NEW YORK STATE BAR ASSOCIATION TAX SECTION

REPORT ON

TAX OPINIONS IN REGISTERED OFFERINGS

April 4, 2012
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. Purpose and Scope of Tax Disclosure and Tax Opinions in Registered Offerings</td>
<td>2</td>
</tr>
<tr>
<td>A. In General</td>
<td>2</td>
</tr>
<tr>
<td>B. Expertized Tax Disclosure</td>
<td>3</td>
</tr>
<tr>
<td>1. If the Federal Tax Consequences are “Material to an Investor”, the Tax Disclosure Must Be Expertized</td>
<td>3</td>
</tr>
<tr>
<td>2. Tax Opinion Expertizing Tax Disclosure on Federal Tax Consequences that are “Material to an Investor”</td>
<td>5</td>
</tr>
<tr>
<td>3. Strength of the Tax Opinion</td>
<td>7</td>
</tr>
<tr>
<td>4. Tax Disclosure in the Registration Statement Addressing the Non-Expertized Matters</td>
<td>8</td>
</tr>
<tr>
<td>C. Tax Opinions Required Pursuant to a Contract Entered Into by the Issuer in a Registered Offering</td>
<td>10</td>
</tr>
<tr>
<td>1. Tax Opinions Contractually Required As a Condition to Closing the Transaction and/or Offering</td>
<td>10</td>
</tr>
<tr>
<td>2. Disclosure Opinions Required To Be Delivered to Underwriters</td>
<td>12</td>
</tr>
<tr>
<td>II. Factual Basis for Tax Opinions in Registered Offerings</td>
<td>12</td>
</tr>
<tr>
<td>A. How the Preparer of a Tax Opinion Determines the Facts</td>
<td>12</td>
</tr>
<tr>
<td>B. Representations Regarding Facts and Future Conduct</td>
<td>13</td>
</tr>
<tr>
<td>C. Assumptions Regarding Facts and Future Conduct</td>
<td>14</td>
</tr>
<tr>
<td>D. When the Relevant Facts Include a Conclusion of Law (other than U.S. Federal Tax Law)</td>
<td>16</td>
</tr>
<tr>
<td>E. Standards for Reliance Upon Representations, Assumptions and Opinions of Other Professionals</td>
<td>17</td>
</tr>
<tr>
<td>1. Customary Practices</td>
<td>17</td>
</tr>
<tr>
<td>2. Circular 230</td>
<td>17</td>
</tr>
<tr>
<td>III. Form and Delivery of Tax Opinions in Registered Offerings</td>
<td>18</td>
</tr>
<tr>
<td>A. Form of Tax Opinion</td>
<td>18</td>
</tr>
<tr>
<td>B. Timing of Delivery of Tax Opinion</td>
<td>19</td>
</tr>
<tr>
<td>IV. SEC Staff Review of Tax Disclosures and Tax Opinions</td>
<td>19</td>
</tr>
<tr>
<td>V. Conclusion</td>
<td>20</td>
</tr>
</tbody>
</table>
New York State Bar Association Tax Section

Report on Tax Opinions in Registered Offerings*

The Tax Section of the New York State Bar Association is an organization of tax lawyers with over 2600 members. Our primary function is to comment on pending tax legislation, regulations and other guidance from Congress, the Internal Revenue Service (“IRS”) and the Treasury Department in a manner that we believe will further the public interest in a fair and equitable tax system.

When an offering of securities is registered with the U.S. Securities and Exchange Commission (the “SEC”), pursuant to the Securities Act of 1933, 15 U.S.C. 77a et seq., as amended (the “Securities Act”), the issuer must file a registration statement with the SEC. A registered offering may involve an offering of securities, typically for cash, or a transaction that includes an exchange of one security for another (and thus an offering of the latter security). Regulation S-K, promulgated by the SEC under the Securities Act, contains the rules governing the information that must be disclosed in the registration statement and, under certain circumstances, the requirement that a tax opinion be filed as part of the registration statement.

On October 14, 2011, the SEC’s Division of Corporate Finance (the “Division”) released Staff Legal Bulletin No. 19 (CF) entitled “Legality and Tax Opinions in Registered Offerings” (the “Bulletin”). The Bulletin provides the Division’s views concerning when tax opinions are required to be filed with the SEC in a registered offering of securities, the required characteristics of such tax opinions and current practice of the Division’s staff (the “Staff”) in reviewing such opinions.

We understand that the views expressed in the Bulletin were intended to reflect current and longstanding administrative practice in this area and were not intended to signal any change of policy regarding either the types of securities offerings that require a tax opinion or the scope of such tax opinions.† We appreciate the Staff’s decision to make its views on this subject available to the public.

* The principal author of this report is Lisa A. Levy. Diana L. Wollman made significant contributions to the drafting of this Report. In addition, Howard B. Dicker and Robert Buckholz, chairman and member, respectively, of the Securities Regulation Committee of the Business Law Section of the New York State Bar Association, provided substantial contributions to this Report as members of the working group. Helpful comments were received from Kimberly S. Blanchard, Peter H. Blessing, S. Douglas Borisky, Peter J. Connors, Edward E. Gonzalez, Stanley Keller, Andrew W. Needham, Yaron Z. Reich, Robert P. Rothman, Michael L. Schler and Jodi J. Schwartz. This report reflects solely the views of the Tax Section of the NYSBA and not those of the NYSBA Executive Committee or the House of Delegates.

† See Legal Opinion Newsletter (Volume 11 – No. 2, Winter 2011) published by the ABA Section of Business Law, Committee on Legal Opinions, at pp. 8-9 (report of a meeting of the Subcommittee on Securities Law Opinions on November 9, 2011 at which Thomas Kim, Chief Counsel in the Division, participated and stated that the guidance in the Bulletin “was not intended to revise substantially the existing practice with respect to tax opinions”).
Because our members include many tax lawyers with extensive experience in private practice providing U.S. federal income tax advice to issuers and underwriters in registered offerings of securities, we believe we are well-positioned to describe current market practices in this area. Given the Staff’s increased attention to these issues, we therefore undertook to prepare this Report and to make it publicly available to the tax bar, to members of the Division and to other interested parties.

The purpose of this Report is to describe current market practice regarding tax opinions in registered offerings. More specifically, the Report describes current market practices regarding the content and form of tax disclosures and tax opinions prepared and rendered in connection with public offerings of securities that are registered with the SEC. These tax disclosures and tax opinions generally address the U.S. federal income tax consequences to an investor of acquiring, holding and disposing of the securities to be issued in the offering.

