

PKF PERSPECTIVES

REVISED IRS CIRCULAR 230

Effective June 21, 2005, the IRS enacted revised rules which govern the manner in which attorneys, certified public accountants, enrolled agents and actuaries (“tax practitioners”) practice before the Internal Revenue Service. The rules are summarized in the IRS publication known as Circular 230 and affect all areas of tax practice, including tax return preparation and client communication in the form of a covered opinion. The following discusses some of the salient points of Circular 230 and how it will affect PKF’s written communications with you, including letters, faxes and e-mails.

TAX SHELTER ABUSE

The new rules are the reaction of the IRS to various tax shelter schemes which have been widely marketed and considered to be abusive tax shelters. Taxpayers who have entered into these abusive transactions have relied on opinions from tax practitioners to escape the substantial underpayment penalty of 20 percent or more by asserting they have acted in “good faith” by relying on these opinions.

Although the intent of Circular 230 is to combat the proliferation of boilerplate tax opinions, the new rules will apply to tax advice tax practitioners provide on common, generally accepted transactions. We discuss below the new standards imposed upon us as tax practitioners for tax return preparation and the rendering of tax advice.

STANDARDS FOR TAX RETURN POSITIONS

Under the *realistic* possibility standard, as CPAs, we may not sign a tax return that contains a position that does not have a realistic possibility of

being sustained on its merits unless the position is not frivolous and is adequately disclosed to the IRS. A position is considered to have a realistic possibility of being sustained on its merits if a *reasonable and well-informed analysis of the law and the facts by a tax-knowledgeable person would lead such person to conclude that the position has a one in three or greater likelihood of being sustained*. A frivolous opinion is one which is patently improper.

We will advise you of any opportunities to avoid any such penalties by disclosures, if relevant, and the requirements for adequate disclosure.

REQUIREMENTS FOR COVERED OPINIONS

Circular 230 has promulgated certain standards for providing tax advice in the form of a “covered opinion.” The definition of a covered opinion is intentionally broad. It includes not only transactions that the IRS has “listed” as Abusive Tax Shelters and transactions that have a principal purpose of tax avoidance, but also includes any partnership, investment plan or other arrangement that has as a significant purpose the avoidance or evasion of tax. Thus, it appears that all tax advice may fall under this umbrella.

These standards require tax practitioners to follow the following steps in providing tax advice. If the practitioner does not follow such steps, taxpayers cannot rely upon the opinion to escape IRS penalties. The practitioner must:

1. make reasonable efforts to ascertain and identify the relevant facts and cannot base an opinion on unreasonable factual assumptions and information which he/she knows to be inaccurate or untrue;
2. apply the applicable law to the relevant facts;

3. consider all significant tax issues;
4. provide a conclusion regarding each issue [or state that a conclusion cannot be reached] as to the likelihood that the taxpayer will prevail if the IRS challenges the transaction.

If these standards are not met, the opinion cannot be relied upon to avoid IRS penalties. An opinion of such nature may be costly to the client, but could potentially pay for itself due to the severity of potential IRS penalties. However, as an alternative to writing an expensive tax opinion on all routine tax advice and correspondence, we will include a disclaimer on all such communications.

The disclaimer will state that you, as a client, or anyone else who obtains our written advice, cannot rely upon our opinion for protection from penalties. For this reason, PKF written communications will routinely include the following legend (or a variant thereof):

Under Section 6662 of the Internal Revenue Code, an accuracy-related penalty may be imposed on an underpayment of tax unless it can be shown that there was a reasonable cause for the underpayment and the taxpayer acted in good faith with respect to the underpayment. Pursuant to IRS Circular 230 regulations, we wish to advise you that this communication, including any attachments hereto, has not been prepared to be used, and cannot be used, by you for the purpose of avoiding such penalties should any be imposed.

PKF QUALITY STANDARDS

Please be aware that this legend will not affect the quality standards we impose upon ourselves as professionals. We value our relationship with you and the trust you place in us. We, as always, are

committed to providing sound advice and do not desire to be constrained by the rigors of Circular 230 on common routine tax matters. If a covered opinion as described above is desired, we can provide a comprehensive tax opinion which meets the Circular 230 standards.

Taxes are the dues that we pay for the privileges of membership in an organized society.

Franklin D. Roosevelt
1882-1945
Thirty-second President
of the United States

Items in this publication should not be considered official statements of position, nor advice for individuals or organizations without consulting a tax advisor. Pursuant to Treasury Regulations, any U.S. Federal tax advice contained in this communication, unless otherwise stated, is not intended, and cannot be used, for the purpose of avoiding tax-related penalties. For more information, please contact Howard Pell or Leo Parmegiani at:

PKF

**Certified Public Accountants
A Professional Corporation**

29 Broadway
New York, NY 10006
Telephone: (212) 867-8000
Telefax: (212) 687-4346
www.pkfnewyork.com
E-mail: info@pkfnyc.com

August 2005