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National Association
of Bond Lawyers

March 1, 2005

DELIVERED

CC:PA:LPD:PR (REG—159824—04)
Courier's Desk
Internal Revenue Service
1111 Constitution Ave., NW
Washington, DC 20044

Re: Proposed Regulations Governing Practice
Before the Internal Revenue Service

Ladies and Gentlemen:

Enclosed are the comments of the National Association of Bond Lawyers on the proposed "Circular 230" regulations relating to State or local bond opinions as published December 20, 2004. The comments were prepared by the members listed on the attachment to this letter.

Sincerely,

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NATIONAL ASSOCIATION OF BOND LAWYERS

Comments on Proposed Circular 230 Regulations

I. Introduction

We appreciate the effort that the Treasury Department and Internal Revenue Service have made in the proposed Circular 230 regulations relating to State or local bond opinions. One of the goals of the National Association of Bond Lawyers is to promote a high standard of practice by its members. We agree that practitioners rendering opinions concerning the tax treatment of State or local bonds should be subject to the same professional standards as those applicable to other tax practitioners; and the proposed regulations seek to make a necessary accommodation for the practice of delivering unqualified opinions in the municipal bond market by permitting practitioners to use a "separate written advice" under § 10.39 of the proposed regulations, to deal with matters that would have to be part of the bond opinion if it were subject to the rules for "covered opinions" under § 10.35 of the final regulations dealing with transactions other than State or local bond issuances. This structure acknowledges that, if the written advice were included in the opinion, the opinion might be perceived as a "reasoned" opinion containing qualifications that would be unacceptable to investors in municipal securities, and result in substantial disruption to the municipal securities markets.

Reasoned opinions have the potential to disrupt the municipal securities market (since investors have traditionally relied, for reasons of economic efficiency, upon bond counsel to evaluate tax and state law invalidity risk and have not incurred the expense of developing the ability to conduct independent analyses of tax risk) and may lead indirectly to a lowering of opinion standards (since some practitioners may be willing to deliver opinions with disclosed tax risk that they would not deliver otherwise). For that reason, the opinion standards of the National Association of Bond Lawyers treat reasoned opinions as qualified opinions, even if they are "will hold" opinions. However, by requiring that a written analysis be delivered to the issuer, and especially that it be included in a publicly available transcript, the proposed regulations may fail to avoid the adverse consequences that the proposed regulations attempt to forestall.

If a written analysis is delivered to the issuer, we anticipate that underwriters may ask their counsel to review it (to satisfy their securities law duty to make a professional investigation into the material accuracy and completeness of key representations in the offering document, one of which is that interest on the bonds is excluded from gross income in the opinion of bond counsel). If the written analysis discloses risk of any possible position to the contrary, underwriters and issuers likely will insist that the analysis be disclosed to investors (to avoid a possible material omission that might make the offering materials misleading and expose both the issuer and the underwriter to liability under federal securities laws). In that case, the opinion and analysis together will effectively resemble a reasoned opinion, with substantially the

same adverse consequences to the market and to opinion standards as those that the revisions to the proposed regulations were designed to avoid.[1]

Adoption of the proposed regulations in their present form would create an incentive for practitioners to analyze federal tax issues as if they were significant, even when, in their judgment, there is no significant federal tax issue (which we would expect would almost always be the case)[2]. Otherwise, practitioners would risk being second-guessed as to whether any particular issue is significant. Accordingly, the requirement of a written analysis has the potential to increase issuer expense (to compensate bond counsel for preparing the analysis) and underwriter expense (to compensate their counsel for reviewing and possibly disclosing it), all of which would increase the per issue expense of financing needed improvements to public infrastructure.

We have worked closely with the other market participants in reviewing the proposed regulations, and we support the comments filed by those organizations. In particular, these market participants have expressed significant concerns about the potential costs, as a result of either higher legal fees or higher interest rates, that could result from the implementation of the proposed regulations. As members of the public finance community, we share those concerns.

We and other market participants are committed to upholding the integrity of the municipal securities market, and believe that investor confidence in municipal securities market practices has permitted that market to serve as a cornerstone of local self government built upon fiscal autonomy. For this reason, we are working with other market participants, and would welcome the opportunity to work in tandem with the Treasury and Internal Revenue Service to study the appropriate levels of documentation and allocation of responsibility to assure that facts that are certified to counsel in connection with the preparation of a state or local bond opinion are accurate and complete. In addition to our organization, other market participants such as the GFOA are planning to develop recommended practices that will address the impact Circular 230 will have on the marketplace and the issuer community and to draft standardized models

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[1] Development of a practice of inserting extensive discussion of tax issues into the offering document could have the effect of reducing the level of conviction for federal tax issues necessary to render an approving opinion from "highly confident" (which most practitioners describe as requiring a very high assessment of chances of success) to "more likely than not" (which most practitioners describe as requiring a probabilistic assessment closer to 51%). There are no doubt a not insignificant number of potential transactions that are completed today as taxable financings that could be marketed as tax exempt bond transactions under such a lowered standard.

[2] This tendency is exacerbated by the variety of possible interpretations of the phrase "significant federal tax issues," which according to some could include any federal tax issue as to which there is no published guidance.

for engagement letters, checklists and other materials that may be used in the preparation of state or local bond opinions. We know that the issuer community is concerned about the additional costs associated with the implementation of the proposed regulation. Thus, we wish to work jointly with them and Treasury and the Service to provide necessary guidelines to comply with Circular 230, insofar as that may be possible.

We request that the proposed regulations not be made final until we and other market participants are able to complete this study and issue a report because we believe that the report will have implications for the language of the proposed regulations and the manner in which the duties of counsel are described.