Although we have not submitted this Report to the Division or requested any of its members to comment on its contents, we believe that the practices described in this Report are consistent with the views of the Staff as expressed in the Bulletin. We hope and expect that this Report, as well as any further dialogue it may produce, will promote greater consistency, transparency and efficiency, both in the preparation by tax counsel of the tax disclosure and tax opinion in registered offerings that require a tax opinion and in the process by which the Staff reviews such tax disclosure and tax opinion. We believe that these goals are shared by most members of the tax bar, the Staff and issuers of securities.

I. Purpose and Scope of Tax Disclosure and Tax Opinions in Registered Offerings

A. In General

Current market practice is to include, in the registration statement filed with the SEC, a description of the U.S. federal income tax consequences of the ownership and disposition of the offered security or of the underlying transaction, in each case to the extent relevant to the type(s) of investors expected to invest in the offered security or to the investors whose votes are being solicited in connection with the transaction. The precise reasons why such tax disclosure is included in a particular offering are beyond the scope of this Report.2

Although certain potential investors in a registered offering are subject to special tax rules, the primary target of most tax disclosure in registered offerings is the average investor expected to invest in the offered security or whose vote is being solicited in connection with the offering, necessitating a balance between detail and clarity such that the disclosure can be readily understood by that investor. Moreover, the tax consequences are likely to vary significantly for investors subject to special tax rules (such as, for example, insurance companies, financial institutions, dealers in securities, certain traders in securities, tax exempt organizations, partnerships and equity owners of partnerships, and investors that hold the security as part of an

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2 In some cases tax disclosure is specifically required by the relevant registration statement form or by Regulation S–K, and in other cases the issuer provides such disclosure in an effort to provide helpful information to investors. The discussion in the tax disclosure is typically limited to U.S. federal income tax consequences, with no discussion of any U.S. state or local or other tax consequences.
integrated transaction, hedge or straddle). Accordingly, it is customary for the tax disclosure to (1) clearly state that it does not address the tax consequences to such investors and (2) recommend that all investors seek the advice of their own tax advisors concerning the particular tax consequences to them of the transaction or investment in light of their specific circumstances.

While the tax disclosure constitutes the issuer’s statements concerning these tax consequences, it is customary for the issuer’s tax counsel to review (and, in most cases, draft) the disclosure. When the tax disclosure names that tax counsel and states that statements in the tax disclosure are the opinion of tax counsel or a certified public accountant, the disclosure is considered “expertized” (see the discussion below in sections I.B.1-3). When the tax disclosure does not name that tax counsel and does not state that statements in the tax disclosure are the opinion of tax counsel or a certified public accountant, the disclosure is considered “unexpertized” (see the discussion below in section I.B.4).

B. Expertized Tax Disclosure

1. If the Federal Tax Consequences are “Material to an Investor”, the Tax Disclosure Must Be Expertized

When a registered offering involves a U.S. federal income tax consequence that is “material to an investor” (the term used in Regulation S-K), the issuer is required, by the applicable registration statement form and SEC regulations (including Regulation S-K), to include in the registration statement a tax disclosure discussing the material tax consequence and to have the portion of the disclosure discussing the material tax consequence “expertized” by obtaining (and filing with the SEC) an opinion from a tax lawyer or a certified public accountant.

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3 We note that the federal income tax consequence relating to a transaction or security that is “material to investors” (discussed below) typically is not the type of tax consequence that is affected by a particular investor’s specific circumstances.

4 We also note that investors subject to special tax rules tend to be more sophisticated than average investors and therefore more able to take into account their particular tax situations in making voting or investment decisions without relying on specific disclosure that addresses their particular situation. Inclusion of disclosure specifically addressing their situations, which are often complex, would often lead to voluminous disclosures, undermining the clarity of the disclosure for those investors not subject to such rules.

5 Although this Report uses the term “expert” and “expertized” throughout (which terminology is also used in the Bulletin), we are not expressing any view regarding whether lawyers providing Exhibit 8 tax opinions are “experts” for Securities Act purposes. As discussed below, tax counsel must consent to the disclosure’s discussion of the tax opinion and to tax counsel being named in the registration statement. See note 14 below and accompanying text. However, lawyers are not required to admit expressly in their consent that they are “experts” within the meaning of Sections 7 and 11 of the Securities Act, and some lawyers include a statement in the tax opinion to the effect that the giving of the consent is not an admission that counsel is an expert within the meaning of Section 7 of the Securities Act. See Bulletin, Part IV (Consents).

6 Item 601(b)(8) of Regulation S-K. Under Regulation S-K, a “revenue ruling” from the IRS addressed to the registrant that deals with the specific facts of the proposed transaction may be provided in lieu of the requisite tax opinion to the extent that the revenue ruling covers the material tax consequences of the proposed transaction. Although Regulation S-K and the Bulletin refer to a “revenue ruling”, it is clear from footnote 37 of the Bulletin that it is describing a “private letter ruling” issued solely to a particular taxpayer.
A federal income tax consequence is “material to an investor” if there is a substantial likelihood that a reasonable investor would consider the information to be important in deciding how to vote on the relevant transaction or whether to purchase the offered security. In the current market, the most common federal income tax consequences usually regarded as “material to an investor” are the tax-free treatment of a particular transaction and the special tax status of the issuer of a particular security. Common examples include:

- qualification of a merger or exchange as a tax-free reorganization under section 368 or as a tax-free exchange under section 351;
- qualification of a transaction as a tax-free spin-off under section 355; or
- treatment of the issuer as a publicly-traded partnership, real estate investment trust (“REIT”) or grantor trust for federal income tax purposes.

Consistent with the prevailing market interpretation, the Bulletin provides the following examples of transactions involving federal income tax consequences that are “material to an investor”: (i) transactions intended to be tax-free and (ii) transactions offering significant tax benefits or where the tax consequences are so unusual or complex that investors would need to have the benefit of an expert’s opinion to understand the tax consequences in order to make an informed investment decision. Likewise, the Bulletin’s statement that no tax opinion is required when a registrant represents that an exchange offer or merger is taxable is consistent with current practice of not issuing a tax opinion in a taxable transaction.

While the foregoing seems relatively straightforward, in practice confusion may arise regarding which portions of the tax disclosure (if any) must be expertized. As discussed in this Report, virtually any tax disclosure in a registered offering, whether or not the offering requires a
tax opinion, will include a discussion of federal income tax consequences that are not “material to an investor” as well as other factual information. In some cases, the offering will not involve any federal income tax consequences that are “material to an investor”. In others, there may be some consequences that are “material to an investor” and others that are not.

