

# THE TAX LAWYER'S DILEMMA: RECENT DEVELOPMENTS HEIGHTEN TAX LAWYER RESPONSIBILITIES AND LIABILITIES

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## I. INTRODUCTION

The complexity and uncertainty of the tax laws in the United States ensure the need for individuals, corporations and other business entities to depend on tax lawyers for advice. The lack of clarity in our nation's tax system requires the advice of tax lawyers for a variety of reasons and in a number of contexts.<sup>1</sup> In private practice, tax lawyers spend a considerable amount of their time helping clients plan and structure transactions so as to minimize the impact of federal income taxes. While the need for tax advice is undeniable, opportunities for exploitation abound. As a result, tax practitioners, courts, and lawmakers have long struggled with the question of where to draw the line between legitimate and appropriate tax advice and illegal tax avoidance.

The financial prosperity of the 1990s fueled the emergence of a substantial market in abusive tax shelters.<sup>2</sup> In a series of largely unsuccessful attempts to thwart these new structures, a string of legislative and judicial developments emerged, which have transformed the nature of tax practice in the United States.<sup>3</sup> The most important of these developments for tax lawyers were the changes adopted by the Treasury in Treasury Department Circular No. 230 (hereinafter "Circular 230").<sup>4</sup> In conjunction with the changes instituted by the government, courts have seen

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<sup>1</sup> See generally David T. Moldenhauer, *Tax Opinions*, reprinted in LEGAL OPINION LETTERS: A COMPREHENSIVE GUIDE TO OPINION LETTER PRACTICE (M. John Sterba, Jr. ed., 2008), at § 7.1.

<sup>2</sup> Tanina Rostain, *Sheltering Lawyers: The Organized Tax Bar and the Tax Shelter Industry*, 23 YALE J. ON REG. 77, 78 (Winter 2006).

<sup>3</sup> Jay A. Soled, *Tax Shelter Malpractice Cases and Their Implications for Tax Compliance*, 58 AM. U. L. REV. 267, 268–69 (Dec. 2008) ("In conjunction with more stringent statutory penalties, heightened disclosure requirements in the tax and securities regulatory regimes, and stricter ethical standards for tax practitioners, these civil lawsuits have fundamentally transformed the nature of tax practice.").

<sup>4</sup> Scott A. Schumacher, *Macniven v. Westmoreland and Tax Advice: Using "Purposive Textualism" to Deal with Tax Shelters and Promote Legitimate Tax Advice*, 92 MARQ. L. REV. 33, 35 (2008).

an avalanche of litigation arising out of failed tax shelters in the form of malpractice suits brought by clients against opining lawyers and accountants.<sup>5</sup> Furthermore, courts and prosecutors have displayed an increased willingness to use civil and criminal liability to deal with tax avoidance tactics.<sup>6</sup> More recently, President Obama signed into law the Health Care and Education Reconciliation Act of 2010 ("Health Care Act"), which codified the common law "economic substance" doctrine to help pay for some of the anticipated costs of the healthcare reform measures.<sup>7</sup> Although the codification of the economic substance doctrine is intended to clarify the doctrine and promote its uniform application, this legislation actually presents new problems and areas of uncertainty.<sup>8</sup> Not surprisingly, these developments, acting in concert, have caused many of the nation's preeminent tax lawyers to re-evaluate their attitudes toward tax planning practice.<sup>9</sup> Unfortunately, however, these changes will not succeed in preventing tax shelter abuse, but instead will have an unwarranted adverse effect on tax lawyers attempting to provide legitimate tax advisory services.<sup>10</sup>

The efforts to curb the use of tax shelters have had a significant detrimental impact on the vast majority of tax professionals who seek to provide legitimate tax advice.<sup>11</sup>

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<sup>5</sup> Soled, *supra* note 3, at 268.

<sup>6</sup> See generally Joshua D. Blank, *What's Wrong With Shaming Corporate Tax Abuse*, 62 TAX L. REV. 539, 571 (Summer 2009).

<sup>7</sup> Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (2010).

<sup>8</sup> See David B. Strong and Timothy E. Glasgow & Travis J. Logge, *Codification of the Common Law "Economic Substance Doctrine": Taxpayers Subject to New Standards to Obtain Tax Benefits and Avoid Penalties*, NAT'L LAW REV. (Apr. 30, 2010), available at <http://www.natlawreview.com/article/codification-common-law-economic-substance-doctrine-taxpayers-subject-to-new-standards-to-ob>.

<sup>9</sup> See, e.g., Soled, *supra* note 3, at 269–270 (explaining how the risk of tax shelter malpractice claims has changed operating procedures for tax professionals in law and accounting firms).

<sup>10</sup> Schumacher, *supra* note 4, at 35.

<sup>11</sup> See *id.* at 35–36 (noting that the vast majority of taxpayers and their advisors act in accordance with the laws).

Recent legislative and administrative efforts, based largely on heightened disclosure requirements and increased penalties, are not effective solutions for the tax shelter problem, largely because they are only prospective in nature and taxpayers often move on to new types of shelters.<sup>12</sup> Furthermore, the recent court decisions are unlikely to provide sufficient guidance to tax professionals for them to determine what the proper standards should be.<sup>13</sup> Although tax shelter litigation has been ongoing for nearly two decades,<sup>14</sup> the recent wave of cases stands out due to both the astonishing financial recoveries<sup>15</sup> and the prominent institutions targeted.<sup>16</sup> For example, in *United States v. Stein*, dubbed the largest tax fraud case in history, the government filed a forty count indictment against seventeen former KPMG accountants, a former partner at Sidley Austin Brown & Wood LLP, and a former financial

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<sup>12</sup> See Marvin A. Chirelstein & Lawrence A. Zelenak, *Tax Shelters and the Search for a Silver Bullet*, 105 COLUM. L. REV. 1939, 1939–42 (2005); see also David M. Schizer, *Enlisting the Tax Bar*, 59 TAX L. REV. 331, 369, 370 (2006).

<sup>13</sup> Schumacher, *supra* note 4, at 35; see also Patricia B. Hsue, *Lessons From United States v. Stein: Is the Line Between Criminal and Civil Sanctions for Illegal Tax Shelters a Dot?*, 102 NW. U. L. REV. 903, 907 (Special Issue 2008).

<sup>14</sup> See, e.g., *Ackerman v. Schwartz*, 947 F.2d 841, 843 (7th Cir. 1991) (tax shelter investors commenced malpractice action against attorney whose opinion letter was used by promoter to support a transaction's supposed legitimacy); *Newmyer v. Philatelic Leasing, Ltd.* 888 F.2d 385, 387 (6th Cir. 1989) (investor brought suit against tax shelter promoter).

<sup>15</sup> Soled, *supra* note 3, at 270–71; see also, e.g., *Simon v. KPMG LLP*, No. 05-CV-3189, 2006 WL 1541048, at \*12 (D.N.J. June 2, 2006) (approval of \$178 million settlement to be paid by KPMG and the law firm Sidley Austin Brown & Wood); *Denney v. Jenkins & Gilchrist*, 230 F.R.D. 317, 324 (S.D.N.Y. 2005) (settlement agreement of \$81,557,805).

<sup>16</sup> Soled, *supra* note 3, at 270–77; see also, e.g., *Swartz v. KPMG LLP*, 476 F.3d 756 (9th Cir. 2007) (naming KPMG, Sidley Austin Brown & Wood LLP, and Deutsche Bank among the defendants); *Palmer Ventures v. Deutsche Bank AG*, 254 F. App'x 426 (5th Cir. 2007) (unpublished) (asserting that Deutsche Bank, KPMG, Presido Advisory Services, and Sidley Austin Brown & Wood, among others, devised BLIPS, were aware of its potential illegality, and fraudulently conspired to market it to others).

executive.<sup>17</sup> These cases have contributed to a seismic shift in the nature of tax practice by deterring lawyers and law firms from providing opinions for legitimate tax planning purposes.<sup>18</sup> The codification of the economic substance doctrine as part of President Obama's Health Care Act inflicts further harm on the nation's tax system by increasing uncertainty because it is overly broad and fails to specify when the doctrine applies.<sup>19</sup> Furthermore, the Act threatens legitimate business transactions, which if tested for economic substance under the unreasonably broad provision, could fail the statutory test.<sup>20</sup>

This Note argues that the burdens of heightened liability and increasing uncertainty undermine the ability of tax lawyers to add value through viable tax advisory services, and that the rules and standards governing tax opinions should be revised to encourage lawyers to give legitimate tax advice, rather than driving lawyers away from the practice altogether. Part II provides a brief overview of the wide variety of services provided by tax lawyers, and examines the purpose and function of tax opinions. Part III documents the rise of the tax shelter market and the role of lawyers in the tax shelter industry. Part IV examines the judicial and legislative responses to tax shelters, and considers how the developments in the law have affected tax lawyers as a profession. Part V explores the dilemma currently facing lawyers engaged in legitimate tax practice and analyzes recent efforts to improve the tax system. This section proceeds with a critique of the recent developments and proposed changes before offering an alternative solution. Part VI concludes.

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<sup>17</sup> See generally Hsue, *supra* note 13, at 920–24.

<sup>18</sup> See generally Schumacher, *supra* note 4, at 36.

<sup>19</sup> See McGuire Woods, *Economic Substance Doctrine Codified in New Legislation*, McGuireWoods (Apr. 9, 2010), available at <http://www.mcguirewoods.com/news-resources/item.asp?item=4687>.

