TAX LAWYERS AS TAX INSURANCE

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ABSTRACT

Transactional tax lawyers, by rendering tax opinions, provide a version of insurance to clients. This insurance is clearly incomplete, but by providing a tax opinion, a lawyer conditionally agrees to indemnify the client for at least part of the potential loss the client incurs if the favorable tax treatment described in the opinion is successfully challenged. Although insurance is not the primary function of transactional tax lawyers, and although this Article does not argue that tax opinions should be regulated as insurance, indemnification—a key element of insurance—is an important part of the economic relationship between a client and a lawyer who provides a tax opinion. Surprisingly, this insurance-like function has been largely overlooked in the literature. Thus, by identifying and exploring the insurance-like aspect of the transactional tax lawyer's role, this Article fills a gap in the literature and offers a new framework for understanding the value of tax lawyers. Additionally, this Article argues that the insurance-like aspect of tax opinions has important implications for the profession, potentially affecting tax advisers' billing practices, the terms of client engagements, the design of tax opinions, the market for tax advice, and more.

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INTRODUCTION

Transactional tax lawyers, by rendering tax opinions, provide an element of insurance to clients. This insurance is clearly incomplete, but by providing a tax opinion, a lawyer conditionally agrees to indemnify the client for part of the potential loss the client incurs if the favorable tax treatment described in the opinion is successfully challenged. Thus, tax lawyers serve, at least partly, as tax insurers.

This insurance function is missing from the literature about the transactional tax lawyer's role. Ronald J. Gilson's seminal work, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, explains that transactional lawyers add value for clients by being "transaction cost engineers."[1] The voluminous literature that followed Gilson's article provided various other explanations, conceiving transactional lawyers as reputational intermediaries,[2] regulatory cost reducers,[3] enterprise designers,[4] transaction quarterbacks,[5] "risk managers,"[6] aggregators of information about market terms,[7] and more.[8] Considering transactional *tax* lawyers specifically, Victor Fleischer added the role of a "regulatory arbitrageur,"[9] who "tweak[s] a deal structure to achieve better regulatory

1. 94 YALE L.J. 239, 255 (1984).

2. *See, e.g.*, Karl S. Okamoto, *Reputation and the Value of Lawyers*, 74 OR. L. REV. 15, 15, 17-19 (1995).

3. *See, e.g.*, Steven L. Schwarcz, *Explaining the Value of Transactional Lawyering*, 12 STAN. J.L. BUS. & FIN. 486, 506 (2007).

4. *See, e.g.*, George W. Dent, Jr., *Business Lawyers as Enterprise Architects*, 64 BUS. LAW. 279, 299 (2009).

5. *See, e.g.*, Jeffrey M. Lipshaw, *Beetles, Frogs, and Lawyers: The Scientific Demarcation Problem in the Gilson Theory of Value Creation*, 46 WILLAMETTE L. REV. 139, 143 (2009).

6. Praveen Kosuri, *Beyond Gilson: The Art of Business Lawyering*, 19 LEWIS & CLARK L. REV. 463, 488-89 (2015).

7. *See, e.g.*, Elisabeth de Fontenay, *Law Firm Selection and the Value of Transactional Lawyering*, 41 J. CORP. L. 393, 396 (2015).

8. *See, e.g.*, Lisa Bernstein, *The Silicon Valley Lawyer as Transaction Cost Engineer?*, 74 OR. L. REV. 239, 240 & nn.7-11 (1995) (business advisers); Therese Maynard, *Teaching Professionalism: The Lawyer as a Professional*, 34 GA. L. REV. 895, 918 (2000) (someone who is relied upon for excellent judgment); James C. Freund, *Teaching Problem Solving: New Business Lawyers Need to Know How to Find the Deal: A Lawyer's Perspective*, BUS. L. TODAY, July/Aug. 1999, at 32, 36 (problem solvers).

9. Victor Fleischer, *Regulatory Arbitrage*, 89 TEX. L. REV. 227, 236-37 (2010).

treatment [for example, better tax treatment, thereby shifting value from the government to the deal parties] without unduly altering the underlying business arrangements."[10]

The insurance-like aspect of the lawyer-client relationship, however, has been largely overlooked until now. When the insurance aspect of opinions (tax or nontax) is mentioned in the literature, it is most commonly with a brief comment to the effect that "[a] legal opinion is not an insurance policy."[11] These comments, however, are typically made to assert that an opinion does "not guarantee[ ] that a court will reach any particular result."[12] But insurance need not promise a particular result or provide for 100 percent loss coverage if that result is not achieved. Arrangements can have aspects of insurance without providing a full guarantee of results.

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10. Victor Fleischer, *Taxing Blackstone*, 61 TAX L. REV. 89, 94 (2008); *see also* Fleischer, *supra* note 9, at 240.

11. Charles R. Beaudrot, Jr., *Transactional Skills Training: Opinion Letters*, TRANSACTIONS: TENN. J. BUS. L. 405, 410 (2009) (discussing nontax third-party opinions); *see also* Robert P. Rothman, *Tax Opinion Practice*, 64 TAX LAW. 301, 326 (2011) (citing M. JOHN STERBA, JR., LEGAL OPINION LETTERS § 12.9 (3d ed. 2003) (discussing tax opinions)). Examples of such comments arise in the general (as opposed to tax-specific) context. *See, e.g.*, DONALD W. GLAZER ET AL., GLAZER & FITZGIBBON ON LEGAL OPINIONS: DRAFTING, INTERPRETING AND SUPPORTING CLOSING OPINIONS IN BUSINESS TRANSACTIONS 15 (3d ed. 2008) ("Another benefit sometimes ascribed—wrongly—to a closing opinion is that it serves as an insurance policy."); STERBA, *supra*, § 12.12 (3d ed. 2018 Supp.) ("[L]awyers are not insurers of their opinions in the absence of an express agreement, [but] a nonspecialist who practices in a specialized field may end up as a de facto insurer of his or her work."); Comm. on Legal Ops., *Third-Party Legal Opinion Report, Including the Legal Opinion Accord, of the Section of Business Law, American Bar Association*, 47 BUS. LAW. 167, 171 (1991) ("By rendering a professional opinion, the opinion giver does not become an insurer or guarantor of the expression of professional judgment."). Examples also arise in the tax context. *See, e.g.*, Frederic G. Corneel, *Guidelines to Tax Practice Third*, 57 TAX LAW. 181, 184 (2003) (commenting that in the tax context, "[a]n opinion is rarely an insurance policy"); Calvin H. Johnson, *Ending Reliance on Tax Opinions of the Taxpayer's Own Lawyer*, 141 TAX NOTES 947, 948 (2013) ("Tax advisers are not insurers."); Robert G. Woodward, *Tax Opinions*, 2010 ABA TAX-CLE 0923078 (citing Committee on Legal Opinions, *supra*, at 171).

12. Comm. on Legal Ops., *Legal Opinion Principles*, 53 BUS. LAW. 831, 832 (1998); *see also, e.g.*, Comm. on Legal Ops., *supra* note 11, at 171; Rothman, *supra* note 11, at 326 (commenting that in the tax context "even a 'will' level opinion does not guarantee absolute certainty"); Steven L. Schwarcz, *The Limits of Lawyering: Legal Opinions in Structured Finance*, 84 TEX. L. REV. 1, 42 (2005) ("Opining lawyers ... are not ... the ultimate guarantors of legality."); TriBar Op. Comm., *Third-Party "Closing" Opinions*, 53 BUS. LAW. 592, 596 (1998); *cf.* Johnson, *supra* note 11, at 948 ("Tax advisers ... do not promise to pay the taxpayer's tax if the opinion fails.").

Thus, the brief assertions in the literature about opinions not being insurance are too conclusory.

The literature includes rare acknowledgments of the possibility that opinions contain insurance-like features. In the tax area, commentators occasionally mention that tax opinions may serve as "'insurance' against penalties."[13] These commentators typically put the word "insurance" in quotations and imply that tax opinions create a form of government-provided insurance because having an opinion may protect a client from penalties that the client would otherwise owe to the government.[14] These commentators do not, however, seem to contemplate the possibility that the client will recover from the *lawyer* if penalties are imposed.[15]

Outside the tax area, few commentators acknowledge the possibility of an insurance-like role for opinion-writing lawyers.[16] Of the two commentators who come closest, albeit in a nontax context, to the assertions made in this Article, one briefly—in three sentences—raises and sets aside the possibility that business lawyers could add value for a client by taking on some of the client's risk

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13. Jeffrey Morse & Marnin Michaels, *The Changing Role of the International Tax and Estate Planning Practitioner:* Pasquantino*, Circular 230—What's Next?*, 16 J. INT'L TAX'N 46, 51 (2005); *see also, e.g.*, Karen C. Burke & Grayson M.P. McCouch, *COBRA Strikes Back: Anatomy of a Tax Shelter*, 62 TAX LAW. 59, 65 n.27 (2008) (criticizing the marketing of tax opinions as "insurance"—a tool for "shielding a taxpayer from the 20% substantial-understatement penalty"); Leandra Lederman, *A Tisket, A Tasket: Basketing and Corporate Tax Shelters*, 88 WASH. U. L. REV. 557, 603 (2011) (noting that the revisions to Circular 230 were intended to "limit the use of tax opinions as 'penalty insurance' for shelters"); Charles H. Egerton, *ABA Members Seek More Guidance on Codification of Economic Substance Doctrine*, 2011 TAX NOTES TODAY 12-13 (Jan. 18, 2011) (discussing efforts to "dissuade[] taxpayers from viewing opinions as 'penalty insurance'").

14. *See, e.g.*, Morse & Michaels, *supra* note 13, at 51.

15. *See, e.g.*, *id.* at 49-52 (discussing possible adverse consequences, including fines, censure, disbarment and even criminal sanctions, for a lawyer who renders tax opinions, but never mentioning the possibility that a client could recover from a lawyer on account of the tax opinion).

16. Other commentators describe a "lawyer-as-insurer" role where the lawyer drafts detailed contracts that shift risk among parties to the deal but not to the lawyer herself. *See* Robert A. Kagan & Robert Eli Rosen, *On the Social Significance of Large Law Firm Practice*, 37 STAN. L. REV. 399, 415-17 (1985). Another "lawyer-as-insurer" concept contemplates the opinion-writing lawyer primarily as a guarantor to third parties of the veracity of the client's representations. *See* Mark C. Suchman & Mia L. Cahill, *The Hired Gun as Facilitator: Lawyers and the Suppression of Business Disputes in Silicon Valley*, 21 LAW & SOC. INQUIRY 679, 694-97 (1996).

via the possibility of a malpractice claim.[17] The other commentator, who provides a slightly longer discussion in two separate articles,[18] approached third-party closing opinion practice primarily through a sociological study rather than through a detailed legal analysis as provided herein.[19] His findings offer a relatively limited account of the insurance role of third-party closing opinions,[20] but he suggested that the insurance-like function of closing opinions may increase in the future.[21] Moreover, he implied that tax opinions, in contrast to third-party closing opinions that were his focus, might be a special case.[22]

The absence of meaningful scholarly attention to the insurance-like function of tax lawyers is surprising because, as this Article demonstrates, the risk shifting from clients to tax opinion-givers can be meaningful and can affect important aspects of the lawyer/client relationship. Specifically, understanding tax opinions through an insurance lens can affect tax advisers' billing practices, the terms of client engagements, the design of tax opinions, the market for tax advice, and more. Appreciating the tax lawyer's indemnification role is especially important now, after the enactment of the most sweeping tax changes in more than thirty years.[23] The new tax laws bring tremendous uncertainty, which means that clients will be even more dependent on guidance (including opinions) from their tax advisers.[24] Thus, this Article fills the gap in the literature by identifying,

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17. *See* Schwarcz, *supra* note 3, at 493, 495 (dismissing the insurance construct because of hurdles to malpractice recovery, because there are more effective ways for clients to protect against bad outcomes, and because insurance-like risk-shifting was outside the scope of the article).

18. *See* Jonathan C. Lipson, *Cost-Benefit Analysis and Third-Party Opinion Practice*, 63 BUS. LAW. 1187, 1201-03 (2008) [hereinafter Lipson, *CBA*]; Jonathan C. Lipson, *Price, Path & Pride: Third-Party Closing Opinion Practice among U.S. Lawyers (A Preliminary Investigation)*, 3 BERKELEY BUS. L.J. 59, 102-09, 124 (2005) [hereinafter Lipson, *Price*].

19. *See* Lipson, *Price*, *supra* note 18, at 127.

20. Very generally, he concluded that third-party opinion practice places the lawyer "in harm's way to a greater extent than in perhaps any other aspect of business law practice," but that concern about reputation and other considerations, rather than fears about liability, may feel more pressing to these lawyers. *See id.* at 104-05, 108-13, 124.

21. *See id.* at 65.

22. *See* Lipson, *CBA*, *supra* note 18, at 1201.

23. *See generally* Act of Dec. 22, 2017, Pub. L. No. 115-97, 131 Stat. 2054 (2017) (to be codified in 26 U.S.C.).

24. *See, e.g.*, Lee A. Sheppard, *Transatlantic Tax Planning Tips*, 94 TAX NOTES INT'L 477, 477 (2018) ("Even with the U.S. Treasury's yeoman efforts to issue TCJA guidance,

exploring, and explaining the consequences of the insurance-like aspect of the transactional tax lawyer's role.

This Article examines only transactional *tax* lawyers, and leaves for future study how the insurance-like paradigm resonates in other transactional practices. It is certainly possible that transactional lawyers in practice areas outside of tax may also serve an insurance-like function when they provide opinions. This Article, however, focuses on the tax context, both because of my expertise and because of features of tax law and tax practice (for example, the centrality of tax opinions to tax practice,[25] the history of professional liability payouts related to tax shelters and tax shelter opinions,[26] and Circular 230's detailed ethical obligations applicable only to tax practice[27]) that may cause the indemnity function of opinions to have particular resonance in the tax context.

To be clear, this Article does not argue that the *primary or predominant* function of transactional tax lawyers is to provide insurance, nor does this Article assert that tax opinions, or their providers, should be *regulated* as insurance (or insurers). Rather, this Article argues that indemnification (in other words, one element of insurance) is *part* of the economic relationship between a client and a lawyer who provides a tax opinion, and that the insurance paradigm is an important additional lens through which to understand the role of transactional tax lawyers and the value they provide.

Moreover, this Article acknowledges that the risk shifting accomplished by tax opinions is neither unidirectional nor complete. Tax opinions, by creating penalty-free zones in some cases,[28] can also shift some of the risks and costs of incorrect positions from the taxpayer to the government. And given the barriers to malpractice recoveries and how carefully tax opinions are often written to protect the opinion writer, a taxpayer does retain a significant portion of the risk for taking positions that are successfully challenged.[29]

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practitioners on both sides of the Atlantic face uncertainty in advising on cross-border transactions and structures.").

25. *See infra* notes 38-42 and accompanying text.

26. *See infra* notes 261-63 and accompanying text.

27. *See infra* notes 180-82 and accompanying text.

28. *See supra* note 13.

29. The liability arising from an unsuccessful tax position falls on the taxpayer who took

Yet, as this Article demonstrates, tax opinions do shift some portion of that risk from the taxpayer to the opinion writer.

In addition, this Article's claim is descriptive, not normative. Should tax lawyers be required (or allowed) to indemnify their clients for the liability arising from successful challenges to tax positions on which the lawyers opined? Should the law be adjusted to emphasize or deemphasize the tax lawyer's indemnification obligation? Would increasing the extent to which and frequency with which tax advisors indemnify their clients (for example, by lowering the hurdles to malpractice recoveries or increasing the damages that are recoverable)[30] cause advisors to give more conservative advice, thereby increasing tax compliance? Or would doing so hinder compliance by encouraging taxpayers to take riskier positions than they otherwise would because of their ability to recover the costs from their advisors if the positions are wrong?[31] Are tax lawyers effective at managing and distributing risks of client losses or should the large-scale transfer and distribution of tax risks be left to third-party tax insurers? If the latter, does that portend a rise in the market for third-party tax insurers and a decline in tax opinions? These important questions are outside the scope of this Article. They cannot be answered without first examining the extent to which transactional tax lawyers are currently serving an insurance-like role. Only once that baseline is understood can normative questions be engaged effectively. This Article, by identifying that and explaining the extent to which transactional tax lawyers serve an insurance-like function, provides a critical step in understanding and evaluating the risk-shifting dynamic between clients and their tax lawyers.

This Article proceeds as follows. Part I provides background on transactional tax practice in general, tax opinion practice specifically, and tax insurance available from third-party insurers. Part II

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the position. Thus, when discussing the potential shifting of that risk, this Article will generally discuss any such risk ultimately borne by the taxpayer as being "retained" by the taxpayer and will discuss any risk borne by another party as being "shifted" to that party.

30. *See* Jay A. Soled, *Tax Shelter Malpractice Cases and Their Implications for Tax Compliance*, 58 AM. U. L. REV. 267, 316-22, 326-27 (2008).

31. *See* 1 NEW APPLEMAN ON INSURANCE LAW LIBRARY EDITION § 1.01[4][b] (Jeffrey E. Thomas ed., 2017) [hereinafter APPLEMAN] (explaining that insurance can create a moral hazard).

draws an analogy between tax opinions and third-party tax insurance to demonstrate how the former are similar to the latter. Part III examines the extent to which tax opinions reflect traditional indicia of insurance. Part IV discusses evidence, including from malpractice insurance claims data, illustrating how the indemnity function of tax opinions resonates in the reality of tax practice. Part V discusses several implications of understanding the tax lawyer/client relationship through the insurance lens.

I. TAX ADVICE, TAX OPINIONS, AND THIRD-PARTY TAX INSURANCE

This Part provides background on the role of transactional tax advisers, tax opinion practice, and third-party tax insurance.

A. Transactional Tax Advising

Transactional tax lawyers provide clients with tax advice on a wide variety of matters, including corporate mergers, acquisitions and dispositions (domestic and cross-border); acquisitions/dispositions of major assets; choice of entity decisions; internal restructurings and transfer pricing for multi-national enterprises; real estate transactions (including REIT formation/qualification and Section 1031 exchanges); capital markets transactions; structured finance transactions; fund formation/operations (for example, for private equity funds or hedge funds); tax-equity investing transactions (for example, involving monetization of tax credits); qualification for favorable tax status (for example, as a Section 501(c)(3) organization or an S corporation); the availability of particular tax benefits (for example, deductions); and, of course, tax avoidance/shelter transactions. All of these transactions have material tax consequences and potential liability if the tax planning is successfully challenged, so good tax advice is critical.

1. In General

In these transactions, the tax lawyer will typically analyze the transaction and work with the client and other lawyers to try to structure the matter to achieve the client's business goals while

minimizing tax costs.[32] The lawyer will inform the client about the tax consequences that arise from the transaction's structure, advise the client about opportunities for improving the tax treatment, and counsel the client about the risks and benefits of different approaches, all as part of helping the client determine whether and how to proceed.[33] The transactional tax lawyer may also render a formal tax opinion about the tax consequences, and the tax lawyer may discuss with the client the possibility of obtaining tax insurance.[34]

In addition, a transactional tax lawyer also often helps implement the transaction. For example, a transactional tax lawyer typically drafts and negotiates the tax representations, warranties, covenants, and other tax-related provisions in the agreement(s) governing the transaction. The transactional tax lawyer may conduct, or at least review, tax diligence about target businesses/assets and help the client mitigate (for example, through additional representations or indemnities) any risks that are revealed.[35] If the matter involves soliciting investors or asking shareholders to vote, a disclosure document describing the transaction will typically be prepared, and the transactional tax lawyer will draft the tax portions of the disclosure document, explaining the material tax consequences of the investing, voting, or other choice presented.[36]

Through these actions and more, transactional tax lawyers add value for clients in many of the ways described in the literature.[37]

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32. *See generally* Heather M. Field, *Giving Useful Tax Planning Advice*, 134 TAX NOTES 1299, 1302 (2012) (explaining that part of the role of a tax advisor, particularly on transactional matters, is to "help [the] client achieve its business objectives in tax-efficient ways").

33. *See generally id.* at 1302-03.

34. *See infra* Parts III.A.2 & III.B.

35. *Cf. generally* 5 MARTIN D. GINSBURG ET AL., MERGERS, ACQUISITIONS, AND BUYOUTS (Dec. 2018) (providing a variety of sample transaction agreements from buyer, seller, and neutral perspectives, with annotations, to assist tax lawyers as they draft and negotiate deal documents).

36. *Cf.* Omri Marian, *Reconciling Tax Law and Securities Regulation*, 48 U. MICH. J.L. REFORM 1, 6-10 (2014) (discussing considerations relevant to the requirements for, and the contents of, tax disclosures).