Under Regulation S-K, tax counsel is not required to expertize the portion of the tax disclosure addressing the tax consequences of owning and selling common stock when those tax consequences are not “material to an investor”. That tax counsel may have been required to expertize the tax consequence of the transaction pursuant to which the common stock was issued is irrelevant. In such a case, therefore, it is customary for tax counsel to expertize only the discussion of the federal income tax consequences that are “material to an investor”, and not to expertize any other portion of the discussion.

For example, in a registered offering of common stock to be issued in a tax-free merger, although the tax consequences to investors of the receipt of the common stock in the merger are “material to an investor”, the “plain vanilla” tax consequences to investors of holding and selling the common stock in the future are not. Consistent with the Bulletin, although a mere offering of common stock issued for cash does not involve any tax consequences that are “material to an investor”, the tax disclosure will typically describe the “plain vanilla” tax consequences for non-U.S. investors of owning and selling the common stock. That the same disclosure also appears in a registered offering of common stock issued in a tax-free merger does not make the tax consequences of holding and selling the common stock any more material to such investors.

We believe that much of the confusion regarding this point emanates from the heading or title introducing the tax disclosure in many offerings, which typically refers to “Material U.S. Federal Income Tax Consequences”. In this context, use of the word “material” is intended to communicate to investors that the tax disclosure contains information that will be useful to them in some relevant way. In this context, this word has a different meaning from the meaning attributed to it in the phrase “material to an investor” under Regulation S-K, as discussed above.

We hope that this in-depth discussion of these matters in the Report, together with the Bulletin’s clear affirmative statements regarding these matters, will assist in dispelling any remaining confusion.

2. Tax Opinion Expertizing Tax Disclosure on Federal Tax Consequences that are “Material to an Investor”

A tax opinion that expertizes the portion of the disclosure discussing the tax consequence that is “material to an investor” consists of one or more conclusions of federal income tax law. Like any tax opinion, a tax opinion in a registered offering reflects the professional judgment of

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11 Item 601(b)(8) of Regulation S-K.
12 Part III.A.2. (omitting common stock from list of securities offering “unusual” tax benefits).
13 The Bulletin discusses this issue and the reason the Staff does not accept headings that refer to “certain” or “principal” tax consequences. See Part III.C.1 (Substance of Tax Opinions – Material Federal Tax Consequences) (second paragraph).
tax counsel regarding the application of the relevant legal authorities to the specific facts and circumstances. A tax opinion is not binding on the IRS or the courts. As such, it is not a guarantee that the IRS will not assert a contrary position with respect to the subject matter of the opinion or that a court will not uphold such a position in litigation.

When the portion of the disclosure addressing the tax consequence that is “material to an investor” must be expertized, it is customary for the tax disclosure to (1) articulate the actual tax opinion of the issuer’s tax counsel or (2) state that the opinion will be delivered at closing and to describe the content of such opinion. In both cases, it is customary to identify issuer’s tax counsel by name in the disclosure. Under the Securities Act, the counsel providing such an opinion must set forth the opinion (or a confirmation of the opinion articulated in the tax disclosure) in a separate letter to the issuer and must consent to the disclosure’s discussion of the opinion, being named in the registration statement and the reproduction of such letter as an exhibit to the registration statement.14 (This tax opinion is filed as Exhibit 8 to the registration statement and thus is commonly referred to as an Exhibit 8 opinion.) We discuss below the form of opinion that is filed with the SEC.

When there is a Code section governing a federal income tax consequence that is “material to an investor”, the tax disclosure describing this consequence typically will refer to such Code section. Specific references to additional authorities, such as Treasury regulations, revenue rulings and judicial decisions, are rare and typically occur only when one of these authorities is highly relevant or directly on point. We interpret the Bulletin as being consistent with this aspect of current market practice, as well as the SEC’s plain English rule.15

14 The Bulletin discusses this in Part IV (Consents).
15 Specifically, the Bulletin states in Part III.C.1.:

The tax opinion should address and express a conclusion for each material federal tax consequences, and the staff expects the opinion to identify the applicable Internal Revenue Code provision, regulation or revenue ruling. Regardless of whether the tax opinion is long or short form, it should

• clearly identify each material tax consequence being opined upon;
• set forth the author’s opinion as to each identified tax item; and
• set forth the basis for the opinion.

Under Securities Act Rule 421 (referred to herein as the “Plain English Rule”), “companies filing registration statements under the Securities Act of 1933 must:

• write the forepart of these registration statements in plain English;
• write the remaining portions of these registration statements in a clear, understandable manner; and
• design these registration statements to be visually inviting and easy to read.”

3. Strength of the Tax Opinion

In some cases, issuer’s tax counsel is unable to provide a “will” opinion on a specific federal income tax consequence at issue that is “material to investors”. Although this may occur for a variety of reasons, the typical reason is that the federal income tax law governing the issue in question is unclear in one or more respects. Although there often is authority addressing an issue in a general way, it is not unusual in many registered offerings that no authority directly applies to the specific facts and circumstances (or closely comparable facts and circumstances) related to the transaction, security or issuer’s method of operation. In other cases, the federal income tax laws are unclear because the relevant authorities are susceptible to differing (but reasonable) interpretations or are in actual conflict. On some occasions, the uncertainty relates to the highly factual nature of the issue in question (e.g., existence of a corporate “business purpose” in a spin-off). For one or more of these reasons, after analyzing, interpreting and weighing the various authorities as applied to the relevant facts, tax counsel may judge that it is not possible to render a “will” opinion on a material issue.

To reflect this uncertainty, issuer’s tax counsel may render a “should” opinion on the issue. Although the degree of risk associated with a “should” opinion is inherently difficult to quantify with precision, an unqualified “should” opinion is generally regarded as a robust opinion that reflects a relatively high level of confidence on an issue. We also note that there are situations where, by reason of the absence of any controlling authority, tax counsel provides, and the market accepts, an opinion expressing a lower level of certainty on an issue than a “should” opinion (e.g., a “more likely than not” opinion or an opinion that the expected tax treatment is “reasonable”).

When the expertized portion of any tax disclosure expresses anything other than a “will” opinion, it is customary for the tax disclosure to include an explanation of the nature of the uncertainty (e.g., absence of authority, lack of authority directly on point, conflicting authority or the inherently factual or subjective nature of the issue). If appropriate and informative to the investor, the tax disclosure is also likely to include a description of one or more possible alternative characterizations that the IRS could assert and the resulting tax consequences to the issuer and/or investors in the offering if the IRS were to prevail. The tax disclosure may also express a view on the likelihood of the IRS prevailing on the merits with respect to one or more alternative characterizations.

