

ISDA

International Swaps and Derivatives Association, Inc.
360 Madison Avenue, 16th Floor
New York, NY 10017
United States of America
Telephone: (212) 901-6000
Facsimile: (212) 901-6001
email: isda@isda.org
website: www.isda.org

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Internal Revenue Service

**Attn: CC:ITA:RU (REG-103735-00; REG-154117-02; REG-154116-02; REG-154115-02;
REG-154423-02; REG-154426-02; REG-110311-98)**

Room 5226

P.O. Box 7604 - Ben Franklin Station
Washington, DC 20044

**Re: Additional Comments by ISDA Relating to the Tax Shelter Regulations Issued on
October 22, 2002 and Amended by Notice 2003-11**

In a letter dated December 2, 2002 (the *December 2002 letter*), the International Swaps and Derivatives Association, Inc. (*ISDA*) commented on the disclosure rules under section 6011 and the list-maintenance rules under section 6112, both issued on October 22, 2002 (the *October 2002 temporary regulations*) and later amended by Notice 2003-11. As discussed in the December 2002 letter and as is still true today, ISDA supports the Internal Revenue Service (the *IRS*) and the Treasury's efforts to curb tax abuse, and accordingly, recommends that certain amendments be made to the October 2002 temporary regulations that will enable the IRS to more accurately target potentially abusive transactions (and their material advisors) while eliminating the disclosure and list-maintenance requirements associated with routine, non-potentially-abusive transactions occurring in the ordinary course of business. This letter further highlights some of ISDA's concerns. As an initial matter, ISDA expresses its appreciation for the amendments made by Notice 2003-11 to certain effective dates contained in the October 2002 temporary regulations.

ISDA is the global trade association representing leading participants in the privately negotiated derivatives industry, a business which includes interest rate, currency, commodity, credit, and equity swaps as well as related products such as caps, collars, floors, and swaptions. ISDA was

chartered in 1985, and today numbers over 600 member institutions from 46 countries on six continents. These members include most of the world's major institutions who deal in, and leading end-users of, privately negotiated derivatives as well as associated service providers and consultants.¹

A. SUMMARY OF ADDITIONAL COMMENTS BY ISDA

In addition to the recommendations made by the December 2002 letter, ISDA respectfully recommends the following:

I. Effective Dates with respect to "Listed" Transactions

- Material advisors should not be required to maintain lists on account of any transaction (not otherwise requiring a list to be maintained) becoming a "Listed" transaction more than two years after the date on which such transaction was entered into.

II. The Disclosure Rules under Section 6011

Indirect Participation

- The definition of "indirect participation" under Treasury Regulation § 1.6011-4T(c)(3) should be amended to apply only when a taxpayer receives a tax benefit from the transaction, which is the benefit (or among the benefits) that is the reason for the transaction being reportable.

Confidential Transactions

- The safe-harbor presumption for non-confidential transactions should be amended to properly include certain transactions that are entered into after January 1, 2003 but for which discussions commenced prior to January 1, 2003, by allowing persons, making or providing statements about the potential tax consequences that may result from the transaction, to separately send retroactive "written authorizations to disclose," within 60 days of the date on which final regulations are filed, that will be given the same effect as if such authorizations were sent at the commencement of discussions occurring prior to January 1, 2003.
- The term "taxes" should be uniformly defined to include only U.S. federal income taxes (and thus, to exclude foreign and state taxes) for all reportable transactions, including confidential transactions.
- For purposes of determining whether a transaction is a confidential transaction under Treasury Regulation § 1.6011-4T(b)(3), the phrase "structure or tax aspects" should be replaced by the phrase "tax aspects or elements of the structure relevant to the tax analysis."

¹ For further information on ISDA, please consult our website at <http://www.isda.org>.