<sup>20</sup> See *id.*

## II. THE ROLE OF THE TAX LAWYER AND THE FUNCTIONS OF TAX OPINIONS

### A. The Tax Lawyer's Role

The modern tax lawyer wears many different hats. Tax advice covers a broad spectrum—from assisting with individual tax returns to arranging complex business transactions in the most tax-efficient form.<sup>21</sup> Therefore, whether you are an individual seeking assistance with your tax return or a multinational corporation engaging in a billion-dollar merger transaction, the services of a good tax lawyer are essential. Clearly, a thorough examination of all the roles and functions of the modern tax lawyer is well beyond the scope of this Note. This Note focuses on a particular aspect of tax practice in the United States, namely, the need for and importance of tax opinions. However, it is critical to remember that tax opinions are just one facet of legal advice provided by tax lawyers, and tax shelters are just one context in which legal opinions are used. Tax shelters receive a lot of scrutiny and debate in tax opinion practice, but the practice and the tensions are much broader.

The complexities and uncertainties of the tax laws are well documented.<sup>22</sup> To help deal with these issues, individual taxpayers and corporations often seek advice from tax lawyers.<sup>23</sup> Generally speaking, tax opinions describe the application of the tax laws to a particular situation faced by a taxpayer, and are required in a wide variety of contexts for legitimate purposes.<sup>24</sup> The tax shelter marketing opinions

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<sup>21</sup> See generally Linda M. Beale, *Tax Advice Before the Return: The Case for Raising Standards and Denying Evidentiary Privileges*, 25 VA. TAX REV. 583, 586–87 (Winter 2006).

<sup>22</sup> See, e.g., *U.S. v. El Paso Co.*, 682 F.2d 530, 534 (5th Cir. 1982), cert. denied, 466 U.S. 944 (1984) (describing the Internal Revenue Code as “a sprawling tapestry of almost infinite complexity”).

<sup>23</sup> See Moldenhauer, *supra* note 1, at § 7.1.

<sup>24</sup> Classic uses of legal opinions in the tax context include taxpayer planning opinions, tax return position opinions, penalty protection opinions and financial audit opinions. See Moldenhauer, *supra* note 1, at

that have attracted so much attention in recent years represent only a small slice of the much larger role played by tax opinions.

The legitimacy and importance of efficient tax planning is a prevalent theme of this Note. There is nothing inherently immoral about legitimate tax minimization, nor is it morally questionable to structure one's tax compliance in a manner that efficiently and effectively maximizes deductions.<sup>25</sup> Tax professionals help their clients achieve compliance, while also providing creative solutions to limit tax liabilities and avoid penalties.

## B. Standards for Lawyers Issuing Tax Opinions

When issuing a tax opinion, the lawyer has a duty to give his professional opinion as to what he believes would likely be a court's ultimate decision if the position were challenged.<sup>26</sup> In rendering such advice, tax practitioners are subject to a variety of requirements and standards.<sup>27</sup> The result of this dynamic is a complex web of relationships involving the taxpayer, the tax lawyer, the Treasury Department, and regulators.<sup>28</sup> The primary authorities governing tax opinions include state professional ethics rules that are generally based on the ABA Model Rules of Professional Conduct (the "Model Rules") or the ABA Model Code of Professional Responsibility (the "Model Code"),

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§ 7.1. Beyond these common uses, there are an unlimited number of potential transactions and contexts in which a tax opinion might be rendered. *See id.* (noting the various uses of tax opinions in commercial transactions).

<sup>25</sup> Norris Darrell, *Responsibilities of the Lawyer in Tax Practice*, reprinted in PROFESSIONAL RESPONSIBILITY IN FEDERAL TAX PRACTICE 87, 100 (Boris I. Bittker ed., 1970) ("To infer that there is something morally wrong with avoiding tax in a legitimate way, there being no fraud, deceit or make-believe, is pure hypocrisy.").

<sup>26</sup> MODEL CODE OF PROF'L RESPONSIBILITY EC 7-3, 7-5 (1983). *See also* MODEL RULES OF PROF'L CONDUCT R. 2.1 cmt. 1 ("A client is entitled to straightforward advice expressing the lawyer's honest assessment."); *see also infra* note 40 and accompanying text.

<sup>27</sup> MODEL CODE OF PROF'L RESPONSIBILITY EC 7-3, 7-5 (1983).

<sup>28</sup> *Id.*

Treasury Department Circular 230, Internal Revenue Code and Treasury Regulations, securities laws, state malpractice laws, general tort and criminal liability, and evidentiary rules.<sup>29</sup>

Lawyers are regulated under the relevant State ethics rules, which are enforced by State ethics bodies.<sup>30</sup> State ethics bodies frequently issue interpretive opinions to help guide opining lawyers.<sup>31</sup> The ABA Committee on Ethics and Professional Responsibility also enacted model ethical rules prescribing standards governing attorney conduct.<sup>32</sup> The opinions issued by the ABA Standing Committee on Ethics and Professional Responsibility are influential in practice, as are the commentaries to the Model Rules and the Model Code.<sup>33</sup> In addition, the Committee on Standards of Tax Practice of the ABA Section of Taxation issues statements concerning the standards of tax practice.<sup>34</sup>

The relevant ethical guidance for tax planning opinions is ABA Formal Opinion 85-352, which describes the duties of a lawyer rendering tax advice as follows:

the lawyer should counsel the client as to whether a court will likely sustain the position, the lawyer should counsel the client regarding potential penalties and other legal consequences of the position, and the lawyer should not deliberately mislead the IRS, either through misstatements, silence, or permitting the client to mislead.<sup>35</sup>

A lawyer may recommend positions favorable to a client if the lawyer has a good-faith belief that the positions are

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<sup>29</sup> See Moldenhauer, *supra* note 1, at § 7.2.

<sup>30</sup> *Id.*

<sup>31</sup> *Id.*

<sup>32</sup> See Hsue, *supra* note 13, at 915 (referencing ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 346, reprinted in Formal and Informal Ethics Opinions: Formal Opinions 316-348, Informal Opinions 1285-1495 (1985)).

<sup>33</sup> See Moldenhauer, *supra* note 1, at § 7.2.

<sup>34</sup> *Id.*

<sup>35</sup> ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 85-352 (1985); see also Moldenhauer, *supra* note 1, at § 7.8.



supportable under existing law or can make a good-faith argument for an extension, modification, or reversal of existing law.<sup>36</sup> “Good faith” requires a realistic possibility of success in the event the position is litigated.<sup>37</sup> According to a Special Task Force established by the ABA Tax Section, a position has a realistic possibility of success if the likelihood of success before a court approaches one-third, or if the position is supported by “substantial authority.”<sup>38</sup> In response to the increasing prevalence of tax shelters, the ABA issued Formal Opinion 346 in 1982.<sup>39</sup> Formal Opinion 346 sets forth general standards that tax lawyers should meet in issuing opinion letters, including making factual investigations to ensure accuracy, relating the law to the facts while stating any assumptions, and providing an overall evaluation of the likely outcome on the merits of the transaction.<sup>40</sup>

The Secretary of the Treasury has the authority to regulate lawyers and other professionals practicing before the Treasury Department.<sup>41</sup> Circular 230 sets forth a broad set of rules regulating many aspects of federal tax practice.<sup>42</sup> The Circular 230 rules are generally mandatory in nature

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<sup>36</sup> ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 85-352 (1985); *see also* Moldenhauer, *supra* note 1, at § 7.8.

<sup>37</sup> *See* Moldenhauer, *supra* note 1, at § 7.8.

<sup>38</sup> Paul J. Sax, James P. Holden, Theodore Tannenwald, Jr., David E. Watts & Bernard Wolfman, *Report of the Special Task Force on Formal Opinion 85-352*, 39 TAX LAW. 635 (1986); *see also* Moldenhauer, *supra* note 1, at § 7.8.

<sup>39</sup> Hsue, *supra* note 13, at 917; ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 346, n.1 (1985) (A ‘tax shelter’ . . . is an investment which has as a significant feature for federal income or excise tax purposes either or both of the following attributes: (1) deductions in excess of income from the investment being available in any year to reduce income from other sources in that year, and (2) credits in excess of the tax attributable to the income from the investment being available in any year to offset taxes on income from other sources in that year.).

<sup>40</sup> ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 346 (1985).

<sup>41</sup> 31 U.S.C. § 330(a) (2006); *see also* Moldenhauer, *supra* note 1, at § 7.2.

<sup>42</sup> 31 C.F.R. § 10 (2004); *see also* Moldenhauer, *supra* note 1, at § 7.2.

and are enforced by the Treasury Department Office of Professional Responsibility.<sup>43</sup> Circular 230 provides specific confidence standards and diligence requirements that opinion letters must meet.<sup>44</sup> These regulations represent the primary governing body of law for tax opinions under the current scheme and are discussed in detail below.<sup>45</sup> The Internal Revenue Code (the "Code") and certain Treasury regulations promulgated under the Code also include rules affecting tax practitioners who render tax opinions.<sup>46</sup> For example, Sections 6111 and 6112 of the Code require a "material advisor" to disclose certain "reportable transactions," while Section 6700 of the Code imposes penalties on those who participate in the organization or sale of tax shelters.<sup>47</sup>

In addition to the aforementioned standards and regulations, lawyers issuing tax opinions may face liability from other sources, depending on the context in which the opinion is provided. For instance, a tax lawyer who provides an opinion in connection with a public offering of securities is subject to the general rules relating to securities offerings, including Rule 10b-5.<sup>48</sup> Similarly, a tax opinion provided in connection with a public company audit is subject to a wide range of rules regarding public company accounting and audit, including the Sarbanes-Oxley Act of 2002.<sup>49</sup> In addition, opining lawyers are also subject to a variety of standard-based rules. A lawyer who issues an incorrect tax opinion could face liability in the form of a malpractice claim,<sup>50</sup> and could also be subject to general tort claims (for example, negligent misrepresentation or fraud) if it were determined that the tax opinion was part of a general

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<sup>43</sup> 31 C.F.R. § 10 (2004) (setting forth best practices for tax advisors); see also Moldenhauer, *supra* note 1, at § 7.2.

