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FOCUS ON TAX CONTROVERSY AND LITIGATION

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Supreme Court Limits a Taxpayer's Ability to Examine the IRS at a Summons Enforcement Hearing

In this issue:

In addition to a discussion of the Supreme Court's recent decision in *Clarke*, this month's issue features articles regarding the Southern District of New York's decision in *Schaeffler*, which denied attorney-client privilege and work product protection to a tax memorandum circulated to a bank consortium, the IRS's recent announcement to expand the OVDP streamlined program to include resident US taxpayers, developments in connection with OECD's BEPS Action Plan, welcomed changes to Circular 230 covered opinion rules, and criminal sentencing of a former partner at Jenkens & Gilchrist in connection with tax shelter activities.

Supreme Court Limits Taxpayer's Ability to Examine the IRS at a Summons Enforcement Hearing

On June 19, 2014, the United States Supreme Court held that a taxpayer has a right to examine IRS officials regarding their purpose of issuing a summons.[1] However, in reversing and vacating an Eleventh Circuit's decision, the Supreme Court did not recognize a taxpayer's right to a formal hearing based on unsupported allegations that the summons was issued in bad faith. The Supreme Court found that the Eleventh Circuit erred in ruling that a bare allegation of improper purpose was sufficient to question IRS officials and remanded the case to the circuit court for further consideration in light of the Supreme Court's decision.

[1] *United States v. Clarke*, 573 US ____ (June 19, 2014, No. 13-301)

In the summons enforcement proceeding, respondents pointed to circumstantial evidence that the IRS had ulterior motives for issuing the summons.

The summons dispute arose from an IRS examination of the tax returns of Dynamo Holdings Limited Partnership (Dynamo) for the 2005–2007 tax years. The IRS questioned interest expenses that those returns had reported. As its investigation proceeded, Dynamo agreed to two year-long extensions of the usual 3-year limitations period for assessing tax liability. In 2010, with that period again drawing to a close, Dynamo refused to grant the IRS a third extension. Shortly thereafter, in September and October 2010, the IRS issued summonses to the respondents, four individuals associated with Dynamo whom the Service believed had information and records relevant to Dynamo's tax obligations. None of the respondents complied with those summonses. In December 2010 (within the limitations period), the IRS issued a Final Partnership Administrative Adjustment proposing changes to Dynamo's returns that would result in greater tax liability. Dynamo responded by filing suit in the United States Tax Court to challenge the adjustments. While that litigation was pending, a few months later, the IRS instituted proceedings in District Court to compel the respondents to comply with the summonses.

In the enforcement proceeding respondents disputed the IRS's reasons for issuing the summonses. The IRS submitted the usual investigating agent's affidavit attesting to the *Powell* factors; among other things, the declaration maintained that the testimony and records sought were necessary to "properly investigate the correctness of [Dy-namo's] federal tax reporting" and that the summonses were "not issued to harass or for any other improper purpose."[2] In reply, the respondents pointed to circumstantial evidence that, in their view, suggested "ulterior motive[s]" of two different kinds.[3]

In response, the respondents asserted that the IRS issued the summonses to punish the taxpayer for refusing to agree to a further extension of the applicable statute of limitations. In particular, respondents alleged in sworn declarations that after Dynamo refused to grant a third extension of time, the IRS, "despite having not asked for additional information for some time, . . . suddenly issued" the summonses.[4] In addition, the respondents asserted that the IRS sought to enforce the summonses, subsequent to Dynamo's filing suit in Tax Court, to "evad[e] the Tax Court['s] limitations on discovery" and thus gain an unfair advantage in that litigation.[5] In

[2] Slip Opn. at 3.

[3] Id.

[4] Id. at 4.

[5] Id.

The Eleventh Circuit held that the District Court's refusal to allow the respondents to examine IRS agents constituted an abuse of discretion.