III. The List-Maintenance Rules Under Section 6112

- In order to add a “materiality” component to the definition of a “material advisor,” ISDA now proposes a two-prong approach. First, assuming that the fee requirement is otherwise met, all tax statements made by “professional tax advisors,” i.e., lawyers (and law firms), accountants (and accounting and professional service firms), and any other persons in the business of giving accounting or tax advice would make such a person a “material advisor”. This first prong would cover the vast majority of relevant transactions. Second, a statement made by a person who is not a “professional tax advisor” would make such a person a “material advisor”, again assuming that the fee requirement is otherwise met, if and only if such statement indicates that it was reviewed by, based on the advice of, was originally made by, or otherwise refers to a statement made by, a professional tax advisor and is related to the reason the transaction is reportable.
- In regards to the list’s content, a material advisor should only be required to retain those items, enumerated in Treasury Regulation § 301.6112-1T(e)(3)(i), that it knows, or has reason to know, at the time of the transaction.

B. DISCUSSION

I. Effective Dates

On October 22, 2002, the IRS and the Treasury issued the October 2002 temporary regulations that amended existing tax shelter regulations. These amendments related primarily to the disclosure rules for reportable transactions under section 6011 and the list-maintenance rules for “material advisors” of potentially abusive tax shelters under section 6112.² Generally, the October 2002 temporary regulations applied to transactions entered into on or after January 1, 2003, although the list-maintenance rules applied to transactions in which interests were acquired on or after that date as well as to transactions entered into on or after February 28, 2000 that subsequently became “Listed” transactions subject to the disclosure regulations.³

On January 17, 2003, the IRS issued Notice 2003-11, which made various modifications to the effective dates of the October 2002 temporary regulations. For purposes of the disclosure rules under section 6011, Notice 2003-11 permits taxpayers who enter into transactions on or after January 1, 2003 but before the filing date of the revised regulations, to elect to apply the revised regulations instead of the October 2002 temporary regulations. Likewise, for purposes of the list-maintenance rules under section 6112, Notice 2003-11 generally changes the effective date of such rules from January 1, 2003 to the future filing date of the revised regulations, subject to a carve-out for “Listed” and “section 6111 shelter” transactions as defined in Treasury Regulation § 301.6112-1T(b)(1) of the October 2002 temporary regulations. Under Treasury Regulation § 301.6112-1T(j), this carve-out effectively requires material advisors to maintain certain lists of

² See generally Treasury Regulations §§ 1.6011-4T & 301.6112-1T.

³ Treasury Regulation § 1.6112-1T(j).

transactions that they promote and that are entered into on or after February 28, 2000, if such transactions become “Listed” transactions on or after January 1, 2003.

Material Advisors Should Not Be Required to Maintain Lists on Account of any Transaction (Not Otherwise Requiring a List to be Maintained) Becoming a “Listed” Transaction More Than Two Years After the Date on Which Such Transaction was Entered Into.

Although ISDA applauds the amendments made to the effective dates of the October 2002 temporary regulations, ISDA recommends that the effective dates of the list-maintenance rules be further modified. As written, the list-maintenance rules could potentially apply retroactively to “Listed” transactions commencing several years prior to the date on which they become “Listed”. For example, a taxpayer could enter into a transaction (not otherwise requiring a list to be maintained) in March 2000 and the IRS could list the transaction in January 2006, causing the transaction to become subject to the list-maintenance rules. In such a case, the material advisors may not have retained all of the information necessary to comply with the list-maintenance rules because, at the time they gave the advice relating to the transaction, they were unaware that the transaction would later become “Listed”.

Dealers in securities and derivatives often maintain their transaction files based on who the customer/counterparty is, not the transaction type. This is particularly true where a transaction is part of a larger transaction, which will often be the case with dealers in securities and in derivatives. Further, there is substantial turnover of personnel in the dealer community so that institutional knowledge of transactions as a practical matter tends to diminish over time. Thus, even where a dealer has raw information in its files, after a period of time it may not be able to locate it if the sole basis for identifying the information is the transaction type of a larger transaction.

