Jeremy A. Spector is a partner at Blank Rome LLP and is a nationally recognized public finance tax practitioner. He heads the firm’s Public Finance Tax Enforcement and Compliance Practice and counsels clients in virtually all areas of tax-exempt bond law, including tax-exempt bond financing, tax-exempt bond refunding, tax-exempt bond structuring and planning, tax-exempt bond enforcement, tax-exempt bond compliance, and related issues. Mr. Spector represents issuers, underwriters, bond counsel, borrowers, and others in tax-exempt bond matters before the IRS, including examinations and representation in tax-exempt bond enforcement proceedings before the IRS and the Treasury Department. Mr. Spector has also represented tax-exempt bond issuers, underwriters, and traders in federal court and federal appeals court litigation challenging governmental and private activity bond and master tenant bond allocations made by the Treasury and the IRS. Mr. Spector received his J.D. from New York University School of Law and his B.A. from the University of Pennsylvania.

### Maintaining the "Gold Standard" in Tax Opinions

The tax opinion embedded in the traditional bond counsel opinion has been receiving unprecedented attention by the Treasury, the IRS and the SEC in the last two years. Emblematic of this attention is an opinion released by the IRS in December 2005 finding that a bond counsel was negligent in rendering an "unqualified opinion that interest on notes...would be exempt from federal income taxation" based on objective facts and circumstances of the transaction. Seven or eight attorneys have already been referred by the IRS in Tax-Exempt Bond Divison to the Office of Professional Responsibility for investigation concerning the adequacy of their due diligence under the Code Section 141. The IRS has since added seven other tax opinion areas to its list of violations that are eligible for voluntary resolution. Mr. Spector discussed the program’s flexibility as well as the importance of investors in the marketplace and the need for strong tax counsel opinion and tax opinion enforcement to maintain market efficiency.

### Significant Tax Developments in Public Finance

#### Enforcement, Circular 230 and Other Significant Tax Developments in Public Finance

By: Jeremy A. Spector

February 16, 2006

The municipal securities market, like the corporate securities market, needs an effective and viable enforcement program to maintain its healthy functioning. However, the enforcement efforts of the IRS and the SEC always need to be kept in perspective. Every bond transaction has its own team of professionals and unique legal and financial structure. As a result, whenever a transaction is the subject of an enforcement action, careful attention needs to be paid to the facts and circumstances that led to the examination. A rush to judgment about the market or even other transactions based upon the facts of any transaction involving a unique legal and financial structure would be entirely inappropriate. That said, to prevent the further use of any suspect bond structure, we welcome prompt guidance whenever needed from the IRS and the SEC to provide greater certainty in planning and structuring bond transactions as essential to maintaining our nation’s infrastructure at reasonable cost.

#### Developments in IRS Enforcement

**Voluntary Resolution Program**

On December 1, 2005, NABL sponsored a teleconference on the Voluntary Resolution Program administered by the Tax Exempt Bond Division’s Outreach, Planning and Review Function. The IRS panelists were Clifford Gannett, Acting National Director, Tax Exempt Bonds, and Michael Muratore, Senior Tax Law Specialist. Scott R. Lillenthal and W. Mark Scott completed the panel, and I served as moderator. This was an educational program which focused on the types of violations that are eligible for voluntary resolution. Mr. Gannett discussed the program’s flexibility as well as the importance of investors in the marketplace and the need for strong tax counsel opinion and tax opinion enforcement to maintain market efficiency.

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as its limitations. To encourage voluntary compliance, anonymous requests are accepted and closing agreement amounts, where possible, are based on taxpayer exposure on the "nonqualified bonds." Even in the case of an alleged abuse, discretionary authority may be used to resolve the problems of any innocent party. Parties to transactions who are concerned about more egregious conduct may be encouraged to report it. Section 6707 penalty to bear, in advance of an audit, were advised to call the National Director to determine whether they can access the program on a discretionary basis.

