July 21, 2006

Hon. Mark W. Everson
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Comments Regarding the Proposed Section 10.39 of Circular 230

Dear Commissioner Everson:

Enclosed are comments addressing the proposed Section 10.39 of Circular 230. These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association and should not be construed as representing the policy of the American Bar Association.

Sincerely,

Dennis B. Drapkin
Chair, Section of Taxation

Enclosure

cc: Donald L. Korb, Chief Counsel, Internal Revenue Service
    Eric Solomon, Acting Deputy Assistant Secretary (Tax Policy), Treasury Department
    Michael J. Desmond, Tax Legislative Counsel, Treasury Department
    Stephen Whitlock, Deputy Director Office of Professional Responsibility, Internal Revenue Service
    Deborah A. Butler, Associate Chief Counsel (Procedure & Administration), Internal Revenue Service
    Richard Goldstein, Special Counsel, Internal Revenue Service
COMMENTS CONCERNING PROPOSED SECTION 10.39 OF CIRCULAR 230

These comments are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or the Board of Governors of the American Bar Association. Accordingly, these comments should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these comments was exercised by David J. Cholst, Chair of the Tax Exempt Financing Committee’s Subcommittee on Opinions and Practice Standards. Substantive contributions were made by David A. Caprera. These comments were reviewed by Clifford M. Gerber and Michael G. Bailey, Chair and Vice Chair (respectively) of the Tax Exempt Financing Committee. These comments were further reviewed by Dean M. Weiner of the Section’s Committee on Government Submissions and by Peter J. Connors, the Council Director for the Tax Exempt Financing Committee.

Although members of the Section of Taxation who participated in preparing this recommendation have clients that would be affected by the federal tax rules applicable to the subject matter addressed by this recommendation, or have advised on the application of such rules, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of this recommendation.

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Dated: July 5, 2006
These comments are being submitted by the Section of Taxation of the American Bar Association to express certain concerns about the adverse impact proposed Section 10.39 of the Circular 230 regulations related to tax-exempt financing is expected to have on the delivery of tax advice. The Section previously filed extensive comments on the application of the proposed Circular 230 regulations to tax-exempt financing.¹

Executive Summary

These comments relate to the applicability and scope of proposed Section 10.39 of the Circular 230 regulations, particularly as applied to written tax advice other than the traditional bond counsel opinion rendered upon issuance of a bond issue. These comments include descriptions of certain types of written tax advice commonly provided by bond counsel (and, in certain cases, other counsel) concerning tax-exempt bonds, other than the traditional bond counsel opinion. These comments recommend that tax practitioners not be subject to rules under Section 10.39 that are any more restrictive than those under Section 10.35, including the ability to “opt out” of the content rules of Section 10.35. Further, these comments enumerate several actual-practice situations that support this recommendation and suggest that an explanatory, likely expensive memorandum should not be required to achieve the goals of Circular 230 with respect to such written advice. These comments draw a distinction between advice furnished to bondholders and advice provided to others for various purposes, including assistance to issuer in following bond-related covenants.

Particular types of advice discussed in these comments include advice concerning, arbitrage rebate, advice that assists in compliance with bond covenants, and advice that assists in negotiating contracts. We recommend that such written advice be excepted from the content requirements of a State or Local Bond Opinion (as defined below) or that the practitioner providing the advice be given the option to provide disclaimers that obviate the need for such content.

Discussion

I. Regulatory Framework

Sections 10.35 and 10.37 and proposed Section 10.39² provide rules regarding the form and content of written tax advice provided by tax practitioners. While these three sections must


be read in the context of the complete Circular 230, they contain the bulk of the rules concerning written tax advice. Section 10.37 contains rules applicable to all written tax advice and generally covers the types of written tax advice tax practitioners may ethically provide. Section 10.35 provides specific requirements for the form and content of written tax advice and identifies certain types of tax advice, referred to as a “covered opinion,” that the Treasury Department views as more important, and thus subject to the requirements of Section 10.35. Specifically, those requirements relate to the identification of the facts, the manner in which the practitioner relates the law to the facts and the evaluation of “significant Federal tax issues.” Those requirements, as finalized on December 20, 2004, and amended on May 19, 2005, became effective for written advice rendered after June 20, 2005.

One exception from the definition of covered opinion is a “State or Local Bond Opinion.” The currently applicable definition of State or Local Bond Opinion is found in Notice 2005-47, which, as discussed below, provides a broad definition of that term. Proposed Section 10.39 imposes form and content rules similar to the rules of Section 10.35 on State or Local Bond Opinions.

