the authors think they've provided objective standards for measuring willful conduct. Anyway, that's the way the proposals stand at the moment.

These proposed amendments were issued on September 4, 1980; comments were due by November 14, and a public hearing was held thereon on November 25, 1980. I would like to know what Gordon Henderson thinks of these new proposals.

§ 25.03 IMPLICATIONS OF CIRCULAR 230

GORDON D. HENDERSON: I think every responsible tax practitioner has been quite troubled by the explosion in recent years of tax shelter offerings, and by the kinds of opinions that are too requently given in connection with them. I think we are all sympathetic with the Treasury's concerns in this area.

On the other hand, the proposed amendments to Circular 230 have so many problems inherent in them that there is a serious question whether the suggested remedy isn't more troublesome than the problem it is addressing. My function on this program is to focus on these problems. Harvey Dale will then suggest some possible solutions.

Let me begin by summarizing some major issues presented by the proposals. To begin with, Circular 230 as proposed to be amended would cause a very, very fundamental change in the role of counsel in tax matters, and could perhaps begin by example to cause a similar change in nontax matters as well. The proposed amendments, while they purport to be addressed only to tax shelter offerings, are couched in terms of ethical standards. Therefore, there will probably be a tendency to cause these standards to apply outside the tax shelter area.

Further, the ethical standards that are being proposed are not ones that would be generally accepted today as representing proesent ethical requirements. What is being established here or proposed to be established are entirely new standards, that do not apply today, either in tax shelter transactions or in non-tax shelter transactions.

Moreover, the method of enforcement of the proposed amendments essentially eliminates the separation of powers. The enforcement proceeding for a violation of Circular 230 is brought by the Director of Practice of the Treasury Department. If the taxpayer representative wishes, he can have a hearing before an administrative law judge. There is presently one administrative law judge assigned to the Treasury Department. He is located at, and is paid by, the Treasury Department, although his salary is determined by the Office of Administrative Law Judges. He will make findings and recommendations, and an appeal from those can be taken to the Secretary of the Treasury, represented by the General Counsel. There is no specific grant of a right to judicial review, but review in a few cases has been sought and granted in the District Courts under the grants of general jurisdiction.

The decision to seek disbarment, to seek disciplinary action, will be brought therefore by an adversary party interested in the outcome of the substantative issues that the lawyer has opined upon, namely the Treasury Department; and the decision will be make in large part, with perhaps rather limited judicial oversight, but that same party. There is a serious question whether pracitioners will feel that these decisions will be fair, however hard the Treasury may try to make them so.

Those, I think, are the primary problems with the proposed amendments. Now let us examine some additional points. First, while the present Code of Professional Ethics contains both ethical aspirations and mandatory minimum requirements, the proposed amendment to Circular 230 would establish mandatory standards only, not ethical aspirations that go beyond these mandatory standards. This happens also to be the approach that has been taken in the Model Rules of Professional Conduct that is currently being considered by the American Bar Association.

Second, the amendments specifically provide that a practitioner can be disbarred if he violates these proposed mandatory standards, even if his action is not willful.

Third, the standards employed in the proposed amendments are couched in vague adjectives. Ken Liles has given you some examples. The vagueness of the language is particularly troublesome, since a person can be disciplined or disbarred for a violation of these vague standards even if it is not willful. For example, if he guesses wrong as to whether a tax aspect is "an important tax aspect," or whether the offering circular "fully and fairly discloses," or whether the "bulk" of the tax benefits are likely to be allowed, he can be disbarred. So these vague words take on an extremely penal connotation.

Another problem is that it's unclear who will in effect will be disciplined for violation of Circular 230. Most opinions are given in the name of a law firm. The work is done of course by individuals. It's unclear whether the intention is that the law firm as a whole could be suspended or disbarred, or whether only the individuals working on the matter are to be suspended or disbarred. If it is only the individuals, there is a further question whether it will be considered a violation of Circular 230 for a law firm to continue to employ the suspended or disbarred person during the period of suspension or disbarment. The present provisions of Circular 230 are unclear on the question whether a firm can continue to employ a person who has been disbarred, provided that it prohibits him from working on tax matters, or whether it just simply has to have him leave the firm. Certainly that point needs to be clarified.

