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March 1, 2005

CC:PA:LPD:PR (REG-159824-04)
Courier's Desk
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, D.C. 20224

Re: Disruption of Municipal Marketplace Due to Proposed Circular 230 Regulations

Ladies and Gentlemen:

I am submitting these comments on the proposed Circular 230 regulations issued on December 20, 2004 (REG-159824-04, 69 Fed. Reg. 75887 (2004)) (the "Proposed Regulations") on behalf of The Bond Market Association ("TBMA"). TBMA, with offices in New York, Washington, D.C. and London, represents securities firms and banks that underwrite, trade and sell debt securities in the United States and globally. Our members collectively account for approximately 95 percent of the nation's municipal bond underwriting and trading activity. Our goals include the promotion of fairness and efficiency through open access to the bond markets and improvements in the legislative, regulatory, educational, and market practice arenas for all participants in the bond markets.

As a threshold matter, we continue to question why municipal bond opinions are subject to Circular 230 in the first instance. The final Circular 230 regulations (T.D. 9165, 69 Fed. Reg. 75839 (2004)) (the "Final Regulations"), released on the same day as the Proposed Regulations, eliminate the concept of "tax shelter" that was used in the 2003 proposed Circular 230 regulations (REG-122379-02, 68 Fed. Reg. 75186 (2003)) (the "2003 Regulations") to define the types of opinions subject to the rules. Regardless, the types of opinions subject to Circular 230 are defined by reference to the same standards—whether the transaction has the principal purpose or a significant purpose of avoiding or evading any tax imposed by the Internal Revenue Code (the "Code"). We do not believe that municipal bonds, which enjoy a specific exclusion from gross income under the Code, are tax shelters or satisfy this standard. Moreover, no clear explanation has been provided for the elimination of the exclusion from Circular 230 for municipal bonds in the 2003 Regulations that have been in effect since 1984.

Notwithstanding the foregoing, we appreciate the efforts of the Treasury Department and Internal Revenue Service ("IRS") to understand the special characteristics of the municipal bond market, and the extent to which these characteristics were taken into account by proposing special rules for municipal bonds. However, TBMA is submitting these comments because it is concerned that the municipal market will be significantly altered and disrupted if the Proposed Regulations are adopted in their current form. We believe that the Proposed Regulations may have the effect of creating two classes of municipal bonds—those with Federal tax issues identified as significant and those without such issues. This will likely result in confusion in the marketplace, as well as different pricing for the different classes of bonds. We expect that many

current investors will be discouraged from buying bonds where significant Federal tax issues have been identified. As a result, we believe that the costs of borrowing will increase for most issuers. We believe that this problem can be solved with limited changes to the Proposed Regulations that are consistent with the purposes of Circular 230.

TBMA's Comments

We have the following comments regarding the Proposed Regulations.

1. Requiring Practitioners to Identify Significant Federal Tax Issues in Written Advice to the Issuer Will Cause Market Disruption. Section 10.39(b) of the Proposed Regulations provides that a practitioner providing a State or local bond opinion must separately provide written advice to the issuer that satisfies the requirements of section 10.39(b). In particular, section 10.39(b)(3) of the Proposed Regulations requires that the written advice consider all significant Federal tax issues that are relevant to the overall conclusion provided in the State or local bond opinion and must provide the practitioner's conclusion as to the likelihood that the taxpayer will prevail on the merits with respect to each significant Federal tax issue considered in the written advice.

Under Section 10.35(b)(3) of the Final Regulations, a Federal tax issue will be significant if "the Internal Revenue 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 transaction(s) or matter(s) addressed in the opinion."

Under the standards adopted by the National Association of Bonds Lawyers ("NABL") for rendering an unqualified opinion with respect to municipal bonds, "Bond counsel may . . . give an unqualified opinion with respect to federal income tax matters if it is firmly convinced that, upon due consideration of the material facts and all of the relevant sources of applicable law on federal income tax matters . . . , the Supreme Court would reach the federal income tax conclusions stated in the opinion or the IRS would concur or acquiesce in the federal income tax conclusions stated in the opinion" (the "NABL Standard"). Model Bond Opinion Report, National Association of Bond Lawyers, Committee on Opinions and Documents (February 14, 2003).

To the extent that bond counsel renders an opinion that meets the NABL Standard, as a theoretical matter, they should be able to conclude that there are no significant Federal tax issues present in the transaction. Notwithstanding, we are concerned that even if bond counsel is willing to render an opinion that it believes will meet the NABL Standard, bond counsel will likely identify certain Federal tax issues as potentially being significant. This may occur for two reasons. First, the definition of when a Federal tax issue is significant is unclear. This is because the Final Regulations provide no standards for determining whether the IRS has a reasonable basis for successful challenge. For example, if the IRS were to take the position that an issue was significant if there was no published guidance directly on point, there would be a very large number of Federal tax issues that could be significant. Second, we expect that bond counsel will be overly inclusive in determining which issues to identify as potentially significant. This is due to a concern that the failure to identify a particular Federal tax issue as significant could be a violation of Circular 230 and could result in the firm no longer being able to practice before the IRS. This would eliminate the ability of most law firms to practice in the municipal bond area.