Although we applaud the Treasury Department's recognition in the proposed regulations of the unique features of municipal bond practice, the implication of the separate rules for State or local bond opinions is that all municipal bond transactions involve a tax avoidance or tax evasion arrangement. Our members and the investing public do not believe that the vast majority of State or local bond transactions involve an arrangement of which either the "principal" or a "significant" purpose is the avoidance or evasion of any tax imposed by the Internal Revenue Code. Because Congress has specifically provided for the tax exemption of interest on State or local bonds, we submit that the issuance of bonds that qualify for that exemption cannot properly be viewed as having a purpose to avoid or evade tax.

Certain public finance transactions may be abusive in nature and have the characteristics of an avoidance or evasion scheme. The proposed regulations are not, however, limited to these transactions. A less intrusive method for dealing with these transactions would be for the regulations to provide that a State or local bond opinion is not a "covered opinion" under § 10.35 and does not have to meet the requirements of § 10.39 of the proposed regulations unless the bond issue has the principal purpose of tax avoidance or evasion, with an accompanying presumption that this purpose was not present unless the transaction was a listed transaction. With this approach, the vast majority of bond opinions could continue to be given in the efficient fashion that is appropriate for most public finance transactions.

At a minimum, we suggest the possibility of a compliance presumption for bond issues meeting objective standards for lack of an abuse potential. A rule of this type would alleviate the concern over the compliance expense for these transactions.

The following comments will generally address the proposed regulations in their present structure, with the recognition that the Treasury Department and Internal Revenue Service may reject our proposed approach and determine to implement regulations on a more nearly parallel regime between § 10.39 and § 10.35. Although the proposed regulations do provide a strategy for addressing certain of the unique aspects of State or local bond opinions, certain modifications and clarifications are necessary to provide more ease of application and certainty as to result. Comments are offered generally in the order of the relevant sections.

As will be indicated, we generally believe that the definition of "State or local bond opinion" is too narrow. Many types of advice that ought to fall within the protection of that definition will in fact fall outside it. This will create difficulties when the final regulations of December 20, 2004, for covered opinions other than a State or local bond opinion, become effective on June 21, 2005. Pending revision of the definition, which would seem necessary in both the final regulations of December 20, 2004, and the proposed regulations of the same date, we request an interim announcement similar to Announcement 2004-29 to the effect that, until the end of the 120 day transition period following adoption of the proposed regulations as final regulations, traditional opinions related to the excludability of interest on State or local bonds from gross income and other written advice concerning State or local bonds will not be treated as covered opinions under § 10.35 or as "other written advice" governed by the provisions of § 10.37.

II. Definition of Bond Opinion

(a) References to Related Tax Matters; Non-Exclusivity; Supplemental Opinions. The definition of a State or local bond opinion ("bond opinion") in Prop. Reg. § 10.35(b)(9) requires that the opinion "consists only of advice that concerns" (emphasis added) the excludability of the bond interest from gross income or certain other specified tax attributes: namely, applicability of the alternative minimum tax, status of the bonds as qualified tax-exempt obligations in the hands of financial institutions under section 265(b)(3) of the Internal Revenue Code of 1986 (the "Code"), and status as a qualified zone academy bond under section 1397E of the Code. The proposed regulations also require that the bond opinion be included in the bond offering materials, defined to include an official statement if one is prepared. While this definition will generally cover most bond opinions as delivered in current practice, we believe it should be clarified in certain respects.

(i) Definition Does Not Allow Other Tax Matters. Many bond opinions include other tax-oriented language that references, for example, (a) the consequences under section 265(a)(2) to "retail" bondholders who are not financial institutions, if they incur or continue debt to purchase or carry the bonds, or (b) the treatment of the interest on the bonds received by property or casualty insurance companies. This type of language addressing tax provisions not on the list may raise a question whether the bond opinion is a State or local bond opinion and thus entitled to the protection of the proposed regulations. Further, any list of federal income tax consequences that may be relevant with respect to State or local bonds will evolve over time as new provisions are added to the Code and others are eliminated. For example, until recently, many bond opinions referred to the environmental tax, which is no longer in existence. Attempting to create a specific list of the relevant provisions that may be included could prove problematic in the likely event that, as with the environmental tax, future Code changes either add to the consequences that bond counsel discuss in an opinion or cause provisions to be subtracted from the list.

The same problem arises in connection with qualified 501(c)(3) bonds under section 145 of the Code. Commonly, the 501(c)(3) exemption of the borrowing

entity will be addressed by the opinion of a special counsel or possibly by bond counsel. The 501(c)(3) opinion will typically be referred to in the offering materials for the bonds, and therefore the 501(c)(3) opinion will be treated as a covered opinion under § 10.35 because it is a marketed opinion unless it qualifies as a bond opinion under § 10.39. As described below in the context of advice that relies on the advice of another counsel, one possible analysis of this situation is to treat the 501(c)(3) opinion as part of the bond counsel opinion that relies on it, thus treating the combined two opinions as a single State or local bond opinion. To permit this analysis, however, the regulations must be clear that the presence of the 501(c)(3) opinion in the combined bond counsel opinion does not violate the rule against dealing with tax questions other than exclusion of the bond interest from gross income.

(ii) Definition Includes Tax Disclosure as an Opinion. Another variation of the definitional problem concerns treatment of the tax section of the offering document as an "opinion" for purposes of the regulations. Typically, if bonds are offered at a discount or premium, the tax section of the offering materials will include a discussion of such premium or discount, including its relationship to the bond interest, the amortization of the premium or discount, and the effects thereof on a bondholder's tax basis for the bonds. Sometimes other tax-related matters are also discussed, such as pointing out that certain miscellaneous provisions of the Code may apply to certain types of purchasers or noting that subsequent review by the Service of the bonds may adversely affect the market price of the bonds. The substance of such discussions in the offering document generally will not be part of the bond counsel opinion, but its accuracy may be confirmed by a "supplemental" opinion delivered at closing, usually without repeating the discussion verbatim, but simply referring to it by reference to the document caption under which it appears. We believe that the appropriate analysis in these cases is (a) not to treat the language in the offering documents as an opinion covered by the regulations, but rather (b) to treat both the primary opinion and the supplemental opinion as a single bond opinion under § 10.35(b)(9) (notwithstanding that the supplemental opinion is a separate document that is not included in the official statement but that confirms tax statements that do appear there and may deal with matters that go beyond the tax-exemption of the bond interest). A single separate written advice could cover all the required discussion with respect to both opinions.