The proposed new rules are said to apply only to tax shelter offerings and only to offerings in which the opinion will go to investors who are not clients of the lawyer. Thus, the rules are said not to apply to advice given to one's clients, or to opinions given in nontax shelter types of transactions.

This means that if you have four wealthy clients who get together to do a transaction which would come within the definition of a tax shelter, you may give them a "reasonable basis" opinion, or an opinion limited to less than all the important issues. You may in effect ignore the proposed amendments to Circular 230. At least that's what the release relating to the Circular 230 amendments seems to suggest. The problem with this, of course, is that it means wealthy investors will be able to receive advice that the smaller investor who can only participate in a syndicated offering will not be able to receive. Thus, the function of the lawyer will differ, depending on whether he has wealthy clients, or is dealing with a transaction more broadly offered.

It seems to me, however, that the role the lawyer plays in both transactions is precisely the same. When he is advising with respect to a proposed transaction, he is not, as yet at least, acting as an advocate: ABA Opinion 314, which deals with the question of what you may do in advising on preparation of a tax return, deals with a situation where the facts have already been established. The Opinion takes the position that in deciding how to reflect the transaction on the tax return, the lawyer can assist his client to assume an advocacy position. But when the lawyer is advising his clients as to whether they should or should not go into a proposed investment transaction, and tells them what the risks and benefits are, he is not yet acting as an advocate, he is acting as an advisor, just as he is when he writes an opinion or prepares an offering circular for a public offering. So one cannot truly distinguish these two situations based on the function that the lawyer is performing.

The theory underlying this distinction in the proposed amendments seems to be that the practitioner owes a higher duty to a nonclient than to a client. Or, perhaps the assumption is not so much that the duty is owed to the nonclient as that it is owed to the Treasury Department, to the fisc, at least, if one is dealing with nonclients. This distinction obviously creates a tremendous tension of logic, and I would think that if this approach is adopted, there would be a strong pressure of logic and consistency that would tend eventually to require that one deal with his clients under the same standards that he deals with nonclient investors.

As mentioned a moment ago, the release accompanying the amendment indicates that it is not intended to apply to nontax shelter transactions. As to this point, there is an obvious threshhold problem in defining what a tax shetler trasaction is. The definition contained in the proposed amendments says that a tax shelter is a transaction in which the claimed tax benefits are likely to be perceived by the investor as the principal reason for participation. Obviously, this is too broad if one wants to limit the definition to what is commonly thought of as a tax shelter, because this definition seems to apply to a municipal bond opinion. It would apply to opinions relating to a mutual fund that invests in municipal bonds. It probably would apply indeed to any mutual fund offering, since the tax-exempt pass-through status of the fund is highly significant. It may apply to an REIT; it may apply to a reorganization. It may apply to a Section 337 transaction. Literally, all you would need is to have a taxpayer who would say, "Look, I won't do this deal unless it's a tax-free reorganization, or a Section 337 transaction," or what have you, and you would come within the literal terms of this definition. That's obviously not intended. Perhaps the definition can be rephrased so that it will apply more narrowly to the kinds of transactions that are more typically thought of as tax shelters, but this will not be easy. Even if this can be done, the harder point is that the standards proposed to be imposed on tax shelter opinions are different from the standards that exist today and which purportedly will continue to apply to nontax shelter transactions. Yet, the concepts are phrased broadly as ethical standards. How can it be that there is one set of ethics for oil and gas deals, for example, and yet another set of ethics for mutual fund offerings or reorganizations? There is a tension of logic here, too, that I think will lead to problems. There will be a tendency for the new standards to expand outside the tax shelter opinion area into other tax areas, and even into nontax areas.

