International Swaps and Derivatives Association, Inc.
360 Madison Avenue, 16th Floor
New York, NY 10017
United States of America
Telephone: 1 (212) 901-6000
Facsimile: 1 (212) 901-6001
email: isda@isda.org
website: www.isda.org

March 25, 2011

Karl Walli, Esq.
Senior Counsel - Financial Products
United States Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220

Dear Karl:

I am writing on behalf of the North American Tax Committee (the "NATC") of the International Swaps and Derivatives Association ("ISDA") with comments on selected issues relating to regulations to be issued by the Treasury Department pursuant to Section 871(m) of the Internal Revenue Code of 1986, as amended (the "Code").[1] The selected issues represent those that NATC members believe have the potential to have the most significant practical impact on the market for equity derivatives. Accordingly, NATC members agree that it is important for the Treasury Department to address these issues by establishing clear rules that may be applied consistently across the industry. Although in some instances there may be a diversity of views as to how best to address the selected issues, NATC members agree that the proposals contained herein represent a workable approach to these issues that adequately implements the purpose of Section 871(m).

The NATC's primary concern is the manner in which the Treasury Department may exercise its regulatory discretion to define the categories of transactions that are treated as specified notional principal contracts ("SNPCs") and that will be subject to withholding taxes on "dividend equivalent payments." This can occur either by an immediate exercise of regulatory authority or by refraining from exercising regulatory authority that is necessary to prevent virtually all equity swap transactions from becoming SNPCs after March 18, 2012. We believe that the Treasury Department's overall approach in issuing regulations should be to prevent foreign counterparties from avoiding a dividend

[1] Unless otherwise specified, section references are to the Code. References to regulations are to the Treasury regulations promulgated thereunder.

withholding tax by risklessly converting a physical position in a security to a synthetic position over dividend payment dates and then back to a physical position. Accordingly, we believe the current provisions of Section 871(m), as clarified and augmented in the manner we discuss in further detail below, adequately address inappropriate U.S. dividend withholding tax avoidance.

The remainder of this letter assumes that the Treasury Department will not choose to expand the scope of Section 871(m) beyond its current boundaries. Should that not be the case, most of the suggestions herein would need to be fundamentally reevaluated in the context of whatever the expanded scope may be, and we would respectfully request an opportunity to meet with you.

Summary of Recommendations

1. The Treasury Department should not expand, by action or inaction, the categories of SNPCs beyond those that have the characteristics (such as “crossing”) currently enumerated in Section 871(m).

2. Swaps on certain types of indices should be excluded from the scope of Section 871(m).

3. To avoid inappropriate “cascading” of withholding taxes, mechanisms created by Notice 2010-46 should be applied interchangeably to actual dividends, dividend equivalent payments with respect to SNPCs and substitute dividends. If the Treasury Department chooses not to adopt this recommendation, at a minimum, rules should be provided to prevent cascading of withholding taxes that might occur in connection with certain transactions involving back-to-back swaps between affiliated broker-dealers.

4. A withholding agent that receives representations in ISDA documentation should be entitled to rely on those representations in connection with discharging its responsibilities as withholding agent. The ability to do so would be particularly useful with respect to the issue of whether a “transfer” has occurred in connection with the entering into or termination of a swap.

5. Consistent with the first recommendation, the term of the swap should not be added to the criteria that would cause a swap to be treated as an SNPC.

6. The recently proposed regulations under Section 1273, clarifying when property is “traded on an established securities market,” should be used for the purpose of defining the meaning of “readily tradable on an established securities market” for purposes of Section 871(m).

7. Clear definition should be given to the term "transfer" for purposes of Section 871(m)(3). In addition, special rules should be provided to address the meaning of "transfer" in connection with a swap on an index.

8. The types of swaps that are treated as SNPCs generally should be confined to those that provide "delta one" exposure to the underlying equity securities. Similarly, transactions other than swaps, such as forward and futures contracts, generally should be included as SNPCs under regulations only if the transactions give delta one exposure to the underlying equity securities.

9. Clarification is needed regarding the treatment of dividend equivalent payments under treaties and for purposes of Section 892. We recommend that dividend equivalent payments be treated as dividends for purposes of all treaties and for purposes of Section 892. We also recommend that recipients of dividend equivalent payments that are subject to withholding be permitted to claim the benefits of an applicable treaty without supplying a TIN under the same conditions that a recipient of an actual dividend on the underlying security could do so.

10. The term "dividend equivalent" should be clarified to mean the amount that the long party to an SNPC would not have received or been credited but for payment of an underlying dividend, and that such amount should be determined at the moment of such receipt or credit. Withholding or remittance by the short party to the SNPC with respect to the dividend equivalent should not be required prior to the next date on which a payment under the swap is made.

11. The use of an underlying security as collateral posted by the short party to the long party is not indicative of tax avoidance. To avoid possible interference with normal business practices involving the pledge of portfolios of stock to a prime broker, regulations should eliminate this feature as one that causes a swap to be treated as an SNPC or otherwise specify the particular fact pattern of concern.

12. There should be clarification regarding whether or to what extent swaps executed on an electronic platform should be treated as SNPCs. The NATC believes that a swap should not be treated as an SNPC solely by reason of its having been executed on an electronic platform.

Swaps on Equity Indices

Exclusion of Certain Indices

The NATC believes that it is appropriate to exclude certain indices from the scope of Section 871(m). An index generally is meant to reflect a market sector or segment, and

components of the index (including additions and deletions of those components) are not within the control of the investor wishing to gain exposure to such sector or segment. As such, market participants enter into index swaps primarily for the economic exposure to the index, and also for credit, leverage and other significant non-tax reasons. This is evidenced by the large number of index swaps effected with tax indifferent long parties, such as pension funds. An index swap used for sector trading does not facilitate tax avoidance. Moreover, we note that if an index swap were considered to be an SNPC, withholding tax administration could become exceedingly complex, particularly for indices with large numbers of dividend paying securities.[2]

For the foregoing reasons, the NATC recommends that regulations create a concept of a "qualified index" and exempt swaps on any such qualified index from the application of Section 871(m).[3] The definition of qualified index would have two components. First is the definition of "index." We recommend defining an index as (i) a measure of a portfolio of stocks that are chosen to reflect the changing value of a certain market, industry, market sector, geographical sector, combination thereof, or similar segment of the market, (ii) the value of which is determined by reference to the prices of its constituent shares (calculated by reference only to the share value or also taking into account actual dividends paid on those shares), and (iii) that is modified or rebalanced at set intervals according to predefined objective rules (except, in customary limited circumstances, where adjustments must be made to eliminate ambiguities or to preserve the integrity of the index) to most accurately reflect the changing landscape of the particular market, industry, market sector, geographical sector, combination thereof, or similar segment of the market. The NATC believes an index should include not only the well known indices, but also proprietary indices established by market participants that are intended to achieve the same goals as the widely used indices, and the recommended definition would include both types.