37. For example, she helps the client manage tax risks, including by drafting and negotiating contractual provisions (such as representations, warranties, and indemnities) that shift risk away from the client to other parties in the transaction. *See* Kosuri, *supra* note 6, at 466-81.

2. Tax Opinion Practice

Tax opinions are an important part of the practice of a transactional tax lawyer. A tax opinion is a formal written statement of the law firm's opinion about the tax consequences of the matter.[38] Although many types of written advice can express tax opinions,[39] formal opinions are said to be "the pinnacle of legal advice."[40] They are a "central part of a tax adviser's practice,"[41] and their prominence is expected to grow even more.[42]

Formal tax opinions generally use a common structure. They are generally rendered on the firm's letterhead, and they typically describe the role of the lawyer, the materials reviewed, and the purpose of the opinion.[43] They include disclaimers; a description of the facts, representations, and assumptions on which the opinion is based; the legal analysis (for complex or uncertain matters); the statement of certainty about the tax treatment; and any restrictions on use of the opinion.[44] These opinions often rely on lawyer-drafted representation letters or certificates signed by the client and other parties to the transaction, in which the client and other parties attest to a variety of factual matters relevant to the lawyer's analysis.[45]

When preparing tax opinions, lawyers must comply with the applicable ethical constraints,[46] including the standards of practice

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38. *See* Rothman, *supra* note 11, at 301-11; Woodward, *supra* note 11, at 3.

39. *See* STERBA, *supra* note 11, § 1.1; Robert W. Wood, *Liability for Tax Opinions: What's an Opinion and Who Can Sue?*, TAXES, Jan. 2008, at 53-54.

40. Rothman, *supra* note 11, at 301.

41. Woodward, *supra* note 11, at 4. *But cf.* Schwarcz, *supra* note 3, at 488 n.15, 531 (finding that opinion practice constituted only approximately 5-15 percent of transactional lawyers' work, although reaching this finding in a study that did not include transactional *tax* lawyers).

42. *See* Jasper L. Cummings, Jr., *Tax Opinion Practice Today*, 145 TAX NOTES 1049, 1049 (2014) (tax opinions are "on the rise").

43. *See* Rothman, *supra* note 11, at 361-66.

44. *See id.*; *see also* LINDA GALLER & MICHAEL B. LANG, REGULATION OF TAX PRACTICE 150 (2d ed. 2016); Woodward, *supra* note 11, at 20-22.

45. *See* Cummings, *supra* note 42, at 1049 (critiquing how tax certificates are prepared for use in opinion practice).

46. *See, e.g.*, ABA Comm'n on Ethics & Prof'l Responsibility, Formal Op. 85-352 (1985) (regarding advising on reporting positions); ABA Comm'n on Ethics & Prof'l Responsibility, Formal Op. 346 (1982) (regarding tax advice for marketed tax shelters).

articulated in IRS Circular 230,[47] which includes specific requirements for written tax advice.[48] The practitioner's analysis for a tax opinion typically requires significant effort,[49] and opinions, including tax opinions, are often subject to heightened risk management procedures in law firms (for example, approval by a firm's opinion committee).[50]

The key part of a tax opinion is the statement pertaining to the firm's confidence in the tax treatment of the transaction. Opinions are rendered at various levels of confidence.[51] Terms of art are used to articulate the firm's confidence about how likely it is that a particular tax treatment will be sustained on the merits if challenged.[52] Levels of comfort range from "will" on the high end (approximately 95 percent or greater chance of success on the merits)[53] to "reasonable basis" on the lower end[54] (approximately 20-30 percent chance of success on the merits).[55] Opinions are also commonly rendered at "should" (approximately 70-75 percent), "more likely than not" (greater than 50 percent), and "substantial authority" (approximately 35-40 percent) levels, and opinion levels are sometimes qualified with phrases such as "although not free from doubt."[56]

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47. 31 C.F.R. § 10 (2017) [hereinafter Circular 230].

48. *Id.* § 10.37.

49. *See* Dennis J. Ventry, Jr. & Bradley T. Borden, *Probability, Professionalism, and Protecting Taxpayers*, 68 TAX LAW. 83, 94-95 (2014).

50. *See* Woodward, *supra* note 11, at 35-36; *see also* Circular 230 § 10.36 (procedures to ensure compliance with tax practitioners' ethical obligations). *See generally* Legal Ops. Comm. of the ABA Section of Bus. Law, *Report on the 2010 Survey of Law Firm Opinion Practices*, 68 BUS. LAW. 785, 787-93 (2013) (discussing firms' opinion procedures for nontax opinions).

51. *See* Rothman, *supra* note 11, at 311.

52. *See id.*

53. *See id.* at 312, 327.

54. *See* GALLER & LANG, *supra* note 44, at 151. An opinion could also be rendered at a "not frivolous" level, which might reflect around a 5-10 percent chance of success on the merits, but this opinion level is relatively uncommon. *See* Ventry & Borden, *supra* note 49, at 89; *see also* Rothman, *supra* note 11, at 324-25 (describing "not frivolous" as "the lowest level at which there is some modicum of comfort as to a position," and noting that "the not frivolous standard does not come up very often in the context of formal opinions").

55. *See* Rothman, *supra* note 11, at 322-24, 327; *see also* Treas. Reg. § 1.6662-3(b)(3) (defining "reasonable basis").

56. *See* GALLER & LANG, *supra* note 44, at 150-53; *see also* Rothman, *supra* note 11, at 312-27. Some of these opinion levels are explicitly defined in the regulations. *See, e.g.*, Treas. Reg. § 1.6662-3(b)(3) (2017) (defining "reasonable basis"); *id.* § 1.6662-4(d) (defining "substantial authority").

Formal tax opinions are used for a variety of purposes.[57] Opinions can be used to provide the client with comfort about the tax consequences of the transaction.[58] Opinions may satisfy a contractual condition; for example, the closing of a corporate acquisition may be conditioned on the receipt of a tax opinion that the acquisition will qualify as a tax-free reorganization within the meaning of Section 368 of the Code.[59] Opinions are also used to induce others to take a particular action (for example, invest).[60] Opinions are sometimes sought to assist clients in defending against the possible imposition of penalties if the desired tax treatment is not sustained.[61] And tax opinions are increasingly used to provide information needed for determining how an uncertain tax position should be reflected on a company's financial statements under Financial Accounting Standards Board Interpretation Number 48 (FIN 48).[62]

The purpose of the opinion will often dictate the minimum confidence level at which the client wants the opinion to be rendered.[63] For example, if an opinion will be used to solicit third parties to invest, the strength of the tax opinion may affect the pricing of the deal (because investors might pay less if the tax benefits are less certain), so a stronger opinion may be preferred.[64] Under FIN 48, a taxpayer cannot book an uncertain tax benefit at all if the tax benefit is not "more likely than not" to be sustained.[65] And to assist with penalty protection, the tax position generally needs to be supported by "reasonable basis," "substantial authority," or more.[66]

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57. *See* GALLER & LANG, *supra* note 44, at 150-51; *see also* Rothman, *supra* note 11, at 301-11; Woodward, *supra* note 11, at 13-19.

58. *See* Rothman, *supra* note 11, at 302.

59. *See* Woodard, *supra* note 11, at 13. All references to the "Code" in this Article refer to the Internal Revenue Code of 1986, as amended.

60. *See* Rothman, *supra* note 11, at 303-04.

61. *See id.* at 307-08.

62. *See id.* at 308-09.

63. *See* Heather M. Field, *Aggressive Tax Planning & the Ethical Tax Lawyer*, 36 VA. TAX REV. 261, 271-74 (2017) (summarizing the consequences of tax opinion levels).

64. *See id.* at 274.

65. *See* FIN. ACCT. STANDARDS BD., *FASB Interpretation No. 48: Accounting for Uncertainty in Income Taxes, An Interpretation of FASB Statement No. 109*, FIN. ACC. Series No. 281-B (June 2006).

66. *See, e.g.*, I.R.C. § 6662(d)(2)(B) (2017) (reducing the taxpayer's accuracy-related penalty for substantial understatement if a position had substantial authority or, if disclosed, had reasonable basis). If the transaction is a tax shelter, substantial authority or reasonable basis is generally not enough. *Id.* § 6662(d)(2)(C). The availability of penalty reduction is

Clients, even clients who seek formal tax opinions to assist with penalty protection, generally want the favorable tax treatment described in the opinion to be sustained.[67] If the tax position addressed in the opinion is not sustained, a client wants protection from penalties, but a rational client generally prefers that the tax position be sustained in the first instance so that the favorable tax treatment is obtained and penalties do not become an issue.[68]

Regardless of the purpose for which the tax opinion was obtained, if the tax treatment described in the formal tax opinion is not sustained, the client is likely to be unhappy and may sue the lawyer.[69] These are generally malpractice cases,[70] commonly on tort

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based on whether the particular tax position actually had the articulated level of support, and not on what an opinion may have said about the strength of the position. *See id.* § 6662(d)(2)(B). However, the opinion can establish the legal basis for concluding that a position has the requisite support. *See* Treas. Reg. § 1.6662-4(d) (2017). In some circumstances, tax opinions can also be relied upon to enable a "reasonable cause" and "good faith" reduction of the taxpayer's penalty. *See, e.g.*, I.R.C. § 6664(c)(1) (2017). *But see infra* notes 346-49 and accompanying text (discussing limits on taxpayer reliance on an opinion to reduce penalties).

67. *See* Robert W. Wood, *What Good is a Tax Opinion, Anyway?*, 128 TAX NOTES 1071, 1071 (2010). Clients also care about contest costs. Ideally, clients prefer the position not be contested at all, so that the desired tax treatment is obtained and no controversy costs are incurred. However, if there is a controversy, the client would like to prevail while minimizing controversy costs. *Cf. id.* An opinion may help expedite the controversy process, thereby reducing contest costs.

68. *See id.*

69. *See* STERBA, *supra* note 11, § 12.1.

70. *See, e.g.*, ATTORNEYS' LIAB. ASSURANCE SOC'Y, RECENT CLAIMS TRENDS IN THE TAX PRACTICE 1-4 (2011) [hereinafter ALAS], http://cc.talkpoint.com/alas001/40522/written.pdf [https://perma.cc/G4BU-MVLF] (discussing tax malpractice claims that arise from tax opinions related to tax shelters and "taxpayer's disappointment in how a transaction played out"); DOUGLAS R. RICHMOND ET AL., THE AON CLAIMS EXPERIENCE 7 (2015), https://www.americanbar.org/content/dam/aba/events/professional_responsibility/2017%20Meetings/Conference/conference_materials/session5_mistakes_coping_ethically/summer_2015_qar.pdf [https://perma.cc/HY7B-TACM] (describing Aon's malpractice claims experience and citing "allegedly faulty tax opinions" as examples of "substantive errors" alleged in malpractice claims). *See generally* Jacob L. Todres, *Malpractice and the Tax Practitioner: An Analysis of the Areas in Which Malpractice Occurs*, 48 EMORY L.J. 547 (1999) [hereinafter Todres I]; Jacob L. Todres, *Tax Malpractice: Areas in Which it Occurs and the Measure of Damages—An Update*, 78 ST. JOHN'S L. REV. 1011 (2004) [hereinafter Todres II]; Jacob L. Todres, *Tax Malpractice Damages: A Comprehensive Review of the Elements and the Issues*, 61 TAX LAW 705 (2008) [hereinafter Todres III]; Jacob L. Todres, *Bad Tax Shelters—Accountability or the Lack Thereof: Ten Years of Tax Malpractice*, 66 BAYLOR L. REV. 602 (2014) [hereinafter Todres IV).

(negligence) or contract grounds.[71] Briefly, for a malpractice action to succeed under either a tort or contract theory, the lawyer generally must have failed to meet the standard of care, which requires the "exercise [of] reasonable competence and diligence."[72] Damages sought typically include

> additional taxes resulting from ... malpractice [which may be less than the total taxes that the taxpayer owes if such taxes were unavoidable and thus not the result of the adviser's negligence], interest and penalties ... and corrective costs incurred in attempting to eliminate or mitigate all or some of the foregoing damages.[73]

There is evidence of recoveries on tax malpractice claims,[74] and in particular, there have been some very high-profile malpractice claims (and payouts) for failed tax shelter opinions.[75]

B. Third-Party Tax Insurance

For some matters, clients will obtain tax insurance from a third-party insurance company that is not otherwise involved in the transaction. This insurance, which goes by various names including tax liability insurance, tax risk insurance, and tax indemnity

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71. *See* Todres III, *supra* note 70, at 708. The claim of attorney liability may also be based on federal securities law if the opinion was part of materials used in a securities offering. *See* Wood, *supra* note 39, at 59-61. Practitioners can also be subject to a wide variety of other adverse consequences as a result of a bad tax opinion, including

> disciplinary action by state or federal authorities, a civil suit under any number of legal theories, including aiding and abetting liability, RICO statutes, unfair trade practice laws, wire or mail fraud, or securities laws, or other common law theories, penalties under the Internal Revenue Code, criminal prosecution by state or federal authorities.

STERBA, *supra* note 11, at § 12.1 (footnotes omitted).

72. Todres II, *supra* note 70, at 1016; *see infra* Part III.B.2.a.

73. Todres III, *supra* note 70, at 712; *see also infra* Part III.B.2.b.

74. *See* Todres IV, *supra* note 70, at 606-07; *see also infra* Part IV.A.

75. *See, e.g.*, Denney v. Jenkens & Gilchrist, 230 F.R.D. 317, 324 (S.D.N.Y. 2005) (describing a class-action settlement in which malpractice carriers paid out over $70 million, the firm paid $5.25 million, and individual defendants paid $6.25 million); *see also* Soled, *supra* note 30, at 332 (providing a table detailing tax malpractice claims against high-profile defendants).

insurance,[76] is a tax-specific form of transaction insurance.[77] Briefly, third-party tax insurance[78] is a contract between a taxpayer and an insurance company pursuant to which the taxpayer pays a premium to the insurer, and in exchange, the insurer agrees to indemnify the taxpayer from losses that arise if the insured tax treatment is successfully challenged.[79]

Third-party tax insurance may be available for a wide variety of matters, including "tax-free reorganizations/mergers, Section 355 spin-offs, REITs/real estate acquisitions/sales, S corp qualification/ 338(h)(10) elections, partnership issues, employee benefits issues (including 409A), NOLs, federal or state tax credits (renewable energy ITC, low income housing, etc.), and transfer pricing."[80] Tax insurers typically will not, however, provide insurance for tax shelters, reportable or listed transactions, "abusive schemes" or "weakly supported tax positions."[81]

The process for obtaining tax insurance is often relatively brief and can be completed in as little as fifteen days.[82] Typically, a taxpayer seeking insurance submits information about the transaction (for example, tax analysis done by the taxpayer's lawyer) to insurers to obtain a quote for the coverage.[83] Assuming at least one insurer indicates interest in providing the insurance,[84] the taxpayer

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76. *See* Jeffrey H. Kahn, *Hedging the IRS—A Policy Justification for Excluding Liability and Insurance Proceeds*, 26 YALE J. ON REG. 1, 2 & n.4 (2009); Kyle D. Logue, *Tax Law Uncertainty and the Role of Tax Insurance*, 25 VA. TAX REV. 339, 343 (2005).

77. *See generally* 4 APPLEMAN, *supra* note 31, at § 32.01 (discussing various transactional insurance products).

78. This Article will generally refer to tax insurance obtained from an insurance company as "third-party tax insurance" to clarify that the insurance is not provided by a party (for example, the lawyer) who is otherwise involved in the underlying transaction.

79. *See* 4 APPLEMAN, *supra* note 31, § 32.03; Richard A. Wolfe, *Tax Indemnity Insurance: A Valuable and Evolving Tool for Managing Tax Risks*, *in* 28 THE CORPORATE TAX PRACTICE SERIES: STRATEGIES FOR ACQUISITIONS, DISPOSITIONS, SPIN-OFFS, JOINT VENTURES, FINANCINGS, REORGANIZATIONS & RESTRUCTURINGS ch. 445, at 445-22 to -45 (Louis S. Freeman ed., Tax Law and Practice, Course Handbook Ser. No. J-954, 2014).

80. DANIEL SCHOENBERG, AON, THE COMMERCIAL, STRATEGIC, AND LEGAL IMPLICATIONS OF TAX INSURANCE: HOW, WHEN AND WHERE TO USE IT 5 (Mar. 2016).

81. Letter from David S. De Berry, Vice President, The Hartford, to the Internal Revenue Serv., 2003 TAX NOTES TODAY 3-57 (commenting on Temporary Regulation § 1.6011-4T); *see also* 4 APPLEMAN, *supra* note 31, § 32.03[5][a].

82. SCHOENBERG, *supra* note 80, at 7.

83. *Id.*

84. *See* Kahn, *supra* note 76, at 7 (reporting a tax insurance industry professional's estimate that "over half of tax insurance applications are refused").

selects an insurer. Then, the insurer engages in a more detailed review of the transaction and its tax analysis,[85] and the insurer and the taxpayer negotiate the details of the policy that the insurer is underwriting.[86] The lump-sum charged for the insurance is typically a small percentage of the policy limits.[87]

If the insured tax treatment is successfully challenged, the policy requires the insurer to indemnify the taxpayer for losses, which typically include "(i) any taxes legally owed by the insured arising solely from an insured tax event; plus (ii) any interest[,] penalties, contest expenses and gross-up."[88] The insured taxpayer typically retains responsibility for a certain amount of losses before the insurer becomes responsible (in other words, a retention or deductible), and the coverage provided by the indemnity is typically subject to a cap.[89] Each policy will specify a period, typically tied to the statute of limitations for the tax issue, during which the insured can make a claim.[90] Third-party tax insurance policies generally do not impose a duty on the insurer to defend the insured tax treatment from a government challenge, but the tax insurer does typically retain the right to approve any settlement of a contest.[91] In addition, if the tax insurer covers a taxpayer's losses, the insurer often has the right to pursue a subrogation claim against the taxpayer's adviser who advised on, and who may have written an opinion on, the insured matter.[92]

More broadly, third-party tax insurance is typically used as a risk management strategy because it "can help a company reduce or eliminate an unwanted or contingent liability arising from a successful challenge by ... the IRS and/or other taxing authority of a

85. SCHOENBERG, *supra* note 80, at 7.

86. *Id.* at 7.

87. *See id.* at 9, 13 (giving examples with premiums less than 5 percent); Laura Davison, *Tax Insurers Eye Mega-Deals as Sector Hits $1 Billion Mark*, BLOOMBERG BNA (Nov. 28, 2016), https://www.bna.com/tax-insurers-eye-n73014447652/ [https://perma.cc/T2E7-GBDK] ("[P]remiums usually cost about 4 percent to 7 percent of the policy coverage.").

88. 4 APPLEMAN, *supra* note 31, § 32.03[3]. "A 'Gross-Up' means the amount by which a payment under the policy must be increased to take into account any federal income taxes which will be imposed on the insured in respect of such payment." *Id.* § 32.03[2].

89. Wolfe, *supra* note 79, at 445-25 to -30.

90. *See* 4 APPLEMAN, *supra* note 31, § 32.03[7].

91. *Id.* § 32.03[4]; Wolfe, *supra* note 79, at 445-41 to -45.

92. *See* 4 APPLEMAN, *supra* note 31, § 32.03[12]; Logue, *supra* note 76, at 389.

company's tax treatment of a current, pending or historical transaction or investment."[93]

Although tax liability insurance has been around for a long time,[94] it has historically been relatively uncommon in the United States,[95] but the industry has grown significantly in recent years[96] and is expected to continue to grow.[97]

II. THE SUBSTITUTABILITY OF TAX OPINIONS AND THIRD-PARTY TAX INSURANCE

Although there are differences between tax opinions and third-party tax insurance policies, both are used by taxpayers to obtain the comfort needed to allow them to proceed with their transactions despite tax uncertainty.[98] Thus, both tax opinions and

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93. SCHOENBERG, *supra* note 80, at 4; *see also* PETER ROSEN & GARY BLITZ, AM. COLL. COVERAGE & EXTRACONTRACTUAL COUNSEL, TRENDS AND FEATURES OF TRANSACTIONAL LIABILITY INSURANCE AND ITS EFFECTS ON THE M&A MARKETPLACE 2 (2017), https://accec.memberclicks.net/assets/LawSchoolSymposium-UMich/accec_symposium_2017michigan_papers_transactionalliability_rosen.pdf [https://perma.cc/BQX7-DSX2] ("A tax indemnity policy can be used to improve the odds of execution by bridging the gap between a buyer's evaluation of a particular tax issue and the seller's evaluation of the same issue.").

94. Tax insurance dates back to "the early 1980's, when Lloyd's of London first provided tax insurance for leasing transactions." ROSEN & BLITZ, *supra* note 93, at 2.