Accordingly, ISDA recommends that the potential retroactive application of the list-maintenance rules be limited with respect to transactions that subsequently become “Listed”. ISDA proposes that material advisors should not be required to maintain lists with respect to any transaction entered into more than two years prior to the date on which such transaction becomes a “Listed” transaction. For example, if a material advisor is involved in a transaction that is entered into on February 1, 2001, it should only be subject to the list-maintenance rules with respect to that transaction if such transaction becomes a “Listed” transaction on or before February 1, 2003.

II. The Disclosure Rules Under Section 6011

The disclosure rules under section 6011 require, in general terms, that every taxpayer that participates, either *directly or indirectly*, in a “reportable transaction” must attach a disclosure statement to its federal income tax return for each taxable year, in which its federal income tax liability is affected by its participation.

1. Indirect Participation

The Definition of “Indirect Participation” Should Be Amended to Apply Only When a Taxpayer Receives the Tax Benefit (or is among the Tax Benefits) that is the Reason that the Transaction is Reportable.

Treasury Regulation § 1.6011-4T(c)(3) provides that: “A taxpayer will have indirectly participated in a reportable transaction if the taxpayer's Federal tax liability is affected ... by the transaction even if the taxpayer is not a direct party to the transaction” Many persons, particularly banks and securities/derivatives dealers, earn income, such as interest income, income from writing notional principal contracts, and income from selling securities in the ordinary course of their business, that is not tax “favored” and does not provide any of the tax benefits that a transaction is intended to generate for investors. Under the disclosure rules, this income should not give rise to “indirect participation” but the language is not entirely unambiguous. Thus, ISDA recommends that the definition of “indirect participation” be clarified to apply only when a taxpayer receives a tax benefit that is the benefit (or among the benefits) that is the reason the transaction is reportable. For example, such benefit might include the item resulting in a "significant book-tax difference;" a "section 165 loss" causing the transaction to be a "loss transaction;" or a tax credit causing the transaction to have a "brief asset holding period." For confidential transactions, which do not require a tax benefit, this rule would not apply.

2. Confidential Transactions

Reportable transactions are transactions that fall into one of six categories, including: confidential transactions, transactions with contractual protection, loss transactions, transactions with a significant book-tax difference, transactions involving a brief asset holding period, and “Listed” transactions. Under the disclosure rules, a “confidential transaction” is defined as “a transaction that is offered under conditions of confidentiality.”⁴ The disclosure rules go on to further delineate when a transaction is considered to be offered under conditions of confidentiality.

(i) The “Written Authorization to Disclose” Presumption Should Be Broadened to Include Transactions With Pre-2003 Discussions.

The disclosure rules carve out a safe-harbor presumption, which provides that a transaction is not a confidential transaction if every person, making or providing statements about the potential tax consequences that may result from the transaction, sends “written authorizations to disclose” to the taxpayer.⁴ The regulations, however, state that “[t]his presumption is available only in cases in which the written authorization to disclose is effective ... from commencement of discussions.”⁵ Although not entirely clear, this presumption appears to be unavailable for a

⁴ Treasury Regulation § 1.6011-4T(b)(3).

⁴ Treasury Regulation § 1.6011-4T(b)(3)(iv).

⁵ *Id.*

transaction unless every person, making or providing statements about the potential tax consequences that may result from the transaction, sends a written authorization to disclose to the taxpayer on or about the time discussions relating to the transaction begin. As such, one quirk with this very limited presumption is that it necessarily excludes transactions that are entered into after January 1, 2003 but for which discussions relating to this transaction began prior to the effective date of the October 2002 temporary regulations (and perhaps, prior to any awareness that written authorizations to disclose were even required to satisfy this presumption). Accordingly, ISDA recommends that the presumption be amended to properly include such transactions with pre-2003 discussions by allowing persons, making or providing statements about the potential tax consequences that may result from the transaction, to separately send, within 60 days of the final regulations being filed, “retroactive” written authorizations to disclose that will be given the same effect as if such authorizations were sent at the commencement of the discussions occurring prior to January 1, 2003.⁶

(ii) The Scope of the Term “Taxes” Should Be Uniformly Defined to Include Only U.S. Federal Income Taxes.

