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Via Email

To: Clients, Friends & Colleagues

Re: **Potential Applicability of Treasury Circular 230 Tax Shelter
Opinion Guidelines to Municipal Bond Transactions**

Ladies and Gentlemen:

This past December, the U.S. Treasury Department proposed certain amendments to Circular 230 which, if adopted, could impose tax shelter opinion guidelines on the approving opinions delivered by Bond Counsel in municipal bond transactions. This would likely lead to the delivery of a much longer, more qualified Bond Counsel approving opinions than the standard one- to two-page “unqualified” opinions which are the industry standard today. The nature of these guidelines and their potential implications for tax-exempt bond deals is more fully discussed in the attached memorandum which we prepared immediately following a National Association of Bond Lawyers conference call on this topic this past week. Because the Treasury Department’s proposal would have made these changes effective immediately upon publication of the final regulations in the Federal Register, some Bond Counsel had begun to insist on disclosure in official statements to the effect that the opinion delivered at closing could be substantially different from that set forth in the official statement. As a result, a number of Underwriter’s Counsel firms had begun to include “market-out” provisions in bond purchase agreements relieving the Underwriter from its obligation to purchase the bonds if these developments occurred between pricing and closing and adversely affected the price of the bonds.

Under Treasury Announcement 2004-29, released today (also attached), the Treasury and the IRS have made it clear that if they do determine to apply these tax shelter opinion guidelines to municipal bond transactions, they will not do so with respect to any opinions rendered less than 120 days after publication of the final regulations in the Federal Register. As a result, we believe it should no longer be necessary to include this type of disclosure in official statements at this time and that this announcement eliminates the need for a parallel “market-out” provision in

the bond purchase agreement (except in the case of certain “forward delivery” transactions calling for delivery of the bonds more than 120 days after pricing).

Of course, if the final regulations are worded in such a way that municipal bond opinions do become subject to the opinion guidelines of Circular 230, we would expect to see substantial changes in the nature and scope of Bond Counsel’s opinion, as is discussed in the attached memorandum. The announcement today, however, should give the market some time to respond to this development in an orderly manner, if it does occur.

Please do not hesitate to contact us if you have any questions regarding these developments. These materials are also posted on our website: www.enbonds.com under “Articles.”

Very truly yours,

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Potential Applicability of Treasury Circular 230 Tax Shelter Opinion Guidelines to Municipal Bond Transactions¹

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The U.S. Treasury has recently proposed amendments to Circular 230, which sets forth the standards of practice and sanctions for lawyers and others who practice before the IRS in “tax shelter” transactions. Where Circular 230 applies, it generally requires lawyers rendering tax opinions to (i) identify and consider all relevant facts relating to the opinion (ii) to relate the applicable law to those facts, (iii) to evaluate all material tax issues raised by the opinion and (iv) to reach an overall conclusion as to the tax consequences of the transaction or say why no opinion can be rendered. Such opinions must also describe the compensation and any referral arrangements between the attorney and the “promoter” of the tax shelter and, if the opinion will be used to market the investment, it must state that the opinion may not be adequate to avoid underpayment penalties and that taxpayers should seek the advice of their own advisors in these matters. While failure to adhere to these standards, when applicable, would not jeopardize the tax status of the obligations covered, such a failure could subject the tax opinion author to debarment from representing clients in federal tax related matters and to other draconian sanctions. Since these standards began to apply to tax shelter opinions in 1984, typical opinions on these transactions are often far more lengthy and complex (e.g., 10-15 pages or more, often reading much like a legal memo) than the type of one-to-two-page “unqualified” opinion which has long been the standard for the approving opinion delivered by Bond Counsel in municipal Bond transactions.

Since the advent of Circular 230 in 1984, municipal bonds have been expressly excepted in Circular 230 from the definition of what constitutes a “tax shelter.” As a result, it has had virtually no impact on municipal bond transactions. On December 29, 2003, however, the Treasury proposed a revision to Circular 230, which if adopted, would appear to eliminate the explicit exemption of municipal bonds from the definition of “tax shelter” within the Circular and thus potentially apply these complex standards to Bond Counsel’s approving opinion in tax-

¹ By its nature, any memorandum of this nature provides only a general description of the material covered. The descriptions of legal standards set forth herein are intended to represent only general guidelines which may or may not apply in certain situations or which may vary depending upon the facts and circumstances of a particular financing.

exempt Bond financings. On a conference call yesterday sponsored by the National Association of Bond Lawyers (“NABL”), the panel leaders indicated that the Treasury’s deletion of the provision excluding municipal bonds from Circular 230 was **not** an inadvertent omission.