95. *See id.* at 2 (noting that early liability insurance was limited and not of much use); Logue, *supra* note 76, at 343-44 (noting in 2005 that, "tax risk insurance is a recent development and is still only a niche market" but that "there are reports that the tax indemnity insurance market is growing rapidly").

96. As of 2016, the tax insurance industry has grown enough to underwrite a policy as big as $1 billion. Davison, *supra* note 87 (remarking that "[t]hese insurance policies are graduating from middle-market deals"). The aggregate value of policy limits has also risen fairly dramatically, even since 2013. For example, Aon's transactional liability insurance policy limits (including *tax and nontax* transaction insurance) totaled approximately $2.1 billion in 2013 and approximately $12.6 billion in 2016. ROSEN & BLITZ, *supra* note 93, at 3 (explaining that, in 2016, tax insurance policies comprised almost 20 percent of the $12.6 billion policy limits, implying that the tax insurance policy limits *alone* totaled approximately $2.5 billion in 2016). Part of this growth is attributed to streamlined diligence processes and the addition of new insurers to the marketplace. *Id.* In addition, Revenue Procedure 2014-12 identified tax insurance as a preferred strategy for managing risks for tax credit equity investments, which may give taxpayers more confidence in the value of using tax insurance. *See* Davison, *supra* note 87 (discussing the revenue procedure).

97. *See* Davison, *supra* note 87 (commenting, in 2016, that "[t]he industry is at the 'precipice' of being discussed in the boardrooms of large publicly traded companies," and quoting an industry insider as saying, "[t]here is a lot of runway left in this [tax insurance] market").

98. *See* SCHOENBERG, *supra* note 80, at 6 (articulating reasons for using third-party tax

third-party tax insurance policies help taxpayers manage risks associated with uncertain tax positions.[99]

Moreover, both function as, and are discussed as, alternatives to obtaining private letter rulings (PLRs) from the government.[100] Of course, neither a tax opinion nor a third-party insurance policy is binding on the government, and so both contemplate that the desired tax treatment might not be sustained.[101] However, both are perceived to provide more certainty about the tax consequences than a taxpayer would have without either.[102] Taxpayers typically rely on tax opinions and/or third-party tax insurance, rather than PLRs, if, for example, the transaction is on a timeline that is too fast to allow for obtaining a PLR, which typically takes several months.[103] In addition, taxpayers commonly use these alternatives to get tax comfort on the many issues on which the IRS will not provide PLRs.[104] The decline in areas in which the IRS will provide

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insurance); Woodward, *supra* note 11, at 13 ("[V]ery generally, the purpose of a tax opinion is to provide the opinion giver's client with some level ... of comfort or assurance regarding the tax treatment or consequences relating to a particular transaction or series of transactions.").

99. Taxpayers use other risk management tools as well, including representations, warranties, and indemnities, which shift risk among the parties to the transaction rather than between the client and the lawyer. *See* Kahn, *supra* note 76, at 7; Logue, *supra* note 76, at 385-86. Other tools for risk-shifting among the taxpayer and its tax advisor include tax advisors warranties, which generally operate as money-back guarantees that give the taxpayer a refund of some or all of the fees paid to the adviser if the tax benefit is not obtained; these warranties are generally limited to fees paid (plus sometimes interest and penalties) but do not generally cover broader losses that may arise from the adviser's error. *See* Kahn, *supra* note 76, at 5; Logue, *supra* note 76, at 382-83.

100. *See, e.g.*, Robert W. Wood, *Tax Opinion or Private Letter Ruling? A 12-Point Comparison*, 149 TAX NOTES 835 (2015) (discussing the choice between tax opinions and PLRs); George Wang, Counsel, Haynes & Boone LLP, Remarks at the Deal Lawyers Program on Transaction Insurance as a M&A Strategic Tool (Oct. 7, 2015) [hereinafter Transaction Insurance], http://www.aon.com/risk-services/asats/aon-insights/transaction-insurance.jsp [https://perma.cc/V4Q9-EX82] ("On the tax indemnity side, you can think of this insurance as an alternative to a private letter ruling from the IRS.").

101. *See* Wood, *supra* note 100 (discussing tax opinions); Transaction Insurance, *supra* note 100 (discussing tax insurance).

102. *See* Wood, *supra* note 100 (discussing tax opinions); Transaction Insurance, *supra* note 100 (discussing tax insurance).

103. *See* SCHOENBERG, *supra* note 80, at 7 (explaining that tax insurance can be obtained in as little as fifteen days); Wood, *supra* note 100 ("Rulings take time. An opinion can be knocked out in days or weeks. A ruling takes weeks or months (usually you should assume six months or more).").

104. *See* Rev. Proc. 2019-3, 2019-1 I.R.B. 130 (listing domestic no-rule areas); Rev. Proc. 2019-7, 2019-1 I.R.B. 268 (listing international no-rule areas); *see also* Wolfe, *supra* note 79,

PLRs has contributed to the increased use of both tax opinions and third-party tax insurance.[105] Given that both tax opinions and third-party tax insurance are alternatives to PLRs for coping with tax uncertainty, they are also alternatives to each other.[106]

There are several other similarities as well. Both tax opinions and third-party tax insurance are bespoke (that is, tailored to a given situation's facts and analysis).[107] In both, tax experts (either the lawyer writing the opinion or experts hired by the insurance company) carefully analyze the transaction to determine the likely tax consequences and the likelihood that those tax consequences will be achieved.[108] When doing so, both rely on factual representations by the taxpayer, and misrepresentations will preclude a taxpayer from recovering; similarly, both are subject to exclusions and carve-outs (for example, for future changes in law), which limit the potential financial exposure of the lawyer (for tax opinions) and the insurer (for third-party tax insurance).[109]

There is also overlap between the types of transactions for which tax opinions and third-party tax insurance are obtained. Both are

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at 445-12 to -16 (providing examples where third-party tax insurance provides a useful alternative to a PLR); Wood, *supra* note 100 (suggesting the use of tax opinions when PLRs are not available).

105. *See, e.g.*, Cummings, *supra* note 42, at 1049 (attributing the growth in tax opinions to the growth of the IRS's no-rule list); Amy S. Elliott, *Greater Reliance on Tax Liability Insurance Raises Questions*, 149 TAX NOTES 477 (2015) ("As the IRS Office of Associate Chief Counsel (Corporate) expands the scope of its no-rule policy to turn away more tax-free spinoff transactions, taxpayers are increasingly relying on the [tax] insurance market to manage the risks."); Kenneth A. Gary, *New Opportunity for Tax Lawyers: Insuring Tax Transactions*, 104 TAX NOTES 26 (2004) ("[H]eavy interest in policies insuring tax results for specific transactions in the wake of the IRS's giving 'no rule' status to more issues.").

106. STERBA, *supra* note 11, § 7.1 (discussing tax opinions, tax insurance, and PLRs as alternatives to each other).

107. *See* Woodward, *supra* note 11, at 21-23 (illustrating that the process for tax opinions is tailored to the specific facts and circumstances of the situation); Transaction Insurance, *supra* note 100 ("These [tax indemnity] policies are negotiated with the underwriter to fit the specific needs of the parties and issues at hand.").

108. *See* Circular 230 §§ 10.35, 10.37 (articulating requirements for rendering written advice, including tax opinions); Gary, *supra* note 105 (describing insurance companies' needs for expert tax input on transactions in order to assess risk); Kahn, *supra* note 76, at 8 (describing the process for a client to receive third-party tax insurance); Woodward, *supra* note 11, at 22 (explaining that rendering a tax opinion requires expert analysis); De Berry, *supra* note 81 (describing their process when issuing a tax insurance policy).

109. *See* 4 APPLEMAN, *supra* note 31, § 32.03[5][a], [b] (tax insurance); Wolfe, *supra* note 79, at 445-31 to -32 (tax insurance); Woodward, *supra* note 11, at 21-23 (tax opinions).

used to increase tax certainty for mergers and acquisitions, REIT and other favorable tax statuses, cross-border tax structuring, tax credit transactions, et cetera.[110] However, third-party tax insurers generally do not insure any transaction that is a shelter, reportable or listed transaction, or where the insured tax treatment is not more likely than not to succeed.[111] This approach precludes third-party tax insurers from providing pure penalty protection insurance (in other words, they will generally not insure the tax treatment of a matter if there is only substantial authority or reasonable basis for the position).[112] Thus, at this point in the development of the third-party tax insurance industry,[113] insurers have been relatively conservative about which transactions they will insure.[114] In contrast, and although tax opinion practices vary by lawyer and firm, some firms and some lawyers will write opinions for aggressive transactions, including for reportable or listed transactions and for matters on which the desired tax treatment is only supported by substantial authority or reasonable basis.[115] Thus, while there is substantial overlap in the transactions for which a tax opinion or tax insurance might be obtained, tax opinions are available more broadly and can increase a taxpayer's tax certainty in situations where third-party tax insurance may be unavailable.

Whether a taxpayer has obtained a tax opinion or third-party tax insurance, the taxpayer has some expectation of protection if the tax position is not sustained,[116] but the certainty and magnitude of any such protection does differ. With tax insurance, the insured is

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110. *See supra* notes 57-60, 80 and accompanying text.

111. *See* Transaction Insurance, *supra* note 100 ("[T]he sweet spot for the carriers, on any tax issue, is about a 'should' level of comfort and above. But really, for anything that's a 'more likely than not' or above, it's worth giving us a call to see if we can do something."). An insurer may also decline to insure a tax position even if reputable counsel gives a "more likely than not" opinion, particularly if the matter is a shelter. 4 APPLEMAN, *supra* note 31, § 32.03[8]; *supra* note 81 and accompanying text.

112. *See supra* note 66.

113. Insurers could become more aggressive as the market develops and becomes more competitive. *See* Logue, *supra* note 76, at 400.

114. *See* Kahn, *supra* note 76, at 8; De Berry, *supra* note 81, at 2 (arguing that insurers are, and are "rewarded" for being, conservative).

115. *See supra* note 66 and accompanying text.

116. *See infra* Part IV.B (discussing that disappointed clients sue lawyers who rendered bad tax opinions); *supra* note 88 and accompanying text (discussing losses covered by tax insurance).

certain to recover if a loss is sustained, assuming that the insured has otherwise abided by the terms of the insurance contract.[117] In contrast, with tax opinions, recovery is uncertain, even if a loss is sustained, because recovery for a bad tax opinion depends on the malpractice rules, pursuant to which a client typically only recovers if the lawyer failed to meet the applicable standard of care.[118] Similarly, the magnitude of the recovery from a lawyer who wrote a tax opinion generally depends on proof of damages, and courts vary as to how they define damages, meaning that, in some cases, the client might only be able to recover a very small amount.[119] In contrast, the magnitude of recovery from a third-party insurer is typically clearer, as it merely depends on the magnitude of the loss sustained and the contract terms (for example, the contract's coverage cap).[120] Thus, the amount of a potential recovery on account of a tax opinion is less certain and may differ in magnitude as compared to the potential recovery from an insurance policy, but the former is technically uncapped, whereas the latter is generally capped.

There are several other differences between tax opinions and third-party tax insurance policies, including the fee, period for recovery, and the timing and degree of the lawyer/insurer's involvement in the matter. The fee for third-party tax insurance is typically calculated as a percentage of the coverage (with that percentage based partly on the risk involved),[121] whereas the fee for a tax opinion is typically calculated based on the billable hours spent by the lawyers preparing the opinion, although sometimes lawyers charge a flat fee.[122] The period for recovery is specified in the third-party tax insurance contract; the period for making claims is typically six years and is often selected based on the tax law's applicable statute of limitations.[123] In contrast, the period for potential

117. *See* Wolfe, *supra* note 79, at 445-34 to -40.

118. *See infra* Part III.B.2.a.

119. *See infra* Part III.B.2.b.

120. *See* 4 APPLEMAN, *supra* note 31, § 32.03[2]-[3] (adding that there can still be disputes about defined losses); Wolfe, *supra* note 79, at 445-25 to -30.

121. *See* Wolfe, *supra* note 79, at 445-24 to -25.

122. *See infra* notes 309-12 and accompanying text.

123. 4 APPLEMAN, *supra* note 31, § 32.03[7]; AON, MANAGING TAX RISK THROUGH TAX INSURANCE (2016), http://www.aon.com/taxinsurance/attachments/US-Tax-brochure-Web-version.pdf [https://perma.cc/46Q9-CUZS].

recovery on account of a tax opinion depends on the jurisdiction's statute of limitations for malpractice actions.[124] As to involvement by the lawyer/insurer, the lawyer preparing a tax opinion is usually heavily involved ex ante with structuring the transaction and typically provides advice that may increase the likelihood that the desired tax benefits will be sustained;[125] however, the lawyer who writes the tax opinion is not typically the same counsel that defends the matter if the tax position is challenged by the government. In contrast, the third-party tax insurer is typically not very involved in the ex ante tax structuring; the insurer typically focuses on evaluating and pricing insurance for the transaction as it is presented to them.[126] The insurer has more involvement ex post if the tax treatment is challenged. Specifically, the insurer often has the right to be involved in the defense of the tax treatment, and although insurers may not take control of the defense of the matter, they generally retain the right to approve of important decisions in the handling of the case, including whether to settle with the government.[127]

Although there are many similarities between tax opinions and third-party tax insurance policies, the differences make clear that they are not perfect substitutes for each other. This notion is confirmed by the fact that sometimes taxpayers obtain both tax opinions and third-party tax insurance on the same matter.[128] There may be many reasons to do so, including that having a tax opinion can expedite the underwriting process for the third-party tax insurance.[129] There are also many reasons a client might prefer third-party tax insurance over a tax opinion or vice versa.[130] For example,

124. *See* Jacob L. Todres, *Investment in a Bad Tax Shelter: Malpractice Recovery from the Tax Adviser Is No Slam Dunk*, 107 TAX NOTES 217 (2005) (discussing the statute of limitations in tax malpractice cases).

125. *See* Wood, *supra* note 100, at 836.

126. *See* 4 APPLEMAN, *supra* note 31, § 32.03[10].

127. *See* Wolfe, *supra* note 79, at 445-41 to -45; AON, *supra* note 123.

128. *See, e.g.*, Robert Willens & Harley G.A. Wright, *Tax-Free Real Estate Spinoffs: Will They Catch On?*, 94 TAX NOTES 619, 621 (2002) (discussing a transaction on which both a tax opinion and tax liability insurance were obtained).

129. *See* ROSEN & BLITZ, *supra* note 93, at 2.

130. *See, e.g.*, SCHOENBERG, *supra* note 80, at 14 (giving an example of where third-party tax insurance was helpful in part because "no tax opinion was available"); Davison, *supra* note 87 (quoting insurance executives who suggested that a transaction that failed to close because counsel could not render a tax opinion could have closed if tax insurance (rather than

a taxpayer concerned with whether to take a reserve on its balance sheet for an uncertain tax position in accordance with FIN 48 might only need a tax opinion (so that the company can conclude that the tax benefits are certain enough to book),[131] but a taxpayer who is more concerned with cash flow if the desired position is not sustained would likely want third-party tax insurance.[132]

Ultimately, while there are some (sometimes significant) differences between the availability of, details of, and degree of protection afforded by tax opinions and third-party tax insurance, both increase comfort with respect to, and reduce the risks associated with, uncertain tax positions. And both are used as substitutes for each other and for PLRs. Understanding the similarities and differences between tax opinions and third-party tax insurance provides insight into the extent of their substitutability and helps to demonstrate how tax lawyers, through their tax opinions, serve partly as tax insurers.

III. INDICIA OF INSURANCE INHERENT IN TAX OPINIONS

Understanding the insurance-like aspect of tax opinions requires going beyond drawing parallels to third-party tax insurance. It requires an analysis of the extent to which tax opinions reflect traditional indicia of insurance.

The precise definition of insurance subject to regulation varies from state to state,[133] but "[t]he essence of insurance is a transaction where risk is transferred to another and then distributed across a pool of similarly situated persons or properties."[134] Thus, "[t]hree concepts are central to an insurance contract: risk; risk transference; and risk distribution."[135] This Part examines the extent to which tax opinions involve these three elements.

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an opinion) was a condition to closing).

131. *Cf.* FIN. ACCT. STANDARDS BD., *supra* note 65, at 3-4.

132. *See supra* note 117 and accompanying text (explaining that third-party tax insurance generally ensures a recovery if a loss is sustained).

133. *See* 1 APPLEMAN, *supra* note 31, § 1.03[3][a].

134. *Id.* § 1.01[3]; *see also* STEVEN PLITT ET AL., COUCH ON INSURANCE 3D § 1.6 (supp. 2018) [hereinafter COUCH].

135. 1 APPLEMAN, *supra* note 31, § 1.03[1].

As explained below, tax opinions reflect some indicia of insurance but do not fit perfectly within the definition. However, because this Article is not arguing that tax opinions ought to be regulated as insurance under state law, the lack of a perfect fit is not problematic. The fact that tax opinions ought not to be *regulated* as insurance does not mean that there is not an insurance-like element inherent in tax opinions. Thus, this Part uses the legal definition of "insurance" as a tool to identify the extent to which the economic relationship between tax opinion-givers and clients includes features of insurance. That is, this analysis identifies tax opinions as "insurance-like"—as one of a "number of other relationships" (aside from things that are actually regulated as insurance) "that closely resemble the insurance agreement and may, for some purposes, be claimed to be the equivalent of insurance"[136] even though they are "so intimately entwined with [an]other field[ ] of law that [their] insurance character is secondary."[137]

A. Insurable Risk

Insurance requires an insurable risk, meaning that there must be a "risk" and the insured must have an "insurable interest" in the specific thing that is at risk.[138]

1. "Risk"

The concept of "risk" requires uncertainty or fortuity. "[T]he loss must be one that is uncertain to occur or [that is] unpredictable and outside the substantial control of the parties."[139] "[T]he loss must be accidental in some sense,"[140] and the contract must be aleatory in that the insurer's obligation "depend[s] upon some contingent event"[141] and that there is a possibility that "the insurer[ ] will never have to perform."[142]

136. COUCH, *supra* note 134, § 1.12.
137. *Id.* § 1.13.
138. 1 APPLEMAN, *supra* note 31, § 1.05[3]; *see also* COUCH, *supra* note 134, § 1.6.
139. 1 APPLEMAN, *supra* note 31, § 1.03[2]; *see also id.* § 1.05[2].
140. *Id.* § 1.05[2][a] (elaborating on the fortuity principle).
141. COUCH, *supra* note 134, § 1.10.
142. *Id.* § 1.10, n.10 (citing Root v. Am. Equity Specialty Ins., 30 Cal. Rptr. 3d 631 (Cal. Ct.

The tax treatment that is the subject of a tax opinion, while not perfectly fortuitous, is uncertain, which is why a tax opinion is obtained. Whether the tax treatment addressed in the opinion is sustained depends on whether the client is audited, which issues are raised upon audit, what arguments are made by the government and the taxpayer in the contest, and how the government and/or the court perceives those arguments.[143] Of course, the tax lawyer can make predictions about these issues and can help the client to structure the transaction to reduce the risks, but the tax law and its application to a particular set of facts are often uncertain.[144] Thus, whether the taxpayer's desired tax treatment described in an opinion is ultimately obtained is, at least to some degree, dependent on chance.

Indeed, the existence of the third-party tax insurance market supports this conclusion because third-party tax insurance and tax opinions often cover the same type of risks.[145] If these risks did not reflect sufficient fortuity, there could be no tax insurance policies covering them.[146]

2. "Insurable Interest"

In addition to the existence of "risk," the insured must have an "insurable interest" in the risk. Typically, insurance requires that the insured has a "lawful and substantial economic interest in the safety or preservation of property from loss, destruction or pecuniary damage."[147] The insured's economic interest in the "specific

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App. 2005)).

143. Even when the taxpayer has a strong position, there can be an audit, with drawn-out, expensive, and uncertain litigation. *See* Wood, *supra* note 100.

144. *See generally* Sarah B. Lawsky, *Probably? Understanding Tax Law's Uncertainty*, 157 U. PA. L. REV. 1017 (2009) (discussing probability statements in tax as subjectivist, meaning that they should be understood as reflecting the speaker's belief about the likelihood something will occur).

145. *See supra* notes 98-99, 110 and accompanying text.

146. *See* 1 APPLEMAN, *supra* note 31, § 1.05[2][a] ("The public policy underlying the fortuity requirement is so strong that if the insurance policy itself does not expressly require that the loss be accidental courts will imply such a requirement.").

147. *Id.* § 1.05[3] (citation omitted).