II. Purpose of Section 10.39

Proposed Section 10.39 is intended to provide special rules to accommodate the unique aspects of municipal finance. Like its counterpart in Section 10.35, Section 10.39 should foster better communication between practitioners and the recipients of their advice. It is most important that Section 10.39 not create roadblocks that discourage practical written tax advice or discourage advice that would enhance tax compliance.

We believe that, apart from the vehicle required to be used to communicate the practitioner’s tax advice to the intended recipient, as a general matter, the thresholds and requirements of Section 10.39 should not be stricter than those of Section 10.35. We believe that such approach would be consistent with Treasury’s objectives, and we understand from informal comments of Treasury that the two regulation sections should operate to treat the tax-exempt bond area no differently from other areas of taxation except for the form of the required written advice.

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3The term “significant Federal tax issue,” defined in Section 10.35(b)(3), means a federal tax issue if the Service has a reasonable basis for a successful challenge and its resolution could have a significant impact, whether beneficial or adverse and under any reasonably foreseeable circumstance, on the overall federal tax treatment of the subject matter of the opinion. A discussion of the scope of “significant Federal tax issue” is beyond the scope of this submission.


6Reg. § 10.35(b)(9).

72005-26 I.R.B. 1373.
For example, if written advice rendered by a practitioner would not otherwise rise to the level of a reliance opinion or a marketed opinion if analyzed under Section 10.35 (in which case the requirements of Section 10.37 but not Section 10.35 would apply), then such written advice should not be subject to what would turn out to be stricter requirements of Section 10.39 as applied to municipal bonds.

Further, practitioners providing written tax advice in other tax areas are generally able to “opt out” of the content rules of Section 10.35 by putting the recipients of the advice on notice that the advice is not intended to be used for certain purposes. Advice recipients often but not always choose to accept this “opt out” in an effort to keep costs down and because the advice recipient is not intending to take aggressive tax positions for which it feels it needs “penalty protection.”

We understand that Treasury is considering not making the same option available to recipients of advice from practitioners providing State or Local Bond Opinions. We believe that it is inappropriate for practitioners and advice recipients to be denied the option to provide or receive cheaper, less cumbersome advice, although, we acknowledge that, in many situations, market forces may effectively remove that option even if Treasury were to allow it.

III. Scope of Section 10.39 — In General

Proposed Section 10.39 applies to “State or Local Bond Opinions.” As currently defined in Section 10.35, a State or Local Bond Opinion refers in today’s practice primarily to the traditional bond counsel opinion rendered upon issuance of the bonds, i.e., the unqualified bond counsel opinion delivered to bondholders at that time indicating that in such counsel’s opinion interest on a bond is tax-exempt.

In Notice 2005-47, however, the definition was expanded considerably. Under Notice 2005-47, a State or Local Bond Opinion is written advice (including electronic communications) that concerns:

(i) The excludability of interest on a State or local bond from gross income under section 103 of the Internal Revenue Code (the “Code”);

(ii) The status of a State or local bond as a qualified zone academy bond under section 1397E of the Code;

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8 In the vast majority of cases involving tax advice related to tax-exempt bonds, the recipient of advice would be very unsatisfied if the advice turned out to be wrong even if there were no penalties.

9 State or Local Bond Opinion is defined in the regulation as “written advice with respect to a Federal tax issue included in any materials delivered to a purchaser of a State or local bond in connection with the issuance of the bond in a public or private offering, including an official statement (if one is prepared), that concerns only the excludability of interest on a State or local bond from gross income under section 103 of the Internal Revenue Code, the application of section 55 of the Internal Revenue Code to a State or local bond, the status of a State or local bond as a qualified tax-exempt obligation under section 265(b)(3) of the Internal Revenue Code, the status of a State or local bond as a qualified zone academy bond under section 1397E of the Internal Revenue Code, or any combination of the above.” Reg. § 10.35(b)(9).
(iii) One or more other Federal tax issues reasonably related and ancillary to advice described in paragraph (b)(9)(i) or (ii) of this section. Such issues include, but are not limited to - -

(A) The application of section 55 of the Code to a State or local bond;

(B) Whether a State or local bond has been reissued for Federal tax purposes;

(C) The status of a State or local bond as a qualified tax-exempt obligation under section 265(b)(3) of the Code;

(D) The treatment of original issue discount or premium on a State or local bond under the Code; and

(E) Whether the organization that is borrowing the proceeds of the State or local bond is described in section 501(c)(3) of the Code; or

(iv) Any combination of the above.