The second part of the definition is what makes an index "qualified." We recommend defining a qualified index as any index (i) the value of which is published and publicly available, whether freely or by any license or similar arrangement, or (b) which is

---

2 If an index is not excluded from Section 871(m), unless there is clarification, there would be uncertainty in determining whether a "transfer" of and "underlying security" has occurred. This issue is discussed further below.

3 The exemption could be effected as a technical matter in different ways. One possibility would be to provide that a dividend equivalent does not include any amount paid with respect to any swap calculated by reference, in whole or in part, to a qualified index, but only to the extent the amount is attributable to the qualified index.

made available for use by multiple unrelated parties, and (ii) satisfies appropriate size and concentration tests.[4]

Cascading Withholding Issues in Equity Swaps

As discussed in our November 19, 2009 comment letter relating to the initial legislative proposal that eventually became Section 871(m), the withholding requirements for dividend equivalent payments under Section 871(m), like the withholding rules for securities lending transactions, create the potential for multiple impositions of withholding tax with respect to a single physical dividend payment. The potential for multiple withholding taxes is very real for a number of our members. In particular, it is common for a non-U.S. entity to enter into an equity swap with a non-U.S. dealer that in turn enters into an identical offsetting equity swap with an affiliated U.S. dealer.[5] In this situation, absent rules similar to the qualified securities lender and credit forward rules of Notice 2010-46, there would be the potential for multiple withholding taxes on a single economic trade if for some reason the swaps were SNPCs. Under Section 871(m), the Treasury Department has authority to prescribe rules on the tax treatment of dividend equivalent payments for purposes of chapters 1, 3 and 4 of the Code. In this regard, under Section 871(m)(2), dividend equivalent payments arising from stock loans, repurchase agreements ("repos") and SNPCs are treated similarly, and Section 871(m)(6) provides that the Treasury Department may publish guidance to reduce occurrences of over-withholding that may arise in chain of dividend equivalent payments.

---

[4] For size or concentration tests, the NATC suggests that it might be appropriate to look to the concentration tests set out in Section 3(a)(55) of the Securities Exchange Act of 1934 (which is referenced in Section 1256(g)(6) for purposes of determining whether index options should be treated as equity options). Although Regulation Section 1.246-5 uses 20 stocks as a minimum for constituting a "portfolio," we do not believe this would be an appropriate standard to use for purposes of defining a "qualified index." There are no fewer than 80 traded indices reflecting particular economic sectors that have fewer than 20 components. For example, the S & P Banks Index has 16 components, the S & P Chemicals index has 14 components, the S & P Pharmaceutical Index has 13 components, the Amex Utilities Index has 18 components, and the Philadelphia Housing Index has 19 components.

[5] Alternatively, a non-U.S. customer may have an outstanding physical short position under which it makes substitute dividend payments without withholding tax to a U.S. lender of the securities. The non-U.S. customer may wish to convert the physical short position into a synthetic short position and enters into a transaction with a non-U.S. broker-dealer under which the non-U.S. broker-dealer is the long party. (The customer may wish to do so to achieve better financing terms.) The non-U.S. broker dealer might borrow the stock from a U.S. affiliate as its hedge and deliver the stock to the non-U.S. customer, which in turn uses the stock to cover its original short position, thus arguably making the swap an SNPC. Under these circumstances, it is inappropriate to impose a withholding tax on dividend equivalent payments made under the SNPC, where no such tax would have been imposed if the non-U.S. customer had transacted directly with the U.S. affiliate of the broker-dealer.

The NATC believes that as a general matter of tax policy, actual dividends, substitute dividend payments and dividend equivalent payments made with respect to SNPCs (and therefore subject to US withholding tax) should be treated the same for all purposes of the "anti-cascading" provisions and that doing so would be consistent with the intent of Section 871(m)(6). The NATC also believes that the mechanisms put in place by Notice 2010-46 to prevent cascading of substitute dividend payments are well conceived and administrable. Accordingly, we believe that the principles of Notice 2010-46 should be adapted to apply to dividend equivalent payments under SNPCs as well as actual and substitute dividend payments, and that all three types of payments should be treated interchangeably in applying the anti-cascading provisions of that Notice. Treating all such payments in this manner also provides significant administrative benefits with regard to the development of operational systems and for tax information reporting purposes.

If our primary recommendation is not adopted, it is vitally important to the efficient conduct of the markets, at a minimum, to provide relief with respect to transactions where an affiliate is acting in a capacity similar to a qualified securities lender ("QSL") within the meaning of Notice 2010-46 and there is only one economic transaction. A typical example is like the one described above, where the U.K. affiliate of a U.S. broker-dealer enters into a swap transaction with a U.S. or non-U.S. customer, and then hedges the transaction by entering into an offsetting swap with the U.S. broker-dealer affiliate. The main reason for the back to back arrangement is that the customer has a preference or regulatory constraint, or even a desire for the convenience of being in the same time zone, that drives it to transact with the U.K. broker-dealer and not the U.S. affiliate. If for some reason the swaps were treated as SNPCs and no relief was given, there would be excess withholding taxes imposed with respect to what is in effect the same dividend equivalent payment. In particular, rules like those of Notice 2010-46 relating to QSLs should apply to the transaction such that the U.K. affiliate effectively can elect to be ignored. Accordingly, if our primary recommendation is not adopted, we recommend that regulations provide an exclusion from Section 871(m) for any swap between affiliated parties that can be matched with a swap, security lending, or repo transaction between one of those parties and an unrelated third party so long as one affiliate agrees to withhold and remit the tax appropriate to the ultimate third party recipient of the dividend equivalent.

Reliance on Representations in Documentation

One item of significant concern to NATC members is the potential withholding tax liability of the withholding agent if it fails to withhold on a swap that is determined to be an SNPC. In particular, if the term "transfer in connection with" is broadly defined (discussed further below), there is great potential for circumstances in which the short party would have no knowledge or reason to know whether such a transfer has occurred.