(iii) Definition Requires "Written" Materials. Another technical problem in the definition of a State or local bond opinion is the requirement that it be contained in "written" offering materials, including an official statement if one is prepared. While virtually every official statement in contemporary practice is prepared in printed form, in some cases what is actually distributed may be an electronic version. We anticipate that the use of electronic, "paperless" offerings will increase over time[3]. The

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[3] The Municipal Securities Rulemaking Board has proposed amending its rules G-32 and G-36 to require the delivery of official statements in electronic form. See MSRB Notice 2005-06 (January 21, 2005).

regulations should clarify that written offering materials in this context include electronic versions, and that the State or local bond opinion may be summarized or referred to in the offering materials.

(iv) Suggestions for Changes in the Definition. We believe that all of the foregoing problems would be eliminated by revising the definition of State or local bond opinion in § 10.35(b)(9) to (a) permit a bond opinion to include written tax advice that is reasonably related to the excludability of the bond interest from gross income or to the other specific tax attributes addressed in the current language of the proposed regulations, (b) clarify that a bond opinion may consist of two or more documents of legal advice, but does not include descriptive portions of offering materials that are not signed by the practitioner, and (c) clarify that the requirement that a bond opinion be included in a written official statement, if one is prepared, may be satisfied by an opinion that is referred to or summarized in a written or electronically communicated official statement if one is prepared (or that is delivered to the purchasers).

Language to this effect would comport with the fact that typically it is not the State or local bond opinion itself that is included in the official statement, but only a proposed form of it. It would also deal with the practice, used occasionally with smaller issues, in which the bond opinion is only summarized in the official statement without attaching the proposed form of it. Even when the form of bond opinion is included in the official statement, a 501(c)(3) opinion or some other opinion that we believe should be treated as, or as part of, a bond opinion will typically not be included in the official statement, but only referenced there. Further, by removing the language causing the offering document itself to be treated as an opinion covered by the regulations, the regulations would obviate the related difficult question as to when opinion advice contained in an offering document is rendered – on the dated date of the document, on the issue date of the related opinion or on the bond delivery date.

(b) Remarketings. The definition of a State or local bond opinion specifically limits this term to opinions delivered in connection with the "issuance" of bonds. The explanation of provisions in the proposed regulations anticipates the scenario in which a bond opinion is "redelivered unchanged" in connection with a remarketing of a qualified tender bond. While it is unusual for an original bond opinion to be "redelivered unchanged" in connection with a remarketing of qualified tender bonds, nonetheless we appreciate this effort to accommodate a bond remarketing. However, we believe the regulations should permit the delivery of a new opinion in addition to redelivery of the original opinion. Notice 88-130, 1988-2 C.B. 543, permits an issuer to remarket an issue of qualified tender bonds, including remarketings in connection with a change in tender period or fixing the interest rate to the bond maturity, without having the remarketing treated as a new issuance (or "reissuance") of the bonds. Even so, remarketings permitted by Notice 88-130 are financially equivalent to the issuance of new bonds in a refunding, since the remarketing establishes the interest rate payable on the bonds subsequent to the remarketing. The final regulations or the explanation should make clear that, in connection with a remarketing of qualified tender bonds, the practitioner may deliver a new opinion if useful in the remarketing, without regard to the fact that the remarketing is not treated as a reissuance.

Similar "redelivery" questions can arise with commercial paper programs. Treas. Reg.§ 1.150-1(d)(4)(ii) allows an issuer to treat notes issued in a qualified commercial paper program, including the notes in post-issuance "rollovers," as a single issue for tax purposes, or alternatively to break tranches of commercial paper into separate issues for tax purposes. The general practice in the financial markets is for the bond counsel for a commercial paper program to deliver an "evergreen" opinion that applies to both the original and the successive notes in the program on a continuing basis. The use of evergreen opinions has developed to avoid the prohibitive logistics, and cost to issuers, of producing a new bond counsel opinion in connection with each issuance of a commercial paper note (which may occur daily, weekly, or monthly and typically is part of a program in which different tranches of commercial paper roll with different periodicities). This practice appears to fall within the concept of "unchanged redelivery" as set forth in the explanation of the proposed regulations. We suggest that the Treasury recognize explicitly, either in the final regulations or the explanation, that a commercial paper program may use a continuing § 10.39 opinion or alternatively a new § 10.39 opinion with its attendant separate written advice at any point in the life of the program, as the parties deem appropriate.

The status of tender bond remarketing opinions or commercial paper programs should also be clarified by revising the definition of "offering materials" in § 10.39(c) so that it refers to remarketings of bonds as well as to their original issuance. This change would effectively amend the definition of a State or local bond opinion in § 10.35(b)(9), which operates by cross-reference to § 10.39(c). The explanation could make clear that, for this purpose, remarketings do not include transactions in which a partial interest in a bond (such as a stripping transaction) is marketed.

(c) Limited Scope Opinions. It would be helpful if the final regulations permitted a State or local bond opinion to include a limited scope opinion with respect to one or more substantive provisions. For example, in a remarketing of qualified tender bonds, the parties might want to use a redelivered original opinion as permitted by the explanation to the proposed regulations, together with a new limited scope opinion that the remarketing does not constitute a reissuance of the bonds or does not adversely affect the tax-exempt status of the bonds. This procedure might lead to a better marketing than a simple redelivery of the original opinion and is more efficient than the use of a complete new opinion as discussed above. The limited scope opinion rules as set forth in § 10.35 are generally workable in the bond context with only a few technical modifications: such an opinion should be permitted on the basis of an agreement between the practitioner and issuer or, if different, the counsel's client (as opposed to an agreement with the taxpayer as required by § 10.35) and should not have to include the disclaimers required by § 10.35(c)(3)(v). A limited scope opinion on a bond issue would have to be accompanied by a separate written advice, but the regulations should allow the separate written advice to be limited to the matters addressed in the limited scope opinion.

