

EXHIBIT A

**Communications between NASD
(including its attorneys) and the IRS**

DAVIS POLK & WARDWELL

Date: August 9, 2006

To: Carter C. Hull, Internal Revenue Service

From: Mario J. Verdolini

... provides a general description of the background of the

well as responsibility for regulation of its broker/dealer members, listed companies and other market participants. The NYSE Group, Inc. ("NYSE Group"), NYSE Regulation's ultimate corporate parent, is a publicly traded Delaware corporation that was formed as a holding company in 2005 to accomplish the merger of the New York Stock Exchange LLC ("NYSE"), a floor-based auction stock market, and Archipelago Holdings, Inc., an operator of an electronic trading system for matching buy and sell orders automatically. At the time of the formation of NYSE Group, NYSE separated its existing market activities and regulatory operations into two newly formed subsidiaries, respectively NYSE Market, Inc., a Delaware corporation, and NYSE Regulation.

Description of the proposed transaction:

In recent years, the SEC has expressed policy concerns regarding both the conflicts inherent in for-profit exchanges performing regulatory functions and the inefficiencies of multiple, overlapping self-regulatory schemes. Consistent with that view, the SEC has encouraged discussions between NASD and the NYSE Group to combine the oversight activities currently performed by NASDR and NYSE Regulation, and is an active participant in the current discussions between the two organizations.

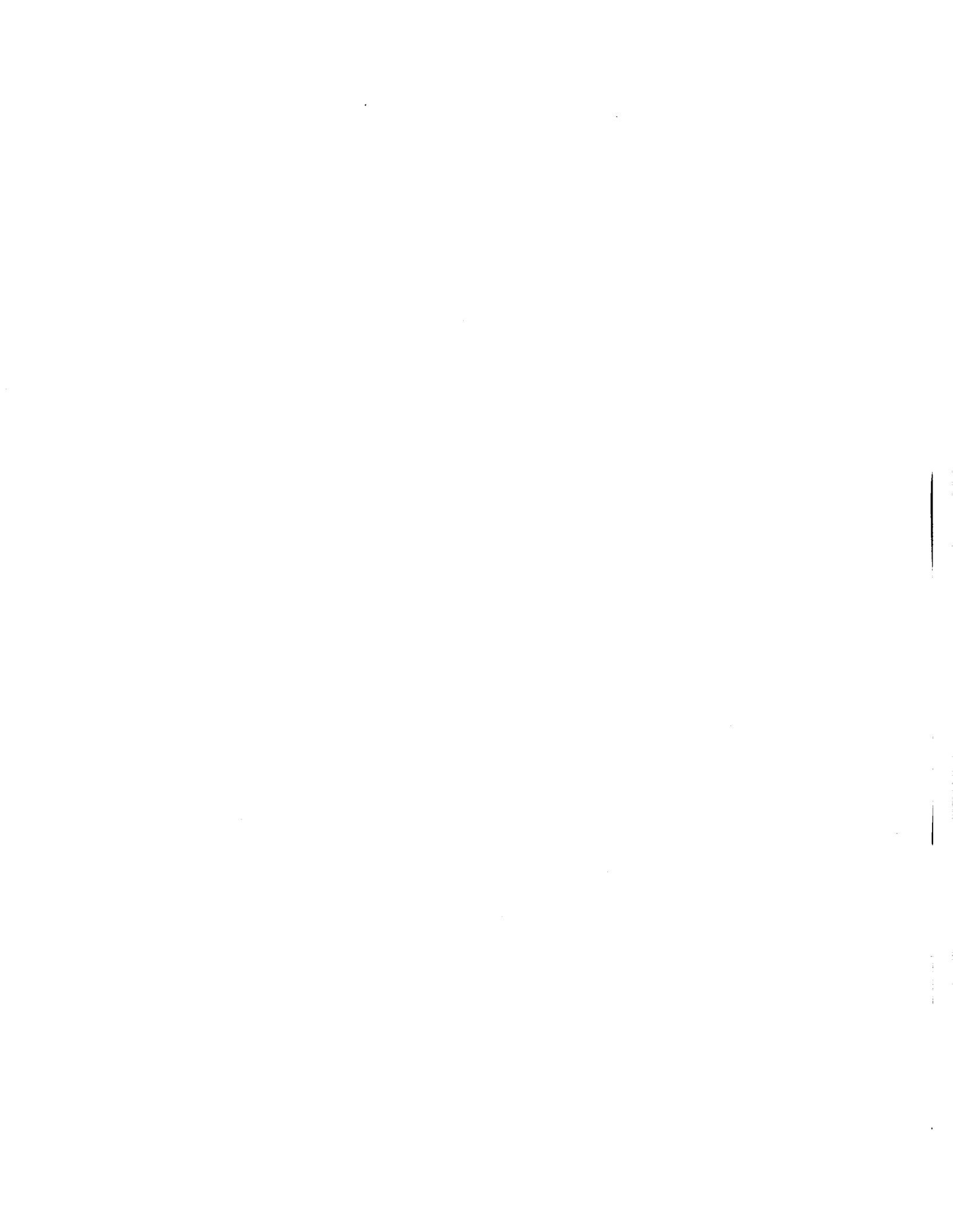
NASD and the NYSE expect that the combination of their respective regulatory activities will provide significant cost and compliance efficiencies that will benefit both market participants and the investing public. For example, cost reductions will likely accrue to NASDR and NYSE Regulation from the combination of the staffs, technologies, and facilities currently maintained separately by each. In addition, the firms subject to both NASDR and NYSE Regulation oversight will be relieved of the administrative and economic burden of compliance with two independent—sometimes duplicative and potentially conflicting—regulatory regimes. Further, the combination of regulatory expertise, technology and data within a single organization should improve the effectiveness of the self-regulatory system as a whole, to the direct benefit of the investing public.

The form of the proposed transaction is still subject to discussion between the management committees of each of NASD and the NYSE. The transaction may be accomplished by means of a merger of NYSE Regulation with either a newly created merger subsidiary of NASD, NASD itself, or NASDR. Other approaches to the combination may also be considered. The combined entity would be responsible for the regulation of all U.S. registered broker-dealers doing

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In addition, it is expected that the ultimate transaction developed by NASD and
[REDACTED] will bring certain reforms to NASD's

[REDACTED]



FAX

**INTERNAL REVENUE SERVICE
TAX EXEMPT AND GOVERNMENT ENTITIES DIVISION
EXEMPT ORGANIZATIONS**

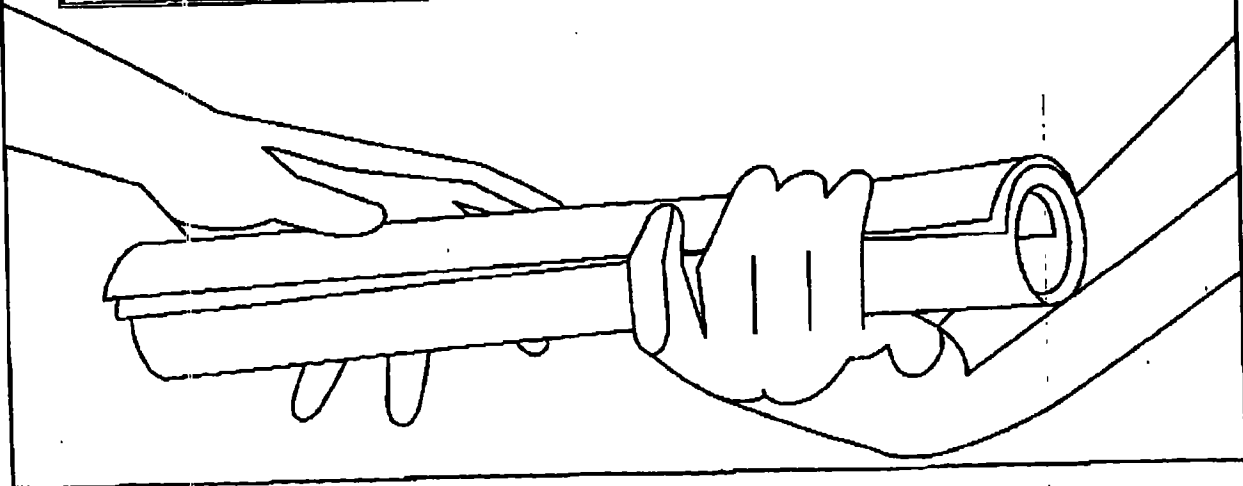
**TO: Mr. Mario Verdolini
Davis Polk & Wardwell
FAX: 212-450-3969**

**FROM: Mr. Carter C. Hull, ID 50-03480
Phone: 202-283-8908
FAX: 202-283-8937
Office symbols: SE:T:EO:RA:T:2**

**COMMENTS: Copy of letter to National Association of Securities Dealers,
Inc.**

Number of pages (including this coversheet): 8

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TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: MAR 13 2007

Mr. Mario J. Verdolini, Jr.
Davis Polk & Wardwell
450 Lexington Avenue
New York, NY 10017

Contact Person:
Carter C. Hull
ID Number:
50-03480
Telephone Number:
(202) 283-8908

Dear Mr. Verdolini:

The enclosed copy of a letter is sent to you under the provisions of a Power of Attorney, Authorization and Declaration, or other proper authorization currently on file with the Internal Revenue Service.

Sincerely yours,

Debra J. Kawecki
Manager, Exempt Organizations
Technical Group 2

Enclosure:
Copy of letter to National Association of Securities Dealers, Inc.



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: **MAR 13 2007**

Contact Person:
Carter C. Hull
Identification Number:
50-03480
Telephone Number:
(202) 283-8908

National Association of Securities Dealers, Inc.
1735 K Street, N.W.
Washington, D.C. 20006-1506

Employer Identification Number: 53-0088710

Legend:

- M = National Association of Securities Dealers, Inc.
- N = NASD Regulation, Inc.
- O = Securities and Exchange Commission
- P = NYSE Group, Inc
- R = New York Stock Exchange, LLC
- S = NYSE Regulation, Inc.
- m = securities
- p = 5.10%
- q =
- r =
- s = 103 million
- t =
- u =
- v = 35,000
- w = 175 million
- x = 178.5 million
- y =
- z =

REDACTED

Dear Applicants:

This letter is in reference to the request dated October 26, 2006, as amended and supplemented by letters dated November 27, 2006, December 4, 2006, December 22, 2006, and February 13, 2007, from the authorized representative of M and N, in which M and N requested rulings that the proposed transaction will not affect their exempt status under section 501(c)(6) of the Internal Revenue Code.