The Supreme Court reversed the Eleventh Circuit because summons enforcement proceedings are summary in nature and not designed for courts to oversee IRS determinations to investigate a taxpayer.

support of the allegations, the respondents submitted an affidavit from the attorney of another Dynamo associate, who had chosen to comply with a summons issued at the same time. In light of those submissions, the respondents asked for an opportunity to question the IRS agents about their motives.

The District Court denied the respondents' request and ordered compliance with the summonses. The court found that the respondents' theory was "mere conjecture" and "ha[d] made no meaningful allegations of improper purpose" warranting examination of the IRS agents.[6]

On appeal, the Eleventh Circuit reversed, holding that the District Court's refusal to allow the respondents to examine IRS agents constituted an abuse of discretion. In support of that ruling, the circuit court cited binding Circuit Court precedent holding that a simple "allegation of improper purpose," even if lacking any "factual support," entitles a taxpayer to "question IRS officials concerning the Service's reasons for issuing the summons."[7]

In reversing the Eleventh Circuit, the Supreme Court first noted that a taxpayer who receives a summons is entitled to contest it in an enforcement proceeding.[8] But summons enforcement proceedings are to be "summary in nature." According to the Court, the purpose of a summons is "not to accuse," much less to adjudicate, but only "to inquire." Accordingly, it is well established that courts may ask only whether the IRS issued a summons in good faith, and must eschew any broader role of "oversee[ing] the [IRS's] determinations to investigate."[9] A simple affidavit from the investigating agent can satisfy the IRS's burden.

Notwithstanding this low threshold of proof required by the IRS, as part of the adversarial process concerning a summons's validity, the taxpayer is entitled to examine an IRS agent when he can point to specific facts or circumstances plausibly raising an inference of bad faith. The court provided guidance to the Eleventh Circuit and for future disputes over the availability of such hearings. According to the Supreme Court, the standard to be applied by a court in considering the summoned party's right to a hearing must focus on whether the summoned party has pointed "to

[6] Id.

[7] Id. at 5, citing 517 Fed. Appx. 689, 691 (2013) (quoting *United States* v. *Southeast First Nat. Bank of Miami Springs*, 655 F.2d 661, 667 (CA 5 1981)); see *Nero Trading, LLC* v. *United States Dept. of Treasury*, 570 F. 3d 1244, 1249 (CA 11 2009) (reaffirming *Southeast*).

[8] Id. citing *United States* v. *Bisceglia*, 420 U. S. 141, 146 (1975); *Powell*, 379 U. S., at 57–58

[9] Id. at *Powell*, 379 US at 56.

"The taxpayer is entitled to examine an IRS agent when he can point to specific facts and circumstances plausibly raising an inference of bad faith."

specific facts or circumstances plausibly raising an inference of improper motive."[10] It elaborated on that standard and stated:

> [T]he taxpayer is entitled to examine an IRS agent when he can point to specific facts or circumstances plausibly raising an inference of bad faith. Naked allegations of improper purpose are not enough: the taxpayer must offer some credible evidence supporting his charge. But circumstantial evidence can suffice to meet that burden; after all, direct evidence of another person's bad faith, at this threshold stage, will rarely if ever be available. And although bare assertion or conjecture is not enough, neither is a fleshed out case demanded: the taxpayer need only make a showing of facts that give rise to a plausible inference of improper motive. That standard will ensure inquiry where the facts and circumstances make inquiry appropriate, without turning every summons dispute into a fishing expedition for official wrongdoing.[11]

Richard A. Nessler

Court Determines Tax Memo not Protected by Attorney-Client Privilege and Work Product Doctrine

The Southern District of New York, in *Schaeffler v. United States*[12], recently denied a petition to quash an IRS summons for a tax memorandum prepared by the petitioner's accounting firm in connection with a complex refinancing and corporate restructuring on the part of the Schaeffler Group, determining that (i) the tax memorandum was not protected by the work product doctrine, and (ii) attorney-client and tax practitioner privilege was waived when the tax memorandum was shared with a consortium of banks that funded the original transaction being refinanced and restructured.

