

THE EVOLUTION OF THE AMERICAN BAR ASSOCIATION ETHICS RULES INTO THE INTERNAL REVENUE SERVICE CIRCULAR 230 RULES

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I. INTRODUCTION

The American Bar Association (hereinafter referred to as ABA) 2002 Model Rules of Professional Conduct,¹ now adopted by most states, define what constitutes the ethical practice of law. The Internal Revenue Service (hereinafter referred to as IRS) Circular 230 Rules² define what constitutes ethical tax practice for attorneys, accountants, enrolled agents, actuaries, and appraisers practicing before the IRS (hereinafter referred to as practitioners). The Circular 230 Rules also specify content requirements and conditions under which tax professionals may issue tax opinions that address minimizing tax liability.³ In 1982, the legal profession defined standards for preparing tax opinions addressing tax minimization in ABA Formal Opinion 346.⁴ ABA Formal Opinion 346 and the Model Rules impose on attorneys almost all of the obligations the IRS imposes on all tax practitioners today.

Earlier versions of Circular 230 Rules,⁵ like the current rules, addressed tax practice, practitioner honesty, diligence, objective analysis,⁶ completeness,⁷ practitioner's reasonable belief the asserted facts in an opinion were true, and refusing to submit fraudulent, misleading or false returns or other material to the IRS. The rules were seldom enforced because they included exceptions that permitted practitioners to

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alone and not necessarily those of either the Texas Center for the Judiciary or the State Bar of New Mexico.

¹ Model Rules of Prof'l Conduct (2002), adopted by ABA House of Delegates, Feb. 5, 2002 (hereinafter referred to as ABA Model Rules). Most states have adopted the rules. *See, e.g.*, Texas Disciplinary Rules of Professional Conduct (2008); N.M. STAT. ANN. §§ 16-101-805 (2008).

² The I.R.S. ethics rules are found at 31 C.F.R. §§ 10.1-10.101 and are hereinafter referred to as *Circular 230 Rules*.

³ 31 C.F.R. §§ 10.34-10.37.

⁴ ABA Comm. on Ethics and Prof'l Responsibility, Formal Op. 346 (revised, Jan. 29, 1982), (hereinafter ABA Formal Op. 346). The opinion was followed by ABA Comm. on Ethics and Prof'l Responsibility, Formal Op. 85-352 (July 7, 1985), (hereinafter ABA Formal Op. 85-352). In addition, the ABA developed a draft opinion, Draft Statement of Standards of Tax Practice (2000-2), but never adopted it.

⁵ Old 31 C.F.R. § 10.33(a)(1)(ii).

⁶ *Id.* §§ 10.35(c), 10.37(a).

⁷ *Id.* § 10.33(a)(1)(i).

largely ignore them.⁸ The old rules exempted practitioners if the taxpayer: 1) participated in the transaction in the ordinary course of business in a form consistent with customary commercial practice and the taxpayer would have participated irrespective of expected income tax benefits;⁹ 2) participated in the ordinary course of business and there was a generally accepted understanding that the taxpayer's intended tax treatment was properly allowable under the Internal Revenue Code (hereinafter referred to as IRC) for substantially similar transactions;¹⁰ or 3) reasonably determined that there was no reasonable basis under federal tax law for denial of any significant portion of the expected federal income tax benefits from the transaction.¹¹

The data on disciplinary actions support the conclusion of the Joint Committee on Taxation. From 2002 through 2005, ending with the issuance of the new Circular 230 Rules, the IRS Office of Professional Responsibility concluded cases resulting in 21 disbarments, 496 suspensions, 36 censures, and 113 reprimands.¹² The new rules appear to represent an effort by the IRS to curb unethical behavior of tax practitioners. Since the IRS issued new Circular 230 Rules in 2005, 2007, and 2008, it is too early to know if the new rules will result in increased prosecution.

The new Circular 230 Rules impose extensive drafting and content requirements, substantial use restrictions on opinions addressing tax avoidance transactions, and strict ethics rules. Violation of any of these rules exposes a practitioner to censure, reprimand, disbarment, and/or monetary penalties. In addition, state attorney and accountant disciplinary bodies may prosecute practitioners for violations of Circular 230 Rules. However, the strictures of the current Circular 230 Rules had previously been outlined in ABA formal ethics pronouncements and in the ABA Model Rules.

The IRS Circular 230 Rules governing practice are divided into IRS drafting and disclosure requirements associated with tax avoidance and general rules governing practitioner interaction with clients and the IRS. Under the rules, the Office of Director of Practice administers qualification to practice before the IRS and discipline of practitioners.¹³

⁸ STAFF OF JOINT COMM. ON TAXATION, STUDY OF PRESENT-LAW PENALTY AND INTEREST PROVISIONS AS REQUIRED BY § 3801 OF THE INTERNAL REVENUE SERVICE RESTRUCTURING AND REFORM ACT OF 1998 (INCLUDING PROVISIONS RELATED TO CORPORATE TAX SHELTERS), JCS-3-99, at Vol. I, 173-250 (Comm. Print. 1999). For example, under I.R.C. § 6662, the understatement penalty was abated in all cases in which the taxpayer could demonstrate that there was reasonable cause for the underpayment and that the taxpayer acted in good faith. The regulations provide that reasonable cause exists where the taxpayer acts based on a tax advisor's analysis of the pertinent facts and authorities [that] . . . unambiguously states that there is a greater than 50-percent likelihood that the tax treatment of the item. Treas. Reg. §§ 1.6662-4(c), 1.6662-4(g)(4)(i)(B).

⁹ Treas. Reg. § 1.6011-4(b)(2)(A).

¹⁰ However an opinion of counsel supporting the position is not sufficient. Treas. Reg. § 1.6011-4(b)(ii)(B).

¹¹ The standard applicable was that of Treas. Reg. § 1.6662-3(b)(3). See Treas. Reg. § 1.6011-4(b)(ii)(C). It is not clear what this meant since a position that is merely arguable or colorable is not enough; it must also take into account the entirety of the circumstances surrounding the transaction.

¹² MICHAEL R. PHILLIPS, FINAL AUDIT REPORT - THE OFFICE OF PROFESSIONAL RESPONSIBILITY CAN DO MORE TO EFFECTIVELY IDENTIFY AND ACT AGAINST INCOMPETENT AND DISREPUTABLE TAX PRACTITIONERS, (AUDIT # 200410031), at 4 Tbl. 1, No. 2006-10-066 (Mar. 31, 2006). The Inspector General found that many attorneys and CPAs with revoked or suspended licenses were still listed eligible to practice before the I.R.S. *Id.* at 8 Tbl. 3.

¹³ 31 C.F.R. § 10.1.

II. SUMMARY OF NEW CIRCULAR 230 OPINION DRAFTING RULES FOR TAX AVOIDANCE TRANSACTIONS

The Circular 230 opinion drafting rules impose mandatory standards for drafting, content, and disclaimer requirements on written communications addressing tax avoidance.¹⁴ The rules are difficult to follow and the terminology is often highly specialized.

A *tax avoidance transaction* is “[a]ny partnership or other entity, any investment, plan or arrangement, or any other plan or arrangement, the principal purpose [or a significant purpose] of which is the avoidance or evasion of any tax . . . if the written advice is a reliance opinion, a confidential opinion, or subject to contractual protection.”¹⁵

A *covered opinion* is written advice addressing tax issues that arise from a tax avoidance transaction.¹⁶ Violation of the covered opinion rules exposes a practitioner to IRS sanctions. A covered opinion can be a *reliance opinion*, a *marketed opinion* or a *limited scope opinion*.¹⁷ A covered opinion is any opinion that addresses: 1) a *listed transaction* that the IRS “has determined to be a tax avoidance transaction in published guidance”;¹⁸ 2) a transaction similar to a listed transaction;¹⁹ 3) “[a]ny partnership or other entity, any investment, plan or arrangement, or any other plan or arrangement, the principal purpose of which is the avoidance or evasion of any tax imposed by the Internal Revenue Code”;²⁰ or 4) “any entity, investment, or any other arrangement, a significant purpose of which is the avoidance or evasion of tax imposed by the Code if the written advice is a reliance opinion, marketed opinion, subject to conditions of confidentiality, or subject to *contractual protection*.”²¹ A *listed transaction* is: 1) a transaction the IRS has listed in published guidance as a tax avoidance transaction;²² 2) any transaction expected to provide similar tax consequences or based on a similar tax strategy;²³ and 3) a *listed transaction of interest* that is under IRS review to determine if it is a tax avoidance transaction.²⁴ Written advice concerning tax avoidance that need not be addressed in a covered opinions is limited to 1) preliminary written advice to be followed by subsequent written advice;²⁵ 2) advice concerning a qualified retirement plan, state bond opinion, or filed with the SEC;²⁶ 3) advice concerning an already filed return;²⁷ 4) employee advice to his or her employer;²⁸ and 5) advice finding against the taxpayer on all issues.²⁹

¹⁴ *Id.* § 10.35.

