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National Association
of Bond Lawyers

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U.S. Department of Treasury
Office of Tax Policy
1500 Pennsylvania Avenue, NW
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Re: Circular 230-State or Local Bond Opinions

Dear Michael:

I am writing on behalf of the National Association of Bond Lawyers (NABL) to follow up on one aspect of the panel discussion of Circular 230 at the recent Bond Attorneys' Workshop in Chicago. The members of NABL greatly appreciated your remarks during the panel, and we thank you again for your participation in it.

The subject that NABL believes merits elaboration is the desirability of allowing a bond lawyer delivering a State or local bond opinion to satisfy the requirements of proposed § 10.39 of Circular 230 by having the opinion include a "penalty protection disclaimer," i.e., a statement that the opinion cannot be relied on to protect the bondholder from penalty if the Internal Revenue Service (IRS) audits the bond issue and concludes that, contrary to the conclusion in the bond opinion, the interest on the bonds is subject to federal income tax. A penalty protection disclaimer can be used under § 10.35, the parallel provision for tax advice in other capital market transactions, and NABL believes that § 10.39 should be the same as § 10.35 in this regard.

The advantage to the parties from using a penalty protection disclaimer under § 10.35 is that it enables counsel to deliver conclusory advice that does not include the otherwise required statement of facts and law and evaluation of significant federal tax issues. Parties may prefer this form of advice if they believe it is more efficient and can save them time and expense. If § 10.39 permitted a similar form of advice in municipal bond financings, bond counsel could deliver a traditional, conclusory bond opinion and would not have to supplement it with the "separate written advice" that proposed § 10.39 would require as documentation of the facts, law, and evaluation of significant federal tax issues.

NABL understands and appreciates the Treasury's premise that § 10.39 should be similar to § 10.35 except on points where there are principled differences between a tax-exempt municipal bond issue and a conventional, taxable transaction. Your remarks at the Workshop and other statements by representatives of the Treasury and the IRS have identified two possible points of distinction between tax-exempt bond financings and the remainder of the capital market transactions that are covered by § 10.35. First, it is said that the penalty protection disclaimer was intended for situations where the tax advisor and the recipient of the tax advice engage in a dialogue regarding the penalty protection disclaimer so that the recipient would appreciate the impact of the disclaimer. Second, it is said that a penalty protection disclaimer would not be meaningful in the context of a tax-exempt bond opinion, since the opinion is delivered to the bond issuer, which is not a taxpayer that would be subject to an accuracy-related penalty, and the taxpayer bondholders are rarely if ever subjected to penalties.

NABL believes that there is no principled difference between the application of the penalty protection disclaimer under § 10.35 to many capital market transactions and the potential application under § 10.39 to the municipal bond market, and that the purpose for allowing a penalty protection disclaimer applies equally well to bond opinions as to any other tax advice. More importantly, as NABL has suggested in prior submissions, the Treasury ought not to prevent the use of a penalty protection disclaimer in a municipal bond financing if the parties want to use this form of opinion, acting in a market context where investors can decline to purchase the bonds if they do not like any aspect of a bond offering, including the bond opinion.

With respect to the first concern that there may be no dialogue between the lawyer rendering the State or local bond opinion and the recipient of that advice, NABL offers the following:

1. The use of penalty protection disclaimers will certainly be a point of intense focus in the marketplace for tax-exempt bonds. NABL is aware of at least one market participant that has submitted comments to Treasury and the IRS objecting to the potential authorization of the penalty protection disclaimers for tax-exempt bonds, noting, among other observations, that a penalty protection disclaimer may not be acceptable to investors or underwriters. NABL recognizes this concern and the possibility that the penalty protection disclaimer may be rejected by the marketplace and be unacceptable to issuers of the bonds. NABL anticipates that there will be substantial, healthy dialogue among all market participants regarding the import of penalty protection disclaimers. The dialogue may not take place directly between an individual bond purchaser and the bond counsel, but similarly such a dialogue may not occur directly between the tax advisor and the taxpayer in most capital market transactions that are covered by § 10.35. For example, in connection with securitized debt offerings (e.g., debt issued by a trust securitizing

receivables), there is generally no dialogue between the tax advisor and the prospective taxpayer-investors regarding the form of the tax opinion. NABL does expect that the penalty protection disclaimer will be closely scrutinized by the tax-exempt bond marketplace and issuers of bonds. NABL further believes that § 10.39 should allow the use of the penalty protection disclaimer so that the market dialogue can, in fact, take place. The marketplace will and should decide the acceptability of a penalty protection disclaimer, rather than the federal government by regulation.