'thing'" that could be "destroyed or injured"[148] distinguishes insurance from gambling.[149]

With a tax opinion, the taxpayer is taking a position that it is entitled to favorable tax treatment, which yields an economic benefit to the taxpayer.[150] If that tax treatment is not sustained, then that economic benefit would be reduced or completely eliminated, and in some circumstances, the taxpayer could suffer further economic loss in the form of penalties, contest costs, et cetera.[151] Thus, a taxpayer has an insurable risk in the particular tax treatment that is the subject of a tax opinion. Again, this conclusion is supported by the existence of third-party tax insurance that insures taxpayers for similar matters.

B. Transfer of Risk

Insurance also requires the "assumption of a risk of loss" and an "undertaking to indemnify the insured against such loss."[152] In typical insurance policies, the risk is transferred explicitly via a contract providing that, in exchange for a fee, the insurer agrees to indemnify the insured against the risk of loss.[153]

As discussed below, tax opinions involve the transfer of risk from the client to the lawyer. However, the risk transference via tax opinions is somewhat different than in traditional insurance because (1) the risk transfer agreement is implicit, rather than explicit; (2) the extent of the indemnity provided depends on the application of the laws governing malpractice cases; and (3) the transfer of risk is not the principle object and purpose of the tax opinion. This Part will elaborate on these key aspects of the risk transference achieved via tax opinions.

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148. COUCH, *supra* note 134, § 1.6.

149. 1 APPLEMAN, *supra* note 31, § 1.05[3]. *See generally* Kendall J. Burr et al., *Stranger-Initiated Annuity Transactions and the Case for Insurable Interest*, 19 CONN. INS. L.J. 113, 128-30 (2012) (discussing the "insurable interest" requirement as preventing wagering on human lives).

150. *See supra* note 67 and accompanying text.

151. *See supra* note 73 and accompanying text.

152. COUCH, *supra* note 134, § 1.9.

153. *Id.* § 1.10; *see also* 1 APPLEMAN, *supra* note 31, §§ 1.05[4], 1.07.

1. The Risk Transfer Is Implicit

The opinion-writer's agreement to accept some of the client's risk of loss arises implicitly via the operation of the malpractice rules. When the lawyer agrees to provide the client with a tax opinion, she does so against the backdrop of default rules, including those regarding malpractice, which govern the lawyer-client relationship.[154] These rules apply and become part of the terms of the lawyer-client engagement unless the parties explicitly opt out. The Model Rules of Professional Conduct[155] restrict a lawyer's ability to enter into a contract with a client that limits the lawyer's malpractice liability, but such agreements are allowed if "the client is independently represented in making the agreement."[156] As a result, any lawyer who provides a tax opinion and who does not limit her malpractice exposure in accordance with the ethical rules implicitly agrees to indemnify the client for losses to the extent required by

154. *See supra* note 72 and accompanying text. Liability on the lawyer could also be imposed via securities laws and other theories, but malpractice liability is the most common and is thus the focus of this discussion.

155. The Model Rules are used in this Article as the applicable ethical standards governing lawyers' behavior because they have been adopted in some form in most states. 1 GEOFFREY C. HAZARD, JR. ET AL., THE LAW OF LAWYERING § 1.15 B (4th ed. 2018). Each lawyer should, of course, analyze her obligations under the version of the ethical rules that apply in her jurisdiction. *See generally* AM. BAR ASS'N, JURISDICTIONAL RULES COMPARISON CHARTS (Oct. 30, 2018), https://www.americanbar.org/groups/professional_responsibility/policy/rule_charts/#1 [https://perma.cc/6ACE-2EE9] (providing information about "how each jurisdiction has modified (or, in the case of California, proposes to modify) each of the ABA Model Rules of Professional Conduct").

156. MODEL RULES OF PROF'L CONDUCT r. 1.8(h)(1) & cmt. 14 (AM. BAR ASS'N 2017) (restricting a lawyer's ability to contractually limit her prospective liability for malpractice). These rules vary state-to-state, so lawyers should check the applicable rules in the jurisdiction in which they practice. *See, e.g.*, CAL. RULES OF PROF'L CONDUCT r. 3-400(a) (Sept. 14, 1992) (not allowing lawyers to contractually limit malpractice liability); N.Y. RULES OF PROF'L CONDUCT § 1.8(h)(1) (Apr. 1, 2018) (same). *See generally* AM. BAR ASS'N CPR POLICY IMPLEMENTATION COMMITTEE, VARIATIONS OF THE ABA MODEL RULES OF PROF'L CONDUCT r. 1.8: CONFLICT OF INTEREST: CURRENT CLIENTS: SPECIFIC RULES (Sept. 29, 2017), https://www.americanbar.org/content/dam/aba/administrative/professional_responsibility/mrpc_1_8.pdf [https://perma.cc/GLZ4-6RP4] (identifying state-by-state deviations from Model Rule 1.8). Tax accountants may have more flexibility to limit the applicability of the malpractice rules, thereby making it easier for them to avoid accepting as much risk when rendering tax opinions. *See, e.g.*, Aaron v. Deloitte Tax LLP, 2016 WL 4430495 (N.Y. Sup. Ct. 2016), *aff'd* 149 A.D.3d 580 (N.Y. App. Div. 2017) (enforcing a contract pursuant to which client contractually agreed to shorten the time within which it could sue Deloitte for malpractice).

the laws governing malpractice claims.[157] Although this risk transfer agreement is implicit rather than explicit as in typical insurance, tax opinions do involve an agreement to indemnify.[158]

2. The Extent of the Risk Transferred Is Limited by Requirements for Malpractice Recovery

The extent of the lawyer's agreement to indemnify is, however, limited by the laws governing malpractice recoveries. An unhappy client who sues her tax lawyer for malpractice often does so on either a tort (typically negligence) or contract theory.[159] Suits on other grounds are possible as well.[160] Focusing on the most common

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157. *See infra* Part V.B. (arguing that tax advisors who are concerned about the insurance-like aspects of tax opinions might want to do more to prospectively limit their malpractice liability).

158. Any risk transfer achieved by a tax opinion is via an *indemnity* obligation (that is, where the lawyer may provide "compensation necessary to reimburse the [client's] loss," and where the lawyer's obligation to compensate for malpractice liability is owed directly to the client and not to third parties such as the government). *See* 1 APPLEMAN, *supra* note 31, § 1.05[4]; COUCH, *supra* note 134, § 103.4. However, neither the laws governing malpractice liability nor the tax law penalties imposed upon tax advisors cause the lawyer to *assume* the client's risk of loss; the lawyer, by issuing a tax opinion, does not become directly and personally liable to the government for the taxes, interest, or penalties that the client owes. *See generally* 1 RONALD E. MALLEN, LEGAL MALPRACTICE chs. 6-7 (2018) (discussing limited scope of malpractice liability to nonclients); *see also, e.g.*, I.R.C. §§ 6694, 6700, 6701 (2012) (imposing penalties on tax preparers, but not obligating the preparer to be liable for the client's taxes due); Circular 230 § 10.50(c) (allowing the imposition of monetary penalties on a tax practitioner, but not providing that amounts paid by the lawyer would satisfy the *client's* tax obligations). This difference between indemnification and assumption may matter because some definitions of insurance require more than an agreement to indemnify another for risk of loss; they also require the actual "assumption of another's risk." COUCH, *supra* note 134, § 1.6 (citing Garcia v. City of Bridgeport, 51 A.3d 1089 (Conn. 2012)); *see also In re* Texas Ass'n of Sch. Bds., 169 S.W.3d 653, 658-59 (Tex. 2005) (explaining that insurance involves "*assuming the risk* ... in exchange for the premium payment" and not merely "promising to compensate the insured for an actual ... loss"). Thus, the lack of an actual assumption of risk may cause the opinion-writer/client relationship to fail to qualify as "insurance" under some definitions. Nevertheless, it remains clear that tax opinions transfer some risk of loss from client to lawyer, albeit via an indemnity and not an assumption. The presence of risk transfer via an implicit indemnification agreement is sufficient to support this Article's contention that tax lawyers, by providing tax opinions, are serving an insurance-like function, even though that function may not meet the definition of "insurance" for purposes of regulation.

159. *See* 1 MALLEN, *supra* note 158, § 8.28.

160. *See* STERBA, *supra* note 11, § 12.1 (listing other possible claims); *see also* Todres III, *supra* note 70, at 709-10. Different claims may result in, for example, different statutes of limitations, different damage measures, and differing abilities to recover for legal fees. *See*

grounds for tax malpractice cases, a client alleging malpractice must establish the following: "(1) a duty owed by the attorney to the plaintiff; (2) breach of that duty; (3) injuries suffered by the plaintiff; and (4) a proximate cause between the injury suffered and the breach of duty."[161]

Taken together, these requirements for malpractice recovery impose two key limitations on the extent of the risk transferred, and thus on the indemnity implicitly agreed to, by a lawyer who renders a tax opinion. First, the tax opinion-giver's indemnification obligation is conditional, and it exists only if she has breached the applicable standard of care.[162] Second, the amount of that indemnification obligation will be limited to the damages that arise from the lawyer's breach, as "damages" are understood in the malpractice context.[163] Thus, the risk that a lawyer accepts when providing a tax opinion is both conditional and partial.

a. Indemnification Is Conditional on Breach of Standard of Care

A tax opinion-writer's indemnification obligation is conditional because merely being wrong when providing legal advice generally does not result in malpractice liability. For a disgruntled client to recover under a negligence tort or contract theory, the lawyer must have done more than make a "mere error in judgment"; she must have failed to meet the applicable standard of care.[164] The standards of care for tort-based and contract-based malpractice actions are "virtually identical" despite "emanating from different areas of the law."[165] Specifically, a lawyer "must exercise reasonable competence

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id. at 708-10.

161. Todres I, *supra* note 70, at 552 (citing BERNARD WOLFMAN ET AL., STANDARDS OF TAX PRACTICE 312 (1997)).

162. *See infra* Part III.B.2.a.

163. *See infra* Part III.B.2.b.

164. Todres I, *supra* note 70, at 558; *see also* Woodward, *supra* note 11, at 7. *See generally* 2 MALLEN, *supra* note 158, § 17.27.

165. Todres II, *supra* note 70, at 1016.

and diligence."[166] Failure to do so is a prerequisite for any recovery in a negligence tort or contract malpractice action in court.[167]

The fact that any indemnity provided via a malpractice claim is conditional on the *lawyer's* (that is, the "insurer's") behavior is quite different from typical insurance. With typical insurance, the insurer's obligation to indemnify is "conditional in a number of aspects," including the "need for a loss to fall within the contract's terms as to covered perils," finality of the loss, and the *insured's* compliance with its obligations (for example, to provide truthful representations and/or mitigate loss).[168] Similar conditions apply to recovery for tax malpractice. For example, an opinion-writer's obligation to indemnify a client for liability arising from an unsuccessful tax position is contingent on the truthfulness of client's representations on which the tax opinion reasonably relies,[169] although the opinion-writer generally cannot use the client's representations to escape liability if the opinion-writer knew the representations to be false.[170] However, an insurer's obligation is generally not contingent on behavior of the *insurer* itself; if there is a loss within the meaning of the insurance contract and the loss is not subject to an exclusion included in the contract, the insurer is generally obligated to indemnify the insured. In contrast, a lawyer is obligated to indemnify a client for a bad tax opinion only if the lawyer failed to meet her standard of care.[171] Thus, the conditionality of the indemnity provided by a tax opinion giver is an important way in which tax opinions differ from typical insurance.

Nevertheless, the liability imposed on a tax opinion writer may be less conditional than a basic recitation of the malpractice standards may suggest. This is for several reasons.

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166. *Id.*; *see also* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS §§ 48-53 (AM. LAW INST. 2000); 2 MALLEN, *supra* note 158, § 20.2 ("Determining the reasonableness of the lawyer's conduct requires consideration of the following criteria: (1) the requisite skill and knowledge; (2) the degree of skill and knowledge to be possessed and exercised; (3) the effect of local considerations and custom; and (4) any special abilities possessed by the lawyer.").

167. *See supra* notes 159, 161 and accompanying text.

168. COUCH, *supra* note 134, § 1.10.

169. Circular 230 § 10.37(a)(2)(iv) (requiring a tax opinion-writer's reliance on representations be reasonable).

170. *See, e.g.*, Kline v. First W. Gov't Sec., Inc., 24 F.3d 480, 486-87 (3d Cir. 1994).

171. *See* Todres I, *supra* note 70, at 558.

First, tax lawyers are subject to a heightened standard of care because tax is a specialized area. In general, to meet the standard of care, "an attorney should exercise the skill and knowledge ordinarily possessed by attorneys under similar circumstances."[172] Where, as in tax law, the practice "requires special knowledge and skills," the practitioner will be held to the standard of care that would ordinarily be exercised by a specialist.[173] Thus, the standard of care in tax matters is heightened,[174] meaning that it may be easier to breach than in nonspecialty areas.

Moreover, the standard of care relevant in opinion matters, as compared to less formal advice, may be especially high. Formal tax opinions are typically sought from experts only on particularly important or difficult matters, and formal tax opinions have been described as "the pinnacle of legal advice"[175] and "one of the more specialized tasks tax lawyers undertake."[176] As a result, commentators emphasize the importance of being particularly prudent when rendering tax opinions[177] and note that "[m]ost attorneys view formal opinions as the type of work product that calls for the highest standard of care."[178] Thus, the applicable standard of care in tax *opinion* matters may be even higher than in tax matters that are less pressing, less difficult, less formal, and less specialized and that could be handled by a general tax attorney, rather than a specialist in the particular tax issues critical to the tax opinion.[179] Again, the higher the standard of care, the easier it may be to breach, thereby increasing the chance of an indemnity via a malpractice claim.

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172. 2 MALLEN, *supra* note 158, § 20.2; RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS, *supra* note 166, § 52(1).

173. 4 MALLEN, *supra* note 158, § 35.5; *see also* Horne v. Peckham, 158 Cal. Rptr. 714 (Cal. Ct. App. 1979) (holding that where expert assistance is needed, the practitioner will be held to the standard expected of an expert); Todres I, *supra* note 70, at 553-59.

174. *See* STERBA, *supra* note 11, § 12.11; Todres I, *supra* note 70, at 553-54; Todres IV, *supra* note 70, at 609.

175. Rothman, *supra* note 11, at 301.

176. Wood, *supra* note 67, at 1071.

177. *See, e.g.*, Corneel, *supra* note 11, at 184; Wood, *supra* note 39, at 65; Woodward, *supra* note 11, at 4 (describing rendering tax opinions as "a hazardous activity").

178. Rothman, *supra* note 11, at 361.

179. *See* 4 MALLEN, *supra* note 158, § 35.5 (distinguishing between the degree of expertise expected from those who practice tax in highly specialized areas); Michael B. Lang, *Tax Malpractice: Issues and Avoidance*, 54 TAX MGMT. MEMO. (BNA) 19 (2013) (making similar points).

Second, tax lawyers are subject to an extra set of ethics guidelines—Circular 230[180]—that apply to lawyers (and others) who "practice before the [IRS]"[181] in addition to the general ethical rules applicable to all lawyers in the lawyer's jurisdiction. Circular 230 provides specific standards to which tax advisers must adhere both in general and when providing written advice such as a tax opinion.[182]

Both the broadly applicable legal ethics rules and the tax-specific standards of practice may be relevant when establishing whether a tax lawyer met the applicable standard of care. In general, the Model Rules of Professional Conduct provide that a "[v]iolation of a Rule should not itself give rise to a cause of action against a lawyer nor should it create any presumption in such a case that a legal duty has been breached.... [The Model Rules] are not designed to be a basis for civil liability."[183] However, the Model Rules also provide that "since the Rules do establish standards of conduct by lawyers, a lawyer's violation of a Rule may be evidence of breach of the applicable standard of conduct."[184] Similarly, given that Circular 230 establishes standards of conduct by tax practitioners, a tax advisor's violation of Circular 230 may be evidence of breach of the standard of conduct applicable to tax practitioners.[185] Ultimately, the existence of additional standards of practice in the tax context (that is, beyond those that apply to all lawyers) means that the relevant ethical standards impose more requirements on tax

180. Circular 230 § 10.

181. *Id.* §§ 10.0, 10.2(a)(4), 10.3 (applying Circular 230 to tax lawyers, CPAs, enrolled agents, and more).

182. *Id.* § 10.37.

183. MODEL RULES OF PROF'L CONDUCT pmbl. ¶ 20 (AM. BAR ASS'N 2017).

184. *Id. See generally* 1 MALLEN, *supra* note 158, § 1.19; 2 *id.* § 15.12 (discussing the relationship between malpractice and ethics rules); 1 HAZARD ET AL., *supra* note 155, § 5.01 (discussing the same).

185. Technically, Circular 230 does not explicitly address the relationship between the standards of practice articulated therein and potential malpractice liability. However, the principles articulated in the Model Rules about the relevance of the ethics rules to the standard for civil liability should arguably apply not only to state bar ethics rules but also Circular 230 rules that "parallel state bar ethics rules or are otherwise designed to protect clients." Lang, *supra* note 179; *see also* GALLER & LANG, *supra* note 44, at 293. Many of the Circular 230 rules are designed to protect clients. *See, e.g.*, Circular 230 §§ 10.35, 10.37 (setting standards for competence and for written advice). Thus, it is reasonable to use these rules as guidance about the standard of care that tax advisors must meet as part of their duty to clients.

practitioners than on other lawyers. Where there are more requirements with which a lawyer should comply, there may be more opportunities to fail to do so. As a result, it may be easier for a client to establish that the tax lawyer breached her standard of care.

Relatedly, the IRS Office of Professional Responsibility (OPR), which is responsible for enforcing Circular 230,[186] may operate to assist a client pursuing a malpractice claim against a tax lawyer. OPR exists in addition to the State Bar Associations that enforce the ethics rules applicable to lawyers in the State.[187] If a tax lawyer is subject to an OPR investigation that results in an adverse determination, that could help the client establish the lawyer's failure to meet the applicable standard of care.[188] This could be helpful for an aggrieved client in the same way as if the Department of Justice (DOJ) or State Bar Association reached an agreement with a lawyer in which the lawyer admitted misconduct; such an admission "helps establish the taxpayer's case for adviser malfeasance."[189] Admittedly, OPR's disciplinary actions typically involve matters unrelated to tax opinions,[190] but it is at least possible that OPR could become involved in a matter involving an opinion-writer. And the existence of a body tasked with enforcing the tax-specific standards of practice means that tax clients may have another ally (that is, beyond those agencies that focus on compliance of all lawyers with the generally applicable ethical rules)—OPR—if they are claiming, in a malpractice action, that a tax lawyer failed to meet her professional responsibilities.

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186. *OPR: Frequently Asked Questions (FAQ's)*, IRS, https://www.irs.gov/tax-professionals/frequently-asked-questions [https://perma.cc/5J3J-G7JQ].

187. *See, e.g.*, *Conduct & Discipline*, ST. B. CAL., http://www.calbar.ca.gov/Attorneys/Conduct-Discipline [https://perma.cc/Y6E6-CNA9] (explaining the California State Bar's "central role in the development and enforcement of laws that govern attorney conduct").

188. *See supra* note 185 and accompanying text.

189. Johnson, *supra* note 11, at 956. *But see* Soled, *supra* note 30, at 294 (noting that state disciplinary boards may not be particularly effective in "reprimand[ing] rogue practitioners for orchestrating abusive tax shelters").

190. OPR frequently addresses a tax advisor's prior (tax or nontax) court convictions and various other types of advisor fraud or malfeasance (such as theft of client funds, threats against an IRS agent, and multiple failures to file or respond to inquiries). *See OPR: Frequently Asked Questions (FAQ's)*, *supra* note 186; *see also* IRS, IRS TAX FORUM 2017, OPR DISCIPLINE WHAT YOU NEED TO KNOW 14-23 (2017), https://www.irs.gov/pub/irs-utl/2017ntf-oprdDiscipline.pdf [https://perma.cc/PX2T-V6Y2].

Third, the varying levels of confidence at which tax opinions are rendered[191] pose additional malpractice risks.[192] For example, the levels of confidence provide more opportunities for a lawyer to overstate, perhaps dramatically, the confidence warranted for the tax position.[193] When arguing about the breach of a standard of care, the higher the confidence level in the opinion, the more opportunity that the client has to argue that a competent practitioner would not have rendered an opinion at such a high level.[194] This could increase the likelihood that the tax lawyer breached her standard of care, leading to an increased likelihood of malpractice recovery.

