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Thank you for inviting me to speak to you today. I want to talk with you today about the IRS's efforts to address abusive tax avoidance transactions and in particular the attorney-client and tax practitioner privileges. Some might think it is appropriate for me to deliver my remarks today near the site of the Alamo, embattled as the IRS as in its efforts to rein in those transactions. Others might even suggest a better battle analogy is Goliad. For those that don't know, at the Alamo, the Texans went down fighting; at Goliad, they surrendered. In both cases, the result was the same – they were slaughtered. I am here to tell you I do not plan to allow a repeat of those Texas tragedies in the battle against abusive tax avoidance transactions. I much prefer to emulate the example set by Sam Houston at the Battle of San Jacinto. Like General Houston and the Texans who delivered a crushing defeat to Santa Anna at San Jacinto, I believe that the IRS is poised to gain the upper hand in its assault against abusive transactions, equipped with the right weapons! But because I am, unlike General Houston, a good sport (and because I hope you and they are listening) – I don't plan to catch the purveyors of these aggressive transactions "napping."

The battle against abusive tax avoidance transactions is a high priority for the Office of Chief Counsel. Today, I will highlight for you how we are helping the IRS use the tools currently at its disposal, and what some of the issues we face are as we move forward with our enforcement efforts.

At the outset, it seems clear that the currently existing set of registration, disclosure and list maintenance rules are not working well. Unlike Col. Travis at the Alamo, the IRS has not been overwhelmed! The Treasury Enforcement Proposals released on March 20, 2002 are designed to change that landscape. The new and enhanced tools relating to disclosure and registration of questionable transactions (coupled with penalties for noncompliance) in the Treasury Enforcement Proposals will provide much better and earlier access to information regarding abusive transactions, and those who invest in and promote them. By bringing investments in abusive transactions to light, these changes will enhance the IRS's continuing efforts to ensure compliance with the tax laws. I am encouraged that the Senate Finance Committee is moving forward with legislation that reflects these priorities. And we are working on the regulatory proposals and invite your comments. Modifying and using these information gathering tools are the first new major cannon shots across the bow of abusive tax avoidance transactions as they will help the IRS identify and locate questionable transactions. The second round of shots will be more frequent and expeditious published guidance that states the IRS position on these transactions. I have spoken publicly a number of times about the need for increased and prompter published guidance to help taxpayers comply with the tax rules and help the IRS ensure compliance.

Enforcement is the final salvo necessary to ensure compliance. My goal here is simple: I want to interdict the promotion of abusive tax avoidance transactions at the front end – that is as the transactions are being marketed and sold to taxpayers. To achieve this, we need to obtain and use a web of information from investors and promoters and aggressively pursue questionable transactions that we determine are improper.

Because early detection is central to my goal of early interdiction, I believe that the promoters should be the first source of information and the first target of IRS investigations. Promoters have the first obligation to register transactions; therefore, their registrations provide the first opportunity to learn about questionable transactions. Moreover, their lists of investors will allow the IRS to identify how widespread transactions are and to devise plans for audit and resolution even before the first tax returns are under examination in the normal course. Finally, focusing our efforts on the promoters will reinforce to both taxpayers and promoters the certainty of detection of questionable transactions and the certainty of examination of those transactions. Under this approach, promoters may continue to engage in tax planning and advise their investors on ways to minimize taxes, but they are on notice that these strategies will come under scrutiny that will deter the most egregious transactions.

The IRS already has increased its use of the tools and information at its disposal to determine whether taxpayers and promoters are in compliance with the tax laws. The IRS requested information (through “soft letters”) from over 30 promoters to determine whether they have complied with the registration and list maintenance requirements. That was about two years ago, and to date, a number of promoters have yet to provide us with the information requested. Where the IRS has obtained information from promoters, it is in the process of reviewing that information and contacting the investors listed. In addition, the IRS is using information from investor audits and from disclosures to challenge promoters who have claimed they did not promote such transactions. It is undeniable, however, that our attempts to remain current with the market are hampered by the promoters’ failure to cooperate. In response to this recalcitrance, the IRS, with the support of Chief Counsel attorneys, has begun to issue summonses for the requested information. In addition, to ensure that the summonses are both proper and enforceable, the IRS and the Office of Chief Counsel have established a pre-issuance clearance program with the Department of Justice. Under this program, summonses to promoters are cleared with DOJ lawyers before they are served on promoters.

As of May 23, the IRS had issued 110 summonses to 6 different promoters and has a number of summonses about to be issued. It is my understanding that prior to this year, no summonses had been issued requesting information under sections 6111 and 6707 or 6112 and 6708, with the exception of one summons issued in 2001. (Some may also recall a significant summons enforcement effort at the end of 1992 in connection with the installment sale partnerships at issue in ACM -- those summonses involved the tax liability of the investment bank itself.)