2. Penalty protection disclaimers have been used and accepted in capital market transactions covered by § 10.35, including matters relating to retail investors. For example, investment plans established as qualified tuition programs under section 529 of the Internal Revenue Code offer an investment that is purely for the retail customer. It is becoming increasingly common for 529 plans to include § 10.35 penalty disclaimer language in the federal tax matters discussion contained in the program disclosure statement. NABL sees no principled difference between the use of the penalty disclaimer for section 529 plans (and many other similar capital market transactions) and its application to tax-exempt bond financings.

3. Penalty protection disclaimers are already being used in many municipal bond transactions where the tax advice is covered by § 10.35 rather than proposed § 10.39. For example, conclusory tax advice with a penalty protection disclaimer is offered as to the pass-through nature of trusts or partnerships which receive deposits of outstanding tax-exempt bonds and offer certificates of interest to investors. Similarly, penalty protection disclaimers are being used in the issuance of taxable municipal bonds. In fact, in some cases a single official statement will be used to market separate series of tax-exempt bonds and taxable bonds issued by the same State or local governmental issuer. A penalty protection disclaimer may be provided with respect to the taxable bonds (which may be purchased by foreign investors in reliance on the portfolio exemption for bond interest under section 871 if the bond counsel's opinion that the bonds qualify as debt for federal tax purposes is correct). Thus, if the penalty protection disclaimer were not permitted under § 10.39, there would exist a confusing and inappropriate situation in which the penalty protection disclaimer applies for some types of municipal bond transactions but not others.

With regard to the second indicated concern regarding the tax-exempt bond opinion being delivered to the bond issuer, not the taxpayer bondholder, NABL notes the following:

1. The tax-exempt bond opinion is a crucial aspect of every municipal bond transaction. Delivery of a satisfactory opinion is a condition to the purchasers' obligation to pay for and take delivery of the bonds in virtually all transactions. The form of opinion is typically included in the disclosure document for each transaction so that investors are aware of its terms Practice varies regarding the addressees of the bond opinion. Often, the opinion is addressed to the issuer, the underwriters (or other original purchasers), or both. But in general, subsequent owners of the bonds are also intended to rely on the opinion, although it speaks only as part of its date.

2. A further concern is that a penalty protection disclaimer would have little impact in the municipal bond market as a practical matter. However, while accuracy-related penalties in bond transactions are unusual, there is no legal reason why a penalty could not be assessed in particular circumstances. A penalty protection disclaimer will be significant to any bond purchaser who is concerned that the bond in question may be the subject of an audit that could lead to tax, and penalty, on the bondholders. Representatives of the IRS' bond audit group have recently

informed the marketplace that they expect a significant increase in the number of audits that may result in direct taxation of bondholders. In fact, this point was reiterated by IRS representatives during the Workshop. These audits certainly could include penalty assessments where the presence or absence of a penalty protection disclaimer would be distinctly relevant.

In short, a tax-exempt bond financing is not different from capital market transactions covered by § 10.35 in the ultimate exposure of the investor to penalties as well as tax. With any marketed opinion, the tax advisor's client may be a party other than the taxpayer, and advice may be rendered to the client regarding tax matters with the knowledge and expectation that the opinion will be relied upon by third-party investor taxpayers.

Please accept this letter as a supplement to NABL's comments on Circular 230 dated July 13, 2005. NABL hopes the discussion above is helpful and will assist in resolving this issue by permitting the use of a penalty protection disclaimer under § 10.39 in the same manner as under § 10.35. In light of the use of penalty protection disclaimers under § 10.35, it would be troubling if a decision were made by Treasury and the IRS that tax-exempt bonds were to be the only element of the entire capital market for which the penalty protection disclaimer is not available. NABL believes the tax-exempt bond market differs from many other capital market transactions in significant respects, but not in a manner that would have the parties to these transactions treated more harshly than all others in this particular regard.

The foregoing comments were prepared by a task force consisting of the members listed on the attachment to this letter.

Very truly yours,

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