¹⁵ *Id.* § 10.35(b)(2)(i). See also Tax Shelter Definition, I.R.C. § 6662(d)(2)(C).

¹⁶ 31 C.F.R. § 10.35(b)(2)(i).

¹⁷ *Id.* § 10.35(b)(2)(i)(B).

¹⁸ 26 C.F.R. § 1.6011-4(b)(2)(A).

¹⁹ *Id.*

²⁰ 31 C.F.R. § 10.35(b)(2)(i)(B).

²¹ *Id.* § 10.35(b)(2)(i)(C) (confidentiality refers to confidentiality of the tax scheme, and contractual protection refers to a provision providing for refunds if the promised tax benefits are not received).

²² Treas. Reg. § 1.6011-4(b)(2).

²³ *Id.* § 1.6011-4(c)(4).

²⁴ *Id.* § 1.6011-4(b)(6).

²⁵ 31 C.F.R. § 10.35(2)(ii)(A).

²⁶ *Id.* § 10.35(2)(ii)(B).

²⁷ *Id.* § 10.35(2)(ii)(C).

²⁸ *Id.* § 10.35(2)(ii)(D).

²⁹ *Id.* § 10.35(2)(ii)(E).

A *principal purpose transaction* is a transaction in which “the principal purpose of a partnership or other entity, investment plan or arrangement, or other plan or arrangement is the avoidance or evasion of any tax imposed by the Internal Revenue Code if that purpose exceeds any other purpose.”³⁰ A *significant purpose transaction* is a transaction in which “the Internal Revenue Service has a reasonable basis for a successful challenge and its resolution could have a significant impact, whether beneficial or adverse . . . on the overall federal tax treatment of the . . . matter(s) addressed in the opinion.”³¹ The IRS has not provided much guidance for determining when a transaction that is not a listed transaction or substantially similar to a listed transaction is a principal purpose transaction.³² The lack of clarity caused by applying the rules differently depending on whether a covered transaction is categorized as a principal purpose transaction or a significant purpose transaction can be problematic for practitioners.

A *reliance opinion* is a covered opinion upon which a taxpayer may rely to avoid penalties if it is “written advice . . . that concludes at a confidence level of at least more likely than not (a greater than 50% likelihood) that one or more significant federal tax issues would be resolved in the taxpayer’s favor” and the opinion contains no prominent disclaimer stating that it is not a reliance opinion.³³ A covered opinion cannot be issued unless it is a reliance opinion if the opinion addresses a listed transaction or a transaction substantially similar, or a transaction whose principal purpose is tax avoidance. An opinion other than a listed transaction or a principal purpose transaction is not treated as a reliance opinion (and is not subject to the restrictive rules on opinions) if the opinion contains the following prominent disclosure:

The opinion does not reach a conclusion at a confidence level of at least more likely than not with respect to one or more significant federal tax issues addressed by the opinion; and with respect to those significant tax issues, the advice was not intended and cannot be used by the taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer.³⁴

Placing the disclosure on a principal purpose transaction does not remove the opinion from the reliance opinion category and does not relieve the practitioner of the obligation to comply with the reliance opinion requirements.³⁵

A practitioner may issue a limited scope opinion that considers less than all of the significant federal tax issues if the taxpayer and practitioner agree that the opinion does not address a listed transaction or a transaction substantially similar to a listed transaction, the transaction is not a principal purpose transaction, and the opinion being provided is not a marketed opinion.³⁶

A practitioner [issuing a limited scope opinion] may make reasonable assumptions regarding favorable resolution of a tax issue (an assumed issue) for the purpose of providing an opinion on less than all of the significant Federal tax issues The opinion must

³⁰ *Id.* § 10.35(b)(10).

³¹ *Id.* § 10.35(b)(3).

³² See, e.g., Kip Dellinger, *How Broad Is the Scope of Significant Purpose?*, TAX NOTES (2006).

³³ 31 C.F.R. § 10.35(b)(4)(i).

³⁴ *Id.* § 10.35(e)(4)(i)(ii).

³⁵ *Id.*

³⁶ *Id.* § 10.35(c)(3)(v)(A)(1), (2).

identify in a separate section all issues for which the practitioner assumed a favorable resolution.³⁷

A limited scope opinion must contain the following required prominent disclosure:

The opinion is limited to one or more Federal tax issues addressed in the opinion; additional issues may exist that could affect the Federal tax treatment of the transaction or matter that is the subject of the opinion and the opinion does not consider or provide a conclusion with respect to any additional issues; and with respect to any significant Federal tax issues outside the limited scope of the opinion, the opinion was not written, and cannot be used by the taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer.³⁸

A *marketed opinion* is:

Written advice . . . the practitioner . . . has reason to know . . . will be used or referred to by a person other than the practitioner [or member or employee of the practitioner's firm] in promoting, marketing or recommending a partnership or other entity, investment plan, or arrangement to one or more taxpayer(s).³⁹

An opinion is always a marketed opinion despite disclosure if it is prepared for anyone other than another member of the same firm or a specific taxpayer client and is a listed transaction, a substantially similar transaction, or a transaction having a principal purpose of tax avoidance.⁴⁰ A marketed opinion must be a covered opinion and must "provide the practitioner's 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."⁴¹

Written advice is not a marketed opinion if the advice does not address a listed transaction or principal purpose transaction and the opinion includes the following prominent disclosure:

[T]he advice was not intended or written by the practitioner to be used, and [it] cannot be used by any taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer; the advice was written to support the promotion or marketing of the transaction(s) or matter(s) addressed by the written advice, and the taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor.⁴²

³⁷ *Id.* § 10.35(c)(3)(v)(B).

³⁸ *Id.* § 10.35(e)(3)(i),(ii)(iii).

³⁹ *Id.* § 10.35(b)(5)(i).

⁴⁰ *Id.* § 10.35(b)(5)(ii).

⁴¹ *Id.* § 10.35(c)(3)(ii).

⁴² *Id.* § 10.35(b)(5)(ii)(A)-(C). Note that 31 C.F.R. § 10.35(e)(2), required disclosures, marketed opinions, requires somewhat different disclaimer language. It specifies, "[all] marketed opinion[s] must prominently disclose that: (i) The opinion was written to support the promotion or marketing of the transaction(s) or matter(s) addressed in the opinion; and (ii) The taxpayer

An opinion for a third party addressing a principal purpose transaction, a listed transaction, or a transaction substantially similar to a listed transaction, is always a marketed opinion and cannot be removed from the category with a disclaimer.

Other disclosures required by Circular 230 Regulations include the following: 1) all covered opinions must prominently disclose any compensation arrangement, referral fee or fee-sharing arrangement between the practitioner and any other party promoting, marketing or recommending the tax avoidance plan addressed in the opinion;⁴³ 2) an opinion that does not conclude that the taxpayer will prevail on one or more federal tax issues at a confidence level of at least *more likely than not* must prominently disclose:

The opinion does not reach a conclusion at a confidence level of at least more likely than not with respect to one or more significant Federal tax issues addressed by the opinion and with respect to those significant Federal tax issues, the opinion was not written, and cannot be used by the taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer.⁴⁴

III. CIRCULAR 230 RULES DESCRIBING REQUIREMENTS IMPOSED WHEN DRAFTING A COVERED OPINION

The Circular 230 Rules governing a practitioner drafting a covered opinion obligate the practitioner to meet the following requirements:

1. "Use reasonable efforts to identify and ascertain facts [and forecasts], to determine which facts are relevant, and . . . not base the opinion on any unreasonable factual assumptions. . . . the practitioner . . . should know are incorrect or incomplete";⁴⁵
2. "Identify in a separate section all factual assumptions relied on by the practitioner";⁴⁶
3. Review factual presentations (projection, financial forecast, or appraisal) of third parties for accuracy and completeness before relying on them;⁴⁷
4. "[N]ot base the opinion on any unreasonable factual representations, statements or findings of the taxpayer or any other person";⁴⁸
5. Relate applicable law, and judicial doctrines, to relevant facts without assuming favorable resolution of disputed tax issues or relying on inconsistent legal analysis or conclusions;⁴⁹
6. Describe the facts and analysis and provide a conclusion of the likelihood the taxpayer will prevail on the merits with respect to

should seek advice based on the taxpayer's particular circumstances from an independent tax advisor."

⁴³ 31 C.F.R. § 10.35(e)(1).

⁴⁴ *Id.* § 10.35(e)(4).

⁴⁵ *Id.* § 10.35(c)(1)(i), (ii).

⁴⁶ *Id.* § 10.35(c)(1)(ii).

⁴⁷ *Id.* § 10.35(c)(1) (iii).