The Schaeffler Group believed an IRS audit and possible dispute as to at least some of the US tax consequences of the proposed transactions was likely, and therefore engaged outside tax and legal advisors to assist with the US tax implications of the transactions. As part of its engagement, Ernst & Young LLP prepared a memorandum that identified potential US tax consequences of the proposed transactions, as well as possible IRS challenges to the Schaeffler Group's treatment of the transactions (the "E&Y memo").

[10] Id. at 6.

[11] Id.

The tax memorandum that identified potential US tax consequences of the proposed transaction was shared with a bank consortium pursuant to a common interest agreement.

Because the US tax consequences of the proposed refinancing and restructuring transactions could materially affect the Schaeffler Group's ability to repay the bank consortium's debt, the consortium and its law firm worked closely with the Schaeffler Group's outside tax advisors in effectuating the transactions and analyzing the US tax consequences of them. In this regard, the Schaeffler Group and the bank consortium signed an agreement whereby they agreed to share privileged, protected and confidential documents and their analyses without waiving those privileges, protections or the confidentiality of the information. After the execution of this agreement, the Schaeffler Group shared with the bank consortium, among other things, the E&Y memo.

The IRS, in conjunction with an audit of the Schaeffler Group's tax returns for 2009 and 2010, issued a number of IDRs requesting all tax opinions and analyses that discussed the US tax consequences of the Schaeffler Group's restructuring, and, eventually, an administrative summons to Ernst & Young requiring it to provide all legal opinions that it provided to parties outside the Schaeffler Group. The Schaeffler Group petitioned to quash this summons on the grounds that it sought legal opinions and other confidential advice protected by both the work product doctrine and the attorney-client privilege, as extended to Ernst & Young by the tax practitioner privilege.

The Court held that the common interest rule did not apply because the shared interest between the two parties was economic, not legal.

With respect to attorney-client privilege, the petitioners argued that no waiver of the privileged tax memorandum occurred when the documents were provided to the bank consortium because the Schaeffler Group and the consortium had a common legal interest. The court disagreed, holding that the shared interest between the two parties was economic, not legal. The consortium may have shared the desire that the transactions receive favorable tax treatment from the IRS so that the Schaeffler Group could service its debt to the bank consortium, but there was no common legal stake in the Schaeffler Group's putative litigation with the IRS. The court noted that this result would be different if the bank consortium could have been named as a co-defendant in the anticipated dispute with the IRS. Accordingly, the court held that the common interest rule did not apply and, therefore, petitioners waived any attorney-client or tax practitioner privilege that attached to the E&Y memo when they shared it with the

[12] No. 1:13-cv-04864 (S.D.N.Y. May 28, 2014)

bank consortium. The fact that the parties had previously signed an agreement that sought to preserve privilege did not affect the court's analysis on this point.

The petitioners also argued that the E&Y memo was protected from disclosure to the IRS under the work product doctrine. The court rejected an argument by the Government that the Schaeffler Group had waived work product protection by sharing the E&Y memo with the bank consortium. The court held that, because the parties had a shared commercial incentive in keeping the details of the refinancing negotiations from the Schaeffler Group's potential adversaries, including the IRS, and because the bank consortium was contractually required to keep the disclosed information confidential, the disclosure of the E&Y memo to the consortium did not materially increase the likelihood of disclosure to an adversary. Accordingly, to the extent the E&Y memo was entitled to work product projection, the court held that the disclosure did not waive the protection.

On the merits of the work product protection claim the court followed the requirement set out in *United States v. Adlman*, 134 F. 3d 1194 (2d Cir. 1998), that documentation protected by the work product doctrine would have been created in essentially similar form had litigation not been anticipated. The court determined that, as a sophisticated businessperson engaging in a complex financial transaction, the petitioner would likely have sought out the same sort of tax advice Ernst & Young provided to ensure that advantageous tax strategies were employed to their fullest potential, even in the absence of anticipated litigation. The court noted that petitioners had presented no facts suggesting that Ernst & Young would have acted any differently had it known no audit or litigation would ensue. Furthermore, the court focused on the requirement of Treasury Department Circular 230 that tax practitioners cannot allow the possibility that a tax return will remain unaudited to affect the advice they give, concluding that when Ernst & Young provided legal advice on the tax treatment of the transactions, it had a responsibility to consider in full the relevant legal issues regardless of whether they anticipated an audit and ensuing litigation with the IRS. The court held that the E&Y memo would have been produced in the same form irrespective of any concern about litigation, and therefore, that it was not protected from disclosure under the work product doctrine.