NASD_DEFS0014849

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National Association of Securities Dealers, Inc.

M is an organization recognized as exempt from federal income tax under section 501(c)(6) of the Code. M was organized to address the m industry's need for a self-regulatory organization that would have authority to promulgate and enforce business conduct and certain other ethical rules. M's primary responsibilities have included conducting examinations of its member firms, investigating possible violations of applicable federal laws and regulations and of its own rules, conducting disciplinary proceedings, and administering qualifications testing. M states that over time, its scope of authority has expanded to cover transactions in U.S. government and municipal m as well as corporate m. Every m firm in the United States that is transacting business with the public is currently required to be a member of a registered m association, and M is the only such registered association. M currently has approximately q members, and each member is entitled to vote directly on all but one of the non-staff seats on M's board of directors.

N has conducted most of M's regulatory operations. N is recognized as exempt from federal income tax under section 501(c)(6) of the Code, and is a subsidiary of M.

O, a federal agency that supervises the m industry, provides close oversight of the regulatory functions performed by both M and N. M and N provided information which shows that O has expressed policy concerns regarding what it perceives as inherent conflicts in the existing self-regulatory system in the m industry and the inefficiencies of overlapping self-regulatory schemes. M and N have provided information which shows that O has published reports stating that those inherent conflicts can arise both in circumstances where a self-regulatory organization is subject to influence by the members it is supposed to regulate, and also where the regulator is owned by a for-profit entity. O has also identified inefficiencies where regulators have co-extensive regulatory mandates, including conflicting rules, duplicative infrastructure and multiplied compliance costs. O has indicated that reform of the self-regulatory system to alleviate such conflicts and inefficiencies is important if the m industry in the United States is to remain competitive globally.

P is a for-profit publicly traded corporation that is the corporate parent of R and S. R is a limited liability company that maintains an auction-based market for the sale and purchase of m. S, a not-for-profit corporation, is responsible for promulgating and enforcing business conduct and certain other rules applicable to the m business activities conducted through R. S's activities are generally divided into its regulation of firms authorized to do business through R, m surveillance of activity carried out

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National Association of Securities Dealers, Inc.

Both M and N expect that the consolidation will result in an expansion of their member regulatory operations in furtherance of their exempt purposes. M has represented that O has encouraged and publicly supported the proposed transaction and the benefits it is expected to produce.

M has represented that P and S have stated that they would not proceed with the proposed transaction unless M changed its one-member, one-vote governance structure. M has represented that the governance reforms required by P and S are intended to minimize member conflict issues presented by the disproportionate concentration of voting power in M presently held by "small firms," defined in M rules as firms with fewer than a certain number of representatives. M represents that as a result of changes in the m industry over recent decades, small firms today account in the aggregate for only 12% of registered m representatives, and only 18% of M's member firm gross revenue, but they hold more than 90% of the voting power in M.

Accordingly, M's Board of Governors has asked its member firms to relinquish their existing ability to vote directly on non-staff seats on M's member Board. A new structure would be implemented to provide for class voting for specific Board seats. This change in the voting structure will require an affirmative vote of the members to amend M's bylaws.

M represents that it believes that the member vote required to change its governance structure and by-laws, and proceed with the proposed transaction, will not succeed if members do not perceive that the reduction of their collective voting power – and the transaction as a whole – is in their best interests and the interests of a well-functioning, well-regulated m industry. In order to improve the chances of a favorable outcome in the member vote and thereby achieve the public benefits that O, M, and N believe will accrue from the combination of member regulatory activities, a pro-rata payment will be made to all of M's members if the proposed transaction is consummated. Therefore, M believes that it is necessary to make the payment in order to achieve the proposed governance reforms and effect the transaction with P.

Accordingly, M represents that if the proposed transaction is consummated, a payment will be paid to each firm that is a member of M, regardless of whether, or how, the firm votes. The payment will be made in compliance with the corporate law of the State in which M is incorporated, and will give rise to taxable ordinary income in the hands of the recipient members. M expects the payment to its members, as well as other costs it expects to incur in connection with the proposed transaction, will be supported entirely by the expected value of the incremental cash flows that will be produced by the proposed transaction, with the remaining surplus to be used to expand its regulatory functions and reduce regulatory costs in support of its exempt purposes.

M has received an opinion of an independent valuation firm determining that the expected value of the proposed consolidation, which is attributable to projected cost savings, is in the range of \$g to \$r. This is in addition to the assets S would transfer to M at their net book value, an amount M believes reflects the fair market value of those assets, and the final amount of which will be subject to an independent fairness opinion. M represents that it and P have agreed to structure the proposed transaction so as to leave the parties in a financially neutral

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National Association of Securities Dealers, Inc.

position. Accordingly, M will pay P \$s of the projected cost savings, an amount negotiated at arm's-length to make the proposed transaction financially neutral to P's public shareholders. M states that it will effectively act in a manner similar to a constructive trustee to the remaining \$t to \$y in transaction value.

In connection with the change in M's member voting rights and to achieve the governance reform required by P and S as a condition to the proposed transaction, a one-time payment is proposed to be made to each member of M in the amount of \$v, or approximately \$w to \$x in the aggregate, depending on the size of M's membership immediately before the closing of the proposed transaction. M issued a proxy statement to its members describing the proposed transaction, including the proposed member payment. Subsequently, M's membership voted on and approved the governance reforms described in the proxy statement. The governance reforms – and, indirectly, the proposed transaction – remain subject to approval by O following a public comment period.

M believes that the payment to members is supported by the transaction value P has forgone in agreeing to a financially neutral transaction and the remaining transaction value of \$t to \$u exceeds the expected payment to the members. In addition, the independent valuation states that if the parties did not agree to a financially neutral transaction, P would have received an additional \$y to \$z. By agreeing to enter into the proposed transaction on a financially neutral basis, P has forgone any share in the remaining transaction value.

Section 501(c)(6) of the Code provides for the exemption from federal income tax of business leagues, chambers of commerce, real-estate boards, or boards of trade, not organized

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National Association of Securities Dealers, Inc.

An organization is not exempt under section 501(c)(6) of the Code if any part of the organization's net earnings inure to the benefit of any private shareholder or individual. An organization exempt under section 501(c)(6) may not be operated for the profit of its individual members, but members may, nevertheless, receive some kinds of benefits from the organization. A finding of inurement is generally based on a payment being made by the section 501(c)(6) organization. Section 1.501(a)-1(c) of the regulations defines a private shareholder or individual as a person having a personal and private interest in the activities of the organization.

With regard to the payment to M's members, if P made an arm's-length payment to M's members out of P's own assets, that payment would not constitute inurement of M's earnings. Although in form the proposed payment to members will be made by M, the payment is being made to satisfy a condition to the transaction imposed by P and S. The payment to M's members is supported by the value forgone by P by its agreeing to participate in the proposed transaction on a financial neutral basis. The independent valuation shows a transaction value after making the \$5 payment to P, in the range of \$1 to \$11, which M has stated that it will hold effectively in a manner similar to a constructive trust for use in achieving the purposes of the proposed transaction. This remaining value exceeds the amount that would be paid to M's members. The payment to M's members has the same practical effect as payment from P to the members in exchange for their agreement to the governance reform.

The effect of the proposed transaction will further M's exempt purpose by producing benefits for both the m industry and, by extension, for the public that relies on M and N to ensure fairness in the industry. M's exempt purpose is to address the m industry's need for self-regulation, and the promulgation and enforcement of business conduct and certain other ethical rules within the m industry. Therefore, we find that the effect of the transaction as a whole furthers M's exempt purpose under section 501(c)(6) of the Code.

Therefore, based on the facts submitted by M and N, we do not find that there was a payment from a section 501(c)(6) organization to a shareholder or individual and thus there can be no inurement. This is based on our understanding that the payment to M's members will be made from value created by the transference of the regulatory functions from S to M. P could have retained this value but chose to have it distributed to M's members. M has indicated that while it will receive the value, part of the value M holds is in a manner similar to a constructive trustee for the benefit of M's members and to make the payment from P that is necessary to effectuate the transference of the regulatory functions.

Accordingly, based on the facts and circumstances concerning the proposed transaction, we rule that the proposed transaction will not affect M's or N's tax-exempt status under section 501(c)(6) of the Code.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

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National Association of Securities Dealers, Inc.

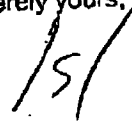
This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. Any such change should be reported to the Ohio Tax Exempt and Government Entities (TE/GE) Customer Service Office. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records. Pursuant to a Power of Attorney on file in this office, a copy of this letter is being sent to M's and N's authorized representative.

Except as we have specifically ruled herein, we express no opinion as to the consequences of this transaction under the cited provisions or under any other provision of the Code.

This ruling is directed only to the organizations that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

If there are any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely yours,



Debra J. Kawecki
Manager, Exempt Organizations
Technical Group 2

DAVIS POLK & WARDWELL

450 LEXINGTON AVENUE
NEW YORK, N.Y. 10017
212-450-4000

CONFIDENTIAL

October 26, 2006

Re: **Application of NASD and NASDR for Ruling under Section 501(c)(6)**

Internal Revenue Service
TE/GE (SE:T:EO:RA:T:2)
Mr. Carter C. Hull
1111 Constitution Avenue, N.W. (PE-3N3)
Washington, D.C. 20224

Dear Mr. Hull:

On behalf of the National Association of Securities Dealers, Inc. ("NASD") and NASD Regulation, Inc. ("NASDR"), the undersigned submits this request for a ruling regarding a pro-rata cash payment to be made to each of NASD's members in connection with the proposed transaction described below. The transaction is part of an undertaking with the active support and participation of the Securities and Exchange Commission ("SEC" or the "Commission") to consolidate the member regulatory operations of NASD and NYSE Regulation, Inc. ("NYSE Regulation") in order to achieve reforms viewed by the parties as important to the long-term stability and integrity of the U.S. financial markets.