In those circumstances, it obviously would be unfair to hold the short party responsible for withholding since payments on a swap of that kind are based on the assumption that the short party will not have to withhold tax or pay any additional amounts on account of the withheld tax. Moreover, we assume that the Treasury Department is aware of the practical problems associated with the potential for withholding being imposed on a swap that only becomes an SNPC because of a transfer in connection with the termination of the contract. The unfairness to the potential withholding agent in this situation would be particularly acute if the withholding agent were not aware of the transfer taking place.

Accordingly, NATC members feel it is important for withholding agents to be able to rely on representations received from counterparties in order to relieve themselves of the obligation to withhold. A standard such as the one in Regulation Section 1.1441-7(b) which allows withholding agents to rely on documentation, unless they have actual knowledge or reason to know that the documentation is false, should be applied in the context of Section 871(m). An example of the type of representation that we would like a withholding agent to be able to rely on is contained in the ISDA Short Form Protocol.[6] We note that the Treasury Department has deemed representations in ISDA documentation to be acceptable documentation for a potential withholding agent in other circumstances.[7]

In this connection, it is important to clarify how the "reason to know" standard might be applied in the context of a broker-dealer with multiple trading desks that transacts with a customer that similarly has multiple trading desks. Although the particular circumstances may vary, it is entirely typical among broker-dealers for significant information barriers to be in place between trading desks that transact in physical securities and trading desks that transact in swaps. Accordingly, the NATC recommends that the reason to know standard be applied only by reference to the particular trading desk executing the relevant transactions and that there should be no presumption that knowledge of individuals on one trading desk is possessed by individuals on another trading desk.

Relevance of the Term of a Swap

Certain legislation proposed as a precursor to Section 871(m) indicates some concern that swaps with a relatively short term are somehow indicative of improper avoidance of tax on dividends.[8] In general, we agree that a riskless change from a physical

---

6 "Long Party represents that (A) it has not transferred and will not transfer the underlying security to Short Party in connection with its entering into such Transaction, and (B) it will not acquire the underlying security from Short Party in connection with the termination of such Transaction." *See* International Swaps and Derivatives Association, Inc., 2010 Short Form Hire Act Protocol (2010).

7 Reg. § 1.6041-4(a)(4)

8 S. Rep. No. 111-40, at p. 1746 (2010).

position to or from a synthetic position in an underlying security in a transaction that takes place in a short period around an ex-dividend date is indicative of tax avoidance. Such a transaction should be subject to Section 871(m) without regard to the term of the swap, as we expect it would be.

As a general matter, however, we see no reason to distinguish among swap transactions that otherwise are purely synthetic based solely on the length of time the swap is outstanding. A short term swap is not inherently different from a longer term in regard to the imposition of withholding tax on a foreign investor. Moreover, the market risk that an investor would have to take (in connection both with entering into and terminating a purely synthetic swap) is a significant deterrent against executing such a transaction for the purpose of avoiding withholding tax, since market movements could be more costly to the investor than any withholding tax avoided. Thus, absent other factors indicative of tax avoidance, a foreign investor who enters into a swap for only a short term has done no more or less to avoid U.S. withholding tax than an investor who maintains the swap for a longer term.[9] Accordingly, the NATC would be very concerned that any category of SNPC based on the term of a swap would be overinclusive, subjecting purely synthetic short term swaps to withholding when such trades do not involve tax avoidance.

In the case of short term swaps around an ex-dividend date, one factor potentially indicative of tax avoidance is the related dividend being an extraordinary dividend. In such a case, a non-US person might be more willing to accept market risk in connection with converting a physical to a synthetic position or vice versa in order to avoid the withholding tax on the extraordinary dividend since the absolute amount of the potential withholding tax by definition is larger than that associated with an ordinary dividend. Thus, we believe any rule using the term of a swap as a criterion for the swap to be treated as an SNPC should be confined to swaps that are entered into on or prior to and terminated after the ex-dividend date for an extraordinary dividend.[10]

If contrary to our suggestion, the Treasury Department intends to issue a rule that treats swaps of less than a certain minimum term as SNPCs, we request an opportunity to discuss the underlying concerns of the Treasury Department. In addition, we note that (1) any such rule would require a corresponding anti-hedging rule, since a client could, instead of terminating a short term position with its original dealer counterparty, enter into an

---

[9] In practice, a number of foreign investors currently choose to trade their equity strategies solely in derivative form, *i.e.*, they trade solely in swaps, not in the physical shares.

[10] The term "extraordinary dividend" of course would have to be defined. We would recommend using the definition in Section 1059 for this purpose. In addition to having the benefit of consistency, the definition used in Section 1059 represents Congress's determination of a bright line identifying the circumstances under which a dividend is sufficiently large for a taxpayer to take market risk in order to achieve a tax benefit.

offsetting position with another dealer,[11] and (2) there would need to be a significant effort made to adapt compliance systems to be able to properly identify swaps on which withholding was due and to implement systems that would allow the proper withholding to be made.[12] Hence, we would request that any rule of this nature have an effective date that is sufficiently prospective to allow the systems adjustment to take place.

Readily Tradable

Section 871(m)(3) defines an SNPC to include any notional principal contract if the underlying security is not "readily tradable on an established securities market." Section 871(m) does not, however, define that term.[13] The legislative history of Section 871(m) sheds no light on the intended meaning. Furthermore, the various statutory and regulatory provisions incorporating the phrase "readily tradable on an established securities market" and similar phrases, do not have consistent meanings. The definition of "readily tradable" is fairly consistent -- stock is "readily tradable" if it is regularly quoted by brokers or dealers making a market in the security. However, the term "established market" or "established securities market" differs among the provisions, depending upon the policy underlying each such provision. In some instances, a determination of fair market valuation for the security is primarily relevant to the policy of the statute, while in other instances, liquidity, or the ability to easily buy and sell, appears to be primarily relevant.

---

[11] We note that in such a situation, the original dealer is likely to be unaware of hedging transactions by the counterparty with another dealer, and it would be inappropriate to hold the original dealer responsible as a withholding agent if the original swap is deemed to be an SNPC.

[12] The identification of short term swaps is complicated, since clients increase and decrease swap exposure to particular names over time. Withholding systems typically do not keep track of which swap positions are terminated. The systems would need to be modified to do so in accordance with client preferences for terminating positions (*e.g.*, FIFO or LIFO).