(d) Miscellaneous "No Adverse Effect" Opinions. Bond counsel (or special tax counsel) are sometimes called upon, subsequent to the issuance of bonds, to deliver an opinion that a particular modification to the bond documents or in the use of

the financed facilities has no adverse effect on the tax exemption of the interest on the bonds. Other examples of when these opinions are rendered include (i) substitutions of one letter of credit for another (an action sometimes, but not always, accompanied by a tender of the bonds), (ii) release of a debt service reserve fund in accordance with the bond documents upon substitution of a debt service reserve fund surety policy, (iii) creation of a refunding defeasance escrow, and (iv) a transfer of the project from one conduit obligor to another as permitted by the documents. Depending on the circumstances, these opinions may be delivered to some or all of the bond issuer, the trustee, or the conduit borrower.

A "no adverse effect" opinion may fall into any of several categories under the proposed regulations. For example, if the form of it is attached to offering materials for a remarketing, it will presumably be a "marketed opinion" under § 10.35 unless it meets the requirements for a State or local bond opinion as a limited scope opinion, assuming limited scope opinions in bond matters are permitted as recommended above. A "no adverse effect" opinion ought also to be able to use the prominent disclosures that are permitted for other § 10.35 covered opinions if the parties would rather use those disclosures than have a separate written advice under § 10.39. If the opinion is not marketed, and does not address any significant Federal tax issue (so that it is not a "reliance opinion" under § 10.35), neither § 10.35 nor § 10.39 would seem to apply to the opinion in any way. We believe this analysis is implicit in the proposed regulations as currently drafted, but confirmation in the explanation would be welcome.

In this regard the final regulations or the explanation should confirm that a tax-exempt bond issue is not per se a transaction with the principal purpose of tax avoidance. Without this premise, a post-issuance opinion will not be able to avoid treatment as a covered opinion in the ways noted above. The final regulations defining covered opinions appear to assume that municipal bond issues are not principal purpose transactions, in their rule that excludes State or local bond opinions from treatment as covered opinions in the first place, by conditioning that exclusion as well as others on the premise that the transaction is a significant purpose transaction. See Treas. Reg. § 10.35(b)(2)(ii)(B). The regulations under the pre-1997 version of section 6662 defining principal purpose transaction for purposes of the accuracy-related penalty are similar. See 31 C.F.R. § 1.6662-4(g)(2)(ii).

Given these authorities, unless the Service makes a definitive statement to the contrary, we anticipate our members will take the position that any transaction done with the involvement of an issuer, including the original issuance of bonds, modifications thereof and refundings, has at most a significant purpose of tax avoidance or evasion and not the principal purpose of tax avoidance or evasion within the meaning of the regulations.

In many instances, the counsel rendering the post-issuance advice is not the same counsel that rendered the original bond opinion -- for example, where the issuer has subsequently engaged a different bond counsel or the conduit borrower has engaged special counsel to render the post-issuance advice. The requirements set out in bond documents typically require that the opinion be rendered only by "nationally recognized

bond counsel," and they do not typically require that the nationally recognized bond counsel be the same as that rendering the initial opinion. The initial bond counsel may be unaware that the subsequent opinion is rendered, much less of its content. Among other points, the final regulations or explanation should clarify that the delivery of a post-issuance "no adverse effect" opinion does not cause the original opinion to become a covered opinion subject to section 10.35, except in the special circumstance of an authorized redelivery as discussed hereafter (see footnote 5 and accompanying text).

Finally, it would be helpful if the explanation could confirm that post-issuance advice might relate to a transaction that did not have a significant purpose of tax avoidance even if the original issuance of the bonds may be regarded as having that purpose. For example, many post-issuance opinions relate to actions that do not prolong or enlarge the amount of financing outstanding but simply confirm that the action will not affect the issue's tax exemption. If the opinion is not given, the action will not be taken, and the bonds will remain outstanding. Post-issuance opinions are important to issuers in dealing with numerous matters that arise during the life of a bond issue, and it would be appropriate for the regulations to facilitate such opinions.

(e) Exclusion with Prominent Disclosures. Under § 10.35 of the final regulations, a practitioner may exclude a covered opinion from treatment as a reliance opinion or a marketed opinion by making a prominent disclosure that the opinion will not protect the taxpayer from penalties (provided the transaction is not a listed transaction or a transaction with the principal purpose of tax avoidance). In the case of an opinion that would otherwise be treated as a marketed opinion, the final regulations require additional disclosure (i) that the opinion was written to support the promotion or marketing of the transaction and (ii) that the taxpayer should consult the taxpayer's independent tax advisor. There may be cases in which the parties to bond financings, including but not limited to private placements, would prefer to use such disclosures rather than the procedures for a separate written advice under the proposed regulations. It is arguable, however, that the proposed regulations make § 10.39 the exclusive route for compliance by a State or local bond opinion. This argument treats a State or local bond opinion more harshly than covered opinions generally, and it should be negated in the final regulations or explanation.

(f) Exclusion for Preliminary Advice. The final regulations exclude advice from treatment as a covered opinion if it is provided to a client and the practitioner is reasonably expected to provide subsequent written advice to the client that satisfies the requirements of § 10.35. This exclusion should be incorporated into § 10.39 as well, with a deletion of the requirement that the preliminary and subsequent advice must be provided to the "client." In a bond transaction, preliminary advice may be given to any of several different non-client parties (for example, advice that the bond counsel gives to the underwriters), and the final bond opinion may not necessarily be addressed to the party that is the bond counsel's actual client. For example, bond counsel's client in a qualified 501(c)(3) bond offering may be the 501(c)(3) organization, and the bond opinion may be addressed to the issuer and the bond trustee.