NASD and NASDR request a ruling that the proposed cash payment will not affect NASD's or NASDR's tax-exempt status under Section 501(c)(6) of the Internal Revenue Code of 1986, as amended (the "Code"). Information relating to NASD and NASDR that is required by Revenue Procedure 2006-4, 2006-1 I.R.B. 132, is set forth in the Appendix.

BACKGROUND

1. NASD and NASDR

NASD is a Delaware nonstock membership corporation exempt from U.S. federal income tax under Section 501(c)(6). It was organized in 1939 pursuant to the 1938 Maloney Act Amendments to the Securities Exchange Act of 1934 (the "Exchange Act"). NASD was founded in response to Congress' mandate that the U.S. securities industry have a self-regulatory organization with authority to promulgate and enforce business conduct and other ethical rules, including rules applicable to non-exchange markets, that were more detailed than the anti-fraud regulations promulgated by the SEC. Today, virtually every U.S. securities firm transacting business with the public is required by law to be a member of, and is subject to regulation by, NASD. NASD currently has approximately 5,100 members and has supervisory responsibility for more than 655,000 individual securities representatives and brokers at those member firms. As the sole U.S. registered securities association, NASD regulates the broad range of broker-dealer conduct, as well as all trading activity in the over-the-counter equity and corporate and municipal fixed income markets. NASD also provides regulatory services to the Nasdaq Stock Market ("Nasdaq"), the American Stock Exchange and the International Securities Exchange. All activity of NASD is subject to the close oversight of the SEC.

Since 1996, most of NASD's regulatory activity has been conducted

million. As of June 30, 2006, the consolidated balance sheet of NASD and NASDR reflected \$2.9 billion in assets, of which \$2.1 billion was equity. A substantial part of that equity is attributable to the proceeds derived from the sale of NASD's interest in Nasdaq. The endowment supports NASD's annual operating budget to carry out its regulatory responsibilities.

2. NYSE Regulation

NYSE Regulation, a New York Type A not-for-profit corporation, has regulatory responsibility for trading activity on the New York Stock Exchange, as well as responsibility for regulation of its broker/dealer members, listed companies and other market participants. The NYSE Group, Inc. ("NYSE Group"), NYSE Regulation's ultimate corporate parent, is a publicly traded Delaware corporation that was formed as a holding company in 2005 to accomplish the merger of the New York Stock Exchange LLC ("NYSE"), a floor-based auction stock market, and Archipelago Holdings, Inc., an operator of an electronic trading system for matching buy and sell orders automatically. At the time of the formation of NYSE Group, NYSE separated its existing market activities and regulatory operations into two newly formed subsidiaries, NYSE Market, Inc., a Delaware corporation, and NYSE Regulation.

NYSE Regulation's activities fall into four general categories: regulation of NYSE members, market surveillance of the New York Stock Exchange, enforcement (relating to both members and the market) and regulation of issuers listed on the NYSE. NYSE Regulation has approximately 450 examiners and other employees engaged in member-related regulation and enforcement activities, all of whom are located in its offices in New York City. NYSE

things, satisfy the SEC that it is adhering to standards of fairness articulated by Congress in section 15A(b) of the Exchange Act, including the requirement that:

The rules of the association are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers, to fix minimum profits, to impose any schedule or fix rates of commissions, allowances, discounts, or other fees to be charged by its members, or to regulate by virtue of any authority conferred by this title matters not related to the purposes of this title or the administration of the association.

15 U.S.C. § 78o-3(b)(6). As part of the SEC's ongoing oversight, any change in a registered securities association's structure or purpose is subject to prior approval by the Commission. Since the addition of section 15A in 1938, NASD is the only entity to register with the SEC as a registered securities association.

In recent years, the SEC has expressed policy concerns regarding both the inherent conflicts in the existing self-regulatory system and the inefficiencies of overlapping self-regulatory schemes. In an SEC "concept release" issued in 2004, the Commission described oversight by SROs as a "key component of U.S. securities industry regulation" while noting that inevitable tensions (which we

The concept release observes that the potential for market conflict concerns arises in the context of an SRO that is part of a for-profit exchange, as is currently the case with the NYSE and NYSE Regulation and as was the case when NASD owned Nasdaq. The SEC is concerned that rulemaking and enforcement may suffer because while "regulatory staff is responsible for carrying out self-regulatory obligations, they are also a component of a competitive business organization ... [and a] potential loss of objectivity could accompany the greater knowledge and expertise that result from having SRO regulatory staff interwoven with SRO market operations." *Id.* at 71,262.

As part of the concept release, the SEC solicited comments on various proposed approaches to the conflicts and inefficiencies described above. One such approach described by the SEC, which was dubbed the "Hybrid Model," would create a single neutral membership SRO to regulate the conduct of all brokers and dealers in the U.S. securities industry, while each exchange would continue to operate a market SRO to govern conduct on that exchange. *Id.* at 71,277-78. Because the single membership SRO would not be affiliated with any

governed by rules that "assure a fair representation of its members in the selection of its directors and administration of its affairs." 15 U.S.C. § 78o-3(b)(4). Historically, NASD has met this "fair representation" standard with its one firm, one vote governance model, pursuant to which all members vote on 15 of the 16 non-staff seats on NASD's 17-member Board. As a result of changes in the securities industry over recent decades, however, there is now a disproportionate concentration of voting power in "small firms," defined in NASD rules as firms with fewer than 150 representatives. Today, small firms account in the aggregate for only 12% of registered securities representatives and only 18% of NASD's member firm gross revenue, but they have more than 90% of the voting power in NASD.

This concentration of voting power in firms with a relatively minor role in the overall market leaves NASD susceptible to private interest capture if a faction among the members dissatisfied with the level of regulation were to persuade those small firms to support their efforts to gain control of the Board. The current structure is subject to the risk that a non-representative bloc of firms could influence NASD for their private benefit. In light of the fairness standards mandated in section 15A of the Exchange Act, there is a desire that NASD's governance be reformed to minimize the risks of the current voting structure. This is especially important given the expanded authority that the combined organization will have over the markets. In fact, the NYSE views governance reform as sufficiently important to the success of the overall transaction that it has advised NASD that it will not participate the combination if the reform is not accomplished.

Accordingly, the Board of Governors of NASD expects to ask member firms to relinquish their existing ability to vote directly on 15 of the 16 non-staff seats on NASD's 17-member Board. A new structure would be implemented to provide for class voting for specific board seats. The current negotiations between NASD, the NYSE and the SEC provide for, initially, an expanded 23-member board comprising 11 seats set aside for public governors; three for large firms; three for small firms; one for mid-size firms; one for an NYSE floor member; one for an independent dealer/insurance affiliate; one for an investment company, and two for staff. In the new structure, the 11 public governors would be approved by a nominating committee of the Board and, unlike the current structure, would not be voted on by the member firms. This change in the voting structure will require an affirmative vote of the members to amend NASD's bylaws.

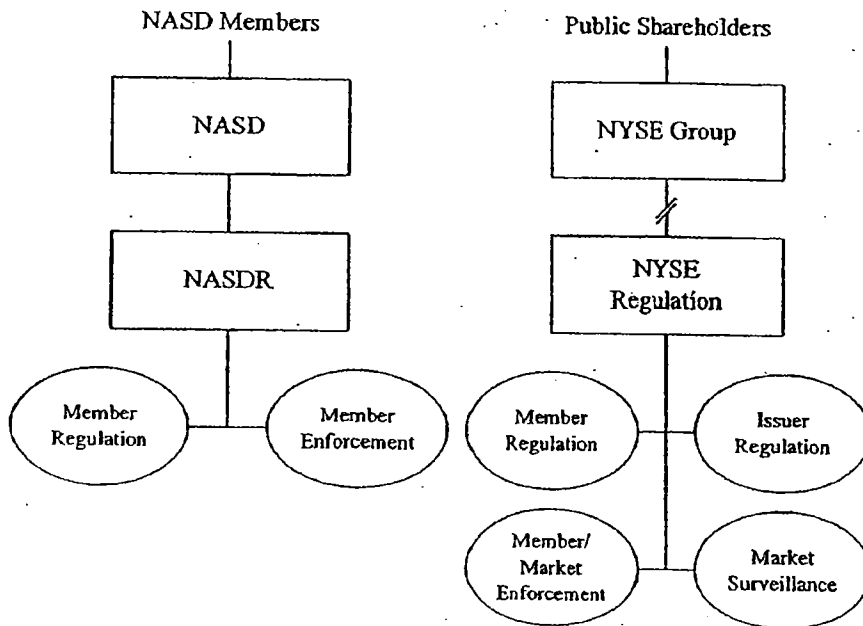
NASD believes that the vote to change its governance will not succeed if members do not perceive that the reduction of their collective voting power—and the transaction as a whole—is in their best interests and the interests of a well-functioning, well-regulated market. In order to improve the chances of a favorable outcome in the member vote and thereby achieve the public benefits

that the Commission, NASD and NYSE believe will accrue from the combination of member regulatory activities, NASD proposes to make a payment pro-rata to NASD's members if the transaction is consummated. This payment is in recognition of the reduction in the members' collective voting power, as well as the fact that their contributions have enabled NASD to provide benefits to the investing public and that NASD will have sufficient assets to achieve its exempt purposes after the payment. NASD believes that it is necessary to make the payment in order to achieve the proposed governance reforms and effect the transaction with NYSE Regulation.

Accordingly, if the transaction is consummated, a payment will be paid to each firm that is a member of NASD, regardless of whether, or how, the firm votes. The payment will be made in compliance with Delaware corporate law (see memorandum of Delaware counsel attached at Tab C) and will give rise to taxable ordinary income in the hands of the recipient members. NASD expects that the aggregate amount of the payments will be in the range of ~~of~~ REDACTED NASD's total assets. The amount of the payment will be determined by the NASD Board of Governors and is subject to the review process described more fully below.