§ 25.04 ALTERNATIVES

HARVEY P. DALE: It is always a difficult thing to try to deal with a legally undesirable phenomenon, not by putting pressure on those who are taking advantage of it but by putting pressure on some other party in the transaction. It is always a nervous time for accountants and lawyers and others when the squeeze is put on the professional.

What can we do if we want to take the attorney off the hot seat? What other possibilities are there? Service and Treasury representatives have been quite candid and say that they don't necessarily want to adopt Circular 230 as a remedy in the area, and that they would be happy to drop the proposed amendments to Circular 230 in favor of some other method of fixing what they perceive to be the problem. What is the real heart of the problem? The real heart of the problem has to do with the structure of the tax law. But to come back and say the right way to deal with the problem is to improve the tax law is at once responsive and completely unresponsive. It is true, of course, but it is a prescription that is not likely to be filled quickly.

The rate structures could be compressed. If we see that happening, if the rate structure came down if the upper rates were reduced and the spread between capital gains and ordinary income were narrowed, then some of the pressure might go off of these issues also. I doubt that that will happen. Even if we get a reduction in rates; it looks as though the reduction in rates will be accompanied by an even further reduction in capital gains taxation, which would preserve rather than ameliorate the problem. There is a further aspect to this, I suppose, which, at least in my practice, I have found, and that is that not all of these investors are motivated either by sound investment goals or by tax avoidance goals. There is at least one aspect of this phenomenon that has to do with other drives: being able to share something in common with your friends at the country club or in the locker room. I have had clients who, after having it clearly demonstrated to them that the proposed investment is preposterous, both from an economic and a tax point of view, are truly very sad; they wanted it very badly. It may have to do with the fact that after you are 18 and can no longer talk about your conquests on the football fields, you'd rather talk about conquests on the 1040.

I am quoting Commissioner Kurtz from October 30, 1980, Daily Data Tax Report, "I have a feeling that a penalty on the order of 25 percent of the tax deficiency would be effective." I have the same feeling. He went on to say, "For purposes of discussion, let us say that such a penalty would only attach to deficiencies exceeding the greater of 10 percent of the tax reported or $10,000." What are the issues here? We could propose a penalty —penalty is a harsh word but that is what we are really talking about. We could target it for deductions claimed in a tax shelter offering, but that creates an administrative question because it compounds the difficulty of definition. Alternatively, we could propose a penalty to be applied only after some deductible amount had been reached, for example, 10 percent of the tax reported, or $10,000. We could apply that regardless of fault, so that we no longer have a situation perceived (although not so clearly correctly) by the Service that the opinion of the attorney serves with respect to the negligence penalty as the gold cross serves with respect to a vampire.

Any such proposal could be cast in the form of a penalty. It could also be cast simply in the form of an extra interest rate, a higher interest rate, after a certain amount of deficiency had been reached, sufficiently high so that it was a true disincentive. Presumably it would be targeted at individual investors and not corporations, for reasons that I don't think need elaboration. And presumably it would have some deductible amounts so that it wouldn't be imposed at all levels. It's possible to discuss that further, it seems to me. There are problems in that, too. But given an imperfect system and no immediate choice of fixing it to perfection, we may have to choose the better of two imperfect proposals. My own feeling is that this one might be better, for a variety of reasons, than proceeding on Circular 230 amendments.

Well, if the alternative isn't accepted, if there is no significant approval of that, what else can we do?

There will soon be an announcement made in Washington, that a peer review panel be selected. In the same remarks that Kurtz made, quoted in the October 30 Daily Tax Report, he said that he thought that the Treasury Department would seriously consider the use of a peer panel to review cases dealing with revised Circular 230. The announcement instantly forthcoming will be to solicit comments on that. The notion would be that the Treasury Department, not the Service itself, would appoint an advisory panel. Those people would become unpaid consultants to the government. That would give them an opportunity to hear the evidence against the attorney without violating the provisions of Internal Revenue Code Section 6103, dealing with confidentiality of tax return information. Those people in turn would first hear the case and they would recommend sanctions or no sanctions to the director of practice. Kurtz said this would increase the confidence of practitioners that the decisions would be made objectively, rather than as part of an adversary process. My own view is that if we must have Circular 230, this is better than the way it was originally proposed. It may not be Nirvana, but it is a step forward.

