

[4830-01-p]

DEPARTMENT OF THE TREASURY

Office of the Secretary

31 CFR Part 10

[REG-122379-02]

RIN 1545-BA70

Regulations Governing Practice Before the Internal Revenue Service

AGENCY: Office of the Secretary, Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This notice proposes modifications of the regulations governing practice before the Internal Revenue Service (Circular 230). These regulations affect individuals who are eligible to practice before the IRS. The proposed modifications set forth best practices for tax advisors providing advice to taxpayers relating to Federal tax issues or submissions to the IRS and modify the standards for certain tax shelter opinions. This document also provides notice of a public hearing regarding the proposed regulations.

DATES: Comments: Written or electronically generated comments must be received by February 13, 2004.

Public hearing: Outlines of topics to be discussed at the public hearing scheduled for February 18, 2004, in the Auditorium of the Internal Revenue Building at 1111 Constitution Avenue, NW., Washington, DC 20224, must be received by February 11, 2004. ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-122379-02), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the

hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG-122379-02), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC.

Alternatively, taxpayers may submit comments electronically via the IRS Internet site at: www.irs.gov/regs.

FOR FURTHER INFORMATION CONTACT: Concerning issues for comment, Heather L. Dostaler or Bridget E. Tombul at (202) 622-4940; concerning submissions of comments, Guy Traynor of the Publications and Regulations Branch at (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by March 1, 2004. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the Office of Professional Responsibility, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proper collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

The collections of information (disclosure requirements) in these proposed regulations are in Sec. 10.35(d). Section 10.35(d) requires a practitioner providing a tax shelter opinion to make certain disclosures in the beginning of marketed tax shelter opinions, limited scope opinions and opinions that fail to conclude at a confidence level of at least more likely than not. In addition, certain relationships between the practitioner and a person promoting or marketing a tax shelter must be disclosed. A practitioner may be required to make one or more disclosure at the beginning of an opinion. The collection of this material helps to ensure that taxpayers who receive a tax shelter opinion are informed of any facts or circumstances that might limit the taxpayer's use of the opinion. The collection of information is mandatory.

Estimated total annual disclosure burden is 13,333 hours.

Estimated annual burden per disclosing practitioner varies from 5 to 10 minutes, depending on individual circumstances, with an estimated average of 8 minutes.

Estimated number of disclosing practitioners is 100,000.

Estimated annual frequency of responses is on occasion.

An agency may not conduct or sponsor, and a person is not required to respond to a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by section 6103 of the Internal Revenue Code.

Background

Section 330 of title 31 of the United States Code authorizes the Secretary of the Treasury to regulate the practice of representatives before the Treasury Department. The Secretary has published the regulations in Circular 230 (31 CFR part 10). On February 23, 1984, the regulations were amended to provide standards for tax shelter opinions (49 FR 6719). On May 5, 2000, an advance notice of proposed rulemaking was published (65 FR 30375) which requested comments regarding amendments to the standards of practice governing tax shelters and other general matters. On January 12, 2001, a notice of proposed rulemaking (66 FR 3276) was published that proposed amendments to the regulations relating to practice before the Internal Revenue Service in general and addressing tax shelter opinions in particular. On July 26, 2002, final regulations (67 FR 48760) were issued incorporating only the non-tax shelter related

matters. The IRS and the Treasury Department announced that regulations governing standards for tax shelter opinions would be proposed again at a later date.

This document proposes new proposed amendments to the standards governing tax shelter opinions and withdraws proposed amendments to §§10.33, 10.35 and 10.36 of the regulations governing practice before the IRS that were published in 2001. See 66 FR 3276 (Jan. 12, 2001).

Explanation of Provisions

Tax advisors play an increasingly important role in the Federal tax system, which is founded on principles of voluntary compliance. The tax system is best served when the public has confidence in the honesty and integrity of the professionals providing tax advice. To restore, promote, and maintain the public's confidence in those individuals and firms, these proposed regulations set forth best practices applicable to all tax advisors. These regulations also amend the mandatory requirements for practitioners who provide certain tax shelter opinions. These regulations are limited to practice before the IRS and do not alter or supplant other ethical standards applicable to practitioners.