⁴⁸ *Id.*

⁴⁹ *Id.* § 10.35(c)(2).

each significant tax issue or indicate that the practitioner cannot reach a conclusion with respect to an issue;⁵⁰

7. “[N]ot take into account the probability that a return will be audited, that an issue will not be raised . . . or resolved through settlement if raised”;⁵¹ and
8. “The opinion must provide an overall conclusion as to the likelihood that the Federal tax treatment . . . is the proper treatment and provide the reasons for that conclusion . . . [or state that] the practitioner is unable to reach an overall conclusion and describe the reasons. . . .”⁵²

An unreasonable factual representation includes a factual representation that the practitioner knows or should know is incorrect or incomplete. . . . For example, a practitioner may not rely on a factual representation that a transaction has a business purpose if the representation does not include a specific description of the business purpose. . . . The practitioner must be knowledgeable in all aspects of the Federal tax law relevant to the opinion being rendered, except the practitioner may rely on the opinion of another practitioner . . . unless the practitioner knows or should know that the opinion of the other practitioner should not be relied on.⁵³

If a practitioner relies on the opinion of another practitioner, “the relying practitioner must identify the other opinion and set forth the conclusions reached in the other opinion.”⁵⁴ The practitioner must be satisfied that the combined analysis and overall conclusion satisfy the requirements for issuing a covered opinion. The IRC imposes the *reasonable possibility of success* standard on disclosed covered opinions and a *more likely than not* standard on undisclosed positions.⁵⁵

IV. ABA FORMAL OPINION 346 CONCERNING ATTORNEYS DRAFTING TAX OPINIONS

The ABA imposed essentially the same ethical limits on lawyers in 1982 and 1985 that the IRS imposes on tax practitioners drafting opinions addressing tax minimization

⁵⁰ *Id.* § 10.35(c)(3)(ii).

⁵¹ *Id.* § 10.35(c)(3)(iii).

⁵² *Id.* § 10.35(c)(4)(i).

⁵³ *Id.* § 10.35(d)(1).

⁵⁴ *Id.*

⁵⁵ I.R.C. § 6694(a). The implications of the code provision with respect to Circular 230 are less than clear. The I.R.S. has issued interim rules in Notice 2008-13, 2008-3 IRB 282, specifying that a non-signing advisor may issue an opinion with a reasonable possibility of success if the advisor also advises of the possibility of avoiding penalties by disclosure. A preparer who signs the return is bound by the statutory requirements; however, the preparer is not necessarily in violation of Circular 230 for violating I.R.C. § 6694 according to I.R.S. Notice, Tax Return Preparer Penalties Under Sections 6694 and 6695, 2008-27 I.R.B. 32, June 16, 2008. The problems the interim standard creates are discussed in detail in Patrick C. Gallagher, Proposed Circular 230 Amendments on Tax Return Standards, 118 TAX NOTES 1015 (Mar. 3, 2008); Jonathan G. Blattmachr, Circular 230 and Preparer Penalties: Evil Siblings for Practitioners, 19 TAX NOTES 397 (Apr. 28, 2008).

in the Current Circular 230 Rules.⁵⁶ ABA Formal Opinion 346 was originally drafted to identify content requirements for what it referred to as a *tax shelter opinion* based on the then-current ABA model disciplinary rules and pronouncements. ABA Formal Opinion 85-352 addressed advice concerning positions taken on tax returns.⁵⁷

A. TAX AVOIDANCE AND MARKETED OPINIONS

ABA Formal Opinion 346 addresses tax shelter opinions, which are similar to the current tax avoidance opinions and marketed opinions. A tax shelter transaction was defined as producing deductions or credits in excess of the income of a transaction produced “to offset taxes on income from other sources in that year.”⁵⁸ Tax shelter opinions were “advice by a lawyer concerning the Federal tax law applicable to a tax shelter if the advice is referred to either in offering materials or in connection with sales promotion efforts directed to persons other than the client who engages the lawyer to give the advice.”⁵⁹

The *dissemination to third parties* component as defined by ABA Formal Opinion 346 parallels the definition of a *marketed opinion* found in Circular 230 Rules:

Written advice is a marketed opinion if the practitioner knows or has reason to know that the written advice will be used or referred to by a person other than the practitioner (or a person who is a member of, associated with, or employed by a practitioner’s firm) in promoting, marketing or recommending a partnership or other entity, investment plan or arrangement to one or more taxpayers.⁶⁰

Unlike the Circular 230 language quoted above, the ABA language distinguishes between advice offered by one tax professional to another tax professional for other than marketing and promotion of tax shelters and advice offered to market or promote tax shelters. In addition, ABA Formal Opinion 346 covers oral as well as written advice; Circular 230 does not.⁶¹

B. REQUIREMENTS FOR TAX AVOIDANCE OPINIONS

ABA Formal Opinion 346 includes a set of requirements for opinions that parallels the standards found in Circular 230.⁶² The 1982 opinion provides that an opinion must:

1. Include full disclosure of the structure and intended operations of the venture;
2. Provide complete access to all relevant information;
3. Include an accurate and complete statement of all material facts in offering materials;
4. Provide clear and complete identification of all representations and intended future activities;

⁵⁶ ABA Formal Op. 346 and ABA Formal Op. 85-352, *supra*, note 3.

⁵⁷ *Id.*

⁵⁸ *Id.* note 1.

⁵⁹ ABA Formal Op. 346, ¶4.

⁶⁰ 31 C.F.R. § 10.35(b)(5).

⁶¹ *Id.*

⁶² *Id.* §§ 10.34, 10.35(a)(2)-(4), 10.35(c)1-4.

5. Relate the law to the actual facts of the transaction, and identify assumed facts;
6. Ascertain that a good faith effort has been made to address legal issues other than those to be addressed in the tax shelter opinion;
7. Assure all material tax issues have been considered that have a reasonable possibility of being challenged by the IRS;
8. Include an opinion as to the likely outcome of each material issue and the extent to which the tax benefits are likely to be realized; and
9. Assure offering materials correctly represent the nature and extent of the tax shelter opinion.⁶³

ABA Formal Opinion 346 defines a *false opinion* as “one which ignores or minimizes serious legal risks or misstates the facts or the law, knowingly or through gross incompetence.”⁶⁴ An attorney who issues a false opinion, or an opinion that is intentionally or recklessly misleading, violates the Model Rules.⁶⁵ Circular 230 follows ABA Formal Opinion 346. It prohibits a practitioner from basing advice on unreasonable factual or legal assumptions or unreasonably relying on statements or findings of others, or not considering all relevant facts.⁶⁶

ABA Formal Opinion 346 prohibits practitioners from issuing a false opinion and tied the same to the then-current ABA disciplinary rules: “The lawyer also violates DR 7-102(A)(7) by counseling or assisting the offeror in conduct that the lawyer knows to be illegal or fraudulent. In addition, the lawyer’s conduct may not involve the concealment or knowing nondisclosure of matters which the lawyer is required by law to reveal because such conduct constitutes a violation of DR 7-102(A)(3).”⁶⁷ The opinion continues, “[t]he lawyer who accepts as true the facts which the promoter tells him, when the lawyer should know that a further inquiry would disclose that these facts are untrue, also gives a false opinion.”⁶⁸ The position is followed in the Circular 230 Rules, which prohibit practitioners from relying on client or third party information that appears to be incorrect or incomplete and prohibits submission of documents that omit information or disregard rules or regulations.⁶⁹ The minimum extent of the knowledge required for the lawyer’s conduct to have violated these disciplinary rules is the knowledge required to sustain a Rule 10b-5 recovery.⁷⁰ Formal Opinion 346 goes further, stating:

⁶³ ABA Formal Op. 346, ¶31.

⁶⁴ The statement continued by explaining that knowingly misstating facts or law violates DR 7-102(A)(5) and is “conduct involving dishonesty, fraud, deceit, or misrepresentation,” a violation of DR 1-102(A)(4).” ABA Formal Op. 346, ¶5.

⁶⁵ The opinion relied on DR 7-101; EC 7-10 in effect in 1982 in reaching that conclusion.

⁶⁶ 31 C.F.R. § 10.37(a).

⁶⁷ ABA Formal Op. 346, ¶5.

⁶⁸ *Id.* ¶6, citing to *United States v. Benjamin*, 328 F.2d 854, 863 (2d Cir. 1964) (“[L]awyers cannot escape criminal liability on a plea of ignorance when they have shut their eyes to what was plainly to be seen.”).

⁶⁹ 31 C.F.R. § 10.34(b), (d). ABA Formal Op. 346 goes further: “[r]ecklessly and consciously disregarding information strongly indicating that material facts . . . are false or misleading involves dishonesty as does assisting the offeror in conduct the lawyer knows to be fraudulent.” It violates DR 1-102(A)(4) (fraud, deceit, or misrepresentation) and DR 7-102(A)(5) (knowingly misstating facts), and DR 7-102(A)(7) (counseling the client in conduct that the lawyer knows to be illegal or fraudulent).
ABA Formal Op. 346, ¶5.

⁷⁰ See *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976) (rather than the lesser negligence standard).