2. Current Structure and Description of Proposed Transaction

The current structures of NASD and the NYSE are as follows:



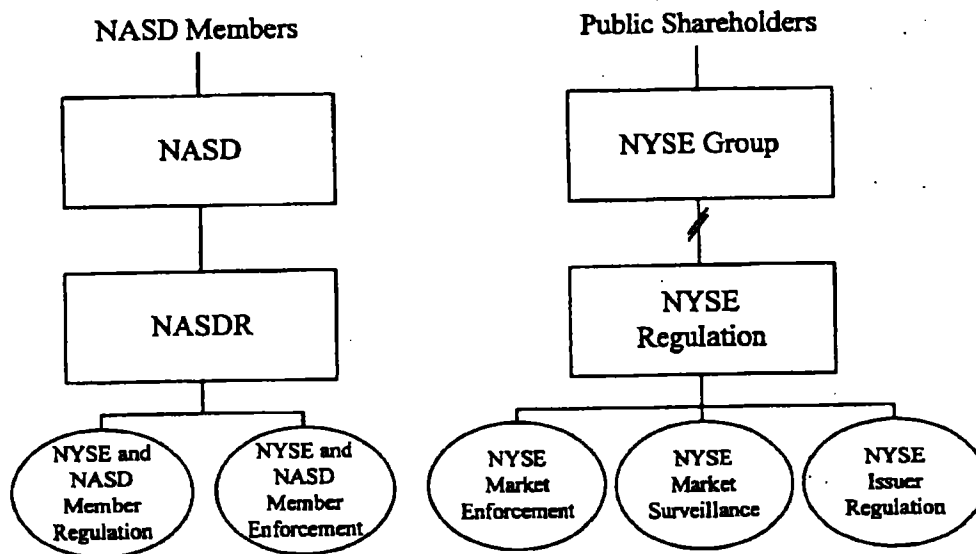
In the proposed transaction, the member-related activities of NYSE Regulation (both member regulation and member-related aspects of enforcement) would be combined with those of NASD and NASDR. Because our understanding is that NYSE Regulation is not exempt from tax under Section 501(c), it is expected that the combination would be achieved by means of an assignment of assets. The specific elements of the transaction would be as follows:

Recapitalization of NASD. Once the approvals described below have been obtained, the charter and bylaws of NASD will be amended as necessary to (i) change NASD's name to reflect the combination; (ii) eliminate the one-member, one-vote governance; (iii) increase the size of NASD's Board of Governors, adopt class voting and set aside, initially, eleven seats for public governors, three for large firms, three for small firms, one for mid-size firms, one for NYSE floor members, one for independent dealer/insurance affiliates, one for investment companies, and two for staff; and (iv) make a payment to each of NASD's 5,100 members in an amount to be determined by the NASD Board of Governors.

Transfer of Assets. Immediately after, and in connection with, the recapitalization NYSE Regulation will transfer member-related assets to either

3. Resulting Structure

Following the recapitalization of NASD and transfer of assets by NYSE Regulation, the structures of NASD (which will be renamed) and NYSE are expected to be as follows. We have shown NASDR as the recipient of the NYSE Regulation assets. As noted above, they may be transferred to a limited liability company wholly owned by NASD (or by NASDR). Since the limited liability company would be treated as a disregarded entity for all federal tax purposes, such a transfer would be treated as if it were to NASD (or NASDR).



4. Necessary Approvals

Effecting the combination will require the approval of several constituencies. The SEC has already shown an unprecedented level of interest in the discussions between NASD and NYSE, having attended meetings between NASD and the NYSE since the exploratory phase of the proposed transactions.

affirmative vote. Governors who are affiliated with member firms will either
not be affiliated with the proposed transaction or

firms with a relatively minor role in the overall market to support their efforts to gain control of the Board. The current structure is subject to the risk that a non-representative bloc of firms could influence NASD for their private benefit. Restructuring the governance will allow NASD to better achieve its exempt purpose and satisfy the requirements of the Exchange Act by redistributing voting power in a manner more consistent with NASD's purposes. In addition, NYSE Regulation has advised NASD that it will not participate in the proposed transaction unless NASD's governance is reformed.

Even if an entity serves an exempt purpose, tax-exempt status under Section 501(c)(6) is denied where part of the net earnings of that entity inures to the benefit of any private shareholder or individual. The applicable Regulations define a "private shareholder or individual" as a person "having a personal and private interest in the activities of the organization." Treas. Reg. Sec. 501(a)-1(c). This proscription is generally understood to prohibit the flow of benefits to persons in control positions within an entity claiming exemption from tax. See generally, *American Campaign Academy v. Comm'r.*, 92 T.C. 1053 (1989); *Church of Scientology of Cal. v. Comm'r.*, 83 T.C. 381 (1984); *Goldboro Art League, Inc. v. Comm'r.*, 75 T.C. 337 (1980), *acq.*, 1986-1 C.B. 1. However, the Tax Court has, on at least one occasion, suggested that the existence of prohibited inurement should be reviewed in light of "the reasonableness and appropriateness of the expenses" to the exempt purpose of the organization and that "control of financial decisions by individuals who appear to benefit personally from certain expenditures does not necessarily indicate inurement." *Unitary Mission Church v. Comm'r.*, 74 T.C. 507, 515 (1980) (ultimately finding inurement); see also *Orange County Agric. Soc., Inc. v. Comm'r.*, 65 AFTR 2d 90-631 (893 F.2d 529) (citing *Unitary Mission Church*). In cases involving Section 501(c)(3), the Tax Court has observed that the private inurement test appears redundant in that it is an alternative way of asking whether an entity is organized and operated exclusively for an exempt purpose. See *Unitary Mission Church*, 74 T.C. at 512 n.7; *Lowry Hosp. Ass'n. v. Comm'r.*, 66 T.C. 850, 857 n.8 (1976).

In the proposed transaction, the payment is in furtherance of the exempt purposes of NASD and NASDR because the transactions contemplated by the SEC, NASD and NYSE Regulation will not occur unless the payment is made. In addition, none of the member firms that would receive the payment is in "control" with respect to the approval of the payment, or with respect to the operation of NASD generally. Governors who are affiliated with member firms will either forgo any payment to their firms in connection with the proposed transaction or recuse themselves from the votes to approve both the payment to member firms and the amount of the payment.

Moreover, although the payment to member firms is necessary to effect the governance reform in furtherance of NASD's and NASDR's exempt purposes, it is only incidental to the achievement of those purposes. NASD and NASDR

play central roles in rulemaking and enforcement vital to the operations of the nation's financial industry, roles that will be expanded once the combination with NYSE Regulation is accomplished. The current one firm, one vote governance structure has placed disproportionate control in the hands of small firms, which could produce results that are in tension with NASD's and NASDR's exempt purposes and the section 15A fairness standards under which NASD operates. Governance reform is, therefore, necessary to the achievement of NASD's and NASDR's exempt purposes, and the payment is an incidental component of the plan to secure those ends. A payment that is necessary and incidental to the achievement of an exempt organization's exempt purposes should not constitute private inurement or affect the organization's tax-exempt status. See, e.g., *Unitary Mission Church v. Comm'r*, supra; see also *Mill Lane Club, Inc. v. Comm'r*, 23 T.C. 433 (1954), acq., 1955-1 C.B. 5 (distribution to club members of proceeds of sale of clubhouse at a profit did not cause club to lose exemption when sale was incidental to exempt purpose); Gen. Couns. Mem. 38,559 (Nov. 7, 1980) (short-term emergency loans made by union to striking members preserved united front in on-going negotiations, and thus were incidental to union's exempt purpose of furthering collective bargaining, rather than private inurement); S.M. 2710, III-2 C.B. 230 (1924) (exempt social club's repurchase of retiring and deceased members' interests in exchange for their equity contributions plus 5% interest was "reasonable and necessary" to keep organization in hands of active members and did not affect exempt status).

REDACTED The proposed payment is also insubstantial when viewed in relation to NASD's operations and balance sheet. The contemplated payment is expected to be in the range of _____ per member firm. The total payment to NASD's 5,100 member firms would be less than _____ and in the range of _____ of the total assets reflected on the consolidated balance sheets of NASD and NASDR. The proposed payment also would be permissible under Delaware law.

While there is no authority directly addressing a payment in analogous circumstances, NASD and NASDR believe the payment is a "reasonable and appropriate" expense to achieve the combination of member regulatory activities with the NYSE and the proposed governance reform. This conclusion is supported by the unique circumstances of the present case, in which the SEC supports the purposes of the transaction, has participated in the discussions regarding the specific structure of the transaction, including the changes to NASD's governance, and will need to approve the bylaw changes in order for the proposed transaction to be consummated. In sum, the payment to the members will further the exempt purposes of NASD and NASDR by enabling the consolidation of the member regulatory operations of NASD and NYSE Regulation and the achievement of reforms viewed by the parties and the SEC as important to the long-term stability and integrity of the U.S. financial markets.

For the reasons set forth above, we respectfully request a ruling that the pro-rata payment that will be made to each of NASD's member firms will not affect NASD's or NASDR's tax-exempt status under Section 501(c)(6).

REPRESENTATIONS

In connection with the proposed transaction, the following representations are hereby made:

[REDACTED]

October 26, 2006

PROCEDURAL MATTERS

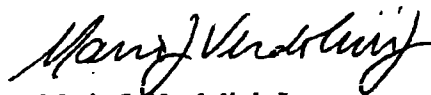
Enclosed with this ruling request letter are (i) Powers of Attorney on Forms 2848 authorizing the undersigned to represent NASD and NASDR, (ii) Penalties of Perjury Statements attesting to the veracity of the information set forth herein and in the Appendix, (iii) a Statement of Proposed Deletions, (iv) a Ruling Request Checklist (Appendix B of Revenue Procedure 2006-4), and (v) a check in payment of the required user fee.

In the transmittal letter for this submission, we have requested expedited treatment and explained the reasons for that request. We also would be pleased to meet with you again, if that would be helpful, and to provide a draft ruling letter.

NASD, NASDR, and their representatives are not aware of any authorities contrary to the rulings requested; nor are they aware of any pending legislation that affects the transaction. While NASD and NASDR believe that the rulings requested herein are supported by the relevant authorities and are therefore correct, because of the factual nature of the inquiry, the application of the law in connection with these rulings is believed to be uncertain.

