

## Dirt Off Your Shoulder

Addressing Ethics in a Time of Uncertainty

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# Agenda

- Circular 230
- Analysis of Authority
- Tax Opinion Standards
- Dealing with Uncertainty

# Circular 230

## Circular 230

31 C.F.R. Part 10, TD 9668 (June 12, 2014)

- Governs federal tax practice (many states have analogous regulations)
- Requirements for written advice (10.37)
  - Reasonableness standard
    - Reliance on factual and legal assumptions
    - Reliance on the advice of others
    - Consideration of all relevant facts that are known or should be known
    - Efforts to identify and ascertain relevant facts
  - Relate applicable law and authority to the facts
  - Not rely on the “audit lottery”
- Reasonableness determined considering all facts and circumstances
  - Scope of the engagement
  - Type and specificity of the advice sought
  - Practitioner knows or reasonably should know that representations/assumptions are incorrect, incomplete or inconsistent

## Circular 230

### Written Advice

- “Heightened standards” for marketed opinions with a “significant purpose” of tax avoidance or evasion
  - Reasonable practitioner standard still applies
  - Emphasis on additional risk due to practitioner’s lack of knowledge of taxpayer’s circumstances
  
- Not considered written advice
  - Government submissions on matters of public policy
  - Continuing education presentations for improvement of professional knowledge
    - Not presentations promoting or marketing a transaction
  
- Disclaimers not needed (or effective)

## Circular 230

### Rules

- **CIRCULAR 230 DISCLOSURE:** In order to comply with Treasury Department regulations, you hereby are informed that, unless otherwise expressly indicated, any tax advice contained in this document is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties that may be imposed under the Internal Revenue Code of 1986, as amended, or any other applicable tax law, or (ii) promoting, marketing or recommending to another party any transaction, arrangement or other matter.

## Circular 230

### Penalties for Conduct Which Violates Circular 230 (10.50)

- Sanctions for practitioners
  - Censure (public reprimand)
  - Suspension
  - Disbarment
  
- Sanctions for practitioners or firms
  - Monetary penalty (up to the amount of gross income derived from the conduct giving rise to the penalty)
  
- Expedited suspension
  - Failure to file annual returns in 4 of 5 immediately preceding years
  - Failure to file quarterly, etc., returns in 5 of 7 immediately preceding taxable periods

# Circular 230

## Conditions for sanction

### — Incompetent or disreputable conduct (10.51)

- Conviction of a federal tax crime or crime of dishonesty or breach of trust
- Conviction of a felony rendering the practitioner unfit to practice
- Giving false or misleading information to the Treasury
- Solicitation of clients in violation of the rules in 10.30
- Willfully failing to file Federal tax return or evading tax
- Willfully assisting others in violating federal tax law or evading tax
- Misappropriation of client funds intended for tax payment
- Attempting improper influence on the IRS
- Disbarment, suspension by state regulator
- Knowingly aiding and abetting unauthorized practice
- “Contemptuous conduct” in connection with IRS practice
- Giving a false opinion, knowingly, recklessly, or through gross incompetence, including an opinion which is intentionally or recklessly misleading, or engaging in a pattern of providing incompetent opinions
- Willful failure to sign a tax return
- Willful unauthorized disclosure
- Willful failure to file using electronic means
- Willful preparation of substantially all of a tax return without a PTIN
- Willful unauthorized representation before the IRS



# Preparer Penalties and Tax Crimes

- 6694 - Understatement due to unreasonable, willful or reckless position
- 6695 – Specific acts such as failure to provide copy of return, sign, etc.
- 6700 – Promoting abusive tax shelters
- 6701 – Aiding and abetting understatement of tax liability
- 6713 – Unauthorized disclosure
- 7206 – Fraud and false statements
- 7207 – Fraudulent returns, statements or other documents
- 7216 – Knowing or reckless unauthorized disclosure
- 7407, 7408 - Injunctions