Compare *SEC v. Coven*, 581 F.2d 1020, 1025 (2d Cir. 1978) *cert. denied*, 440 U.S. 950, *reh’g denied*, 441

Even if the lawyer lacks the knowledge required to sustain a recovery under the *Hochfelder* standard, the lawyer's conduct nevertheless may involve gross incompetence, or indifference, inadequate preparation under the circumstances and consistent failure to perform obligations to the client.⁷¹

C. REVIEW FOR COMPLETENESS AND RELIABILITY OF SUPPORTING MATERIALS

ABA Formal Opinion 346 referenced an earlier 1974 opinion on factual inquiries involving an opinion based on assumed facts:

The lawyer should . . . make inquiry of his client as to the relevant facts and receive answers. If any of the alleged facts, or the alleged facts taken as a whole, are incomplete in a material respect; or are suspect; or are inconsistent; or either on their face or on the basis of other known facts are open to question, the lawyer should make further inquiry.⁷²

The discussion continues, "[w]here the lawyer concludes that further inquiry of a reasonable nature would not give him sufficient confidence as to all the relevant facts, or for any other reason he does not make the appropriate further inquiries, he should refuse to give an opinion."⁷³ The opinion emphasizes:

The lawyer should relate the law to the actual facts to the extent the facts are ascertainable when the offering materials are being circulated. A lawyer should not issue a tax shelter opinion which disclaims responsibility for inquiring as to the accuracy of the facts, fails to analyze the critical facts or discusses purely hypothetical facts. It is proper, however, to assume facts which are not currently ascertainable . . . so long as the factual assumptions are clearly identified as such in the offering materials, and are reasonable and complete.⁷⁴

ABA Formal Opinion 346 provided general guidance on a lawyer's obligation to evaluate supporting materials provided by other professionals: "If another professional is providing the overall evaluation, the lawyer should nonetheless satisfy himself that the evaluation meets the standards set forth above."⁷⁵

The opinion concludes:

In all cases, the lawyer who issues a tax shelter opinion, especially an opinion which does not contain a prediction of a favorable outcome, should assure that the offerees will not be misled as a

U.S. 928 (1979); *Rolf v. Blyth, Easteman Dillon & Co.*, 570 F.2d 38, 44-47 (2d Cir.) cert. denied, 439 U.S. 1039 (1978); *Sharp v. Coopers & Lybrand*, 457 F. Supp. 879 (E.D. Pa. 1978).

⁷¹ ABA Formal Op. 346 ¶7 See also, ABA Comm. on Ethics and Prof'l Responsibility, Informal Op. 1273 (1973).

⁷² *Id.* 346, ¶14, citing to ABA Formal Op. 335 (1974).

⁷³ *Id.* 346, ¶15.

⁷⁴ *Id.* 346, ¶18.

⁷⁵ ABA Formal Op. 346, ¶28.

result of mischaracterizations of the extent of the opinion in the offering materials or in connection with sales promotion efforts. In addition, the lawyer always should review the offering materials to assure that the standards set forth in this Opinion are met and that the offering materials, taken as a whole, make it clear that the lawyer's opinion is not a prediction of a favorable outcome of the tax issues concerning which no favorable prediction is made. The risks and uncertainties of the tax issues should be referred to in a summary statement at the very outset of the opinion or the tax aspects or tax risks section of the offering materials.⁷⁶

Circular 230 Rules impose essentially the same standards. It requires that a practitioner not base an opinion on unreasonable factual assumptions the practitioner should know are incorrect or incomplete.⁷⁷ The practitioner may not ignore implications of information furnished that appears to be incorrect, inconsistent with the facts, or incomplete.⁷⁸ Finally, a practitioner may not rely on the opinion of another practitioner unless it appears to be sound, and even then, must set forth the conclusions reached in the other opinion.⁷⁹

ABA Formal Opinion 346 concludes:

If the lawyer disagrees with the client over the extent of disclosure made in the offering materials or over other matters necessary to satisfy the lawyer's ethical responsibilities as expressed in this Opinion, and the disagreement cannot be resolved, the lawyer should withdraw from the employment and not issue an opinion."⁸⁰

D. REQUIRED REPORTING OF THE OUTCOME OF EACH MATERIAL ISSUE AND OF THE OVERALL OUTCOME

With respect to analysis of the outcome of tax issues, ABA Formal Opinion 346 requires that "the lawyer should, if possible, state the lawyer's opinion of the probable outcome on the merits of each material tax issue. . . . However, if the lawyer determines in good faith that it is not possible to make a judgment as to the outcome of a material tax issue, "the lawyer should so state and give the reasons for this conclusion."⁸¹

[Disclosure of tax risks] should include an opinion by the lawyer or by another professional providing an overall evaluation of the extent to which the tax benefits, in the aggregate, which are a significant feature of the investment to the typical investor are likely to be realized . . . probably will be realized or probably will not be realized, or that the probabilities . . . are evenly divided.⁸²

⁷⁶ *Id.* ¶29.

⁷⁷ 31 C.F.R. § 10.35(c)(1)(ii), (iii).

⁷⁸ *Id.* § 10.34(d).

⁷⁹ *Id.* § 10.35(d).

⁸⁰ ABA Formal Op. 346, ¶30.

⁸¹ *Id.* ¶23. ABA Formal Op. 346, ¶24, continues, "The opinion also should set forth the risks of an adversarial proceeding if one is likely to occur."

⁸² *Id.* ¶25.

In rare instances the lawyer may conclude in good faith that it is not possible to make a judgment of the extent to which the significant tax benefits are likely to be realized. . . . The lawyer should fully explain why the judgment cannot be made and assure full disclosure in the offering materials of the assumptions and risks which the investors must evaluate.⁸³

Circular 230 Rules again parallel ABA Formal Opinion 346. Circular 230 Rules require the practitioner to reach a conclusion with respect to each material issue⁸⁴ as well as reaching an overall conclusion.⁸⁵ ABA Formal Opinion 346 says a material tax issue is:

Any income or excise tax issue . . . that would have a significant effect in sheltering from Federal taxes income from other sources by providing deductions in excess of the income from the tax shelter investment in any year or tax credits which will offset tax liabilities in excess of the tax attributable to the tax shelter investment in any year.⁸⁶

Similarly, Circular 230 defines a covered opinion as written advice addressing any “partnership or other entity, any investment plan or arrangement, or any other plan or arrangement the principal [a significant purpose] of which is the avoidance or evasion of any tax imposed by the Internal Revenue Code.”⁸⁷ Circular 230 continues, “[t]he lawyer should satisfy himself that either he or another competent professional has considered all material tax issues.”⁸⁸ Further, “the tax shelter opinion should fully and fairly address each material tax issue respecting which there is a reasonable possibility that the Internal Revenue Service will challenge the tax effect proposed in the offering materials.”⁸⁹ Circular 230 provides that opinions must “consider all significant Federal tax issues⁹⁰ and reach a conclusion regarding the likelihood of prevailing on each issue.”⁹¹

ABA Formal Opinion 346 makes clear that a lawyer may not issue an opinion if the above standards are not met.

If . . . the lawyer believes that there is a reasonable possibility that the Internal Revenue Service will challenge the proposed tax effect respecting any material tax issue . . . and the issue is not fully addressed in the offering materials, the lawyer has ethical responsibilities to so advise the client and the other professional and to refuse to provide an opinion unless the matter is addressed adequately in the offering materials. . . . The lawyer also should

⁸³ *Id.* ¶26.

⁸⁴ 31 C.F.R. §10.35(c)(3)(ii).

⁸⁵ *Id.* § 10.35(c)(4).

⁸⁶ ABA Formal Op. 346, ¶20.

⁸⁷ 31 C.F.R. 10.35(b)(2)(i).

⁸⁸ ABA Formal Op. 346, ¶21.

⁸⁹ *Id.*

⁹⁰ 31 C.F.R. § 10.35(c)(3)(i).

⁹¹ *Id.* § 10.35(c)(3)(ii).

assure that his own opinion identifies clearly its limited nature, if the lawyer is not retained to consider all of the material tax issues.⁹²

The language is followed in Circular 230 Rules pertaining to *limited scope opinions* in which practitioners may address less than all of the issues a tax proposal raises.⁹³

V. ABA FORMAL OPINION 85-352 STANDARDS FOR ESTABLISHING TAX RETURN POSITIONS

ABA Formal Opinion 346 was followed by ABA Formal Opinion 85-352, issued in 1985 to address the standard required for advice provided by an attorney concerning tax return positions.⁹⁴ ABA Formal Opinion 85-352 permits an attorney to give advice even though the likelihood of success if the advice is followed is lower than the *more likely than not* standard of the current Circular 230 Rules required to issue a reliance opinion or a marketed opinion.⁹⁵ ABA Formal Opinion 85-352 states, “[a] lawyer shall not bring or defend a proceeding, or assert or controvert an issue therein, unless there is a basis for doing so that is not frivolous, which includes a good faith argument for an extension, modification or reversal of existing law.”⁹⁶ From this language, the committee derived the conclusion, “[a] lawyer can have a good faith belief in this context even if the lawyer believes the client’s position probably will not prevail. However, “good faith requires that there be some realistic possibility of success if the matter is litigated.”⁹⁷ The minimum level of confidence required for providing written advice in a limited scope opinion, or an opinion with a prominent disclaimer is the higher reasonable basis standard now required by statute.⁹⁸

ABA Formal Opinion 85-352 continues by again restating the standards found in the ABA Model Rules and in the Circular 230 Rules:

A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law.⁹⁹

ABA Formal Opinion 85-352 requires a lawyer to counsel the client regarding whether the position is likely to be sustained by a court if challenged by the IRS, as well as the potential penalties to the client if the position is taken on the tax return without

⁹² ABA Formal Op. 346, ¶22.