(g) Tax Risk Disclosures. Offering materials for bond issues will occasionally include risk disclosures on questions that may relate to the tax exemption of the bonds. An example is the disclosure of possible circumstances that may jeopardize the 501(c)(3) exemption of a conduit borrower in an issue of qualified 501(c)(3) bonds under section 145. Such a discussion is usually separate from the tax matters section, which discusses the underlying tax rules rather than risks related thereto. One or more firms involved in the offering will customarily give the bond underwriters a letter generally relating to the knowledge of the firm with respect to the circumstances relevant to the risk disclosures, including tax risk disclosures. Unlike supplemental opinions addressing the tax matters section, a letter with respect to tax risk disclosure that is part of offering materials that include or reference a separate State or local bond opinion meeting the requirements of § 10.35 or § 10.39 should not be treated as itself a State or local bond opinion or as part of one. The disclosure letter merely relates to facts relevant to risk. It would be helpful for the final regulations or explanation to confirm this point so that the practitioner giving a disclosure letter will be safe in foregoing the requirements for covered opinions under § 10.35 or separate written advice under § 10.39.

(h) Relationship to Final Regulations. At the June 21 effective date of the final regulations, the final regulations will apply generally to written advice on State or local bond matters unless the advice falls within the definition of a State or local bond opinion or some other exclusion. As indicated in these comments, we believe the current form of this definition is too narrow. For example, an opinion that addresses matters other than tax exemption of the bond interest, delivered after June 21, 2005, may be exposed to treatment as a covered opinion under § 10.35 because it is too broad to qualify as a State or local bond opinion. To deal with the period from June 21 until the regulations for State or local bond opinions themselves become final, an announcement should be made that traditional opinions "related to" the exemption of interest on State or local bonds from gross income and other written advice concerning State or local bonds will not be treated as covered opinions if delivered before the effective date of the final regulations relating to bond opinions, notwithstanding that the opinions may not fall within the definition of a State or local bond opinion in § 10.35. An announcement of this nature would be consistent with Announcement 2004-29, to the effect that the "tax shelter opinion" definition in the then proposed form of § 10.35 would not apply to written advice concerning municipal bonds until at least 120 days after the applicable regulations become final.

III. Practitioner Opinions vs. Firm Opinions

Sections 10.39(a) and 10.39(b) of the proposed regulations require a "practitioner" who provides a State or local bond opinion to provide also separate written advice meeting the requirements of § 10.39(b). Bond opinions are generally signed in the name of a firm rather than the name of an individual practitioner, though in some cases an individual will sign his or her own name while indicating that the signature is on behalf of the firm. We suggest that to deal with the various practices that have evolved in rendering bond opinions, language to the following effect could be added at the end of § 10.39(a): "For purposes of this section, an opinion or separate written advice signed in the name of a firm will be treated as having been provided by any practitioner who is a

member of or employed by the firm and participated in the preparation of the State or local bond opinion or separate written advice."

IV. Inclusion of Advice in Transcript

Section § 10.39(b) of the proposed regulations requires that the separate written advice be provided to the bond issuer and states that the separate written advice "may" be set forth in a tax certificate or other documents included in the transcript of proceedings or, if no transcript is prepared, in other documents made available to the issuer. In contrast, the explanation of provisions states affirmatively that the proposed regulations require that the written advice be included in the transcript if one is prepared, eliminating any possibility that the word "may" in the language of the regulations means that the bond counsel has a choice in the matter. The explanation further states that the reason for requiring inclusion in the transcript is to ensure that the written advice is made available to the issuer and is intended to be consistent with the current practice of including the tax certificate and other supporting documents in the transcript. The explanation asks for comments on this requirement.

Bond counsel generally use the term "tax certificate" to refer to a combined statement of facts and representations, including expectations required to be certified by Treas. Reg. § 1.148-2(b)(2) relating to arbitrage, that is signed on behalf of the issuer and other parties. As is noted in the explanation of the proposed regulations, the tax certificate is normally included in the transcript of proceedings, meaning the documents listed in an agenda of the closing and bound into one or more volumes or recorded on a compact disk. A copy of the transcript, or in some cases the unbound documents making up the transcript, is delivered to each party to the closing, including the issuer, for whom the documents are public records, open to the public for inspection. Agents of the Internal Revenue Service auditing a bond issue will customarily begin by requesting and reviewing the transcript. The tax certificate performs the function of stating the basic requirements for the tax exemption of interest on the bonds.

The proposed regulations allow a tax certificate to take on added significance as part of the documentation of compliance with the requirement of the proposed regulations that the written advice of bond counsel must identify and consider all facts that bond counsel determines to be relevant. In some cases, admittedly unusual, the factual investigation by bond counsel into relevant matters may include some that one or more parties deem confidential. An example might be the engineering allocation of the costs of a solid waste disposal facility. The vendor of the facility may be willing to provide great detail to bond counsel as to the respective disposal and electric generation costs, including information as to its profit and overhead, under a confidentiality arrangement, but would not be willing to have that information available to its competitors for use by them in the context of other competitive procurements.

Engineering and financial details of a solid waste disposal facility are only one example. There may be facts concerning the issuer itself that are appropriate for disclosure and consideration by counsel, but not necessarily for newspaper discussion as may be expected to occur if they are transcript items. A transcript requirement could in

fact create a chilling effect on the dialogue with counsel, because of the prospect of publicity.