Another suggestion that has been made is that maybe the Service should take these proceedings and instead of themselves initiating disciplinary action, bring them to a bar association. There are a couple of problems with that. The first is strictly legal. Once again Section 6103 on confidentiality of tax information would make it impossible for the Service, at least in some cases, to present the grievance, or to present all of the relevant evidence from their point of view. Would we all support an amendment to Section 6103 for this purpose? Would we approve the use of information that the Service got on tax returns to initiate local grievance procedures? If we would, we could make a claim that maybe those would be more appropriate bodies. There are other problems with going to local grievance procedures. They may not all be efficient; that has been a broad criticism of our own self-policing. And it may be difficult where the local grievance proceedings are held significant distances from Washington.

Those are possible changes to the rule. What about avoiding the rule altogether? Here, there is one great glowing hope. It is very easy to avoid being affected by this rule. Don't give third party opinions. That doesn't sound so harsh to me, actually. How many of you really have a significant part of your practice involved in that? Unfortunately, the corollary of that—avoiding the impact of the rule by no longer issuing third party opinions—may be a disastrous Gresham's law result; what we may have left is a specialized Bar willing to give those opinions, which steps forward into the breech, and takes these risks. Another possibility that occurs to me is to change the structure of these offerings. We have already seen some tax shelter offerings that have provided to the investor not only the hope of finding the treasure in the pyramid but also some guidance in the event he gets lost; stand-by counsel have been prepaid and have been offered to all investors, as just waiting to carry them through the audit procedure up through appellate and right through the tax court, all free. Maybe future offerings could be structured so that the promoter's counsel, instead of issuing an opinion to the investors for their reliance, gives the investors the address of stand-by tax counsel, prepaid, who will advise them face to face.

None of those routes seems to be perfectly happy, and the future of Circular 230 is uncertain, but we will have a changing of the guard in Washington, and for that reason alone, we may see action on Circular 230, in the relatively near future.

MR. LILES: The point that they're trying to get at is the use of the opinion to peddle the shelter to the public, and if it's not identified that a lawyer is involved, that he hasn't been a part of this thing at all, then how could the public be misled? So I don't understand why in the world we want to broaden the Treasury's proposal anymore than it is. I'd go the other way. It did shock me a little when the New York State Bar suggested that the proposal wasn't broad enough; it ought to cover practitioners doing what you're talking about. I certainly don't ascribe to that.

MR. HENDERSON: If it's unethical to put your name on a "reasonable basis" opinion why is it ethical for you to draft a document that has someone else say the same thing?

MR. LILES: Because they haven't used your reputation to peddle it to the public.

MR. JACOBOWITZ: I think the real issue is such and such attorney has drafted all the tax disclosure portions of the circular, but will not give an opinion with respect to this transaction, just finding some nice fancy way of saying that in no opinion; is that okay?

PROFESSOR DALE: Well, from the tax point of view that doesn't seem to me to cause any concern, either under current law or under the proposed revisions to Circular 230. But it does raise a bit of an SEC problem with an offering made to the public, because Guide 60 to public offering statements requires a tax opinion in some detail when the proposed offering has significant tax effects; we are here caught in a tension to which Gordon referred.

MR. HENDERSON: Yes, I think that if the rule is viewed simply as an arbitrary rule applicable to certain opinions and not as an ethical standard, then there would be no problem with this. But if it's an ethical standard, how can it be so clearly proper to participate in an offering circular, and help draft it, if under the new rules you can't give an opinion? It seems to me that if the Treasury disbars somebody, they are going to send information about this to the local Bar Association or other disciplinary body and challenge to to follow up. The S.E.C. these days, I am told, is doing that when it brings a so-called Section 2(e) proceeding against accountants or lawyers. So I think that anyone who gets in trouble under Circular 230 is going to find himself in trouble with his local disciplinary body and will perhaps be disbarred from practice entirely.