⁹³ 31 C.F.R. § 10.35(c)(3)(v).

⁹⁴ ABA Formal Op. 85-352.

⁹⁵ 31 C.F.R. §§ 10.35(b)(4), (c)(3)(iv).

⁹⁶ *Id.* The same language is now found at ABA Model Rule 3.1, N.M. STAT. ANN. §16-301

⁹⁷ *Id.*

⁹⁸ I.R.C. § 6694.

⁹⁹ *Id.* The committee relied on what were then Rules 1.2(d), and 3.4. The language referring to a “good faith argument . . .” is now found at ABA Model Rule 3.1, N.M. STAT. ANN. §16-301. The language referring to a client’s position *that probably will not prevail* is not found in the current ABA Model Rules.

disclosure and the IRC benefits of disclosure under what is now IRC § 6662.¹⁰⁰ The lawyer must either show substantial authority for a position or advise the client of the penalty the client may suffer and any opportunity to avoid such penalty by adequately disclosing the facts in the return or in a statement attached to the return.¹⁰¹

With respect to candor toward the IRS, ABA Formal Opinion 85-352 bluntly states, “[i]n all cases—preparation of returns and negotiating administrative settlements—the lawyer is under a duty not to mislead the Internal Revenue Service deliberately, either by misstatements or by silence or by permitting the client to mislead.”¹⁰²

VI. SANCTIONS IMPOSED ON THOSE WHO VIOLATE CIRCULAR 230 RULES

Circular 230 Rules provide that the Secretary of the Treasury may censure, reprimand, suspend, or disbar a practitioner if the practitioner is shown to be incompetent or disreputable, or if the practitioner fails to comply with any regulation with intent to defraud, willfully and knowingly misleads, or threatens a client or prospective client.¹⁰³ In addition, the Secretary may impose monetary penalties on a practitioner equal to the amount of gross income to be derived from the conduct giving rise to the penalty instead of or in addition to other sanctions.¹⁰⁴ Sanctions may be imposed for: 1) willfully violating any Circular 230 Rule other than the aspirational standards; 2) recklessly or through gross incompetence violating requirements for written opinions, covered opinions, reliance opinions, marketed opinions, or standards for preparing and filing tax returns, documents, affidavits, or other written advice; or 3) “otherwise failing to comply with the rules.”¹⁰⁵ Finally, the rules extend to non-practitioner financial advisors who prepare a document they have “reason to believe” will be used to understate tax liability are subject to penalty.¹⁰⁶

Imposition of sanctions by the IRS is similar to imposition of state sanctions against a lawyer for violating state ethics rules. Rules governing prominent disclaimers attached to limited scope opinions, marketed opinions, and what would otherwise be reliance opinions do not always insulate tax practitioners from either IRS or state imposed sanctions. An opinion addressing a principal purpose transaction may not be a limited scope opinion and may not be exempted from reliance opinion and marketed opinion rules.¹⁰⁷ Because there is substantial uncertainty as to what constitutes a principal purpose as opposed to a significant purpose transaction, there is corresponding uncertainty as to when a practitioner can issue a limited scope opinion

¹⁰⁰ I.R.C. § 6662 was created to replace old I.R.C. §§ 6653(a) (negligence) 6661 (substantial understatement); 6659 (substantial valuation understatement); 6659A (overstatement of pension liability); and 6660 (estate and gift tax valuation understatement) by the Revenue Reconciliation Act of 1989, Pub. L. No. 101-239, 103 Stat. 2301. Note that I.R.C. § 6662A is a penalty for reportable transaction understatements including accuracy related underpayments.

¹⁰¹ ABA Formal Op. 85-352.

¹⁰² Now ABA Model Rule 3.3., N.M. STAT. ANN. § 16-303. Formerly Rules 4.1 and 8.4(c); DRs 1-102(A)(4), 7-102(A)(3) and (5).

¹⁰³ 31 C.F.R. § 10.50(a)(b).

¹⁰⁴ *Id.* § 10.50(c).

¹⁰⁵ *Id.* § 10.52(a)(1), (2).

¹⁰⁶ I.R.C. § 6701(a).

¹⁰⁷ 31 C.F.R. §§ 10.35(b)(4)(ii), 10.35(b)(5)(ii), 10.35(c)(3)(v)(2).

or an opinion with a prominent disclaimer.¹⁰⁸ Further, since a marketed opinion is defined to include an opinion provided by a tax professional for another tax professional to use when advising clients, advice provided by a tax practitioner to a second tax practitioner that relates to minimizing client tax liability must often be provided as a marketed opinion. A disclaimer protects a practitioner when the tax consequences of a transaction are unambiguously subordinate to other purposes. A practitioner is also insulated from the threat of sanctions when the answer to a tax question is provided by the IRC, regulations, or unambiguous controlling authority.¹⁰⁹

The Circular 230 disciplinary rules provide that a practitioner may be censured, reprimanded, suspended, or disbarred from practice before the IRS, and may be subjected to monetary penalties for:

1. Conviction of criminal offense under revenue laws;
2. Conviction of criminal offense involving dishonesty or breach of trust;
3. Conviction of a felony rendering the practitioner unfit to practice before the IRS;
4. Participating in any way in the giving of false or misleading information to the Department of Treasury or to a court, knowing information in returns, financial statements, oral or written statements is false or misleading;
5. Unlawful solicitation of employment (under § 10.30) by use of false or misleading representations with intent to deceive a prospective or current client or intimidating the practitioner may improperly obtain special consideration;
6. Willfully failing to file a federal tax return or participating in evading or attempting to evade any assessment or payment of any federal tax;
7. Willfully assisting, counseling, encouraging, suggesting a client violate, any federal tax law, or knowingly counseling or suggesting an illegal plan to evade federal taxes or payment thereof;
8. Misappropriation of, or failure to properly remit funds received from a client to pay taxes due;
9. Offering or agreeing to attempt to influence, the official action of any employee of the IRS by use of threats, false accusations, duress or coercion, by the offer of any special inducement or promise of an advantage, . . . gift, favor, or thing of value,
10. Having been disbarred or suspended from practice by a state licensing or ethics organization; or
11. Knowingly aiding another person to practice before the Internal Revenue Service during a period of suspension or disbarment.¹¹⁰

Prohibited activities also include:

¹⁰⁸ For other than marketed opinions, listed transactions and transactions subject to contractual protection the test is whether the importance of tax considerations “exceeds any other purpose,” 31 C.F.R. § 10.35(b)(10).

¹⁰⁹ *Id.*

¹¹⁰ 31 C.F.R. § 10.51(a)(1)-(11) (incompetence and disreputable conduct).

1. Contemptuous conduct in connection with practice before the IRS, including abusive language, making false accusations or statements, knowing them to be false or circulating or publishing malicious or libelous matter;
2. Issuing a false opinion, a knowing misstatement of fact or law, or asserting a position known to be unwarranted under existing law, making a highly unreasonable omission or engaging in a pattern of providing incompetent opinions on questions arising under the federal tax laws;
3. Willfully failing to sign a tax return prepared by the practitioner when the practitioner's signature is required by the federal tax laws unless the failure is due to reasonable cause; or
4. Willfully disclosing tax return information in a manner not authorized by the IRC, contrary to the order of a court or administrative law judge.¹¹¹

The ABA Model Rules address the same violations addressed above in Circular 230. It is professional misconduct to commit a criminal act that reflects adversely on the lawyer's honesty, trustworthiness or fitness as a lawyer.¹¹² A lawyer may not knowingly make a false statement of material fact or law to a third person or fail to disclose a material fact to avoid assisting in a criminal or fraudulent act by a client.¹¹³ In addition, it is professional misconduct to engage in conduct involving dishonesty, fraud, deceit or misrepresentation.¹¹⁴ A lawyer may not "by in-person, live telephone or real-time electronic contact solicit professional employment from a prospective client unless the person contacted is a lawyer; or has a family, close personal, or prior professional relationship with the lawyer."¹¹⁵ In addition, a lawyer may not solicit professional employment from a prospective client by written, recorded or electronic communication or by in-person, telephone or real-time electronic contact if the prospective client has made known to the lawyer a desire not to be solicited, or if the solicitation involves coercion, duress or harassment.¹¹⁶ Both failing to file a tax return and evading taxes are crimes prohibited by the ABA Model Rules.¹¹⁷ The rules also prohibit counseling a client to violate tax law. They state that a lawyer shall not knowingly make a false statement of fact or law, offer evidence the lawyer knows to be

¹¹¹ *Id.* § 10.51(a)(12)(15).