As part of our efforts, we have, and will, issue summonses to law firms, accounting firms, investment banks and others who may have been involved in the promotion of questionable transactions. More summonses will follow – some imminently. We also are in discussions with promoters to obtain requested information without the issuance of summonses and without enforcing summonses that have been issued. And we are pursuing the imposition of penalties for failure to register under section 6111. In appropriate and egregious circumstances, we are considering aiding and abetting penalties under section 6701.

In response to the IRS summonses, a number of promoters have asserted that requested information is privileged – either under the attorney client privilege or the tax practitioner privilege in section 7525. I have reviewed the privilege log in a couple of cases and frankly have been dismayed. I value the attorney-client privilege and believe it is fundamental to our legal system. I am also mindful that, as part of IRS Restructuring Act in 1998, Congress enacted the tax practitioner privilege in section 7525 (although Congress properly declined to extend the privilege to tax advice furnished to corporations with regard to transactions with a significant purpose of tax avoidance). But under the guise of these privileges, promoters are claiming that they are not required to disclose to the IRS investor lists, presentation charts, and even K-1s. These claims of privilege, under the traditional attorney client privilege or the tax practitioner privilege, are without merit.

The attorney-client privilege and the tax practitioner privilege in section 7525, which is itself a limited privilege based on and narrower than the attorney-client privilege, are intended to protect client communications to obtain legal advice made with a reasonable expectation of confidentiality and not otherwise waived. I have a very good friend, now in government, who in private practice wrote all of her opinions assuming that the IRS would see them. I would not go that far. But I want to emphasize that the attorney-client privilege and especially the tax practitioner privilege are narrower than they are often represented to be. They have important boundaries.

First, the attorney-client and tax practitioner privileges only protect confidential communications made to the advisor by the client in the course of seeking legal or tax advice. These privileges do not protect communications from the advisor unless those communications would reveal confidential client communications. The privilege belongs to the client, not to the advisor, and it is incumbent on a party claiming the privilege to establish that all of the elements of a privilege exist for each item for which it is claimed. We will require a taxpayer claiming the attorney-client or tax practitioner privilege with respect to opinions promoting these transactions to establish that each such opinion was given in the context of an attorney client relationship (or parallel relationship in the tax practitioner context) before we will accept a privilege claim as potentially valid.

Second, the privilege may be waived. For example, a legal opinion that might have been privileged when given to the client loses its privileged status when it is circulated to third parties, including investors (e.g., in the case of opinions given to promoters). Privilege logs, as you know, must indicate all recipients of a document and their relationship to the client, to address this waiver issue. The privilege logs I have seen are deficient in this respect, and, unless corrected, it is my view that we should move to enforce the summons.

Additionally, information communicated to an attorney or tax practitioner that will be incorporated into a tax return is not privileged, since it is intended to be disclosed to the IRS. This includes information appearing on a K-1 as well as the information required under the list maintenance regulations, such as a tax shelter's name and registration number, transactional data, and all written promotional materials provided to investors. I was stunned to see K-1s listed on a privilege log I reviewed.

Finally, as a general rule, the privilege does not protect the name, address, or whereabouts of the investor who receives the tax advice. It does not protect pre-existing facts, documents, or intra-corporate communications unrelated to the seeking of legal or tax advice. It does not protect the existence of the attorney-client or practitioner-client relationship or the fees paid. Nor does it protect communications made in connection with providing non-legal services, such as accounting or tax preparation activities or investor promotions, or for non-legal advice, such as business or accounting advice.

The tax practitioner privilege under section 7525 offers no greater protection for such information than does the attorney-client privilege; indeed, it offers none with respect to communications by a corporation regarding a transaction with a significant tax avoidance purpose. This privilege only protects client-practitioner communications to the same extent that communications to an attorney are protected. This is explicit in the legislative history to the provision. Those claiming such a privilege will be required to establish the existence of the relationship, all of the necessary elements for a privileged communication, and the absence of dissemination or waiver destroying confidentiality. In addition, a privilege log would have to reveal enough details about the transaction to allow the IRS to determine whether a significant tax avoidance purpose exists; if so, the privilege does not apply. Again, the privilege logs I have seen are deficient in failing to provide sufficient (or any) information about the nature or structure of the transaction to which the document claimed to be privileged relates. Again, it is my view that unless this deficiency is corrected, we should move to enforce the summons.

Now let us put these rules in the context of the abusive tax avoidance transactions and the promoter and taxpayer enforcement activities. I have already addressed the fact that investor names, K-1s and promotional materials used in marketing transactions do not enjoy the privilege. The harder questions involve the tax advice – such as the tax opinions rendered. I recognize that the legal and factual line between legal advice and tax return preparation or business advice may be difficult to draw. But there are some obvious cases. First, one might argue that anything a "promoter" does is not privileged as a promoter intends to market the tax opinion to more than one client. In addition, if the opinion is not based on facts supplied by the client in the context of rendering legal advice, there is no client communication to protect. Where the tax advice is given based on a set of hypothetical facts not posed by the client (as is often the case in marketed tax avoidance transactions), divulging that advice would not disclose a privileged communication by the client. There may be no attorney-client relationship with the potential investor; nor may there be an expectation of confidentiality. Finally, when the opinion is marketed, any privilege will be waived.