<sup>44</sup> *Id.* at 917-18; see also 31 C.F.R. §§ 10.33-10.34 (2004).

<sup>45</sup> See *infra* Part IV.A.

<sup>46</sup> See Moldenhauer, *supra* note 1, at § 7.2.

<sup>47</sup> *Id.* at §§ 7.2 and 7.3.

<sup>48</sup> *Id.*

<sup>49</sup> *Id.*

<sup>50</sup> *Id.*

scheme to defraud the relevant taxpayer or the government.<sup>51</sup> A lawyer providing a tax opinion must also consider the extent to which the opinion is covered by the attorney-client privilege or the attorney work product doctrine.<sup>52</sup> In one recent case, *United States v. Textron*, the First Circuit reversed an earlier opinion, holding that the work product doctrine does not apply to a company's tax accrual work papers, and found that indeed attorney work product had to be turned over to the IRS as part of its tax shelter investigation.<sup>53</sup> This case has serious implications for tax lawyers and tax opinions, as it potentially narrows the work product doctrine by holding that it does not apply to tax accrual work papers.<sup>54</sup>

### C. Duties Owed by the Tax Lawyer

Depending on the conditions under which an opinion is issued, a tax lawyer issuing a tax opinion may owe duties to one or more of the following parties: the client taxpayer, the non-client taxpayer, the tax system and tax administrators, and various other third parties.<sup>55</sup> These duties may give rise to civil and criminal liability for the opining lawyer, as discussed more fully in Part II.B and Part IV.

Generally, a tax lawyer owes fiduciary duties to her client.<sup>56</sup> Under Canon 7 of the Model Code of Professional Responsibility, the lawyer must zealously represent her client within the bounds of the law.<sup>57</sup> Furthermore, the lawyer must act competently<sup>58</sup> and exercise independent

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<sup>51</sup> *Id.*

<sup>52</sup> *Id.*

<sup>53</sup> *United States v. Textron*, 577 F.3d 21, 31–32 (1st Cir. 2009) (en banc).

<sup>54</sup> *Textron* at 31–32; see also Jocelyn Allison, *US v. Textron Raises Concerns Over Work Product*, LAW360, Oct. 9, 2009, <http://www.law360.com/articles/123606>.

<sup>55</sup> See Moldenhauer, *supra* note 1, at § 7.6.

<sup>56</sup> See *id.*

<sup>57</sup> MODEL CODE OF PROF'L RESPONSIBILITY EC 7-1 (1983).

<sup>58</sup> *Id.* at EC 6-1 (1983); MODEL RULES OF PROF'L CONDUCT R. 1.1 (2002).

professional judgment<sup>59</sup> in favor of the client. In addition, under general tort and contract principles, a lawyer issuing tax advice must use the skill, care, and diligence ordinarily displayed by tax specialists in similar circumstances.<sup>60</sup>

A common activity in opinion practice involves tax lawyers rendering opinions to third parties. This can happen in a variety of business transactions and contexts, including matters involving tax-related issues.<sup>61</sup> In these transactions, the practitioner typically assumes responsibilities to the third party, as well as to the client.<sup>62</sup> First, under Model Rule 2.3(a), a lawyer may only issue an opinion to a third party if the lawyer reasonably believes his actions to be "compatible with other aspects of the lawyer's relationship with the client."<sup>63</sup> Where the opinion is likely to have a material adverse effect on the client's interests, the lawyer must first obtain the consent of the client before issuing the opinion.<sup>64</sup> Generally, when issuing a third-party opinion, a lawyer must not knowingly make a false statement of material fact or law.<sup>65</sup> Ethical rules mandate that the lawyer rendering an opinion to a third party has a duty of candor and must also exercise independent professional judgment.<sup>66</sup> Therefore, the lawyer has a duty to disclose to third parties any limitation on the scope of the opinion imposed by the client.<sup>67</sup> Moreover, a practitioner's duties to a third party may also arise under tort law principles or securities laws.<sup>68</sup>

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<sup>59</sup> MODEL CODE OF PROF'L RESPONSIBILITY EC 5-1 (1983); MODEL RULES OF PROF'L CONDUCT R 5.4 (2002).

<sup>60</sup> See generally BERNARD WOLFMAN, JAMES P. HOLDEN & KENNETH L. HARRIS, STANDARDS OF TAX PRACTICE § 603.3 (6th ed. 2004).

<sup>61</sup> See Moldenhauer, *supra* note 1, at § 7.6 (noting the various uses of tax opinions in business transactions).

<sup>62</sup> *Id.*

<sup>63</sup> MODEL RULES OF PROF'L CONDUCT R. 2.3(a) (2002).

<sup>64</sup> *Id.* at R. 2.3(b).

<sup>65</sup> *Id.*

<sup>66</sup> MODEL CODE OF PROF'L RESPONSIBILITY Canon 5 (1983); MODEL RULES OF PROF'L CONDUCT R. 2.1, 2.3, 4.1 (2002).

<sup>67</sup> MODEL RULES OF PROF'L CONDUCT R. 2.3 cmt. (2002).

<sup>68</sup> See Moldenhauer, *supra* note 1, at § 7.6.

In addition to the duties owed to client and non-client taxpayers, opining tax lawyers may also have duties to the tax system and tax administrators. However, these duties are largely unsettled, and may actually be in conflict with other duties owed by the lawyer to his client.<sup>69</sup> For instance, under Canon 8 of the Model Code of Professional Responsibility, a lawyer should generally assist in improving the legal system.<sup>70</sup> However, the Model Code mandates that any conflict between the lawyer's duties to the legal system and the lawyer's duties to the client should be resolved in favor of the client.<sup>71</sup> Therefore, although commentators and scholars fundamentally agree that tax lawyers do owe certain general duties to the tax system, the basis and scope of this duty to the system is not entirely clear.<sup>72</sup>

### III. THE RISE OF THE TAX SHELTER INDUSTRY

#### A. The History of Tax Shelters

*"Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes."*<sup>73</sup>

These famous words, written by Judge Learned Hand three quarters of a century ago, establish a fundamental premise of American tax law, namely the legitimacy of tax planning practice.<sup>74</sup> However, even though society appears comfortable with the practice of tax planning, tax avoidance is an entirely different matter. While tax avoidance has been an issue since the earliest days of our nation's history,<sup>75</sup> the modern tax shelter industry first rose to prominence

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<sup>69</sup> *Id.*

<sup>70</sup> MODEL CODE OF PROF'L RESPONSIBILITY Canon 8 (1983).

<sup>71</sup> *See id.* at EC 7-1, EC 8-4.

<sup>72</sup> *See Moldenhauer, supra* note 1, at § 7.6.

<sup>73</sup> *Helvering v. Gregory*, 69 F.2d 809, 810 (2d Cir. 1934) (emphasis added).

<sup>74</sup> *See Schumacher, supra* note 4, at 39-42.

<sup>75</sup> *See Merle H. Miller, Morality in Tax Planning*, 10 INST. ON FED. TAX'N 1067, 1068 (1952).

during the 1970s.<sup>76</sup> Tax shelters are defined generally as “arrangements organized and promoted to produce tax losses to use against unrelated income.”<sup>77</sup> Put simply, tax shelters are a particular method of reducing taxable income in a way that decreases the payments to tax collecting entities, primarily state and federal governments. Abusive tax shelters are distinguishable from legitimate tax planning in that abusive shelters have no independent economic value: their sole purpose is to lower tax liabilities. The wave of tax shelters that began in the 1970s and 1980s was promoted primarily by financial advisers to middle income individuals.<sup>78</sup> The IRS, which is tasked with identifying and dismantling abusive tax shelters, attempted to restrain tax shelter activity through increased scrutiny and conventional administrative programs.<sup>79</sup> However, the IRS simply does not have the staff or the resources to thwart every shelter it encounters.<sup>80</sup> Moreover, investors and practitioners have continued to prevail through the development of unique strategies designed to circumvent IRS countermeasures.<sup>81</sup>

As part of the Tax Reform Act of 1986, Congress enacted certain provisions aimed at curbing the use of abusive tax shelters.<sup>82</sup> The Tax Reform Act of 1986 was, at least initially,

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<sup>76</sup> See Paul J. Sax, *Lawyer Responsibility in Tax Shelter Opinions*, 34 TAX LAW. 5, 6 (1980).

<sup>77</sup> *Id.*

<sup>78</sup> See Rostain, *supra* note 2, at 83.

<sup>79</sup> *Id.* at 87.

<sup>80</sup> See Cassell Bryan-Low, *Accounting Firms Face Backlash Over the Tax Shelters They Sold*, WALL ST. J., Feb. 7, 2003, at A1 (The scope of the tax-avoidance problem has reached huge proportions. During 2002, the IRS got information suggesting that a million taxpayers could have been using one scheme alone—anonymous offshore bank accounts that allow them to hide money away yet gain access to it through credit or debit cards. The IRS confronts 82,100 cases of abusive devices a year, though it doesn't have the staff to pursue all of them, former IRS Commissioner Charles Rossotti wrote in a report late last year.).

<sup>81</sup> See Chirelstein & Zelenak, *supra* note 12, at 1951–52.