The risk of malpractice recovery for an over-confident tax opinion is exacerbated if the opinion is an important part of completing the transaction and the tax lawyer receives a larger than normal fee in the transaction.[195] Caselaw suggests that such situations create an inherent conflict of interest for the lawyer because "[t]he lawyer then has a strong incentive to provide the opinion necessary to assure that the transaction will proceed, regardless of what an objective analysis of the transaction would conclude."[196] This incentive could cause the "trier of fact in a malpractice action, observing this conflict, [to] be more inclined to find the opinion itself negligent, if not intentionally misleading."[197]

In addition, the varying opinion levels present greater risk that a lawyer could fail to meet her duty to communicate effectively with a client, which could also trigger malpractice liability. An important

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191. *See supra* Part I.A.2. Outside of tax, legal opinions generally do not use these levels of confidence; nontax legal opinions are generally binary.

192. The varying levels of confidence at which tax opinions are rendered could also cut the other way and reduce malpractice risk. For example, a "more likely than not" opinion provides relatively weak assurance about the likelihood of success of a tax position, so if the position is ultimately not sustained, it may be hard to establish that liability should be imposed. *See* Todres IV, *supra* note 70, at 653.

193. *See* Corneel, *supra* note 11, at 184.

194. *See id.*; Lang, *supra* note 179; Todres IV, *supra* note 70, at 610-11, 652-53.

195. Lang, *supra* note 179.

196. *Id.* (citing Canal Corp. v. Comm'r, 135 T.C. 199 (2010) (involving the issuance of an opinion in exchange for a large fixed fee, contingent on the closing of the transaction)).

197. *Id.*; *see also* 1 HAZARD ET AL., *supra* note 155, § 5.03.2 (conflict of interest can lead to an inference of breach of the applicable standard of care); Michael B. Lang, *Conflicts about Conflicts: Implications of the Tax Court* Canal Corp *Decision for Disciplinary and Malpractice Actions*, 53 TAX MGMT. MEMORANDUM (BNA) 3, 14 n.102 (2012).

part of discharging one's duty to a client in matters where the law is unsettled is

> advis[ing] [the client] of the unsettled status of the law and giv[ing the client] the opportunity to knowingly assess the risks and knowingly elect from among available courses of conduct. Fail[ing] to inform the client would give rise to malpractice liability, despite the fact that the advice actually given was otherwise justifiable under the mere error in judgment rule.[198]

In the tax opinion context, for example,

> [t]erms such as "reasonable basis" and "substantial authority" [which are important thresholds for avoiding penalties if a position is not sustained] need to be carefully explained to the client unless the lawyer has reason to know that the client understands the terminology.... [E]ven if the terminology used is a usage of the trade, such as in a so-called "should" opinion or "will" opinion ... the level of confidence should be fully explained to the client.[199]

If a lawyer fails to adequately explain to her client the import of the confidence level at which the opinion is rendered, she risks breaching her duties to her client and thereby opening herself up to malpractice liability.[200]

Fourth, although a breach of the standard of care is required to succeed in court on a malpractice claim, it is not clear how this standard of care is applied in practice because the few published cases generally focus on procedural, rather than substantive, tax malpractice issues.[201] Further, many tax opinion malpractice cases go to binding arbitration or settle privately, rather than being resolved with finality in court.[202] The use of confidential arbitration to resolve disputes between taxpayers and their tax advisers means

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198. Todres I, *supra* note 70, at 559 (footnote omitted) (citing caselaw).

199. Lang, *supra* note 179.

200. *See* Circular 230 § 10.33(a)(3); MODEL RULE PROF'L CONDUCT r. 1.4(b) (AM. BAR ASS'N 2017).

201. Todres IV, *supra* note 70, at 605-06.

202. *See* Lang, *supra* note 179 ("[I]t is difficult to get a handle on how large areas of malpractice law apply or should apply to tax practitioners."); Soled, *supra* note 30, at 274-75.

that the applicable standard of care is relitigated in secret in each matter. Lack of public disclosure about how the standard of care is applied in these cases makes it difficult to get insight into what tax malpractice really entails and how often (and how much) liability is imposed on tax advisors.[203] In addition, the secrecy in which the standard of care is litigated in tax malpractice cases could lead to material variability from matter to matter as to what a breach of the standard of care entails, meaning that it could be easier to establish a breach of the standard of care in some cases than in others. Further, some tax opinion malpractice matters may involve payouts when the breach is unclear because the tax opinion giver (and likely, her malpractice insurer) may agree to settle merely to end the matter and avoid expensive litigation.[204] Thus, unhappy clients who sue for tax malpractice may receive some indemnification even where there are questions about whether the lawyer breached the applicable standard of care. As a result, the indemnity provided via malpractice may be less conditional than it appears at first.

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In sum, although the indemnity provided by malpractice liability is conditional on the lawyer's breach of the standard of care, there is at least some risk transfer occurring when a lawyer renders a tax opinion, and there are reasons to believe that the risk transfer may be less conditional in the tax opinion context than in other contexts.

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203. *See* Kip Dellinger, *End Tax Opinion Reliance? Never!*, 142 TAX NOTES 217 (2014) ("[M]any [tax malpractice] disputes were subject to confidential, binding arbitration, [so] it's impossible to know their costs.").

204. Clients who received tax opinions on matters that are successfully challenged by the tax authorities are inclined to sue. *See* Soled, *supra* note 30, at 287-88; Todres IV, *supra* note 70, at 606. Defending tax opinion malpractice cases can entail "huge cost[s]." Dellinger, *supra* note 203. Thus, it is reasonable to infer that some matters settle, even in the absence of clear liability, if the settlement costs are less than the expected costs of litigation. *See* RICHMOND ET AL., *supra* note 70, at 10 (noting, when discussing litigation malpractice, that some matters settle for nuisance value); Lorelei Laird, *ABA Study Suggests Legal Malpractice Insurers Are Settling Sooner*, A.B.A. J. (Oct. 17, 2016, 11:30 AM), http://www.abajournal.com/news/article/aba_study_suggests_legal_malpractice_insurers_are_settling_sooner [https://perma.cc/86US-WSSW] ("[T]he cost of litigation has increased, which is causing insurers to offer settlements earlier."). Of course, a lawyer or firm may continue to defend against a malpractice claim even if the insurer wants to settle, but insurer preferences about settlement may affect the disposition of at least some malpractice matters.

b. Indemnification Is Limited in Amount to "Damages"

The indemnity implicitly agreed to by a lawyer who renders a tax opinion is limited in another way—by the definition of "damages" that are recoverable in malpractice cases.

Generally, in an insurance contract, the insured "is entitled to compensation for such loss as has been occasioned by the perils insured against, the right to recover being commensurate with (1) the loss sustained, or (2) the amount contractually specified."[205] With third-party tax insurance, the covered loss, although often subject to coverage caps and deductibles, usually includes taxes owed if an insured tax position is not sustained, interest on such taxes, penalties, contest expenses, and a gross-up.[206]

Damages recoverable pursuant to a malpractice claim may not cover all such costs. Penalties[207] and corrective costs (including costs to contest the tax treatment, but not the costs of the malpractice claim)[208] are typically recoverable in malpractice actions. However, as explained in the remainder of this Part, malpractice recovery for taxes owed, interest, and gross-ups may be limited. Thus, the magnitude of the risk transferred to the tax lawyer pursuant to a tax opinion may be less than the risk transferred to an insurance company pursuant to a third-party tax insurance policy.

As to the malpractice recovery for taxes owed, "[t]he general rule ... seems well settled that recovery is available for additional taxes that were avoidable but for the [lawyer's breach of the standard of care] but not for other, unavoidable taxes."[209] That is, the client is generally entitled to recover for the taxes paid, but only to the extent that those taxes exceed the taxes the client would have paid had the client received competent advice.[210] Thus, if no taxes would

205. COUCH, *supra* note 134, § 1.10.

206. *See* Wolfe, *supra* note 79, at 445-25 to -30.

207. *See* Todres III, *supra* note 70, at 731-32.

208. *See id.* at 733-36, 750-52.

209. Todres III, *supra* note 70, at 712.

210. *See, e.g.*, Thomas v. Cleary, 768 P.2d 1090, 1091-92 n.5 (Alaska 1989); O'Bryan v. Ashland, 717 N.W.2d 632, 633-33, 638 (S.D. 2006). The entire tax loss, including the unavoidable portion, may be recoverable in limited cases, if for example, the tax adviser perpetrated fraud rather than merely behaved negligently. *See* JOSEPH ERWIN, 619 T.M.: TAX OPINIONS AND OTHER TAX ADVICE—PREPARATION, USE AND RELIANCE § VII.C.2 (2018) (citing Alpert v. Shea Gould Climenko & Casey, 559 N.Y.S.2d 312 (N.Y. App. Div. 1990)); *see also*

have been due had the client been competently advised, the entire amount of taxes paid by the client could be recoverable. On the other hand, if there was no opportunity to avoid the unfavorable tax result, then the taxes borne by the client are not proximately caused by the lawyer's behavior; rather the taxes were unavoidable and are generally not recoverable at all in a malpractice action. In addition, although the standard for calculating "additional taxes" is easily stated, courts have been inconsistent in the application of this standard, meaning that "[d]amages that should be recoverable as a result of the payment of additional tax liabilities caused by a practitioner's malpractice have not been awarded in a variety of situations."[211] Notwithstanding these inconsistencies and the "possibility that the trier of fact will not understand the proof of causation and damages,"[212] commentators caution that "tax lawyers and other tax practitioners should [still] anticipate that awards for damages resulting from malpractice will include back taxes payable because of the malpractice."[213] Even if a court carefully applies the "additional taxes" definition for purposes of calculating tax malpractice damages, this definition means that the indemnity for "additional taxes" provided via a tax opinion will often cover less than an indemnity provided by a third-party tax insurance policy, which would typically cover all taxes due (subject to coverage limits and retentions).

As to interest, there is considerable variability in different states' approaches to whether interest paid on tax underpayments is recoverable in malpractice actions. The three divergent views are summarized as follows:

> According to the view that is probably the majority view, such interest is recoverable from a defendant just like any other damages proximately caused. A second view, diametrically opposite and likely the minority view, absolutely prohibits the recovery of such interest. A third view, a middle view followed in several states, permits the recovery of such interest, but only to

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Hosfelt v. Miller, No. 97-JE-50, 2000 Ohio App. LEXIS 5506, at *14 (Ohio Ct. App. Nov. 22, 2000).

211. Lang, *supra* note 179, at 6.

212. *Id.*

213. *Id.* at 7.

> the extent it exceeds the interest actually earned by the plaintiff on the underpaid taxes.[214]

Thus, whether a client will be able to obtain a malpractice recovery for interest on underpaid taxes depends on the court's approach.[215] In some courts, the recovery for interest pursuant to a malpractice claim could be equivalent to the recovery for interest in a full-coverage insurance policy—that is, fully recoverable. But in other courts, the malpractice recovery for interest could be considerably less.

As to gross-ups, the few cases considering this issue have split.[216] The leading author of articles about tax malpractice argues, however, that "if the goal of the law is to put the injured party as close as possible to where he or she would have been with non-negligent tax advice, then ... the damage award should be grossed-up [if the award is taxable]."[217] Nevertheless, it remains uncertain whether a malpractice recovery for a bad tax opinion would include a gross-up. In contrast, third-party tax insurance policies often do.[218]

An additional complexity in the determination of damages (and thus, in determining the magnitude of the indemnity provided by a tax opinion) arises because of the different confidence levels at which an opinion can be rendered.[219] Two examples help illustrate this concept.

First, consider a "substantial authority" level opinion, which reflects less than a 50 percent chance of success on the merits (typically 35-40 percent).[220] If a tax position has "substantial authority," a taxpayer in a non-shelter matter is generally able to avoid an accuracy-related penalty for a substantial understatement

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214. Todres III, *supra* note 70, at 723-24 (citations omitted).

215. *See id.*

216. *Compare* Pytka v. Gadsby Hannah, LLP, No. 01-1546 BLS, 2002 Mass. Super. LEXIS 461, at *25 n.1 (Mass. Super. Ct. Nov. 12, 2002) (holding no gross-up recovery), *with* Oddi v. Ayco Corp., 947 F.2d 257, 267-68 (7th Cir. 1991) (holding that gross-up is recoverable).

217. Todres III, *supra* note 70, at 767. The taxability of the malpractice damage award is outside the scope of this Article. *See generally* Robert W. Wood, *Tax Treatment of Legal Malpractice Recoveries*, 114 TAX NOTES 665 (2007).

218. *See* AON, *supra* note 123.

219. *See* Todres IV, *supra* note 70, at 653.

220. Treas. Reg. § 1.6662-4(d)(2); *see also* Rothman, *supra* note 11, at 319-21.

without disclosing the position.[221] If the tax position described in the opinion is not sustained, there should be no recovery for "additional taxes" at all because the opinion itself states that the lawyer rendering the opinion believes that the tax position was not likely to be sustained. Thus, the taxes due were likely unavoidable, and not caused by the tax lawyer's negligence. Penalties may be recoverable if the penalties are imposed because of the lawyer's breach of the standard of care and would not have been imposed had competent advice been provided.[222] But there is almost no chance that the tax itself would be recoverable in a typical malpractice action.

Second, consider the damages recoverable on account of a "pie-in-the-sky" tax opinion that dramatically overstated the likelihood of success (for example, opining at a "will" level of confidence when competent counsel would have only opined at a "substantial authority" level).[223] "Additional taxes" that are recoverable in a malpractice action are generally not determined based on the extent to which the actual tax result differed from what the tax adviser promised (meaning that, malpractice actions generally do not award "expectation damages").[224] Thus, there would not be more "additional taxes" owed by a lawyer who rendered a "will" level opinion than a "more likely than not" level opinion on a matter if there was no way to structure the transaction to avoid taxes. The "additional taxes" in these circumstances would be the same (zero), but at higher opinion levels, it may be easier to establish that the opining lawyer breached the applicable standard of care (for example, that "the opinion has ... vastly overstated the likelihood for success"), thereby triggering liability for damages.[225]

The foregoing makes it clear that the magnitude of an indemnity implicitly provided by a lawyer who renders a tax opinion may not cover all of the losses typically covered by third-party tax insurance. However, the fact that coverage is less than full does not mean that the arrangement is not insurance-like. Many insurance policies

221. I.R.C. § 6662(d)(2)(B) (2017).

222. *See* Todres III, *supra* note 70, at 712, 731-33.

223. *See id.* at 719-22.

224. *See id.* (discussing the damages that courts award in "cases involving 'pie-in-the-sky' promises by tax professionals" and arguing that "a more appropriate measure of damages would have been the difference between the promised and the actual tax results").

225. Todres IV, *supra* note 70, at 653; *see supra* notes 191-94 and accompanying text.

provide less than full coverage for losses; policies regularly limit the coverage by imposing coverage caps and/or retentions/deductibles and by limiting the types of losses that are covered.[226] Similarly, a third-party insurance policy may limit the indemnity to a maximum of some fixed percentage of any covered loss.[227] With the indemnity provided by a tax opinion, such limits are imposed not explicitly by contract, but rather implicitly by the laws applicable to malpractice recoveries. Again, these laws are part of the backdrop against which lawyers and clients enter into engagements and become part of the terms of the engagement. Thus, the coverage limitations imposed by the rules about malpractice "damages" could be understood as inherent in the terms of the indemnity agreement to which the parties implicitly agreed.[228] Ultimately, limitations on the extent of the damage coverage via a possible malpractice recovery does not mean that there is no transfer of risk. It merely means that a subset of the risk is transferred, and that is still consistent with an insurance-like indemnity arrangement.

3. Risk Transfer Is Not the "Principle Object and Purpose"

The foregoing demonstrates that there is some risk transfer to a lawyer who renders a tax opinion, even though the indemnity provided may be conditional and limited in amount. Not all agreements to indemnify, however, constitute "insurance" within the meaning of state insurance statutes.[229] An indemnification agreement will generally only constitute "insurance" for purposes of regulation if the "principle object and purpose" of the arrangement is the transfer of risk.[230] "The risk transfer [must be] the point of the contract; it is

226. *See* 4 APPLEMAN, *supra* note 31, § 32.03[2]-[3], [10]; Wolfe, *supra* note 79, at 445-25 to 445-30.

227. *See* 4 APPLEMAN, *supra* note 31, § 32.03[1] (providing an example where the parties insured for 60 percent of the potential loss).

228. *See infra* Part III.B.1.

229. 1 APPLEMAN, *supra* note 31, § 1.03[1]; COUCH, *supra* note 134, §§ 1.7-1.8.

230. Jordan v. Grp. Health Ass'n, 107 F.2d 239, 248 (D.C. Cir. 1939) ("The question [of whether a state insurance statute applies to regulate an arrangement] turns, not on whether risk is involved or assumed, but on whether that or something else to which it is related in the particular plan is its principal object and purpose."); *see also supra* note 158 (discussing that tax lawyers do not actually assume a client's risk of loss).

as if risk is the commodity being transferred, much like another contract would transfer real estate or personal property."[231]

This requirement is not met by indemnities provided via tax opinions because the primary objective of a tax opinion is not the transfer of risk. Rather, an opinion is intended to "express[] ... professional judgment on the legal issues explicitly addressed,"[232] and the primary objective of any tax opinion is to provide "some level ... of comfort or assurance regarding the tax treatment or consequences relating to a particular transaction or series of transactions."[233] Various concerns motivate clients to seek tax opinions, but clients generally do not ask for opinions solely or primarily to put the lawyer "on the hook" for the potential losses if the desired tax treatment is not sustained, nor would tax lawyers likely be willing to render an opinion solely or even primarily for that purpose.[234]

The conclusion that the risk transfer inherent in a tax opinion is not the principle object and purpose of a tax opinion—and thus should not be regulated as insurance—is supported by the analysis in a case about H&R Block's "[p]eace of [m]ind program."[235] The "[p]eace of [m]ind program" was "an enhanced version" of H&R Block's "basic guarantee of the accuracy of its tax-preparation services," pursuant to which, "in the event Block ma[de] an error which results in the customer's tax liability being initially underestimated, Block [would] pay up to $5,000 of the customer's newly revealed tax liability."[236] In concluding that the company was not subject to a penalty for selling insurance without a license, the court held that the "[p]eace of [m]ind program" was not a contract for "insurance" because, among other reasons, the indemnity was "inextricably linked to those [tax preparation] services [provided by

231. 1 APPLEMAN, *supra* note 31, § 1.03[2]; *see also* COUCH, *supra* note 134, § 1.8 (indicating that the risk transfer must be "the contract's dominant purpose").

232. Comm. on Legal Ops., *supra* note 11, at 171 (discussing opinions in general); Woodward, *supra* note 11, at 5 (noting that tax lawyers likely believe that this description applies to tax opinions as well as third-party legal opinions).

233. Woodward, *supra* note 11, at 13.

234. STERBA, *supra* note 11, § 1.3.

235. *See* H&R Block E. Tax Servs., Inc. v. Dep't of Commerce & Indus., Div. of Ins., 267 S.W.3d 848, 849 (Tenn. Ct. App. 2008).

236. *Id.*

Block],"[237] meaning that the tax preparation service (and not the indemnity) was the primary purpose of the contract.[238] The indemnity provided via a tax opinion is similarly inextricably linked to the provision of the advice contained in the tax opinion. Indeed, the indemnity provided via a tax opinion is even less like "insurance" subject to state regulation than H&R Block's indemnity because: (a) the agreement to indemnify pursuant to a tax opinion is implicit, whereas the H&R Block "peace of mind" program was an explicit agreement;[239] (b) the agreement to indemnify pursuant to a tax opinion is not triggered if the opinion is merely wrong—there must be a breach of the applicable standard of care—whereas the H&R Block indemnity was triggered upon mere error;[240] and (c) the "additional taxes" owed by the taxpayer may or may not be covered under the implicit indemnity effectuated by the malpractice rules, whereas up to $5,000 of the taxpayer's additional taxes are definitely covered by the H&R Block "peace of mind program."[241]

Ultimately, the transfer of risk is not the primary object and purpose of a tax opinion and is, instead, inextricably linked to the provision of tax advising services. Thus, it is clear that tax opinions should not be regulated as insurance, even though tax opinions involve a key element of insurance (specifically, indemnification) and may even be described as the "equivalent of insurance" for some purposes.[242]

C. Distribution of Risk

Although the prior Part concluded that tax opinions should not be regulated as insurance, it is still useful to complete the three-pronged "insurance" analysis by examining the third prong—whether tax opinions involve the "distribut[ion of risk] across a group of similarly situated persons, each of whose risk has been assumed in a similar transaction."[243]

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237. *Id.* at 863.
238. *Id.* at 863-66.
239. *Compare infra* Part III.B.1., *with H&R Block E. Tax Servs.*, 267 S.W.3d at 849.
240. *Compare infra* Part III.B.2.a., *with H&R Block E. Tax Servs.*, 267 S.W.3d at 849.
241. *Compare infra* Part III.B.2.b., *with H&R Block E. Tax Servs.*, 267 S.W.3d at 849.
242. COUCH, *supra* note 134, §§ 1.12-1.13.
243. 1 APPLEMAN, *supra* note 31, § 1.03[2].

