

MEMORANDUM

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& MAW

June 20, 2005

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TO: Our Clients

FROM: Mayer, Brown, Rowe & Maw LLP

RE: **Circular 230: Standards Imposed by the
IRS and Treasury Governing Written
Tax Advice**

ALERT

We have prepared this memorandum to apprise you of how our communication with you will be affected by changes to the "Circular 230" regulations governing written tax advice rendered by tax professionals admitted to practice before the Internal Revenue Service. As a result of these changes, virtually every written communication containing any Federal tax advice on a transaction, including the most casual e-mails, that any attorney in our firm provides to you must contain either (a) a "banner" declaring that you cannot rely on the conveyed tax advice to avoid potential Federal tax penalties or (b) a complete analysis of every significant Federal tax aspect of the transaction. In some cases, option (a) will not be available to us, and we will, therefore, be required either to give you our complete analysis of every significant Federal tax aspect of the transaction or no advice in writing at all. In other situations, additional statements may be necessary in the advice.

Exceptions may apply if the tax advice is to be followed by a memorandum or opinion, concerns the qualification of a qualified plan, is a state or local bond opinion or is included in documents required to be filed with the SEC. Also, in some cases the scope of the opinion may be limited by express agreement with you.

A practitioner who fails to satisfy the requirements of the new rules risks censure, disbarment and substantial penalties.

Because advising you as to the Federal tax consequences of every aspect of a transaction would normally be a costly undertaking (and not what you would expect absent your request for that scope of guidance), we believe that most written communications that we make to you will now contain the banner in (a) above. Although inclusion of the banner in the communication means

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that you cannot rely on the advice to avoid the imposition of Federal tax penalties, there may be other defenses to the imposition of such penalties. Of course, where you desire an opinion or other formal written advice on which you may rely as a defense to the imposition of penalties, we will do what is required to comply with the rules and provide you the advice without a banner.

A more complete discussion of the changes to Circular 230 is set forth below. For further information, please feel free to contact any of our firm's tax attorneys.

1. What has happened?

On December 20, 2004, final regulations were published under Circular 230

“... to restore, promote, and maintain the public's confidence in those individuals and firms ...”

who act as tax advisors. These regulations apply to “written advice that is rendered” after June 20, 2005. Written advice includes “electronic communications,” so these regulations apply to e-mails as well as formal opinions, memoranda, power-point slides -- any tax advice that is not delivered orally. The application of these regulations to all phases of Federal tax practice will be onerous and time consuming.

2. What will clients see immediately?

Clients of tax practitioners will see “banners” affixed to e-mails and every other form of written communication received from those practitioners in any case where the communication is not intended to constitute a full-blown tax opinion or memorandum. These banners will closely follow language contained in Circular 230. This language, if present in the tax advice rendered, relieves a practitioner from the obligation to satisfy the more stringent requirements of Circular 230 in certain cases. The tax bar is referring to these banners as “opt-out” disclosures, and they generally are of two forms. One states –

“This advice was not intended or written to be used, and it cannot be used by the taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer.”

A second, intended to apply in the case of advice which a practitioner's client might forward to others, contains additional language –

“This advice was not intended or written to be used, and it cannot be used by any taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer. This advice was written to support the promotion or marketing of the transaction(s) or

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matter(s) addressed by the written advice. The taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor."

It is likely that almost every e-mail sent by a tax practitioner will contain one or a combination of the foregoing "banners." Mayer, Brown, Rowe & Maw LLP has adopted a combination banner which will be the same on all e-mails. Many memoranda and other written advice will contain such banners. Circular 230 even has rules as to the required type size and location of the banners.

3. What are the basics?

Very generally, Circular 230 places all written tax advice in one of two categories: "covered opinions" ("Covered Opinions") and "other written advice." If the written advice provided constitutes a Covered Opinion, then such advice must satisfy a series of requirements which are set forth over a number of pages in Circular 230. In summary, the requirements are:

- 1) Due diligence -- The practitioner must use reasonable efforts to identify and ascertain the facts and the opinion must consider all relevant facts;
- 2) The opinion must not be based on unreasonable assumptions (including business purpose assumptions) and projections, financial forecasts and appraisals cannot be relied upon if the practitioner knows, or should know, that such material is incomplete or incompetently prepared. All factual assumptions relied upon must be identified in a separate section of the opinion;
- 3) The opinion must not be based upon any unreasonable representations, statements or findings of the taxpayer. All factual representations, statements and findings of the taxpayer relied upon must be identified in a separate section of the opinion;
- 4) The opinion must relate the applicable law, including potentially applicable judicial doctrines, to the relevant facts and the opinion must not contain internally inconsistent legal analyses or conclusions;
- 5) The opinion must consider ALL SIGNIFICANT FEDERAL TAX ISSUES (unless the opinion is a "limited scope opinion" as defined below), must provide a conclusion as to the likelihood that the taxpayer will prevail on the merits with respect to each significant Federal tax issue considered, must describe the reasons for the conclusions (including the facts and analysis supporting the conclusions) and must state the reasons that the practitioner is unable to reach a conclusion with respect to any issue. The practitioner must not consider the possibility that a tax return will not be audited in evaluating the tax issues addressed;

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6) The opinion must provide the practitioner's overall conclusion as to the likelihood that the Federal tax treatment of the transaction or matter being addressed is the proper treatment and the reasons for that conclusion. If an overall conclusion cannot be reached, the opinion must so state and describe the reasons for the inability to reach an overall conclusion. If the advice is in a marketed opinion, the practitioner must give a favorable overall conclusion.

