

National Association of Bond Lawyers
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**BOND COUNSEL OPINIONS IN A
TAXABLE WORLD: ETHICAL AND
PRACTICAL CONSIDERATIONS**



Current Practices for BABs, RZEDBs and Tax Credit Bonds:

Circular 230

Opinions

Tax Disclosure

Based on a review of Official Statements for
a number of recent issues

Identification of Issues:

Searched EMMA as of 1/04/10

Transactions closing after 11/1/09

Issue name contained “BAB” or “Build” or
“Recovery” or “QSCB” or “Credit”

Principal amount over \$5 million

OS contained form of bond or tax opinion (6 or
7 BAB deals did not and were left out)

Resulting Survey Pool:

BABs or RZEDBs – 164 issues

From 38 states, with bond or tax opinions from 68 different firms; one firm appeared 12 times, no other firm more than 7 times

QSCBs – 42 issues

From 26 states, with bond or tax opinions from 30 different firms; one firm appeared 4 times, 6 other firms appeared 2 or 3 times

Circular 230 Application:

Written advice – no particular form

Circular 230 Application:

Written advice

By a practitioner – includes any attorney in good standing

Circular 230 Application:

Written advice, by a practitioner

On a Federal tax issue – “item of income, gain, loss, deduction or credit”

Circular 230 Application:

Written advice, by a practitioner, on a Federal tax issue

In an arrangement with a significant purpose as the avoidance or evasion of any tax

Circular 230 Application:

Written advice, by a practitioner, on a Federal tax issue, in an arrangement for avoidance or evasion,

unless it is in a “state or local bond opinion” – covers excludability of interest from gross income, among other things

Circular 230 Application:

Written advice, by a practitioner, on a Federal tax issue, in an arrangement for avoidance or evasion, unless it is in a “state or local bond opinion”

or has a disclaimer to prevent it being a reliance opinion or a marketed opinion

Circular 230 Application:

Written advice, by a practitioner, on a Federal tax issue, in an arrangement for avoidance or evasion, unless it is in a “state or local bond opinion” or has a disclaimer

which is prominently disclosed – “separate section”

Circular 230 Disclaimers:

For a Reliance Opinion must say – “advice is not intended or written to be used and cannot be used to avoid penalties”

This is the “Short Form”

Circular 230 Disclaimers:

For a Marketed Opinion must say –

“advice not intended or written to be used to avoid penalties; and

“advice written to support promotion or marketing of the arrangement; and

should seek advice from an independent advisor”

This is the “Long Form”

230 Disclaimer or Not?

	<u>BABs</u>	<u>Percentage</u>
Disclaimer In OS	108 of 164	65.9 %
Disclaimer In Opinion	56 of 164	34.1 %

	<u>QSCBs</u>	<u>Percentage</u>
Disclaimer In OS	42 of 42	100.0 %
Disclaimer In Opinion	35 of 42	83.3 %

230 Disclaimer or Not? (by pairs)

<u>In OS</u>	<u>In Opinion</u>	<u>BABs</u>	<u>Percentage</u>	<u>QSCBs</u>	<u>Percentage</u>
Yes	Yes	50	30.5 %	35	83.7 %
Yes	No	58	35.4	7	16.3
No	Yes	6	3.6	0	0
No	No	<u>50</u>	<u>30.5</u>	<u>0</u>	<u>0</u>
		164	100.0 %	42	100.0 %

230 Disclaimer: Long form or Short form?

Official Statement

	<u>BABs</u>	<u>Percentage</u>	<u>QSCBs</u>	<u>Percentage</u>
Long	104	96.3 %	42	100.0 %
Short	<u>4</u>	<u>3.7</u>	<u>0</u>	<u>0</u>
	108	100.0 %	42	100.0 %

Opinion

	<u>BABs</u>	<u>Percentage</u>	<u>QSCBs</u>	<u>Percentage</u>
Long	40	71.4 %	27	77.1 %
Short	<u>16</u>	<u>28.6</u>	<u>8</u>	<u>22.9</u>
	56	100.0 %	35	100.0 %

Variations in 230 Disclaimers

230 Disclaimer – only Short Form (no “written to promote”)

“The advice contained herein cannot be used by any taxpayer, including the owners of the Bonds, for the purpose of avoiding penalties related to Federal income tax matters that may be imposed on the taxpayer. Taxpayers, including the owners of the Bonds, should seek advice based upon the taxpayer’s particular circumstances from an independent tax advisor. This notice is intended to comply with the provisions of Section 10.35 of the United States Treasury publication Circular 230.”