¹¹² ABA Model Rule 8.4(b), N.M. STAT. ANN. § 16-804(B).

¹¹³ ABA Model Rule 4.1, N.M. STAT. ANN. § 16-401.

¹¹⁴ ABA Model Rule 8.4(c), N.M. STAT. ANN. § 16-804(C).

¹¹⁵ ABA Model Rule 7.3(a), N.M. STAT. ANN. § 16-703(A).

¹¹⁶ ABA Model Rule 7.3b, N.M. STAT. ANN. § 16-703(B). In addition, ABA Model Rule 7.1, N.M. STAT. ANN. § 16-701, states that a lawyer shall not make a false or misleading communication about the lawyer or the lawyer's services.

¹¹⁷ ABA Model Rule 8.4(b), N.M. STAT. ANN. § 16-804(B) (prohibiting committing a criminal act); ABA Model Rule 8.4(c), N.M. STAT. ANN. § 16-804(C) (prohibiting dishonesty, deceit, or deception). In addition, ABA Model Rule 3.3, N.M. STAT. ANN. § 16-303, provides that a lawyer shall not knowingly mislead the I.R.S. by making a false statement of fact or law (by failing to file a return, implying no return is required under the law) or permit a client to do so.

false, or permit a client to do so.¹¹⁸ In addition, a lawyer may not bring or defend a matter unless there is a good faith basis in law and fact for doing so.¹¹⁹

The ABA Model Rules provide a broader proscription against failure to remit client tax payments than does Circular 230. An attorney is required to keep safe and properly remit client property.¹²⁰ Specifically, the rule states that “a lawyer shall promptly deliver to the client or third person any funds or other property that the client or third person is entitled to receive and, upon request by the client or third person, shall promptly render a full accounting regarding such property.”¹²¹ A lawyer may not assist a disbarred or suspended practitioner in doing so.¹²² Similarly, knowingly aiding an ineligible person to practice, is also a violation of ABA Model Rules.¹²³ An attorney may not act contemptuously before the IRS, nor can a lawyer imply an ability to improperly influence the IRS or an IRS official.¹²⁴ A lawyer may not improperly seek to influence an IRS official or engage in conduct intended to disrupt the IRS.¹²⁵ A lawyer may not knowingly make a false statement of fact or law, offer evidence the lawyer knows to be false, or permit a client to do so.¹²⁶ Willfully failing to sign a tax return constitutes fraud or misrepresentation prohibited by the ABA Model Rules.¹²⁷ Finally, disclosing confidential tax return information is a violation of the prohibition against revealing information relating to the representation of a client without the client’s informed consent.¹²⁸

VII. CIRCULAR 230 ETHICAL REQUIREMENTS AND PARALLEL ABA MODEL RULES REQUIREMENTS

A. PROVISION OF MATERIALS REQUESTED BY THE IRS

Practitioners must produce all non-privileged material upon the IRS’s request. Circular 230 Rules specify that all information and records the IRS requests must be furnished unless there are reasonable grounds to claim privilege if the information is in

¹¹⁸ ABA Model Rule 3.3(a), (b), N.M. STAT. ANN. § 16-303(A) (prohibit submitting false evidence). See also ABA Model Rule 1.16, N.M. STAT. ANN. § 16-116(B) (declining or terminating representation if the representation will result in violation of rules of professional conduct or other law).

¹¹⁹ ABA Model Rule 3.1, N.M. STAT. ANN. § 16-301.

¹²⁰ ABA Model Rule 1.15, N.M. STAT. ANN. § 16-115.

¹²¹ ABA Model Rule 1.15(d), N.M. STAT. ANN. § 16-115(D).

¹²² ABA Model Rule 5.5(a), N.M. STAT. ANN. § 16-505(A).

¹²³ *Id.*

¹²⁴ ABA Model Rule 8.4(e), N.M. STAT. ANN. § 16-804(E).

¹²⁵ ABA Model Rule 3.5(b), N.M. STAT. ANN. § 16-305(B).

¹²⁶ ABA Model Rule 3.3, N.M. STAT. ANN. § 16-303 (a lawyer shall not knowingly make a false statement of fact or law, offer evidence the lawyer knows to be false, or permit a client to do so); ABA Model Rule 3.1, ABA Model Rule 4.1, N.M. STAT. ANN. § 16-401 (a lawyer shall not knowingly make a false statement of material fact or law to a third person or fail to disclose a material fact to avoid assisting in a criminal or fraudulent act by a client); ABA Model Rule 8.4(c), N.M. STAT. ANN. § 16-804(C) (it is professional misconduct to engage in conduct involving dishonesty, fraud, deceit or misrepresentation).

¹²⁷ ABA Model Rule 8.4(c), N.M. STAT. ANN. § 16-804(C) (it is professional misconduct to engage in conduct involving dishonesty, fraud, deceit or misrepresentation).

¹²⁸ ABA Model Rule 1.6(a),(b), N.M. STAT. ANN. §16-106(A),(B). The provision provides for an exception, to prevent to prevent the client from committing a crime or fraud reasonably certain to result in substantial injury to the financial interest of another and in furtherance of which the client has used or is using the lawyer’s services. *Id.*

the control of the practitioner or the practitioner's client. If the material is not in the control of either, the practitioner must provide any information the practitioner or the practitioner's client has regarding the identity of the person who may have possession of the material.¹²⁹ Circular 230 Rules further state, "[a] practitioner who knows that a client has not complied with the revenue laws of the United States or has made an error in or omission from any return, document, affidavit or other paper . . . must advise the client promptly . . . of the consequences [of not complying]. . . ."¹³⁰ The parallel ABA Model Rules prohibit an attorney from restricting access to evidence, altering or destroying or falsifying evidence, assisting a witness who does so, or knowingly disobeying an obligation to produce evidence absent an assertion of privilege.¹³¹ Further, ABA Rules prohibit a lawyer from counseling or assisting a client who engages in conduct that is criminal, fraudulent, or misleading to the court.¹³² The commentary to the rule explains that a lawyer must withdraw if he or she discovers a client is engaging in criminal or fraudulent activity, and concludes, "[i]t may be necessary for the lawyer to give notice of the fact of withdrawal and to disaffirm any opinion, document, affirmation or the like."¹³³

The commentary is reinforced by rules which require an attorney to reveal information to prevent or rectify financial injury reasonably certain to result from client commission of a crime or fraud as well as to comply with the law.¹³⁴ The rules state that the requirement of candor toward the tribunal makes it a violation of ethics rules to make a false statement, fail to correct a false statement previously made, or allow a client or a witness to offer false oral or written testimony, "even if compliance requires disclosure of information otherwise protected by Rule 1.6 [confidentiality of information]."¹³⁵ "A lawyer shall not bring or defend a proceeding, or assert or controvert an issue therein, unless there is a basis in law and fact for doing so that is not frivolous, which includes a good faith argument for an extension, modification or reversal of existing law."¹³⁶

The rules state that "[a] lawyer who represents a client in an adjudicative proceeding and who knows that a person intends to engage, is engaging or has engaged in criminal or fraudulent conduct related to the proceeding shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal."¹³⁷ In addition, the rules state that "[a] lawyer shall not counsel a client to engage, or assist a client, in

¹²⁹ 31 C.F.R. § 10.20.

¹³⁰ *Id.* § 10.21.

¹³¹ ABA Model Rule 3.4, N.M. STAT. ANN. § 16-304.

¹³² ABA Model Rule 1.2(D); N.M. STAT. ANN. § 16-102(D).

¹³³ Commentary, ABA Model Rule 1.2(d); N.M. STAT. ANN. § 16-102(D).

¹³⁴ ABA Model Rule 1.6(b) (1), (2), (3), (6); N.M. STAT. ANN. § 16-106(B) (1), (2), (3), (6).

¹³⁵ ABA Model Rule 3.3; N.M. Stat. Ann. § 16-303. If filing an income tax return and being audited is an ex parte proceeding, the rules require, "[i]n an ex parte proceeding, a lawyer shall inform the tribunal of all material facts known to the lawyer that will enable the tribunal to make an informed decision, whether or not the facts are adverse." ABA Model Rule 3.3(d), N.M. Stat. Ann. § 15-303(D). Whether a proceeding is ex parte or adversarial, it is a violation of the rules to obstruct the I.R.S.'s access to evidence, ABA Model Rule 4.1, N.M. Stat. Ann. § 16-401 prohibits a lawyer from knowingly making a false statement of material fact or law or failing to disclose material when necessary to avoid assisting in a criminal or fraudulent act by a client. ABA Model Rule 3.4; N.M. Stat. Ann. § 16-304 prohibit a lawyer from concealing material having potential evidentiary value or assisting anyone else trying to do so.

¹³⁶ ABA Model Rule 3.1, 3.3(a)(1), (3) (candor toward the tribunal), N.M. STAT. ANN. §§ 301, 303(A)(1), (3).