PROFESSOR DALE: It hasn't been the practice of the Service up until now. In fact, they admit that they have used the provisions of Circular 230 in very few cases over the past decade, and in most of those cases, the Treasury disbarment of an attorney turned on a finding of a disbarment earlier in some other grievance procedure, locally, usually on grounds of conviction of a felony. So it has not until now been a matter for very vigorous enforcement. That is certainly expected to change if these amendments are adopted. Maybe what we should talk about is what the real impact of a Circular 230 transaction is. If someone, Gordon, were disbarred, who was a member of a law firm, could he, by erecting a so-called Chinese Wall, continue to practice law—just not "before the Internal Revenue Service"? Or would his disbarment taint the entire firm?

MR. HENDERSON: Well, I think that's unclear, and I think the issue needs to be addressed as to what the rule should be. There is not articulation of this point in the release. The current

Circular 230 is ambiguous. It seems to suggest that nobody can be a partner of, share fees with, employ, or be employed by someone who has been disbarred or suspended under Circular 230. On the other hand, it is perhaps conceivable to argue that the language means only that you can't employ or associate with such a person in connection with further representation before the Treasury, so that if someone in a firm were disbarred, and the firm said he can't participate in preparing tax returns or protests, of in tax rulings or the like, maybe this would be enough.

Whatever decision is finally made on this point, there will nonetheless be a lot of very practical negotiation that goes on, as there is in S.E.C. Section 2(e) proceedings. And it may well be that if the Treasury decides to go against somebody, the matter will be settled with some kind of disciplinary action being taken against the whole firm on some theory that the firm had a duty to supervise or the like. Now if this prospect troubles you, I should mention what has happened so far on this type of issue. There was an S.E.C. disciplinary proceeding brought against a reputable lawyer in a reputable firm several years ago in connection with the so-called Geo-Dynamics oil and gas public offering. The S.E.C. alleged that the tax risks were inadequately disclosed, that the opinion was too buoyant. The lawyers involved entered into a consent order to settle the matter, which is a very troubling thing for any firm or lawyers to do.[3] Just a few months ago, the Tax Court in the *Brountas* decision found that the claimed tax benefits were proper.[4] The important point here is not whether the Tax Court was right, or whether the S.E.C. was right. The real point here is that a government agency decided that the opinion was unreasonable and imposed drastic professional sanctions. But when the opinion finally got to court, its conclusions were upheld by a judge. This illustrates the danger in giving such power to nonjudicial parties.

[3] Securities Exchange Commission v. Geo Dynamics, CA No. 76–0957 (D.D.C.).

[4] 73 T.C. 42 (1979).

PROFESSOR DALE: The firm in question has also been involved in the inevitable civil litgation that followed the consent decree. And in addition to all of the other problems, it may be of some interest that hundreds of thousands of dollars have been spent in legal fees and continue to be spent in some of the litigation.

Let me give you some citations from Circular 230 on this question of the possibility of taint, should any member of the firm be involved in this. The major two provisions are Section 10.24, and Section 10.51(h). Section 10.24 says that no attorney, CPA or enrolled agent shall, in practice before the Service, knowingly and directly or indirectly employ or accept assistance from any person who is under disbarment or suspension from practice before the Service, or accept employment as associate, correspondent or subagent from, or share fees with, any such person. The definition of conduct before the Service is in Section 10.24(a) and it's reasonably expansive. I think a careful reading of that nevertheless gives rise to the possibility that you could Chinese-wall a member of your firm or practice, even if he had been sanctioned or disbarred, so long as he was not involved in any practice before the Service and didn't assist in practice before the Service as defined. That is far from perfectly clear. The final problem with this analysis, textually comes from Section 10.51(h) which is captioned: "Disreputable Conduct." It is disreputable conduct knowingly to aid and abet another person to practice before the Service during a period of suspension, disbarment or ineligibility. "Maintaining a partnership for the practice of law, accountancy, or other related professional service with a person who is under disbarment from practice before the Service shall be presumed to be a violation of this provision." That's strong. It appears not to affect someone who is an employee, and it doesn't appear to affect someone who is counsel, so a disbarred associate may be a better person to have around than a disbarred partner. I don't know what to make of that.