When the tax opinion reflects a level of certainty lower than a “will” opinion (e.g., a “should” or “more likely than not” opinion), the level of detail provided in the tax disclosure regarding the foregoing matters will vary depending upon the level of the opinion expressed and the tax issue at hand. However, as a general matter, it is not customary for tax disclosure to contain an extensive and highly detailed technical analysis of the tax issue, all of the possible alternative characterizations or why counsel reached the level of the opinion expressed. We

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16 The various levels of tax opinions and the degrees of uncertainty they express is beyond the scope of this report. For a discussion of these topics, see R. Rothman, Tax Opinion Practice, 64 The Tax Lawyer 301 (Winter 2011); and J. Cummings, Jr., The Range of Legal Tax Opinions, with Emphasis on the “Should” Opinion, 98 Tax Notes 1125 (Feb. 17, 2003).
interact the Bulletin’s discussion of the substance of opinions as consistent with customary practice and the Plain English Rule.\textsuperscript{17}

In other cases, tax counsel is unable to express \textit{any} opinion on a federal income tax consequence that is “material to investors”. This may occur because the particular issue is of a highly factual nature or because the existing facts and circumstances may change in the future. Alternatively, there may be no relevant authority. Examples of highly factual issues in this category include the status of a foreign issuer as a “passive foreign investment company”, the status of a domestic issuer as a “United States real property holding corporation” and the status of a foreign issuer with some nexus to the United States as exempt from federal income tax because it not engaged in a trade or business in the United States. In these cases, it is customary for the tax disclosure to (i) explain why it is not possible for tax counsel to provide a tax opinion, (ii) state the issuer’s intended reporting position on the tax issue and, if relevant, its intentions and expectations regarding its future activities, and (iii) describe the related tax risks to the investors or the issuer, as applicable, arising from the various alternative resolutions of the tax issue. In these cases, the explanations do not provide an extensive and highly detailed technical analysis of the foregoing matters, nor are all of the possible alternative characterizations necessarily discussed. In addition, tax counsel typically conducts a level of diligence regarding statements concerning the issuer’s intended reporting position on the relevant tax issue or any statements describing the issuer’s intentions or expectations regarding its future operations that, in tax counsel’s professional judgment, is sufficient under the particular circumstances to support the reasonableness of such statements.

The Bulletin is consistent with market practice in acknowledging that there are cases where expertization of a federal income tax issue that is “material to investors” is not possible by reason of the highly factual nature of the issue or uncertainty in the law and where tax opinions expressing uncertainty are provided in registered offerings.\textsuperscript{18} The Bulletin comports with market practice in requiring that the tax disclosure or tax opinion explain the uncertainty and risks involved in these situations.\textsuperscript{19}

4. Tax Disclosure in the Registration Statement Addressing the Non-Expertized Matters

When a registered offering does not involve any U.S. federal income tax consequences that are “material to an investor”, Regulation S-K and the Bulletin do not require that the tax disclosure be expertized.\textsuperscript{20} Accordingly, it is market practice to \textit{not expertize} a disclosure that discusses no consequences that are “material to an investor”. Common examples of federal

\textsuperscript{17} See Part III.C.1 and 4 (Substance of Tax Opinions – Material Federal Tax Consequences; – Opinions Subject to Uncertainty),

\textsuperscript{18} Footnote 44 of the Bulletin; Part III.C.4 (Substance of Tax Opinions – Opinions Subject to Uncertainty).

\textsuperscript{19} Part III.C.1 (Substance of Tax Opinions – Material Federal Tax Consequences); Part III.C.4 (Substance of Tax Opinions – Opinions Subject to Uncertainty).

\textsuperscript{20} Item 601(b)(8) of Regulation S-K; Part III.A.1 and 2 (Requirements for Tax Opinion – Regulation S-K Requirements for a Tax Opinion; – When a Tax Consequence is “Material” to Investors).
income tax consequences that are not “material to an investor”, which may be discussed in a disclosure, but need not be expertized include:

- tax consequences arising from the ownership and disposition of debt or equity securities that are generally known and readily understood by the average investor (e.g., the taxation of interest, dividends, capital gains, “plain vanilla” original issue discount and bond premium); and

- tax consequences arising from transactions that are wholly taxable, such as a taxable merger or exchange or a taxable spin-off (e.g., recognition of gain, impact on a shareholder’s tax basis and holding period of any security received in the exchange).\(^2\)

A tax disclosure addressing a federal income tax consequence that is “material to investors” will often discuss other U.S. federal income tax consequences that are not “material to investors” (i.e., there is not a substantial likelihood that a reasonable investor would consider the information to be important in deciding how to vote on the transaction or whether to invest). It is market practice to not expertize this portion of the tax disclosure (just as it is market practice to not expertise a disclosure that discusses no consequences that are “material to an investor”).

A tax disclosure addressing a federal income tax consequence that is “material to an investor”, for example whether a merger is tax-free or a security with unusual terms is debt or equity, may also discuss certain “derivative” federal income tax consequences that follow from the conclusion regarding the material tax consequence. These derivative consequences are generally not considered “material to an investor” and, thus, it is market practice to not expertize this portion of the tax disclosure. Examples of such derivative tax consequences are:

- the impact of the tax-free merger or spin-off on a typical shareholder’s tax basis and holding period in the security received in the transaction and the recognition of gain on the receipt of cash in lieu of fractional shares; and

- the consequences to the investor of the treatment of the issuer as a partnership for federal income tax purposes, i.e., the “plain vanilla” tax consequences resulting from the ownership and disposition of an equity interest in a partnership.

Disclosure regarding non-material tax consequences is necessarily general in nature and typically does not contain technical citations to relevant provisions of the Code, Treasury regulations or IRS revenue rulings. In addition, when the tax disclosure describes or contains an opinion expressing uncertainty on a federal income tax consequence that is “material to an investor”, it is typical to preface the discussion of the non-material and derivative tax consequences by stating that that discussion assumes the legal conclusion that is the subject of

\(^2\) See Part III.A.2 (Requirements for Tax Opinion – When a Tax Consequence is “Material” to Investors) (indicating expertization is not required when an exchange offer or merger is a taxable transaction). The tax consequences of a taxable transaction are generally not considered “material to an investor” because an investor would expect taxable treatment in the absence of a representation in the disclosure document to the contrary, and the tax treatment of the transaction does not purport to provide an investor with any special tax benefit.
the tax opinion. For example, if the tax disclosure describes an opinion that the issuer “should” qualify as a partnership for federal income tax purposes, the discussion regarding the non-material tax consequences to investors of owning and disposing of an equity interest in the issuer assumes that the issuer “will” qualify as a partnership for federal income tax purposes. Similarly, if the tax disclosure describes an opinion that a spin-off “should” qualify as tax-free to the shareholders of the distributing corporation, the discussion of the non-material, derivative tax consequences to those shareholders of receiving stock in the spun-off corporation assumes that the spin-off “will” qualify as a tax-free transaction.