Examination Program and Appeals

On February 3, 2006, the American Bar Association’s Tax-Exempt Financing Committee met in San Diego and discussed selected enforcement topics and possible modifications to Revenue Procedure 99-35, which is on the IRS’s business plan. Charles Anderson, Manager, TEB Field Operations, and Charles F. Fisher, Appeals Team Manager, TEGE Programs, served on the panel with me as moderator. During the panel discussion, Mr. Anderson expressed the need of the Tax Exempt Bond Division ("TEB") to accelerate case development to avoid open years on investor tax returns being barred by the statute of limitations. Contemplated changes include a reduction in the time period during which closing agreement discussions are held prior to the issuance of a Proposed Adverse Determination Letter. Mr. Anderson and the earlier issuance of Proposed Adverse Determination Letters will lead to more productive closing agreement discussions since the IRS will be better equipped to assess the hazards of litigation once it is in receipt of the issuer’s protest in support of the appeal request. Since written protests are reviewed by TEB in advance of making recommendations to TEB Appeals, there is a final opportunity for closing agreement discussions with TEB before it permanently relinquishes the case. Another noteworthy change to the internal policy governing the use of Fast Track Settlement, as set forth in Revenue Procedure 2003-40, while a case is still in TEB. Failure to reach a settlement under “Fast Track” will not jeopardize an issuer’s appeal rights. In the event settlement is not reached with the issuer in Appeals, Mr. Fisher advised that Revenue Procedure 2002-44 permits "post appeals" mediation to further attempt to reach a settlement utilizing the assistance of a trained IRS Appeals Office Mediator. Although the availability of TEB mediation and “post appeals” arbitration as they appear in Announcements 2003-16 and 2000-4, respectively, has technically expired, both TEB and Appeals are continuing to consider their continued application when requested by an issuer. Both Mr. Fisher and Mr. Anderson were supportive of revisions to Revenue Procedure 99-35 to reflect the availability of alternative dispute resolution programs. On behalf of TEB, Mr. Anderson expressed the need for more specific time guidelines in Revenue Procedure 99-35 to ensure the speedy resolution of cases in TEGE Appeals to protect open years on investor tax returns from being barred by the statute of limitations.

Proposed Changes to Circular 230

Treasury officials have announced that they are unable to predict when and if the proposed changes directed at tax-exempt bonds in Section 10.39 will go final in their present form. Governing tax professionals who practice before the IRS, these proposed amendments would, among other things, modify rules pertaining to the definition of practice, contingent fees, conflicts of interest, due diligence standards, sanctions, and publicity. Comments are requested by April 7, 2006, and a hearing on the proposed regulations is scheduled for June 21, 2006.

Many of these revisions affect our public finance practices. The proposed rules clarify that conduct covered by Circular 230 includes the rendering of written advice, such as opinions, by practitioners. The proposed rules also broaden the prohibition against practitioners entering into a contingent fee arrangement. The definition of “contingent fee” set forth below does not appear to affect the type of fixed-fee arrangement that Treasury continues to support where the fee is guaranteed to be paid. The proposed rules also include a transitional rule which may be applied to eliminate bonds issued before May 16, 1997, from the combined measurement period.

The proposed rules also supplement the requirement under existing Section 10.33 that a practitioner exercise due diligence in rendering written tax advice. Proposed Section 10.34 in pertinent part permits a practitioner to:

- rely in good faith without variation from opinion information furnished by the client.
- The practitioner may not, however, ignore the implications of information furnished to, or actually known by, the practitioner, and must make reasonable inquiries if the information furnished appears to be incorrect.

Given the extensive reliance of tax practitioners on certifications in our industry, this additional gloss on the due diligence standard for rendering tax opinions appears extremely helpful. So long as a certificate upon which we rely does not contain inconsistencies, errors in assumptions or conflicts with other facts known to us, we should be able to rely upon it in good faith without having a duty to make further inquiry.

Other changes in the proposed rules require conflict waivers to be co-signed by the client, permit the disclosure of disciplinary proceedings to the public, subject to certain safeguards, and authorize the imposition of monetary penalties in addition to or in lieu of other sanctions. Section 10.90 of Circular 230 is also broadened to allow public disclosure of those subject to monetary penalties as well as individuals and firms censured, suspended or disbarred from practice before the IRS. NABL members rendering and relying on tax opinions should carefully review these proposed regulations.