Lawyers who write tax opinions regularly engage in some degree of distribution of risk. They typically provide multiple opinions for multiple clients, thereby accepting a variety of risks for a variety of clients, although often on the same issue.[244] Some clients might get audited, and some tax positions might not be sustained. Thus, by accepting fees in these various situations, only some of which (or hopefully, none or very few of which) are likely to result in indemnity payments, the clients' risks that are transferred to the lawyers are distributed across a broader pool of similarly situated persons.

However, with typical insurance, the distribution of risk via pooling typically "employs the law of large numbers. As you average together more numbers in a certain range, the average becomes more stable and predictable.... By pooling insureds, the average cost and risks become more stable."[245] Effective pooling and risk distribution generally require very large numbers, as with auto insurance, health insurance, and life insurance.[246] Even a large law firm that provides tax advice and opinions regularly may not advise on enough matters to be able to pool risks so as to leverage the law of large numbers and make the law firm's exposure to such risks stable and predictable.[247] In this way, the risk pooling done by a law firm differs from that by an insurance company. Of course, third-party tax insurers also insure only tax matters, and an insurance company may only have a small pool of tax policies, in part because tax insurance is still a relatively young industry.[248] However, the companies that provide tax insurance also typically provide a variety of other types of insurance, and thus are able to pool tax risks with various other risks.[249] Then again, large law firms that have malpractice risk in nontax departments (such as in securities or litigation) may be similarly pooling tax risks with other risks.

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244. *See generally supra* Part I.A.

245. 1 SHERILYN PASTOR, NEW APPLEMAN INSURANCE LAW PRACTICE GUIDE: COVERAGE ANALYSIS AND PRELITIGATION PROCEDURES § 1.05 (2017) (emphasis omitted).

246. *Cf. id.*

247. *Cf. id.*

248. *See supra* notes 94-97 and accompanying text.

249. *See, e.g.*, *Insurance for Business and Enterprises*, AIG (2019), https://www.aig.com/business/insurance [https://perma.cc/4Q8B-5TGK] (listing some of the "broad range of products and services" they provide, including not only tax liability and other mergers and acquisitions-related insurance, but also casualty insurance, cyber insurance, health insurance, professional liability insurance, property insurance, and more).

In addition, "[f]or risk pooling to work, the risks pooled must be independent."[250] However, the risks transferred through tax opinions rendered by a particular law firm may not be particularly diversified. This is because the lawyers of the law firm may be giving similar advice on similar transactions. Lawyers often become experts in narrow areas of law and then attract clients needing exactly that particular type of advice. On the other hand, the clients may have different business goals and risk preferences, so lawyers may adjust their approach to an issue based on the particular client. And clients may have different likelihoods of being audited and, if audited, the clients and lawyers may encounter different government employees who may handle the matters differently. In these and other ways, the risks accepted by a law firm that writes many opinions may be somewhat diversified, but to the extent that the relevant substantive issues (and advice with respect to such issues) are similar across clients, that would reduce diversification and the efficacy of the risk pooling that a firm is able to achieve.[251]

The "distribution of risk" concept may also require an insurance company to assemble capital (whether from premiums or otherwise) to ensure that the company has a minimum amount of resources available to pay claims.[252] Law firms typically do not aggregate client fees in this way, but law firms often do have malpractice insurance.[253] If a firm has sufficient malpractice insurance (which it may not), the malpractice insurance is effectively reinsurance

250. 1 PASTOR, *supra* note 245, § 1.05.

251. It is also possible that the law firm does not want to pool and diversify risk. Instead, the firm may want to make a directional bet on the success of a particular tax position that the firm helps multiple clients take.

252. *See generally* Kris DeFrain, *U.S. Insurance Financial Regulatory Oversight and the Role of Capital Requirements*, CTR. INS. POL'Y & RES. NEWSL., (Jan. 2012), https://www.naic.org/cipr_newsletter_archive/vol2_oversight.htm [https://perma.cc/4YPX-SX6Z] (discussing risk-based capital requirements for insurance companies).

253. *See* Woodward, *supra* note 11, at 12 (suggesting, in an article on tax opinions, that "malpractice insurance is an imperative for all practitioners"). However, some lawyers (more commonly in small and solo practices) forego liability insurance entirely, and other lawyers are underinsured. *See* Tom Baker & Rick Swedloff, *Liability Insurer Data as a Window on Lawyers' Professional Liability*, 5 U.C. IRVINE L. REV. 1273, 1277-87 (2015) (describing data about the levels of professional liability insurance that different lawyers and firms obtain). Underinsured lawyers may not be able to use malpractice insurance as a reinsurance strategy to distribute risk effectively.

through which the firm ensures that it would have sufficient funds to pay indemnity claims if any arise.[254]

Ultimately, the distribution of risk in the tax opinion context may or may not be enough for indemnities via tax opinions to constitute insurance. However, law firms that regularly write tax opinions engage in the distribution of risk, at least to a limited degree. Concerns about the efficacy of the risk pooling and risk distribution may raise questions about whether law firms *should be* acting as insurers, but that is a normative (rather than descriptive) question, and therefore is outside the scope of this article.

D. Conclusion About the Applicability of the Insurance Construct to Tax Opinions

The foregoing demonstrates that the insurance framework is not a perfect fit for describing the loss protection provided via a tax opinion. The traditional indicia of insurance are present, at least to some degree, when a lawyer provides a tax opinion: the client's desired tax treatment is an insurable risk; the lawyer does agree (albeit implicitly and conditionally) to indemnify the client for some of the client's risk of loss if the desired tax treatment is not sustained; and the lawyer may distribute the transferred risk—at least minimally—across multiple clients and matters on which the lawyer advises. The implied indemnification agreement inherent in a tax opinion is, however, unlikely to meet traditional definitions of insurance for several reasons, including because the primary objective of the tax opinion is not the transfer of risk. Thus, tax opinions are not sufficiently like insurance to merit regulating them as insurance.

Nevertheless, an important *element* of insurance—an agreement to indemnify for some risk of loss—is inherent in the relationship between the client and the tax-opinion-writing lawyer. And such indemnification obligations, in the form of malpractice recoveries, may be more likely among tax opinions for several reasons, as detailed above.[255]

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254. *See* 7 APPLEMAN, *supra* note 31, § 71.02[1],[3] (defining reinsurance and its purpose).
255. *See supra* Part III.B.2.

Despite tax opinions' role in shifting, to the opinion-writing lawyer, some of the client's risk that the client's tax position will be successfully challenged, it is important to acknowledge that tax opinions shift only some of the client's risk to the lawyer. A tax opinion also offloads some of the client's risk to the government, and a tax opinion ensures that client retains some of its own risk.

A tax opinion can shift some portion of the risk of an unsuccessful tax position away from the taxpayer and over to the government because tax opinions can, at least in some circumstances, help create a penalty-free zone for taxpayers, even if the taxpayer's position is incorrect.[256] In this zone, the government bears risks and costs (such as, enforcement costs or foregone revenue) all without the opportunity to recover penalties that the taxpayer would otherwise owe.[257] Moreover, this dynamic—in which getting a tax opinion increases the chance that a client who takes an aggressive position will only have to pay back taxes and interest (and not penalties) if the position is successfully challenged—can encourage taxpayers to take aggressive positions more frequently, thereby exacerbating the use of tax opinions to shift risk from the taxpayers to the government.

Even if the client's tax position, taken in reliance on a tax opinion, is successfully challenged and interest and penalties are imposed, clients often bear the economic burden of these losses and cannot shift the losses to their tax advisor. The client's ability to recover from the tax advisor is limited for several reasons, including the fact that recovery is generally contingent on the advisor's breach of the standard of care.[258] In addition, the opinions themselves are designed to ensure that some of the client's risk remains with the client. Specifically, the assumptions, caveats, and client representations on which opinions rely significantly limit the extent of the

256. *See* Wood, *supra* note 67, at 1071, 1073; *see also* Johnson, *supra* note 11, at 960 (explaining that "[c]lient[s] get[ ] [v]alue [o]ut of [w]rong [o]pinions").

257. Even where penalties may be available, the government bears the risk of nondetection and the risk of an unsuccessful challenge. Where penalties are available, however, they serve as a mechanism for reducing, on net, the costs borne by the government. Note that the government can bear some costs of aggressive taxpayer positions even without tax opinions, but tax opinions, and the sophisticated tax advice that they often reflect, increase the likelihood that the taxpayer will end up in this penalty-free zone. *See* Johnson, *supra* note 11, at 949-51.

258. *See supra* Part III.B.2.a. (discussing this requirement and how it is applied in the tax opinion context).

lawyer's advice, thereby making malpractice recovery less likely.[259] Given that lawyers typically draft these provisions (including the representations to which clients and third parties attest), a lawyer can try to use the opinion-writing process to reduce the extent to which she takes on the client's risk of loss.[260]

Notwithstanding the fact that both the client and the government bear part of the risk associated with the client's tax position, the opinion-writing lawyer still implicitly agrees to indemnify the client, albeit partially and conditionally, if the client's tax position, taken in reliance on a tax opinion, is successfully challenged.

IV. THE INDEMNITY FUNCTION OF TAX OPINIONS AND THE REALITY OF TAX PRACTICE

Evidence about tax malpractice payouts and about attitudes within the community of opinion writing tax lawyers provides insight into how the indemnity theory of tax opinions resonates with the realities of tax practice. Although it is extremely difficult to obtain data, the limited evidence that is available suggests that the risk to tax opinion writers is real.

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259. *See* Rothman, *supra* note 11, at 363, 370-74. For example, a client's position may fail, and penalties may be imposed, not because the lawyer's analysis was faulty (given the stated assumptions, caveats, and representations), but rather because a client's representation on which the lawyer reasonably relied was untrue. In that case, the client should be unable to recover unless the lawyer knew or had reason to know that the representation was false. *See, e.g.*, Kline v. First W. Gov't Secs., Inc., 24 F.3d 480, 484-87 (3d Cir. 1994). That is, the "bells and whistles" in the opinion enable the lawyer to raise various affirmative defenses to the malpractice claim (for example, that the client made and signed false representations and so has unclean hands; or that the proximate cause of the client's damages are outside the stated scope of the representation). *See generally* 3 MALLEN, *supra* note 158, ch. 22 (discussing affirmative defenses to malpractice claims).

260. Another way to frame this is that the opinion-writing lawyer uses the limitations in the opinion to shift to the *client* some of the *lawyer's* risk that the lawyer is incorrect. However, this Article is concerned with who bears the *client's* risk (meaning the client's potential liability—back taxes, interest, and penalties—if the client's tax position is successfully challenged), and liability for a successfully challenged tax position falls on the taxpayer (the client) who took the position. Hence, the text describes the function of the opinion caveats as a method through which the lawyer ensures that the *client retains some of the client's own risk,* and through which the lawyer limits the extent to which she accepts her client's risks of back taxes, interest, and penalties. *See supra* note 29.

A. Tax Malpractice Payouts as Evidence of the Indemnity Function

Several high-profile tax malpractice claims against tax advisers for bad tax opinions, particularly in the tax shelter context, resulted in large payouts. For example, the Jenkens & Gilchrist matter settled for over $80 million,[261] and Sidley Austin Brown & Wood and KPMG[262] settled for over $154 million.[263] As evidenced in these and other published cases, opinion writers were required to provide indemnification for losses that arose from bad tax opinions.

Published cases, even accounting for the class action suits that involved hundreds of plaintiffs,[264] reflect only a subset of matters in which tax opinion-writers provided indemnities for losses. Many tax malpractice "disputes were subject to confidential, binding arbitration"[265] or were resolved by "settlement, or in non-reported litigations."[266] Given the confidentiality of many of these matters, "it's impossible to know their costs," but commentators note that payouts were "significant,"[267] and "plaintiffs prevailed in the majority of these [tax shelter] cases."[268] Thus, providers of tax opinions

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261. *See* Denney v. Jenkens & Gilchrist, 250 F.R.D. 317, 324 (S.D.N.Y. 2005).

262. KPMG is an accounting firm and not a law firm. Caselaw regarding bad tax opinions necessarily blurs the line between tax lawyers who provide opinions and tax accountants who provide opinions because "[t]he dividing line between the work of the tax attorney and tax accountant has always been murky," and because both have been sued for malpractice over tax opinions and provide compensation for losses. Todres IV, *supra* note 70, at 608. Thus, the most prominent articles about tax malpractice cases consider cases against both tax lawyers and tax accountants. *See, e.g.*, *id.* However, where possible (for example, regarding malpractice insurance claims information), this Article tries to focus on evidence about tax *lawyers*. Nevertheless, this Article's observations about the indemnity function of tax opinions likely extend to any professional who gives a tax opinion.

263. *See* Simon v. KPMG LLP, No. 05-CV-3189 (DMC), 2006 WL 1541048, at *3 (D.N.J. June 2, 2006), *stipulation amending settlement filed March 22, 2006*; *see also, e.g.*, Ling v. Cantley & Sedacca, L.L.P., No. 04 Civ. 4566, 2006 WL 290477, at *1 (S.D.N.Y. Feb. 8, 2006) (settlement of over $4.5 million). *See generally* Soled, *supra* note 30, at 332-33 (tallying malpractice cases involving tax shelters); Todres IV, *supra* note 70, at 625-50 (describing several cases).

264. For example, there were 1100 clients in the Jenkens & Gilchrist settlement. *See Denney*, 230 F.R.D. at 330.

265. Dellinger, *supra* note 203.

266. Todres IV, *supra* note 70, at 606; *see also* Soled, *supra* note 30, at 268 n.1.

267. Dellinger, *supra* note 203.

268. Soled, *supra* note 30, at 276.

likely served an indemnity function in many matters that are not publicly reported.

Some insights into the magnitude of the nonpublicly reported indemnity payments can be gleaned from malpractice insurance claims data,[269] noting that the data reflect not only payouts in connection with tax shelter opinions but also payouts made on account of tax opinions and tax advising more generally.[270] Unfortunately, publicly available data about tax malpractice insurance claims are relatively limited, and even when such data are available, the information is generally not parsed finely by and within tax practice.[271] Yet, some insights are available, as detailed below.

In the only tax-specific report about the malpractice insurance claims experience that I could find, the Attorney's Liability Assurance Society (ALAS),[272] which "is the insurer with the largest market share in the medium- to large-firm [lawyers' professional liability] insurance market,"[273] reported "an increase in significant claims involving tax advice" over the several years leading up to 2011.[274] ALAS's report explicitly noted that a significant portion of its reported tax malpractice matters are ones in which a legal opinion was a "critical component"; these were often, but not always, tax

269. The malpractice insurance claims data technically reflect payments made by legal malpractice *insurers* and not the lawyers who committed malpractice. However, the malpractice liability is actually imposed on the lawyer, making the lawyer the primary "insurer" of the client's loss. The malpractice insurance claims data merely reflect claims against those lawyers who had the foresight to obtain malpractice insurance, which operates as reinsurance, pursuant which the lawyer herself is indemnified for the primary indemnification liability that she owes to the client on account of the bad opinion. *See* 7 APPLEMAN, *supra* note 31, § 71.02.

270. *See, e.g.*, ALAS, *supra* note 70, at 2, 4.

271. Baker & Swedloff provide the most comprehensive analysis of legal malpractice insurance claims data to date, and their research required "considerable effort." Baker & Swedloff, *supra* note 253, at 1301. Even with all of the data that they compiled, they are able to provide relatively little insight into tax-related claims given the manner in which the data are reported. *See, e.g.*, *id.* at 1307 n.90 (noting that ALAS did not report on Tax/ERISA claims every year).

272. ALAS is an insurance company that specializes in providing lawyers with professional liability insurance. *The ALAS Story*, ATTORNEYS' LIABILITY ASSURANCE SOC'Y, http://www.alas.com/public/the_alas_story.aspx [https://perma.cc/9W5F-UQWJ] ("ALAS is the country's largest lawyer-owned mutual, insuring more than 210 premier law firms with over 62,000 lawyers around the world.").

273. Baker & Swedloff, *supra* note 253, at 1275.

274. ALAS, *supra* note 70, at 1 ("[M]ore than 20% of ALAS's total gross incurred loss on tax claims [throughout ALAS's history] has occurred within the last five years alone.").

shelters.[275] More generally, ALAS explained that "[b]oth the frequency and severity of opinion-related claims have increased in recent years. Many problematic opinion claims occur in specialized practice areas, such as tax opinions."[276] While useful, there are limits to the ALAS data. The ALAS data do not cover all tax opinion-writing firms, and most notably, the ALAS data may underrepresent large New York and California firms as a result of ALAS's historic geographic restrictions that were lifted in 2000.[277] Nevertheless, the ALAS experience with tax malpractice insurance claims, particularly those based on tax opinions, supports this Article's contention that tax opinions can create costly indemnification obligations.

More general (not tax-specific) reports about malpractice insurance claims data also support the assertion that there is a meaningful risk of payouts because of tax opinions and other tax advice. An example is data provided by Aon,[278] which is "the insurance brokerage company with the largest market share in the lawyers professional liability insurance market."[279] In Aon's 2015 report discussing malpractice insurance claims over the prior ten years, Aon noted that "[s]ubstantive errors ranged from allegedly faulty tax opinions to poor trial strategies. Some of these notifications were generated by unhappy clients with unrealistic expectations, but others arose because the lawyer failed to comprehend and apply the law properly. And many of these substantive errors resulted in significant settlements."[280] That is, faulty tax opinions

275. *Id.* at 1-2. ALAS cites seventeen tax shelter claims involving tax opinions accounting for "nearly $45 million of ALAS's $70 million total incurred cost on tax claims during [the five years leading up to the December 2011 report]." *Id.* at 2. ALAS notes, however, that they "continue to see other [nonshelter] claims arising from the tax practice area as well. These come from all manner of transactions." *Id.* at 4.

276. *Id.* at 12.

277. *See* Baker & Swedloff, *supra* note 253, at 1284.

278. Aon has "over 75 years of history providing insurance to professional service firms [such as lawyers]," and Aon's "Professional Services practice represents more large professional service firms than any other broker in the world." *Professional Services*, AON RISK SOLS., http://www.aon.com/risk-services/professional-services/about-us.jsp [https://perma. cc/7AZH-YHM8]. Aon's law firm clients "may reasonably be classified as large law firms, but [they] also serve numerous midsized firms, as well as some boutique firms." RICHMOND ET AL., *supra* note 70, at 1.

279. Baker & Swedloff, *supra* note 253, at 1287.

280. RICHMOND ET AL., *supra* note 70, at 7.

were important enough for Aon to call out explicitly as among the types of problems that led to significant indemnification payments.

Malpractice insurance claims data also offer at least some support for the notion that the indemnity function of opinions may have more resonance in tax than in some other practice areas. For example, Aon's claims experience reveals that tax claims paid out more frequently than claims in almost all other areas.[281] Additionally, Aon reported that when tax claims resulted in payouts, the losses were relatively severe (approximately $668K median ground up losses per claim paid and $2.7 million mean ground up losses per claim paid, both ranking at sixth out of twenty-one practice areas).[282] Speaking more generally, Aon notes that "[t]ransactional practices [which can include tax] are exponentially more susceptible to severe claims than is litigation practice."[283] Some state-based

281. Tax practice had one of the highest ratios of claims paid to notifications (just under 33 percent). *Id.* at 3. Only two areas (Health Care and Government Affairs/Lobbying) had higher ratios, but the numbers were much smaller; both had fewer total notifications than tax had claims paid. *See id.* Moreover, one of those areas was flagged by Aon as an anomaly, with claims and losses being "primarily the result of a single rogue lobbyist." *Id.* at 4. Tax was not, however, among the practice areas that generated the highest *number* of notifications. *Id.* at 4. This is not surprising, as tax is a much less common practice than many others, such as corporate or litigation. Nevertheless, Aon notes that it can be difficult to interpret the notification data because rates of notification could depend on the number of lawyers in Aon's client population and on different firms' "sensitivity to the need to report to their insurers circumstances that could lead to claims." *Id.* at 2. Sometimes, lawyers report out of an "abundance of caution" even if the notice does not "lead to losses of any sort." *Id.* at 6.