[13] The phrase "readily tradable on an established securities market" is used nine times in the Code. See §§1(h)(11); 170(b)(2); 351(g)(2); 401(a)(28),(35); 409(l)(1); 453(f)(5); 664(g)(4); 871(m); 1042(c)(1); 2057(e)(2); 6166(b)(10). Oddly, despite the wide usage, only one applicable regulation provides any elaboration of the meaning of the phrase. Treasury Regulation Section 1.401(a)(35)-1 states that a security is "readily tradable on an established securities market" if it is traded on a national securities exchange registered under Section 6 of the Securities and Exchange Act, or traded on an officially recognized foreign securities exchange and the security is deemed by the SEC to have a "ready market" under SEC rule 15c3-1. This is a particularly narrow definition that we believe suits the specific purposes of section 401 and should not inform the interpretation of Section 871(m), however. In addition, substantially similar phrases are used in many other sections throughout the Code and respective Regulations: "readily tradable in an established securities market" (§ 453)(f)(5)); "regularly traded on an established securities market" (§§ 883(c), 884(e)(4), 897(c)(3)); "actively traded" (property for which there is an established financial market, § 1092); "publicly traded" (property traded on an established market, § 1273); "marketable stock" (regularly traded on a qualified exchange or other market, § 1296(e)); "traded on an established securities market" and "readily tradable on a secondary market" (§ 7704(b)).

As is the case with many of the other issues addressed in this letter, the primary concern of the NATC is that the Treasury Department provide clear and administrable rules. In that context, we call your attention to the Treasury Department's most recent pronouncement in an analogous area, the proposed regulations issued under Section 1273.[14] These proposed regulations, applicable for determining when property, including stock, is "traded on an established market," treat property as so traded when a trading price, sales price, or quoted price for the property is reasonably available.

The NATC recommends adopting the newly issued proposed regulations as a basis for defining "readily tradable" for purposes of Section 871(m). The concepts contained in the new proposed regulations are reflective of the workings of the modern marketplace and can be readily applied. Nonetheless, we acknowledge that the purposes of Section 871(m) are not necessarily the same as Section 1273. Accordingly, we recognize that some adaptation of the definition in the proposed regulations may be appropriate. In particular, the focus of Section 871(m) on dividend tax avoidance in agency-like arrangements arguably suggests that the term "readily tradable" as used therein should incorporate some concept of reasonable liquidity of the underlying security. If the Treasury Department is inclined to incorporate such a concept, we could envision a number of reasonable possible approaches, and we would be happy to discuss those possibilities with you.

Finally, in regard to application of the "readily tradable" requirement for a swap to avoid being treated as an SNPC, the NATC recommends that regulations clarify that the determination as to whether the requirement is met for a particular transaction should be made only at the time the transaction is entered into. The fact that circumstances beyond the control of the parties changed after a transaction is entered into should have no bearing on whether inappropriate avoidance of dividend taxation is taking place.

Definition of "Transfer"

Definition of Transfer Generally

The meaning of the term "transfer" as used in Section 871(m)(3)(A)(i) and (ii) is critical to the application of Section 871(m). We urge the Treasury Department to provide clear and comprehensive guidance regarding what arrangements will be considered to involve a "direct or indirect transfer" of an underlying security to a counterparty "in connection with" entering into or terminating a swap. In particular, we urge the Treasury Department to articulate the standards to be applied in any case where there is no clear answer. There appear to be differences in opinion among commentators regarding whether the hallmark of a "transfer" for purposes of Section 871(m) should be the existence of a

[14] Prop. Treas. Reg. § 1.1273-2, Fed. Reg. Vol. 76, No. 5, p 1101 (Jan. 7, 2011).

transaction in which the long party can sell its underlying security and establish a swap position on that security without market risk, or whether the hallmark should be some measurable likelihood that the short party was the actual purchaser of shares sold by the long party. Since swap transactions frequently use "market on open" ("MOO") and, even more so, "market on close" ("MOC") pricing, it is crucial for market participants to understand whether, or under what circumstances, transfers by a long party on an MOO or MOC basis in connection with entering into a swap at that price would be considered to constitute a transfer to a short party for purposes of Section 871(m). Clarification of this issue would be useful and appreciated.

In addition, there has been considerable discussion regarding whether swap transactions that use a guaranteed "volume weighted average price"[15] or "VWAP" facilitate improper tax avoidance and therefore should be treated as subject to Section 871(m). We believe that the mere fact that a swap transaction is priced based on guaranteed VWAP (either on execution or termination) is not suggestive of the swap facilitating inappropriate tax avoidance. We would be happy to discuss the issues relating to VWAP trades with you further.

Clarification of "Transfer" in Connection With a Swap on an Index

Another issue that should be addressed is clarification of when a "transfer" of the "underlying security" may have occurred with respect to swaps referencing an index, to the extent the index is not a "qualified index" and excluded from being classified as an SNPC (as discussed above). Section 871(m) provides that a notional principal contract is an SNPC if in connection with entering into or terminating the swap, the "underlying security" is transferred to the counterparty. Section 871(m)(4)(C) further provides that "any index or fixed basket of securities shall be treated as a single security" for this purpose. The legislative history to Section 871(m) does not expand on how to determine whether, in this context, an index or basket has been transferred."[16]

---

[15] Guaranteed VWAP refers to an arrangement where the purchase or sale of a security, or execution of a swap referencing the security, is made at the security's actual, objectively determined, VWAP for the particular day (or agreed to shorter period). In contrast, "best efforts VWAP" refers to an arrangement where purchase, sale or swap execution is based on the volume weighted average of prices of transactions actually executed by a dealer that is using its "best efforts" to replicate the actual VWAP for the day (or shorter period). We assume that transactions using "best efforts" VWAP do not implicate the same issues as transactions at guaranteed VWAP, however, because of the risk of the best efforts VWAP diverging from the actually determined VWAP.

[16] The only elaboration in the legislative history relating to an index or basket of securities addresses the determination of whether an index or basket is "readily tradable." With regard to this issue, the legislative history states is that "any index or fixed basket of securities is treated as a single security," and that an index will be deemed to be regularly traded on an established market "if every component of such index or fixed basket is a security that is readily tradable on an established

Against this background, it is unclear how to determine whether a taxpayer who enters into a swap with respect to an index or fixed basket has transferred the index or basket in connection with entering into or terminating the swap. The "single security" language of the statute can be interpreted to mean that a transfer (within the meaning of Section 871(m)(3)(A)(i) or (ii)) will have occurred with respect to a swap on an index only if every security in the index was transferred between the counterparties. That result would make little sense, however, as the omitted transfer of a single component of the S & P 500 in connection with entering into a swap on that index should not prevent the swap from being covered by Section 871(m). At the same time, it would make equally little sense to treat a swap on the S & P 500 as an SNPC if there was a transfer of only a single component of the index in connection with entering into or terminating the swap.