<sup>82</sup> See Soled, *supra* note 3, at 270–71; see also Chirelstein & Zelenak, *supra* note 12, at 1951–52; Rostain, *supra* note 2, at 83; Joseph Bankman, *The New Market for Tax Shelters*, 83 TAX NOTES 1775, 1776 (1999); George

one of the most successful initiatives in preventing tax shelter activity.<sup>83</sup> However, as Professor Soled has offered, "this overly optimistic attitude quickly gave way to a much grimmer reality: tax practitioners' ingenuity and taxpayers' greed resulted in the circumvention of these safeguards, resulting in an onslaught of abusive tax shelters that have cost the nation's coffers billions of dollars in lost tax revenue."<sup>84</sup>

## B. The Rise of the Modern Tax Shelter Industry

Recently, a new era of tax shelters has emerged. The economic boom of the 1990s produced a large class of wealthy taxpayers, the majority of whom were unfamiliar with the complexities of the tax laws.<sup>85</sup> This period of financial prosperity also gave rise to a new era of corporate tax shelters, which flourished over the next decade.<sup>86</sup> Meanwhile, tax departments at many large companies faced pressure from management to act as profit centers, rather than focusing solely on legal compliance.<sup>87</sup> Many tax lawyers and accounting firms saw this series of developments as an opportunity to promote tax shelter strategies to both wealthy investors and corporate clients.<sup>88</sup> Advisers designed schemes to serve ostensibly as legal shields for profits and capital gains.<sup>89</sup> While these activities did not constitute an entirely new enterprise, this period was distinguished by the energy

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K. Yin, *Getting Serious About Corporate Tax Shelters: Taking a Lesson from History*, 54 SMU L. REV. 209, 218–19 (2001).

<sup>83</sup> See Chirelstein & Zelenak, *supra* note 12, at 1951–52.

<sup>84</sup> Soled, *supra* note 3, at 330.

<sup>85</sup> Bryan-Low, *supra* note 84, at A1.

<sup>86</sup> Rostain, *supra* note 2, at 83.

<sup>87</sup> *Id.* at 86.

<sup>88</sup> See Bryan-Low, *supra* note 84, at A1 (describing the developments in the 1990s that provided a springboard for new profit opportunities from the use of tax shelter schemes).

<sup>89</sup> See *id.* ("So big accounting firms formed teams dedicated to promoting high-margin tax strategies. Fees to the accounting firm ranged from 10% to 40% of taxes saved. The individual tax salesmen who snagged deals could get up to 10% of this.").

that large accounting firms devoted to devising strategies and the size of their marketing efforts.<sup>90</sup> Large-scale tax shelter strategies were particularly successful for accounting firms because, once devised, they could be marketed to thousands of clients.<sup>91</sup> These mass-marketed strategies came to be known by various names and acronyms (Son of Boss, BLIPS, FLIP, OPIS), but they all shared a similar purpose of shielding taxpayers from federal and state taxes.<sup>92</sup> This practice of producing largely standardized tax shelter products is clearly distinguishable from the established practice of bespoke individualized tax planning for individuals and corporations. During the same time that tax advisers were reaping huge rewards through large-scale tax shelters, the IRS was cracking down.<sup>93</sup> Recognizing that it could not prevent new types of abusive tax shelter strategies from forming, the IRS focused increasingly on the promoters of the strategies.<sup>94</sup> Initially, the government primarily targeted accounting and investment firms in its war against tax shelters.<sup>95</sup> Gradually, however, its attention shifted to the law firms that provided legal opinions justifying the use of the tax shelter strategies.<sup>96</sup>

### C. The Importance of Legal Opinions in the Tax Shelter Industry

To provide much-needed comfort, individual taxpayers, businesses, and tax shelter promoters sought the services of

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<sup>90</sup> *Id.*

<sup>91</sup> *Id.*

<sup>92</sup> *See id.* (describing the prevalence and widespread use of the BLIPS strategy by KPMG partners); *see also* Tommy Fernandez, *Tax Shelter Crackdown Hits Law Firms*, CRAIN'S N.Y. BUS. 1 (June 14, 2004) (describing the use of legal opinions to justify the "Son of Boss" strategies).

<sup>93</sup> *See* Bryan-Low, *supra* note 85.

<sup>94</sup> *See id.* ("The IRS, knowing it can be years before audits identify a new type of abusive shelter, has focused increasingly on the promoters of the strategies.").

<sup>95</sup> *See id.*; *see also* Del Jones, *Banks Face Suits in Contested Tax Plans*, USA TODAY, Feb. 10, 2003, at B1; Rostain, *supra* note 2, at 88–92.

<sup>96</sup> *See generally* Fernandez, *supra* note 92.



reputable law firms to provide legal opinion letters “blessing” tax shelter transactions as a legitimate way to reduce taxes.<sup>97</sup> For abusive tax shelter transactions and large-scale tax shelter marketing strategies, the real value of the opinion letter was its ability to shield taxpayers from government penalties.<sup>98</sup> However, taxpayers involved in potentially abusive transactions often failed to appreciate the purpose of the opinion letters, seeing them as an indestructible “insurance policy” rather than as what they really were: a letter stating an opinion.<sup>99</sup>

Nevertheless, from a basic cost-benefit perspective, engaging in tax shelter transactions and purchasing the requisite legal opinion made sense financially for many individual taxpayers and businesses.<sup>100</sup> Before the enactment of the American Jobs Creation Act in 2004, a lack of effective regulatory impediments encouraged abusive shelter transactions.<sup>101</sup> The Internal Revenue Code did impose a variety of penalties for underpayments of tax, including civil penalties for fraud, negligence, or disregard of rules or regulations, substantial understatement of federal income tax, and understatements with respect to reportable transactions.<sup>102</sup> However, applicable penalties were set at

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<sup>97</sup> David Cay Johnston, *Costly Questions Arise on Legal Opinions for Tax Shelters*, N.Y. TIMES, Feb. 9, 2003 (Like sellers of treasure maps, promoters of tax shelters promise that for a large fee one can navigate a secret route. What clinches these deals is not the chart itself but a second document that appears to warrant that the map is as good as gold . . . . That document is called an opinion letter and it blesses the tax shelter as a legitimate way to reduce taxes.).

<sup>98</sup> *See id.*

<sup>99</sup> *Id.* (“What even sophisticated tax shelter buyers often fail to appreciate is that it’s just an opinion, not an insurance policy. . . . [P]romoters try to imbue opinion letters with great significance, . . . implying that there is some standard for grading the quality of assurances, but this is not true.”) (internal quotations omitted).

<sup>100</sup> Rostain, *supra* note 2, at 86.

<sup>101</sup> *See id.*; *see also* The American Jobs Creation Act, Pub. L. No. 108-357, 118 Stat. 1418.

<sup>102</sup> I.R.C. §§ 6662 and 6663; *see also* Moldenhauer, *supra* note 1, at § 7.4.

twenty percent, providing little deterrence value for many taxpayers.<sup>103</sup>

Furthermore, when faced with the threat of penalties, a taxpayer could usually avoid liability by claiming reliance on a tax opinion from a professional advisor. In a typical tax shelter transaction, the independent tax lawyer provides an opinion that states the likelihood that a transaction will withstand judicial scrutiny.<sup>104</sup> Under 26 U.S.C. § 6662, a taxpayer can avoid penalties for underpayment of taxes if: (1) he has substantial authority to support the tax treatment, or (2) he has a "reasonable basis" for the tax treatment itself.<sup>105</sup> Treasury Regulation section 1.6664-4(c) establishes "reliance on opinion or advice" of a "professional tax advisor" as a reasonable cause and good faith exception to 26 U.S.C. § 6662 penalties.<sup>106</sup> Until changes were adopted in 2004, applicable regulations set the standard for "reasonable cause" to require an opinion to conclude that there was a "greater than 50-percent likelihood that the tax treatment of the item will be upheld" if challenged by the Internal Revenue Service.<sup>107</sup> Therefore, taxpayers who could meet the "reasonable cause and good faith" exception contained in § 6664(c) of the Code were not subject to a penalty for substantial underpayments of tax liability attributable to investments in tax shelters.<sup>108</sup>

This use of opinions for penalty avoidance placed the participating taxpayer at virtually zero risk, and provided further incentive for the taxpayer to play the "audit lottery." Suppose, for example, a taxpayer, armed with a supporting opinion from a reputable law firm, desired to enter into a harebrained tax scheme, fully aware that the IRS would disallow it upon discovery. First, the probability of an audit would be relatively low, meaning that the taxpayer would

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<sup>103</sup> Rostain, *supra* note 2, at 86.

<sup>104</sup> Hsue, *supra* note 13, at 911.

<sup>105</sup> I.R.C. § 6662; *see also* Hsue, *supra* note 13, at 911.

<sup>106</sup> Treas. Reg. § 1.6664-4; *see also* Hsue, *supra* note 13, at 912.

<sup>107</sup> Treas. Reg. §§ 1.6662-4(g)(B), 1.6664-4(c), 1.6664-4(e)(B)(1) (as of April 2003); *see also* Rostain, *supra* note 2 at 87.

<sup>108</sup> Rostain, *supra* note 2, at 86–87.

have a very good chance of escaping without any investigation.<sup>109</sup> Furthermore, even in the event of an audit, the presence of a “reasonable basis” opinion would protect the taxpayer against any penalties. Thus, the taxpayer would only be required to pay back the taxes along with the additional interest.

