Testimony

By

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on behalf of the ABA Section of Taxation

on the

Proposed Regulations Governing Practice Before the IRS under Circular 230 relating to proposed standards for State or Local Bond Opinions affecting Tax-exempt Bonds (REG-159824-04)

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General Introduction

Good morning. My name is John J. Cross III. I am Chair of the Tax-exempt Financing Committee of the American Bar Association’s (“ABA”) Section of Taxation. My comments today are made on behalf of the over 20,000 members of the ABA Section of Taxation (the “ABA Tax Section”). Our comments have not been approved by the ABA’s House of Delegates or its Board of Governors, so they do not represent formal ABA policy.

The ABA Tax Section appreciates the opportunity to appear today to comment on the Proposed Regulations under Circular 230 on State or Local Bond opinions (the “Proposed Regulations”). We recently submitted detailed written comments on the Proposed Regulations, with a few comments on the related final Treasury Regulations under Circular 230 which were published at the same time (the “Final General Circular 230 Regulations”). Today, I will highlight certain points following roughly from the Executive Summary in our written comments.

The ABA and the ABA Tax Section have been leaders in developing tax practice standards for tax opinions for over 20 years. In 1982, the ABA released Formal Opinion 346 on tax shelter opinions, which was largely incorporated into Circular 230.

We commend Treasury and the IRS for providing flexibility to address tax matters for State or local bond opinions in separate written advice. Although it is uncertain whether this proposed alternative approach ultimately will prove workable, we offer our comments with that goal in mind.

One theme expressed by Treasury and IRS officials publicly has been to apply Circular 230 “reasonably” and with “common sense.” At the risk of generalizing, one theme of our written comments is to flesh out the Circular 230 standards reasonably and with common sense.
Certain Special Considerations for State or Local Bond Opinions

Initially, I want to touch on certain special considerations in the tax-exempt bond area. The municipal bond market has over $2 trillion in outstanding bond issues, over 15,000 separate bond issues annually, over 50,000 bond issuers, and a wide range of bond issues.

This area involves State and local governments, which are almost uniformly subject to public “sunshine” laws for meetings and records. This area is notable for its very public transparency.

This area focuses on public purposes, which is very different than the corporate area. We believe that the tax-exempt bond area generally has a high level of tax compliance and high tax practice standards, which are grounded in this public purpose focus and public transparency. This area is accustomed to short-form unqualified tax opinions.

This area also is complex for many reasons, including the number of projects financed (which can include hundreds of projects for a major general purpose issuer), the complex program targeting rules, and the long-term compliance periods (which extend typically for the 30-term of the bonds and much longer if bonds are refunded).

The proposed broad expansion of Circular 230 into this area will result in increased costs to State and local governments.

We urge you to consider carefully the special nature of the tax-exempt bond area and to craft more tailored rules under Circular 230.

Statement of Purposes

A statement of the purposes of Circular 230 in general and its application to tax-exempt bonds in particular would be helpful. We observe that tax-exempt bond opinions are not typically provided with a view towards avoidance of tax penalties.
Fundamental Requirements to Identify Facts, Relate Law to Facts, and Address Significant Federal Tax Issues

Next, I want to focus on the fundamental rules to identify facts, relate applicable law to relevant facts, and address significant Federal tax issues for State or local bond opinions and covered opinions.

Given the heightened importance, impact, and broadened application of these basic rules, we strongly recommend further development of these standards.

Statement of Same Professional Standard. In general, we suggest an express statement in the final rules that State or local bond opinions under §10.39 are subject to the same professional standards as covered opinions under §10.35.

Identifying Facts. For the rule on identifying facts, our main recommendation is to give tax practitioners positive comfort that they can rely on factual representations of others without independent verification and without assuming nonlegal roles as investigatory “auditors” of facts. This recommendation is consistent with longstanding standards on “due diligence” under Circular 230, such as under §10.34(c), and as previously under §10.33(a)(1)(ii) of the 1984 final Circular 230 rules.

We also recommend tailoring factual inquiries to give due weight to the relative settled or unsettled nature of the law and to how clearly it applies to the facts under the circumstances. For example, identifying that the City of Los Angeles has the “sovereign” powers of a political subdivision does not advance Circular 230, even though plainly “relevant” to the Federal tax analysis of the City’s tax-exempt bond issues.
**Relating Law to Facts.** For the rule on relating the law to facts, we recommend clarifying whether this rule requires a discussion of relevant law beyond law that is relevant to significant Federal tax issues.

Our primary recommendation here is to limit this rule to a discussion of law *relevant to significant Federal tax issues* to provide a more meaningful emphasis for this rule.

Alternatively, absent limiting this rule to law that is relevant to significant Federal tax issues, we recommend providing express discretion to tailor the scope and extent of the legal analysis to give due weight to whether the particular facts and law are routine, settled, or noncontroversial under the circumstances.

