Bond Case Briefs

Municipal Finance Law Since 1971

The E-Mail Caveat Is Dead! Long Live the E-Mail Caveat!

Kip Dellinger discusses recent revisions to Circular 230 that removed the covered opinion provisions promulgated in 2004 that led to the "you can't rely on this advice" statements so common in the e-mails of law and accounting firms. He also comments on protective engagement letter language regarding tax advice.

* * * * *

On June 12 tax professionals were finally required — not merely allowed — to dump the Circular 230 e-mail caveat.1 One would think everyone would be quite pleased. After all, slogging through a string of e-mail tax advice disclaimers embedded in a conversation can be an aggravating task (we stopped reading them ages ago). This is particularly true when the e-mail is simply coordinating a lunch or planning a trip to the ballpark.

No sooner had the e-mail removal directive arrived than many practitioners decided they loved their e-mail caveats and related disclaimers — presumably, if not primarily, because it allowed them to avoid any responsibility to the recipients of less-than-formal written advice (as in protection from malpractice claims). Many in tax practice upper management positions also surely believe that the caveats insulate them from responsibility under the supervisory provisions of Circular 230 for any "wrong" e-mail or similar advice provided by lower-level tax personnel. CPAs and accounting firms across the country sought guidance in this area from their errors and omissions insurance carriers.

Never Required on E-Mail Communications

The original e-mail caveat was never a requirement for tax practitioners. It was a defense mechanism to opt out regarding two of six specific types of tax opinions2 described in section 10.35 of Circular 230 — a reliance opinion and a marketed opinion — which labeled them as covered opinions.3 If written advice of any type (formal, informal, e-mail, text, or crayon on a napkin) was actually furnished4 regarding any of the other four types of opinion, technically, the requirements of section 10.35 would apply, and the opt-out would be useless.

Those four types of opinions concerned (1) a listed transaction; (2) a tax strategy whose principal purpose was the evasion or avoidance of a federal tax when that purpose was clearly unintended by Congress in enacting the law relied upon; (3) a tax strategy requiring confidentiality (the "if you tell anyone, I'll shoot you" approach5); and (4) a tax strategy that provided contractual protection of some type.6 Interestingly, the manner in which the caveat appeared on countless e-mails wasn't even sufficient to opt out of marketed opinion advice.

Yet somehow, the larger tax profession of attorneys and CPAs took comfort that they were shielded from IRS discipline for any tax advice contemplated in section 10.35 because their e-mails said you can't rely on our advice for penalty protection. In fact, that outcome sounded so cool that at least some practitioners apparently became enamored with the idea that if they didn't put their tax advice in formal legal writing (whatever that is), they'd have no exposure to malpractice claims of any type regarding that advice.

Today's Tax Advice Rules

To change the topic for just a moment, written tax advice is now governed under section 10.37 of Circular 230. For years before the covered opinion provisions, section 10.37 was the pertinent provision under Circular 230, and it remained so following the addition of section 10.357 for advice other than covered opinions. It has been revised and expanded to govern all written advice provided by Circular 230 practitioners (attorneys, CPAs, and enrolled agents for purposes of written advice). So, under the written advice provisions of Circular 230, a practitioner should:

- base her advice on reasonable factual and legal assumptions (including assumptions about future events8);
- reasonably consider all relevant facts and circumstances that she knows or reasonably should know;
- use reasonable efforts to identify and determine the facts relevant to written advice on each federal tax matter;9
- not rely on representations, statements, findings, or agreements (including projections, financial forecasts, or appraisals) of the taxpayer or any other person if reliance on them would be unreasonable;10 and
- not, in evaluating a federal tax matter, take into account the possibility that a tax return will not be audited or that a matter will not be raised on audit.

One later, critical provision in Circular 230 states:

In the case of an opinion the 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 to one or more taxpayers a partnership or other entity, investment plan or arrangement a significant purpose of which is the avoidance or evasion of any tax imposed by the Internal Revenue Code, the Commissioner, or delegate, will apply a reasonable practitioner standard, considering all facts and circumstances, *with emphasis given to the additional risk caused by* the practitioner's lack of knowledge of the taxpayer's particular circumstances, when determining whether a practitioner has failed to comply with this section.11 [Emphasis added.]

Some practitioners may contend that those Office of Professional Responsibility folks are out to trap us. And the IRS doesn't provide a stitch of guidance regarding that directive. How do we deal with that lack of guidance?

Well, one suggestion is to simply save and follow as guidance the requirements of "old" section 10.35. It's actually a nice guide for what tax opinions that address uncertain areas of the law (or facts) should contain. Following the principles set forth in that provision would surely go a long way toward satisfying OPR that the heightened standard was met by the tax opinion writer.