Please send the original ruling letter to the taxpayers' representative, Grant Callery, and, in accordance with the enclosed Powers of Attorney, a copy of the ruling letter to the undersigned. You are also authorized to send a copy of the ruling letter by facsimile transmission to Mario J. Verdolini, Jr. at fax number (212) 450-3969. NASD and NASDR waive any disclosure violations resulting from the nature of facsimile transmission. If further information is desired, please call the undersigned. If there is any doubt concerning the issuance of a favorable ruling, we request the privilege of a conference.

Very truly yours,



Mario J. Verdolini, Jr.
Davis Polk & Wardwell
(212) 450-4969

DAVIS POLK & WARDWELL

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HONG KONG

December 4, 2006

Re: NASD/NASDR Ruling Request

Internal Revenue Service
Attention: EO Letter Rulings
Mr. Carter C. Hull
P.O. Box 27720
McPherson Station
Washington, D C. 20038

Dear Mr. Hull:

In a telephone conversation on November 30, Ms. Kawecki and Mr. Chasin asked us to provide additional analysis regarding certain elements of the Proposed Transaction described in the ruling request we submitted to the Service on behalf of the National Association of Securities Dealers, Inc. and NASD Regulation, Inc. (together "NASD") on October 26, 2006 (the "Original Ruling Request") and in the amended and restated ruling request submitted on November 27, 2006 (the "Amended Ruling Request"). In particular, they asked that we address the payments to be made to NYSE Group or NYSE Regulation (together "NYSE") and others, as well as the rebates and fee reductions proposed to be made in future years, which will be subject to separate annual Board ratification before they can be made. Capitalized terms used but not defined here have the meaning provided in the Original Ruling Request and Amended Ruling Request, as applicable. Before the end of the week, we shall submit statements under penalties of perjury with respect to this letter and the Amended Ruling Request.

1 Payments to NYSE and others

Ms. Kawecki and Mr. Chasin asked us to discuss the payments to NYSE that are described on page 8 of the Original Ruling Request and page 9 of the Amended Ruling Request, as well as any other payments to be made to NYSE or others in connection with the proposed transaction.

As described in the Original Ruling Request and the Amended Ruling Request, NASD and NYSE have been engaged in arm's-length negotiations over

the purchase price for the NYSE member regulatory functions. These negotiations occurred over a period of several months, and on November 21, 2006, NASD's Board of Governors agreed to make a payment in connection with the Proposed Transaction consisting of \$103 million plus the net book value of the assets being transferred, which was \$15.5 million as of June 30, 2006 and will be adjusted as of the closing date. The payment is designed to make the Proposed Transaction "neutral" to NYSE Group shareholders.

REDACTED . From NASD's perspective, the Proposed Transaction will result in an expansion of its member regulatory operations in furtherance of its exempt purposes. NASD has estimated that the expansion will result in substantially increased annual net cash flow, beginning at [REDACTED] in 2007, growing to [REDACTED] in 2008, rising to [REDACTED] per year by 2011 and continuing at that level into the future. The projected aggregate increased net cash flow for the first five years alone is approximately [REDACTED] not including the substantial value in the [REDACTED] in incremental annual net cash flows projected for each year after that. The terms of the arrangements with NYSE are conditioned on the receipt by NASD of a fairness opinion from an independent valuation firm.

NASD will make other incidental payments in connection with the Proposed Transaction, all of which are also conditioned on the receipt of the fairness opinion. These payments, which were described in the term sheet attached to the Original Ruling Request as Exhibit A and in the final term sheet attached to the Amended Ruling Request at Tab K, include an assumption of compensation obligations to the employees transferred from NYSE to NASD, as well as payments pursuant to a sublease and security agreement and a transitional services arrangement. The sublease and security agreement relates to the office space currently occupied by the transferred employees, and the payments under this agreement will equal the base rent for the space plus other reasonable direct and allocated costs. Under a transitional services arrangement, to the extent NASD requires technology or other services from NYSE during a one-year transition period, NASD will pay for direct expense hours at actual rates incurred, plus a 25% mark-up to cover NYSE's fixed and allocated costs. Any services provided after that period would be subject to future negotiation. NASD is not obligated to use any of these services.

Other costs associated with the Proposed Transaction will include fees and expenses of financial advisors, counsel and accountants, filing fees, printing costs, and out-of-pocket costs, such as travel in connection with explaining the Proposed Transaction to members. Rebates and reductions of member assessments and fees are discussed separately below. We have previously discussed the one-time special member payment of \$35,000.

An entity exempt from U.S. federal income tax under Section 501(c)(6) will lose its exemption if part of its net earnings inures to the benefit of any

private shareholder or individual. The applicable Regulations define a "private shareholder or individual" as a person "having a personal and private interest in the activities of the organization." Treas Reg Sec. 1.501(a)-1(c). This proscription is generally understood to prohibit the flow of benefits to persons in control positions within an entity claiming exemption from tax. See generally, *American Campaign Academy v. Comm'r.*, 92 T.C. 1053 (1989); *Church of Scientology of Cal. v. Comm'r.*, 83 T.C. 381 (1984); *Goldsboro Art League, Inc. v. Comm'r.*, 75 T.C. 337 (1980), *acq.*, 1986-1 C.B. 1. The purpose of the bar against private inurement is to prohibit the "siphoning of charitable receipts to insiders" and not "arm's length contracts made by charitable organizations with the firms that supply them with essential inputs, whether premises, paper, computers, legal advice, or fundraising services." *United Cancer Council Inc v. Commissioner*, 165 F.3d 1173, 1176 (7th Cir. 1999), *rev'g* 109 T.C. 326 (1993).

Here, the payments NASD is making in connection with the Proposed Transaction are arm's-length payments in exchange for assets and services needed to expand and further its exempt purposes. The payments to NYSE cannot result in private inurement because NYSE does not have control over any operations of NASD and had no influence on the vote by the Board of Governors to approve the terms or structure of the Proposed Transaction. While NYSE would, if the Proposed Transaction is consummated, have a voice in certain appointments and nominations to NASD's Board of Governors, as well as one seat on the 23-member board, this board structure would be in place only prospectively and cannot create retroactive insider status in connection with the negotiation of the Proposed Transaction's terms.

Secondly, the amount being paid to NYSE in connection with the Proposed Transaction was determined through arm's-length negotiations and is subject to an independent fairness opinion, and it would not represent an impermissible excess benefit even if NYSE were somehow deemed to be an insider. NASD and NYSE met only as "a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts," the essence of fairness in a negotiated transaction. See, e.g., Treas. Reg. Sec. 1.170-1(c)

Similarly, the payment made to NYSE in connection with the Proposed Transaction does not confer an impermissible private benefit under principles generally applicable in the 501(c)(3) context. In order for a charity to satisfy its exemption from tax under Section 501(c)(3), the applicable regulations provide that it must engage "primarily in activities which accomplish one or more" of its exempt purposes, and that it will lose its exemption if "more than an insubstantial part of its activities is not in furtherance of an exempt purpose." Treas. Reg. Sec. 1.501(c)(3)-1(c)(1); compare *Ginsberg v. Commissioner*, 46 T.C. 47 (1966) (primary beneficiaries of would-be exempt organization formed to dredge local waterways were the homeowners who supported its activities, and thus

organization was ineligible for exemption) with Rev. Rul. 70-186, 1970-1 CB 128 (organization founded to preserve lake for recreational use was eligible for exemption because its activities primarily benefited the public, and benefits to waterfront landowners were only incidental to that exempt purpose).

The Proposed Transaction directly furthers NASD's and NASDR's exempt purposes and the SEC has actively encouraged the consolidation in light of the expansive benefits that will accrue to the investing public. Indeed, SEC Chairman Cox has said, in voicing SEC support for the Proposed Transaction, that "[T]he fact is, nothing that we do in our country impacts more people, or offers greater opportunity to serve our fellow citizens, than the improvement of our capital markets. That's because they're the wellspring of support for our entire free enterprise system. And they touch the lives of almost everyone." See copy of Cox speech attached to Amended Ruling Request at Tab L. The payment being made to NYSE in connection with the Proposed Transaction is incidental to the achievement of that broad-based public benefit.

2. *Anticipated future reductions in or rebates of member assessments*

NASD expects that following the Proposed Transaction, several factors will reduce its need to rely on yearly dues assessments from its members. NASD expects to realize _____ in additional revenue in 2007 as a result of the Proposed Transaction and expects this incremental annual revenue to grow to _____ by 2011. Initially, its costs will also increase. However, the Proposed Transaction is expected to produce cost efficiencies as a result of increased economies of scale of operations, mainly through a reduction of staffing costs through normal attrition and reductions in technology spending over the next five years. As noted above, these factors are anticipated to produce increases in net cash flows (before rebates or reductions in assessments or fees) of approximately _____ in the first year following the Proposed Transaction increasing to approximately _____ by the fifth year following the Proposed Transaction and each year thereafter.

In recognition of these expected savings, NASD's Board of Governors has committed, subject to annual ratification by the Board, to make \$30 million of

expects to reduce other service fees as the savings from the Proposed Transaction materialize.

The IRS has acknowledged that "it is well established that a business league or other organization exempt under § 501(c)(6) may refund part of the dues or contributions previously paid to the organization for its activities. Such refunds are treated as reductions in dues." Rev. Rul. 81-60, 1981-1 C.B. 335; *see also* Priv. Ltr. Rul. 8226013 (1981) (pro rata refund of excess dues by § 501(c)(6) organization to members, where refund did not exceed amount of dues paid by members, was merely a rebate of membership dues paid during the same taxable year and not private inurement); Rev. Rul. 77-206, 1977-1 C.B. 149 (1977) ("An exempt business league may generally make cash distributions to its members without loss of exemption where such distributions represent no more than a reduction in dues or contributions previously paid to the league to support its activities."); *King County Ins. Assoc. v. Commissioner*, 37 B.T.A. 288, 292 (1938) (refunds and credits to members by exempt business league did not result in private inurement where incidental income, which would be taxable to a corporation engaged in a business for profit, served merely to reduce the amount of dues which otherwise would have been due from members and where refund did not exceed amount of dues paid for such year).