282. *See id.* at 3, 5. In comparison, ALAS's cumulative data put tax malpractice claims (measured by mean gross loss per claim) more in the middle of the pack with other practice areas, but even ALAS's data reflected that tax claims resulted in slightly outsized payouts, with Tax/ERISA claims constituting 5 percent of ALAS's gross loss but only 4 percent of the number of claims. *See* Baker & Swedloff, *supra* note 253, at 1308 (reporting on cumulative ALAS data). The ABA Standing Committee on Lawyers' Professional Liability also ranks tax practice in the middle of the pack based on the number of claims in each practice area. AM. BAR ASS'N STANDING COMM. ON LAWYERS' PROF'L LIAB., PROFILE OF LEGAL MALPRACTICE CLAIMS 2008-2011 5 (2012). However, the Standing Committee itself notes that this information cannot be used to determine which practices are high risk or low risk because the data do not adjust for "how much of the practice of law is devoted to particular subject matters," nor do the data provide an indication of the severity of the claims by practice area. *Id.* at 4. Thus, the ABA's data are not probative for this Article's inquiry.

283. RICHMOND ET AL., *supra* note 70, at 5. Aon attributes some of the concern in this area to "representation of unworthy clients in corporate and transactional matters." *Id.* at 11. However, it is sometimes difficult to tell, when beginning a client engagement, whether a client is unworthy. *See generally* DOUGLAS R. RICHMOND, ABA, DISHONEST OR UNWORTHY CLIENTS: PINK FLAGS (2018), https://www.americanbar.org/content/dam/aba/events/professional_responsibility/2018_cpr_meetings/2018conf/materials/session7_clients_go_

malpractice insurance claims data similarly show tax as a practice area on the higher end of malpractice claim success rates and mean/median losses.[284]

Although the foregoing supports the contention that material financial exposure can arise from bad tax opinions, the data are limited in several ways, including not being finely parsed enough to distinguish between malpractice claims based on tax opinions and claims based on other tax advice or reporting choices.[285]

However, some limits of the malpractice insurance claims data likely understate the indemnity function of tax opinions. Aon notes that its data may "materially underreport[ ]" malpractice liabilities because, among other reasons, many claims remain open given that "claims against law firms are typically long-tail events."[286] This is likely to be equally true of ALAS's data. Moreover, underreporting of long-tail malpractice liability may be particularly common in tax where the malpractice claim depends on the finality of the client's underlying dispute with the tax authority, which may only commence several years after the initial tax filing and which can then take many years to resolve.[287] As a result, opinion writers' indemnity obligations may be larger than the data reflect, particularly in tax practice. In addition, although ALAS and Aon are huge players in the professional liability insurance market, their data do not cover all insured tax lawyers.[288] Moreover, some lawyers and some matters are not covered by malpractice insurance, in which cases any malpractice/indemnification payouts made by such lawyers would not be captured by the data made available by malpractice insurers. Thus, tax opinions and advice likely result in more indemnification obligations than are reflected in the available legal malpractice insurance claims data.[289]

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rogue/dishonest_client_pink_flags.pdf [https://perma.cc/A2T4-C6CS].

284. Herbert M. Kritzer & Neil Vidmar, *When the Lawyer Screws Up: A Portrait of Legal Malpractice Claims and Their Resolution*, DUKE L. SCH. PUB. L. & LEGAL THEORY, SER. NO. 2015-29, at 37-39, 45, 49 (July 7, 2015), https://ssrn.com/abstract=2627735 [https://perma.cc/XYS5-VMB8] (analyzing Missouri and Florida claims data in particular).

285. *See, e.g.*, *id.*

286. RICHMOND ET AL., *supra* note 70, at 1, 3.

287. *See id.*

288. *See* Baker & Swedloff, *supra* note 253, at 1301-02, 1312.

289. An even fuller picture of the indemnity obligations created by tax opinions could be provided by also looking to the professional liability insurance claims against tax accountants,

B. Tax Lawyers' Perceptions About the Indemnity Function of Tax Opinions

When assessing the extent to which the indemnity function of tax opinions resonates in tax practice, it is useful to look beyond malpractice payout data to professional norms within the tax bar, which reveal whether tax practitioners perceive a real risk of having to make indemnification payments for bad opinions. However, just as it was difficult to obtain good data about indemnification payouts on bad tax opinions, it is difficult to get data about lawyers' attitudes about the indemnity function of tax opinions. Lawyers are understandably reluctant to discuss erroneous tax opinions rendered by their firm, any payouts made in connection therewith, or their internal firm attitudes about the possibility of payouts on bad tax opinions. Nevertheless, commentary in articles about tax opinions provides at least anecdotal evidence about tax lawyers' perceptions of the risk that a tax opinion will result in an indemnification obligation.

Published articles suggest that commentators perceive significant downside risk from tax opinions. Comments include the following: "when a formal [tax] opinion goes bad, it can go really bad."[290] "[I]n the right (or wrong) circumstances, legal opinion problems can spell serious trouble—i.e., death—for a law firm."[291] "[I]t is useful to remember that the client whose representative today urges that we stretch to give a favorable opinion may tomorrow be replaced by a merger successor or bankruptcy trustee" who seeks to sue for malpractice.[292] "What practitioners have learned is that erstwhile clients who have met with defeat at the hands of the IRS will likely turn around and sue them."[293]

When reflecting on the impact of the tax shelter malpractice cases in particular, one commentator remarked, "[o]ne of the most pow-

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and not just tax lawyers. However, given this Article's emphasis on tax lawyers, the text and analysis focus, to the extent possible, on claims of malpractice against *lawyers* rather than accountants.

290. Rothman, *supra* note 11, at 361.

291. Lipson, *CBA*, *supra* note 18, at 1201 (citing "recent high-profile lawsuits involving disallowed tax shelters").

292. Corneel, *supra* note 11, at 184.

293. Soled, *supra* note 30, at 287-88.

erful and penetrating aspects of malpractice litigation is the monetary punishment it inflicts upon wayward practitioners.... The malpractice cases cast a long shadow over firms."[294] This commentator also noted that, after the tax shelter malpractice cases, "fear of ... being sued for malpractice" has affected tax practitioner behavior.[295] Similarly, another commentator said that the tax shelter malpractice cases "have taken a huge toll" and "have had serious effects on firms[ ]."[296] A third noted that "it is safe to conclude that tax professionals who render incorrect opinions that an invalid tax shelter is likely valid will most assuredly be the target of a tax malpractice suit brought by the disappointed purchaser of the tax shelter"[297] and that "[i]nvolvement with clients investing in tax shelters seems to be deleterious to a tax professional's malpractice health."[298]

More broadly, commentators caution that "[r]endering [tax] opinions ... can be a hazardous activity"[299] and that tax opinion-givers should "[b]e careful out there."[300] Even in transactional practice generally, "lawyers perceive this risk [of being sued based on opinion letters] to be increasing."[301] Indeed, a study about third-party closing opinions (which are not tax opinions) found that lawyers thought that, even in that context, they "were becoming increasingly attractive litigation targets when transactions failed, and that opinion letters would form an important link in the chain leading to liability."[302]

Not all commentators, however, agree that tax practitioners regard seriously the risk of malpractice liability. For example, one commentator dismissed the fear of malpractice suits as ineffective

294. *Id.* at 284-86 (primarily discussing tax shelter malpractice cases).

295. *Id.* at 306, 330 (making them "toe the compliance line" and making them "reluctant to promote abusive tax shelters").

296. Dellinger, *supra* note 203, at 219.

297. Todres IV, *supra* note 70, at 606.

298. Todres I, *supra* note 70, at 584 (footnotes omitted).

299. Woodward, *supra* note 11, at 4.

300. Wood, *supra* note 39, at 65.

301. Lillian Blackshear, *Wait ... What Did I Just Say?: What Lawyers Need to be Concerned About When Issuing Third-Party Closing Opinions,* 10 TRANSACTIONS: TENN. J. BUS. L. 71, 73 (2008) (citing Lipson, *Price*, *supra* note 18).

302. Lipson, *Price*, *supra* note 18, at 65.

for keeping tax adviser behavior "within some bounds."[303] Instead, the commentator explained that "[m]alpractice suits are no slam dunk for the taxpayer" and that "[i]n private, the opinion writers sometimes say they are confident that they can avoid any obligation to clients if the position fails, provided they have put enough bells and whistles on the opinion."[304]

Others, however, pushed back against that characterization of the tax profession.[305] Moreover, that commentator's focus was on penalty protection opinions,[306] where the magnitude of damages payable in a malpractice action is generally less than that payable on account of an opinion with higher confidence.[307] In that context, the seriousness with which practitioners regard malpractice liability might be lower with opinions with very low levels of confidence because of the lawyer's lower potential financial exposure.[308]

Ultimately, remarks from published articles, while anecdotal, suggest that many tax lawyers, including some with sufficient expertise with tax opinions to write about them, perceive the risk of malpractice liability for bad tax opinions to be real. Even if there are legal barriers to indemnification payouts, how lawyers perceive the tax opinion relationship matters—and many perceive there to be a real risk that they could have to indemnify the client if the tax opinion is wrong.

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Information about tax malpractice payouts and commentary about the perceived risk posed by tax opinions suggest that the indemnification function of tax opinions is part of the reality of tax practice. Data suggest that tax malpractice claims can result in payouts, and so tax opinion writers should be cautious about the potential indemnification obligation they are accepting when writing

303. Johnson, *supra* note 11, at 948, 955.

304. *Id.*

305. *See, e.g.*, Dellinger, *supra* note 203, at 219; Dennis B. Drapkin, *Response to Ending Reliance on Tax Opinion of Own Lawyer*, 141 TAX NOTES 1353 (2013) (responding based on his "long-time experience as a tax professional").

306. Johnson, *supra* note 11, at 947-48.

307. *See supra* text accompanying notes 220-22.

308. *See supra* text accompanying notes 220-22.

opinions. Commentary about professional attitudes suggests that many are.

V. IMPLICATIONS OF THE INSURANCE ANALYSIS FOR TAX OPINIONS

The existence of an element of insurance (specifically, an indemnity obligation) in the relationship between a client and its tax opinion-writing lawyer has important implications for the tax profession. Tax lawyers might adopt insurance premium-style billing to tie their compensation to the value of the implicit indemnity they are providing. Lawyers may also try to limit their potential indemnification obligations by, among other things, changing the terms of client engagements and changing how they prepare the tax opinions. In addition, in the market for tax advice, clients may change what they look for in lawyers, and lawyers may change how they market themselves to clients. These are only some potential consequences of the indemnity function of tax opinions. This Part will briefly discuss these consequences.

A. Tax Lawyers' Billing Practices

Increased awareness of the indemnity implied by a tax opinion could lead lawyers to alter their historic billing practices. Lawyers typically charge for their services based on billable hours expended.[309] Some lawyers also use alternative fee structures, such as value billing or flat-fee billing.[310] Although alternative fee arrangements are increasingly common in practice areas including transactional practices,[311] it is difficult to obtain insight into the extent

309. *See* Ani Krikorian, *Billing Outside the Box,* 27 GEO. J. LEGAL ETHICS 655, 655-59 (2014); Douglas R. Richmond, *An Inconvenient Truth: There Is Nothing Wrong with the Billable Hour*, 19 PROF. LAW. 3, 3 (2009); *see also* Frank Strong, *Key Metric: The Current Law Firm Billing Rates by Practice Area*, LEXISNEXIS: BUS. L. BLOG (Oct. 27, 2015), http://businessoflawblog.com/2015/10/law-firm-billing-rates-2/ [https://perma.cc/YD5W-L8HM].

310. *See generally* HAZARD ET AL., *supra* note 155, § 9.19 (discussing alternative fee arrangements); Committee on Lawyer Business Ethics, *Business and Ethics Implications of Alternative Billing Practices: Report on Alternative Billing Arrangements*, 54 BUS. LAW. 175 (1998).

311. *See* GEO. L. CTR. STUDY LEGAL PROF. & THOMSON REUTERS LEGAL EXECUTIVE INSTITUTE, 2017 REPORT ON THE STATE OF THE LEGAL MARKET 9-10, https://static/legalsolutions.thompsonreuters.com/static/pdf/peer-monitor/8042201-final.pdf [https://perma.cc/5SEY-7B7M]

to which alternative fee structures are used in tax opinion practice,[312] but my sense from lawyers who practice tax is that hourly billing remains the norm. In contrast, "[t]he premiums for [third-party tax insurance], unlike fees typically charged by tax professionals for rendering tax opinions, are based on the financial exposure and the estimated likelihood of liability."[313]

If tax opinions are understood as providing some degree of insurance to the client, fee setting could be dramatically different. The insurance-like features of opinions suggest that the opinion-writer's fee could be analogized to an insurance premium and perhaps should be set not exclusively on hours expended, but perhaps should instead be set at least partly using a premium-style approach—that is, an approach based on the maximum indemnity the lawyer could have to pay and on the likelihood that the lawyer would have to pay that indemnity.[314] This approach ties the lawyer's fee to the risk-adjusted value of the potential indemnity the lawyer provides. The entire fee for a tax opinion would not have to be calculated this way, but the insurance-like aspect of opinions suggests the use of a premium-style fee, at least in part.[315]

1. Illustrations of the Relevance of Premium-Style Fees

Consider two hypotheticals illustrating the potential usefulness of premium-style fees.

First, consider two matters involving the same tax issue, one of which has potential loss of $5 million if the transaction fails to qualify for tax-favorable treatment, and one of which has potential loss of $500 million. Assume the matters are otherwise similar (for

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(describing recent shifts in billing practices at law firms); *Big Data: Steady But Subtle Increase in AFA Use*, LEXISNEXIS: BUS. L. BLOG (Dec. 8, 2015), http://businessoflawblog.com/2015/12/increase-in-afas/ [https://perma.cc/DKU9-E2CB].

312. *See, e.g.*, *Big Data*, *supra* note 311 (lumping tax together with corporate); Strong, *supra* note 309 (doing the same).

313. Woodward, *supra* note 11, at 4; *see also* Wolfe, *supra* note 79, at 445-24 ("[T]he premium depends upon the degree of risk involved and the dollar amount of the coverage sought.").

314. Wolfe, *supra* note 79, at 445-24; Woodward, *supra* note 11, at 4.

315. An alternative would be to adjust billing rates by type of matter, such that lawyers who charge $X/hour for "regular" tax work might charge a premium rate at some multiple (for example, $X*1.5/hour) for tax opinion work or other work with heightened indemnity risks.

example, with respect to the tax analysis required, the time that each will involve, and the level of certainty at which the tax opinion will be rendered). The insurance paradigm suggests that the lawyer might want to charge a (potentially significantly) higher fee for the matter with the $500 million exposure. Charging a higher fee for the higher-exposure matter does not seem unreasonable, and perhaps this already happens for matters that are billed using a flat fee. But what if the billing is hourly? Perhaps the lawyer would spend more time on the second transaction because of the magnitude of the exposure. If, however, the analyses for the two matters are very similar, the additional time the lawyer might bill is quite unlikely to be enough to compensate for the additional indemnity risk the lawyer accepts by rendering the opinion on the matter with more exposure.[316]

Second, consider a situation where a tax lawyer, after her initial tax analysis, advises a client that she can opine at a particular level of confidence, but the client pressures the lawyer to reach a higher confidence level. Assume the lawyer endeavors to get to the higher confidence level (for example, by putting in more work to make recommendations about how to change the transaction to achieve more confidence or by looking for additional authority that could be used to more strongly support the position on the unchanged transaction). The insurance paradigm suggests that the lawyer would want to charge more than merely the hourly billing rate for the additional hours that it takes for the lawyer to get comfortable at the higher level of confidence, given that the lawyer would be accepting the additional risk associated with agreeing to render the opinion at a higher level.

Some tax lawyers may think they would never succumb to such pressure—that they would just say "no" and be done. But it is not so easy; pressure can be part of the reality of practice. Clients engage in "opinion shopping" and exert pressure on lawyers to reach

316. The lawyer's hourly fees may already be set so that the high-exposure client is paying approximately the "right" premium. Then, the low-exposure client would be dramatically overpaying for the indemnity and would be better off seeking other counsel, unless the lawyer was willing to reduce the fee. Moreover, if the low-exposure client does not seek other counsel and if the lawyer does not reduce the fees to account for the situation, then the lawyer runs the risk that she is charging unreasonable or even unconscionable fees, possibly in violation of Model Rule 1.5. *See* MODEL RULES OF PROF'L CONDUCT r. 1.5 (AM. BAR ASS'N 2017).

the client's desired conclusion.[317] This can include explicitly "threatening to take business elsewhere" and playing lawyers from different law firms against each other.[318] Tax lawyers can also get internal pressure from corporate/finance colleagues not to get in the way of a deal with momentum.[319] And these pressures could even lead tax lawyers to give opinions that "might not be totally 100% right" just to keep the transaction alive,[320] though doing so is highly inadvisable. People may have different views on the prevalence of "opinion shopping" and client pressure about opinion levels, but these pressures can be real. Acknowledging the opinion's indemnity function and using a premium-style fee can be part of a tax lawyer's response.

Perhaps lawyers do not need to charge additional premium-style fees in situations like the hypotheticals because the lawyers are already getting compensated in other ways for taking on the additional risk. This compensation could come in the form of retaining the client's current work, obtaining the client's future work,[321] or even being associated with the particular client or with transactions of such magnitude or importance.[322] However, if this is the risk/compensation tradeoff that a lawyer is making, she should be aware that it is occurring and make an intentional choice, understanding the stakes.

Ultimately, the more compelling the insurance paradigm is for a particular tax opinion matter, the more a lawyer should consider using a premium-style fee for the opinion.

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317. Fleischer, *supra* note 9, at 266-67; *see also* Johnson, *supra* note 11, at 959 (citing *Report on Corporate Tax Shelters*, N.Y. STATE BAR ASS'N (Apr. 29, 1999)) (discussing pressure on tax professionals to "give favorable opinions").

318. Fleischer, *supra* note 9, at 266-67.

319. *See id.* at 267.

320. Suchman & Cahill, *supra* note 16, at 695-96 (quoting a nontax lawyer recounting an anecdote about an opinion regarding intellectual property rights); *see also* Fleischer, *supra* note 9, at 266-67.

321. *Cf.* Fleischer, *supra* note 9, at 267 ("In the old days, clients tended to rely on a single firm as outside counsel for most deals. This is less true today. 'Clients now use 100 different law firms. You have to fight for every piece of business.'"(footnote omitted)).

322. Lawyers can gain prestige and reputation from the number and value of deals on which they advise. *See, e.g.*, *M&A Law Firms Power Rankings*, DEAL (2018), http://www.thedeal.com/league-tables/ma/ [https://perma.cc/MPT2-FFFD] (publishing "Deal Power Rankings" that rank firms based on these metrics).

2. Questions Raised by Premium-Style Fees

The use of premium-style fees for tax opinions could, however, raise ethical questions. This Part addresses a few such questions by analyzing whether premium-style fees are likely allowed at all, and by discussing some other potential consequences of using premium-style fees.

a. Are Premium-Style Fees for Tax Opinions Allowed?

Both the Model Rules and Circular 230 limit the types of fees that tax lawyer can use, but neither is likely to prohibit the use of premium-style fees for tax opinions. Model Rule 1.5, which provides rules regarding lawyer fees, would likely allow the use of a premium-style, risk-based flat fee if the fee is set reasonably and clearly communicated to the client.[323] A premium-style flat fee is merely a variation on an allowable flat value-based fee, in that the client is paying the lawyer a fixed amount based on the expected value of the protection from damages that the tax opinion provides.[324]

The analysis under Circular 230 is more complex because Circular 230 raises two key questions about the permissibility of premium-style fees: are they prohibited "contingent fees"? And are they prohibited because they are based partly on the taxpayer's audit risk? Both questions are analyzed below.

Circular 230 generally prohibits contingent fees in tax matters.[325] Circular 230 defines contingent fee as a

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323. MODEL RULES OF PROF'L CONDUCT r. 1.5 (AM. BAR ASS'N 2017). This assumes that the lawyer would clearly communicate with the client the potential impact of such a fee structure, including the possibility that the client would be precluded from relying on the opinion for penalty protection purposes. *See infra* notes 346-49 and accompanying text. Some states depart from Model Rule 1.5, so lawyers should, of course, check the ethics rules applicable in their jurisdictions. *See* AM. BAR ASS'N CPR POLICY IMPLEMENTATION COMMITTEE, VARIATIONS OF THE ABA MODEL RULES OF PROF'L CONDUCT r. 1.5: FEES (Dec. 11, 2018), https://www.americanbar.org/content/dam/aba/administrative/professional_responsibility/mrpc_1_5.pdf [https://perma.cc/385K-YUBB] (identifying state-by-state deviations from Model Rule 1.5).

324. *See generally* Kasey W. Kincaid & Kimberly J. Walker, *Managing Litigation Costs: The Client Cannot Start Too Soon*, 41 DRAKE L. REV. 67, 78 (1992) (discussing value-based fees).

325. Circular 230 § 10.27(b) (generally prohibiting "contingent fees" except in specified circumstances, which generally involve controversy matters).