230 Disclaimer – only Short Form (no “written to promote” or “seek advisor”)

“Any federal tax advice contained herein (including any attachments) is not intended or written to be used, and it cannot be used, for the purpose of (i) avoiding penalties under the Code, or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.”

230 Disclaimer – Long Form?

“You should be aware that:

- (i) the discussion with respect to United States federal tax matters in this Official Statement and the opinion of Bond Counsel was not intended or written to be used, and cannot be used, by any taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer;
- (ii) such discussion was not written and the opinion of Bond Counsel was not provided to support the promotion or marketing (within the meaning of IRS Circular 230) of the transactions or matters addressed by such discussion; and
- (iii) each taxpayer should seek advice based on his or her particular circumstances from an independent tax advisor.

This notice is given solely for purposes of ensuring compliance with IRS Circular 230.”

230 Disclaimer – only Short form!

“You should be aware that:

- (i) the discussion with respect to United States federal tax matters in this Official Statement and the opinion of Bond Counsel was not intended or written to be used, and cannot be used, by any taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer;
- (ii) such discussion was not written and the opinion of Bond Counsel was not provided to support the promotion or marketing (within the meaning of IRS Circular 230) of the transactions or matters addressed by such discussion; and
- (iii) each taxpayer should seek advice based on his or her particular circumstances from an independent tax advisor.

This notice is given solely for purposes of ensuring compliance with IRS Circular 230.”

230 Disclaimers – various starts

“To ensure compliance with requirements imposed by the Internal Revenue Service, Bond Counsel informs you that . . .”

“Internal Revenue Service regulations require us to advise you that . . .”

“Under 30 C.F.R. part 10, the regulations governing practice before the Internal Revenue Service (Circular 230), the Issuer and its tax advisors are (or may be) required to state that . . .”

230 Disclaimer – may be entirely ineffective if not a separate section

“3. Interest on the Bonds is not excluded from gross income for federal income tax purposes. This opinion is not intended to be used, and cannot be used, by any taxpayer for the purpose of avoiding any penalties that may be imposed on the taxpayer under the Code. The opinion set forth in this paragraph is provided to support the marketing of the Bonds. We express no opinion herein regarding other federal tax consequences arising with respect to the Bonds.”

230 Disclaimer – admits Bond Counsel drafted tax disclosure

“This advice was written to support the promotion or marketing of the Bonds. This advice is not intended or written by XXX (Bond Counsel) to be used, and may not be used, by any person or entity for the purpose of avoiding any penalties that may be imposed on any person or entity under the U.S. Internal Revenue Code. Prospective purchasers of the Bonds should seek advice based on their particular circumstances from an independent tax advisor.”

BAB/RZEDB Opinions

<u>Points Made</u>	<u>Out of 164</u>	<u>Percentage</u>
Interest is includable or not excludable	115	70.1 %
Silent on interest taxability	36	22.0
States no opinion on interest taxability	<u>13</u>	<u>7.9</u>
	164	100.0 %
States that Bonds are BABs	10	6.1 %

Correlation of 230 Disclaimers in Opinions to BAB/RZEDB Opinion Points

	<u>Interest Included</u>		<u>Silent on Interest</u>		<u>No Opinion on Interest</u>		<u>Bonds are BABs</u>	
	<u>No.</u>	<u>Percentage</u>	<u>No.</u>	<u>Percentage</u>	<u>No.</u>	<u>Percentage</u>	<u>No.</u>	<u>Percentage</u>
Long Form	35	30.4%	5	13.9%	0	0.0%	2	20.0%
Short Form	12	10.4	4	11.1	0	0	0	0
None	<u>68</u>	<u>59.2</u>	<u>27</u>	<u>75.0</u>	<u>13</u>	<u>100.0</u>	<u>8</u>	<u>80.0</u>
	115	100.0%	36	100.0%	13	100.0%	10	100.0%

Selected Concepts from BABs Opinions

Excludability is conditioned

“Interest on the Bonds is not excludible from gross income for federal income tax purposes. In rendering the opinion in this paragraph, we have assumed continuing compliance with certain covenants designed to meet the requirements of Sections 54AA and 6431 of the Code.”