If a swap on an index is considered to be eligible for application of Section 871(m), then we recommend an intermediate approach to determining whether a transfer has occurred. Regulation Section 1.246-5(c)(ii) creates a methodology for determining whether one portfolio of stock is "substantially similar" to another for purposes of limiting the availability of the dividends received deduction. The prescribed methodology looks to whether there is a measurable overlap of 70 percent of the portfolios. This methodology can be adapted to the application of Section 871(m). In effect, there would be a transfer for purposes of Section 871(m)(3)(A)(i) or (ii) in connection with the entering into or termination of a swap on the index to the extent that the index and the transferred securities would be treated as substantially similar under the rules of Regulation Section 1.246-5(c)(ii).

We note that as discussed above, the exemption of swaps on qualified indices from Section 871(m) would make these transfer provisions much simpler by requiring their application to considerably fewer situations. If a swap references a qualified index, there would be no need to determine if a transfer has occurred. If a swap references a basket of securities that does not satisfy the definition of an index, it can be evaluated as a collection of individual swaps on the particular securities that make up the basket. Accordingly, the transfer test would have to be applied only in the case of a swap that relates to an index that is not a qualified index.

Clarification of Swaps Covered by Section 871(m) and Exercise of Regulatory Authority to Include "Other Transactions"

Limitation of Section 871(m) to Swaps With "Delta One" Characteristics

---

securities market." J. Comm. Taxation, *Technical Explanation of the Revenue Provisions Contained in Senate Provision 3310*, (JCX-4-10), February 23, 2010, p. 81. This legislative history is not at all enlightening with respect to the "transfer" issue, however.

The definition of notional principal contract under Regulation Section 1.446-3 is very broad and flexible. An infinite variety of swaps can reference an equity security in some manner and qualify as a notional principal contract while not at all resembling economic ownership of the referenced security. Accordingly, by definition, Section 871(m) could result in the imposition of withholding tax on payments under a variety of swaps that do not represent, in any way, a derivative form of ownership of an "underlying security" and therefore do not have the potential for inappropriate tax avoidance. A possible example is a notional principal contract that pays the dividend yield on a basket of stocks subject to meaningful caps and floors.

The paradigm for a swap that is intended to be subject to the potential application of Section 871(m) is one that provides "delta one" exposure to an underlying security.[17] It would of course be inappropriate, however, to distinguish between a swap that offers delta one exposure to an underlying security and one that offers only slightly less than delta one exposure. Accordingly, a sensible dividing line should be drawn to assure that there is a reasonably close relationship between the economic exposure provided by the swap to the underlying security and the economic exposure to the underlying security itself. Otherwise, the relationship between the underlying security and the swap becomes sufficiently disconnected such that it becomes difficult to identify any real avoidance of dividend taxation. To draw that dividing line, the Treasury Department might consider a rule that provides a bright line based on the delta of a particular swap.[18] Alternatively regulations could provide that as a general rule, only delta one swaps are eligible to be treated as SNPCs (if the other relevant criteria are met), but also provide an anti-abuse rule under which swaps that are not delta one swaps are so eligible.

One potential issue that the recommended "delta one" rule would present is that a non-U.S. investor could replicate a delta one swap by entering into two separate swaps with two unrelated dealers, where neither dealer is aware of the other swap. A simple example would be one where an investor enters into a "price only" swap with one dealer and a swap of actual dividends against a fixed amount with another dealer, in each case with respect to the same underlying security. While the delta of each swap would depend on the particular characteristics of the underlying security, we can assume for purposes of illustration that neither of the swaps in the example would meet the delta one criterion. Where an investor enters into transactions such as these, and does so risklessly, (e.g., by

---

[17] The "delta" of an instrument relative to a particular underlying security will be between 1.0 and -1.0 and reflects the change in the value of the instrument relative to the change in the value of the underlying security, with a delta of 1.0 indicating a virtually perfect correlation.

[18] We note, however, that there is some subjectivity in the inputs that are used to calculate the delta of a particular non-delta one swap, so that there could be different reasonable calculations of the delta of such a swap.

transferring the underlying security to the "price only" counterparty in connection with entering into the swap), the investor has placed itself in exactly the situation in which Section 871(m) would call for imposition of withholding tax on dividend equivalent payments.[19] Accordingly, we believe that the "delta one test" should be applied looking at the overall position of the long party and that dividend equivalent payments should be subject to tax in that party's hands when the test is met. Nonetheless, it would be unfair to impose liability for withholding on either dealer in the example, since neither dealer is aware of the customer's overall position. Accordingly, we request that regulations make clear that no potential withholding agent is liable for withholding the tax imposed Section 871(m) on any individual swap that fails to meet the delta one test, unless that withholding agent knows or has reason to know of its counterparty having an overall delta one position.

Regulations Identifying "Other Transactions" Subject to Section 871(m)

The intended reach of Section 871(m)(3)(v) is to allow the Treasury Department to designate transactions (besides the ones enumerated in Sections 871(m)(3)(A)(i) to (iv)) as having sufficient potential for tax avoidance to be subject to the rules of Section 871(m). The Treasury's exercise of its authority under this provision should have two components. First is to identify equity derivative transactions, other than swaps, that have similar potential to give a non-U.S. person the economic benefits of the receipt of a U.S. source dividend. Second, accepting that purely synthetic transactions, without the presence of other factors, do not create an inappropriate tax avoidance situation, is to identify what other factors must be present in connection with one or more of these other transactions in order for the transaction to be considered to create an inappropriate tax avoidance situation.

Forward contracts, futures contracts, and sufficiently deep in the money options are the types of financial contracts that can be most similar to notional principal contracts with respect to conferring the benefit of a U.S. source dividend payment to the counterparty. However, as discussed above with respect to notional principal contracts, these instruments can have terms that vastly differ from a synthetic investment in a particular underlying security. For example a forward contract might reference a particular stock, but only give limited upside and downside exposure to the stock. Such a forward contract is not fairly seen as a substitute for investment in the physical underlying security or as giving rise to inappropriate tax avoidance. Thus, the NATC believes that, as with notional principal contracts, the other identified instruments generally should be eligible to be treated as SNPCs only if they bear a delta one relationship to the underlying security, and that a

---

[19] We would not suggest that having the counterparty risk of two different counterparties instead of a single counterparty is a relevant distinction for implanting Section 871(m).

reasonable dividing line should be drawn that also would include such instruments that have a nearly delta one relationship.[20] As is the case with swaps, a particular non-US investor can replicate a delta one instrument with a combination of instruments entered into with different unrelated parties. Likewise, we believe that the delta one relationship should be determined based on the overall position of the long party, and a withholding agent with respect to an instrument that does not meet the delta one test should be liable for withholding absent knowledge or reason to know the long party's overall position.