To the extent that bond counsel identifies a Federal tax issue as potentially significant, the underwriter of the municipal bonds and its counsel will need to make a determination of whether the existence and substance of the Federal tax issue is material and therefore needs to be disclosed in the offering statement for the bonds to comply with Federal securities laws. We expect that in most cases, rather than risk a violation of the Federal securities laws, issues identified as potentially being significant will be disclosed in the offering documents for the bonds. We suspect this would be the case even if none of the counsel in the transaction believe there is any merit to the issues raised and would be willing to render a favorable opinion applying the NABL Standard.

As we indicated in our February 13, 2004 comments on the 2003 Regulations, tax disclosure provided in offering statements for municipal bonds is typically very short and generally indicates that the bond counsel is giving an unqualified opinion regarding the tax-exempt status of interest on the bonds, and that bond counsel is relying on certain covenants and representations of the issuer. While there is also typically disclosure relating to the treatment of "original issue discount" and "original issue premium" and the existence of certain other ancillary Federal tax matters, there is rarely any detailed discussion of particular Federal tax issues. Disclosure of such issues has generally been considered to seriously hinder the marketability of bonds, particularly to retail investors. Accordingly, the disclosure and discussion of potentially significant Federal tax issues will substantially change the tax section of the offering materials, and will undoubtedly confuse and disrupt the marketplace. All but the most sophisticated investors will not understand the substance of the Federal tax issues being discussed, and all investors will be confused by the notion that bond counsel is giving an unqualified opinion in the presence of Federal tax issues being identified as potentially significant.

We believe that the result of this confusion could be the creation of two classes of municipal bonds during the marketing process—those with Federal tax issues identified in the tax disclosure, and those with the typical disclosure. The mere existence of these classes will confuse and divide the market, and will likely result in higher borrowing costs for most issuers. With respect to municipal bonds where there are Federal tax issues identified as potentially significant, some buyers will likely chose not to purchase such bonds. This will reduce liquidity and transparency in the municipal marketplace, which typically results in higher borrowing costs. Some buyers may continue to purchase these bonds, but will charge a higher rate of interest to compensate them for the additional risk they perceive as existing due to the tax disclosure, or to compensate them for the cost of hiring outside counsel to review the transaction. While we cannot project how many bonds will fall into each class of bonds, we are confident that virtually all issuers will be adversely impacted by this problem at one point or another. This result is particularly troubling in light of the fact that in virtually all situations, compliance issues raised by the IRS are settled with the issuer of the bonds, and not the bondholders.

In considering how to formulate a recommended solution to these concerns, we first considered why the municipal market may differ from other areas, and then considered the purpose of Circular 230. The primary difference between the municipal market and other areas is that the party which directly benefits from the tax-exemption (*i.e.*, the bondholder) is not the party whose actions determine whether the tax-exemption will be allowed (*i.e.*, the issuer or the conduit borrower). The only other major area where this dichotomy exists is the area of "qualified plans", an area that itself receives special treatment under section 10.35(b)(2)(ii)(B)(*1*) of the Final Regulations. We believe the unique nature of the municipal market justifies special consideration to the extent consistent with the purpose of Circular 230. The purpose of Circular 230 is to improve the standards of practice by tax advisors. We believe this purpose is satisfied in the

municipal bond context where bond counsel would not be required to identify particular Federal tax issues as significant, but rather would be required to document and show that they performed sufficient due diligence on all Federal tax issues that are presented in a transaction in order to render their tax opinion. This documentation could take any reasonable form necessary to demonstrate that bond counsel performed sufficient diligence in each transaction, and could include memoranda, checklists, or through the issuer's tax certificate, which is drafted by bond counsel. We believe that providing practitioners this kind of flexibility will reduce the costs imposed on issuers associated with Circular 230 compliance. While this approach would not eliminate the requirement to disclose material issues under the Federal securities laws, it would eliminate the Circular 230 spotlight on particular Federal tax issues as a result of being labeled as significant. As a result, we believe that this approach will likely minimize confusion amongst buyers of municipal bonds.

We understand that the Treasury Department and the IRS may determine that it is appropriate to apply the significant Federal tax issue concept to municipal bonds. In that case, we recommend clarifying that if a practitioner provides the issuer with written advice that addresses all Federal tax issues in the transaction but does not identify any of those issues as being significant, there will be no Circular 230 violation if the IRS subsequently asserts that there were, in fact, one or more significant Federal tax issues present in the transaction. We believe this approach will reduce the pressure felt by practitioners to label issues as significant unless they truly believe the issues are, in fact, significant, and should help to reduce any market disruption caused by practitioner's efforts to comply with Circular 230.

