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March 7, 2006

Internal Revenue Service
Courier's Desk
1111 Constitution Avenue, N.W.
Washington, D.C. 20044

Attention: CC:PA:LPD:PR (REG-100420-03)

Re: Proposed Book-Tax Conformity Safe Harbor

Ladies and Gentlemen:

This letter contains the comments of the International Swaps and Derivatives Association, Inc. ("ISDA") on the proposed regulations¹ issued by the Department of the Treasury and the Internal Revenue Service and published in the Federal Register for May 24, 2005.² The proposed regulations would provide an elective safe harbor that would enable dealers in over-the-counter derivatives ("OTC derivatives") and securities to satisfy the mark-to-market ("MTM") valuation requirement of section 475 of the Internal Revenue Code of 1986, as amended (the "Code") by using the MTM methods they use in valuing such instruments on their relevant financial statements.

¹ Proposed regulation section 1.475(a)-4.

² 70 Fed. Reg. 29,663 (May 24, 2005).

I.

Preliminary Statement

ISDA is an international organization, and its more than 670 members in 50 countries include the world's leading dealers and traders in OTC derivatives. ISDA has long supported the development of a book-tax conformity safe harbor under section 475. As ISDA has discussed in its prior submissions on this issue,³ a book-tax conformity safe harbor of the type contemplated by the proposed regulations will (1) carry out the intent of Congress; (2) result in an appropriate determination of fair market value under section 475 in accordance with applicable tax principles; (3) clearly reflect a taxpayer's income; (4) reduce administrative burdens for both the Service and taxpayers; and (5) reduce the risk that income from global trading activities would be overtaxed or undertaxed.

For these reasons, we welcome on behalf of ISDA the issuance of the proposed regulations. We commend the Treasury and the Service for pursuing this important initiative to facilitate the ability of our members to comply with, and the Service to administer, the MTM requirements of section 475. Although, as discussed in subsequent portions of this letter, we support certain changes to the proposed regulations, those changes are in our view consistent with the basic principle on which the proposed safe harbor is based; namely, that, for purposes of section 475, the Service will accept a taxpayer's valuations of "eligible positions" if the taxpayer can establish that those valuations are generally consistent with section 475 and are used for substantial non-tax purposes to demonstrate their reliability. We hope that the Treasury and the

³ ISDA's earlier recommendations to the Treasury and the Service are set forth in letters dated August 4, 2003, May 9, 2000 and September 21, 1999. The complete texts of these letters are available on ISDA's website at www.isda.org.

Service will act expeditiously to finalize the proposed safe harbor, and we are committed to its effective implementation on an ongoing basis.

II.

Comments on the Proposed Regulations

A. Concurrence with SIA Recommendations.

In addition to our comments in section B below, we have also reviewed the comments on the proposed regulations submitted by (i) the Securities Industry Association (the “SIA”) on July 13, 2005 and August 17, 2005 (collectively the “SIA Letters”), (ii) the Institute of International Bankers on September 13, 2005 (the “IIB Letter”), and (iii) the American Bar Association on December 7, 2005 (the “ABA Letter”). We generally concur in both the administrative and substantive recommendations contained in these comment letters. Specifically, we recommend as follows:

1. Section 1.475(a)-4(k)(2)(A) of the proposed regulations should be modified to limit the information taxpayers must provide to reconciliation schedules and related information necessary to establish that the values on the taxpayer’s applicable financial statement are consistent with the values on the taxpayer’s tax return and otherwise meet the requirements of section 475.

2. Taxpayers should have 60 days to respond to requests for information by the Service with respect to the safe harbor.

3. Section 1.475(a)-4(k)(2)(B) of the proposed regulations, which permits portfolio valuation adjustments, should be revised to delete the condition that a taxpayer must demonstrate that it can compute gain or loss with respect to each individual eligible position. In lieu of that condition, taxpayers could be required to demonstrate that a portfolio adjustment is attributable to the characteristics of the individual positions within the pool at the time such adjustment is made.

4. The exception for eligible positions traded on a “qualified board or exchange” from the general rule in section 1.475(a)-4(d)(3)(i) of the proposed regulations, which prohibits MTM values “at or near” the bid or ask values, should be expanded to include liquid OTC markets for physical securities (e.g., “established financial markets” within the meaning of section 1.1092(d)-1(b)). In addition, there should be no requirement that MTM values of OTC derivatives be confined to any range other than their bid-ask spreads.

5. Section 1.475(a)-4(d)(2)(ii) of the proposed regulations should be modified to eliminate the requirement that changes in the value of eligible positions be recorded on the taxpayer's income statement and thus extend the safe harbor to cases where the changes in value are recorded as "other comprehensive income" on a balance sheet or are included in "call reports" filed with the Federal Reserve or the Office of the Comptroller of the Currency.

6. Sections 1.475(a)-4(d)(2)(iv) and -4(h) of the proposed regulations, which limit the safe harbor to those cases where the applicable financial statements are prepared in accordance with U.S. GAAP, should be modified to at least authorize the Service to include (through notice or otherwise) non-U.S. mark-to-market accounting standards that are found to be "sufficiently consistent" with section 475 for purposes of the safe harbor.

B. Additional Comments on the Proposed Regulations

1. GAAP MTM Changes Not Shown on Applicable Financial Statement. As discussed above, we concur with the recommendation to delete the proposed regulation's requirement that changes in the value of an eligible position must flow through the income statement. We also urge the Treasury and the Service to include in the safe harbor eligible positions that are not marked to market on a taxpayer's applicable financial statement but are marked to market in accordance with GAAP fair value principles on the taxpayer's books and records.