One should also keep in mind the potentially far ranging effect of a waiver. In many jurisdictions, including the D.C. Circuit, a waiver constitutes a "subject matter" waiver. That is, if privileged information is provided to third parties, the privilege for any communication related to that subject is waived. Thus, if an opinion on a transaction was once privileged, but the privilege is waived, there may be no privilege left to claim for any communications about the transaction, at least with respect to that advisor.

I would certainly argue that asserting the reasonable cause and good faith defense under section 6664 and using an opinion to establish reasonable cause waives privilege with respect to that opinion and all communications (and consequently other tax advice) relating to that transaction because the taxpayer has put at issue mental state or knowledge regarding the transaction. In addition, I cannot see how advice given by a company's independent auditors could be privileged regardless of whether the taxpayer's communication is to that firm's audit team or a tax partner of that firm. As the United States Supreme Court stated in Arthur Young, there can be no expectation that the communications by the client to a partner of the auditing firm would be privileged if the auditors have a duty to disclose publicly the propriety of financial statements made by the taxpayer, which have imbedded in them assumptions about tax positions. In fact, when I was in private practice, I always advised clients not to use their auditors for tax consulting work in which I was involved, out of concern that the attorney client privilege would be waived unless the general counsel of the firm was willing to opine that the tax partner was under no obligation to disclose communications that might reveal material facts to the auditing partner. I never met a lawyer who was willing to give that opinion.

I do not intend to encourage the IRS to challenge each and every privilege claim. We will respect claims that fall within the boundaries of the attorney-client privilege and tax practitioner privilege. But I do know those boundaries and have instructed Chief Counsel attorneys to examine carefully privilege assertions to ensure that they are proper. When we believe a claim falls outside those boundaries, you can expect us to challenge the claim. Likewise, when promoters and taxpayers intend to assert privilege, they should be careful to apply the privilege properly and should be prepared to substantiate each and every component of their privilege claim for each item individually. I have personally met with representatives of one promoter as part of our enforcement activity to discuss my intent to pursue summons enforcement actions and to challenge privilege claims that are without merit. In that case, the representatives decided to produce to the IRS the requested information. We are evaluating other summons enforcement actions relating to privilege claims, and I plan to pursue those actions vigorously, if necessary.

I also am reviewing other rules that might apply to tax practitioners when they withhold information from the IRS on grounds that such information is privileged. In particular, I am reviewing Circular 230 to determine whether there are ethical violations when tax practitioners make baseless claims of privilege. Section 10.20(a) of Circular 230 provides:

> “No attorney, certified public accountant, enrolled agent, or enrolled actuary shall neglect or refuse promptly to submit records or information in any matter before the Internal Revenue Service, upon proper and lawful request by a duly authorized officer or employee of the Internal Revenue Service, or shall interfere, or attempt to interfere, with any proper and lawful effort by the Internal Revenue Service or its officers or employees to obtain any such record or information, unless he believes in good faith and on reasonable grounds that such record or information is privileged or that the request for, or effort to obtain, such record or information is of doubtful legality.“

IRS requests for documents are set forth in “Information Document Requests” (“IDRs”). While informal, IDRs are properly directed toward relevant information in furtherance of a legitimate investigation and, as such, constitute requests by authorized agents for information. Unless privileged, the requested information must be produced to the IRS. Practitioners have an ethical duty to see that the requested information is produced. I believe that failures of this ethical duty should be sanctioned. And a violation of Circular 230 may be subject to sanction whether or not a summons enforcement action has commenced.

I intended the battle analogy I began with to be amusing. I do not want to leave you with the impression that the IRS views taxpayers or promoters as the enemy. Far from it. Our overarching goal and obligation to the tax system and to taxpayers is to fairly and impartially administer the tax rules to ensure that each taxpayer pays the amount of tax required by law – no more and no less. We assume that taxpayers want to comply with the rules, but we also need to ensure that taxpayers believe that others are complying with their obligations to pay. In fact, I assume that many in this room were as concerned as I was while in private practice that the IRS was not aggressively pursuing promoters and investors in these abusive transactions. While we must be careful not to interfere with legitimate tax planning, we must also curb abusive tax practices under which taxpayers take advantage of complex tax laws to obtain unintended tax benefits.

I am working very hard to make sure that the IRS wisely uses the tools at its disposal to find out about questionable transactions early and issue guidance on those transactions quickly. As part of this effort, the IRS will be careful and diligent in requesting the information it needs to ensure compliance with the Internal Revenue

Code. We will expect promoters and taxpayers to exercise the same care and diligence in responding to IRS requests for information and to follow their legal and ethical obligations in asserting privilege.

Remember the Alamo! I would be happy to take any questions.