We do not question the premise that any relevant information should be made available to the bond issuer and to the Internal Revenue Service, if not otherwise privileged, but we do question whether the goal of availability to the bond issuer necessarily requires inclusion in a transcript that is available on a nonconfidential basis to many other parties. We believe the goal of ensuring availability to the bond issuer can be achieved in a manner consistent with this concern by amending the proposed regulations to require only that the written advice be provided to the issuer prior to or contemporaneously with the issuance of the bonds. We believe that in most cases the written advice will in fact be included in the transcript, but the ability to have it cover matters that are not appropriate for inclusion in a widely distributed document should be preserved. It would not be inconsistent with that suggestion for the final regulations to provide that any portion of the separate written advice that is not included within the transcript must have its receipt acknowledged by the issuer in a document that is in fact included in the transcript.

Bond counsel is not always counsel to the issuer of the bonds, but may be counsel to a conduit borrower or other party. While bond counsel in such capacity may, in fact, prepare the transcript, the act of doing so is less likely in that situation to achieve the stated goal of this requirement – namely, advising the issuer. Therefore we again submit that it is more important to require that the written advice be provided to the issuer prior to or contemporaneously with the issuance of the bonds than to require its inclusion in the transcript of proceedings.

V. Factual Assumptions and Representations

(a) "Due Diligence" Requirement. Prop. Reg. § 10.39(b)(1) requires the practitioner to use reasonable efforts to identify and ascertain the facts and states that the practitioner's written advice may not be based on unreasonable factual assumptions or on unreasonable factual representations, statements, or findings of any person. The proposed regulations state that an "unreasonable" assumption, representation, statement, or finding "includes" one that the practitioner knows or should know is incorrect or incomplete. (Without clarification, an "unreasonable" representation could include a representation that is unreasonable for the third party to give, even if, based on differences in knowledge, it is not unreasonable for the practitioner to rely on it.) At a minimum, the word "includes" should be changed to "is," since it does not seem appropriate in an ethical rule or any other context to hold a practitioner responsible for more than what the practitioner knows or should know.

Further, the explanation adds to the language of the regulations by stating that a practitioner may not base the written advice on an assumption, representation, statement, or finding unless the practitioner has exercised "due diligence" in identifying and ascertaining the relevant facts. The explanation gives the example that a practitioner may not rely on a representation that the issuer has met the "three-bid" safe harbor for the price of an investment contract, if the representation does not include a specific

description of how these requirements were satisfied or if the practitioner knows or should know that the representation was incorrect or incomplete. The significance of this discussion in the explanation is uncertain, because the regulations providing for the three-bid safe harbor would not be satisfied merely by a conclusory certification of compliance in any event. To the contrary, the regulations require the issuer to maintain specific records as to the identity of all bidders and the date and time of the bid. More generally, the explanation creates considerable concern because of uncertainty as to the scope of the due diligence concept.

We suggest that in this situation it would be appropriate for the final regulations or explanation to summarize the requirements for the factual portion of the written advice without the reference to due diligence. Instead, the explanation should elaborate the "knows or should know" standard by stating that the question of what a practitioner should know will depend on all the facts and circumstances, including the degree to which the matter involves financial or engineering matters as to which the practitioner is not reasonably expected to have an expertise, the nature of the practitioner's experience with the person making the representation, and whether the person making the representation is a public official who ought to be presumed to be correct and complete in representations made in the course of official duties. The proposed regulations, taken together with the explanation in its present form, can be read to suggest that practitioners must investigate the accuracy of factual representations even if the practitioner has no reason to believe that they are suspect, which we believe was not intended.

Bond counsel are lawyers and typically are not trained as financial analysts or engineers or retained by the client to act in these capacities. In rendering bond opinions, they act diligently to perform lawyerly tasks. They review applicable law and identify the factual issues that are relevant to the opinion expressed. They then ascertain the relevant facts by making inquiries of, and recording responses as representations by, individuals who are in a position to know the facts and have no reputation for misrepresenting facts. In most instances, these individuals are officers of the State or local government issuer. Bond counsel review the responses and representations to determine whether they are consistent internally and with other facts known to bond counsel. If they are consistent, then bond counsel typically relies upon the representations without further inquiry. Further inquiry is undertaken only if the representations are suspect on their face or inconsistent with facts actually known to bond counsel. Under current practice, when facts are represented by a knowledgeable person with no record of misrepresentation, the diligence that is "due" is to review the certification for internal consistency and compare it to facts already known to bond counsel. The final regulations and explanation should clarify that no more is required of bond counsel.

Unless these clarifications of the due diligence requirement are made to correct unwarranted implications of the proposed regulations and the explanation, practitioners will likely believe they must engage in time-consuming, expensive investigations of the representations of their state and local government clients at public

expense. If that result is not avoided by appropriate clarifications, the time and expense required to comply with the regulations could increase substantially.

(b) Organization of Information. The proposed regulations require that the separate written advice must "identify in a separate section" all factual assumptions relied upon, and in another separate section, all factual representations, statements or findings relied upon. The separate written advice will be more easily understood by the issuer if the practitioner is permitted to organize it by grouping with each legal issue the facts that are relevant to that issue, together with the relevant factual assumptions, factual representations, and "reasonable expectations" as required to be certified for arbitrage purposes under Treas. Reg. § 1.148-2 or permitted for private activity bond purposes under Treas. Reg. § 1.141-2. The requirement that factual assumptions and representations be identified can be preserved without the requirement that the identification be in separate sections.

VI. Legal Assumptions

Prop. Reg. § 10.39(b)(2)(ii) provides that in relating the applicable law to the relevant facts, the practitioner may not assume the favorable resolution of any significant Federal tax issue, except in the case of a qualifying reliance opinion under § 10.39(d), or otherwise base an opinion on any unreasonable legal assumptions. The final regulations or explanation should confirm that it is reasonable for the practitioner to assume the correctness of any conclusion in the bond opinion as to matters other than Federal tax law. This assumption will avoid the need for the separate written advice to deal with facts, including procedural actions taken, that establish the validity of the issue under State and local law, when these matters have already been opined upon in the non-tax portion of the opinion. These matters are technically relevant to the Federal tax exemption of the bonds since a bond that is not validly issued may not be tax-exempt because an invalid bond is not an obligation of a State or political subdivision under section 103 of the Code. But requiring the separate written advice to include a full-scale recitation of the facts that establish validity seems beyond the scope of what the regulations are trying to accomplish, especially since many of these facts are already recorded elsewhere in the transcript. The Service has ample other enforcement tools to deal with validity issues in appropriate cases.