Tax lawyers played a central role in the rise of the tax shelter industry during the 1990s and early 2000s. During the “boom years” of the tax shelter industry, fees for opinion letters ran into the hundreds of thousands of dollars, with some lawyers commanding fees of \$1 million dollars or more.<sup>110</sup> The failure of regulatory mechanisms to deter the production and issuance of tax opinions approving highly questionable transactions promoted the continuing use of opinion letters.<sup>111</sup> Efforts to enforce ethical standards were met with difficulties related to the complexity of the Code and the rise of the textualist interpretative approach.<sup>112</sup> The textualist interpretative approach allowed lawyers to issue opinion letters that emphasized how transactions fit within the explicit terms of the statute, while avoiding the issue of whether the transactions had an underlying business purpose or economic substance.<sup>113</sup> Lawyers faced pressure to issue opinions in support of questionable transactions, largely because the lawyer knew if he refused that the client could easily find a lawyer who would provide the opinion.<sup>114</sup>

#### IV. RECENT DEVELOPMENTS AFFECTING OPINING LAWYERS

While tax shelters have been an important subject for more than four decades, recent events have substantially

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<sup>109</sup> *Id.* at 87 (“Apart from this ineffectual penalty scheme, the probability that the IRS would detect that a highly complex financial transaction is a tax shelter was slight. The IRS had not had adequate resources for enforcement.”).

<sup>110</sup> Rostain, *supra* note 2, at 94.

<sup>111</sup> *See id.* at 93.

<sup>112</sup> *See* Rostain, *supra* note 2, at 93–94.

<sup>113</sup> *Id.* at 94.

<sup>114</sup> *Id.* at 94; *see also* Bankman, *supra* note 82, at 1782–83.

transformed the nature of tax practice in the United States. By the end of the 1990s, it was clear that the “piecemeal” approach of targeting specific shelters after they came to the attention of government regulators was not an adequate solution.<sup>115</sup> Legislators and regulatory groups began to consider more far-reaching efforts to curb the use of abusive tax shelters. For example, the Treasury issued regulations requiring the registration of certain tax shelters, the maintenance of lists of investors in potential abusive shelters, and taxpayer reporting requirements under §§ 6112 and 6011.<sup>116</sup> Congress also pitched in, enacting the American Jobs Creation Act, a far-reaching legislative effort containing several measures directed at tax shelters.<sup>117</sup> For lawyers issuing tax opinions, however, by far the most important changes were the 2005 revisions to Circular 230. Today, Circular 230 regulations require that a tax opinion adhere to a strict set of requirements.<sup>118</sup>

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<sup>115</sup> Rostain, *supra* note 2, at 95.

<sup>116</sup> Treas. Reg. § 301.6112-1T (2000); Treas. Reg. § 1.6011-4T (2000); Rostain, *supra* note 2, at 95–96.

<sup>117</sup> American Jobs Creation Act of 2004, Pub. L. No. 108-357, §§ 811–22, 118 Stat. 1418, 1575–87 (2004); *see also* Rostain, *supra* note 2, at 97.

<sup>118</sup> David T. Moldenhauer, *Circular 230 Opinion Standards, Legal Ethics and First Amendment Limitations on the Regulation of Professional Speech by Lawyers*, 29 SEATTLE U. L. REV. 843, 844–45 (2006) (stating that, under Circular 230, a tax opinion must: identify and evaluate all facts relevant to the transaction; relate all applicable law to the facts; identify and evaluate each “significant Federal tax issue,” meaning a federal tax issue that meets a materiality threshold and to which the IRS has a “reasonable basis for a successful challenge; not contain internally inconsistent legal analyses or conclusions, nor may it take into account the possibility that the IRS might not audit a tax return or raise an issue on audit, or might resolve the issue by settlement if raised; conclude whether the overall tax treatment of the transaction is proper; conclude that the taxpayer will prevail on each significant federal tax issue affecting the transaction, and that the overall tax treatment is proper, at a confidence level of at least “more likely than not,” if someone other than the practitioner will use or refer to the opinion to promote, market or recommend a transaction; and disclose any compensation arrangement the practitioner has with a third party for marketing the transaction, and any referral agreement with a third party who markets such a transaction).

In addition to the legislative and regulatory changes, over the last decade, “taxpayers who invested in tax shelters have brought an avalanche of malpractice cases against their advising lawyers and accountants.”<sup>119</sup> The increased threat of criminal liability is also a primary concern for opining tax lawyers. In conjunction with increasingly stringent statutory penalties, heightened disclosure requirements, and stricter ethical standards, these developments combine to impose heightened liability upon opining lawyers, and pose serious risks for the future health of tax planning practice.

### A. Circular 230

The Treasury Department adopted Circular 230 to determine the standards for those who wish to practice before the IRS.<sup>120</sup> The rules under Circular 230 address, among other things: “(1) eligibility to practice before the IRS; (2) duties and restrictions relating to such practice; and (3) rules applicable to disciplinary proceedings for violation of the regulations.”<sup>121</sup> The standards set forth in Circular 230 apply to all persons preparing tax returns or providing tax advice for compensation. In general, only lawyers, certified public accountants, enrolled agents, enrolled actuaries, and enrolled retirement plan agents may practice before the IRS.<sup>122</sup> While Circular 230 has far-reaching implications for various aspects of tax practice, this Note focuses primarily on the provisions related to the production and issuance of tax opinions, and in particular on the revisions added in 2005.

The Treasury Department first adopted rules regulating tax shelter opinions in 1984, in former Section 10.33 of

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<sup>119</sup> Soled, *supra* note 3, at 268.

<sup>120</sup> 31 C.F.R. §§ 10.0–10.93 (2005).

<sup>121</sup> Jay A. Soled, *Third-Party Civil Tax Penalties and Professional Standards*, 2004 WIS. L. REV. 1611, 1626 (2004).

<sup>122</sup> 31 C.F.R. § 10.3. Circular 230 also provides that federal and state officers may practice in front of the IRS as well. *Id.*

Circular 230.<sup>123</sup> Former Section 10.33 required an opining lawyer to: (1) identify, describe, and analyze relevant facts, (2) relate the law to the facts, (3) identify and assess material tax issues, and (4) provide an overall evaluation whether an investor will realize the material tax benefits.<sup>124</sup> Former Section 10.33 was adopted in 1984, primarily to address problems related to "heavily qualified, hypothetical, inconclusive or incorrect opinions which promoters used to market tax shelters."<sup>125</sup> In enacting the former rules, the Treasury emphasized certain restraints that would protect against the hindrance of legitimate tax opinions.<sup>126</sup> The Treasury also underlined the consistency of the rules with ABA Formal Opinion 346.<sup>127</sup> However, by early 2000, public outcry over large corporate scandals, such as Enron, and the

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<sup>123</sup> Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries Before the Internal Revenue Service, 49 Fed. Reg. 6719 (Feb. 23, 1984). Treasury considered such rules to be authorized by 31 U.S.C. § 330 as then in effect, as well as other statutory provisions. 49 Fed. Reg. 6720, 6720 n.1 (Feb. 23, 1984); see also Moldenhauer, *supra* note 118, at 847.

<sup>124</sup> Former Circular 230, 31 C.F.R. § 10.33(a)(1)–(3), (5) (1984); see also Moldenhauer, *supra* note 125, at 847.

<sup>125</sup> Moldenhauer, *supra* note 118, at 847; see also Department of the Treasury, Proposed Rule, Tax Shelters; Practice Before the Internal Revenue Service, 45 Fed. Reg. 58,594, 58,595 (Sept. 4, 1980).

<sup>126</sup> See Moldenhauer, *supra* note 118, at 848 (In the preamble to the proposed former rules, Treasury emphasized that the rules would not affect or regulate the practitioner's relationship with individual clients, and that it was the use of a tax shelter opinion that the proposed rule would regulate, not the rendering of an opinion by a lawyer to his client.) (internal quotations omitted).

<sup>127</sup> *Id.* at 848–49 (The preamble also stated that the proposed rules were consistent with a 1982 American Bar Association opinion concerning tax shelter opinions, Formal Opinion 346. After final publication of Formal Opinion 346, the regulations were revised to conform more closely to the ABA opinion. The legal profession, as Treasury described the relationship, has, by publication of ABA Opinion 346, recognized that attorneys have unique ethical responsibilities when they render tax shelter opinions to persons who are not their clients. This action by the ABA reinforces Treasury's belief that tax practitioners must meet minimum standards of conduct with respect to tax shelter opinions.) (internal quotations omitted).

continued emergence of abusive tax structures convinced government officials that a change was needed.<sup>128</sup> Over the next few years, the Treasury published proposed revisions to Circular 230 that would greatly expand the technical definition of a “tax shelter.”<sup>129</sup> Also during this period, Congress passed the American Jobs Creation Act of 2004,<sup>130</sup> which amended the current authorizing statute, 31 U.S.C. Section 330, to specifically authorize the Treasury to impose standards for written advice with respect to entities, plans, or arrangements having a potential for tax avoidance or evasion.<sup>131</sup> The Treasury published its final rules in December 2004, bringing about a sweeping set of changes that included “best practices for tax advisors, requirements for ‘covered opinions,’ requirements for other written advice, and procedures to ensure compliance.”<sup>132</sup> The regulations became effective on June 21, 2005, representing the culmination of a series of steps taken by the IRS over the previous decade to address the abuses of the tax shelter industry.<sup>133</sup>

The rules that make up Circular 230 impose new standards and regulations for all tax advice, with a primary distinction between “covered opinions” and “written

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<sup>128</sup> See William H. Simon, *After Confidentiality: Rethinking the Professional Responsibilities of the Business Lawyer*, 75 FORDHAM L. REV. 1453, 1453–57 (2006).

<sup>129</sup> See Moldenhauer, *supra* note 118, at 849.

<sup>130</sup> American Jobs Creation Act of 2004, Pub. L. 108-357, 118 Stat. 1418 (2004).

<sup>131</sup> Under 31 U.S.C. § 330(d):

[n]othing in this section or in any other provision of law shall be construed to limit the authority of the Secretary of the Treasury to impose standards applicable to the rendering of written advice with respect to any entity, transaction plan or arrangement, or other plan or arrangement, which is of a type which the Secretary determines as having a potential for tax avoidance or evasion.