The IRS and Treasury have informally announced their intentions to define “taxes” for purposes of the disclosure rules to mean U.S. federal income taxes; however, in the narrower context of confidential transactions, their intentions are to define the term “taxes” to also include state and foreign taxes. ISDA recommends that the term “taxes” be uniformly defined to include only U.S. federal income taxes for all reportable transactions, including confidential transactions.

Broadening the term “taxes” beyond U.S. federal income taxes appears unnecessary and may impose unrealistic demands on ISDA’s members. For example, assume that a German branch of, or German subsidiary of, a U.S. bank along with a German resident structure a transaction that is in no way connected to the United States. Assume further that various aspects of how the transaction is taxable under German law are kept confidential. In such a case, the U.S. bank will be forced to report the transaction because the U.S. bank will be considered to have participated, either directly (via the branch) or indirectly (via the subsidiary), in a “confidential transaction” under Treasury Regulation § 1.6011-4T(b)(3). In this way, the disclosure rules may place ISDA’s members into the unseemly position of having to police persons and transactions that have absolutely no nexus to the United States. This may also place U.S. banks and securities dealers at a competitive disadvantage since disclosure that an item is a reportable transaction for U.S. tax purposes (while not substantively relevant) may be a reason for investors to enter into transactions with banks and securities dealers that are not U.S. persons or subsidiaries of U.S. persons.

ISDA understands that the concern here is that if material advisors are allowed to place a veil of confidentiality around the state and/or foreign tax aspects of a transaction, they may attempt to

⁶ Because it is may not be possible for one person to compel another person to retroactively waive confidentiality, these written authorizations to disclose should be separately effective for each person required to send them. Thus, if a transaction is determined to be offered under conditions of confidentiality, the disclosure rule should apply to, and only to, those persons that fail to send retroactive written authorizations to disclose.

further spread the veil over the U.S. federal tax aspects of a transaction as well. The October 2002 temporary regulations, however, state that whether a transaction is confidential is determined on the basis of all of the facts and circumstances.⁷ Accordingly, ISDA believes that if the confidentiality of state and/or foreign tax aspects of a transaction is used as a means of limiting the disclosure of the U.S. federal income tax aspects of the transaction, the transaction would nonetheless be confidential under the October 2002 temporary regulations, even if the term “taxes” is uniformly limited to U.S. federal income taxes. Thus, ISDA urges that the revised regulations adopt a uniform definition of “taxes” and that such definition be limited to U.S. federal income taxes. The regulations could include an example that clarifies how the rule works in this context if it were deemed helpful to clarify the issue.

(iii) The Phrase “Structure or Tax Aspects” Should Be Replaced by the Phrase “Tax Aspects or Elements of the Structure Relevant to the Tax Analysis.”

In determining when a transaction is offered under conditions of confidentiality, the regulations look to whether there are limitations on the disclosure of the “structure or tax aspects” of the trade.⁸ Unfortunately, the term “structure” is exceedingly broad and arguably includes aspects of a transaction that are not relevant to the tax considerations of the transaction but would nonetheless be considered sensitive information (for example, models used in pricing the transaction). Accordingly, ISDA recommends that the phrase “structure or tax aspects” be replaced by the phrase “tax aspects or elements of the structure relevant to the tax analysis.” This substitution will allow material advisors to properly keep both trade secrets as well as other sensitive information, not relevant to the tax considerations of the transactions, privy to the appropriate parties.

III. The List-Maintenance Rules Under Section 6112

For purposes of the list-maintenance rules under section 6112, the term “material advisor” is broadly defined as any person who (i) receives, or expects to receive, at least a specified minimum fee in connection with a transaction that is a potentially abusive tax shelter; and (ii) makes or provides any statement, oral or written, to any person as to the potential tax consequences of that transaction.⁹ In the December 2002 letter, ISDA noted that the definition of “material advisor” hinges almost exclusively on the fee arrangement, regardless of the materiality of the advice given. Arguably, answering a routine question over the phone or using after-tax profits and losses in demonstrating the economic effects of a transaction would trigger the definition of material advisor so long as there is otherwise a minimum fee present. Thus, ISDA recommended that the promoter regulations be amended to incorporate a “materiality” component in the definition of “material advisor.”