**Evaluating Significant Federal Tax Issues.** For the rule on evaluating significant Federal tax issues, we prefer the approach previously recommended in ABA Tax Section comments to raise the bar for a significant Federal tax issue from one with a reasonable basis to one with a “realistic possibility of success” (implying about a one in three chance of success) (as defined in §10.34(d)(1) or similarly in Treas. Reg. §1.6694-2(b)). We continue to think that such a higher bar would provide a more targeted and workable emphasis under Circular 230 on more clearly serious Federal tax issues.

At the same time, we acknowledge that a sound policy basis may exist for using the reasonable basis standard to broaden the types of Federal tax issues covered by Circular 230. Our comments generally assume that the reasonable basis standard will be retained.

We focus, instead, on recommending strongly that the reasonable basis standard be further clarified to the fullest extent possible in light of its heightened importance.
Here, while recognizing the limits of math tests, we suggest that including a stated chance of success as part of the reasonable basis standard (such as, at least a 20% chance of success) would help to give a better sense of this standard.

We also recommend clarifying that the reasonable basis standard generally is the same as that used for purposes of the accuracy-related penalties under Code Section 6662 and Treas. Reg. §1.6662-3(b)(3), but with certain suggested refinements. We suggest clarifying the kinds of guidance that can be relied upon by the IRS in finding a reasonable basis for a “successful” court challenge for Circular 230 purposes. We suggest that one possible approach here would be to limit the types of authority that the IRS could consider for this purpose to authorities that courts would view as legal precedents.

We also suggest that the failure of a transaction to meet a “safe harbor” in published guidance, taken alone, should not suggest a significant Federal tax issue.

**Certain Definitions**

We make technical recommendations on the definition of State or local bond opinion. We suggest expanding this definition to include other tax opinions reasonably connected to or subsidiary to the basic Code Section 103 tax exemption.

We also suggest carving out tax-exempt bonds from the definition of transactions with “the principal purpose” of tax avoidance or tax evasion under §10.35(b)(2)(i)(B) in a manner similar to a previous exemption from the definition of a tax shelter under Treas. Reg. §1.6662-4(g)(2)(ii). Tax-exempt bonds issued for public purposes further the Congressionally-authorized Section 103 tax exemption and properly should not be treated as having such a principal purpose as a tax policy matter.
Clarify the Treatment of Various Tax Opinions Related to Code Section 103 Tax Opinions, Including No Adverse Effect Opinions

Standard bond counsel opinions given at the time of original issuance of tax-exempt bonds regarding the Code Section 103 tax exemption clearly are the main opinions covered by the proposed definition of State or local bond opinions. The treatment of a number of other common tax opinions related to tax-exempt bonds, however, is less clear in terms of where they fit under the Proposed Regulations and the Final General Circular 230 Regulations.

Here are a few examples of tax opinions related to tax-exempt bonds: (1) various subsidiary tax opinions given at original issuance by other counsel on which bond counsel rely for the Code Section 103 tax exemption opinion, such as Code Section 501(c)(3) status opinions on borrowers in qualified 501(c)(3) bond financings; (2) tax opinions given at original issuance regarding original issue discount, bond premium, and other collateral matters; and (3) various post-issuance tax opinions given under issuer tax covenants to preserve the Code Section 103 tax exemption (often called “no adverse effect” opinions”) to address the effects of various actions (such as changes in interest rate modes or changes in use of tax-exempt bond financed property).

We suggest possible ways to clarify the treatment of these common related opinions under the definitions of State or local bond opinions in the Proposed Regulations, limited scope opinions under §10.35(c)(3)(v) in the Final General Circular 230 Regulations, and otherwise. The important point here is clarify where these common related opinions fit.

Electivity of Special Alternative for State or Local Bond Opinions

We also recommend clarifying that the special alternative for State or local bond opinions under §10.39 is elective and that a tax practitioner may use the general rules for covered opinions under §10.35 instead.
Application of Opt-Out Disclaimer Provisions to State or Local Bond Opinions

We also recommend clarifying that tax practitioners may use the opt-out disclaimer exceptions available for reliance opinions (under §10.35(b)(4)(ii) and marketed opinions (under §10.35(b)(5)(ii)) for State or local bond opinions that otherwise would be eligible. These opt-out provisions involve disclaiming tax penalty protection. Although we are unsure of the extent to which the tax-exempt bond market would accept these opt-outs, it would be helpful to have the flexibility to use them in the same manner as other tax opinions.

Various Special Considerations

In our written comments, we also make various recommendations regarding certifications in connection with refundings, certifications involving Section 501(c)(3) status and operations in connection with qualified 501(c)(3) bonds under Section 145 of the Code, and certain small or plain vanilla tax-exempt governmental bond issues.

Effective Date of Final General Circular 230 Rules

We have one effective date comment associated with our comments about the need to clarify the treatment of various tax opinions which are related to tax-exempt bonds. Specifically, we urge Treasury and the IRS to delay the effective date of the Final General Circular 230 Regulations (which generally are scheduled to become effective on June 20, 2005), for tax opinions related to tax-exempt bonds until the Proposed Regulations on State or local bond opinions are finalized and become effective so that the proper treatment of various tax opinions related to tax-exempt bonds can be made clear.

Conclusion
That concludes my remarks. Thank you very much. I would be glad to try to answer any questions.