<sup>132</sup> Moldenhauer, *supra* note 118, at 850.

<sup>133</sup> *New IRS Circular 230 Regulations for Written Advice*, GIBBONS, <http://www.gibbonslaw.com/circular230/>.

advice.”<sup>134</sup> An essential function of the revised regulations is to impose certain procedural and substantive requirements on tax advisors when they issue a “covered opinion.”<sup>135</sup> The 2005 modifications impose heightened due diligence standards and disclosure for covered opinions, and increase penalties for violations including censure, suspension, fines, or even disbarment from practice before the IRS.<sup>136</sup>

Circular 230 defines a “covered opinion” as written advice (including emails) by a practitioner that concerns one or more federal tax issues arising from: (1) a “listed” or similar transaction determined by the IRS to be a tax avoidance transaction; (2) any partnership, entity, plan, or arrangement whose principal purpose is tax avoidance or evasion; or (3) any partnership, entity, plan or arrangement that has a significant tax avoidance purpose, but only if such advice is a “reliance opinion,” a “marketed opinion,” or is subject to “conditions of confidentiality” or “contractual protection.”<sup>137</sup> Covered opinions do not include preliminary tax advice<sup>138</sup> or advice concerning the qualification of a qualified plan, a state or local bond opinion, or opinions included in documents required to be filed with the Securities and Exchange Commission.<sup>139</sup> In addition, “covered opinions” do not include advice reflecting the tax benefits of the taxpayer after the taxpayer has filed a tax return (unless the practitioner has reason to know that the advice will be relied upon by the taxpayer to take a position on a tax return filed in the future),<sup>140</sup> written advice provided to an employer by a practitioner in his or her capacity as an employee of the employer solely for the purposes of

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<sup>134</sup> 31 C.F.R. §§ 10.35(b) and (f); § 10.37.

<sup>135</sup> GIBBONS, *supra* note 140.

<sup>136</sup> 31 C.F.R. § 10.35(e); *see also* Bridget J. Crawford, *Tax Practice in a Circular Revolution: A Review of PLI's Circular 230 Deskbook*, 42 REAL PROP. PROB. & TR. J. 213, 214 (2007); GIBBONS, *supra* note 133.

<sup>137</sup> 31 C.F.R. § 10.35(b)(2); *see also* GIBBONS, *supra* note 133.

<sup>138</sup> 31 C.F.R. § 10.35(b)(2)(ii)(A).

<sup>139</sup> 31 C.F.R. § 10.35(b)(2)(ii)(B).

<sup>140</sup> 31 C.F.R. § 10.35(b)(2)(ii)(C).



determining tax liability of the employer,<sup>141</sup> or 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.<sup>142</sup>

A tax lawyer providing a "covered opinion" must: (1) use reasonable efforts to identify and ascertain all relevant facts; (2) base the opinion only on reasonable factual assumptions; (3) rely only on reasonable factual representations, statements or findings of the taxpayer or any other person; (4) relate the applicable law to the relevant facts; (5) consider all significant federal tax issues (unless the opinion is expressly limited in scope); (6) provide a "conclusion as to the likelihood that the taxpayer will prevail on the merits with respect to each significant federal tax issue considered in the opinion;" and (7) provide an "overall conclusion as to the likelihood that the federal tax treatment of the transaction . . . is the proper treatment and the reasons for that conclusion."<sup>143</sup> Tax lawyers providing covered opinions cannot rely on factual assumptions or taxpayer representations that they know or should know are incorrect or incomplete.<sup>144</sup> Furthermore, the regulations for covered opinions require the tax lawyer to disclose any compensation arrangements between the lawyer and tax shelter promoters, as well as any related referral agreements.<sup>145</sup> For marketed opinions, limited scope opinions, and opinions that fail to reach a more-likely-than-not conclusion, additional disclosures are required.<sup>146</sup>

The 2005 revisions to Circular 230 radically transformed the nature of tax practice in the United States. One of the stated purposes of the 2005 revisions was to make tax planning practice more transparent and accountable.<sup>147</sup> The IRS is moving toward auditing lawyers and accountants as a

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<sup>141</sup> 31 C.F.R. § 10.35(b)(2)(ii)(D).

<sup>142</sup> 31 C.F.R. § 10.35(b)(2)(ii)(E).

<sup>143</sup> 31 C.F.R. § 10.35(c); *see also* GIBBONS, *supra* note 133.

<sup>144</sup> GIBBONS, *supra* note 133.

<sup>145</sup> *Id.*

<sup>146</sup> *Id.*

<sup>147</sup> *See* Simon, *supra* note 128, at 1470.

means of assessing the reliability of professional advisers vouching for their clients through heightened disclosure requirements and increased penalties.<sup>148</sup> However, as David T. Moldenhauer noted, the Circular 230 requirements may actually do more harm than good, as:

the Circular 230 requirements are intended to address the significant policy and budgetary issue of practitioners' involvement in the development, marketing and encouragement of abusive tax shelters. Professionals connected with these abusive shelters certainly have acted inappropriately in some cases, but the Circular 230 requirements are in many respects an inappropriate response to these problems. The framework and prohibitions they impose prevent a lawyer from giving taxpayers a complete, informed assessment of their rights. In certain circumstances, the rules create significant ethical conflicts and deny the public legal advice. In general, they distort the lawyer's role and erode the principles underlying legal ethics rules.<sup>149</sup>

One of the most troubling aspects of the Circular 230 standards is that they conflict with the traditional rules of legal ethics and pronouncements regarding tax opinions.<sup>150</sup> The requirements imposed by Section 10.35 may actually conflict with a lawyer's duties under the ethics rules and traditional standards governing tax opinions.<sup>151</sup> Not surprisingly, the majority of tax practitioners view Circular 230 as at least a thorn in their side, and at most a dangerous development with potentially devastating effects for legitimate tax practice. One tax practitioner, expressing a sentiment shared by many, offers his view of the disparate impact that Circular 230 has had on the profession:

[t]he Treasury has overreacted in its attempt to police tax collections by treating tax professionals as

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<sup>148</sup> *Id.* at 1470–71.

<sup>149</sup> Moldenhauer, *supra* note 118, at 845–46.

<sup>150</sup> *See id.* at 867; *see also supra* Part II.B.

<sup>151</sup> *See* Moldenhauer, *supra* note 118, at 882.

presumptive criminals. Circular 230 will drive a wedge between taxpayer and professional advisor. It will encourage professionals to give only oral advice, unsupported by writing . . . . It will encourage IRS examiners to use intimidation tactics on tax professionals. Worst of all, it will encourage taxpayers to seek tax advice where the cost is lower . . . possibly resulting in more flawed or aggressive tax reporting rather than less.<sup>152</sup>

## B. Tax Shelter Litigation

Courts have long struggled with the dividing line between “good” tax planning and “bad” tax planning. The judicially-developed “economic substance” doctrine has been used by many courts to help discern whether a transaction has a legitimate economic purpose.<sup>153</sup> Courts have employed the economic substance test to deny tax shelters when the transaction generating tax benefits lack an underlying economic purpose. A transaction deemed to lack an economic purpose can be found invalid even when it satisfies all statutory and administrative requirements. Federal courts, including the Supreme Court, have yet to delineate how much “economic substance” a transaction must have to pass muster. This lack of uniformity has led courts to vary in their treatment of similar transactions.<sup>154</sup> However, courts

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<sup>152</sup> Dan W. Holbrook, *Imagine the Worst the U.S. Treasury Could Do To Us—They’ve Done It. Revenge of the IRS: Circular 230 Changes Law Practice*, TENN. B.J. (August 2005).

<sup>153</sup> See Mik Shin-Li, *Strictly Wrong as a Tax Policy: The Strict Liability Penalty Standard in Noneconomic Substance Transactions*, 78 FORDHAM L. REV. 2009, 2014–20 (2010).

<sup>154</sup> See, e.g., *Pasternak v. Comm’r of Internal Revenue*, 990 F.2d 893, 898 (6th Cir. 1993) (requiring the taxpayer to establish the presence of both economic substance and business purpose in a conjunctive test); *Rice’s Toyota World, Inc. v. Comm’r*, 752 F.2d 89, 91–92 (4th Cir. 1985) (finding that either economic substance or a business purpose is sufficient for the transaction to be respected); *ACM P’ship v. Comm’r*, 157 F.3d 231, 248 (3d Cir. 1998) (characterizing economic substance and business purpose as simply more precise factors to consider in determining whether a transaction has any practical economic effects other than the creation of tax benefits).

have generally been successful in applying the doctrine fairly and reasonably.<sup>155</sup>

In recent years, tax shelter cases involving high-profile organizations and law firms have led to increased scrutiny for opining lawyers. Prominent law firms, accounting firms, and investment banks, including such names as KPMG, Ernst & Young, Deutsche Bank, Sidley Austin, and Jenkins & Gilchrist, have found themselves under fire in litigation arising out of questionable tax shelters. While tax shelter malpractice litigation is not a recent phenomenon, the latest outbreak of malpractice litigation stands apart from its predecessors.<sup>156</sup> The financial recoveries involved in the recent cases were extraordinary, often reaching the multimillion-dollar range.<sup>157</sup> In addition, the defendants in many of these cases were well known firms—not lesser-known firms traditionally associated with tax shelter marketing.<sup>158</sup> Rather, they represented the upper echelon of well-known law firms, accounting firms, and financial institutions. Largely due to the prominent names involved, the recent wave of professional malpractice cases garnered considerable public and media attention.<sup>159</sup> The abusive tax shelters in many of these cases relied heavily upon the reassuring legal opinions prepared by prominent law firms, and it is unlikely that the promotion of these transactions would have been possible without these opinions.<sup>160</sup>

The response from academics and practitioners to this new litigation trend is mixed. Undoubtedly, these developments are responsible for some encouraging progress

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<sup>155</sup> See McGuire Woods, *supra* note 19.