## Form 2848

### Power of Attorney and Declaration of Representative

- September 2014 directive requires a Form 2848 for all persons practicing before the IRS on behalf of themselves and/or somebody else
- “Practitioners” – attorneys, CPAs, enrolled agents, enrolled actuaries, enrolled retirement plan agents or registered tax return preparers
- A corporate employee who is not a “practitioner” may be engaged in “limited practice” and treated as a “corporate employee” on Form 2848
  - Subject to standards of conduct under Circular 230 and can be denied eligibility to engage in limited practice under the same standards that would justify sanctions for a practitioner

## Form 2848

### Power of Attorney and Declaration of Representative

- Gives the OPR greater ability to sanction persons representing others before the IRS, rather than persons only authorized to receive tax return information
- IRS LB&I Division urged by Former OPR Director Karen Hawkins to get forms from in-house tax practitioners when they are representing the company before the IRS
  - “Making the distinction between someone who is a fact producer and advocacy”
  - Signature on a Form 2848 acknowledges that the signer is covered by Circular 230

# **Analysis of Authority**

# Analysis of Authority

## Introduction

- Substantial authority is the minimum level of authority for a position a taxpayer can take on a tax return without a penalty if the position is not disclosed
- Generally regarded as a one in three chance of success if the issue were to be litigated
- Under FIN 48/ASC 740, taxpayers are not permitted to take the benefit of a tax position on their books unless the position is “more likely than not”

## Substantial Authority

- The substantial authority regulations describe the types of authorities and analysis required to get to a particular comfort level
- FIN 48 made the comfort level higher, but the type of analysis required is still the same
- Circular 230 affirmatively requires “competent practice,” i.e., “the knowledge, skill, thoroughness, and preparation necessary for the matter for which the practitioner is engaged”

# Substantial Authority

## Principles

- Only certain types of authorities count
- Authorities more than 10 years old count for very little
- Reversed, overruled authorities do not count
- Each authority must be weighed
- Even if there is no “authority” on point, a well-reasoned construction of the Code can itself be substantial authority

# Substantial Authority

## Types of Authority

- Code and other statutes
- Proposed, temporary and final regulations
- Revenue Rulings and Revenue Procedures
- Treaties, regulations under treaties, and official explanations of treaties
- Cases
- Committee reports, joint statements of managers in conference committee reports, floor statements of managers
- The Bluebook



# Substantial Authority

## Types of Authority

- Private letter rulings and technical advice issued after 10/31/76 (date they started to be released under FOIA)
- AODs and GCMs published in the CB (pre-1955) or issued after 3/12/81 (date they started to be released under FOIA)
- IRS releases, notices, announcements and other pronouncements in the IRB
- Rulings issued to the taxpayer – not rulings issued to others
- Treatises, articles or opinions are not substantial authority

# Substantial Authority

## Weighing the Authorities

- Weight of the authorities supporting the desired treatment must be evaluated in relation to the weight of authorities supporting contrary treatment
- Weight depends on relevance, persuasiveness and the type of document providing the authority
  - Authorities must be factually analogous
  - Authorities higher in the hierarchy get greater weight (e.g., Rev. Rul. trumps PLR)
  - Older authorities get less weight than newer authorities. The regulations say that authorities more than 10 years old get “very little” weight
  - Persuasiveness and relevance can overcome age

# Tax Opinion Standards

# Substantial Authority

## Tax Opinion Standards

### TAX OPINION STANDARDS

Percentage chance of success	Standard of Opinion
100%	Will
99%	Will at the Ivory Soap level
98%	Will almost certainly
97%	Will almost all the time
96%	I would be astounded if we lost
95%	I would be very surprised if we lost
94%	We will not lose this one
93%	It had better be right
92%	I would tell my mother-in-law to do this
91%	I would tell my mother to do this
90%	I would tell your mother to do this
89%	Like crossing the street
88%	It's in the bag
87%	They don't get much better
86%	You don't need an opinion
85%	Why are you asking the question?
84%	It's almost in the bag
83%	One could imagine a "will"
82%	Stronger than strong should
80%	Strong should
79%	Essentially, strong should
78%	Better view is a strong should
77%	Not without hesitation, strong should
76%	Better than good should
75%	Good should
74%	Odds are high
73%	Remarkably likely
72%	Very likely
71%	Better than weak should
70%	Weak should
69%	We expect to win
68%	In all probability
67%	In all likelihood
66%	Looking good
65%	Should probably
64%	Most likely
63%	Likely
62%	Favorable prospect
61%	Not without hesitation, should
60%	Not a bad prospect
59%	Reasonable prospect
58%	Fair prospect
57%	Well grounded hope
56%	There is reason to expect
55%	Better view
54%	Ought to be right
53%	Not without hesitation, the better view
52%	More likely than more likely than not
51%	More likely than not
50%	Your guess is as good as mine