Other Significant Tax Developments

Refrunding Regulations

On December 19, 2005, the IRS issued final regulations applicable to governmental and qualified 501(c)(3) refunding bonds (“Refrunding Regulations”) sold on or after February 17, 2006. Refunding bonds being refund-ed were issued prior to May 16, 1997, and the weighted average life of the prior bonds is not being extended. Issuers may apply the Refunding Regulations in whole, but not in part, to certain bonds subject to Section 144 as to which the regulations would not otherwise apply.

Except in the case of relatively simple transactions, the Refunding Regulations can be quite complex in application, particularly in the case of multiple partial refundings. For those transactions, the Refunding Regulations, due diligence must be undertaken with respect to the issues being refunded. Except in the case of the refunding of taxable or qualified private activity bonds (other than qualified 501(c)(3) bonds), the bonds being refunded must be analyzed to see if they qualify the private business test under the shortened measurement period (generally the period extending from the date of issuance of the prior bonds to the date of issuance of the refunding bonds). If so, a "combined measurement period" (generally the period extending from the date of issuance of the prior bonds to the date of issuance of the refunding bonds) is required to be used for the refunding bonds. When a combined measurement period is required to be used in applying the private business test to the prior bonds, the combined measurement period for the issuance and maturity of refunding bonds, debt service, private payments, and projects may be required in all but simple refundings not involving significant use. Some of these limitations may need to be made on a conservative basis because the regulations lack precise rules. In a somewhat helpful revision to the Refunding Regulations, the Refunding Regulations include a useful transitional rule which may be applied to eliminate bonds issued before May 16, 1997, from the combined measurement period.

Gulf Opportunity Zone Act of 2005 ("Act")

On December 21, 2005, the Act was signed by the President to provide extensive federal tax relief and benefits for
as its limitations. To encourage volun-
tary compliance, anonymous requests are accepted and closing agreement amounts, where possible, are based on taxpayer exposure on the "unqualified bonds." Even in the case of an alleged outlier, the Internal Revenue Service may be used to resolve the problems of any innocent party. Parties to transactions who are concerned about more egre-
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sious conduct by a taxpayer are requested to file a Section 6706 penalty to bear, in advance of an audit, were advised to call the National Director to determine whether they can access the program on a discre-
tionary basis.

On February 6, 2006, the Treasury Department and the IRS proposed further revisions to the existing rules in Circular 230 governing tax profes-
sionals who practice before the IRS. These proposed amendments would, among other things, modify rules pertaining to the definition of practice, contingent fees, conflicts of interest, due diligence standards, sanctions, and publicity. Comments are request-
ed by April 7, 2006, and a hearing on the proposed regulations is scheduled for June 21, 2006.

Many of these revisions affect our public finance practices. The proposed rules clarify that conduct covered by Circular 230 includes the rendering of written tax advice. The proposed rules also supplement the requirement under existing Section 10.22 that a practitioner exercise due diligence in rendering written tax advice. Proposed Section 10.27(c)(1) defines a “conting-
tent fee” as:

- any fee that is based, in whole or in part, on whether or not a position taken on a tax return or other filing avoids challenge by the Internal Revenue Service or is sustained either by the Internal Revenue Service or in litigation. A con-
tingent fee includes a fee that is based on a percentage of the refund of taxes or on a fee that is based on a percentage of the taxes saved, or that other-
wise depends on the specific result attained. A contingent fee also includes any fee arrange-
ment in which the practitioner will reimburse the client for all or a portion of the client’s fee in the event the position taken on a tax return or other filing is challenged by the Internal Revenue Service or is not sustained, whether pur-
suant to an indemnity agree-
ment, a guarantee, rescission rights, or any other arrange-
ment with a similar effect.

This definition clearly bars any indemnity or guarantee-type arrange-
ment under which a practitioner would reimburse the issuer all or a portion of his or her legal fee in the event of an IRS audit or tax return audit of the bonds. Under this definition, any indemnity arrangement entered into in connection with a bond transaction relating to the accuracy of a practition-
er’s legal interpretation could come within the ban.

