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New rules eliminate need for IRS disclaimer, attendant confusion

TAXING MATTERS
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If you've ever received an email with tax advice, you're probably familiar with the long block of boilerplate in the email's footer that says you can't rely on the advice.

The IRS has effectively required this since 2005. However, last month it issued new rules that eliminate the need for the disclaimer—and announced that it would send cease-and-desist letters to practitioners that continue to use it.

This article tells the story of how the Treasury came to require the language, how it later decided to ban it, and what the recent changes mean for consumers of tax advice.

The disclaimer rules originated in the heyday of tax shelters. Clients would pay tax attorneys to provide opinions that the transactions they were entering into were in fact permitted under the tax code. Though these opinions often made unreasonable assumptions, taxpayers were able to point to them when the transactions were challenged and thus avoid penalties. This led to a robust market for the sale of opinions.

Unsurprisingly, the IRS did not take kindly to this situation. In 2004 it enacted changes to rules for tax practitioners, known as Circular 230, in part to combat this problem. Under these standards, if an opinion is to be used to avoid penalties, it must meet a number of strict requirements. In essence, such opinions, known as covered opinions, must include an exhaustive survey of the law and its application and may not be based on unreasonable assumptions. The threat of sanctions against tax practitioners who do not comply with these rules put a damper on the market for opinions relating to tax shelters.

The 2004 rules contained an exception stating that advice is not a covered opinion subject to these strict requirements if it contains a legend declaring that it isn't. Enter the Circular 230 disclaimer, familiar from the footers of millions, if not billions, of emails. Practitioners included these legends, which state that the tax advice provided cannot be used to avoid penalties, to make clear that their advice did not need to meet the standards applicable to covered opinions.

The disclaimers, however, led to confusion. In addition, law firms put the disclaimers everywhere—not just on communications relating to tax matters but on all communications.

In 2012, the IRS finally recognized the folly of these rules and issued proposed regulations eliminating the concept of covered opinions from Circular 230 altogether. The agency concluded that the disclaimers caused confusion for clients and stated that the rules were burdensome and provided minimal taxpayer protection.

The revisions to Circular 230 became effective on June 12. The revisions create a single set of rules applicable to all written advice, including advice that constituted a covered opinion under the prior rules and advice that did not. They state that for all written tax advice, the practitioner must:

- Use reasonable factual and legal assumptions (including assumptions as to future events);
- Reasonably consider all relevant facts and circumstances that the practitioner knows or should know;
- Make reasonable efforts to identify and ascertain the facts relevant to written advice on each federal tax matter;
- Not rely upon representations, statements, findings or agreements of the taxpayer or any other person if reliance on them would be unreasonable;
- Relate applicable law and authorities to the facts; and
- Not take into account the possibility that a tax return will not be audited or that a matter will not be raised on audit.

In the preamble to the final regulations, the IRS indicated that these rules are intended to allow flexibility in providing written advice while also maintaining standards that require practitioners to act ethically and competently.

The new rules eliminate the concept of a covered opinion. The scope of the engagement and the type and specificity of the advice sought by the client, in addition to all other appropriate facts and circumstances, are factors in determining the extent to which the items listed above must be set forth in the written advice. Stricter scrutiny applies to advice about tax shelters.

With these changes, the Circular 230 disclaimer is no more. Since the rules eliminate the concept of covered opinions from Circular 230, they also eliminate the requirement for a Circular 230 disclaimer.

Last month, a senior IRS official stated on "Tax Talk Today," an online IRS broadcast, that the agency would send cease-and-desist letters to practitioners who persist in including the disclaimer in communications.

The new standards highlight the need for clients and practitioners to work together to determine the type of tax advice that the client wants and is appropriate in the business context.

Based on the scope of the engagement, the attorney will then need to conduct an appropriate level of due diligence to ensure that the advice complies with the circular. Your tax adviser can no longer get away with an IRS-required disclaimer telling you not to rely on what he or she is saying. You might also get a discount on your bill: The IRS (as required by administrative rules) estimates that tax practitioners nationwide spent 13,333 hours complying with the old regulations.

While the tax code always seems to be getting more complex, the revisions to Circular 230 are a positive, simplifying change.

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