Judy Fisher

Streamlined OVDP Expanded to Resident US Taxpayers

On June 18, 2014, the IRS announced that it will permit resident US taxpayers to participate in its streamline OVDP filing compliance program. Taxpayers currently participating in OVDP who meet certain eligibility requirements for the expanded Streamline Filing Compliance Procedures will benefit from a more favorable penalty structure under the Streamline Program – a 5 percent offshore penalty, rather than the current penalty of 27.5 percent.

In June 2012, effective September 1, 2012, the IRS announced the streamlined program ("Program"), which was limited to US taxpayers living abroad. Eligibility was limited to non-resident non-filer taxpayers who could demonstrate a low level of compliance risk and who did not owe more than $1,500 of tax for each of the three years covered by the Program. Resident US taxpayers were not eligible for the Program. Non-resident US taxpayers who utilized the Program were required to file delinquent tax returns for the past three years and to file delinquent FBARs for the past six years. To be eligible, the non-resident US taxpayer must have resided outside the US since January 1, 2009 and who did not file a US tax return during the same period, and who presented a low level of compliance risk. Low risk was predicated on simple returns with little or no US tax due. The IRS considered risk to be high if, in part, (i) the taxpayer demonstrated material activity in the United States; (ii) the taxpayer was under audit or investigation by the IRS, or (iii) if the taxpayer had US source income, or any indication of sophisticated US tax planning or avoidance.

The streamlined program is designed for US taxpayers who did not act willfully. Resident taxpayers may now benefit from a substantially lower FBAR penalty.

For taxpayers who presented low compliance risk, the IRS agreed to expedite the review and no penalties were asserted. Non-resident US taxpayers who sought to file amended tax returns were not accepted into the program. Notably, the streamlined program did not provide protection from criminal prosecution if the IRS and the DOJ determined that the taxpayer's particular circumstances warrant such prosecution.

Under the IRS's recent announcement, US resident taxpayers living in the United States who qualify may apply to the streamlined program rather than the traditional Offshore Voluntary Disclosure Program ("OVDP"). The Program's expansion also includes changes, which includes eliminating the cap on outstanding taxes owned (formerly $1,500 or less unpaid each year), doing away with the risk questionnaire, and adding a requirement that participants certify that their previous failure to comply with their obligations was due to non-willful conduct.

Returns submitted under the streamlined program will not automatically be subject to IRS audit, but may be selected for audit under existing audit selection applicable to any US tax return, and may be subject to verification procedures against information received from banks and other sources. The streamlined program is only available to taxpayers who actions did not result from willful conduct. The IRS has not provided a list of factors to demonstrate willful behavior, but prior actions brought by the IRS asserting willful conduct includes (i) opening foreign accounts in an entity or

The streamlined program is available to US taxpayers who are currently participating in the existing OVDP Program so long as a Closing Agreement has not been executed by the IRS.

foundation name; (ii) providing false information to taxpayer's tax accountant, or (iii) knowing at the time of filing the tax return that the taxpayer should have reported both the existence of the account and the income earned from it.[13] A taxpayer could be subject to criminal liability and/or substantial monetary penalties if a taxpayer's behavior was willful.

Resident US taxpayers who filed under the OVDP program prior to June 30, 2014, are eligible to seek to participate in the streamlined program if the eligibility requirements of the program are met. A taxpayer seeking such treatment does not need to opt out of OVDP. To participate in the streamlined program, the taxpayer must submit a written statement signed under penalty of perjury certifying their non-willfulness with respect to all foreign activities, and specifically describe the reasons for the failure to report all income and file timely FBARs. Upon IRS approval, US resident taxpayers currently participating in OVDP will not be required to pay the 27.5 percent offshore penalty at the OVDP rate, but will instead be subject to the streamlined penalty rate of 5 percent.

