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Attention: CC:PA:LPD:PR (REG-140974-11)

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RE: Comments on Application of PFIC Shareholder Reporting Requirements to Dealers in Securities

The Securities Industry and Financial Markets Association ("SIFMA")[1] is pleased to submit the following comments on, and suggested changes to, Temporary Treasury regulation section 1.1298-1T and related proposed regulations (REG-140974-11) (the "Regulations").[2] The Regulations impose annual filing requirements on shareholders of passive foreign investment companies ("PFICs") under section 1298(f).

[1] SIFMA brings together the shared interests of securities firms, banks, and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services, and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong. A full list SIFMA's 567 members can be found at http://www.sifma.org/about/memberdirectory.aspx.

[2] Section references are to the Internal Revenue Code of 1986, as amended, or to the Treasury regulations promulgated thereunder.

We request that the Regulations be modified to provide that they do not apply to securities held by dealers in securities and other taxpayers that mark those securities to market under section 475 ("section 475 taxpayers"). As explained in more detail below, the basis for our request is the following:

- The PFIC reporting requirements would yield no relevant information from section 475 taxpayers, because section 475 taxpayers are exempt by law from the section 1291 "excess distribution" rules and, consequently, virtually all of the other PFIC rules relating to inclusion of income.

- The PFIC reporting requirements would, however, impose significant burdens on dealers in securities because, as described below, such dealers regularly hold securities issued by many foreign corporations as part of the ordinary course of their business during the course of a taxable year, and have no current reason to track, and do not track, the PFIC status of those securities.

- A failure to comply with the reporting obligations with respect to the equity of even one PFIC would indefinitely toll the statute of limitations with respect to the section 475 taxpayer's entire tax return, absent reasonable cause to do so. In view of the considerations described above, this would be an extraordinarily harsh result that serves no tax policy objective and, we believe, is not consistent with Congressional intent.

Congress enacted the PFIC regime to minimize the principal tax benefits of investing in offshore corporations: deferral of current U.S. income tax, and the conversion of ordinary income from corporate earnings to capital gains upon disposition of stock. The default taxation regime for PFICs is the excess distribution regime under section 1291. Generally, gain from the sale of stock of a PFIC subject to the excess distribution regime is re-characterized as ordinary income.[3] In addition, this regime imposes an interest charge in order to approximate the tax that would have been imposed had the PFIC's income been distributed currently.[4]

Section 475 requires dealers in securities to mark to market securities that they hold as of the last business day of the year. Traders in securities may elect into this regime. By statute,

[3] Section 1291(a)(2).
[4] Section 1291(a)(1).

stock that is marked to market under section 475 is not subject to the PFIC excess distribution regime.[5] The reasons for this statutory exception are evident. A section 475 taxpayer does not benefit from tax deferral because it must take into income on a current basis any appreciation in securities it holds as inventory.[6] Additionally, gain or loss under section 475 is ordinary gain or loss.[7] Therefore, regardless of the existence of the excess distribution regime, section 475 taxpayers cannot defer taxes with respect to an investment in the stock of a PFIC and cannot convert ordinary income into capital gains. Section 475 taxpayers are also not subject to the two other PFIC regimes—the qualified electing fund ("QEF") regime under sections 1293 and 1295, and the separate mark-to-market regime under section 1296—because both of these regimes are elective. Because Congress has expressly excluded section 475 taxpayers from the PFIC income inclusion regimes, absent the Regulations section 475 taxpayers are under no obligation to, and have no reason to, determine whether a security constitutes stock in a PFIC.

Under Treasury regulation section 1.1298-1T(h), all direct shareholders of a PFIC, as well as certain indirect shareholders, are required to file a Form 8621 with their tax return with respect to shares of each PFIC held by the taxpayer.[8] Form 8621 requires the taxpayer to provide, among other items, the amount of inclusions or gains pursuant to the excess distribution, QEF, or section 1296 PFIC regimes, and any elections with respect to PFIC stock. Those numbers would be zero for securities that are being marked to market under section 475. Any gain resulting from marking the security to market under section 475 would be reported instead on Form 1120 or Form 1120-F in the case of a corporate section 475 taxpayer. Filing a Form 8621 thus would not provide the IRS with any additional information.