The proposed rules also supplement the requirement under existing Section 10.22 that a practitioner exercise due diligence in rendering written tax advice. Proposed Section 10.34 in perti-

nent part permits a practitioner to:

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ever, ignore the implications of information furnished to, or actually known by, the practi-
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Given the extensive reliance of tax practitioners on certifications in our industry, this additional gloss on the due diligence standard for rendering opinions appears extremely helpful. So long as a certificate upon which we rely does not contain inconsistencies, errors in assumptions or conflicts with other facts known to us, we should be able to rely upon it in good faith without hav-
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ed were issued prior to May 16, 1997, and the weighted average life of the prior bonds is not being extended. Issuers may apply the Refunding Regulations in whole, but not in part, to certain bonds subject to Section 141 as to which the regulations would not otherwise apply.

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ple transactions, the Refunding Regulations can be quite complex in application, particularly in the case of multiple partial refundings. For those transactions, in addition to the Refunding Regulations, due diligence must be undertaken with respect to the issues being refunded. Except in the case of the refunding of taxable or qualified private activity bonds (other than qualified 501(c)(3) bonds), the bonds being refunded must be analyzed to see if they satisfy the private business tests under the shortened measurement peri-
dium (generally the period extending from the date of issuance of the prior bonds to the date of issuance of the refunding bonds). If so, a shortened measurement period (generally the period extending from the date of issuance of the prior bonds to the maturity date of the refunding bonds) is required to be used for the refunding bonds. When a combined measure-
ment period is required to be used in applying the private business tests to the refunding bonds, the combined period is limited to the term of the refunding bonds, or the maturity date of the refunding bonds, or the date the underwriter acquires control of the refunding bonds, whichever occurs first.

On the topic of alternative dispute resolution, both Mr. Anderson and Mr. Fisher were supportive of exploring the use of Fast Track Settlement, as set forth in Revenue Procedure 2003-40, while a case is still in TEB. Failure to reach a set-
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ity of TEB mediation and “post appeals” arbitration as they appear in Announcements 2003-16 and 2004-4, respectively, has technically expired, Mr. Anderson and Mr. Fisher are considering continuing this option after an appeal is no longer pending or otherwise.

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The maximum amounts of advance refunding bonds authorized by the Act are $1.125 billion for Alabama, $4.5 billion for Louisiana and $2.250 billion for Mississippi. There are special limitations in the Act which prohibit any advance refunding that would result in more than two separate bond issues relating to the same original bonds being outstanding at the same time. Also, there are other special limitations in the Act prohibiting any benefit to certain prescribed facilities, such as race tracks and golf courses.

Other noteworthy provisions in the Act include the authorization for the issuance of limited amounts of tax credit bonds to provide for short-term debt service relief, the extension of the waiver of the first-time homebuyer requirement provided by the Katrina Emergency Tax Relief Act of 2005 to 2010, the enhancement of the low-income housing credit program to benefit the Gulf Opportunity Zone, and the provision for additional allocations of new market tax credits to the recovery and redevelopment of the Gulf Opportunity Zone.

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Finally, the IRS released Letter Ruling 200542032 which ruled that the sale of firm transmission rights would not be treated as a deliberate action that would cause the bonds to be private activity bonds under Section 141 of the Code. In order to reach its conclusion, the IRS applied Section 1.141-7(g)(4)(ii) which required the IRS to further conclude that there was no sale or exchange of the bond-financed property.

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During this period of heightened regulatory scrutiny, NABL has not remained idle. Through the volunteer efforts of Monty Humble, Walter St. Onge, Carol Lew, NABL Board members, and Director of Governmental Affairs Elizabeth Wagner, among many others, relationships with the federal government committees and agencies that monitor our behavior are strengthening. In addition, NABL-sponsored seminars, teleconferences and commit- tees are all focusing on areas of interest which include ethical standards, due diligence and documentation, disclosure requirements, and substantive areas of the federal tax law. Publications and audio CDs from these seminars and teleconferences are publicly available on NABL’s website.

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