Notice 2005-47 was intended to provide temporary relief from the yet untested requirements for advice relating to tax-exempt bonds. While a broad definition is appropriate in the context of a transition rule, this definition should not be the basis for imposition of the significant burdens of Section 10.39. Many opinions and other written advice never intended for bondholder use could, under the Notice, be treated as State or Local Bond Opinions subject to Section 10.39.

Notice 2005-47 literally does not limit State or Local Bond Opinions to written tax advice that otherwise would be covered opinions under the standards of Section 10.35. This expanded definition has been very useful to the bond community in light of the delayed effective date of Section 10.39. Once proposed Section 10.39 becomes effective, however, it is important that Section 10.39 not impose content requirements on written advice that, without the exception for State and Local Bond Opinions, would never have been subject to Section 10.35. At a minimum, Section 10.39 should not apply to any written tax advice that would not, under the standard provided in Section 10.35 be a reliance opinion, a marketed opinion, an opinion about a listed transaction or an opinion about a transaction whose principal purpose is tax avoidance.

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10For example, written advice that interest on a tax-exempt bond is treated as an item of tax preference for purposes of the alternative minimum tax under Section 55 of the Code would be a State or Local Bond Opinion under Section 10.35(b)(9)(iii)(A) as such section is set forth in Notice 2005-47, but would not be a covered opinion under the current Section 10.35 because of the exception for negative advice in Section 10.35(b)(2)(ii)(E).

11There is one substantive requirement found in Reg. § 10.35(d) and Prop. Reg. § 10.39(d), each of which requires a practitioner providing covered (or State or Local Bond Opinion) written tax advice to be knowledgeable in all relevant aspects of federal tax law. We believe that it is appropriate for this requirement to apply to all written tax advice.
Further, assuming that Section 10.39 continues to require a separate written memorandum containing factual and legal analysis, the regulation should not require such memorandum to be delivered to a bond issuer for placement in a bond transcript if the advice is not intended for either the bondholder or the bond issuer. Prospective bond purchasers, service providers, conduit borrowers, credit enhancers and others sometimes retain their own counsel to provide them with tax advice that is intended solely for the practitioner’s client. Forcing such advice to be given to the bond issuer may impair attorney-client relationships between other parties and their attorneys. Under Notice 2005-47, the broad scope of State or Local Bond Opinions arguably covers advice to other parties and even advice to a particular bondholder from its independent counsel.12

IV. Scope of Section 10.39 — Specific Matters

Written tax advice meeting the description in Notice 2005-47 includes a variety of forms and content written for a variety of purposes. Much of this advice is advice from attorney to client offered in a context that fully supports negotiation between the practitioner and his or her client over the content, form and price of the advice. We believe that it is useful to give some common examples of such advice that is very different from traditional Bond Opinion advice.

A. Advice to Bond Issuers. Tax-exempt bond rules contain many restrictions on the use of bond-financed property. School district officials may, for example, want to know if a proposed lease or service contract would affect outstanding or proposed tax-exempt bond issues. There are many reasons why such lease or service contract might not have an adverse effect on tax-exempt bonds: The property affected might not have been financed with tax-exempt bonds; the bonds may no longer be outstanding; the extent of private use might be within de minimis allowances; the other party might itself be exempt as a governmental unit or an organization described in Section 501(c)(3) of the Code; the lease or service contract might fit within guidelines for short-term leases or qualified management agreements; or an appropriate remedial action might be taken. The school district that asks its lawyers for advice in negotiating a contract generally is not looking for detailed explanations. A full covered opinion (or required separate written advice) discussing the facts and law related to such questions could run for many pages and require many hours of work to prepare. In today’s environment, such questions are generally answered in short letters or memoranda or, more frequently, by short succinct e-mail conversation, either provided without charge by practitioners trying to maintain good relations with their clients or for a minimal charge. School districts are unlikely to wish to pay tens of thousands of dollars for such routine advice. If Circular 230 prohibits practitioners from giving cost-effective written advice, such public districts will be more likely to go it alone or to rely only on oral advice.13 This would likely lead

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12 For example a bondholder could ask its tax advisor for advice concerning whether interest on the bond is tax-exempt in anticipation of completion of a Form 1040. A prospective bond purchaser could ask a tax practitioner for advice about the risks of owning such a bond.

13 Even in today’s environment, we frequently observe bond issuers that make decisions on such matters without contacting their attorneys.
to more decisions being made without consultation with tax counsel, meaning less-informed decisions. One of the purposes of Circular 230 should be to encourage informed decision making.