It is customary practice to limit expertization to the federal income tax consequence that is “material to an investor” for several reasons. First, Regulation S-K does not require the expertization of non-material information. Second, this practice enhances the quality of the tax disclosure because it tends to highlight the tax issue of greatest significance to the ultimate voting or investment decision of the investors (e.g., the tax-free nature of a merger or spin-off). Third, expertization of the entire tax disclosure would tend to create ambiguities concerning which statements in the disclosure represent the opinion of tax counsel and which statements (e.g., factual statements, statements regarding the issuer’s beliefs, intentions or expectations related to a tax issue and descriptions of possible alternative tax characterizations) do not. Finally, as discussed above, a tax disclosure’s discussion of non-material federal income tax consequences is addressed to the average investor that is not subject to special tax rules and, as such, this discussion is general in nature by design. Expertization of the entire tax disclosure would tend to create the misimpression that this general discussion of the non-material federal income tax consequences is more definitive than it actually is.

The Bulletin is consistent with market practice because it states that “the registrant must provide accurate and complete disclosure concerning the tax consequences to investors”\(^\text{22}\) whereas “[i]n general, a tax opinion need address only material federal tax consequences.”\(^\text{23}\)

C. Tax Opinions Required Pursuant to a Contract Entered Into by the Issuer in a Registered Offering

Frequently, the issuer in a registered offering will be contractually obligated to deliver a tax opinion to another party involved in the offering. In a merger or reorganization, the other entity (or entities) participating in the merger or reorganization may also be contractually obligated to deliver a tax opinion. The scope of these tax opinions, why they are required, and the party whose tax counsel delivers them will vary depending upon the type of security or transaction involved in the offering.

1. Tax Opinions Contractually Required As a Condition to Closing the Transaction and/or Offering

The contractual agreements governing corporate combinations (e.g., mergers) and corporate divisions (e.g., spin-offs) that are intended to be tax-free (in whole or in part) for

\(^{22}\) Part III. A.2 (When a Tax Consequence is Material to Investors).

\(^{23}\) Part III.C.1 (Substance of Tax Opinions – Material Federal Tax Consequences).
federal income tax purposes typically provide, as a condition to the closing of the transaction, that a tax opinion be delivered at a pre-agreed-upon level of comfort regarding the tax-free (or partially tax-free) treatment of the transaction for both the participating shareholders and the corporations involved. In the case of a corporate combination, the target corporation’s (and sometimes also the acquiring corporation’s) obligation to close the transaction is conditioned on receipt of this tax opinion from its own counsel (or, on occasion, from the other party’s counsel). In a corporate division, the obligations of both the distributing corporation and the corporation to be spun-off are conditioned upon receipt of this tax opinion from tax counsel to the distributing corporation.

In registered offerings involving either the issuance of stock or other equity interests in an entity that is intended to qualify for a favorable federal income tax classification (e.g., a publicly traded partnership, a REIT, or a grantor trust) or the issuance of a security with unusual terms that is intended to qualify for federal income tax treatment that is particularly important in the context of the offering (e.g., as debt or a prepaid forward contract), the agreement between the issuer and the underwriter typically requires, as a condition to the underwriters’ obligation to underwrite the offering, that the underwriters receive a tax opinion from issuer’s tax counsel at the pre-agreed-upon comfort level regarding the relevant federal income tax treatment.

These types of tax opinions typically cover issues that are “material to investors” and, as such, tax opinions addressing the same issues are also filed with the SEC as part of the registration statement. The Bulletin discusses the Division’s views regarding when these tax opinions must be filed (i.e., before the registration statement is effective or in a post-effective amendment to the registration statement filed prior to the closing).24

The closing tax opinion generally serves two purposes. The first is to protect the bargained for expectations of the recipient of the tax opinion (and, if applicable, its shareholders) by conditioning the consummation of the transaction on the delivery of the required tax opinion. The second is to ensure that tax counsel conducts appropriate and thorough factual and legal diligence, thereby increasing the likelihood that the assumptions reflected in the required tax opinion are in fact correct.

Consistent with these two purposes, a standard closing condition requires that the tax opinion address only the federal income tax consequence that is “material to investors”, i.e., the intended tax-free treatment of the transaction or intended tax status of the issuer; it does not require that the tax opinion address any of the various derivative, ancillary or non-material tax consequences to the issuer or its shareholders (or limited partners) that follow from the “material” federal income tax consequence. For example, a closing condition in a typical merger agreement requires that the tax opinion address the qualification of the merger as a tax-free reorganization and does not require that the tax opinion cover derivative or ancillary matters, such as the target shareholder’s resulting tax basis and holding period for the acquiror stock received in the merger and other commonly understood tax consequences related to the ownership and future disposition of the acquiror stock.

24 Part III.D.2 and 3 (Additional Considerations – Timing; Closing Tax Opinion as a Waivable Condition).
It is customary for tax counsel to cite the relevant authority in connection with the tax opinion on the “material” federal income tax consequence. For example, in the case of a transaction intended to qualify as a tax-free “reorganization” for federal income tax purposes, tax counsel typically will cite section 368(a) of the Code. Similarly, in the case of a registered offering of interests by an issuer intended to qualify as a “publicly traded partnership” for federal income tax purposes, tax counsel typically will cite section 7704 of the Code.

2. Disclosure Opinions Required To Be Delivered to Underwriters

In registered offerings involving the participation of an underwriter or dealer-manager who has agreed to market the security and/or solicit consents to the transaction, the underwriting agreement or dealer-manager agreement typically has as a condition to the closing of the offering that the issuer’s tax counsel provide an opinion to the underwriters or dealer-managers to the effect that the description of the tax laws and the legal conclusions contained in the tax disclosure, as addressed to investors in general without regard to their individual circumstances, is a “fair” or “accurate” summary of the federal income tax consequences of the transaction.25 Although the forms of these opinions vary from law firm to law firm, tax counsel’s ability and willingness to render this opinion provides comfort to the underwriters or dealer-managers concerning the completeness and correctness of the substance of the tax disclosure because it assists them in the establishment of a “due diligence” defense against possible future claims of inadequate disclosure by investors or other third parties. This type of tax opinion typically is not filed with the SEC.26

II. Factual Basis for Tax Opinions in Registered Offerings

A. How the Preparer of a Tax Opinion Determines the Facts

As stated above, a tax opinion states one or more conclusions of federal income tax law. Those legal conclusions result from the application by tax counsel of his or her understanding and judgment regarding the relevant law and how it should apply to the specific facts and circumstances of the security or transaction in question. The relevant facts and circumstances may include not only objectively verifiable facts, but also matters concerning a person’s plans or intentions, or estimates or projections. Tax counsel typically determines what these facts and

25 This type of opinion is often requested and provided even in offerings that do not involve any tax consequences that are “material to investors.”