VII. Evaluation of Significant Federal Tax Issues

Prop. Reg. § 10.39(b)(3) requires that the written advice consider and evaluate any significant Federal tax issue, defined in Reg. § 10.35(b)(3) as an issue as to which the Internal Revenue Service has a reasonable basis for a successful challenge (and which has a significant impact on overall tax treatment of the transaction). Very few tax-exempt bond issues involve any significant Federal tax issue as thus defined. However, we recognize that the goal of parallel treatment with the rules for covered opinions in § 10.35 requires that the proposed regulations address this topic. We have several comments based on the specific characteristics of public finance transactions.

(a) Definition of "Significant Federal Tax Issue." The definition of a significant Federal tax issue requires that the Service have a "reasonable basis" for a "successful challenge." We realize this definition is part of the final regulations in § 10.35 for transactions outside of public finance. However, as applied in the context of public finance, the definition needs elaboration. Our understanding of "successful challenge" is that it refers to a favorable decision in the event the matter were litigated to final judgment in the United States Supreme Court.[4] Tax audits of State or local bond issues almost never reach court due to the lack of effective procedures for judicial review. In general, audits are settled, either with or without a payment by the issuer. We believe that in this situation, a practitioner should not have to conclude that there is a reasonable basis for a successful challenge by the Service merely because the practitioner concludes that the Service might challenge the tax treatment of an item on audit, or that the issuer might ultimately decide to settle the audit with a payment to the Service. To read the definition otherwise would effectively eliminate the requirement that the challenge be successful. Thus we believe there is no significant Federal tax issue unless there is a question as to which there is a reasonable basis for concluding that if it could be brought before the courts and litigated to final judgment, the final decision would favor the Service.

The phrase "reasonable basis" is described in Treas. Reg. § 1.6662-3(b)(3) as "a relatively high standard of tax reporting, that is, significantly higher than not frivolous or not patently improper." Neither this regulation nor the Circular 230 regulations quantify the reasonable basis standard as a percentage. In this situation we believe our members are likely to look to § 10.34, which deals with the somewhat similar "realistic possibility" standard and defines it in general as one-in-three or greater. Put another way, our members may conclude that the reasonable basis standard means that a tax issue is "significant" if the likelihood that the Service would prevail in court exceeds one-in-three or possibly a lower percentage test such as one-in-four or one-in-five. There may be situations in which our members may conclude that a tax issue is not significant under this kind of analysis or any other but will still want to discuss it as if it were a significant Federal tax issue in the separate written advice in order to protect themselves from an argument that they have failed to comply with Circular 230. Bond underwriters then may feel compelled to refer to the tax issue in the official statement for the bonds even though the bond counsel opinion is unqualified. In this situation, the explanation of the final regulations should include a statement recognizing that the mere fact that a tax issue has been discussed as a significant Federal tax issue does not concede that the Service has a one-in-three likelihood of prevailing or any other specific percentage

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[4] Cf. National Association of Bond Lawyers, Model Bond Opinion Report (2003), p. 7: "Bond counsel may render an 'unqualified opinion' regarding the validity and tax exemption of bonds if it is firmly convinced (also characterized as having 'a high degree of confidence') that, under the law in effect on the date of the opinion, the highest court of the relevant jurisdiction, acting reasonably and properly briefed on the issues, would reach the legal conclusions stated in the opinion."

likelihood of prevailing. We want to avoid creating an environment in which investors are led to believe that unqualified opinions are offered even though bond counsel thinks there is a one-in-three risk (or some lower but still appreciable percentage risk) that the bond interest is taxable. This environment would, in our judgment, represent a significant dilution of the traditional standards for unqualified bond opinions.

(b) Safe Harbors. As noted previously, the explanation of the proposed regulations states that a practitioner cannot rely on a party's nonspecific representation that, for example, the party has complied with the requirements of the safe harbor for establishing the fair market value of a guaranteed investment contract under Treas. Reg. § 1.148-5(d)(6)(iii). The final regulations or explanation should confirm that, assuming the practitioner exercises an appropriate level of care, a failure to meet the requirements of this or any other safe harbor will not by itself establish the presence of a significant Federal tax issue if, on the basis of all the facts and circumstances, there is no reasonable basis for a successful challenge by the Service.

(c) No Requirement of Labeling or Separate Section. The proposed regulations do not require that the separate written advice label the significant Federal tax issues as such. Also, unlike the provision on factual assumptions, the proposed regulations do not require that the significant Federal tax issues be identified in a separate section. The proposed regulations are similar in this respect to the final regulations for covered opinions. We believe they reflect a correct policy decision on this matter: as stated above in the context of factual assumptions, we believe the separate written advice will be most meaningful to issuers if the practitioner is permitted to present it in an orderly sequence tailored to the specific nature of the financing, rather than in an artificial format dictated by Federal regulations. The proposed regulations in this respect should not be altered.

VIII. Reliance On Opinions of Others

Section 10.39(d) of the proposed regulations permits a State or local bond opinion to rely on the opinion of another practitioner with respect to any tax issue, and if the tax issue is a significant Federal tax issue, bond counsel must identify the other opinion and set forth its conclusions in bond counsel's separate written advice to the issuer. Bond counsel must also be satisfied that the combined analysis, taken as a whole, meets the requirements of § 10.39. We believe that the regulations with respect to reliance on opinions of others, which we realize are patterned generally on § 10.35, will present a somewhat unique difficulty in the bond context.