> fee that is based ... on whether or not a position taken on a tax return or other filing avoids challenge ... or is sustained. [This includes a fee that is] based on a percentage of the refund reported on a return, that is based on a percentage of taxes saved, or that otherwise depends on the specific result attained.[326]

However, a premium-style fee is unlikely to run afoul of this prohibition.

A premium-style fee for a tax opinion would technically be based on the amount of the indemnifiable loss for which the lawyer might be liable, and not on the taxpayer's anticipated or realized tax savings.[327] Indemnifiable damages may, in some circumstances, include the taxpayer's anticipated tax savings, but the indemnifiable damages may be larger (because of interest, penalties, corrective costs, et cetera) or smaller (because the additional taxes owed by the taxpayer may be excluded).[328] Because the indemnifiable loss is not coextensive with the taxpayer's anticipated tax savings and almost certainly includes amounts (such as corrective costs) other than the taxpayer's anticipated tax savings, a premium-style fee based on the indemnifiable loss is unlikely to be a prohibited "contingent fee."

Even to the extent that the premium-style fee is regarded as based partly on the taxpayer's anticipated tax savings, the fee is unlikely to be a "contingent fee" within the meaning of the Circular 230 prohibition because a premium-style fee is fixed and does not vary depending on whether the tax savings are ultimately sustained. Because the amount of the fee does not change based on whether the tax position succeeds,[329] such a fee is not "based ... on whether or not a position taken on a tax return or other filing avoids challenge ... or is sustained ... [,]" is not "based on a percentage of taxes saved," and does not "otherwise depend[] on the specific result attained."[330] The fee could be based partly on the taxes that the taxpayer and lawyer *hope* will be saved as a result

326. *Id.* § 10.27(c)(1).

327. *See supra* note 314 and accompanying text (explaining premium-style fees for tax opinions would be based on maximum indemnity that could have to be paid).

328. *See supra* Part III.B.2.b.

329. *See supra* note 314 and accompanying text.

330. Circular 230 § 10.27(c)(1).

of the tax planning, but a premium-style fee would never be based on the taxed that are actually saved.[331] That is, the fee is not based on *whether the position is challenged or sustained* or *whether a specific result is attained*.[332] Thus, where the client pays the same fee regardless of the ultimate result, the fee is unlikely to be a prohibited "contingent fee."

There is also a question of whether a premium-style fee could be a prohibited "contingent fee" as a fee "based on a percentage of the refund reported on a return."[333] However, the tax position analyzed in the opinion is typically only one of many items relevant to the amount of a refund (or amount due) reported on a return. That is, the fee may be based partly on the tax treatment of one item relevant to the taxpayer's tax bill, but it is unlikely to be based on the amount of the refund itself.[334] Moreover, even if the taxpayer's refund is determined solely based on the tax savings on the matter on which the opinion is rendered, the fee is still quite unlikely to be "a percentage of the refund reported on the return." This is because, as explained above, the fee is based on a percentage of the indemnifiable loss, and the indemnifiable loss is neither coextensive with nor determined as a percentage of a refund reported on a return.[335] Thus, the premium-style fee is unlikely to be prohibited as a contingent fee based on "a percentage of the refund reported on a return."[336]

Circular 230's "contingent fee" rule also prohibits "any fee arrangement in which the practitioner will reimburse the client for all or a portion of the client's fee in the event that [the client's] position ... is not sustained."[337] A client who pays a premium-style fee might be indemnified for its losses via the malpractice rules, which could include the fee.[338] However, the possibility that the client *might be reimburse[d]* for the fee should not make the fee a "contingent fee" for purposes of Circular 230 because it is unknown if the client "*will*

331. *See supra* note 314 and accompanying text.
332. Circular 230 § 10.27(c)(1).
333. *Id.*
334. *See supra* notes 314, 327-28 and accompanying text.
335. *See supra* notes 314, 327-28 and accompanying text.
336. Circular 230 § 10.27(c)(1).
337. *Id.*
338. *See supra* Part III.B.2.b.

[be] reimburse[d]" for the fee.[339] As discussed herein, malpractice recovery is far from certain even if the tax opinion is wrong.[340] Therefore, it is far from certain that the client would be reimbursed for the fee even if the tax position is successfully challenged.

Ultimately, although there are questions, it is unlikely that premium-style fees for tax opinions would be "contingent fees" within the meaning of Circular 230's prohibition.

The second question about whether premium-style fees are allowed under Circular 230 arises because Circular 230 prohibits tax practitioners, when "evaluating a Federal tax matter, [from] tak[ing] into account the possibility that a tax return will not be audited or that a matter will not be raised on audit."[341] The use of a premium-style fee is unlikely to violate this prohibition for two reasons. First, a premium-style fee would be based upon the probability that the opinion writer would be obligated to indemnify the client for losses.[342] That probability depends partly on the risk of audit and the risk that an issue is raised on audit, but it also depends on many other things, including the likelihood that the position will be sustained on the merits if challenged and, if the position is not sustained, the likelihood that the lawyer will have breached the standard of care.[343] Second, to the extent that the tax advisor is taking account of the possibility of an audit/challenge, she is doing so only for purposes of setting the fee for the advice[344] and not for purposes of "evaluating a Federal tax matter."[345] That is, even if audit risk is part of the fee analysis, the audit risk is not considered when evaluating the substantive tax analysis or when providing the tax advice to the client. Thus, although the analysis is not certain, it is unlikely that an opinion writer would be precluded from using a premium-style fee because of Circular 230's prohibition on taking audit risk into account when evaluating a Federal tax matter.

339. Circular 230 § 10.27(c)(1) (emphasis added).
340. *See supra* Part III.B.2.
341. Circular 230 § 10.37(a)(2)(vi).
342. *See supra* note 314 and accompanying text.
343. *See supra* Part III.B.2.a.
344. *See supra* note 314 and accompanying text.
345. Circular 230 § 10.37(a)(2)(VI).

b. Other Concerns About Premium-Style Fees

Additional concerns could arise from the use of a premium-style fee for tax opinions. For example, a premium-style fee could prevent a client from relying on the tax opinion for penalty protection purposes because the fee might create a conflict of interest for the lawyer, meaning that the advice might not be sufficiently objective so that it could be reasonably relied upon in good faith.[346] However, a fee that is calculated as a premium—based on the risk and magnitude of the potential indemnification obligation—might not present the same conflict as the higher than normal fee in *106 Ltd. v. Commissioner*.[347] If the fee is carefully calibrated to accurately price the lawyer's financial exposure,[348] the fee arguably should not create an extra incentive (or disincentive) for the lawyer. In comparison, a flat fee that is set without regard to (and possibly much higher than) the lawyer's financial exposure would create such an incentive. Whether a fee can be sufficiently carefully calibrated is, of course, a question.

Moreover, there is a possibility that, regardless of how the fee is calculated, a tax adviser that is "intricately involved in planning [the] transaction ... has an 'inherent and obvious conflict of interest'" such that the adviser's advice cannot be relied upon for penalty protection.[349] In that case, switching to a premium-style fee would not necessarily reduce the client's ability to rely on the adviser for penalty protection.

Another concern with a premium-style fee is that it could increase the likelihood of malpractice liability if the opinion is wrong. An increased chance of malpractice liability could arise if the fee provides the lawyer with "a strong incentive to provide the opinion necessary to assure that the transaction will proceed, regardless of

346. *See* Johnson, *supra* note 11, at 952 (citing 106 Ltd. v. Comm'r, 136 T.C. 67, 81 (2011)) (discussing the court's conclusion that "the opinion could not be relied on because the accounting firm charged ... more than its usual fee, indicating that the fee was 'the firm's cut for helping to make the deal happen'"); Michelle M. Kwon, *Dysfunction Junction: Reasonable Cause and Good Faith Reliance on Tax Advisors with Conflicts of Interest*, 67 TAX LAW. 403, 405 (2014); Lang, *supra* note 197; Lang, *supra* note 179 (citing Canal Corp. v. Comm'r, 135 T.C. 1999 (2010)).

347. 136 T.C. at 81; *see also* Johnson, *supra* note 11, at 952 (discussing the case).

348. *See generally supra* note 314 and accompanying text; *supra* Part V.A.1.

349. Lang, *supra* note 197.

what an objective analysis of the transaction would conclude."[350] In such a situation, the "trier of fact in a malpractice action, observing this conflict, may be more inclined to find the opinion itself negligent, if not intentionally misleading."[351] But again, it is not clear that a premium-style fee creates such an incentive, especially if carefully calibrated. Nonetheless, there is some risk.

The foregoing discussion is not exhaustive. Additional concerns about the use of premium-style fees could arise.[352] Ultimately, despite concerns, a tax opinion giver should consider using a premium-style fee particularly for matters where the indemnity function of tax opinions resonates strongly.

B. Terms of Client Engagements

The tax advisor may also want to reduce the likelihood that she will have to make an indemnity payment at all. One way to do that would be by altering the terms of the initial engagement agreement[353] to prospectively limit the advisor's potential malpractice exposure.[354] The Model Rules allow lawyers to "make an agreement prospectively limiting the lawyer's liability to a client for malpractice" but only if "the client is independently represented in making the agreement."[355] Although some states prohibit such agreements,[356] other states allow a lawyer to limit potential malpractice

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350. Lang, *supra* note 179.

351. *Id.*; *see also* Lang, *supra* note 197.

352. *See infra* Part V.E. In addition, it is possible, but unlikely, that a premium-style fee could cause a transaction to be reportable as subject to "contractual protection" under the Treasury Regulations. *See* Treas. Reg. § 1.6011-4(b)(4). This is unlikely for the same reasons that explain why a premium-style fee is unlikely to be a prohibited contingent fee for purposes of Circular 230. *See supra* Part V.A.2.a.

353. *See generally* Marian C. Rice, *Engagement Letters: Beginning a Beautiful Relationship*, 39 LAW PRAC., May/June 2013, at 14; *see also* MODEL RULES OF PROF'L CONDUCT r. 1.5 cmt. 2 (AM. BAR ASS'N 2017) (indicating the "desirab[ility]" of at least having a "written statement concerning the terms of the engagement").

354. Note that a prospective contractual limitation on the tax advisor's malpractice liability does not affect either the advisor's duties under Circular 230 or potential sanctions thereunder.

355. MODEL RULES OF PROF'L CONDUCT r. 1.8(h) (AM. BAR ASS'N 2017). The comments to Model Rule 1.8(h) cast doubt on some clients' abilities to evaluate a request limiting a lawyer's malpractice liability. *Id.* r. 1.8(h) cmts. 14-15.

356. *See, e.g.*, N.Y. RULES OF PROF'L CONDUCT r. 1.8(h)(1) (2018) (prohibiting prospective agreements that limit malpractice liability).

liability by agreement with the client.[357] Such an agreement would typically be made in the engagement letter at the beginning of the representation.[358] However, liability-limiting agreements seem unlikely, partly because

> It is hard to imagine a situation in which independent counsel would advise a client that it was prudent to enter into such an agreement—why should a client trust his affairs to a lawyer who so clearly lacked confidence in his own abilities (at least with respect to the matter in question)?[359]

Clients in some contexts, however, have agreed to such limitations. For example, the former owner of the Detroit Pistons, who engaged Deloitte in connection with his estate plan, agreed to limit the period in which a malpractice claim could be brought to one year, and the court upheld this contractual limitation.[360] That case involved tax malpractice by nonlawyers,[361] and it is likely to be more difficult for lawyers to impose such limits. Nevertheless, the insurance paradigm discussed herein suggests that the more concerned a tax opinion giver is about the risk of having to pay an indemnity on account of a malpractice claim arising from a tax opinion, the more the lawyer might want to try to limit her malpractice exposure prospectively, even if doing so is difficult under the ethical rules.[362]

C. The Design of Tax Opinions

Another way for the opinion writer to reduce her chances of making an indemnity payment is to adjust her approach to the tax

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357. *See generally* AM. BAR ASS'N CPR POLICY IMPLEMENTATION COMMITTEE, *supra* note 156 (identifying state-by-state deviations from Model Rule 1.8).

358. *See* Rice, *supra* note 353, at 14.

359. HAZARD ET AL., *supra* note 155, § 13.33.

360. Aaron v. Deloitte Tax LLP, No. 653203, 2016 WL 4430495, at *7-9 (N.Y. Sup. Ct. 2016), *aff'd,* 149 A.D.3d 580 (2017).

361. *See id.*

362. If the lawyer is so keen on limiting her malpractice exposure because of her lack of competence in the complex subject matter or because of her distrust of an unworthy prospective client, she should decline the matter. *See* MODEL RULES OF PROF'L CONDUCT r. 1.1 (AM. BAR ASS'N 2017) (competence); *see also supra* note 283 (discussing unworthy clients).

opinion. The most obvious way to do this is by working even harder to ensure that she is exercising appropriate care and meeting the highest standards of practice when rendering tax opinions.[363]

A different, more self-serving, strategy is merely to add more "bells and whistles" to the tax opinion.[364] Tax opinions are already limited by various assumptions and caveats, and already rely on representations from clients and others.[365] These provisions narrow the scope of the lawyer's advice and, thus, constrain the lawyer's potential liability if the position is successfully challenged,[366] thereby ensuring that the client itself retains some of the risk of loss from a position that is successfully challenged.[367] These limitations are already perceived by some as a way to "avoid any obligation to clients if the position fails."[368]

A lawyer who is increasingly aware of, and concerned about, the potential indemnity implied by a tax opinion might add even more assumptions and caveats to the opinion. She might also ask the client and others to make a larger number of even more comprehensive representations on which the tax opinion will rely. By pushing more relevant information into representations and assumptions, the lawyer can try to offload responsibility for their contents, thereby limiting the scope of her work and limiting her indemnity obligation if the tax position is not sustained.[369] This strategy could be available as long as reliance on the assumptions and representations is reasonable,[370] the lawyer is still behaving competently and diligently,[371] and the lawyer is still communicating clearly with the client about the terms of the engagement, the advice, and the import of the advice.[372] There are limits to this strategy because responsibility for the core legal analysis must stay with the lawyer, lest the lawyer perform no service at all.[373] However, particularly in contexts

363. *See supra* notes 175-76 and accompanying text.
364. *See supra* note 304 and accompanying text.
365. *See supra* note 259 and accompanying text.
366. *See supra* notes 169-70, 259-60 and accompanying text.
367. *See supra* notes 169-70, 259-60 and accompanying text.
368. Johnson, *supra* note 11, at 948, 955.
369. *See supra* notes 169-70, 257-58.
370. *See* Circular 230 §§ 10.33(a)(2), 10.37(a)(2)(i), (a)(3).
371. *See id.* §§ 10.22, 10.35.
372. *See id.* § 10.33(a)(1), (3).
373. *See* Rothman, *supra* note 11, at 373-74.

where the indemnity function of tax opinions resonates most strongly, it would be unsurprising to see lawyers add more bells and whistles to tax opinions to limit the potential indemnity obligations.

Ultimately, the more sensitized lawyers become to the potential indemnity function of tax opinions, the more that lawyers are likely to do to curtail this function, and the less that tax opinions will ultimately serve this function. That is, the more impactful this Article becomes, the less its core observation—that tax opinion writers serve as potential indemnifiers—may end up being true.

D. The Market for Tax Advice

The insurance paradigm for understanding the function of tax opinions may also affect how clients select counsel and how lawyers market themselves to clients. Specifically, the indemnity function of tax opinions suggests additional factors that clients should consider when hiring a firm to provide a tax opinion. When hiring a lawyer, prospective clients typically consider expertise, experience, reputation, rapport, and billing rates, among many other things.[374] However, if one of the functions of a tax opinion is to provide the client with possible indemnification for damages, a prospective client should also consider (1) whether the firm has the financial strength to pay on any indemnity claim[375] (including the firm's malpractice insurance coverage), (2) how combative or cooperative the firm is likely to be if an indemnity claim is made (including the ease/difficulty of the process of making such a claim), and (3) the amount the client will pay in exchange for a certain type of assurance.[376]

A focus on these types of factors could change the information that clients and lawyers seek during the hiring process. For example, clients who appreciate the potential indemnity function of tax opinions would be more likely to ask about the firm's malpractice insurance coverage, and lawyers would need to be more prepared to disclose this information. Information requests could

374. *See e.g.*, Okamoto, *supra* note 2, at 18 (discussing the importance of reputation).

375. *See* Wolfe, *supra* note 79, at 445-23 (when shopping for insurance generally, "the financial strength of the Insurer is a critical consideration").

376. *See generally supra* note 316 and accompanying text.

go the other direction too. For example, a lawyer who is concerned about potential indemnity exposure might, when considering whether to represent a new client, ask whether the prospective client has ever sued a prior lawyer for malpractice. Ultimately, more pre-engagement disclosure about malpractice insurance coverage and other related matters (for example, average speed of resolution of malpractice claims and history of malpractice claims) could become more common as clients and lawyers develop greater appreciation for the indemnity function of tax opinions.

In addition, states might consider making its requirements about lawyers' malpractice insurance coverage more rigorous.[377] States could, for example, require more malpractice coverage or more disclosure about malpractice coverage. In particular, such requirements could target lawyers in specialized practice areas, such as tax, where the indemnity function of opinions might have particular resonance.[378]

Of course, the client would prefer that a tax opinion is correct, and the desired tax treatment is achieved, such that no malpractice/indemnity claim is made.[379] This is, implicitly, part of one of the key factors relevant today when a client chooses an attorney; clients want to know if their lawyer will provide good advice.[380] Thus, attorneys seeking clients emphasize their expertise and their ability to advise clients well. To bolster a law firm's argument that a client should choose the firm, the firm might also want to share data about, for example, its low rate of malpractice claims, thereby helping to establish that the firm's advice is less likely to result in a potential indemnification claim than the advice of other firms.

Ultimately, how the market for tax lawyers might change due to the indemnity framework depends on how strongly the indemnity function of advice resonates with clients and lawyers, and under

377. Most states do not require lawyers to tell clients about the lawyer's malpractice coverage. *See* Kritzer & Vidmar, *supra* note 284, at 71-76 app. 1 (detailing state-by-state malpractice insurance disclosure requirements); *see also* HAZARD ET AL., *supra* note 155, at 13-84 to 13-85 (lamenting that clients often do not know what resources are available to pay judgments against lawyers).

378. *See, e.g.*, NEV. RULES OF PROF'L CONDUCT r. 7.4(d)(2)(iii) (Feb. 5, 2018) (imposing higher malpractice coverage requirements for lawyers who communicate that they are "specialists").

379. *See supra* notes 67-68 and accompanying text.

380. *See supra* notes 67-68 and accompanying text.

what circumstances. At the very least, understanding tax opinions as implicit indemnity agreements raises important additional questions for clients and lawyers to consider asking each other when deciding whether and how to work together.

E. Conclusion About the Consequences of the Insurance Construct for Tax Opinions

There are more potential consequences of viewing tax opinions through an insurance lens. For example, additional questions include: in what situations might conceiving of the tax lawyer's role as an indemnifier (and possibly using premium-style fees) pose a "significant risk that the representation ... will be materially limited by ... a personal interest of the lawyer,"[381] (which would be problematic under Model Rule 1.7(a)(2))? And if a tax opinion writer really wanted to embrace the indemnity function of a tax opinion, how far could she go with explicit terms of "insurance" in an engagement letter, without becoming subject to regulation as an insurer and without violating Circular 230 or the Model Rules? The answers to these questions (and more) are beyond the scope of this Article. However, the forgoing helps to illustrate that the insurance-like aspect of tax opinions can have many potential consequences, which can affect fundamental aspects of the lawyer-client relationship.

CONCLUSION

Tax lawyers, by providing tax opinions, provide an element of insurance—a limited and conditional indemnity—to their clients. Understanding the role of tax lawyers through the insurance lens can have significant implications for the relationship between the tax lawyer and her client. Lawyers and clients ignore the indemnity aspect of their relationship at their peril.

Policymakers should also consider the implications of the insurance paradigm. Is this insurance-like role of tax lawyers good or bad for society? Does the tax lawyer's insurance-like role enhance tax compliance and decrease enforcement costs? Or does

381. MODEL RULES OF PROF'L CONDUCT r. 1.7(a)(2) (AM. BAR ASS'N 2017).

the insurance-like role embolden taxpayers to take more aggressive positions and embolden tax lawyers to provide more aggressive advice? Can (and should) the laws governing malpractice liability be adjusted, particularly given the lawyer's insurance-like role, to enhance compliance and enforcement and inhibit aggressive behavior? And if so, how would such changes affect the pricing and availability of malpractice insurance, the frequency and costs of malpractice claims, and more broadly, the economics of the legal profession, the nature of the attorney-client relationship, and the availability and cost of legal services? This Article provides the foundation for engaging with these important questions.