26 However, it is the prevailing practice that tax opinions filed with the SEC in connection with offerings on Form S-11 do include this type of opinion. See note 6 above.

In addition, issuer’s counsel typically provides to the underwriters or dealer-managers a negative assurance letter (sometimes colloquially referred to as a “10b-5” letter) on the entire disclosure document, including the tax disclosure. Although the forms of these negative assurance letters vary from law firm to law firm, the negative assurance letter states that, subject to various limitations and qualifications, no facts have come to the attention of counsel that caused counsel to believe that, as of specified dates and times, the disclosure documents contained any untrue statement of a material fact or omitted to state any material fact necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading. See ABA Section of Business Law, Committee on Federal Regulation of Securities, Subcommittee on Securities Law Opinions, Negative Assurance in Securities Offerings (2008 Revision), 64 Bus. Law. 395, at 396-7 (2009).
circumstances are by relying on a variety of sources. Where relevant, these sources usually include the following:

- the substantive terms of a transaction or security as described in the underlying transaction documents (e.g., a merger agreement, separation agreement or indenture) and/or as described in the disclosure document filed with the SEC;
- the constituent organizational documents of the issuer (e.g., a partnership agreement, an operating agreement of a limited liability company or a corporate charter);
- contractual representations, warranties and covenants made by the issuer of the security or the parties to the transaction (and other relevant persons) in the underlying transaction documents;
- factual information and statements in the disclosure document filed with the SEC; and/or
- opinions of other professionals or experts (e.g., economists, valuation experts or investment banks).

In addition, it is customary for tax counsel to rely upon (i) written representations from the issuer or the parties to the transaction (and other relevant persons) concerning relevant factual matters not available from any of the foregoing sources and (ii) assumptions regarding other factual matters.

B. Representations Regarding Facts and Future Conduct

The IRS has published the types of factual representations that it requires (or has required in the past) to grant private letter rulings on a variety of issues that arise in certain transactions (e.g., tax-free reorganizations and tax-free spin-offs). When tax counsel is opining on one of these issues, tax counsel customarily requests written representations from the issuer and/or other parties to the transaction (and, if relevant, other persons) that are based in substantial part upon the types of factual representations that the IRS requires (or required in the past) as a condition to granting a favorable private letter ruling on the same issue. Tax counsel may also request additional factual representations that tax counsel determines are appropriate in the specific context.

Similarly, when an issue is not the subject of such an IRS publication, tax counsel determines what factual representations are needed in the specific context by drawing upon a variety of sources, including the relevant legal authorities.

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27 The IRS modifies its ruling practice from time to time. For issues as to which the IRS will no longer grant private letter rulings, tax counsel may look to the types of representations that the IRS required before the change in ruling practice.
Of course, the subject matter of these representations ultimately depends upon the substantive legal conclusion to be opined on, and may include:

- the manner in which the issuer or a transaction party will operate or conduct itself in the future (including the types of assets that it will or will not acquire, the types of income that it will or will not earn, and the types of actions or activities that it will or will not conduct); and/or

- the issuer’s or a transaction party’s (and other relevant persons’) plans, intentions, understandings and/or agreements or the nonexistence of the foregoing.

We note that, in most tax opinions filed in registered offerings, tax counsel must be able to rely on representations regarding the future conduct of the issuer or the future conduct of some other party to the transaction because such conduct is relevant to the subject matter of the tax opinion. In the case of tax opinions concerning the status of an issuer as a REIT or a publicly-traded partnership, for example, representations concerning the issuer’s future conduct are often extensive and detailed.

These representations typically are given in an officer’s certificate of the issuer or other party to the transaction (or other relevant person) executed by a responsible employee or officer thereof after due inquiry and investigation by the person signing the certificate.

As discussed in more detail below under section II.E, tax counsel will also perform a degree of diligence regarding the factual representations made in the officer’s certificates. Having done so, tax counsel customarily then includes in the tax opinion an assumption that the representations made in the officer’s certificate are true, correct and complete. By doing so, tax counsel communicates that the validity of the tax opinion depends upon those matters being true, correct and complete. While the Bulletin does not explicitly address this point in its discussion of tax opinions, the Bulletin does so in the context of legality opinions, where the purpose and role of this assumption is the same. In that context, the Bulletin contains a list of assumptions and qualifications that the Staff generally believes are necessary or may be appropriate, which includes the assumption that the representations of officers and employees are correct as to questions of fact.28 We therefore interpret the Bulletin to be consistent with customary tax opinion practice in this regard.

C. Assumptions Regarding Facts and Future Conduct

In addition to determining some facts from the available documents and other facts from officers’ certificates of representation, it is customary for tax counsel to make certain assumptions regarding other factual matters relevant to the tax opinion. In such a case, it is customary for tax counsel to disclose these assumptions in the tax opinion (or in the tax disclosure if the disclosure itself constitutes the tax opinion) in summary fashion (comparable to the following summary in this paragraph), although tax counsel may describe any unusual or particularly significant factual assumption concerning the security or the transaction in greater detail.

28 Part II.B.3 (Legality Opinions – Substance of Legality Opinions – Assumptions).
While the nature of the specific factual assumptions ultimately depends upon the type of transaction or security that is the subject matter of the tax opinion, tax counsel typically assumes one or more of the following:

- all parties to the transaction documents will act in accordance with the covenants, agreements, terms and conditions of the transaction documents and will perform their respective obligations under those documents in accordance with their terms;
- the transaction will be effected pursuant to and in accordance with the terms and conditions contained in the relevant transaction document (e.g., the merger agreement or separation agreement), without waiver or modification of any such terms and conditions;
- the factual statements concerning the transaction contained in the transaction documents and the disclosure document filed with the SEC are, and will continue to be until the closing of the transaction, true, correct and complete;
- all representations made in officer’s certificates are, and will continue to be until the closing of the transaction, true, correct and complete (without regard to any qualifications as to knowledge or belief);
- the issuer will operate in a manner consistent with the method of operation described in the disclosure document filed with the SEC and the representations contained in the officer’s certificate; and/or
- there are no arrangements, understandings or agreements among or between any of the parties to the transaction documents relating to the transactions or actions contemplated by the transaction documents other than those evidenced by the transaction documents.