The New (Improved?) E-Mail Caveat

Once any reason (or excuse) for including e-mail tax advice disclaimers — for example, "to ensure compliance with Treasury Department Circular 230" — disappeared, much of the practice community apparently concluded that they enjoyed the seeming malpractice insulation provided by a caveat that states, "We take no responsibility for bad outcomes with the IRS based on the advice contained in this communication." Thus began the "save the e-mail legend" movement for written tax advice.

Of course, an obvious problem faced by lawyers and CPAs is that they provide all kinds of e-mail

(and other informal) advice. Law firms may offer advice on securities, contract, family, environmental, regulatory, and myriad other areas of the law. CPA firms may offer advice in accounting treatment, tax matters, and an endless list of consulting-type matters. Yet, both professions had generally been stating that it's only written e-mail tax advice that the recipient can't rely on. As was pointed out to one malpractice insurance provider, it would look a little silly for a CPA or lawyer to use an e-mail caveat that stated:

Any tax advice contained in this communication, including attachments and enclosures, is not intended as a thorough, in-depth analysis of specific issues, nor is it a substitute for a formal opinion, nor is it sufficient to avoid tax-related penalties.

In fact, what that language would surely imply is that the recipient can rely on e-mail advice in any communications that don't involve tax advice.

Consequently, we are now treated to this type of e-mail legend:

Any accounting, business, or tax advice contained in this communication, including attachments and enclosures, is not intended as a thorough, in-depth analysis of specific issues, nor is it a substitute for a formal opinion, nor is it sufficient to avoid tax-related penalties. [Lawyers would substitute "legal" for "accounting."]

Note that the reference to tax-related penalties is retained in this version, whose phrasing is very close to language suggested by the insurer. Also note that with the appendage of this caveat to e-mails, little has been done to save the forests when e-mails are printed out (or to save thumbs when they are scrolled on a device).

Misguided Reliance on the New Caveat

Beside the belief that the caveat provides a defense in a malpractice case about tax advice, CPAs have expressed to me that the caveat provides insulation from discipline under Circular 230 when the advice of people they supervise (partners, associates, or employees) is incorrect. That's nonsense. And this was a problem — essentially ignored — under Circular 230 before the recent amendments that included the elimination of the covered opinion rules.

Section 10.36, "Procedures to Ensure Compliance," states:

Any individual subject to the provisions of this part who has (or individuals who have or share) principal authority and responsibility for overseeing a firm's practice governed by this part, including the provision of advice concerning Federal tax matters and preparation of tax returns, claims for refund, or other documents for submission to the Internal Revenue Service, 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 subparts A, B, and C of this part, as applicable.

Section 10.22, "Diligence as to Accuracy," states:

A practitioner must exercise due diligence . . . in determining the correctness of oral or written representations made by the practitioner to clients with reference to any matter administered by the Internal Revenue Service.

Taken together, the leadership of tax practice can opt out in e-mails all day long and not avoid OPR's reach regarding erroneous advice given by subordinates. Yes, there is a willful, incompetent, or grossly negligent requirement for discipline concerning supervisory responsibility. It would appear

that simply branding out of responsibility for e-mail advice and nothing more — for example, reviewing or monitoring all forms of significant tax advice contemporaneously or within some reasonable time frame — would be grossly negligent, if not a willful failure to supervise. The supervising tax professional and tax practice leaders should keep this in mind.

Return Prep Engagements

One concept floating around the CPA profession is a suggestion to add to return preparation (rather than tax planning or representation) engagement letter language such as:

While we are, of course, available to provide you with [accounting, tax, and business planning] services, it is our policy to put all advice on which a client might rely into a written memorandum before you rely on that advice. We believe this is necessary to avoid confusion and to clarify the specific nature of our advice. You should not rely on any advice that has not been put into writing for you.

This type of language in most tax advice engagement letters for lawyers would likely be recommended, appropriate, and acceptable since the lawyer rarely prepares the tax return regarding which the advice is given. This would be similarly true for the large CPA firm that provides advice outside the return preparation engagement (or, in fact, for any CPA firm that provides tax planning advice under separate, specific engagement agreements).

However, providing in a return preparation engagement letter that a client (taxpayer) may rely only on written advice (a memorandum, e-mail, letter, or otherwise) would appear to go a step too far. It certainly would not insulate the preparer from the return preparer penalty imposed under section 6694(a) for advising on tax positions of which the preparer has or should have knowledge.

And it is unlikely that a return preparer who has taken a position on a tax return during the preparation process (after perhaps analyzing documents or having discussions with the taxpayer) could later raise the defense that she didn't provide the client written advice regarding the tax treatment that led to the client suffering a significant accuracy-related penalty under section 6662.

In fact, such language in a return preparation engagement letter might be cited by a plaintiff's lawyer — perhaps successfully — as intentional bad faith on the part of the preparer, who would raise it as defense in a malpractice case for recovery of the penalty and other damages.