The immediate problem this development has presented is one of timing, emanating from the potential effective date of the proposed revision. The Treasury proposed this revision on December 29, 2003, obtained comments over a 45-day period ending in mid-February and, most importantly, proposed that the final regulation become effective when published in the Federal Register, which could occur any day. While NABL has pressed the Treasury to make any final regulations in this matter effective no earlier than 180 days after publication and is optimistic that some delay in effectiveness will be incorporated in to the final rule or that most municipal bond issues will continue to be excluded, there can be no assurance that this or other relief from immediate effectiveness on publication will be forthcoming.

This presents the possibility that bonds could be sold under an official statement disclosing that Bond Counsel will deliver at closing a traditional unqualified opinion, in a form often attached as an appendix to the official statement. If the final regulation then were to become effective between the pricing and closing and did not exempt the municipal bond offering, Bond Counsel could be required to deliver a very different, much more lengthy and potentially more qualified opinion at Bond closing than that disclosed in the official statement. Under these circumstances, Bondholders, of course, might refuse to accept delivery of the bonds due to the very different nature of the opinion proposed to be delivered from that which had been disclosed.² Because of this, a number of Bond Counsel firms, have begun to require that language be included in preliminary and final official statements disclosing the fact that the Bond Counsel Opinion delivered at closing could be substantially different from the one attached to the official statement, in the event the final rule is adopted between pricing and closing and applies to municipal bonds. A sample of such disclosure language being used by several major bond counsel firms is attached as Exhibit A to this memo.

Assuming Bond Counsel takes this position with regard to disclosure (and we believe it is reasonable for them to do so), it does raise the parallel issue of whether or not Underwriter’s Counsel should include in the Bond Purchase Agreement a “market-out” relieving the Underwriter from its obligation to purchase the bonds at closing if the Bond Counsel Opinion delivered at closing differs substantially from that which was attached to the preliminary or final official statement, due to these developments relating to Circular 230 and, in the opinion of the Underwriter, the delivery of the opinion in that form has a material adverse effect on the price of

² In a few transactions, Bond Counsel has drafted and included in the official statement the alternate form of opinion which would be delivered if Circular 230 were deemed to apply to the offering. In this case, the Bondholders presumably would be bound to their purchase, since they would have been able to evaluate this alternate opinion in determining whether or not to buy the Bonds. Because most people believe some exclusion for most municipal bond offerings or some relief in the effective date will be granted, and because preparation of this alternative opinion would be lengthy, complex and costly, this approach has been viewed as “overkill” in most situations and has not been followed by most practitioners confronting this dilemma.

the Bonds. The consensus view on the NABL call yesterday appeared to be, that including a “market-out” provision of this type in the Bond Purchase Agreement is a reasonable and prudent precaution. A sample version of the type of provision which has been used by our firm and a number of Underwriter’s Counsel firms is attached as Exhibit B to this memo.

This problem, of course, is likely to be a temporary one. The view on the NABL call appeared to be that while the blanket exception for all municipal bond transactions may not continue, it is quite possible that a given municipal bond transaction would be exempt so long as Bond Counsel satisfies itself that there is a high degree of certainty that the courts and the IRS would not take issue with the opinions expressed. In addition, there appeared to be an even stronger expectation that some reasonable relief will be provided on the proposal that the final regulations will become effective immediately upon publication. Until these matters are resolved, however, we believe the procedures described above, or similar procedures, will become increasingly widespread.

Even if Offering Circular 230 were ultimately deemed applicable to most or all municipal bond transactions, it is possible that the impact on bond yield would not be a major one in most transactions once the market has adjusted to a new opinion format. Of course, the impact, if any, on yield could vary from one transaction to another and is very hard to assess in advance. It seems likely, however that applying Offering Circular 230 to most municipal bond financings would raise the cost of these financings somewhat even if the impact on yield is not an overwhelming one. The consensus appears to be that the Treasury will provide further guidance on this later this spring or this summer.