Taxpayers who have not entered OVDP by June 30, 2014 must decide whether to submit to OVDP or the streamlined program. Once a taxpayer makes a submission under the streamlined program, the taxpayer may not participate in OVDP. Similarly, a taxpayer who submits an OVDP voluntary disclosure letter pursuant to OVDP on or after July 1, 2014 is not eligible to participate in the streamlined procedures. Those taxpayers that enter OVDP after June 30, 2014 may face a civil penalty of 50 percent based on the highest balance of the foreign account during the past 8 years, if the account was held at a bank under investigation by the IRS or Department of Justice.

The streamlined program will continue to be offered to US taxpayers residing outside the United States. For nonresident US taxpayers, the IRS has eliminated the cap on outstanding taxes and no longer requires the risk questionnaire. To qualify as a nonresident, the taxpayer must not maintain a US abode and the individual must be physically present outside the United States for at least 330 full days. Nonresident taxpayers eligible for the streamlined program will not be subject to failure to file and failure to pay penalties, accuracy-related penalties, information return penalties, or FBAR penalties.

Richard A. Nessler

[13] *See United States v. Mcbride*, 908 F. Supp 2d 1186 (D. Utah 2012).

OECD Moves Forward on BEPS Action Plan

The Organization for Economic Cooperation and Development ("OECD") recently held its annual tax conference in Washington, DC focusing on the progress of implementation of its Action Plan on Base Erosion and Profit Shifting (the "BEPS Action Plan").

Overview of the BEPS Action Plan

The OECD will present a final report on BEPS at the G20 Finance Ministers Meeting in September 2014.

The OECD published the BEPS Action Plan in July 2013 to bring about discussion of and to correct perceived problems with base erosion and profit shifting ("BEPS"), tax planning strategies of multinational entities and other international taxpayers that exploit gaps in domestic tax law systems and that shift profits to low tax rate jurisdictions where relatively little economic activity is actually taking place. The Action Plan called for member nations to, among other things, shore up their domestic tax rules where interaction between domestic tax systems has unintentionally led to gaps in corporate taxation (double non-taxation or less than single taxation). The Action Plan (i) identifies 15 actions needed to address BEPS, (ii) sets a timeline of deadlines to implement the actions and (iii) identifies the resources needed, the methodology, and certain output deliverables required to implement the actions. The Action Plan can be viewed on the OECD website.

The 15 action items to be addressed identified by the BEPS Action Plan are as follows: (1) address the tax challenges of the digital economy, (2) neutralize the effects of hybrid mismatch arrangements, (3) strengthen CFC rules, (4) limit base erosion via interest deductions and other financial payments, (5) counter harmful tax practices more effectively, taking into account transparency and substance, (6) prevent treaty abuse, (7) prevent the artificial avoidance of Permanent Establishment status, (8) assure that transfer pricing outcomes regarding intangibles are in line with value creation, (9) assure that transfer pricing outcomes regarding risks and capital are in line with value creation, (10) assure that transfer pricing outcomes regarding high-risk transactions are in line with value creation, (11) establish methodologies to collect and analyze data on base erosion and profit shifting and the actions to address it, (12) require taxpayers to disclose their aggressive tax planning arrangements, (13) re-examine transfer pricing documentation and country by country reporting, (14) make dispute resolution mechanisms more effective, and (15) develop a multilateral instrument to enable jurisdictions to implement these actions items.

Key Upcoming Dates and US Comments

Action items (1), (2), (5), (6), (8), (13) and (15) currently have a September 2014 target delivery date. The OECD expects to present final output reports reflecting fulsome recommendations for additional work to be done regarding these 7 action items at its G20 Finance Ministers Meeting in September 2014. Draft reports for many

US lawmakers and regulators have expressed doubt about the progress and effectiveness of the BEPS Action Plan.

of these action items were released in February and March, and related comments have been collected. The OECD has admitted that it is working at a frantic pace to deliver the final reports by September and to pre-empt the development of unilateral BEPS legislation and regulation in OECD and G20 member nations.