The standards set forth in these proposed regulations differ from the January 12, 2001 proposed regulations in several ways. First, §10.33 prescribes best practices for all tax advisors. Second, §10.35 combines and modifies the standards applicable to marketed and more likely than not tax shelter opinions in former §10.33 (tax shelter opinions used to market tax shelters) and former §10.35 (more likely than not tax shelter opinions) of the January 12, 2001 proposed regulations. Third, these regulations revise

proposed §10.36, which provides procedures for ensuring compliance with §§10.33 and 10.35. Finally, provisions relating to advisory committees to the Office of Professional Responsibility are provided in new §10.37. The Treasury Department and the IRS will publish conforming amendments to §§10.22 and 10.52 in a separate notice of proposed rulemaking.

Best Practices

To ensure the integrity of the tax system, tax professionals should adhere to best practices when providing advice or assisting their clients in the preparation of a submission to the IRS. Section 10.33 describes the best practices to be observed by all tax advisors in providing clients with the highest quality representation. These best practices include: (1) communicating clearly with the client regarding the terms of the engagement and the form and scope of the advice or assistance to be rendered; (2) establishing the relevant facts, including evaluating the reasonableness of any assumptions or representations; (3) relating applicable law, including potentially applicable judicial doctrines, to the relevant facts; (4) arriving at a conclusion supported by the law and the facts; (5) advising the client regarding the import of the conclusions reached; and (6) acting fairly and with integrity in practice before the IRS.

Standards for Certain Tax Shelter Opinions

Section 10.35 prescribes requirements for practitioners providing more likely than not and marketed tax shelter opinions. A more likely than not tax shelter opinion is a tax shelter opinion that reaches a conclusion of at least more likely than not with respect to one or more material Federal tax issue(s). A marketed tax shelter opinion is a tax

shelter opinion, including a more likely than not tax shelter opinion, that a practitioner knows, or has reason to know, 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 the practitioner's firm) in promoting, marketing or recommending a tax shelter to one or more taxpayers.

Definition of Tax Shelter Opinion

These proposed regulations retain the definition of tax shelter proposed in January 2001 by applying the definition found in section 6662 to all taxes under the Internal Revenue Code. A number of commentators expressed concern that this definition is overly broad, encompasses routine tax matters, and is difficult to administer by practitioners and the IRS. After careful consideration of these issues, the Treasury Department and the IRS have determined that the definition in the proposed regulations best defines the scope of these regulations. Section 10.35 has been modified, however, to address commentators' concerns by excluding from the definition of a tax shelter opinion preliminary advice provided pursuant to an engagement in which the practitioner is expected subsequently to provide an opinion that satisfies the requirements of this section. In addition, under §10.35(a)(3)(ii), a practitioner may provide an opinion that is limited to some, but not all, material Federal tax issues that may be relevant to the treatment of a tax shelter item if the taxpayer and the practitioner agree to limit the scope of the opinion. Such a limited scope opinion cannot be a marketed tax shelter opinion, and all limited scope opinions must contain the appropriate disclosures described below.

Requirements for Tax Shelter Opinions

The requirements for all more likely than not and marketed tax shelter opinions include: (1) identifying and considering all relevant facts and not relying on any unreasonable factual assumptions or representations; (2) relating the applicable law (including potentially applicable judicial doctrines) to the relevant facts and not relying on any unreasonable legal assumptions, representations or conclusions; (3) considering all material Federal tax issues and reaching a conclusion, supported by the facts and the law, with respect to each material Federal tax issue; and (4) providing an overall conclusion as to the Federal tax treatment of the tax shelter item or items and the reasons for that conclusion.

In addition to the exception to the requirements for limited scope opinions discussed above, in the case of a marketed tax shelter opinion, a practitioner is not expected to identify and ascertain facts peculiar to a taxpayer to whom the transaction is marketed, but the opinion must include the appropriate disclosure described below. Moreover, if a practitioner is unable to reach a conclusion with respect to one or more material Federal tax issue(s) or to reach an overall conclusion in a tax shelter opinion, the opinion must state that the practitioner is unable to reach a conclusion with respect to those issues or to reach an overall conclusion and describe the reasons that the practitioner is unable to reach such a conclusion. If the practitioner fails to reach a conclusion at a confidence level of at least more likely than not with respect to one or more material Federal tax issue(s), the opinion must include the appropriate disclosures described below.

Required Disclosures

Section 10.35(d) provides disclosures that are required to be made in the beginning of marketed tax shelter opinions, limited scope opinions, and opinions that fail to reach a conclusion at a confidence level of at least more likely than not. In addition, certain relationships between the practitioner and a person promoting or marketing a tax shelter must be disclosed. A practitioner may be required to make more than one of the disclosures described below.