Reliance is denied

“No one other than the Issuer shall be entitled to rely upon this opinion without our prior written approval.”

“This opinion is addressed to and is solely for the benefit of the Issuer and may not be relied upon by any other person without our express written consent.”

Reliance is invited

“\$ _____ County General
Obligation Bonds, 2009 (Federally Taxable -
Issuer Subsidy - Build America Bonds)

TO: THE REGISTERED OWNERS OF THE
ABOVE-CAPTIONED BONDS

We have served as Bond Counsel in
connection with the issuance by”

Reliance is denied and disclaimed!

“This opinion is solely for the benefit of the Issuer in connection with the original delivery of the Bonds and may not be relied upon by any other person or for any other purpose without our express written consent.

Investors are urged to obtain independent tax advice regarding the Bonds based upon their particular circumstances. The opinions herein with respect to the State and federal income tax matters above regarding the Bonds are not intended or written to be used and cannot be used, for the purposes of avoiding federal taxpayer penalties and were written to support the promotion or marketing of the Bonds. The preceding sentence is intended to comply with the provisions of Section 10.35 of the United States Treasury publication Circular 230.”

QSCB Opinions

	<u>Points Made</u>	<u>Out of 42</u>	<u>Percentage</u>
States that Bonds are a QSCB issue	42		100.0 %
Holders get a credit	41		97.6
Credit amount is taxable	41		97.6
Interest is includable or not excludable	29		69.0 %
Silent on interest taxability	8		19.1
States no opinion on interest taxability	<u>5</u>		<u>11.9</u>
	42		100.0 %
Silent on ability to strip credits; may indirectly indicate stripping might occur	39		92.9 %
States no opinion on strips or stripping	<u>3</u>		<u>7.1</u>
	42		100.0 %

Selected Concepts from QSCB Opinions

No opinion on stripping

“As of the date of this offering, the United States Secretary of the Treasury has not yet issued any regulations that authorize the stripping of a tax credit from qualified school construction bonds. As a result, Bond Counsel is not rendering any opinion regarding the availability of a federal income tax credit evidenced by a Tax Credit Strip under these circumstances.”

BAB/RZEDB Disclosure

<u>Subject</u>	<u>Out of 164</u>	<u>Percentage</u>
Interest is includable/taxable or not excludable	161	98.2 %
Bonds are BABs or RZEDBs	98	59.8
Disposition, sale, transfer – recognition, gain/loss, etc.	87	53.0
Treatment of discount (market and/or original issue)	77	47.0
Backup withholding rules	76	46.3
Treatment of premium (not just “talk to advisor”)	53	32.3

BAB/RZEDB Disclosure (cont'd)

<u>Subject</u>	<u>Out of 164</u>	<u>Percentage</u>
Foreign investors (more than just withholding rules)	50	30.5 %
No credit to holders	43	26.2
Information reporting – 1099s, etc.	42	25.6
Defeasance may be reissuance leading to recognition	38	23.2
Conditions to Issuer's receipt of direct credit payments	27	16.5
ERISA matters (sometimes a separate section)	25	15.2

BAB/RZEDB Disclosure (cont'd)

<u>Subject</u>	<u>Out of 164</u>	<u>Percentage</u>
Bonds are a debt instrument	20	12.2 %
Disclosure assumes U.S. holders only	14	8.5
Treatment by tax-exempt investors	10	6.1
Differences in accrual v. cash treatment by holders	8	4.9
European Union savings taxation	5	3.0
U.S. estate taxation	2	1.2
Bonds are not private activity bonds	1	0.6

Disclosure About BABs Opinion

	<u>Out of 56</u>	<u>Percentage</u>
Disclosure that bond opinion has 230 disclaimer	3	5.4 %
	<u>Out of 36</u>	<u>Percentage</u>
Disclosure that opinion is silent on interest taxability	6	16.7 %
	<u>Out of 13</u>	<u>Percentage</u>
Disclosure that opinion states no opinion on interest taxability	8	61.5 %

Selected Points from BAB Disclosures

Disclosure of 230 opinion disclaimer

“The opinion of Bond Counsel contains the following provision (see APPENDIX E):

The advice contained herein cannot be used by any taxpayer, including holders or owners of the Bonds, for the purpose of avoiding penalties related to Federal income tax matters that may be imposed on such taxpayer. Taxpayers, including holders or owners of the Bonds, should seek advice based upon such taxpayers' particular circumstances from an independent tax advisor.”