With regard to determining the other factors that must be present in order for the transaction to be considered to give rise to an inappropriate tax avoidance situation, we generally believe the same factors used for purposes of determining whether a swap is treated as an SNPC should be employed.

Certain special considerations will apply to any of these other transactions that might be traded on an exchange or through a clearing system. In these cases, the long and short parties may or may not know each other's identities, may or may not effect a transfer of the underlying security in connection with the opening or closing of the transaction, and may or may not have the information necessary to withhold or self assess any tax. This is an area that we believe needs considerably more attention and that we would be pleased to discuss with you.

Treatment of Dividend Equivalent Payments for Treaty and Section 892 Purposes

Treaties

Section 871(m) does not provide any guidance on the treatment of dividend equivalent payments for tax treaty purposes. For the reasons described below, it is not clear under U.S. tax treaties, including the United States Model Income Tax Convention of November 15, 2006 (the "2006 Model Treaty"), whether dividend equivalent payments under Section 871(m) are treated as dividends or some other type of income. The NATC requests that the Treasury Department issue guidance clarifying that dividend equivalent payments within the meaning of Section 871(m) are treated as dividends for purposes of U.S. tax treaties.

Because the definition of "dividends" varies among treaties, for purposes of this discussion, we have focused on the 2006 Model Treaty, although clarification is also

---

[20] Also, as with notional principal contracts, the NATC believes that in general other "price only" instruments should not be treated as SNPCs. So, a typical forward contract that does not provided for adjustments to the forward price based on actual dividends would not be treated as an SNPC.

warranted for other treaties.[21] Under the 2006 Model Treaty, the definition of "dividends" is as follows:

> [T]he term "dividends" means income from shares or other rights, not being debt-claims, participating in profits, as well as income that is subjected to the same taxation treatment as income from shares under the laws of the State of which the payer is a resident.

It is not clear under this definition that dividend equivalent payments under Section 871(m) are "dividends" for purposes of the 2006 Model Treaty. First, we note that Section 871(m)(1) provides that "[f]or purposes of subsection [871](a), sections 881 and 4948(a), and chapters 3 and 4, a dividend equivalent shall be treated as a dividend from sources within the United States." The 2006 Model Treaty defines "dividend" to include income that is "subjected to the same taxation treatment" as income from shares under the laws of the State where the payer is resident. Because a "dividend equivalent" under Section 871(m) is treated as a U.S. source dividend only for certain specified Code provisions, and is not treated as a dividend under general U.S. federal income tax law (*i.e.*, it is not a dividend under Section 316 and related provisions), it is not entirely clear that a "dividend equivalent" under section 871(m) meets the definition of a dividend in the 2006 Model Treaty.[22]

Arguably, because Section 871(m) provides that a dividend equivalent is treated as a U.S. source dividend for purposes of the provisions of the Code that relate to withholding tax, a dividend equivalent should be considered taxed as a dividend for purposes of U.S. tax law and thus treated as a dividend under treaties such as the 2006 Model Treaty. We note, moreover, the Treasury Department has issued regulations that treat substitute payments under security loans as dividends under U.S. tax treaties notwithstanding that those payments otherwise might not have met the precise definition of "dividend" under all

---

[21] In contrast to the 2006 Model, the 2010 OECD Model Treaty of (the "OECD Model"), followed in a number of U.S. treaties, provides a definition of "dividends" that includes "income from other corporate rights which is subjected to the same taxation treatment as income from shares by the *laws of the State of which the company making the distribution is a resident*." (Emphasis added.) Another variation is contained in the U.S.-Switzerland Treaty, which has a definition of "dividends" that includes "income which is subjected to the same taxation treatment as income from shares under the *law of the Contracting State in which the income arises*." (Emphasis added.)

[22] The Technical Explanation for the 2006 Model Treaty notes that "[t]he term ["dividends"] also includes income that is subjected to the same tax treatment as income from shares by the law of the State of source." As examples, the Technical Explanation includes (i) a constructive dividend that results from a non-arm's length transaction between a corporation and a related party, (ii) amounts treated as a dividend under Section 304, (iii) distributions from a U.S. publicly traded limited partnership taxed as a corporation under U.S. law, and (iv) a payment denominated as interest that is made by a thinly capitalized corporation to the extent that it is recharacterized as equity under the laws of the source State.

treaties.[23] In our view, the treatment under U.S. tax treaties of dividend equivalents under Section 871(m) and substitute dividend payments under the applicable regulations should be consistent. The Treasury Department should therefore clarify that dividend equivalents under 871(m), which include both substitute dividends and dividend equivalent payments made under SNPCs, are treated as dividends for U.S. treaty purposes.

Further, clarification of whether dividend equivalents constitute dividends under tax treaties would be helpful in the context of swaps entered into between a dealer's non-U.S. affiliate (*e.g.*, its U.K. broker-dealer) and a non-U.S. counterparty. For example, the 2006 Model Treaty, definition of "dividend" discussed above refers to "the laws of the State of which the payer is a resident." If a swap is entered into by a dealer's non-U.S. affiliate, it is not entirely clear whether the term "payer" refers to the U.S. issuer of the stock paying the dividend or the country in which the non-U.S. affiliate is resident. If the "State of which the payer is resident" refers to the jurisdiction of the non-U.S. affiliate, then an item of income would be treated as a dividend for treaty purposes based on the tax treatment under the law of the non-U.S. payer's jurisdiction and not the tax law of the United States. While we do not believe this is the intended result, the technical issue nonetheless exists under the language in the 2006 Model Treaty. In contrast to the 2006 Model Treaty, certain other treaties use the narrower term "Contracting State" instead of "State," and term "company paying the dividend" or "company making the distribution" instead of "payer."[24] It would thus be helpful to clarify that the definition of dividends in the 2006 Model Treaty does not have a different meaning than the definition in these other treaties notwithstanding the more generic language used in the 2006 Model Treaty.