For example, bank loans under U.S. GAAP must be recorded on the lender's balance sheet at the lower of cost or market value (referred to as "LOCOM"). Under LOCOM, a bank loan is initially recorded at its cost and then is only marked down if its fair value thereafter declines, but is never marked up if its fair value rises. In order to comply with LOCOM, a bank lender must necessarily determine on a regular basis the fair values of its loans (in order to ascertain whether any such loans have declined in value). Such valuations are performed in accordance with GAAP fair value principles, and increases in the fair values of such loans are

recorded in the bank's books and records, even if such increases are not reflected on the applicable financial statement.⁴

These MTM valuations are used by banks for significant business management purposes, such as measuring business unit profitability and market and credit risks for risk management and capital allocation purposes. We therefore believe that so long as a valuation of an eligible position is performed under GAAP fair value principles and all other proposed requirements for applicable financial statements are met (including documentation/recordkeeping requirements), the fact that the MTM value for an eligible position may not appear on an applicable financial statement should not preclude the use of such MTM value for purposes of the safe harbor.

2. International Financial Reporting Standards ("IFRS"). As also discussed above, we concur with the recommendation that the proposed regulations be modified to provide a mechanism for the designation in the future of accounting standards, other than U.S. GAAP that will be regarded as "sufficiently consistent" with section 475 for purposes of the safe harbor (as required by proposed section 1.475(a)-4(d)(2)(iv)). While we share the view that the finalization of the safe harbor should not be unduly delayed by the consideration of a wide range of alternative accounting standards, we do believe that special consideration should be given currently to including IFRS as an eligible method for purposes of the safe harbor.⁵

Many of ISDA's members are non-U.S. institutions that conduct their U.S. operations through a branch or subsidiary. As a result, such a branch or subsidiary could be an eligible taxpayer but have financial statements that are prepared in accordance with non-U.S. GAAP standards (because, for example, its financial results are reported by its non-U.S. home office or

⁴ The ABA Letter contained essentially the same comment.

⁵ The IIB Letter contained an extensive discussion of the reasons to include IFRS as an eligible method for purposes of the safe harbor.

its non-U.S. parent). At least where such an eligible taxpayer values its eligible positions in accordance with IFRS, as promulgated by the International Accounting Standards Board (the “IASB”), we believe that the safe harbor should apply, because the fair value principles prescribed under IFRS are essentially the same as the fair value principles of U.S. GAAP and therefore “sufficiently consistent” with the requirements of section 475.⁶

3. Consolidated Groups. Proposed section 1.475(a)-4(h)(5) provides that if a taxpayer is a member of a consolidated group, the “primary financial statement of the taxpayer is the primary financial statement of the common parent (within the meaning of section 1504(a)(1)) of the consolidated group.” While this proposed rule generally makes sense for eligible taxpayers that are members of a consolidated group for which the common parent has a primary financial statement (as defined in proposed section 1.475(a)-4(h)(2)), it does not work for a taxpayer whose common parent does not have a primary financial statement. For example, an eligible taxpayer may be a member of a consolidated group where a lower-tier parent (not the common parent) has a primary financial statement. We do not see any reason that the proposed consolidated group rule must be limited to common parents — the primary financial statement of any parent of the eligible taxpayer whose primary financial statement includes the financial results of the taxpayer should qualify as the primary financial statement for the eligible taxpayer.

⁶ In footnote 14 of the SIA letter of August 17, 2005, the SIA noted that the European Union has limited the scope of the application of International Accounting Standard 39 (“IAS 39”), the standard under IFRS governing fair value accounting for financial instruments, to listed companies within its jurisdiction. We do not believe that such limitations in the scope of the applicability of IAS 39 bear upon the fundamental issue of whether the fair value standards under IFRS are sufficiently consistent with section 475. Rather, the European Union’s limitations merely create differences in the scope of MTM accounting between IFRS and section 475, which differences also exist between U.S. GAAP and section 475.

III.

Ensuring the Success of the Safe Harbor

As the Treasury and the Service are aware, we have been an active advocate of a section 475 safe harbor for OTC derivatives based on book-tax conformity, and we commend the Treasury and the Service for their decision to provide such a safe harbor. We strongly believe that the constructive and transparent process that led to the issuance of the proposed regulations should continue once the safe harbor is finalized so as to ensure its success in an environment where many U.S. derivatives dealers and traders are affiliates of non-U.S. firms and where convergence of global accounting standards is a goal of financial regulators and standard setters.

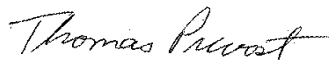
To this end, we will have our global tax and accounting committees develop an appropriate mechanism to address on an ongoing basis certain policy, technical and administrative issues raised by the safe harbor. We will of course reach out to others in the private sector and will, as appropriate, seek meetings with the Treasury and the Service to discuss ongoing and emerging issues that will bear on the ongoing success of the proposed safe harbor.

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We appreciate the opportunity to comment on the proposed safe harbor regulations and stand ready to respond to any questions representatives of the Treasury and the Service may have.

Very truly yours,

Thomas Prevost



Chair, ISDA North America Tax Committee
Managing Director and Americas Head of Tax
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Robert Pickel



ISDA Executive Director and
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cc: Dale S. Collinson, Special Counsel to the Associate Chief Counsel (Financial Institutions & Products), Internal Revenue Service
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