Percentage chance of success	Standard of Opinion
49%	Less likely than not
48%	Less likely than less likely than not
47%	Almost there
46%	I hesitate to predict
45%	Depends on the day of the week
44%	If we get the right judge
43%	A very good shot
42%	A good shot
41%	It arguably could work
40%	It arguably might work
39%	God willing
38%	Depending on the facts
37%	There are good arguments
36%	Could be in the cards
35%	Stranger things have happened
34%	Throw of the dice
33%	As taxpayer's counsel, I would not be ashamed to argue this in court
32%	Not without considerable doubt
31%	With some good fortune
30%	Might
29%	Might be argued that
28%	Stands a chance
27%	Might stand a chance
26%	It could be that it might work
25%	It might be that it could work
24%	Not very likely
23%	Conceivably
22%	Conceivably, but not hopeful
21%	I've seen worse
20%	Perhaps arguable
19%	Within the bounds of possibility
18%	Maybe
17%	Maybe but not likely
16%	Not likely enough
15%	Possible but not likely
14%	Maybe Enron would do this
13%	As a CCRA lawyer, I would not be ashamed to argue this in court
12%	It should work, but it won't
11%	It could work, but it won't
10%	It might work, but it won't
9%	Tell them you didn't know
8%	Perhaps if nobody finds it
7%	You have got to be joking
6%	Anything can happen, but this won't
5%	You must not understand the legislation
4%	Canadian jails aren't bad
3%	I wouldn't wish it on my enemies
2%	Not bloody likely
1%	Not in a month of Sundays
0%	Not

## Substantial Authority

### Tax Opinion Standards – Percentages Subject to Interpretation

- Will
- Should
- More Likely Than Not
- Substantial Authority
- Realistic Possibility of Success
- Reasonable Basis
- Not Frivolous
- Frivolous

# Dealing with Uncertainty

# Uncertain Tax Positions

## Introduction

- Uncertain Tax Position (UTP)
  - Defined as a previously filed tax return or anticipated position to be taken in a future tax return
  - For example:
    - Decision to file a tax return
    - Allocation of income between jurisdictions
    - Classification of a transaction as tax exempt
- For UTPs, taxpayer must comply with FIN 48/ASC 740 if applicable

# Uncertain Tax Positions

## FIN 48

- FIN 48/ASC 740
  - Applies to all companies subject to GAAP
  - If applicable, a company may not take a tax benefit unless the position meets the “more likely than not” standard
  - FIN 48 requires that taxpayers disclose an aggregate tax reserve amount across all taxing jurisdictions where the taxpayer has tax liability exposure
  
- Application of FIN 48/ASC 740
  - Taxpayer must determine whether the position meets a more likely than not standard
    - If so, taxpayer may take the tax benefit for the position (or the tax benefit of the portion of the position that meets the more likely than not standard)
    - If not, the taxpayer cannot recognize the tax benefit



## Dealing With Uncertainty

### Reliance on Proposed Regulations or Notices

- Proposed regulations and Notices are considered “substantial authority” under the section 6662 regulations, regardless of whether they indicate that taxpayers may rely on them
- Chief Counsel ordinarily should not take any position in litigation or advice that would yield a result that would be harsher to the taxpayer than under proposed regulations. IRM 32.1.1.2.2
- Proposed regulations are not binding on taxpayers. E.g., *Driggs v. Commissioner*, 87 T.C. 759, 771 n.10 (1986); *F.W. Woolworth Co. v. Commissioner*, 54 T.C. 1233, 1265-66 (1970)

# Dealing With Uncertainty

## Validity of Regulations

- Procedural invalidity
  - “Arbitrary and capricious” regulations
    - Administrative Procedure Act
    - *Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto. Ins.*
  - APA requirement of 30 days prior to effective date
  