2. If General Diligence Approach is Not Adopted, Clarify What Constitutes a Significant Federal Tax Issue. To the extent that the Treasury Department and the IRS choose not to adopt our preferred approach, for the reasons mentioned above, we recommend that the determination of when a Federal tax issue will be treated as significant be clarified. For example, the definition of Federal tax issue in section 10.35(b)(3) of the Final Regulations could be revised to provide that an issue will not be treated as significant unless a reasonable and well informed analysis of the law and the facts by a person knowledgeable in the tax law would lead such a person to conclude that the position has approximately a one in three, or greater, likelihood of being sustained on its merits. See 10.34(d)(1) of the existing Circular 230 regulations. Clarifying what issues are significant would provide more market certainty, and there would likely be a reduced number of municipal bonds that would be adversely impacted by Circular 230. Moreover, we recommend clarifying the Proposed Regulations to provide that the only facts and law that need to be discussed in sections 10.39(b)(1) and (2) of the Proposed Regulations are those that relate to the significant Federal tax issues. To the extent a Federal tax issue is not significant, we see no reason by Circular 230 should impose a requirement requiring the written advice to satisfy the requirements of section 10.39(b) with respect to issues that are not significant (*i.e.*, where the IRS has no reasonable basis for a successful challenge). To require otherwise would add a burden on practitioners that outweighs any of the benefits from any discussion of such non-significant issues.

3. Allow Practitioners to Comply with 10.35(c) or 10.39. Section 10.35(b)(2)(ii) of the Final Regulations provides that a covered opinion does not include a State or local bond opinion. Section 10.35(b)(9) of the Proposed Regulations provides that written advice, included in bond offering materials for the issuance of a State or local bond, is a State or local bond opinion if the written advice as to Federal tax matters addressed in the bond offering materials consists only of advice that concerns the excludability of interest on a State or local bond from gross income under section 103 of the Code, the application of section 55 of the 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 Code, the status of a State or local bond as a qualified zone academy bond under section 1397E of the Code, or any combination of the foregoing. We suspect that the definition of State or local bond opinion was drafted to apply section 10.39 to bonds likely to be impacted by market disruption as a result of being required to render a Circular 230 compliant bond counsel opinion. However, we see no reason why a practitioner issuing an opinion with respect to municipal bond should not be have the flexibility of choosing to provide an opinion that satisfies the requirements of section 10.35(c) or written advice that satisfies the requirements of section 10.39. We recommend clarifying the Proposed Regulations to allow this option.

By allowing this option, a related concern in the Final Regulations would be addressed. Section 10.35(b)(2)(ii) of the Final Regulations provides that a State or local bond opinion will not be covered advice (and thus be subject to section 10.35 instead of section 10.39) only if it is not advice regarding a listed transaction or a transaction the principal purpose of which is avoidance or evasion. As a result, if a practitioner fully complied with section 10.39, but the IRS asserted that the transaction had the principal purpose of avoidance or evasion, the practitioner may technically be in violation of Circular 230. There is no logical reason for this result. This is particularly disturbing given the difficulty in distinguishing between transactions that have a significant purpose and those that have the principal purpose of avoidance or evasion. If the Treasury Department and the IRS do not give practitioners the option of providing an opinion that satisfies the requirements of section 10.35(c) or written advice that satisfies the requirements of section 10.39, we recommend clarifying that municipal bonds do not have the principal purpose of avoidance or evasion, or eliminating the distinction between significant purpose and principal purpose in the Final Regulations.

4. Do Not Require Written Advice to be Included in the Transcript. Section 10.39(b) of the Proposed Regulations provides that the written advice required under that section must included in the transcript of proceedings for the bonds. The preamble to the Proposed Regulations states that this requirement is "intended to ensure that the practitioner's written advice is made available to the issuer and is intended to be consistent with the current practice of including the tax certificate and other documents supporting the State or local bond opinion in the transcript of proceedings." The preamble also indicates that practitioners rendering municipal bond opinions should be subject to the same standards as other practitioners. There is, however, no similar requirement in the Final Regulations for opinions other than State and local bond opinions. We see no reason why practitioners rendering State and local bond opinions should be subject to requirements not imposed on other practitioners. Moreover, if the Treasury Department and the IRS want to ensure that issuers receive the written advice required under the Proposed Regulations, this could be accomplished simply by requiring the advice to be provided to the issuer, and to require some evidence of this delivery in the transcript. This requirement is particularly troublesome because it has the effect of eliminating any attorney-client privilege that may exist between an issuer and its bond counsel. Moreover, it may force information that is appropriately treated confidential to be made public, such as a conduit borrower's proprietary information about technology used in a bond-financed facility. We recommend that this requirement be eliminated.

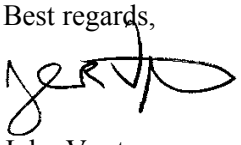
Conclusion

TBMA supports the goal of Circular 230—to improve the standards of practice by tax advisors. Our primary concern is that we believe this goal can be achieved while also minimizing disruption in the municipal marketplace. This can be accomplished by eliminating

the need to distinguish between issues that are significant and those that are not significant. We do not believe this concept is necessary to ensure the highest standards of practice in the municipal market, and believe that the interests of the Treasury Department and the IRS will ultimately be served so long as bond counsel are required to demonstrate that they exercised due diligence in evaluating all Federal tax issues that arise in municipal bond transactions.

Thank you for the opportunity to submit comments on the Proposed and Final Regulations. If you have any questions regarding any of the foregoing, please contact Jill Hershey at (202) 434-8400.

Best regards,



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