B. Advice to Service Providers. When a potential service provider or other party negotiates with an issuer of tax-exempt bonds, the service provider may know that federal tax law limits the terms or scope of the contract. A knowledgeable provider will want to know about such limitations so that it can negotiate the most advantageous contract it can. For example, if a service provider knows that tax law limits the term of a contract to five years, the provider might suggest a contract with a seven-year term knowing that the municipal issuer would have to reject it. The provider can then negotiate a higher price in return for lowering the contract’s term to five years. Such provider may seek advice from tax practitioners on the rules related to tax-exempt bonds not because it wishes to take a tax position or to assist another in taking a tax position, but solely to assist its contract negotiation. We believe that such written advice, although couched as advice concerning the rules under Section 103 of the Code is not really tax advice at all, because when given, it is with the understanding that no one will be relying on the advice for a tax return position. It may be appropriate to clarify by example that such advice is not subject to Section 10.39 or to amend the definition of State or Local Bond Opinion to carve such advice out of the scope of Section 10.39. Further, because this type of written advice is not limited to the bond community, perhaps Section 10.35 should be amended as well so that advice to a party that may have a contractual or other relationship with a party whose tax position is at issue but who does not have a tax position at issue is not considered a covered opinion.14

C. Rebate Opinions. One very common type of written tax advice is advice concerning the amount of payments required under Section 148(f) of the Code, commonly referred to as arbitrage “rebate” payments.15 This advice is different from most other State or Local Bond Opinion advice because the recipient of the advice will use it to take a position on a tax return, a Form 8038-T or 8038-R. We wish to emphasize that although rebate opinions are different from most other tax-exempt bond tax advice, they are also different from general covered opinion tax advice.16 First, rebate itself is

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14 Of course, with an opt-out available, such exception may not be necessary. Such advice would (almost) never be a marketed opinion, and the recipient would never expect to use such advice to avoid penalties since it is not basing a tax position on the advice.

15 Similar advice is provided concerning “yield reduction payments,” which are payments made under Treas. Reg. § 1.148-5 in the same manner as rebate payments.

16 Code Section 148(f)(5) provides for a direct exclusion from gross income of amounts required to be paid as rebate. A consequence of this requirement is that in some circumstances a rebate opinion may also directly serve to advise a taxpayer on how to complete an income tax return without regard to tax-exempt bond rules. Where such use is contemplated, the opinion is likely not a State or Local Bond Opinion. In this context, a rebate opinion that reaches a more likely than not or stronger conclusion on one or more significant tax issues should be treated as subject to Section 10.35 unless an exception applies. To avoid confusion with multiple standards, some practitioners provide separate advice related to Code Section 148(f)(5) and clarify that the standard rebate opinion should not be used for purposes of Code Section 148(f)(5).
not a tax. Although it is paid with a tax return, the Service has, consistent with congressional intent, treated such payments as something other than a tax.\footnote{See, \textit{e.g.}, TAM 200446021, November 12, 2004 (Service and issuer agree that arbitrage rebate is not a tax or penalty).} Rebate also has its own regime of penalties for underpayment of rebate when due. The Service may impose a penalty of either 50\% or 100\% of the amount of a late rebate payment. It is unclear whether an opinion from a tax practitioner would be sufficient or necessary to have such penalty waived. Penalties are generally waived if the payment is made within 180 days of discovery other than in the context of an examination. Nevertheless, it is possible that some bond issuers would want to be able to use a rebate opinion from a reliable tax practitioner to avoid penalties. Practitioners providing rebate opinions must, as a result of market forces, provide the advice for a relatively modest fee.\footnote{Lawyers and accountants providing this service compete with financial advisory firms that are not law firms, not accounting firms, and not firms of authorized tax practitioners. Such firms do not consider themselves bound by the requirements of Circular 230. We would welcome clarification about whether rebate advice is tax advice and whether such advisors who are not lawyers, accountants or other authorized tax practitioners are subject to Circular 230.} Accordingly, the opinion cannot cover all conceivable issues. While recipients of rebate opinions have not yet needed to choose between inexpensive but diligently performed rebate calculations and opinions and equally diligent but expensive and thoroughly annotated rebate opinions, we believe that they should have that choice. We also believe that if given the choice, many recipients of written advice would choose the less expensive option.