Certain limitations have been applied to rebates. First, all money that is refunded must come only from dues and other amounts contributed by members receiving the refund. *See* Rev. Rul. 81-60, 1981-1 CB 335 ("Refunds ... must be made out of funds paid by those receiving the refunds."). Second, implicit in the idea of a "rebate" is that the distribution must not exceed the amount of dues paid in. *See Michigan Mobile Home and Recreational Vehicle Instit v. Commissioner*, 66 T.C. 770, 777 (1976) (finding fault that "a substantial number of the distributions to members were far in excess of the maximum annual dues"); Rev. Rul. 77-206 ("Rebates ... may not exceed the amount of the deposits."). Third, the rebates should not reflect a preference for insiders. *Compare* Rev. Rul. 81-60 (pro rata rebate permitted) with *Michigan Mobile Home and Recreational Vehicle Instit.*, 66 T.C. 770 (exemption denied to § 501(c)(6) organization where rebates of rental fees paid in connection with trade show were made to members while non-members that paid rental fees were denied rebates).

The proposed rebates of member fees to be paid over the next five years, if made, will fall squarely within the authorities allowing rebates of dues paid to a 501(c)(6) exempt organization. The \$6 million in rebates each year would be no more than the aggregate base assessment and would be far less than the aggregate member dues expected to be collected by NASD each year. The rebates also will be less than the projected cost savings from the Proposed Transaction and so are expected to constitute rebates of excess dues. Each member's rebate would be no more than its \$1,200 annual base gross income assessment, and no member's

December 4, 2006

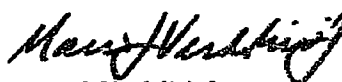
rebate will exceed the dues paid during that year. Finally, the rebates will be paid pro-rata in proportion to the base assessment.

An additional fact you may wish to consider is that aggregate projected rebates to each member over the next five years would be \$6,000 (\$1,200 per year for five years). When added to the special member payment of \$35,000, the total of \$41,000 is within the **REDACTED** range discussed at our October 5, 2006 meeting and in the Original Ruling Request at page 12. The rebates differ from an incremental payment in two respects, however. First, they are rebates of dues that will have been paid in the future and therefore entail no net cost to NASD. Second, they are contingent on separate Board action in each year.

NASD expects to finalize a proxy statement to its members by December 11, 2006, and we will submit a copy of that document when it is ready. The member vote is expected to take place in early January.

If you have any further questions or if I can be of any further assistance, please do not hesitate to call me at (212) 450-4969.

Very truly yours,



Mario J. Verdolini, Jr

DAVIS POLK & WARDWELL

450 LEXINGTON AVENUE
NEW YORK, N.Y. 10017
212-430-4000

CONFIDENTIAL

December 22, 2006

Re: Application of NASD and NASDR for Ruling under Section 501(c)(6)

Internal Revenue Service
TE/GE (SE:T:EO:RA:T:2)
Mr. Carter C. Hull
1111 Constitution Avenue, N.W. (PE-3N3)
Washington, D.C. 20224

Dear Mr. Hull:

On behalf of the National Association of Securities Dealers, Inc. ("NASD") and NASD Regulation, Inc. ("NASDR"), I am writing to amend and restate in its entirety the ruling request I submitted on October 26, 2006, as previously amended on November 27, 2006, and as supplemented by letter on December 4, 2006, in order to reflect the discussions we have since had by [redacted] Federal developments that have occurred in connection with [redacted].

Internal Revenue Service

December 22, 2006

affect NASD's or NASDR's tax-exempt status under Section 501(c)(6) of the Internal Revenue Code of 1986, as amended (the "Code").

Please note that we have included updated statements under penalties of perjury that cover all of our submissions, including this one. In addition, we have included a statement regarding the Proposed

Together, NASD and NASDR have an extensive effect on the U.S. financial markets. They have more than 520 examiners, who completed more than 7,000 examinations across the United States last year. Automated market surveillance covers more than 3,300 stock issues listed on Nasdaq, 8,200 over-the-counter securities, and all corporate and municipal bond transactions required to be reported. This supervisory function resulted in nearly 1,400 enforcement actions in 2005. The operating revenues of NASD for the year 2005 were approximately \$600 million, over \$200 million of which was attributable to member regulatory fees, and its operating cash flow, after expenses, was \$10 million. As of June 30, 2006, the consolidated balance sheet of NASD and NASDR reflected \$2.9 billion in assets, of which \$2.1 billion was equity. A significant portion of the assets reflected the proceeds derived from the sale

for [redacted] voluntary organizations ("SROs") have been a central feature in [redacted] changes in the [redacted]

December 22, 2006

Internal Revenue Service

With respect to the member conflict issues, the release found that membership SROs, which operate for the dual purposes of serving and regulating their members, may yield "poorly targeted SRO rulemaking, less extensive SRO rulemaking, and under-zealous enforcement of SRO rules against members." *Id.* at 71,259. Because "successful self-regulation relies on sufficiently vigorous rule enforcement against members," SRO regulatory operations must be safeguarded against business pressures, including "member domination of SRO funding, member control of SRO governance and member influence over regulatory and enforcement staff." *Id.*

The concept release observes that the potential for market conflict concerns arises in the context of an SRO that is part of a for-profit exchange, as is the case with the NYSE and NYSE Regulation and as was the case with the NYSE and NYSE Regulation that rulemaking and

association, stating that "SRO regulation must change to keep pace [with changes in global financial markets]. Unless we act now to remove unnecessary duplication and conflicts of interests in our regulatory structure, we'll actually impair the ability of America's capital markets to remain the world's strongest."¹ In a speech on November 20, 2006, about the competitiveness of U.S. capital markets, Secretary of Treasury Henry M. Paulson stated that the proposal of the NYSE and NASD "to consolidate their regulatory operations . . . is a positive development . . ."²

The Proposed Transaction would entail the transfer of the member-regulatory functions of NYSE Regulation to NASDR. The parties believe that, as a result of the Proposed Transaction, the U.S. financial markets and the investing public will benefit from increased regulatory and enforcement efficiency and from separation of NYSE Regulation's member regulation functions from the for-profit NYSE Group.

REDACTED

NASD and NASDR expect the Proposed Transaction will result in an expansion of their member regulatory operations in furtherance of their exempt purposes. NASD has estimated that the expansion will result in substantially increased annual net cash flow, beginning at _____ in 2007, growing to _____ in 2008, rising to _____ per year by 2011 and continuing at that level into the future. NASD estimates that the minimum present value of the incremental cash flows that will be produced by the Proposed Transaction in the first ten years after the consolidation is roughly _____ and that the present value of the total cash flows to be produced by the Proposed Transaction is in the range of approximately _____ million.

NYSE Group and NYSE Regulation have stated, however, that they will not proceed with the Proposed Transaction unless NASD changes its one-member, one-vote governance structure. The governance reforms required by NYSE Group and NYSE Regulation are intended to minimize member conflict issues presented by the disproportionate concentration of voting power in NASD presently held by "small firms," defined in NASD rules as firms with fewer than 150 representatives. As a result of changes in the securities industry over recent decades, small firms today account in the aggregate for only 12% of registered

¹ Chairman Christopher Cox, U.S. Securities and Exchange Commission, *More Efficient and Effective Regulation in the Era of Global Consolidation of Markets*, Address Before the Securities Industry and Financial Markets Association (Nov. 10, 2006), <http://www.sec.gov/news/speech/2006/spch111006cc.htm> (copy attached at Tab L).

² Treasury Secretary Henry M. Paulson, *Remarks on the Competitiveness of U.S. Capital Markets*, Address Before the Economic Club of New York (Nov. 20, 2006), <http://www.treasury.gov/press/releases/hp174.htm> (copy attached at Tab M).

December 22, 2006

Internal Revenue Service

securities representatives and only 18% of NASD's member firm gross revenue, but they hold more than 90% of the voting power in NASD.

NYSE Group and NYSE Regulation have expressed a concern that this concentration of voting power in firms with a relatively minor role in the overall market may leave NASD susceptible to private interest capture if a faction among the members dissatisfied with the level of regulation were to persuade those small members to gain control of the Board, thereby allowing a non-

In light

Internal Revenue Service

8

December 22, 2006

law (see memorandum of Delaware counsel attached at Tab C) and will give rise to taxable ordinary income in the hands of the recipient members.

NASD expects the payments to its members, as well as other costs it incurs to incur in connection with the Proposed Transaction, will be supported by the cash flows that will be produced

Recapitalization of NASD. Once the approvals described below have been obtained, the charter and bylaws of NASD will be amended as necessary to (i) change NASD's name to reflect the combination; (ii) eliminate the one-member, one-vote governance; and (iii) increase the size of NASD's Board of Governors, adopt class voting and set aside, initially, eleven seats for public governors, three for large firms, three for small firms, one for mid-size firms, one for NYSE floor members, one for independent dealer/insurance affiliates, one for investment companies, and two for staff.

Transfer of Assets. Immediately after, and in connection with, the recapitalization, NYSE Regulation will transfer member-related assets to either NASDR or a newly created limited liability company of which NASD or NASDR would be the sole member.

The assets transferred by NYSE Regulation would generally include the

3. Resulting Structure

Following the recapitalization of NASD and transfer of assets by NYSE Regulation, the structures of NASD (which will be renamed) and NYSE are expected to be as follows. We have shown NASDR as the recipient of the NYSE Regulation assets. As noted above, they may be transferred to a limited liability company.

because NASD will be required, after the completion of the member vote, to submit the proposed changes in its bylaws to the SEC for approval. The proposed rulemaking will be reprinted in the Federal Register and will be subject to a minimum 21-day comment period, during which the industry and the investing public will have an opportunity to review the change in governance and voice any concerns prior to final SEC approval.

RULING REQUESTED

We respectfully request a ruling that the Proposed Transaction will not affect NASD's or NASDR's tax-exempt status under Section 501(c)(6).

DISCUSSION

Section 501(c)(6) of the Code and Section 1.501(c)(6)-1 of the Regulations provide an exemption from federal income tax for business leagues, associations, or other organizations that undertake to achieve an

needless and often harmful duplication that interferes with that investor protection mission.³³ Consolidation will both expand the reach of NASD's regulatory operations and make those operations more efficient, with the benefit accruing to the investing public.