- Substantive invalidity
  - Conflict with the statute – *Chevron* step 1
  - Unreasonable interpretation of the statute – *Chevron* step 2

# Dealing With Uncertainty – Procedural Invalidity

## *Altera Corporation* (TC 2015, 9<sup>th</sup> Cir. 2018)

- 482 Regulations - A cost-sharing arrangement is not considered qualified unless the entities share the cost of stock-based compensation
  
- Tax Court - Regulation was invalid under the APA because the promulgation of the regulation was “arbitrary and capricious,” failed to adequately explain the departure from arm’s-length standard of not sharing the cost of stock-based compensation, and failed to respond to significant comments
  
- Ninth Circuit – Initial opinion reversed the Tax Court’s decision, holding that Treasury’s process was not arbitrary and capricious because it had followed the commensurate with income standard, which supplemented the arm’s-length standard
  - Court withdrew its opinion after 15 days because one of the judges had died prior to the opinion’s issuance
  - Case reheard with a replacement panel member on 10-16-18

# Dealing with Uncertainty – Procedural Invalidity

## *SIH Partners* (TC 2018, 3d Cir.)

- 956 Regulations – Loan guarantee results in Subpart F income under section 956
  
- Tax Court - The regulation was adequately explained and not arbitrary and capricious. Deference was due under *Chevron* step 2
  - The regulation did not represent an abrupt about-face
  - Treasury did not rely on any (potentially erroneous) factual findings in promulgating the regulation
  - Congress provided the basic rule regarding 956 inclusion for guarantees and did not indicate any limitations on the agency’s ability to regulate, or any factors Congress wanted the agency to balance
  - Observations in nonprecedential IRS releases such as CCAs that the regulations produce strange results does not mean that the means that the regulations are arbitrary and capricious under the APA
  
- Third Circuit – Briefing underway

## Dealing With Uncertainty – Temporary Regulations *Chamber of Commerce (WD Tex, 5<sup>th</sup> Cir.)*

- Inversion Temporary Regulations – Targeting serial inverters, immediately effective, caused demise of certain transactions
- WD Tex – Anti-injunction act did not bar a suit directly under the APA, regulations invalid for failure to comply with notice-and-comment requirement
  - Court rejected an argument that the regulations were procedurally invalid as arbitrary and capricious, or unauthorized by the statute
- 5<sup>th</sup> Circuit – Briefing was completed but parties agreed to withdraw the case after regulations were finalized
- IRS Position – Section 7805(e) allows immediately effective temporary regulations, will continue to litigate “until I lose that at every circuit and the Supreme Court” per Gil Rothenberg

# Dealing With Uncertainty – *Chevron* Invalidity

## ***Good Fortune Shipping* (TC 2017, DC Cir. 2018)**

- 883 Regulations –precluded a foreign corporation issuing bearer shares from taking them into account for purposes of section 883 (exemption from US tax for international operation of ships owned by foreign corporations, if equivalent exemption is granted for US corporations)
  
- Tax Court – Upheld the regulation under *Chevron* step 2, Treasury did not act arbitrarily or capriciously or in violation of section 883 or its legislative history in adopting the regulation
  
- DC Circuit – Invalidated the regulations under *Chevron* step 2. Where the statute directs an inquiry into “ownership” of shares, regulation was not a reasonable interpretation
  - Treasury did not justify a categorical rule
  - Treasury amended the regulation in 2010 to recognize ownership by nominees and trustees
  - Treasury treated bearer shares more favorably in similar contexts
  - Court cannot defer to the agency’s disparate treatment unless the agency adequately supports it

## Dealing With Uncertainty – No Rule Whatsoever

- Other sources of substantial authority
  - Legislative history (including Blue Book)
  - Well-reasoned construction of statutory language
- When the Commissioner fails to issue clear and unambiguous regulations from which a taxpayer can ascertain the prescribed method for calculating its tax liability, the taxpayer may make the computation using any reasonable method it selects
  - *Conn. Gen. Life Ins. Co. v. Commissioner*, 177 F.3d 136, 144 (3d Cir. 1999), affg. 109 T.C. 100 (1997)
  - *Gottesman & Co. v. Commissioner*, 77 T.C. 1147 (1981).





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