However, an interesting take on the quoted engagement letter language was recently noted in a course I was teaching on tax practice conduct. A CPA had given a long-standing return preparation client oral advice that the client had misunderstood, and the CPA admittedly failed to fully answer the client's question by explaining how a subsequent act might invalidate the first act.

Too often return preparers provide planning advice or answer client questions throughout the year when the only understanding (contract) with the client is the return preparation engagement letter. Clearly, when a tax planning engagement letter exists, a caveat that the reliance may only be on written advice would likely be a valid defense for the preparer. As noted, it becomes problematic when the written reliance exception is included without qualification in a return preparation engagement letter.

However, the return preparation engagement letter could include language like the following to provide the preparer some protection regarding oral or similar informal periodic advice to the client during the rest of the year:

In addition to our tax preparation services and our advice regarding return preparation, we are, of

course, available to provide you with tax advice during the year. For planning or similar tax advice, it is our policy to put all advice on which a client might rely into a written memorandum before you rely on that advice. We believe this is necessary to avoid confusion and to clarify the specific nature of our advice. You should not rely on any planning or similar advice that has not been put into writing for you.

While that language is not dramatically different from what was quoted earlier, it appears to insulate the preparer from the type of incorrect or incomplete advice that causes most malpractice claims, while recognizing that the preparer is generally responsible for tax positions taken on a return regardless of whether she provided the client a written communication about the chosen tax treatment. This is as it should be if the practitioner is a professional in the Circular 230 sense.

Meanwhile, it appears that the e-mail caveat isn't going to die a quiet death. Trees are weeping.

FOOTNOTES

1 See Kip Dellinger, "For the New Year: Dump the E-Mail Caveat," Tax Notes, Jan. 9, 2012, p. 235 2012 TNT 8-7: Viewpoint; and William R. Davis, "OPR Will Tell Practitioners to Remove Circular 230 Disclaimers," Tax Notes, June 23, 2014, p. 1360 2014 TNT 117-5: News Stories.

2 The types of tax advice that section 10.35 sought to regulate were clearly developed from a reading of the myriad tax opinions provided (many of them pilfered, expanded, revised, or embellished by subsequent tax opinion writers — not unlike Wikipedia articles). The primary problem with the rule was the lack of a definition for "significant purpose." Thus, many in the practitioner community interpreted that language far too broadly. See Dellinger, "Circular 230: How Broad Is the Scope of 'Significant Purpose'?" Tax Notes, June 26, 2006, p. 1503-1509 2006 TNT 123-32: Viewpoint.

3 See Dellinger, supra note 1.

4 Presumably and realistically, just saying "no, don't" or stating that one cannot provide advice would not subject the writer to the requirements of section 10.35.

5 Some of these transactions apparently appeared mysteriously on Lee A. Sheppard's doorstep at various times.

6 For the uninitiated: Yes, there were insurance companies that actually offered protection against an IRS disallowance of a tax shelter strategy.

7 Section 10.35 now provides a general competency requirement for all Circular 230 practitioners. See Dellinger, "Here We Go Again: Hand-Wringing Over Circular 230," Tax Notes, Mar. 25, 2013, p. 1461-1463 2013 TNT 57-9: Viewpoint.

8 Suppose one PowerPoint slide refers to your seven-year investment program, and the next one says that 50 days later you contribute your long and short positions to an S corporation. The next slide says you close your positions, and the following slide probably doesn't even address your seven-year investment diversification program.

9 The parsers of tax language might really think about the intent of this language for a while. It's always been part of the written advice requirements and, game playing aside, it should be taken seriously.

10 This is amusing in that one should not take seriously any representation spoon-fed to the client

from the tax adviser. The bottom of page 1 through page 2 (and sometimes 3) of most of the late-'90s and early-2000-era tax shelters contained "client" representations that were the handiwork of the opinion draftsman and had little to do with the client's business or investment objectives.

11 Note the presence of the phrase "recommending to one or more taxpayers a partnership or other entity, investment plan or arrangement a significant purpose of which is the avoidance or evasion of any tax imposed by the Internal Revenue Code." Here we have that same troublesome language that many practitioners concluded brought just about every type of tax advice, no matter how benign, into the realm of old section 10.35. See Dellinger, "Hand-Wringing Over Circular 230 and E-Mail Caveats," Tax Notes, Oct. 15, 2012, p. 301 2012 TNT 199-10: Viewpoint; see Dellinger, supra note 2.

END OF FOOTNOTES

Kip Dellinger is a CPA in Santa Monica, California. He is a former chair of the American Institute of Certified Public Accountants Tax Division's Tax Practice Responsibilities Committee, and he writes and teaches in the areas of tax practice, quality control, and ethics. He is also the recipient of the 2013-2014 Award for Instructor Excellence from the Education Foundation of the California Society of Certified Public Accountants.