NASD and NASDR believe the Proposed Transaction, including the steps identified by the parties as necessary to its realization, are essential to the achievement of their exempt purposes. This conclusion is supported by the unique circumstances of the present case, in which the SEC supports the purposes of the Proposed Transaction, has participated in the discussions regarding the specific structure of the Proposed Transaction, including the changes to NASD's ³⁴ ~~structure~~ changes in order for the Proposed

REPRESENTATIONS

In connection with the Proposed Transaction, the following representations are hereby made:

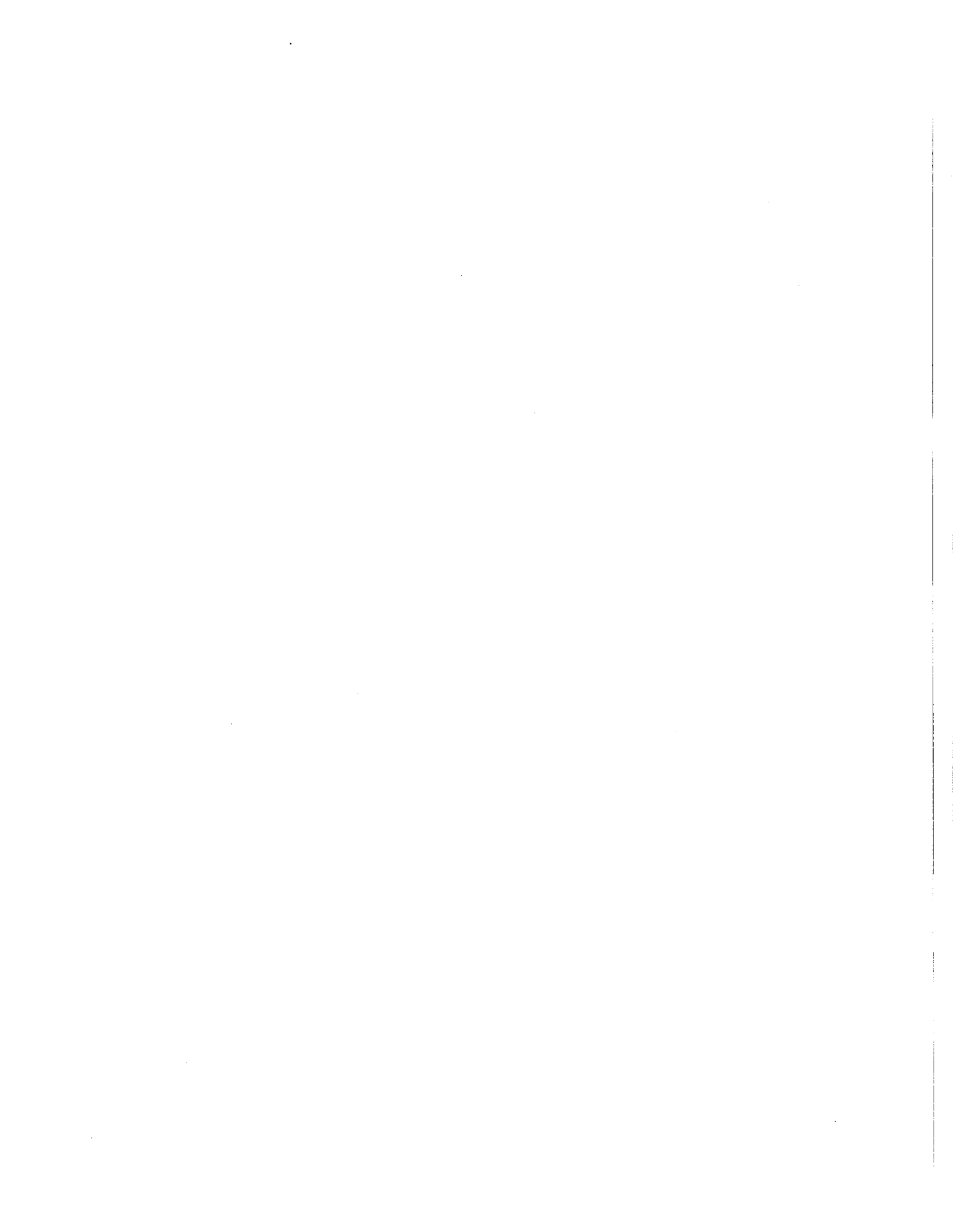
1. NASD will continue to operate in furtherance of its exempt purposes.
2. NASDR will continue to operate in furtherance of its exempt purposes.
3. All of the terms of the Proposed Transaction described herein have been approved by the members of NASD's Board of Governors.
4. No member of NASD's Board of Governors, no officer, and no member of NASD, nor any of their relatives, has received or will receive any compensation, consideration or other form of direct or indirect payment to induce or influence approval of the Proposed Transaction, other than the pro-rata payment made to each of NASD's member firms in connection with the Proposed Transaction.
5. Governors who are affiliated with member firms did not participate in the vote to approve the pro-rata payment to member firms, including the amount of the payment.
6. NASD estimates that the minimum present value of the incremental cash flows that will be produced by the Proposed Transaction in the first ten years after the consolidation is roughly **REDACTED** and that the present value of the total cash flows to be produced by the Proposed Transaction is in the range of approximately **REDACTED**. NASD expects that these cash flows will be sufficient to support the payments it believes are necessary to achieve the Proposed Transaction.
7. The changes in the bylaws of NASD will be subject to approval by the SEC, after a public comment period.
8. The changes in the bylaws of NASD will be subject to approval by NASD's Board and NASD's members.
9. If the Proposed Transaction is consummated, each NASD member firm will be entitled to the pro-rata payment, regardless of whether or how such member firm's vote is cast.

- 10 The payment to each NASD member firm in connection with the Proposed Transaction is permissible under Delaware law.

PROCEDURAL MATTERS

Enclosed with this ruling request letter are (i) Powers of Attorney on Forms 2848 authorizing the undersigned to represent NASD and NASDR, (ii) Penalties of Perjury Statements attesting to the veracity of the information set forth herein and in the Appendix, (iii) a Statement of Proposed Deletions, (iv) a Ruling Request Checklist (Appendix B of Revenue Procedure 2006-4), and (v) a check in payment of the required user fee.

In the transmittal letter for this submission, we have requested expedited treatment and explained the reasons for that request. We also would be pleased to meet with you again, if that would be helpful, and to provide a draft ruling letter.



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CONFIDENTIAL

September 10, 2006

Re: **National Association of Securities Dealers, Inc.
NASD Regulation, Inc.**

Internal Revenue Service
TE/GE (SE:T:EO:RA:T:2)
Mr. Joseph Chasin
Mr. Carter Hull
1111 Constitution Avenue (PE-3N3)
Washington, D.C. 20224

Gentlemen:

I enclose a supplemental memorandum describing the transaction that the National Association of Securities Dealers, Inc. and NASD Regulation, Inc. currently expect to use to achieve the proposed consolidation of regulatory operations with NYSE Regulation, Inc., as requested by Mr. Chasin last week. In addition, packets of materials submitted by NASD and NASDR in connection with the rulings issued in 2000 will arrive at your offices Monday morning by Federal Express. Please let me know if you need us to provide any additional materials.

We look forward to speaking with you to schedule a pre-submission conference.

Very truly yours,

Mario Verdolini
Mario J. Verdolini

Enclosures

DAVIS POLK & WARDWELL

Date: September 10, 2006

To: Joseph Chasin
Carter C. Hull
Internal Revenue Service

From: Mario J. Verdolini

Re: Supplemental information for National Association of Securities
Dealers, Inc. pre-submission conference

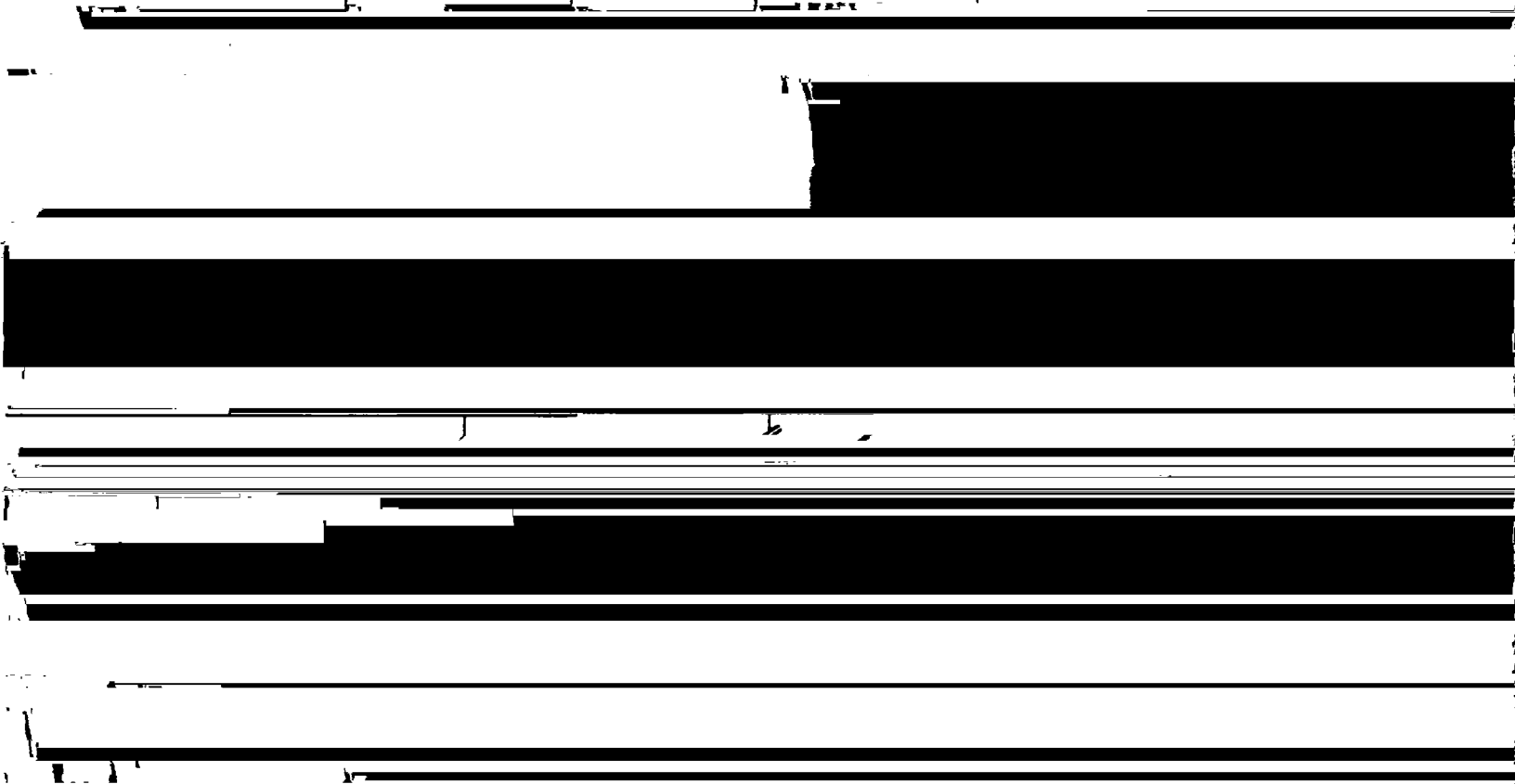
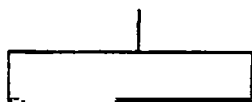
This memorandum provides a description of the transaction that NASD currently expects to be used to achieve the proposed consolidation of member regulatory operations of National Association of Securities Dealers, Inc. ("NASD") and NYSE Regulation, Inc. ("NYSE Regulation"), as described in the materials provided to the Internal Revenue Service on August 9, 2006.