For these reasons, the NATC requests that the Treasury Department issue guidance providing that dividend equivalent payments under Section 871(m) are treated as dividends for U.S. treaty purposes. If the Treasury Department did not adopt this approach, the alternative would be to treat dividend equivalent payments within the meaning of Section 871(m) as dividends for treaty purposes if doing so would be in accordance with the terms

---

[23] *See* Treasury Regulation 1.894-1(c) ("The provisions of an income tax convention dealing with interest or dividends paid to or derived by a foreign person include substitute interest or dividend payments that have the same character as interest or dividends under §1.864-5(b)(2)(ii), 1.871-7(b)(2) or 1.881-2(b)(2). The provisions of this paragraph (c) shall apply for purposes of securities lending transactions or sale-repurchase transactions as defined in §1.861-2(a)(7) and §1.861-3(a)(6)."). According to the Preamble to these regulations, "the IRS and Treasury believe that, in the absence of a transparency rule, many taxpayers would use securities lending transactions in order to avoid tax under tax treaties or under the Code." T.D. 8735 (Oct. 6, 1997).

[24] *See, e.g.*, the U.S.-U.K. Treaty (the term "dividends" includes "any other item which, under the laws of the Contracting State of which the company paying the dividend is a resident, is treated as a dividend or a distribution of a company) or the U.S.-Luxembourg Treaty (the term "dividends" includes "income treated as a distribution by the taxation laws of the State of which the company making the distribution is a resident").

and conditions of a particular treaty. In this case, if a dividend equivalent payment is not treated as a dividend under a particular treaty, the dividend equivalent payment may potentially be treated as "business profits" or "other income." This alternative approach may result in conflicting interpretations of the definition of dividends in U.S. tax treaties among market participants, and create a somewhat anomalous situation where dividend equivalent payments made under SNPCs would be treated as dividends for treaty purposes only in some cases, while dividend equivalent payments that are substitute dividend payments are treated as dividends for all treaty purposes.

In either case, timely guidance is needed on this matter because operational and tax information reporting systems are now being adapted to address the additional burdens on withholding agents associated with implementing Section 871(m) with regard to SNPCs (and any other arrangements specified by the Treasury Department in future guidance).

TIN Requirement for Tax Treaty Benefits

In general, to support a claim for a U.S. tax treaty benefit, the beneficial owner's taxpayer identification number ("TIN") is required to be included on Form W-8BEN.[25] An exemption from the requirement to furnish a TIN is available for certain income.[26] A TIN need not be furnished for treaty claims related to dividends and interest from stocks and debt obligations that are actively traded, dividends from any redeemable security issued by an investment company registered under the Investment Company Act of 1940 (a "U.S. mutual fund"), dividends, interest, or royalties from units of beneficial interest in a unit investment trust that are (or were upon issuance) publicly offered and are registered with the Securities and Exchange Commission under the Securities Act of 1933 (a "U.S. unit investment trust"), and amounts paid with respect to certain securities loans.[27]

Treasury Department guidance should make it clear that a TIN is not required to be furnished for a claim of treaty benefits related to the receipt of a dividend equivalent payment pursuant to a SNPC that is attributable to stock that is actively traded, a U.S. mutual fund or a U.S unit investment trust. The exception from providing the TIN should apply under these conditions without regard to whether the dividend equivalent payments are treated as a dividend, business profits or other income under the applicable treaty.

Section 892

Section 871(m) also does not provide any guidance on the treatment of dividend equivalent payments for purposes of Section 892 (relating to income of foreign

---

[25] Reg. § 1.1441-6(b)(1)
[26] Reg. § 1.1441-6(c)(1)
[27] Reg. § 1.1441-6(c)(2)

governments and international organizations). The NATC requests that the Treasury Department publish guidance that provides that a dividend equivalent payment should be treated the same as a dividend for purposes of Section 892. Absent guidance, some market participants have noted that it is not clear if a dividend equivalent payment should be treated as a dividend or otherwise eligible for the exemption provided by Section 892. Section 871(m)(6) treats dividend equivalent payments and actual dividends the same for purposes of over-withholding, and we see no reason for not applying this policy to Section 892. Clear guidance in this regard would be much appreciated and would resolve an ambiguity that exists between Sections 871(m) and 892.

Definition of "Dividend Equivalent" Payment

Determining the Amount of Any Dividend Equivalent

> For purposes of Section 871(m), the term "dividend equivalent" means:
>
> (A) any substitute dividend made pursuant to a securities lending or a sale-repurchase transaction that (directly or indirectly) is contingent upon, or determined by reference to, the payment of a dividend from sources within the United States,
>
> (B) any payment made pursuant to a specified notional principal contract that (directly or indirectly) is contingent upon, or determined by reference to, the payment of a dividend from sources within the United States, and
>
> (C) any other payment determined by the Secretary to be substantially similar to a payment described in subparagraph (A) or (B).

In our view, the definition of "dividend equivalent" in Section 871(m) as "any payment . . . that (directly or indirectly) is contingent upon, or determined by reference to, the payment of a dividend from sources within the United States" is an appropriate definition for the type of payment that should be subject to withholding for transactions covered by Section 871(m). Put differently, other than in certain potentially abusive situations, we do not believe that a different or expanded definition is needed. Certain points regarding this definition warrant clarification, however, and are discussed below. Our overriding objective with regard to these clarifications is that the applicable rules are clear and administrable.

With an exception for potentially abusive cases, which we discuss below, we recommend that regulations provide that the dividend equivalent amount is the amount that the long party would not have received or been credited with but for payment of an underlying dividend (and the amount of such dividend equivalent should be determined at

the moment it is credited to the long party). This is a simple rule that would allow market participants to readily determine the amount of any dividend equivalent payments associated with a transaction.

For the vast majority of delta one single name swaps, the above rule would provide the sensible result that the dividend equivalent amount is the same as the amount of the underlying dividend. For total return swaps where dividends are notionally re-invested, the dividend equivalent amount would be the value of the unit of the reference security that is received upon the notional re-investment, which should be, again, the amount of the underlying dividend.[28] For a "price only" swap, where underlying dividends have no impact on the amounts to which the long party is entitled, the rule would again provide the sensible result that the dividend equivalent amount is zero.[29]

Determining Timing of Withholding

In addition to a clear definition of the amount of a dividend equivalent, withholding agents also need clarification as to when withholding tax is due on such amount. There are different possible approaches to choosing the time at which a dividend equivalent should be withheld upon. Again, in developing a rule, the main interest of the NATC is that we have clear and administrable rules. One possibility is to require withholding (or remittance to the IRS if there is no payment from which to withhold) at the time a dividend is paid on the underlying securities that will give rise to either a subsequent payment or a deemed reinvestment under the SNPC. This approach is likely inconsistent with the statutory language of Section 871(m), which is focused on "payments" under an SNPC,[30] and would be extremely difficult to administer in practice. Another possibility is to require the

---

28 For indices with large numbers of reference securities, actual administration of this rule would be complex. For this, and other reasons articulated above, we believe that certain index swaps should be exempt from Section 871(m).