(i) For Purposes of Determining Whether a Statement Made by a Material Advisor is “Material,” a Two-Prong Approach Should Be Used.

⁷ Treasury Regulation § 1.6011-4T(b)(3)(i).

⁸ *Id.*

⁹ Treasury Regulation § 301.6112-1T(c).

In order to add a “materiality” component to the definition of a “material advisor,” ISDA now proposes a two-prong approach. First, assuming that the fee requirement is otherwise met, all tax statements made by “professional tax advisors,” i.e., lawyers (and law firms), accountants (and accounting and professional service firms), and any other persons in the business of giving accounting or tax advice would make such a person a “material advisor”. This first prong would cover the vast majority of relevant transactions. Second, a statement made by a person who is not a “professional tax advisor” would make such a person a “material advisor”, again assuming that the fee requirement is otherwise met, if and only if such statement indicates that it was reviewed by, based on the advice of, was originally made by, or otherwise refers to a statement made by, a professional tax advisor and is related to the reason the transaction is reportable. Thus, for example, assuming that the fee requirement is met, if a marketer states that certain tax benefits are based on the advice of tax counsel and the tax benefits are the reason the transaction is reportable, under the second prong, the marketer would be considered a “material advisor.” On the other hand, a trader making off-the-cuff tax remarks would not be considered a “material advisor,” even if the fee requirement is otherwise met.

ISDA believes this revised definition of material advisor will still be broad enough to impose the list-maintenance requirements on persons who promote potentially abusive transactions, while taking the compliance burden off persons who make general tax-related statements but who are not providing material tax advice in furtherance of a transaction.

(ii) A Material Advisor Should Be Required to Retain a List of Certain Items Only If It Knows or Has Reason to Know of Such Items.

As a business matter, a transaction for tax shelter purposes may be comprised of several separate transactions. For example, a transaction may be comprised of a single purpose investment vehicle (such as a partnership), an acquisition of one or more investment assets, and one or more hedges. A person that is a material advisor may participate only in one of the components and may not even be aware of the other components of the transaction. This is often the case with dealers in derivative instruments. Further, even where a material advisor may have a general awareness of a larger transaction, it may not have access to the documents and other information that the list-maintenance rules require it to retain. For example, a dealer may have information about its customer, i.e., the investment partnership that is the counterparty to its hedge, but may not know, or have reason to know, the participants in the larger transaction, i.e., the partners in that partnership. Thus, ISDA recommends that a material advisor only be required to retain a list of the items, enumerated in Treasury Regulations § 301.6112-1T(e)(3)(i), that it knows, or has reason to know, at the time of the transaction.

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Thank you for this opportunity to provide further comments. We would welcome the opportunity to speak with you further on these matters and would be happy to provide you with further explanations of any of the points raised in this letter. Please feel free to call David Nirenberg at (212) 506-5085 or Thomas Prevost at (212) 325-7486.

Sincerely,



Thomas Prevost
Chair, North American Tax Committee

Ruth Ainslie
Senior Policy Director, ISDA

cc: Pamela Olson
Acting Assistant Secretary (Tax Policy)
Department of the Treasury

Barbara Angus
International Tax Counsel
Department of the Treasury

Eric Solomon
Deputy Assistant Secretary for Regulatory Affairs
Department of the Treasury

Helen M. Hubbard
Tax Legislative Counsel
Department of the Treasury

B. John Williams
Chief Counsel
Internal Revenue Service

Lon Smith
Associate Chief Counsel
Internal Revenue Service

Michael Novey
Associate Tax Counsel
Department of Treasury

Viva Hammer
Tax Litigation Counsel
Department of Treasury

Jeff Paravano
Senior Advisor for Tax Policy
Department of Treasury

Julian Kim
Advisor for Tax Policy
Department of Treasury