In light of the quickly approaching target delivery dates, US lawmakers and regulators have publicly expressed doubt about the progress and effectiveness of the project. A joint statement was released by Senate Finance Committee Ranking Minority Member Orrin Hatch and House of Representatives Ways and Means Committee Chairman Dave Camp in late June 2014 regarding the time frame and progress of the implementation of the BEPS Action Plan as well as concerns that the plan is being used by other member nations to increase taxation on American taxpayers. According to Hatch and Camp, the September 2014 deadline for implementation of the 7 early action items (as well as the timeframe for the remaining action items) is “extremely ambitious,” and it limits the ability to review, analyze and comment on the rules being proposed. Accordingly, Hatch and Camp believe the process “raises serious questions about the ability of the United States to fully participate in the negotiations.” Camp and Hatch nevertheless suggest comprehensive US federal income tax reform by lowering the corporate income tax rate to a level which is internationally competitive and modernizing the US international tax system.[14]

Robert Stack, US Treasury Deputy Assistant Secretary for International Tax Affairs for the Office of Tax Policy, similarly expressed concerns regarding the implementation of the BEPS Action Plan in the United States, recently. Specifically, Stack criticized the BEPS Action item (15) call for the development of a multilateral instrument as an idea that is “not well-defined” in terms of its process and substance. He doubts whether such a document is even “doable.”[15]

Ryan Roberts

IRS Issues New Circular 230 Regulations

Circular 230 contains the ethical rules that govern practice before the IRS. On June 9, 2014 the IRS issued new regulations that make significant changes to Circular 230 and

[14] Swinehart, S. (2014, June 2) Camp, Hatch Statement on 2014 OECD Tax Conference. Retreived from www.waysandmeans.house.gov/news.

[15] Stewart, D. (2014, June 20). Failure is an Option, says US Treasury Official. Retrieved from www.taxanalysts.com

Under the new regulations, the Covered Opinion rules under 10.35 will no longer apply to written tax advice.

should reduce costs of practitioner compliance. The regulations had been anticipated since being issued in proposed form on September 17, 2012. As expected the final regulations eliminated the Covered Opinion rules in Section 10.35, and replaced the rule with one standard for all written tax advice under Section 10.37. The Covered Opinion provisions contained burdensome requirements for written tax advice, which went into effect in 2005. These rules apply only to practice before the IRS and do not change or replace other ethical or legal standards applicable to individuals subject to Circular 230.

Revised Section 10.35

The Covered Opinion provisions were contained in Section 10.35. Covered Opinions included written advice concerning:

1. A listed transaction;
2. A transaction with the principal purpose of tax avoidance or evasion; or
3. A transaction with a significant purpose of tax avoidance or evasion, if the advice is a reliance opinion, marketed opinion, subject to conditions of confidentiality, or subject to a contractual protection.

Section 10.35 provided that, to issue a covered opinion, a tax practitioner must determine the facts, relate the facts to the law, evaluate the significant federal tax issues, reach a conclusion about each one, and reach an overall conclusion about the tax treatment of the transaction. Covered Opinions include those concerning listed and substantially similar transactions, transactions principally intended to avoid or evade tax, marketed opinions, and those subject to confidentiality or contractual protection. The covered opinion must also assess the taxpayer’s likelihood of success on the merits of each significant federal tax issue considered in the opinion. In arriving at that conclusion, the practitioner could not take into account the possibility that the return will not be audited or that the issue will not be raised or, if raised, will be resolved through settlement.

Except for opinions issued with respect to listed transactions or transactions with the principal purpose of avoiding or evading taxes, practitioners could opt out of the requirements of Section 10.35, by prominently disclosing in the opinion that the advice was not intended or written to be used, and cannot be used, by the taxpayer to avoid tax penalties.