MR. LILES: Before we close, we ought to cover the effective date of the proposals. Of course, it may never happen, because we are going to have a change of the guard, and you remember what happened in the fringe benefit area; but, assuming the Treasury does take final action, what would be an appropriate effective date for amendments to Circular 230.

Treasury indicates in the preamble to the proposed amendments that the effective date would be when the amendments are finally promulgated, i.e. when filed with the Federal Register in final form; this leads to questions like the one I have here. "If asked to give an opinion today, which does not meet Circular 230 standards," (He is talking about the proposed amendments) "how do you protect yourself from the possibility that the client will not close the deal, and your opinion will not be used, until after the proposed effective date?" I think the ABA Tax Section filed a comment suggesting a delayed effective date?" Gordon, would you care to comment on that question?

MR. HENDERSON: Hopefully there will be a postponed effective date that will allow one to deal with this type of problem.

PROFESSOR DALE: Many agencies have tried to prescribe rules for what they call ethical conduct and implement them by sanctioning professionals; The S.E.C. has done that with its Rule 2(e). The Rule 2(e) sanction was challenged by one of the accounting firms as being beyond the authority of the S.E.C. The S.E.C. statutes, unlike the Treasury situation, do not contain any express statutory authorization to adopt such rules. In the proceeding in question, however, the court found that there was an implicit authority to adopt such rules in the Southern District of New York case, *Touche-Ross.* Do the statutes used by the Treasury as the basis for the proposed amendment require that the rules of practice regulate solely ethical standards, or matters of character or competence, or do they authorize the prescription of rules and the prescription of conduct really for other objections, such as protecting the fisc, and so on?

MR. LILES: I believe in fair reasoning. The Treasury has been criticized by some commentators on the ground that the post Civil War statute was merely trying to protect the public, claimants out there, from being taken advantage of by practitioners, but I don't read the statute in that limited a way; I read it as also authorizing Treasury to protect the revenue. So I think that was an unfair criticism.

I do think, however, that you have raised an interesting question as to whether the different federal agencies ought to be in the business of promulgating different disciplinary rules for those practicing before them and personally enforcing these rules. The American Bar Association has a project involving the discipline of federal practice attorneys, which goes to the question of whether all of these agencies, such as Treasury and S.E.C., should be disciplining the practitioners before them, since they are in an adversary position, and whether instead there should not be some independent mechanism set up using administrative law judges who are not on these Federal Departments' payrolls, to hear the Departments' complaints, and in the ultimate context have these decisions clearly appealable to the courts. Also, the ABA is considering whether Federal practice should be governed by standardized rules. One of the things here that is disturbing to me with respect to the Treasury proposals is that it seems to me we've got conflicting rules between these proposals and the rules of conduct of the bar associations, for example with respect to the ability to give a "negative opinion." Under the ABA Code of Conduct the attorney has a duty to give such an opinion where warranted, but would be prevented from doing so under the Treasury proposals. Also, as I understand it, what the SEC requires is full disclosure. So you could give a "negative opinion," but it must be disclosed fully under the S.E.C. rules. This conflict puzzles me; why in the world would the Treasury want to prevent a tax attorney from giving a negative opinion on a tax shelter. As a practical matter, it is hard to conceive of a deal going forward with such an opinion disclosed. But, that's what the Treasury proposes to prevent.

MR. JACOBOWITZ: I wish to thank all the panelists for contributing to this timely issue.

(End of Session)