Securities Industry Association

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May 8, 2002

The Honorable Pam Olson
Acting Assistant Secretary (Tax Policy)
1334 Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Ms. Olson:

Thank you for meeting with us on April 11, 2002 to discuss how the Treasury Department's enforcement proposals for abusive tax avoidance transactions that were circulated on March 20, 2002 (the "Proposals") and any impending revisions to the regulations under sections 6111 and 6112 of the Internal Revenue Code are intended to apply to the securities industry. As discussed at our meeting, we are submitting some suggestions as to how the Proposals (and any revised regulations) could be modified and/or clarified to assist in their administration.

I. Overview

The Proposals would make two basic changes to the rules for disclosing, registering and listing potentially abusive tax avoidance transactions that we believe would be an improvement from an administrative perspective. First, the Proposals would establish a single definition of the type of transaction that would have to be disclosed, registered and listed (a “reportable transaction”). Second, the Proposals would reduce the vagueness associated with the definition of a reportable transaction by eliminating subjective criteria and exceptions in favor of objective “filters” or standards (*e.g.*, a transaction that gives rise to a taxable loss of $10 million or more in a single year).

In addition, however, the Proposals would extend the registration requirement beyond those transactions that are offered under conditions of confidentiality. The Proposals also would expand the category of persons required to register transactions beyond the “promoter” to include any person (in our case, any securities dealer) that receives a specified level of fees with respect to any transaction that is a component of a tax shelter, without regard to whether that person has in fact advised on, promoted or recommended the tax aspects of the transaction. The proposed broadening of the circumstances under which a securities dealer must register and list a financial transaction is designed to create a web of reinforcing disclosure by requiring the same information from

both taxpayers and their advisors. However, this proposed broadening would give rise to a number of practical issues that the securities industry would have to address in order to administer and comply with the requirements.

II. Scope of the Proposed Registration Requirement

The proposed new registration requirement could potentially apply to many of the transactions that a securities dealer executes, or acts as agent or counterparty in, on a routine basis. Some examples are summarized below:

- A securities dealer sells a block of stock for a client that may result in a taxable loss of more than $10 million (depending on the taxpayer's basis in the stock).

- A securities dealer enters into an interest rate swap, equity swap, commodity swap, option, forward contract or other derivative transaction that may give rise to a deductible loss to the counterparty of more than $10 million.

- A securities dealer helps a client to buy or sell foreign stock that the client turns out to hold, or to have held, for less than 45 days.

- A securities dealer undertakes a routine securitization of a client's assets (*e.g.*, credit card receivables) that results in book income but not taxable income under the relevant accounting and tax rules.

- A securities dealer advises a client with respect to a routine merger or acquisition and the tax and accounting results of the transaction diverge by more than $10 million.

As to many of these (and other) routine transactions, a securities dealer often will not have the information it needs to determine whether the transaction gives rise to registration and listing requirements. We recognize that a securities dealer's obligations would be limited by an objective "material participation" requirement, which would only be met if the financial institution received more than $250,000 in fees in the case of non-individual transactions and more than $100,000 in fees in the case of individual transactions. However, a significant percentage of the transactions entered into by a financial institution will give rise to gross receipts of more than $250,000. Thus, a securities dealer could be required to register and list many transactions under circumstances in which it did not advise on, promote or recommend a tax shelter but merely engaged in a routine financial transaction under terms that were determined on an arm's length basis without regard to the client's tax position or any tax benefits resulting from the transaction.

III. Specific Suggestions

In light of the above, SIA has the following specific suggestions.

A. Treasury should provide an exception from "material participation" such that material participation is not considered to exist in the case of a financial institution that merely executes, or acts as an agent or counterparty in, one or more financial instruments or transactions, or merely provides a financial service, if:

1. Such financial instrument, transaction or service is offered, entered into or purchased in the normal course of the financial institution's business and is readily available from financial institutions generally (for example, acting as an agent or counterparty in a swap, option, notional principal contract, repo transaction, sale or purchase of securities, etc.);

2. The pricing of such financial instrument, transaction or service would be the same without regard to the use of the financial instrument, transaction or service;

3. The financial institution does not advise on, promote or recommend the tax aspects of the financial instrument, transaction or service; and

4. The financial institution does not execute, act as an agent or counterparty in, or provide such financial instrument, transaction or service pursuant to a solicitation by any person whom the securities dealer knows, or should know, is a promoter (or participating in the promotion) of the relevant reportable transaction.

B. Treasury should exclude a defined range of common and well-known financial transactions from the definition of a reportable transaction, so long as the transactions are not an integral part of a larger transaction or series of transactions that would constitute a reportable transaction. For example, sales of stock, or payments on swaps, options and other derivative contracts, should not be reportable transactions merely because they give rise to deductible losses, as they often do. Similarly, mergers, acquisitions or securitization transactions should not be reportable transactions merely because they give rise to book-tax differences, as they often do. We would welcome the opportunity to work with Treasury to develop a list of common transactions that often give rise to either losses or book-tax differences and should not constitute reportable transactions when standing alone.

C. In the case of mergers, acquisitions and securitizations, financial institutions should be permitted to rely in good faith on the written representation of their clients that the transaction is not a reportable transaction. Financial institutions in these cases often will lack the information necessary to make an

independent determination of whether the transaction gives rise to a loss or book-tax difference.

D. Any obligation to register a merger or acquisition transaction involving a public company should be postponed until the transaction is publicly disclosed, so as not to violate applicable securities laws.

E. For penalty purposes, Treasury should provide as a general rule that the term "fees" excludes a financial institution's compensation for *nontax* financial instruments, transactions and services. As a matter of equitable penalty administration, this would ensure that all parties potentially subject to penalty for failure to register or list (*e.g.*, whether financial advisor, accounting firm, law firm or securities dealer) face a uniform penalty base. For example, "fees" should exclude arm's length fees, commissions or spreads (i) for acting as an agent or counterparty in a swap, option or notional principal contract, or (ii) for sale or purchase of securities, so long as the amounts are received under circumstances in which the pricing of the swap, option, notional principal contract or other security would be the same without regard to the use of the financial instrument.

F. Treasury should consider a penalty safe harbor for financial institutions that put in place reasonable procedures that result in the proper registration and listing of the vast majority of reportable transactions. For such institutions, no penalties would apply for failure to register or list with respect to a transaction that was inadvertently not captured by internal reporting systems.

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Thank you for working with our industry to devise rules that will yield the information that you seek in the manner that is most administrable and least burdensome. We would welcome the opportunity to explore these issues further with you, and if we can be of assistance in any way, please contact one of us.

Sincerely,

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