<sup>156</sup> Soled, *supra* note 3, at 269.

<sup>157</sup> *Id.* at 270–71.

<sup>158</sup> *Id.*

<sup>159</sup> *Id.*

<sup>160</sup> See Karen C. Burke & Grayson M.P. McCouch, *Cobra Strikes Back: Anatomy of a Tax Shelter*, 62 TAX LAW. 59, 60 (2008) (“The proliferation of abusive tax shelters could never have gotten off the ground without the active participation of high-priced counsel—some of them at highly reputable firms—who issued reassuring legal opinions concerning the tax consequences of shelter transactions.”).

in the face of tax avoidance and the gross misuse of tax shelters.<sup>161</sup> The “virtues” of recent tax shelter litigation include punishing corrupt practitioners with substantial financial penalties, alternative sanctions for wayward practitioners, such as shaming and reputational harm, and increased adherence to ethical standards.<sup>162</sup> Professor Jay Soled applauds this increase in malpractice litigation and urges lawmakers to help this trend continue.<sup>163</sup> Soled proposes certain revisions to the current legal structure that would provide additional incentives to encourage taxpayers to bring malpractice suits against opining lawyers. He argues that, despite their recent success in tax shelter malpractice suits, plaintiff taxpayers still face severe procedural roadblocks that favor defendant practitioners.<sup>164</sup> Specifically, Soled suggests: (1) eliminating various procedural roadblocks to tax malpractice suits, (2) increasing taxpayer recoveries, and (3) increasing economic exposure and shaming wayward practitioners.<sup>165</sup> Although the threat of litigation has been relatively successful in penalizing certain wayward practitioners, caution should be taken against a system designed to drive a wedge between lawyer and client.<sup>166</sup> While the prospect of litigation might help “scare off” those lawyers who seek to abuse and exploit the tax system, it also brings the adverse effect of making legitimate tax planning more costly and difficult to obtain.

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<sup>161</sup> Soled, *supra* note 3, at 276.

<sup>162</sup> *Id.*

<sup>163</sup> *Id.* at 330.

<sup>164</sup> *Id.* at 276.

<sup>165</sup> *Id.* at 316.

<sup>166</sup> *See id.* at 316. Soled identifies a primary purpose of his reform proposal would be “to undo the seemingly inseparable bonds between tax professionals and taxpayers who participate in abusive tax shelter arrangements.” *Id.* He suggests that by re-defining the relationship between tax professional and clients as one built on skepticism rather than trust, tax lawyers would be prone to greater care when issuing opinions and other legal advice. *See id.*

### C. Criminal Liability for Opining Lawyers

Courts and prosecutors have displayed an increased willingness to threatened and actual criminal prosecution to squeeze out abusive tactics. In recent years, the federal government has successfully pursued criminal tax evasion charges against accountants and tax lawyers who marketed abusive tax shelters.<sup>167</sup> In 2008, a federal jury convicted a former lawyer, Raymond J. Ruble, along with two former KPMG accountants, Robert Pfaff and John Larson, of criminal tax evasion charges stemming from the marketing of abusive tax shelter products.<sup>168</sup> Their conviction largely ended what has been dubbed the largest tax fraud case in history.<sup>169</sup> In 2005, KPMG itself avoided criminal prosecution for its involvement in tax shelter activities by entering into a \$456 million settlement agreement with the federal government.<sup>170</sup> The case against Mr. Ruble, a former partner at Sidley Austin Brown & Wood LLP, is particularly noteworthy. Mr. Ruble's conviction, along with a considerable portion of the prosecution's case, centered on the legal opinion letters he wrote supporting the legality of the questionable transactions.<sup>171</sup> Mr. Ruble's letters opined on the likelihood that the allegedly abusive tax shelters would withstand legal challenges by the IRS.<sup>172</sup>

Prior to *United States v. Stein*, the federal government had never before sought criminal penalties against tax planning professionals for providing opinion letters.<sup>173</sup> In the *Stein* case, the government relied primarily on civil standards regulating opinion letters to support the charge

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<sup>167</sup> See Blank, *supra* note 6, at 571.

<sup>168</sup> See Lynnley Browning, *3 Convicted in KPMG Tax Shelter Case*, N.Y. TIMES, Dec. 18, 2008, at B11.

<sup>169</sup> *Id.*

<sup>170</sup> *Id.*

<sup>171</sup> Assaf Hamdani & Alon Klement, *Corporate Crime and Deterrence*, 61 STAN. L. REV. 271, 305 (Nov. 2008); see also *United States v. Stein*, 429 F. Supp. 2d 633, 637 (S.D.N.Y. 2006).

<sup>172</sup> See Hsue, *supra* note 13, at 907.

<sup>173</sup> *Id.*

that the defendants committed a criminal act.<sup>174</sup> The result of this case is particularly troubling for opining lawyers because the civil standards are uncertain and ambiguous at best.<sup>175</sup> Therefore, the apparent lesson from *Stein* for opining lawyers is that they are not safe from all criminal liability just because the government cannot prove criminal liability for tax evasion.<sup>176</sup> The implications of *Stein* demonstrate the need to reform tax shelter regulations to adequately inform opining lawyers as to what activities could expose them to criminal penalties.<sup>177</sup>

## V. THE DILEMMA FACING TAX LAWYERS: TO OPINE OR NOT TO OPINE?

### A. Hard Times for Tax Lawyers

The prominent role played by lawyers in abusive tax shelter schemes makes it clear that tax advice, and specifically taxpayer planning opinions, deserves some scrutiny. Recent developments, most notably the emergence of Circular 230 and the increased exposure to civil and criminal liability through litigation, have brought about significant changes for tax lawyers. The increased risk facing tax lawyers has prompted tax professionals and law firms to impose strict governance procedures and internal controls. In particular, these firms and their members have instituted rigorous new procedures governing the issuance of legal opinions related to tax planning strategies.<sup>178</sup> In the wake of these changes, many firms have adopted a deliberate and skeptical approach when asked to provide opinions for tax planning purposes.<sup>179</sup> Furthermore, as an additional measure of protection, many of these firms have ceased to

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<sup>174</sup> *Id.*

<sup>175</sup> *Id.*

<sup>176</sup> *Id.* at 938, n.234 (“The government here is using conspiracy as a catch-all to impose criminal liability on individuals who would otherwise escape it . . .”).

<sup>177</sup> *See id.* at 938–43.

<sup>178</sup> *Soled, supra* note 3, at 268–69.

<sup>179</sup> *See id.* at 268–70.

undertake (at least for the time being) coordinated client solicitations for marketed tax shelters.<sup>180</sup>

Clearly, lawyers who intentionally help others in the unlawful and unethical avoidance of their proper tax liability deserve punishment. Additionally, courts must bear some of the responsibility for regulating practitioners by imposing liability upon those opining lawyers that intentionally facilitate abusive tax shelters. However, exposing opining lawyers to increased liability is increasingly troublesome considering the tremendous uncertainty that exists under the current legal structure. The lack of clarity under the current legal regime, coupled with the fear of punishment, has had a significant detrimental impact on legitimate tax planning service, and has driven talented lawyers away from legitimate tax advisory services.<sup>181</sup>

#### B. Things Get Worse—Codification of the Economic Substance Doctrine by the Health Care and Education Affordability Reconciliation Act of 2010

After years of uncertainty and conflicting interpretation, Congress has added a detailed “economic substance” provision as part of the Health Care Act passed into law on March 30, 2010. The decision to codify the doctrine was largely reflective of the need to raise money to pay for President Obama’s healthcare reforms. Section 1409 of the Health Care Act codified the economic substance doctrine by adding new subsection 7701(o) to the Internal Revenue Code, which applies to any transactions entered into after March 30, 2010.<sup>182</sup> Section 1409 also added a new strict liability penalty for transactions lacking economic substance.<sup>183</sup>

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<sup>180</sup> *Id.* at 269–70; *see also* Rachel Emma Silverman, The Search for a Safe Tax Shelter, *Wall St. J.*, Oct. 13, 2005, at D1 (“Big accounting and law firms are being more cautious than in the past, shying away from marketing aggressive shelters, especially those designed to generate losses.”).

<sup>181</sup> *See* Schumacher, *supra* note 4, at 35–37.

<sup>182</sup> Health Care and Education Affordability Reconciliation Act of 2010, H.R. 4872, 111th Cong. § 1409 (2010).

<sup>183</sup> *Id.*



Unfortunately, these new provisions come with significant interpretive problems and impose greater uncertainty on an already ambiguous legal scheme. The lack of clarity in application was a major objection during enactment and will haunt tax lawyers in the years to come.

I.R.C. § 7701(o) provides:

[i]n the case of any transaction to which the economic substance doctrine is relevant, such transaction shall be treated as having economic substance only if (A) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and (B) the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction.<sup>184</sup>

Clause (A) is referred to as the "objective" test, and clause (B) is referred to as the "subjective" test for economic substance.<sup>185</sup> Section 7701(o)(5)(A) defines "economic substance doctrine" as "the common law doctrine under which tax benefits under Subtitle A with respect to a transaction are not allowable if the transaction does not have economic substance or lacks a business purpose."<sup>186</sup>

The other critical aspect of the legislation is the strict penalty provision added by new Code Section 6662(b)(6).<sup>187</sup> A forty percent strict liability penalty would be imposed on underpayments resulting from "a transaction lacking economic substance (within the meaning of section 7701(o)) or failing to meet the requirements of any similar rule of law."<sup>188</sup> This penalty would be reduced to twenty percent if

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<sup>184</sup> I.R.C. § 7701(o) (2010).