1. Relationship Between Practitioner and Promoter

Under §10.35(d)(1), a practitioner must disclose if the practitioner has a compensation arrangement with any person (other than the client for whom the opinion is prepared) with respect to the promoting, marketing or recommending of a tax shelter discussed in the opinion. A practitioner also must disclose if there is any referral agreement between the practitioner and any person (other than the client for whom the opinion is prepared) engaged in the promoting, marketing or recommending of the tax shelter discussed in the opinion.

2. Marketed Tax Shelter Opinion

Under §10.35(d)(2), a practitioner must disclose that a marketed opinion may not be sufficient for a taxpayer to use for the purpose of avoiding penalties under section 6662(d) of the Code. The practitioner also must state that taxpayers should seek advice from their own tax advisors.

3. Limited Scope Opinion

Under §10.35(d)(3), a practitioner must disclose in a limited scope opinion that additional issue(s) may exist that could affect the Federal tax treatment of the tax shelter addressed in the opinion, that the opinion does not consider or reach a conclusion with respect to those additional issues and that the opinion was not written, and cannot be used by the recipient, for the purpose of avoiding penalties under section 6662(d) of the Code with respect to those issues outside the scope of the opinion.

4. Opinions That Fail to Reach a Conclusion at a Confidence Level of at Least More Likely Than Not

Under §10.35(d)(4), a practitioner must disclose that the opinion fails to reach a conclusion at a confidence level of at least more likely than not with respect to one or more material Federal tax issue(s) addressed by the opinion and that the opinion was not written, and cannot be used by the recipient, for the purpose of avoiding penalties under section 6662(d) of the Code with respect to such issue(s).

Procedures to Ensure Compliance

Section 10.36 provides that tax advisors with responsibility for overseeing a firm's practice before the IRS should take reasonable steps to ensure that the firm's procedures for all members, associates, and employees are consistent with the best practices described in §10.33. In the case of tax shelter opinions, a practitioner with this oversight responsibility must take reasonable steps to ensure that the firm has adequate procedures in effect for purposes of complying with §10.35.

Advisory Committees on the Integrity of Tax Professionals

Section 10.37 authorizes the Director of the Office of Professional Responsibility to establish one or more advisory committees composed of at least five individuals authorized to practice before the IRS. Under procedures prescribed by the Director and at the request of the Director, an advisory committee may review and make recommendations regarding professional standards or best practices for tax advisors or may advise the Director whether a practitioner may have violated §§10.35 or 10.36.

Proposed Effective Date

These regulations are proposed to apply on the date that final regulations are published in the **Federal Register**.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. Persons authorized to practice before the IRS have long been required to comply with certain standards of conduct. The added disclosure requirements for tax shelter opinions imposed by these regulations will not have a significant economic impact on a substantial number of small entities because, as previously noted, the estimated burden of disclosures is minimal. This is because practitioners have the information needed to determine whether some of the disclosures are required before the opinion is prepared and for the other disclosures the regulations provide practitioners with the language to

be included in the opinion. Therefore, a regulatory flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Comments and Public Hearing

Before the regulations are adopted as final regulations, consideration will be given to any written comments and electronic comments that are submitted timely to the IRS. The IRS and Treasury Department specifically request comments on the clarity of the proposed regulations and how they can be made easier to understand. All comments will be available for public inspection and copying.

The public hearing is scheduled for February 18, 2004, at 10 a.m., and will be held in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. All visitors must present photo identification to enter the building. Visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the FOR FURTHER INFORMATION CONTACT section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments by February 13, 2004, and submit an outline of the topics to be discussed and the time to

be devoted to each topic by February 11, 2004. A period of 10 minutes will be allocated to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal authors of the regulations are Heather L. Dostaler, Bridget E. Tombul, and Brinton T. Warren of the Office of the Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division, but other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 31 CFR Part 10

Administrative practice and procedure, Lawyers, Accountants, Enrolled agents, Enrolled actuaries, Appraisers.

Proposed Amendments to the Regulations

Accordingly, 31 CFR part 10 is proposed to be amended as follows

Paragraph 1. The authority citation for subtitle A, part 10 continues to read as follows:

[Authority: Sec. 3, 23 Stat. 258, secs. 2-12, 60 Stat. 237 et.seq.; 5 U.S.C. 301, 500, 551-559; 31 U.S.C. 330; Reorg. Plan No. 26 of 1950, 15 FR 4935, 64 Stat. 1280, 3 CFR, 1949-1953 Comp., P. 1017.]