Furthermore, a Covered Opinion must prominently disclose the existence of --

7) Any compensation arrangement, such as a referral fee or fee-sharing arrangement, between the practitioner and any person (other than the client for whom the opinion is prepared) with respect to promoting, marketing or recommending the arrangement that is the subject of the opinion; and

8) Any referral arrangement between the practitioner and a person (other than the client for whom the opinion is prepared) engaged in promoting, marketing or recommending the arrangement that is the subject of the opinion.

4. What is a Covered Opinion?

Except in the case of written advice (a) provided to a client which advice the practitioner reasonably expects to follow with subsequent written advice that satisfies the requirements set forth above or (b) with respect to which the "opt-out" disclosures discussed above have been properly made, a Covered Opinion is written advice (including electronic communications) by a practitioner concerning one or more Federal tax issues arising from

- (i) a listed or similar transaction (a "listed transaction");
- (ii) an arrangement the principal purpose of which is the avoidance or evasion of any tax imposed by the Internal Revenue Code (a "principal purpose" transaction); or
- (iii) an arrangement a significant purpose of which is the avoidance or evasion of any tax imposed by the Internal Revenue Code (a "significant purpose" transaction) if the advice--
 - (W) is a reliance opinion -- that is, it concludes at a greater than 50 percent likelihood level that one or more significant Federal tax issues would be resolved in the taxpayer's favor;
 - (X) is a marketed opinion -- that is, 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 member, associate or employee of the practitioner's firm)

in promoting, marketing or recommending an arrangement to one or more taxpayers;

- (Y) is subject to conditions of confidentiality -- that is, the practitioner imposes on at least one recipient of the written advice a limitation on disclosure of the tax treatment or tax structure of the subject transaction which limitation protects the confidentiality of that practitioner's tax strategies; or
- (Z) is subject to contractual protection -- that is, the taxpayer has the right to a full or partial refund of fees paid to the practitioner (or the practitioner's firm) if all or part of the intended tax consequences from the matters addressed in the written advice are not sustained or if all or part of such fees are contingent on the taxpayer's realization of tax benefits from the transaction.

It should be noted that "opt-out" disclosures are available only for "significant purpose" transactions described in (W) and (X) above. In the case of a "significant purpose" transaction described in (W) or (X) above, written advice lacking the appropriate "opt-out" disclaimer will be a Covered Opinion.

5. Is there any "compromise" opinion?

Circular 230 provides a modified form of Covered Opinion for what is described as a Limited Scope Opinion. Such an opinion requires that all of the requirements set forth in Section 3 above ("What are the basics?") be satisfied but relaxes the otherwise applicable requirement that the opinion consider "all significant Federal tax issues." A practitioner may provide an opinion that considers less than all of the significant Federal tax issues if

- (a) the opinion does not concern a "listed transaction" or a "principal purpose" transaction;
- (b) the practitioner and the taxpayer agree that the scope of the opinion and the taxpayer's potential reliance on the opinion for purposes of avoiding penalties are limited to the Federal tax issues addressed in the opinion; and
- (c) the opinion contains disclosures (i) as described above with respect to compensation or referral arrangements with third parties, (ii) that the opinion is limited to the issues addressed, that additional issues that may exist are not considered and the opinion was not written, and cannot be used by the taxpayer, to avoid penalties with respect to such additional issues and (iii) with respect to an opinion that fails to reach a confidence level of at least more likely than not as to any significant Federal tax issue

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considered, that such opinion was not written, and cannot be used by the taxpayer, to avoid penalties.

6. What is “the Principal Purpose” or “a Significant Purpose” for the avoidance or evasion of tax?

(a) The “principal purpose” of an arrangement is the avoidance or evasion of any tax imposed by the Internal Revenue Code “if that purpose exceeds any other purpose.” However, the principal purpose of an arrangement will not be such avoidance or evasion if the “arrangement has as its purpose the claiming of tax benefits in a manner consistent with the statute and Congressional purpose.” An arrangement may have a “significant purpose” of avoidance or evasion even though it does not have the “principal purpose” of avoidance or evasion.

Whether a transaction is a Principal Purpose transaction will in many instances be a judgment call and a difficult call; if a transaction is a Principal Purpose transaction (or a “listed” transaction), the Limited Scope Opinion option is not available -- in that case, all significant Federal tax issues must be addressed in the manner described above. Furthermore, the opt-out disclosure is not available for any Principal Purpose or Listed transaction.

(b) The words “significant purpose” are not defined as such in Circular 230. It may be presumed that if an issue is being considered for tax advice, it will be significant.

Whether a fairly routine or common transaction is a Significant Purpose transaction will often be unclear, since there is no exception to Significant Purpose classification for a transaction having as its purpose the claiming of tax benefits in a manner “consistent with the statute and Congressional intent.” In such a case, while a Limited Scope Opinion is available, the issues which the taxpayer and the practitioner agree will be addressed must be considered in the same manner as in any other Covered Opinion.

7. What is required in the case of “other written advice”?

When the written advice does not constitute a Covered Opinion, the practitioner (a) cannot base such advice on unreasonable factual or legal assumptions or unreasonably rely on representations, statements, findings or agreements of the taxpayer or any other person, (b) must consider all relevant facts that the practitioner knows or should know and (c) cannot take into account the possibility that a return will not be audited.

RAK/jmg