D. Advice to Bond Trustees. Bond trustees often have responsibility for ensuring that post-issuance compliance rules are followed. To this end, bond trustees often request (and are in fact often required by bond documents to obtain) formal written opinions concerning federal tax requirements. For example, a bond trustee may require such an opinion before it releases a lien on a building that a bond issuer intends to sell. In this case, the bond trustee is looking out for the interests of the bondholders, as well as the issuer and conduit borrower, if any. However, even in this case, it may be appropriate for the bond trustee to negotiate with the opinion provider about restrictions on the use of the opinion. Some of this advice, like the less formal written advice to the bond issuer, may not be made available to the bondholders.\footnote{Because the bond trustee has certain duties to the bondholder, the bond trustee may at times be reluctant to accept restrictions (like a no-penalty-protection limitation) on use of the opinion. However, some issuers and conduit borrowers have begun to see a need to balance the cost against the advantage of formal unrestricted advice. Accordingly, such issuers have begun to require in the trust indenture that the trustee accept appropriately restricted written advice.} In certain cases, because the Bond Trustee is acting for the benefit of the bondholders, such advice might rise to the level of a marketed opinion. Even in such cases, relief from some of the requirements of Section 10.39 is appropriate. For example, such advice often concerns a specific or narrow question. It would be appropriate to allow limited scope opinions with
appropriate disclosure even if such opinions might be classified as marketed opinions.\textsuperscript{20} Bond issuers and others involved in drafting trust indentures recognize that the true purpose of such advice is simply to assure that the bond issuer and other parties comply with the substantive tax covenants. The purpose is not to provide advice directly to bondholders and is certainly not to provide bondholders with penalty protection.

V. Suggested Regulatory Modification.

A. Limitations on Definition of State or Local Bond Opinions. We believe that certain written tax advice described above should not be treated as State or Local Bond Opinions requiring a separate written memorandum with content described in Section 10.39. One approach would be to provide an exception to the definition of State or Local Bond Opinion. Several choices exist.

1. The exception could be totally discretionary. If the tax practitioner wants the advice not to be a State or Local Bond Opinion, he or she could so elect. The consequence might be that the written advice would be a covered opinion subject to Section 10.35 unless an exception applied.

2. An alternative would be to except from State or Local Bond Opinion status written advice provided to recipients that (as discussed below) would be unlikely to benefit from a separate detailed written memorandum. To implement such a rule, it is necessary to identify such advice.

The most compelling indication of whether an advice recipient would be likely to benefit from a separate detailed written memorandum, and therefore whether State or Local Bond Opinion status should apply, is whether the advice is used in the marketing of tax-exempt bonds or is otherwise provided to the tax-exempt bondholder. For example, advice that concerns matters that would otherwise cause it to be a State or Local Bond Opinion should be exempt from Section 10.39 if the advice prominently displays a notice that bondholders may not rely on the opinion and that the advice is not to be used for the marketing of any tax-exempt bonds.

3. We understand that one of Treasury’s concerns about allowing an “opt out” for traditional bond opinions is that the bondholder cannot easily agree with a practitioner whom he has never met on such things as limitations on the use of the advice.\textsuperscript{21} (We believe that by choosing to purchase a bond, the bondholder is consenting to conditions including contractual restrictions described to him in offering materials.)

\textsuperscript{20}We have assumed that an opinion directed to the bond trustee by counsel other than trustee’s counsel would be a marketed opinion under the current broad definition, because it is implicitly referred to by the issuing counsel’s client (usually the bond issuer) to induce the trustee to take some action or not require some action in connection with a transaction. If such an opinion is not a marketed opinion, so that it is eligible to be a limited scope opinion, this treatment should be made clear.

\textsuperscript{21}The same argument could be made for advice provided to investors in taxable investments.
We also believe that this reasoning does not apply when the opinion is not addressed to or intended to be relied upon by a bondholder. Thus, an exception to the content rules of Section 10.39 or an opt-out option should be available with respect to any advice not directed to a bondholder.

4. In many contexts, advice is intended for one recipient only (an issuer or conduit borrower for example). Such recipient would normally be willing to agree that no other party could rely on the advice provided to the recipient at the recipient’s expense. Thus, a disclaimer that indicated that the written advice could not be used by any other person for penalty protection would not only be acceptable to such recipients, it might seem superfluous. If a bondholder is not relying on the written advice to take a tax position (because, for example, the bondholder does not know the advice was given or the advice states clearly that it cannot be relied upon by a bondholder), the bondholder also clearly cannot rely on the advice to avoid underpayment penalties. We would therefore propose that Section 10.39 not apply to any advice that is neither a marketed opinion (as defined in Section 10.35) nor is addressed to a bondholder or other potential taxpayer. 22 One way to implement this rule would be to provide for an exception for written advice that prominently displays a restriction that it cannot be used to support any position on a tax return.