Current Structure

The current structures of NASD and the NYSE are as follows:

NASD Members

Public Shareholders



regulatory supervision by NASD and NASDR. NASD and NASDR have aggregate revenues in the range of \$600 million per year, and they reported approximately \$2.9 billion in assets on their June 30, 2006 balance sheets, of which \$2.1 billion was equity. (See attachments, NASD income statement and balance sheet dated June 30, 2006 and *Better Information, Better Regulation*.)

NYSE Regulation, Inc. is a New York Type A not-for-profit corporation controlled indirectly by the NYSE Group. NYSE Regulation's activities fall into three general categories: member regulation, market surveillance and enforcement (member and market). (See attachment, excerpt from NYSE Group 10-Q for the period ending June 30, 2006.)

Proposed transaction:

In the proposed transaction, the member-related activities of NYSE Regulation (both member regulation and member-related aspects of enforcement) would be combined with those of NASD and NASDR.

Step One: Approvals. The following approvals will be needed.

- SEC regulatory approval;
- NYSE Board of Directors;
- NASD Board of Governors; and
- NASD member vote.

Step Two: Recapitalization of NASD. The charter and bylaws of NASD will be amended as necessary to make the following changes.

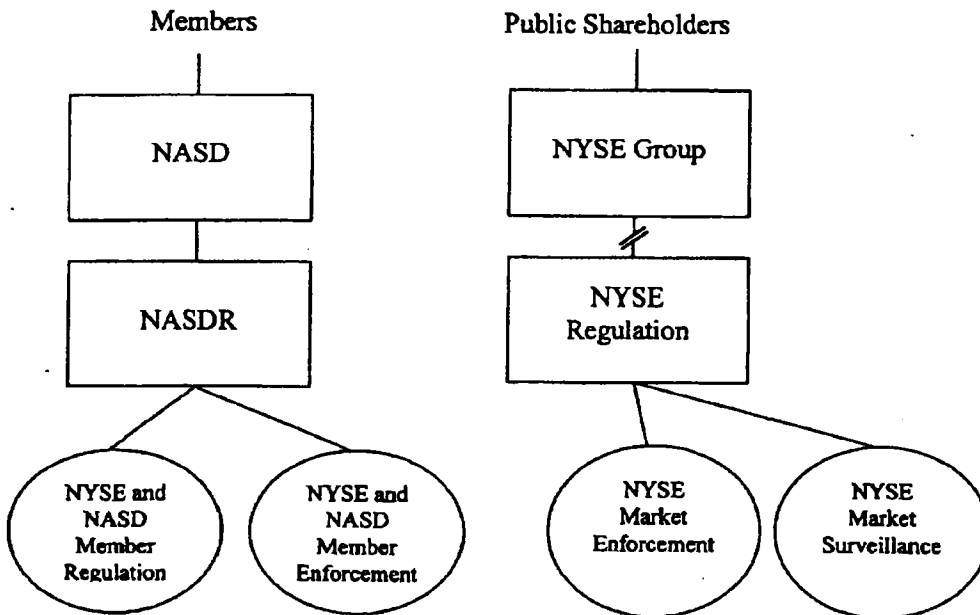
- Change of NASD's name to reflect combination;
- Elimination of one-member, one-vote governance;
- Adoption of class voting for Board Governors:
 - Three Governors for small members;
 - Three Governors for large members; and
 - Three Governors for other firms, including stock exchange floor members, independent dealers and investment companies; and
- Payment of \$[30,000] to each of NASD's 5,100 members.

Step Three: Transfer of Assets. Immediately after and in connection with Step Two, NYSE Regulation will transfer member-related assets to either NASDR or a newly created limited liability company of which NASD would be the sole member.

The assets transferred by NYSE Regulation would generally include the personnel and property it currently uses in its member regulation function, and the personnel and property it uses in the portion of its enforcement function that relates to members, but not to the market. NYSE Regulation would retain the personnel and property it uses in its market surveillance function, and the remainder of the personnel and property employed it uses in its enforcement function. We are not seeking a ruling as to the tax treatment of the transfer of assets by NYSE Regulation.

Resulting Structure

Following the recapitalization of NASD and transfer of assets by NYSE Regulation, the structures of NASD (which will be renamed) and NYSE will be as follows. Note that for illustration, we have shown NASDR as the recipient of the NYSE Regulation assets. As noted above, they may be transferred to an LLC wholly owned by NASD. Since the limited liability company would be treated as disregarded entity for all federal tax purposes, such a transfer would be treated as if it were to NASD.



Under separate cover for delivery on Monday, we are sending you copies of the 1999 ruling request for your convenience.



ement

	June 2005 Parent Only	June 2006 Parent Only	\$ Change	% Change
	19,901,512	30,724,002	10,822,490	54.38%
	(23,988)	(5,889)	18,007	-75.36%
	9,170,876	25,659,581	16,488,885	179.80%
	134,151,721	502,108,003	367,956,282	274.28%
	-	-	-	
	-	-	-	
	-	-	-	
	200,595,127	526,609,511	326,014,384	162.52%
	200,595,127	526,609,511	326,014,384	162.52%
	(89,690)	-	89,690	-100.00%
	200,505,437	526,609,511	326,104,074	162.64%

Report Request: ELIM1 EXTISP
 Layout: parent only income statement_2005_V3
 Layout Directory: Dept\Finance\End User Computing\EUC_GL\In\Vision Layouts\1
 Format: NASD Parent Only income statement - external reporting format

NASD
Parent Company Balance Sheet
30-Jun-06



	December 2006	June 2006	12/05 vs 6/06	12/05 vs 6/06
	Parent Only	Parent Only	\$ Change	% Change
Assets				
Cash and cash equivalents	126,443,147	146,176,897	15,733,751	10.84%
Investments - available for sale	1,774,898,648	2,360,180,977	585,284,328	24.80%
Investments - restricted				
Accounts receivable net	136,472,220	140,871,815	4,399,595	3.12%
Taxes Receivable and Current Deferred Tax				
Other current assets	13,119,333	12,113,802	(1,005,531)	-8.30%
Intercompany receivable	30,042,723	10,471,654	(19,571,069)	-188.90%
Current Assets Discontinued Operations				
Total Current Assets	2,083,974,071	2,668,825,145	584,851,074	21.81%
Land, building and improvements	93,297,753	101,821,502	8,523,749	8.37%
Data processing equipment and software	168,245,798	168,870,240	624,441	0.37%
Furniture, equipment & leasehold improvements	118,727,775	113,578,747	(5,149,028)	-4.53%
Work In Process	(0)	(0)	(0)	83.33%
Accumulated depreciation	380,271,328	364,270,488	3,999,162	1.04%
Net Fixed Assets	(233,479,611)	(233,939,278)	(459,667)	0.20%
	146,781,715	150,331,210	3,539,495	2.35%
Long Term Investments				
Long Term Restricted Investments				
Deferred Taxes				
Line of Credit Receivable	18,030,000	19,035,128	1,005,127	5.28%
Intangible Assets	1,700,325	1,094,288	(606,037)	-55.38%
Goodwill				
Other Long Term Assets	36,615,926	35,356,361	(1,259,566)	-3.58%
Long Term Assets Discontinued Operations				
Investments in consolidated subsidiaries	124,034,928	2,617,328	(121,417,600)	-4638.99%
Investments in affiliates	7,102,059	14,389,153	7,287,094	50.64%
Total Other Assets	187,483,238	72,492,258	(114,990,981)	-158.63%
Total Assets	2,418,249,025	2,881,648,613	473,399,588	16.37%
Liabilities and Equity				
Accounts payable and accrued expenses	31,280,547	41,326,316	10,045,768	24.31%
Accrued personnel costs	121,066,208	61,948,807	(59,117,401)	-95.43%
Deposits and renewals	55,484,739	31,708,662	(23,775,057)	-74.98%
Deferred revenue	61,051,526	131,268,745	70,217,219	53.48%
Deferred revenue SAB101				

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	12/05 vs 6/06 \$ Change	12/05 vs 6/06 % Change
42	(303,709)	-12.71%
98	115,792,667	42.42%
37	(4,328,468)	-11.81%
94	(183,267,226)	-1230.45%
18	(74,737,266)	-12.60%
78	11,198,553	26.70%
28	(154,378)	-0.93%
24	1,627,524	2.97%
96	(1,824,639)	-4.83%
58	10,847,060	7.18%
17	(63,890,226)	-8.58%
66	289,187,694	17.98%
84	-	-
92	23,637,332	17.95%
11	244,484,788	46.42%
8	537,289,815	26.02%
3	473,389,588	16.37%