In addition, when tax counsel relies on the legal opinion of a person outside tax counsel’s law firm concerning a non-tax or non-U.S. tax legal issue, tax counsel usually either explicitly relies on that opinion or explicitly assumes the non-tax or non-U.S. tax legal conclusion contained in that opinion.

Thus, it is customary practice that neither the tax opinion nor the tax disclosure contains a detailed description of all the factual representations and statements of plans or intentions (or the absence thereof) contained in an officer’s certificate (if any). This customary practice is dictated by a number of considerations, among them that including such detail would not be practical in many cases, might breach client confidentiality in some cases, and would not enhance the quality of the tax opinion or tax disclosure in most cases. Particularly with respect to the quality of the tax opinion or tax disclosure, detailed descriptions of the representations contained in officer’s
detail. 29 While the nature of the specific factual assumptions ultimately depends upon the type of transaction or security that is the subject matter of the tax opinion, tax counsel typically assumes one or more of the following:

29 In both non-tax legal opinions and tax opinions, many assumptions underlying opinions are understood to apply even if they are not expressly stated. This practice is described in the report by the TriBar Opinion Committee on third party “closing” opinions. See TriBar Opinion Committee, Third-Party “Closing” Opinions: A Report of the TriBar Opinion Committee, 53 Bus. Law. 592, § 2.3(a) at 615 (1998).
certificates would not assist the average investor in understanding the tax consequences addressed in the opinion. The Bulletin appears to be consistent with this market practice as the Bulletin states that the assumptions on which a tax opinion is based must be disclosed in the tax opinion, and that limited and reasonable assumptions as to future conduct are common and acceptable.

D. When the Relevant Facts Include a Conclusion of Law (other than U.S. Federal Tax Law)

A transaction or security may be governed by or involve aspects of non-tax laws, domestic or foreign, or foreign or U.S. state tax laws, and the accuracy of the U.S. federal tax opinion may depend in part upon a legal conclusion involving these other laws.

For example, certain transactions effected pursuant to foreign statutes, such as an “amalgamation” or other combination of two foreign corporations, may or may not qualify as a tax-free reorganization for U.S. federal income tax purposes. In order for tax counsel to render an opinion on this issue, tax counsel generally will need to rely upon an opinion from the issuer’s foreign counsel at the agreed upon comfort level regarding the legal effects of the transactional documents and the relevant foreign statutes. As another example, in order to render a tax opinion that a foreign corporation is not a “controlled foreign corporation” for U.S. federal income tax purposes, tax counsel generally will need to rely on an opinion of foreign counsel that provisions in the articles of incorporation of the corporation that prohibit the ownership of 10% or more of the stock by U.S. shareholders are enforceable under foreign law.

When a legal issue of this nature is relevant to the tax opinion, and neither the opining tax lawyer nor other members of his or her law firm are qualified to render an opinion on the matter, it is customary for tax counsel to rely upon the opinion of another legal professional regarding the legal issue. While the Bulletin does not describe this practice in the context of tax opinions, the Bulletin does describes this practice in the context of its discussion of legality opinions and states that, for purposes of providing a legality opinion on a debt security or guarantee, the registrant’s primary counsel may assume that the legal conclusions contained in an opinion of

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30 Item 601(b)(8) of Regulation S-K provides that any conditions or qualifications to a tax opinion must be adequately described in the registration statement. Customary practice is to satisfy this obligation in the manner described above.

31 Part III.C.3 (Substance of Tax Opinions – Assumptions and Qualifications).

32 Part III.C.3 (Substance of Tax Opinions – Assumptions and Qualifications).

33 In this regard, the analysis of the U.S. federal income tax consequences of a transaction usually is based on the legal rights and obligations of the parties as determined under applicable local law. See Bittker & Lokken, “Federal Taxation of Income, Estates, and Gifts,” ¶ 4.1.1 (the Code taxes transactions whose legal effects (i.e., the parties’ rights and obligations) are usually prescribed by state law, rather than federal law, and rights and obligations relevant to federal taxes can also arise under the laws of foreign countries).

34 See Treas. Regulation Section 1.368-2(b)(ii) and Treas. Regulations Section 1.368-2(b)(iii), Examples 13 and 14.

35 See Part III.C.3 (Substance of Tax Opinions – Assumptions and Qualifications).
local counsel are correct. Accordingly, we understand the Bulletin to be consistent with current practice regarding tax opinions that depend, in part, upon conclusions of law other than U.S. federal income tax law.

E. Standards for Reliance Upon Representations, Assumptions and Opinions of Other Professionals

1. Customary Practices

It is commonly understood, and typically explicitly stated in the tax opinion, that tax counsel has not conducted an independent investigation or inquiry concerning the accuracy or completeness of the factual items underlying the opinion. Tax counsel typically conducts the level of diligence on representations and other items that, in tax counsel’s professional judgment, is sufficient under the particular circumstances to support the reasonableness of tax counsel’s reliance on such items. With regard to officer’s certificates containing factual representations and representations regarding future conduct, the scope of the diligence typically includes reviewing the substance of the requested representations with the signatories and confirming to the satisfaction of tax counsel that the signatories both understand the representations and have undertaken due inquiry and investigation within their organizations to confirm the accuracy and completeness of the representations. With regard to other factual assumptions, the scope of tax counsel’s diligence depends upon the matters involved. In no event, however, may tax counsel know or have reason to believe that the assumptions are inaccurate or incomplete. Tax counsel must always believe the assumptions are reasonable, given the context. With regard to tax counsel’s reliance upon opinions of other lawyers (as to issues of non-tax law or non-U.S. tax law) or other professionals or experts, tax counsel typically conducts the level of diligence necessary to be reasonably satisfied as to the competence of that person and the reasonableness of that person’s legal or other conclusions.

2. Circular 230

The standards tax counsel should comply with regarding reliance upon factual representations, representations regarding future conduct, assumptions and opinions of other legal counsel and experts, both in registered offerings and otherwise, are determined in part by state bar ethics and professional responsibility rules. The IRS also maintains a set of professional responsibility rules, which apply to attorneys (and other practitioners) who “practice before the IRS” (known as “Circular 230”).