29 We believe this result is proper as it is consistent with the wording of the statute and is consistent with the general tax principle that there is no right to a dividend until it is declared. We have considered the scenario where a company has a longstanding history of paying a regular dividend, in which case there may be a low probability that the amount of actual dividends paid would not equal the amount of expected or assumed dividends. We note the risk exists even for companies with a history of paying dividends that a subsequent dividend will not be paid, a fact that was well documented during the credit crisis. We further note that in these cases, it would be very difficult to craft an administrable rule that would treat a payment as a "dividend equivalent" only if there was a significant likelihood that the amount of the actual dividend would diverge significantly from the expected or assumed dividend. A rule requiring an analysis of a corporation's dividend volatility prior to the execution of any trades would be extremely cumbersome and time consuming for the trading desks to implement and keep records of. Moreover, we do not believe that withholding agents should be in the position of deciding where to draw the line between expected dividends that are far from certain and thus not subject to withholding tax and those that are expected and thus subject to withholding.

30 *See* § 871(m)(2).

withholding or remittance on the next date on which a periodic payment under the SNPC is to be made (regardless of which party otherwise is making the payment). The third possibility is the date on which an amount attributable to the dividend equivalent is actually paid or otherwise taken into account in determining a payment under the SNPC (*e.g.*, in the case of a total return swap where dividends are notionally reinvested in the underlying security and payment based on the value of the underlying security, such a payment is made only at maturity).

In addition, one further timing point should be clarified. Section 871(m)(3)(A)(ii) provides that an SNPC includes a contract, if in connection with its termination, the underlying security is transferred by the short party to the long party. By definition, one or more ex- dividend dates on the underlying shares could have occurred and swap payments "contingent upon, or determined by reference to, the payment of a dividend" could have been made in prior periods. It would be useful to clarify that the withholding tax would be payable only after the contract is terminated (the withholding agent could not have known that any prior dividend payments would give rise to a dividend equivalent payment until that time), and that no interest or late payment penalties will apply in this instance.

Anti-Abuse Rule

We have considered the question of whether the foregoing definition of "dividend equivalent" may be subject to abuse. Where a transaction that otherwise is an SNPC is entered into *after* a dividend has been announced or declared, it may be reasonable to include in the definition of "dividend equivalent" any payment with respect to that SNPC that is based on the amount of the dividends announced or declared, although not explicitly contingent on their actual payment. In such a case, where there is little or no risk regarding actual payment of the dividend in the ordinary course, the parties should not be able to avoid Section 871(m) merely by agreeing to have the short party pay the long party a fixed amount instead of the dividend actually paid.

Collateral Posting Rule

As discussed above, the Treasury Department has the authority to expand the categories of transactions treated as SNPCs. The Treasury Department also has the authority to limit the categories of transactions so treated. We believe that the Treasury Department should exercise its authority to not treat a transaction as an SNPC based solely on the short party having posted the underlying security as collateral to the long party. Where the short party has done so, it is hard to see why any tax avoidance is perceived, and the NATC does not understand why Congress chose to designate transactions with this feature as SNPCs. It is clear in this situation that the short party still owns the underlying security and will receive, subject to any applicable withholding, dividends on the

underlying security (or substitute dividends if the long party lends out the pledged security). Similarly, it is clear that the long party is not the beneficial owner of the stock or any dividend payment with respect to the stock. It is a normal business practice for an investment fund to post its entire portfolio of securities as collateral in a margin account. If the fund wants synthetic short exposure to a particular security that it otherwise has in its pledged portfolio, it would have to manually withdraw that security from the margin account in order to be certain to avoid having the swap treated as an SNPC, which would not always be practical. We simply do not see any tax avoidance inherent in these circumstances, and we would request that regulations eliminate this feature as one that causes a swap to be treated as an SNPC or otherwise specify the particular fact pattern of concern.

Electronic Trading

The NATC believes that regulations under Section 871(m) should clarify whether equity swaps established on electronic trading platforms will be treated as per se SNPCs. “Electronic trading” is a shorthand reference for a system under which the customer of a broker-dealer can place an order, including an order for entering into a swap, through an electronic system, and the broker-dealer executes the order (including entering into a swap with the customer) automatically. Where such a system is used to manage swap order flow, it would typically also provide inputs to manage the swap hedge order process, either within the same system or via an associated system – in each case on an automated basis. The electronic system, or combination of systems, generally replicates the process that would take place using telephonic, text messaging or other means of communication between the customer and the broker-dealer.

In the case of many derivatives dealers, the only clear distinction between swaps established on and off electronic platforms is the process by which the swap orders are submitted to the broker-dealer (*e.g.*, telephone vs. electronic). The manner in which an order is submitted should have no bearing on whether inappropriate dividend tax avoidance is occurring. Swaps on electronic platforms are generally subject to the same internal processes as swaps on conventional platforms, including checks for regulatory requirements and netting of offsetting positions. Moreover, the dealer hedge execution process for swaps established off electronic platforms often involves automated routing once these internal checks are manually satisfied.

Valid concerns about dividend tax avoidance would exist if arrangements in connection with an electronic platform were to provide a counterparty with the ability to direct the execution of a swap dealer's hedge (which is suggestive of an agency relationship) or confer other rights on the counterparty that are not present in a typical

swap. However in the absence of any such other factors, we believe that swaps executed on electronic platforms should be subject to the same rules, including crossing, that apply to swaps executed on non-electronic platforms and should not be treated as per se SNPCs. In any event, we urge the Treasury Department to provide clarification of this issue. To the extent that the Treasury Department would like additional details on electronic trading platforms, our members are available to discuss.

I and other members of the North American Tax Committee would be pleased to discuss any of these proposals with you at your convenience.

Very truly yours,

Thomas S. Prevost, Chair,
ISDA - North American Tax Committee

Copies to:

Hon. Michael Mundaca
Assistant Secretary (Tax Policy)
Department of the Treasury

Hon. William J. Wilkins
Chief Counsel
Internal Revenue Service

Emily McMahon
Deputy Assistant Secretary (Tax Policy)
Department of the Treasury

Jeffrey Van Hove
Tax legislative Counsel
Department of the Treasury

Manal Corwin
International Tax Counsel
Department of the Treasury

Michael Caballero
Deputy International Tax Counsel
Department of the Treasury

Jesse Eggert
Attorney-Advisor
Department of the Treasury

Mark Perwein
Special Counsel to the Associate Chief Counsel
Internal Revenue Service

Peter Merkel
Attorney-Advisor
Internal Revenue Service