

MEMORANDUM FOR COMMISSIONER, LARGE & MID-SIZE BUSINESS DIVISION
COMMISSIONER, SMALL BUSINESS/SELF EMPLOYED
DIVISION

FROM: Mark W. Everson
Commissioner of Internal Revenue

SUBJECT: Penalty Policy Statement of the Internal Revenue Service

The following new penalty policy statement is being issued in conjunction with the issuance of new final regulations under sections 6662 and 6664 and proposed revisions to the Rules of Practice before the Service (Circular 230). Please ensure that your employees are provided with a copy of this statement and implement its provisions immediately.

Promoters of abusive tax shelters have encouraged or arranged for taxpayers to obtain tax opinions regarding the tax shelters from tax advisors with a financial interest in the promotion of the tax shelters or a preexisting referral agreement with the promoter. Tax advisors having a financial interest or a referral agreement relating to a tax shelter are not disinterested or independent tax advisors concerning the merits of the tax shelter.

In some cases, taxpayers do not know of the tax advisor's financial interest or referral agreement. In other cases, taxpayers know or have reason to know of the financial interest or referral agreement, but disregard that interest to obtain a favorable opinion concerning the merits of the tax shelter. In either case, taxpayers seek to rely on the tax advisor's opinion to avoid imposition of the accuracy-related penalty under section 6662.

On December 29, 2003, Treasury and the Service issued proposed revisions to Circular 230 governing tax shelter opinions that address this lack of independence. The proposed rules mandate the disclosure of a tax advisor's referral agreement or financial interest in the promotion of tax shelters. The proposed rules also require that a marketed tax shelter opinion expressly state that taxpayers should seek advice on their individual circumstances from their own tax advisors. These disclosures will provide taxpayers with critical information to evaluate the quality and reliability of the advice they receive and put taxpayers on notice that they should seek independent tax advice.

Taxpayers may not rely on the advice of a tax advisor who has a financial arrangement or a referral agreement with a tax shelter promoter. The tax advisor's independent judgment is compromised by these arrangements and agreements. Accordingly, the Service will question the reasonableness and good faith of taxpayers who know or have reason to know that the tax advisor is not independent. The Service will not accept reliance on an opinion from a non-independent tax advisor as proof of reasonable cause and good faith on the part of the taxpayer.

The Service will scrutinize opinions from tax advisors who have financial interests in the tax shelter promotions as part of its broader effort to combat abusive tax shelters. The Service will impose appropriate penalties on taxpayers who rely on opinions from non-independent advisors regarding the merits of tax shelters. Accordingly, taxpayers should not rely on claims from tax advisors, who are not independent, that their opinions provide protection from accuracy-related penalties.

cc: Deputy Commissioner for Services and Enforcement
Acting Chief Counsel