Disclosure of 230 opinion disclaimer

“Interest on the Bonds is included in gross income for present federal income tax purposes. In order to comply with Treasurer Circular 230, the opinion of xxx bond counsel, will state that unless specifically stated to the contrary in writing, any advice contained in the opinion concerning tax issues or submissions is not intended to be used, and cannot be used, by the taxpayer for the purpose of avoiding any tax penalties that may be imposed upon the taxpayer by any governmental taxing authority or agency.”

QSCB Disclosure

<u>Subject</u>	<u>Out of 42</u>	<u>Percentage</u>
Bonds are QSCBs	42	100.0 %
Holders get a credit	42	100.0
Credit is taxable	42	100.0
Backup withholding rules	40	95.2
Information reporting – 1099s, etc.	38	90.5
Limitation on credit amount	33	78.6

QSCB Disclosure (cont'd)

<u>Subject</u>	<u>Out of 42</u>	<u>Percentage</u>
Carryover of unused credit	33	78.6 %
Treatment of discount (market and/or original issue)	33	78.6
Credit is strippable	29	69.0
Interest is includable/taxable or not excludable	29	69.0
Credit may be used for estimated taxes	29	69.0
Disposition, sale, transfer – recognition, gain/loss, etc.	28	66.7

QSCB Disclosure (cont'd)

<u>Subject</u>	<u>Out of 42</u>	<u>Percentage</u>
Bonds are a debt instrument	18	42.9 %
Recognition treatment/calculation on sale of a strip by Bondholder	17	40.5
Treatment of discount as interest on a strip	17	40.5
Differences in accrual v. cash treatment before stripping	16	38.1
Risk of immediate stripping by underwriters – “recharacterization”	16	38.1
Differences in treatment for short term strips	14	33.3

QSCB Disclosure (cont'd)

<u>Subject</u>	<u>Out of 42</u>	<u>Percentage</u>
Separate discussion of problems “reporting” strip income to holders	14	33.3 %
Warning on risk of adverse effect of future regulations on strips	11	26.2
Disposition, sale, transfer – recognition, gain/loss, etc. for strips	11	26.2
Warning on risk of adverse effect of future legislation on strips	9	21.4
Recombination discussion	6	14.3

QSCB Disclosure (cont'd)

<u>Subject</u>	<u>Out of 42</u>	<u>Percentage</u>
States no disclosure is given on treatment after stripping	4	9.5 %
Treatment of premium (not just “talk to advisor”)	3	7.1
Defeasance may be reissuance leading to recognition	2	4.8
ERISA treatment	2	4.8
Possibility of constant yield election	1	2.4

Disclosure on QSCB Opinion

	<u>Out of 35</u>	<u>Percentage</u>
Disclosure that bond opinion has 230 disclaimer	2	5.7 %
	<u>Out of 13</u>	<u>Percentage</u>
Disclosure that opinion is silent or states no opinion on interest taxability	0	0.0 %

Selected Points in QSCB Disclosures

Problems in reporting

“The Registrar shall prepare such tax information returns as may be required by the IRS. To date, the IRS has not issued any rulings or regulations or otherwise provided any guidance to the mechanics of the reporting of the Federal Tax Credits as the equivalent of interest income, the reporting of the availability of the Federal Tax Credits to the Owners thereof, or the accrual of OID on the Bonds or the Tax Credit Certificates. Failure of the Registrar to furnish a tax reporting form to an Owner does not necessarily mean that the Owner has no taxable income.”

Constant yield election

“A Holder may elect to accrue all interest, including stated interest, the Tax Credit amount treated as interest, OID, de minimis OID, market discount, de minimis market discount, less premium, in income as interest based on a constant yield method. A constant yield election may be revoked only with the consent of the IRS.”

Conclusions

Almost 2/3rds of bond counsel on BABs think a disclaimer is unnecessary in the opinion as printed in most BAB/ RZEDB offerings

If 230 does apply, more care is needed in language

No consensus on disclosure. There is room for a concerted effort at “form” language

Opinions are more consistent, with some exceptions

NABL predictions on BAB opinions – “state law materiality” and “economic materiality” – no instances found of such points

Where are the underwriters?