These rules have been deleted and the final regulations have created a new Section 10.35. Section 10.35 now addresses a practitioner's competence. Specifically, under the new rule 10.35, a practitioner must possess the necessary competence to engage in practice before the IRS. Competent practice requires the appropriate level of knowledge, skill, thoroughness and the preparation necessary for the matter at issue. A

The key element to the new 10.37 regulation is the “reasonableness” standard.

practitioner may become competent by consulting with experts or studying the relevant law.

Revised Section 10.37

Even though the Covered Opinion provisions will no longer apply to written tax advice, a practitioner's advice cannot be based upon unreasonable assumptions about the facts or the law, or unreasonably rely on representations, statements, findings or agreements. Under the new Section 10.37 in the final regulations, practitioners must make reasonable efforts to ascertain and consider all relevant facts that the practitioner knows or reasonably should know, make reasonable factual and legal assumptions, and exercise reasonable reliance. The practitioner must consider all relevant legal authorities and relate the law to the facts. Moreover, the practitioner, when evaluating a tax matter, may not take into account the likelihood of an audit or settlement. When the IRS evaluates a practitioner's advice, the IRS will apply a "reasonableness" standard.

A significant change made in Section 10.37 is the addition of a definition of certain things that do not constitute “written advice.” Written advice was not defined in the proposed or final rules, but the final rules clarify that government submissions on a client’s behalf and continuing education presentations are not written advice under the rules.

The final version of Section 10.37 provides that the practitioner need not describe in the written advice the relevant facts (including assumptions and representations), the application of the law to those facts, and the practitioner’s conclusion about the law and the facts. Instead, the scope of the engagement and the type and specificity of the advice the client seeks, together with all other appropriate facts and circumstances, are used to determine the extent to which relevant facts, the application of the law to those facts, and the practitioner’s conclusion about the law and the facts must be set forth in the written advice. This is a flexible standard, dependent on the facts and circumstances of the engagement. The determination whether a practitioner has failed to comply with Section 10.37 will be based on all facts and circumstances, not on whether each requirement is addressed in the written advice.

A heightened standard of care applies when the practitioner knows or should know that the written advice will be used to promote, market or recommend a course of action that has a significant purpose of avoiding or evading tax. When evaluating a practitioner's advice, the IRS will apply a reasonableness standard which considers all facts and circumstances and places an emphasis on the additional risk associated with a practitioner's lack of knowledge of a taxpayer's particular circumstances.

In addition, a practitioner may rely on the advice of another person if, in light of the facts and circumstances, such reliance is reasonable and made in good faith. Reliance is not reasonable when the practitioner knows or reasonably should know that (1) the opinion of the other person should not be relied upon; (2) the other person is not competent or lacks the necessary qualifications to provide the advice; or (3) the other person has a conflict of interest in violation of Circular 230.

The IRS also stated in the preamble to the regulations that it expects that the current practice by most practitioners of inserting a Circular 230 disclaimer at the conclusion of every email or other writing, whether the disclaimer is necessary or appropriate, will be discontinued because new Section 10.37 does not include the covered opinion disclosure provisions that were in former Section 10.35.

Revised Section 10.36

Practitioners in a position of authority must do more than ensure their own compliance with Circular 230. Practitioners must ensure that all individuals they supervise comply with Circular 230 as it pertains to the preparation of returns or other documents submitted to the IRS. Practitioners must take reasonable steps to ensure that the firm complies with Circular 230.

Under 10.36 a practitioner responsible for implementation of Circular 230 compliance procedures will be subject to disciplinary action if:

1. The practitioner through willfulness, recklessness or gross incompetence does not take reasonable steps to ensure the firm has in effect and follows adequate procedures so as to comply with Circular 230, and one or more individuals who are members of, associated with or employed by the firm engage in a pattern or practice in connection with their practice with the firm, of failing to comply with Circular 230; or

2. The practitioner knows or should know that one or more individuals who are members of, associated with or employed by the firm engage in a pattern or practice, in connection with their practice with firm, that does not comply with Circular 230, and the practitioner, through willfulness, recklessness or gross incompetence fails to take prompt action to correct the noncompliance.