PART 10--PRACTICE BEFORE THE INTERNAL REVENUE SERVICE

Par. 2. Section 10.33 is revised to read as follows:

§10.33 Best practices for tax advisors.

(a) Best practices. Tax advisors should provide clients with the highest quality representation concerning Federal tax issues by adhering to best practices in providing advice and in preparing or assisting in the preparation of a submission to the Internal Revenue Service. Best practices include the following:

(1) Communicating clearly with the client regarding the terms of the engagement. For example, the advisor should determine the client's expected purpose for and use of the advice and should have a clear understanding with the client regarding the form and scope of the advice or assistance to be rendered.

(2) Establishing the facts, determining which facts are relevant, and evaluating the reasonableness of any assumptions or representations.

(3) Relating the applicable law (including potentially applicable judicial doctrines) to the relevant facts.

(4) Arriving at a conclusion supported by the law and the facts.

(5) Advising the client regarding the import of the conclusions reached, including, for example, whether a taxpayer may avoid penalties for a substantial understatement of income tax under section 6662(d) of the Internal Revenue Code if a taxpayer acts in reliance on the advice.

(6) Acting fairly and with integrity in practice before the Internal Revenue Service.

(b) Effective date. This section is effective on the date that final regulations are published in the Federal Register.

Par. 3. Section 10.35 is added to read as follows:

§10.35 Requirements for certain tax shelter opinions.

(a) In general. A practitioner providing a more likely than not tax shelter opinion or a marketed tax shelter opinion must comply with each of the following requirements.

(1) Factual matters. (i) The practitioner must use reasonable efforts to identify and ascertain the facts, which may relate to future events if a transaction is prospective or proposed, and determine which facts are relevant. The opinion must identify and consider all relevant facts.

(ii) The practitioner must not base the opinion on any unreasonable factual assumptions (including assumptions as to future events), such as a factual assumption that the practitioner knows or should know is incorrect or incomplete. For example, it is unreasonable to assume that a transaction has a business purpose or that a transaction is potentially profitable apart from tax benefits, or to make an assumption with respect to a material valuation issue. In the case of any marketed tax shelter opinion, the practitioner is not expected to identify or ascertain facts peculiar to a taxpayer to whom the transaction may be marketed, but the opinion must include the appropriate disclosure(s) required under paragraph (d) of this section.

(iii) The practitioner must not base the opinion on any unreasonable factual representations, statements or findings of the taxpayer or any other person, such as a factual representation that the practitioner knows or should know is incorrect or

incomplete. For example, a practitioner may not rely on a taxpayer's factual representation that a transaction has a business purpose if the representation fails to include a specific description of the business purpose or the practitioner knows or should know that the representation is incorrect or incomplete.

(2) Relate law to facts. (i) The practitioner must relate the applicable law (including potentially applicable judicial doctrines) to the relevant facts.

(ii) The practitioner must not assume the favorable resolution of any material Federal tax issue except as provided in paragraphs (a)(3)(ii) and (b) of this section, or otherwise base an opinion on any unreasonable legal assumptions, representations, or conclusions.

(iii) The practitioner's opinion must not contain internally inconsistent legal analyses or conclusions.

(3) Evaluation of material Federal tax issues. (i) The practitioner must consider all material Federal tax issues except as provided in paragraphs (a)(3)(ii) and (b) of this section.

(ii) The practitioner may provide an opinion that considers less than all of the material Federal tax issues if-

(A) The taxpayer and the practitioner agree to limit the scope of the opinion to one or more Federal tax issue(s);

(B) The opinion is not a marketed tax shelter opinion; and

(C) The opinion includes the appropriate disclosure(s) required under paragraph (d) of this section.

(iii) The practitioner must provide his or her conclusion as to the likelihood that the taxpayer will prevail on the merits with respect to each material Federal tax issue. If the practitioner is unable to reach a conclusion with respect to one or more material Federal tax issue(s), the opinion must state that the practitioner is unable to reach a conclusion with respect to those issues. The practitioner must describe the reasons for the conclusions, including the facts and analysis supporting the conclusions, or describe the reasons that the practitioner is unable to reach a conclusion as to one or more material Federal tax issue(s). If the practitioner fails to reach a conclusion at a confidence level of at least more likely than not with respect to one or more material Federal tax issue(s), the opinion must include the appropriate disclosure(s) required under paragraph (d) of this section.