(a) Refundings. When an issuer refunds an issue of tax-exempt bonds, bond counsel will generally rely in substance, and sometimes explicitly, on the bond opinion for the prior (refunded) issue. Bond counsel for the refunding bonds, often without seeking the permission or approval of the bond counsel for the prior bonds, will typically assume that the opinion on the prior bonds was correct as of its date, thus confirming various facts or legal conclusions that are relevant to the opinion on the refunding issue. Counsel issuing the refunding opinion is responsible for considering events and actions subsequent to the prior opinion that may have affected its conclusions.

For example, a refunding of qualified mortgage bonds under section 143 of the Code will typically refund small amounts of a dozen or more prior issues, many of which may themselves have refunded a dozen or more prior issues. Each original issue received an allocation of state volume ceiling under section 146, or else the bond counsel for the original issue could not have delivered an opinion. Refunding bond counsel will check as to change in use, rebate compliance, and other matters for such issues since the date of the prior opinion. One possible manner for dealing with refundings is to allow the bond counsel for the refunding bonds to simply rely on the opinion of bond counsel for the prior issue. In the alternative, bond counsel for the refunding issue could be permitted to rely on the facts or legal conclusions underlying the bond opinion for the prior issue as indicated in the separate written advice for the prior issue, or the tax certificate for bonds issued prior to the effective date of the regulations.

Another possibility for dealing with this situation is to treat refunding opinions as limited scope opinions within the definition of "State or local bond opinion" as suggested above for certain other opinions. This treatment would allow the related separate written advice to focus solely on the matters addressed in the new opinion. It should be permissible to rely on opinions delivered before the effective date of the regulations in a subsequent refunding, without forcing them to be reanalyzed (except to the extent they are manifestly not reliable), and opinions delivered after the effective date that are relied on in a subsequent refunding would not need to be restated as there would already be the appropriate written advice in existence.

(b) 501(c)(3) opinions, special tax counsel opinions. Another case in which a bond opinion will frequently rely on the opinion of another practitioner is that of qualified 501(c)(3) bonds, issued by a State or local government issuer for the benefit of an organization described in section 501(c)(3) of the Code. In this case, the parties often determine that the appropriate law firm to give an opinion concerning the exemption of the beneficiary of the financing is a different firm from the bond counsel firm. The bond opinion will typically state reliance on the 501(c)(3) opinion; both opinions are included in the transcript. The marketing of the bond issue is based on the 501(c)(3) opinion as well as the opinion of bond counsel, raising the question of how the 501(c)(3) opinion fits into the framework of the proposed regulations. The status of the 501(c)(3) opinion in this context could be clarified by adding a statement to § 10.39(d) to the effect that concurrently rendered advice that is relied upon by a bond opinion in conformity with the requirements of § 10.39 will not be separately subject to the requirements of § 10.35.

Similarly, parties will on occasion engage a firm as special tax counsel to provide an opinion that the bond interest is tax exempt, or in some cases a limited opinion that addresses only selected matters related to tax-exemption of the bond interest, such as whether the bonds are arbitrage bonds under section 148 or whether the bonds are issued to provide an exempt facility under section 142, or to prepare or review documents relating to the tax-exemption of interest. In the future, these documents could include the separate written advice under § 10.39(b). The final regulations or explanation should clarify that neither the opinion of special tax counsel nor separate written advice prepared by special tax counsel is separately subject to § 10.35 if they are provided with a concurrently rendered State or local bond opinion under § 10.39.

As a technical matter, the wording of § 10.39(d)(2) should be changed to recognize the use of separate written advice. We suggest: "The practitioner must be satisfied that the combined analysis of the opinions and separate written advice, taken as a whole, satisfy the requirements of this section."

IX. Effective Date

The reference to redelivery of opinions in the explanations of the proposed regulations has raised questions as to the scope of this concept and its application to the effective date provisions of the proposed regulations. As a practical matter, bond opinions are redelivered frequently. Consider the following situations:

(X) a bearer bond issued in 1981 is purchased in July 2005 on the secondary market through a broker and the printed bond delivered to the buyer has the bond opinion on the back. Bond counsel has no knowledge of this transaction.

(Y) a fixed rate bond issued in 1991 is purchased in July 2005 on the secondary market through a broker and the buyer obtains a copy of the official statement from the broker. The official statement includes a copy of the bond opinion. Bond counsel has no knowledge of this transaction.

(Z) bonds are issued in 1992 and in July 2005, a secondary market purchaser, unable to obtain an official statement on the issue but, knowing the firm that normally acts as bond counsel to the issuer, asks the bond counsel for a copy of the original opinion. The bond counsel firm sends such a copy but notes the opinion "speaks only as of its date" and is "not being redelivered."

We submit that the regulations should not treat the July 2005 event as a "redelivery" of the opinions in these examples. Indeed, we believe that the final regulations or explanation should state that a State or local bond opinion, including an opinion delivered prior to the effective date of the final regulations, will not be treated as redelivered or rendered on any date subsequent to its original delivery except a date on which the practitioner or firm that gave the opinion or an authorized successor executes a document specifically authorizing one or more parties to rely on the opinion. In instances where an earlier opinion is expressly redelivered and authorized to be relied upon, that redelivered advice should be analyzed as a new opinion issued on the date of execution of the reliance document.[5]

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[5] This affirmative reissuance situation is different from that described above under II(d) "Definition of Bond Opinion - Miscellaneous "No Adverse Effect" Opinions" and VIII(a) "Reliance On Opinions of Others - Refundings." In those situations, the firm giving the earlier opinion is usually not contacted for its approval of the reliance since the earlier opinion is read as speaking only as of its date. Therefore the relied-upon opinion should not be treated as "redelivered" or retroactively brought into the category of covered

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opinion, unlike in a situation where the opinion giver specifically authorizes its redelivery (with the usual result that the opinion is then held to speak as of the date of redelivery).