Accordingly, the combination of revised Sections 10.35 and 10.36 require that supervising practitioners have a duty to ensure that their subordinates have the requisite knowledge and skill, and that they appropriately exercise that knowledge and skill in practice before the IRS.

Revised Section 10.82

Under Section 10.82, the IRS may expedite a practitioner's suspension to practice before the IRS for "willful disreputable conduct." Under the final regulations, this phrase now includes the failure to comply with one's own personal tax filing obligations. Note that the new rule pertains to filing tax returns, not payment of tax.

Conclusion

These final regulations apply to written tax advice provided on or after June 12, 2014, the date published as final in the *Federal Register*. The changes to Circular 230, in particular Rule 10.35, are long overdue and welcome news to tax practitioners. Under the new rules tax practitioners who issue written tax advice must make sure that they are able to demonstrate that their advice is reasonable, and the advice cannot be based upon unreasonable assumptions about the facts or the law.

Richard A. Nessler

Former Jenkens & Gilchrist Partner Paul Daugerdas Sentenced to 15 Years in Prison

On June 25, 2014, Judge William Pauley III in the US District Court for the Southern District of New York sentenced Paul Daugerdas, a former partner at Jenkens & Gilchrist, to 15 years in prison for tax evasion, mail fraud, and tax shelter fraud conspiracy. Daugerdas was also ordered to pay more than $371 million in restitution to the IRS and forfeit almost $65 million in "proceeds" from his criminal offenses. Daugerdas' defense counsel asked for a sentence of no more than 30 months.

Daugerdas was convicted on October 31, 2013 on seven of 16 counts arising out of abusive tax shelters promoted by Jenkens & Gilchrist and other professionals and financial institutions between 1999 to 2004. According to the DOJ, Daugerdas marketed and sold hundreds of tax shelters to high net worth individuals, which generated more than $7 billion in false and fraudulent tax losses. Daugerdas had been convicted in 2011, but was later granted a retrial after it was discovered that a juror had lied about her background during voir dire in the hope of being selected for the jury panel. Daugerdas' former partner, Donna Guerin, pled guilty in September 2012 to conspiracy and tax evasion charges and was sentenced by Judge Pauley to eight years in prison. She was also ordered to pay $190 million in restitution and to forfeit $1.6 million.

In their sentencing report, the DOJ called Daugerdas "the most prolific, pernicious, and utterly unrepentant tax cheat in United States history." Daugerdas has also forfeited his law license in the State of Illinois.

Richard A. Nessler

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Tax Controversy and Litigation at Shearman & Sterling

Shearman & Sterling's Tax Controversy and Litigation practice is centered on large case tax controversy examinations, tax litigation matters, and government investigations. Our prominent team of nationally recognized trial lawyers represents taxpayers at the audit and Appeals stages before the Internal Revenue Service and litigates on behalf of taxpayers in the federal courts, from the US Tax Court to the Supreme Court of the United States. Shearman & Sterling's tax lawyers also represent clients in obtaining rulings from tax authorities and in competent authority proceedings and work with clients to obtain advance pricing agreements.

In addition, our tax lawyers are active members of the American Bar Association Section of Taxation ("ABA Tax Section"), the New York State Bar Association Tax Section ("NYSBA Tax Section"), the Wall Street Tax Institute, and the Institute of International Bankers. Our tax controversy lawyers frequently participate in panels at tax law conferences and publish articles regarding significant tax controversy and litigation developments, and one partner recently ended his term as Chair of the ABA Tax Section's Court Practice and Procedure Committee.
Shearman & Sterling was just named "2012 Americas Banking Tax Firm of the Year" at the seventh annual International Tax Review (ITR) International Tax Awards. Shearman & Sterling also has been selected as the Tax Law Firm of the Year in New York for the 2013 Global Law Experts Practice Area Awards.