

MEMO# 18351

December 20, 2004

TREASURY RELEASES PROPOSED CIRCULAR 230 REGULATIONS APPLICABLE TO STATE OR LOCAL BOND OPINIONS

[18351] December 20, 2004 TO: FIXED-INCOME ADVISORY COMMITTEE No. 14-04 MONEY MARKET FUNDS ADVISORY COMMITTEE No. 15-04 TAX COMMITTEE No. 39-04 RE: TREASURY RELEASES PROPOSED CIRCULAR 230 REGULATIONS APPLICABLE TO STATE OR LOCAL BOND OPINIONS The Treasury Department has released two sets of regulations governing practice before the Internal Revenue Service ("Circular 230"). The Final Regulations (attached) apply detailed disclosure obligations to "covered opinions" and other written advice. The term "covered opinion" includes written advice that concerns one or more Federal tax issues arising from, among other things, any plan arrangement, a significant purpose of which is the avoidance or evasion of tax if the written advice is (i) a reliance opinion, (ii) a marketed opinion, (iii) subject to conditions of confidentiality, or (iv) subject to contractual protection.¹ Municipal bond opinions are excluded from the Final Regulations' definition of "covered opinion." The Final Regulations may, however, apply to synthetic municipal investments. The second set of regulations (attached) has been issued in proposed form ("Proposed Regulations"). These regulations provide proposed disclosure requests for municipal bond opinions that have been excluded from the Final Regulations' definition of "covered opinion." The potential application of Circular 230 opinion standards to municipal bond opinions has been an issue since last December, when the Treasury Department proposed rules to include bond counsel opinions relating to the issuance of tax-exempt obligations of state and local governments within the definition of "tax shelter opinion."² Prior to the issuance of the 2003 proposed regulations, municipal bond opinions had always been excluded from Circular 230's definition of "tax shelter." In response to the 2003 proposed regulations, the Institute submitted two comment letters. The first letter urged Treasury to exclude unqualified municipal bond opinions from Circular 230's definition of "tax shelter opinion;" the letter explained that the municipal bond market relies on unqualified tax opinions and that the 2003 proposed regulations would create 1 These terms are defined or more extensively explained in the Final Regulations. 2 See Institute Memorandum (No. 17028) to Fixed-Income Advisory Committee No. 1-04 and Money Market Funds Advisory Committee No. 2-04, dated January 29, 2004. 2 market disruptions.³ The second letter requested that, to prevent market disruptions, any change to the tax treatment of tax opinions on municipal bonds under Circular 230 apply only to opinions rendered on bond offerings and remarketings that close some reasonable period of time after the Circular 230 regulations are finalized.⁴ In response to this request, Treasury issued Announcement 2004-29, which clarified that any final Circular 230 regulations would

not apply to municipal bond opinions rendered less than 120 days after the publication of such regulations.⁵ The Final Regulations require “covered opinions” to contain certain additional disclosures, as applicable, including: (1) the existence of any compensation or referral arrangement between the practitioner and any person (other than the client for whom the opinion is prepared) with respect to promoting, marketing or recommending the entity, plan or arrangement that is the subject of the opinion; (2) with respect to marketed opinions, a disclosure stating that the opinion was written to support the promotion or marketing of the transactions or matters discussed in the opinion and advising that the taxpayer seek advice based on the taxpayer’s individual circumstances from an independent tax advisor; (3) with respect to opinions that are limited in scope, a disclosure that the opinion is limited to one or more Federal tax issues, may not discuss all the relevant Federal tax issues and cannot be relied upon for issues outside the scope of the opinion; and (4) with respect to opinions that fail to reach a more likely than not conclusion, a disclosure that the opinion fails to reach this confidence level and cannot be relied upon by taxpayers for issues for which the practitioner failed to reach a more likely than not conclusion. The Proposed Regulations generally define a “State and local bond opinion” (that is exempt from the definition of “covered opinion” under the Final Regulations) as written advice, included in bond offering materials for the issuance of a State or local bond, if two requirements are satisfied. First, the written advice as to Federal tax matters addressed in the bond offering materials must consist only of advice that concerns specified issues under sections 103 (excludability of interest), 55 (applicability of alternative minimum tax), 265(b)(3) (status as qualified tax-exempt organization), 1397E (qualified zone academy bonds), or any combination of these issues. Second, the practitioner must separately provide to the issuer of the bond, and include in the transcript of proceedings if one is prepared, written advice that satisfies the requirements of the regulations.

3 See Institute Memorandum (No. 17173) to Fixed-Income Advisory Committee No. 4-04, Money Market Funds Advisory Committee No. 5-04 and Tax Committee No. 8-04, dated March 5, 2004. 4 See Institute Memorandum (No. 17204) to Fixed-Income Advisory Committee No. 5-04, Money Market Funds Advisory Committee No. 6-04 and Tax Members No. 16-04, dated March 18, 2004. 5 See Institute Memorandum (No. 17307) to Fixed-Income Advisory Committee No. 6-04, Money Market Funds Advisory Committee No. 7-04 and Tax Members No. 19-04, dated March 29, 2004. 3 The Proposed Regulations require that a practitioner providing a State or local bond opinion separately provide written advice to the issuer of the bond that: (1) shows the practitioner used reasonable efforts to identify and consider all relevant facts and did not base the advice on unreasonable factual assumptions or factual presentations by another person; (2) relates applicable law to the relevant facts, does not apply unreasonable legal assumptions and does not contain internally inconsistent legal analysis; and (3) considers all significant tax issues that are relevant to the overall conclusion set forth in the opinion, including the practitioner’s opinion regarding the likelihood that the taxpayer will prevail on the merits with respect to each significant Federal tax issue without considering the likelihood that a tax return will not be audited or similar assumptions. According to the Preamble to the Proposed Regulations, the Proposed Regulations have been tailored to take into account the customary practice and special circumstances of municipal bonds market. Among other things, the Proposed Regulations do not require State and local bond opinions to include disclosures to taxpayers regarding the extent to which they may rely on the opinion, as is required by the Final Regulations. Effective Date The Final Regulations apply to written advice that is rendered 180 days after publication in the Federal Register. The Proposed Regulations, as requested by the Institute, will become effective no sooner than 120 days after the final regulations on these issues are published in the Federal Register. Request For Comments Treasury and the IRS have requested comments on the proposed regulations.

The deadline for submitting comments is March 1, 2005. A public hearing is scheduled for March 22, 2005. If you have comments on the proposed regulations, please contact Lisa Robinson at 202-326-5835 or lrobinson@ici.org no later than February 15, 2005. Lisa Robinson Associate Counsel Attachment no. 1 (in .pdf format)

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