Section 10.37 of Circular 230 applies to most written tax advice that is included in a document required to be filed with the SEC (among other types of written tax advice that do not constitute “covered opinions” as defined in Section 10.35 of Circular 230). Section 10.37

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37 The IRS has taken the position that Section 10.37 of Circular 230 (as well as certain other provisions of Circular 230) apply to tax practitioners even if they are not representing taxpayers before the IRS. For fuller commentary, see New York State Bar Association, Report on Circular 230 Regulations (March 3, 2005) at 8 (footnote 5).
provides that, in giving such written tax advice, a practitioner must not (i) base the advice on unreasonable factual or legal assumptions, (ii) unreasonably rely on representations, statements, findings or agreements of the taxpayer or any other person, (iii) fail to consider all relevant facts that the practitioner knows or should know or (iv) account for the possibility that a return or issue will not be audited or will be resolved through settlement. All facts and circumstances will be taken into account in determining whether a practitioner has failed to comply with the foregoing requirements.

A tax attorney who willfully, recklessly or through gross incompetence (which includes conduct that reflects gross indifference) violates Section 10.37 may be subject to monetary penalties, censure (i.e., a public reprimand), or suspension or disbarment from practice before the IRS. A tax attorney may not knowingly (directly or indirectly) accept assistance from, or give assistance to, any person who is disbarred or suspended under Circular 230 if the assistance relates to matters constituting practice before the IRS.

III. Form and Delivery of Tax Opinions in Registered Offerings

A. Form of Tax Opinion

When a registered offering involves a federal income tax consequence that is “material to investors”, either a long or a short-form tax opinion is filed with the SEC as an exhibit to the registration statement. When tax counsel’s opinion on this consequence will be delivered at the closing of the transaction described in the tax disclosure, tax counsel typically provides a long-form opinion. The Bulletin explains that a long-form opinion is the full tax opinion filed as an exhibit and summarized in the prospectus, and that this opinion must be consistent with the disclosure in the prospectus. Consistent with market practice, we interpret this to mean that a long-form opinion is the full tax opinion on the federal income tax consequence that is “material to investors.” We do not interpret the Bulletin to require that the summary of the tax opinion in the tax disclosure be verbatim identical to the tax opinion filed with the SEC. Finally, we also do not interpret the Bulletin as requiring that the tax opinion expertize the entire tax disclosure merely because the tax disclosure also describes non-material federal income tax consequences or other factual information.

When tax counsel’s opinion on a federal income tax consequence that is “material to investors” is clearly identified and articulated in the tax disclosure, tax counsel typically provides a short-form opinion. According to the Bulletin, in a short-form opinion, the tax disclosure in the disclosure document serves as the tax opinion, and the opinion filed as an exhibit to the registration statement confirms this. We interpret the Bulletin as consistent with the common understanding of practitioners that the short-form opinion confirming that the tax opinion of named counsel identified in the tax disclosure is the tax opinion of named counsel. We do not

38 Sections 10.50, 10.51 and 10.52 of Circular 230.
39 Section 10.24 of Circular 230.
40 Part III.B.1 (Long and Short-Form Tax Opinions – Long-Form Opinion).
41 Part III.B.2 (Long and Short-Form Tax Opinions – Short-Form Opinion).
interpret the Bulletin as requiring that the short-form opinion state that the entire tax disclosure is the tax opinion of named counsel merely because the tax disclosure also describes non-material federal income tax consequences or other factual information.

B. Timing of Delivery of Tax Opinion

The contractual condition opinion and the disclosure opinion are delivered at the closing of the registered offering.

When a registered offering involves a federal income tax consequence that is “material to investors”, the tax opinion on such consequence is required to be filed with the SEC before effectiveness of the registration statement.\(^{42}\) This is the case even if the closing of the offering is contractually conditioned on delivery of this tax opinion. However, consistent with the common understanding of practitioners, the Bulletin indicates that a tax opinion regarding the treatment of a merger as a tax-free reorganization is not required to be filed before effectiveness if (1) the tax disclosure discusses the substance of the tax opinion that will be provided at the closing of the merger and (2) the merger agreement includes a non-waivable condition to the closing of the merger that the tax opinion be delivered at the closing.\(^{43}\) As a practical matter, this means that if the closing tax opinion condition is eliminated (whether by waiver or amendment of the merger agreement), the terms of the transaction will have changed by mutual agreement, resulting in a change in the tax consequence that is “material to an investor” (e.g., that the merger will be a taxable transaction, rather than a tax-free reorganization). Under these circumstances, the disclosure document must be recirculated and the shareholders resolicited.\(^{44}\)

IV. SEC Staff Review of Tax Disclosures and Tax Opinions

In the ordinary course of the process of registering an offering with the SEC, the Staff reviews and provides comments on the registration statement and exhibits thereto before the SEC declares the registration statement effective. During this period, there may be a series of back and forth communications between the Staff and tax and other counsel concerning the Staff’s comments on the registration statement.

In most registered offerings, the nature and scope of the comments received by issuer’s counsel from the Staff during the review process have been consistent with the views expressed in the Bulletin. On occasion, however, many of our members have received significant comments from the Staff regarding the adequacy of the form and/or scope of the tax opinion filed with the registration statement (as opposed to the tax disclosure itself) that we believe are inconsistent with these views and inconsistent with common market practice, particularly in the context of registered offerings involving mergers and other tax-free exchanges. Although experiences of this kind occur in only a minority of cases, they are not unusual. We hope and expect that this Report, as well as any future dialogue it may produce, will either explain or

\(^{42}\) Item 601(b)(8) of Regulation S-K.

\(^{43}\) Part III.D.2. (Additional Considerations – Timing).

\(^{44}\) See Part III.D.3 (Additional Considerations – Closing Tax Opinions as a Waivable Condition).
resolve the basis for this apparent inconsistency with the views of the Staff as expressed in the Bulletin.

It also appears that the Staff is devoting more time and attention to reviewing and commenting upon tax disclosures and tax opinions, at least for certain types of registered offerings. We support the Staff in this effort because we believe that more time and attention to these matters, in particular following the release of the Bulletin, is likely to lead to the application of more consistent standards by reviewers in assessing the adequacy of tax disclosure and any related tax opinions in registered offerings of similar securities, a goal which we all share. However, it is our experience that the successful achievement of this objective will depend in substantial part upon the receipt of timely feedback from the Staff during the review process. Without sufficient time for any meaningful engagement and dialogue between the reviewer and tax counsel, it is often very difficult for tax counsel to respond to such comments in a thoughtful way. We hope that the Staff shares our views in this regard.

V. Conclusion

We believe that the practices described in this Report are consistent with the Bulletin. We hope and expect that the thorough explanation of tax opinion practice in this Report will advance the objectives of the Bulletin of establishing clear and consistent standards for assessing the adequacy of expertized tax disclosure in registered offerings during the SEC review process, both for tax counsel in its effort to prepare such disclosure and for the Staff in its effort to assess and comment upon the adequacy of such disclosure. We also believe that any future dialogue between members of the tax bar and the Staff that may result from this Report will further these objectives as well.