



Securities Industry Association

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October 18, 2000

Mr. Frank Polk
Majority Staff Director
Senate Finance Committee
219 Dirksen Senate Office Building
Washington, DC 20510

Mr. David Podoff
Minority Staff Director
Senate Finance Committee
203 Hart Senate Office Building
Washington, DC 20510

Dear Sirs:

SIA would like to thank Chairman Roth, Senator Moynihan and members of the Senate Finance Committee for the opportunity to review the revised staff discussion draft concerning tax shelters released on October 5, 2000. We greatly appreciate their sustained efforts to avoid affecting normal business transactions in the process of examining those transactions that violate the clear intent of the tax laws.

The revised draft modifies the preliminary staff discussion draft dated May 24, 2000 in many significant respects. Our initial analysis of this draft, however, indicates that it would do little to improve the *practical effect* of the original staff proposal. From the perspective of our industry, the problem remains one of overbreadth, and the potential for very onerous penalties to attach to securities firms advising clients with respect to numerous types of transactions that involve no tax impropriety whatsoever.

As we explained in our submission of June 9, 2000, current regulations do not provide sufficiently clear standards for determining the transactions for which securities dealers are expected to maintain complex and detailed "lists". The regulations instead require a securities dealer to list a transaction if "tax benefits are an important part of its intended result," where "tax benefits" is defined to

include any "deductions, exclusions from gross income, nonrecognition of gain, tax credits, adjustments (or the absence of adjustments) to the basis of property, and any other tax consequences that may reduce a taxpayer's Federal income tax liability by affecting the timing, character, or source of any item of income, gain, deduction, loss or credit." Since this directive can arguably apply to most of the transactions on which securities dealers advise, securities dealers are expected to "use their judgment" in deciding what to list.

We believe it would violate basic notions of fairness to impose serious monetary penalties for failure to comply with such vague and overbroad standards. A securities dealer will be in noncompliance under the literal terms of the regulations in many of the cases where it advises. For example, failure to list a routine hedge or borrowing would arguably constitute noncompliance under the regulations, since these transactions create tax benefits (nonrecognition of gain, interest deductions, etc.) as compared to alternative means of accomplishing the taxpayer's financial objectives (e.g., a sale, an equity issuance, etc.). It is not realistic to believe that securities dealers will be administratively able to maintain the complex lists which these rules mandate, since they require detailing the specifics of nearly all of the financial transactions that dealers help their clients to enter into every day. We do not believe, however, that the IRS should be left to selectively enforce rules that cannot realistically be complied with and impose serious penalties at their discretion.

SIA has submitted a lengthy comment letter to the Treasury detailing the several ways in which we believe their list-keeping regulations capture far too many wholly legitimate transactions and suggesting many refinements. SIA will continue to work with Treasury in its attempt to improve its regulations. However, the regulatory process takes time to unfold, and its outcome cannot be predicted at this stage. Our experience with attempts to define the truly problematic transactions without at the same time capturing routine financial market transactions (hedges, accepted changes in business structures, etc.) has shown that it is a very difficult task. To inject a greatly increased penalty for failure to list investors at this juncture would be a mistake *when it is apparent that the regulations are not yet properly confined to transactions of concern to tax administrators.*

Finally, we should note that we have confined this letter to issues of particular concern to our member firms in their roles as advisers to investors in capital market transactions. However, other aspects of the revised draft, including the new strict liability penalty imposed on "abusive tax shelter devices" and the new penalty for failure to disclose information on a return, would affect our member firms in their roles as taxpayers. These proposals also raise serious issues that warrant further analysis.

Once again, thank you for engaging in a process that allows SIA and others to provide comments concerning the impact of potential changes to the law. Please

do not hesitate to contact one of us, or call Patti McClanahan, SIA's Vice President and Director for Tax Policy (202-326-5324), if SIA can be of assistance in your ongoing consideration of these difficult issues.

Sincerely,

Saul M. Rosen
Chair, SIA Committee on Federal Taxation
of the Securities Industry
Securities Industry Association

Marc E. Lackritz
President
Securities Industry Association

cc: Mark Prater
Russ Sullivan
Edgar McClellan
Cary Pugh
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