5. We believe that Section 10.39 should explicitly allow limited scope opinions with appropriate disclaimers at least so long as new tax-exempt bonds are not being issued or marketed with such limited scope advice in a manner that would be misleading to bond purchasers.

6. A significant percentage of the current tax-exempt bond market consists of variable rate obligations where the interest rate may be established by tender and remarketing, an auction process or through indexing. Such obligations are often structured as “multi-modal,” which is to say that they may convert from one interest rate setting mechanism to another. As a condition to certain interest rate resets or mode conversions, the bond documents and/or the bond trustee typically require an opinion that the obligations have not been reissued 23 or that their tax exemption has not been adversely affected. Although the obligations will be the subject of a remarketing or auction process, the “no adverse effect” opinions may or may not be directly used in such remarketing. These opinions are usually not addressed to the bondholders. However, these opinions do address issues relating to the tax exemption of the obligations. At least in situations in which the opinions are not addressed to the bondholders and are not directly used in the remarketing of bonds, given the relatively standard form of, and commonplace delivery of, such opinions, we believe that limited scope opinions should be allowed with appropriate disclaimers, in lieu of the expensive requirements that might

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22 Although a bond issuer is treated as a taxpayer for certain purposes, in this context “taxpayer” should be limited to those paying tax.

23 For qualified tender bonds, the analysis is based on an application of Notice 88-130. For other variable rate obligations, bond counsel looks to Section 1001 of the Code and, in particular, Treas. Reg. § 1.1001-3.
be imposed by Section 10.39 if limited scope opinions were not allowed. Moreover, such opinions should not be treated as covered opinions to the extent such opinions would not be so treated under the standards of Section 10.35.

VI. Other Changes Contemplated.

We understand that the Service and Treasury are separately considering excepting from Section 10.39 all post-closing tax advice. We endorse any such exception. However, an exception for post-closing advice is distinct from an exception for non-tax return position advice. Some post-closing tax advice is used to market bonds (e.g., tax disclosure in a remarketing circular). Conversely, some pre-closing advice is advice that is not intended for bondholders (e.g., advice to service providers) and accordingly should be exempt from the scope of additional documentation requirements.

VII. Arbitrage Rebate.

As described above, advice related to arbitrage rebate poses special considerations. Bond issuers (and conduit borrowers) often obtain written advice related to arbitrage rebate (and yield reduction payments that may in certain circumstances be made under Treas. Reg. § 1.148-5). This advice is used by the issuer directly to take a return position on form 8038-T (or 8038-R). Thus, it might seem that such advice should not be subject to the same exception as other advice that is not addressed to the bondholder. In fact, advice related to arbitrage rebate under Section 148(f) of the Code (and to yield reduction payments, which are technically distinct from rebate payments) also deserves either a blanket exception or an opt-out. Treasury Regulation § 1.148-3 provides a direct underpayment penalty for rebate distinct from the penalty for underpayment of taxes, but a penalty nonetheless. It is not clear that such penalty would be waived based on written advice from a practitioner at a more likely than not level. In fact, the penalty has historically been waived in situations without such an opinion at all. However, a penalty waiver disclaimer would have consequences to the bondholder who would then know that the advice could not be used for that purpose. We believe that the majority of recipients of such advice have no interest in penalty protection. In any case, because rebate payments have never been treated as tax payments, advice that concerns a return position on rebate cannot really be said to be for tax avoidance purposes, although it may be advice rendered for rebate avoidance purposes.

We thus encourage the Service and Treasury to provide an exception from Section 10.39 (and Section 10.35) for arbitrage rebate and yield reduction payment opinions, or alternatively to allow an opt-out with disclaimers similar to those allowed under Section 10.35.

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The penalty is generally either 50% or 100% of the deficiency.

They are not interested in playing the audit lottery, but are simply trying to comply with the rebate provisions. Some issuers have paid late rebate after statutes of limitation have made it all but impossible for the Service to challenge the rebate amount. We believe that state and local governments in general make a good faith effort to comply with the applicable tax requirements.
VIII. General Conclusions.

Section 10.39 should include all of the exceptions and limitations on applicability that are included in Section 10.35. Separate detailed written advice should be required only when it is necessary to assure that the practitioner has exercised appropriate diligence because, for example, such opinion is being relied upon by investment purchasers that have had no ability to negotiate with the practitioner.