¹³⁷ ABA Model Rule 3.3(b), N.M. STAT. ANN. § 16-303(B).

conduct that the lawyer knows is criminal or fraudulent. . . .”¹³⁸ The ABA Model Rules require a lawyer to do everything necessary, including disclosing client acts, to prevent the client from presenting a false tax return or report.

B. CANDOR WHEN PREPARING AND FILING TAX RETURNS

The diligence requirements in preparing tax returns discussed in ABA Formal Opinion 85-352 are also found in the Circular 230 Rules. A practitioner must 1) exercise due diligence when preparing and filing tax returns, documents, affidavits, and other papers to ensure oral and written representations to clients and to the IRS are correct, and 2) use reasonable care in engaging and evaluating the product of others.¹³⁹ The current ABA Model Rules impose the same requirements. A lawyer must provide competent representation, knowledge, skill, thoroughness, and preparation.¹⁴⁰ Similarly, the Circular 230 requirement that a practitioner not unreasonably delay prompt disposition of any matter¹⁴¹ is taken directly from ABA Model Rules, which require “[a] lawyer shall act with reasonable diligence and promptness in representing a client.”¹⁴²

Circular 230 imposes standards for submission of tax returns, as well as documents, affidavits, and other papers.¹⁴³ The rules prohibit a practitioner from advising a client to “submit a document, affidavit, or other paper to delay or impede, that is frivolous, or that contains or omits information in a manner that demonstrates intentional disregard of a rule or regulation unless the practitioner also advises the client to submit a document that evidences a good faith challenge to the rule or regulation.”¹⁴⁴ The specific rule reinforces the more general rules. Circular 230 prohibits false or misleading representations, as well as counseling or assisting a client in violation of federal tax law.¹⁴⁵ Similarly, the ABA model rules prohibit fraudulent representations: “A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent.”¹⁴⁶

C. CONFLICTS OF INTEREST

Circular 230 prohibits representation involving conflicting interests, which it defines as representation of one client that is directly adverse to another client, or, “a significant risk that representing one client will be materially limited by responsibilities to another client, a former client, a third person, or a personal interest of the practitioner.”¹⁴⁷ Like Circular 230, the ABA Model Rules prohibit lawyers from representation involving conflicts with either current or former clients.¹⁴⁸ In addition, if

¹³⁸ ABA Model Rule 1.2(d), N.M. STAT. ANN. § 16-102(D).

¹³⁹ 31 C.F.R. § 10.22.

¹⁴⁰ ABA Model Rule 1.1; N.M. STAT. ANN. §16-101.

¹⁴¹ 31 C.F.R. § 10.23.

¹⁴² ABA Model Rule 1.3; N.M. STAT. ANN. § 16-103.

¹⁴³ 31 C.F.R. § 10.34.

¹⁴⁴ *Id.* § 10.34(b)(2).

¹⁴⁵ *Id.* § 10.51(a)(4), (6), (7).

¹⁴⁶ ABA Model Rule 1.2(d) (course of conduct); N.M. STAT. ANN. § 16-102(D).

¹⁴⁷ 31 C.F.R. § 10.29(a).

¹⁴⁸ Representing a client whose interest conflicts with that of a current client is prohibited by ABA Model Rule 1.7 (conflict of interest: current clients), N.M. STAT. ANN. §§ 16-107, ABA Model Rule 1.8 (conflict of interest: current clients; specific rules); N.M. STAT. ANN. §§ 16-108, and ABA Model Rule 1.9 (duties to former clients); N.M. STAT. ANN. § 16-109.

a lawyer has a personal interest in a matter, representation of another in the same matter is classified as a conflict.¹⁴⁹ Notwithstanding a conflict, a practitioner may represent a client if: 1) the practitioner believes he or she can do so reasonably; 2) the representation is not prohibited by law; and 3) each affected client gives informed written consent.¹⁵⁰

Circular 230 imposes advertising and solicitation restrictions that prohibit false, fraudulent, or coercive claims, misleading statements, and direct or indirect uninvited written or oral solicitation.¹⁵¹ Practitioners may publish fee information.¹⁵² The restrictions on advertising and solicitation are derived directly from ABA Model Rules. The rules permit advertising, but prohibit giving anything of value to one who refers a client.¹⁵³ The duty of candor limits a lawyer to only truthful non-misleading advertising.¹⁵⁴ Promising tax benefits the practitioner knows to be questionable is inconsistent with such a duty. The rules also prohibit unwanted personal solicitation; limit solicitations to family, close personal, or prior client relations; and prohibit coercive claims or statements.¹⁵⁵ "A lawyer shall not solicit professional employment from a prospective client by written, recorded or electronic communication or by in-person, telephone or real-time electronic contact . . . if the solicitation involves coercion, duress or harassment."¹⁵⁶

D. RESTRICTIONS ON REPRESENTATION IMPOSED ON FORMER GOVERNMENT EMPLOYEES

Circular 230 Rules prohibit former government employees from subsequently representing or knowingly assisting, in a particular matter in which they personally and substantially participated, any person who is or was a specific party to that particular matter.¹⁵⁷ The rule has two restrictions. First, a government employee who had official responsibility for a particular matter within one year prior to termination of government employment may not, for two years after government employment is ended, represent in that particular matter any person who is or was a specific party to that particular matter.¹⁵⁸ Second, a former government employee who participated in developing a rule within one year prior to termination of government employment may not, for one year after termination of government employment, appear before any employee of the Treasury Department in connection with a matter involving the rule. The former employee may represent a taxpayer in connection with a matter involving application or interpretation of the rule with respect to specific parties.¹⁵⁹ A firm with an employee or partner who is a former government employee may represent a client in such a matter if: 1) the firm isolates the former government employee; 2) the employee and another member of the firm execute an affidavit under oath attesting to the

¹⁴⁹ See generally, ABA Model Rule 1.7 (conflict of interest: current clients), N.M. STAT. ANN. § 16-107.

¹⁵⁰ 31 C.F.R. § 10.29(b); ABA Model Rules 1.7(b), N.M. Stat. Ann. §§ 16-107(B), 1.8(A)(1-3); 108(a)(1-3). In addition, 31 C.F.R. § 10.29(c) requires the practitioner to retain copies of consents for 36 months from conclusion of representation and provides them to the I.R.S. on request.

¹⁵¹ 31 C.F.R. § 10.30(a).

¹⁵² *Id.* § 10.30(b).

¹⁵³ ABA Model Rule 7.2 (advertising), N.M. STAT. ANN. § 16-702.

¹⁵⁴ ABA Model Rule 4.1, N.M. STAT. ANN. § 16-401.

¹⁵⁵ ABA Model Rule 7.3 (direct contact with prospective clients); N.M. STAT. ANN. § 16-703.

¹⁵⁶ *Id.*

¹⁵⁷ 31 C.F.R. § 10.25.

¹⁵⁸ *Id.* § 10.25 (b)(3).

¹⁵⁹ *Id.*

isolation, the firm, and the matter; 3) and the firm retains the affidavit for possible inspection.¹⁶⁰

The ABA Model Rules are more restrictive of a former government attorney's practice than are the Circular 230 Rules. A former government attorney may not "represent a client in connection with a matter in which the lawyer participated personally and substantially as a public officer or employee, unless the appropriate government agency gives its informed consent, confirmed in writing to the representation."¹⁶¹ A firm in which a former government attorney practices may represent a client if the former government lawyer is screened from participation, and written notice is provided to the government agency.¹⁶²

E. RESTRICTIONS ON UNREASONABLE AND CONTINGENT FEES

With respect to fees, Circular 230 Rules provide that a practitioner may not charge an unconscionable fee for representing a client.¹⁶³ Contingent fees are prohibited except in the following instances:

1. In connection with IRS examination of an original tax return,
2. Preparation of an amended tax return where the claim for refund or credit was filed within 120 days of the taxpayer receiving written notice of the examination of the original return,
3. A claim for refund or credit, solely in connection with determination of statutory interest or penalties, or
4. For representation in a judicial proceeding.¹⁶⁴

The ABA Model Rules also prohibit unreasonable fees;¹⁶⁵ however, contingent fees are permitted except in domestic relations and criminal cases.¹⁶⁶

F. SANCTIONS FOR INCOMPETENT REPRESENTATION

In addition to the rules, violation of which can result in sanction, Circular 230 Rules prescribe *best practices* for tax advisors that are aspirational, rather than rules the IRS will enforce.¹⁶⁷ Practitioners are urged to adhere to *best practices* in providing advice and in preparing and submitting materials to clients and to the IRS. Practitioners are also supposed to communicate the terms of the engagement clearly to clients.¹⁶⁸ They are to establish facts, determine which are relevant, evaluate the reasonableness of assumptions or representations, relate applicable law to relevant facts, and arrive at a conclusion. Practitioners must then advise the client of the conclusions reached and whether the taxpayer may avoid accuracy-related penalties in reliance on the advice, and act fairly and with integrity in practice before the IRS.¹⁶⁹

¹⁶⁰ *Id.* § 10.25(c).