<sup>185</sup> See Thomas E. Taylor, Codification of the Economic Substance Doctrine by the Health Care and Education Affordability Reconciliation Act of 2010, McGuire Woods News & Publications (April 9, 2010), available at <http://www.mcguirewoods.com/news-resources/publications/taxation/Economic%20Substance%20Codification.pdf>.

<sup>186</sup> I.R.C. § 7701(o)(5)(A) (2010).

<sup>187</sup> Health Care and Education Affordability Reconciliation Act of 2010, H.R. 4872, 111th Cong. § 1409 (2010); I.R.C. § 6662(b)(6) (2010).

<sup>188</sup> Health Care and Education Affordability Reconciliation Act of 2010, H.R. 4872, 111th Cong. § 1409 (2010).

the transaction were disclosed by the taxpayer.<sup>189</sup> A primary purpose of the strict liability penalty is to encourage taxpayers to give economic substance factors greater weight when considering whether to take a certain position, thereby reducing some aggressive taxpayer behavior.<sup>190</sup> It also eliminates the reasonable cause exception to the application, meaning that a legal opinion from an outside tax advisor would not provide any protection from penalties.

The new statutory economic substance provisions added by the Health Care Act will greatly complicate tax planning, making matters even worse for tax lawyers.<sup>191</sup> Simply put, the provision is too broad and lacks clarity as to application.<sup>192</sup> Specifically, the statute purports to relate to any "relevant" transaction, but provides very little guidance as to when the test should be applied. Instead, it states that the determination of relevance will be made in the same manner as before the Act was adopted.<sup>193</sup> A large part of the perceived problem under the previous structure was that the existing authorities did not have clearly defined criteria for what types of transactions were subject to the economic substance doctrine.<sup>194</sup> As a result, the Act fails to provide proper direction as to when the economic substance doctrine should apply, leaving taxpayers and practitioners without the necessary guidance.<sup>195</sup> For this reason, it is almost certain that situations will arise in which taxpayers might reasonably expect the doctrine not to be relevant but cannot be certain.<sup>196</sup> Furthermore, many legitimate business transactions could fail the legitimate statutory test for

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<sup>189</sup> *Id.*

<sup>190</sup> See Taylor, *supra* note 185 at 12; see also Joint Committee on Taxation Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as Amended, in Combination with the "Patient Protection and Affordable Health Care Act."

<sup>191</sup> See Taylor, *supra* note 185 at 1-2.

<sup>192</sup> *Id.*

<sup>193</sup> I.R.C. § 7701(o)(5)(C) (2010).

<sup>194</sup> See Taylor, *supra* note 185.

<sup>195</sup> *Id.*

<sup>196</sup> *Id.*

economic substance.<sup>197</sup> When considered with the strict liability provision, the effect of the new statute will be to deter taxpayers from engaging in certain legitimate transactions that they otherwise would have.<sup>198</sup>

### C. An Alternative Solution

Over the years, a considerable number of practitioners, professors, and commentators have offered reform proposals for improving the status quo with regard to tax advice.<sup>199</sup> Certainly, there are many different issues and considerations involved in such an undertaking, which are beyond the scope of this Note. However, one must begin with the premise that abusive tax minimization strategies are unavoidable.<sup>200</sup> Practitioners have repeatedly proven that they are capable of adapting to statutory safeguards by developing new tax avoidance schemes. Therefore, any statutory provision would be inadequate in the long-term, as it would inevitably lead to the creation of new abusive schemes. The rules and standards should thus accept that the use of abusive tactics cannot be eliminated entirely, and must focus instead on devising a workable structure for tax planning practice going forward.

This Note proposes alternative measures focused on determining and implementing proper standards for tax opinions and the punishment of those who use tax shelters. First and foremost is the recommendation of the immediate repeal of Section 1409 of the Health Care Act. As discussed above, the codification of the economic substance doctrine only creates more conflict and uncertainty. There is substantial evidence suggesting that the current tax laws (pre-codification) sufficiently target the tax shelter

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<sup>197</sup> *Id.*

<sup>198</sup> *Id.*

<sup>199</sup> See, e.g., Soled, *supra* note 3, 301–03 (arguing in favor of the virtues of successful malpractice litigation); Linda M. Beale, *Tax Advice Before the Return: The Case for Raising Standards and Denying Evidentiary Privilege*, 25 VA. TAX REV. 583, 638 (2006).

<sup>200</sup> Schumacher, *supra* note 4, at 40.

problem.<sup>201</sup> Furthermore, the strict liability feature of the codified economic substance doctrine is unfair to the taxpayer and hinders the ability of courts to analyze the facts and circumstances of each case.<sup>202</sup> State bar associations, including the New York State Bar Association, have expressed disapproval of the strict liability penalties imposed by the codified economic substance doctrine.<sup>203</sup> The codification has been characterized as “replacing judicial uncertainty with statutory uncertainty.”<sup>204</sup> The idea that strict liability serves as an effective deterrent to tax lawyers engaged in tax shelter promotion is misplaced, as tax lawyers are regulated under standards of professional responsibility, rather than through understatement penalties.<sup>205</sup> Regardless of the substantive standards, I believe it is essential to the fair administration of the system to provide a reasonable cause and good faith defense against tax penalties.<sup>206</sup> Absent the protections of these defenses, the legitimacy of the tax system could be undermined.<sup>207</sup>

I also propose that the standards governing tax advice are best left to the judiciary and the organized tax bar.<sup>208</sup> The organized tax bar has strong incentives to curb the abusive tax shelter market and align the long-term interests of tax lawyers as the gatekeepers of the tax system.<sup>209</sup> In addition to the reaffirmation of the organized tax bar, the standards themselves and their interpretation by courts should encourage proper tax advice. Achieving this objective almost

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<sup>201</sup> See Shin-Li, *supra* note 153, at 2042–45.

<sup>202</sup> See *id.* at 2038–39.

<sup>203</sup> See *id.* at 2041–42.

<sup>204</sup> Clinton Stretch, Matthew Lay & John Galotto, *Economic Substance and Strict Liability Do Not Mix*, 123 TAX NOTES 1357, 1361 (2009).

<sup>205</sup> See Shin-Li, *supra* note 153, at 2046.

<sup>206</sup> See *id.* at 2040 (“The ABA Tax Section has recommended that the taxpayer be given the opportunity to challenge noneconomic substance transaction penalties both at the IRS Office of Appeals level and in the courts.”).

<sup>207</sup> See *id.* at 2042–43.

<sup>208</sup> See generally Rostain, *supra* note 2.

<sup>209</sup> *Id.* at 118–19.

certainly requires some reworking of the overly aggressive standards imposed by Circular 230. Tax planning is a vital component of the tax lawyer's role, and any actions taken by Congress and the IRS to combat abusive tax shelters should not impede legitimate tax advice.<sup>210</sup> One possible method for achieving these objectives is to promote opinion standards based on the true construction of the relevant tax statute, rather than in terms of the "chance of success."<sup>211</sup>

While the problems associated with tax shelters should not be taken lightly, it is unquestionably the case that the overwhelming majority of tax professionals seek to provide only legitimate tax advice.<sup>212</sup> Under this view, the threat of criminal prosecution for honest opining lawyers is deeply troubling. To prevent these harms, the government should consider implementing civil penalties in a manner that causes tax lawyers to consider the effects of their behavior before opining, and eliminates the potential for criminal liability for opinion letters that fall short of professional standards.<sup>213</sup> This will allow the government to balance effective regulation of tax shelters with the well-being of the legitimate tax planning practice.<sup>214</sup> The demand for tax advice will likely only continue to grow in the future, and therefore the efforts to curb abusive tax shelters should avoid placing heavy burdens on the tax lawyer who seeks to provide legitimate opinions. The recent "knee jerk" reactions to abusive tax shelters, most notably the overly aggressive standards in Circular 230 and the codification of the economic substance doctrine, pose substantial problems for the health of tax planning going forward. Taxpayers must be able to rely on their tax advisers, and this has become increasingly difficult following the revised standards of Circular 230 and the codification of the economic substance doctrine. Ultimately, the organized tax bar should be responsible for implementing tax planning and opinion

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<sup>210</sup> See Schumacher, *supra* note 4, at 102.

<sup>211</sup> *Id.*

<sup>212</sup> *Id.* at 77.

<sup>213</sup> Hsue, *supra* note 13, at 938–43.

<sup>214</sup> See generally *id.*

standards that are both workable and designed to promote legitimate tax advice while deterring abusive transactions.<sup>215</sup> These proposals would ultimately help to thwart the use of abusive tax shelters, while also protecting the ability of lawyers to add value in legitimate tax planning transactions.

## VI. CONCLUSION

The recent developments aimed at curbing abusive tax shelters, although successful in some respects, pose significant problems for the future of opining lawyers engaged in legitimate tax planning activities. The burdens of heightened liability undermine lawyers' ability to add value in viable tax planning and investment transactions. In addressing these issues, this Note considered recent efforts aimed at improving the status quo and discussed the failure of these measures to provide a workable structure going forward. The rules and standards should be revised to encourage opining lawyers to give proper advice, rather than drive lawyers away from the practice altogether.<sup>216</sup> The proposals suggested in Part V of this Note seek to provide a proper foundation for tax shelter standards going forward and protect the ability of individuals and corporations to seek sound, unadulterated tax advice.

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<sup>215</sup> See Schumacher, *supra* note 4, at 78.

<sup>216</sup> See Schumacher, *supra* note 4, at 35–37.