(iv) The practitioner must not take into account the possibility that a tax return will not be audited, that an issue will not be raised on audit, or that an issue will be settled.

(4) Overall conclusion. The practitioner must provide an overall conclusion as to the likelihood that the Federal tax treatment of the tax shelter item or items is the proper treatment and the reasons for that conclusion. If the practitioner is unable to reach an overall conclusion, the opinion must state that the practitioner is unable to reach an overall conclusion and describe the reasons for the practitioner's inability to reach a conclusion.

(b) Competence to provide opinion; reliance on opinions of others. (1) The practitioner must be knowledgeable in all of the aspects of Federal tax law relevant to the opinion being rendered. If the practitioner is not sufficiently knowledgeable to

render an informed opinion with respect to particular material Federal tax issues, the practitioner may rely on the opinion of another practitioner with respect to these issues unless the practitioner knows or should know that such opinion should not be relied on. 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.

(2) The practitioner must be satisfied that the combined analysis of the opinions, taken as a whole, satisfies the requirements of this section.

(c) Definitions. For purposes of this section--

(1) A practitioner includes any individual described in §10.2(e).

(2) The term tax shelter includes any partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, a significant purpose of which is the avoidance or evasion of any tax imposed by the Internal Revenue Code. A tax shelter may give rise to one or more tax shelter items.

(3) A tax shelter item is, with respect to a tax shelter, an item of income, gain, loss, deduction, or credit, the existence or absence of a taxable transfer of property, or the value of property.

(4) Tax shelter opinion--(i) In general. A tax shelter opinion is written advice by a practitioner concerning the Federal tax aspects of any Federal tax issue relating to a tax shelter item or items.

(ii) Excluded advice. A tax shelter opinion does not include written advice provided to a client during the course of an engagement pursuant to which the practitioner is expected subsequently to provide written advice to the client that satisfies

the requirements of this section, or written advice concerning the qualification of a qualified plan.

(iii) Included advice. A tax shelter opinion includes the Federal tax aspects or tax risks portion of offering materials prepared by or at the direction of a practitioner. Similarly, a financial forecast or projection prepared by or at the direction of a practitioner is a tax shelter opinion if it is predicated on assumptions regarding Federal tax aspects of the investment.

(5) A more likely than not tax shelter opinion is a tax shelter opinion that reaches a conclusion at a confidence level of at least more likely than not (that is, greater than 50 percent) that one or more material Federal tax issues would be resolved in the taxpayer's favor.

(6) A marketed tax shelter opinion is a tax shelter opinion, including a more likely than not tax shelter opinion, that a practitioner knows or has reason to know 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 the practitioner's firm) in promoting, marketing or recommending the tax shelter to one or more taxpayers.

(7) A material Federal tax issue is any Federal tax issue for which the Internal Revenue Service has a reasonable basis for a successful challenge and the resolution of which could have a significant impact, whether beneficial or adverse and under any reasonably foreseeable circumstance, on the Federal tax treatment of a taxpayer's tax shelter item or items.

(d) Required disclosures. An opinion must contain all of the following disclosures that apply--(1) Relationship between promoter and practitioner. A practitioner must disclose in the beginning of the opinion the existence of--

(i) Any compensation arrangement, such as a referral fee or a fee-sharing arrangement, between the practitioner (or the practitioner's firm) and any person (other than the client for whom the opinion is prepared) with respect to the promoting, marketing or recommending of a tax shelter discussed in the opinion; or

(ii) Any referral agreement between the practitioner (or the practitioner's firm) and a person (other than the client for whom the opinion is prepared) engaged in the promoting, marketing or recommending of the tax shelter discussed in the opinion.

(2) Marketed tax shelter opinions. A practitioner must disclose in the beginning of a marketed tax shelter opinion that with respect to any material Federal tax issue for which the opinion reaches a conclusion at a confidence level of at least more likely than not--

(i) The opinion may not be sufficient for a taxpayer to use for the purpose of avoiding penalties relating to a substantial understatement of income tax under section 6662(d) of the Internal Revenue Code; and

(ii) Taxpayers should seek advice based on their individual circumstances with respect to those material Federal tax issues from their own tax advisor(s).