PROPOSED CIRCULAR 230 CHANGES: ADDITIONS TO FORM OF TAX DISCLOSURE

[Insert the following at the end of the first paragraph of the current Tax Matters section in the offering document.]

Bond Counsel expects to deliver an opinion at the time of issuance of the Bonds substantially in the form set forth in [Appendix ___] hereto, subject to the matters discussed below.

[Note that we should also make sure to insert a cross reference to this discussion in the appendix that sets forth the opinion.]

[Insert the following as a new sub-topic at the end of the current Tax Matters section in the offering document.]

Proposed Regulations: Change in Form of Bond Counsel Opinion

The U.S. Department of the Treasury has proposed regulations, contained in Circular 230, governing the practice of attorneys and other tax advisors before the Internal Revenue Service. These proposed regulations classify all opinions regarding federal tax treatment of interest on state or local government bonds as tax shelter opinions and, consequently, subject to certain mandatory requirements applicable to tax shelter opinions. The proposed regulations provide that the final regulations will apply to opinions delivered on or after the date the final regulations are published in the Federal Register, which could occur in time to apply to the Bonds.

If the final regulations are adopted in their present form with an effective date that is applicable to the Bonds, Bond Counsel expects to deliver an opinion that contains the same overall conclusion regarding the exclusion of interest on the Bonds from federal gross income as described above but which differs from the form set forth in [Appendix ___] in order to comply with the requirements of the new regulations. Among other largely technical changes Bond Counsel expects to add to the opinion a paragraph substantially similar to the following:

The opinion set forth herein with respect to federal income tax may not be sufficient for an owner of the Bonds to use for the purpose of avoiding penalties relating to a substantial understatement of income tax under section 6662(d) of the Internal Revenue Code of 1986. Owners of the Bonds should seek advice based on their individual circumstances with respect to any material federal tax issue relating to the Bonds from their own tax advisors. The federal tax opinion represents Bond Counsel's best judgment, based on the matters referred to herein, that there is no federal tax issue for

which the Internal Revenue Service has a reasonable basis for a successful challenge and the resolution of which could have a significant adverse impact on the opinion regarding federal tax treatment of interest on the Bonds. Bond Counsel expects to be paid for this opinion and related services by [_____] / [from proceeds of the Bonds].

There can be no assurance that final regulations will be promulgated with provisions that are similar to those included in the proposed regulations. Bond Counsel expects that its opinion will be delivered to conform with the requirements of the final regulations if applicable to the Bonds. There can be no assurance that the market value of the Bonds will not be adversely affected if the opinion of Bond Counsel delivered at the time of issuance of the Bonds is substantially different from the form of opinion attached as [Appendix __ hereto].

SAMPLE BOND PURHCASE AGREEMENT “MARKET-OUT” PROVISION

Introductory language relieving the Underwriter from its obligation to purchase the Bonds if, between the date of the Bond Purchase Agreement and the closing date...

...() Final regulations shall be adopted by the U.S. Department of the Treasury rendering the proposed revisions to U.S. Treasury Circular 230 applicable to the Bonds, resulting in a change in the form of opinion of Bond Counsel from that included as Appendix __ to the Official Statement which, in the reasonable opinion of the Underwriter, materially adversely affects the price of the Bonds.

Part IV - Items of General Interest

Application of Municipal Circular 230 to Municipal Bond Opinions

Announcement 2004-29

On December 30, 2003, the Treasury Department published a notice of proposed rulemaking in the Federal Register (REG-122379-02) proposing modifications to rules governing practice before the Internal Revenue Service (Circular 230). Section 10.35 (Requirements for certain tax shelter opinions) of the proposed regulations is proposed to be effective for opinions rendered after the date that final regulations are published in the Federal Register.

The Treasury Department and the IRS are continuing to consider all comments on the proposed regulations. In the meantime, the Treasury Department and the IRS announce that, in final regulations, the definition of tax shelter opinion for purposes of section 10.35 will not apply, if at all, to written advice concerning municipal bonds rendered less than 120 days after the publication of such final regulations in the Federal Register. Conforming changes, if necessary, will be made to section 10.36(b).

The principal author of this notice is Heather L. Dostaler of the Office of the Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division, but other personnel from the IRS and Treasury Department participated in its development. For further information regarding this notice, contact Heather L. Dostaler at (202) 622-4940 (not a toll-free number).