¹⁶¹ ABA Model Rule 1.11(a)(2); N.M. STAT. ANN. § 16-111(A)(2).

¹⁶² ABA Model Rule 1.11(b); N.M. STAT. ANN. § 16-111(B).

¹⁶³ 31 C.F.R. § 10.27(a).

¹⁶⁴ *Id.* § 10.27(b)(1)-(4) (2007).

¹⁶⁵ ABA Model Rule 1.5; N.M. STAT. ANN. § 16-105,

¹⁶⁶ ABA Model Rule 1.5(c); N.M. STAT. ANN. § 16-105(C),

¹⁶⁷ 31 C.F.R. § 10.33.

¹⁶⁸ *Id.* § 10.33(a)(1).

¹⁶⁹ *Id.* § 10.33(a)(2)-(4).

While best practices are not actionable under the IRS disciplinary rules,¹⁷⁰ ABA Model Rule 1.1 mandates that a lawyer “shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation.”¹⁷¹ Rule 1.4(a) provides that a lawyer will promptly inform the client of decisions, as well as circumstances requiring informed consent, and will consult with the client about accomplishing the client’s objectives and about the status of the matter. In addition, the lawyer must comply with requests for information and consult about any limits on the lawyer’s conduct.¹⁷² Rules 3.3 and 3.4 both require that the lawyer act fairly and with integrity and candor toward the IRS as well as toward opposing counsel.¹⁷³ Rule 3.1 prohibits a lawyer from bringing or defending a civil action unless there is a legitimate basis in law and fact for doing so.¹⁷⁴

G. OBLIGATION TO ADVISE TAXPAYER OF POTENTIAL PENALTIES

Circular 230 Rules require practitioners to advise clients of any penalties likely to apply to a tax return if the practitioner advised the client on the position or prepared or signed the tax return.¹⁷⁵ The rules also direct practitioners to advise clients of any opportunity to avoid penalties by disclosing the tax treatment in accordance with IRS disclosure requirements.¹⁷⁶ The rules cover tax returns, affidavits, and other documents submitted to the IRS.¹⁷⁷ The Circular 230 disclosure and penalty avoidance rules are subsumed under ABA Model rule 1.4, which imposes on lawyers the obligation to promptly inform the client of any decision or circumstance with respect to which the client’s informed consent is required, consult with the client about how objectives are to be accomplished, and keep the client reasonably informed about the status of the matter.¹⁷⁸ In addition, ABA Formal Opinion 85-352 requires a lawyer to counsel a client as to whether a position is likely to be sustained by a court if challenged by the IRS as well as any potential penalties associated with taking a particular course of action associated with disclosing or not disclosing to the IRS the tax position taken.

Circular 230 Rules provide that a practitioner may rely on information furnished by a client absent a reason not to:

[A practitioner] generally may rely in good faith without verification on information furnished by the client. The practitioner may not, however, ignore the implications of information furnished to, or actually known, by the practitioner, and must make reasonable inquiries if the information as furnished appears to be incorrect, inconsistent with an important fact, or another factual assumption or incomplete.¹⁷⁹

¹⁷⁰ *Id.* § 10.52(a)(1) (which excludes § 10.33 from matters violation of which can be sanctioned under § 10.50).

¹⁷¹ ABA Model Rule 1.1 (competence); N.M. STAT. ANN. § 16-101.

¹⁷² ABA Model Rule 1.4(a) (communication); N.M. STAT. ANN. § 16-101(A)

¹⁷³ ABA Model Rule 3.3 (candor toward the tribunal), N.M. STAT. ANN. § 303; ABA Model Rule 3.4 (fairness to opposing party and counsel), N.M. STAT. ANN. § 304.

¹⁷⁴ ABA Model Rule 3.1 (meritorious claims and contentions), N.M. STAT. ANN. § 301.

¹⁷⁵ 31 C.F.R. § 10.34(c)(1)(i).

¹⁷⁶ *Id.* § 10.34(c)(2).

¹⁷⁷ *Id.* § 10.34(c)(1)(ii).

¹⁷⁸ ABA Model Rule 1.4 (communication), N.M. STAT. ANN. § 104.

¹⁷⁹ 31 C.F.R. § 10.34(d). Relying on information furnished by clients (added in 2007).

The ABA expressed the same position in detail as early as 1974 in ABA Formal Opinion 335:

The lawyer should . . . make inquiry of his client as to the relevant facts and receive answers. If any of the alleged facts, or the alleged facts taken as a whole, are incomplete in a material respect; or are suspect; or are inconsistent; or either on their face or on the basis of other known facts are open to question, the lawyer should make further inquiry. . . . Where the lawyer concludes that further inquiry of a reasonable nature would not give him sufficient confidence as to all the relevant facts, or for any other reason he does not make the appropriate further inquiries, he should refuse to give an opinion.¹⁸⁰

ABA Formal Opinion 346 concludes, “[a] lawyer should not issue a tax shelter opinion which disclaims responsibility for inquiring as to the accuracy of the facts, fails to analyze the critical facts or discusses purely hypothetical facts.”¹⁸¹

In May 2007, Congress imposed minimum probabilities of prevailing in a tax dispute that practitioners signing tax returns must meet when providing advice.¹⁸² The new IRC § 6694(a) Standard prohibits a tax professional signing a tax return from taking a position unless the tax professional concludes that the tax treatment is *more likely than not* (a greater than fifty percent likelihood) to be correct. The tax professional may take the position if the position has a *realistic possibility of success* (a one in three likelihood) of being correct and the position is disclosed on the tax return.¹⁸³ The IRS has proposed amendments to the Circular 230 Rules to conform them to the new § 6694 Standard.¹⁸⁴ A similar standard was included in ABA Formal Opinion 85-352 twenty years earlier.

H. ESTABLISHMENT OF TAX FIRM ETHICS POLICIES

Circular 230 Rules impose an affirmative duty on a practitioner with principal authority for overseeing a firm’s tax practice to take reasonable steps to ensure the firm has adequate procedures in place to assure compliance with the opinion writing requirements of Circular 230 or be subject to discipline. If a member or employee of the firm engaged in a pattern or practice of failing to comply and the practitioner with principal authority should have known and fails to take prompt action to correct the noncompliance, both the member or employee and the practitioner with principal

¹⁸⁰ ABA Formal Op. 335 (1974), reiterated in ABA Formal Op. 346, ¶15.

¹⁸¹ The Opinion continues, “It is proper, however, to assume facts which are not currently ascertainable . . . so long as the factual assumptions are clearly identified as such in the offering materials, and are reasonable and complete.” ABA Formal Op. 346, ¶17.

¹⁸² I.R.C. § 6694 (the § 6694 Standard).

¹⁸³ The Small Business and Work Opportunity Tax Act of 2007, Pub. L. No. 110-28, 121 Stat. 190 (2007). The I.R.S. has proposed amendments to 31 C.F.R. § 10.34 to conform the Circular 230 Rules to the Statute. The authorities described in 26 C.F.R. § 1.6662-4(d)(3)(iii) may be considered for purposes of the analysis; however, audit or settlement probabilities may not be considered. 31 C.F.R. § 10.34(d)(1).

¹⁸⁴ See Notice of Proposed Rulemaking, Regulations Governing Practice Before the Internal Revenue Service, 72 Fed. Reg. 54621 (Sept. 26, 2007); I.R.S. Notice, Tax Return Preparer Penalties Under Sections 6694 and 6695, 2008-27 I.R.B. 32 (June 16, 2008).

authority are subject to sanction.¹⁸⁵ Again, the Circular 230 Rule tracks the rule in the ABA Model Code. Rule 501(c) states:

A lawyer shall be responsible for another lawyer's violation of the Rules of Professional Conduct if: (i) the lawyer orders or, with knowledge of the specific conduct, ratifies the conduct involved; or (ii) the lawyer is a partner or has comparable managerial authority in the law firm in which the other lawyer practices, or has direct supervisory authority over the other lawyer, and knows of the conduct at a time when its consequences can be avoided or mitigated but fails to take reasonable remedial action.¹⁸⁶

VIII. CONCLUSION

The ABA Model Rules and Formal Opinions, specifying what constitutes ethical practice for lawyers, provided the model for the IRS Circular 230 Rules. Whether drafting opinions or advising on the proper way to file tax returns, attorneys are obligated by the Model Rules to provide complete, objective, and competent advice to clients. The Model Rules not only require candor toward the IRS from attorneys, but also prohibit attorneys from knowingly permitting clients to make false or incomplete tax returns, statements, appraisals, or other submissions to the IRS. The Circular 230 Rules do little more than attempt to impose the same requirements long imposed on lawyers by their own professional organizations on non-lawyer tax professionals, appraisers, financial analysts and others who submit materials to the IRS. With the exceptions identified above, the Circular 230 Rules go far to accomplish this end.

¹⁸⁵ 31 C.F.R. § 10.36(a) (procedures to ensure compliance).

¹⁸⁶ ABA Model Rule 5.1(c), N.M. STAT. ANN. § 16-501.