(3) Limited scope opinions. If a practitioner provides an opinion that is limited to one or more Federal tax issue(s) agreed to by the taxpayer and the practitioner, the practitioner must disclose in the beginning of the opinion that--

(i) The opinion is limited to the one or more Federal tax issue(s) agreed to by the taxpayer and the practitioner and addressed in the opinion;

(ii) Additional issue(s) may exist that could affect the Federal tax treatment of the tax shelter addressed in the opinion and the opinion does not consider or provide a conclusion with respect to any additional issue(s); and

(iii) With respect to any material Federal tax issue(s) outside the limited scope of the opinion, the opinion was not written, and cannot be used by the recipient, for the purpose of avoiding penalties relating to a substantial understatement of income tax under section 6662(d) of the Internal Revenue Code.

(4) Opinions that fail to reach a more likely than not conclusion. If a practitioner does not reach a conclusion at a confidence level of at least more likely than not with respect to a material Federal tax issue addressed by the opinion, the practitioner must disclose in the beginning of the opinion that--

(i) The opinion does not reach a conclusion at a confidence level of at least more likely than not that with respect to one or more material Federal tax issues addressed by the opinion; and

(ii) With respect to those material Federal tax issues, the opinion was not written, and cannot be used by the recipient, for the purpose of avoiding penalties relating to a substantial understatement of income tax under section 6662(d) of the Internal Revenue Code.

(e) Effect of opinion that meets these standards. An opinion that meets these requirements satisfies the practitioner's responsibilities under this section, but the

persuasiveness of the opinion with regard to the tax issues in question and the taxpayer's good faith reliance on the opinion will be separately determined under applicable provisions of the law and regulations.

(f) Effective date. This section applies to tax shelter opinions rendered after the date that final regulations are published in the **Federal Register**.

Par. 4. Section 10.36 is added to read as follows:

§10.36 Procedures to ensure compliance.

(a) Best practices for tax advisors. Tax advisors with responsibility for overseeing a firm's practice of providing advice concerning Federal tax issues or of preparing or assisting in the preparation of submissions to the Internal Revenue Service should take reasonable steps to ensure that the firm's procedures for all members, associates, and employees are consistent with the best practices described in §10.33.

(b) Requirements for certain tax shelter opinions. Any practitioner who has (or practitioners who have or share) principal authority and responsibility for overseeing a firm's practice of providing advice concerning Federal tax issues must take reasonable steps to ensure that the firm has adequate procedures in effect for all members, associates, and employees for purposes of complying with §10.35. A practitioner will be subject to discipline for failing to comply with the requirements of this paragraph if--

(1) The practitioner through willfulness, recklessness, or gross incompetence does not take reasonable steps to ensure that the firm has adequate procedures to comply with §10.35, and one or more individuals who are members of, associated with,

or employed by, the firm are, or have, engaged in a pattern or practice, in connection with their practice with the firm, of failing to comply with §10.35; or

(2) The practitioner knows or has reason to know that one or more individuals who are members of, associated with, or employed by, the firm are, or have, engaged in a practice, in connection with their practice with the firm, that does not comply with §10.35 and the practitioner, through willfulness, recklessness, or gross incompetence fails to take prompt action to correct the noncompliance.

(c) Effective date. Paragraph (a) of this section is effective on the date that final regulations are published in the **Federal Register**. Paragraph (b) of this section applies to tax shelter opinions rendered after the date that final regulations are published in the **Federal Register**.

Par. 5. Section 10.37 is added to read as follows:

§10.37 Establishment of Advisory Committees.

(a) Advisory committees. To promote and maintain the public's confidence in tax advisors, the Director of the Office of Professional Responsibility is authorized to establish one or more advisory committees composed of at least five individuals authorized to practice before the Internal Revenue Service. Under procedures prescribed by the Director, an advisory committee may review and make recommendations regarding professional standards or best practices for tax advisors, or more particularly, whether a practitioner may have violated §§10.35 or 10.36.

(b) Effective date. This section is effective on the date that final regulations are published in the **Federal Register**.

Par. 6. Section 10.93 is revised to read as follows:

§ 10.93 Effective date.

Except as otherwise provided in each section and subject to §10.91, Part 10 is applicable on July 26, 2002.

Mark E. Matthews

Deputy Commissioner for Services and Enforcement.

Approved: December 19, 2003

George B. Wolfe

Deputy General Counsel, Office of the Secretary.