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5 Section 1291(d)(1) flush language.

6 Section 475(a)(1).

7 Sections 475(d)(3) and 1221(a)(1).

8 Temporary Treasury regulation section 1.1298-1T(b). There are certain exemptions from these reporting requirements, but these generally would not apply to section 475 taxpayers.

However, compliance with the PFIC reporting requirements would be a substantial burden for dealers in securities due to the nature of their business. By definition, a dealer holds securities in inventory, and regularly offers to buy and sell them with customers. A dealer may hold [thousands] of securities treated as stock for U.S. tax purposes over the course of a year, possibly for only a few days at a time. There is no mechanism in the market to provide dealers with real-time notice that the issuer of a security that the dealer acquires as inventory, rather than as an investment, is or may be a PFIC. [9] There also is no mechanism to inform a dealer at year-end whether securities that it may have held only for a few days at a time at one or more points during the year but does not hold at year-end were or were not issued by a PFIC. Moreover, that information may simply not exist, if shares of a foreign corporation were sold into non-U.S. markets without U.S. tax disclosure. As a result, due to the frequency and volume of purchases and sales of securities, dealers generally are unable to obtain sufficient information in their normal course of business to determine which of the securities they may have held in inventory during the course of a taxable year are treated as stock of a PFIC.

Adding to the filing burden, many U.S. securities dealers have controlled foreign subsidiaries that are also dealers in securities and that carry principally securities of foreign issuers in inventory. The Regulations generally require taxpayers to file a Form 8621 with respect to *indirect* interests in PFIC stock, including stock held by a controlled foreign

[9] We note that the determination of whether a particular security constitutes equity in a PFIC requires not only determining whether the issuer is a PFIC, but also whether a security that is not in the legal form of equity should be treated as such for U.S. federal income tax purposes. For example, it is common for the tax disclosure for legal-form subordinated notes issued by a collateralized loan obligation issuer organized outside the United States to state that it is likely that the notes will be treated as equity for tax purposes. The classification of certain mezzanine notes issued by the same issuer often is not certain. Dealers in securities would have to manually review the tax disclosure of these transactions in order to determine which securities to treat as equity, as that question is not relevant for any purpose other than U.S. tax and related reasons.

Dealers in securities would also have to file a Form 8621 for each PFIC in which they hold stock options because an option with respect to a PFIC is an interest in a PFIC for purposes of the reporting rules.

corporation.[10] In the case of a foreign securities dealer, income from holding stock of a PFIC in inventory generally would not give rise to any current U.S. tax liability, because the income arises from an active business activity.[11] The Regulations would therefore require significant additional diligence and compliance costs by U.S. dealers with foreign broker-dealer subsidiaries even though no current U.S. tax is due.

Notwithstanding the fact that filing a Form 8621 would provide no useful information to the IRS, the failure by a dealer in securities to file a Form 8621 will suspend the statute of limitations with respect to any tax return, event, or period to which such information relates, absent reasonable cause to do so.[12] Even if a dealer reports all of its taxable income from holding PFIC stock, if the taxpayer fails to file a single required Form 8621, the period during which the IRS can assess taxes will remain open, potentially including with respect to items that do not relate to the taxpayer's holding of the securities. In view of the fact that Congress has specifically provided that section 475 taxpayers are exempt from the excess distribution rules of section 1291, and that filing the Form would provide no information of any utility to the IRS, we do not believe that Congress intended the section 1298(f) reporting rules – and by extension, the potential extension of the statute of limitations if there is a failure to comply with those rules – to apply to section 475 taxpayers.

In conclusion, we believe that the new PFIC reporting requirements of Temporary Treasury regulation section 1.1298-1T should not apply to securities held by taxpayers that mark those securities to market under section 475, because such reporting would place significant

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10 Temporary Treasury regulation sections 1.1298-1T(b)(1)(ii), 1.1291-1T(b)(8)(ii).

11 *See* Section 954(c)(1)(B), flush language (gains and losses from inventory are not taken into account for subpart F purposes); Proposed Treasury regulation section 1.1296-6 (securities income earned by an active dealer or active broker is nonpassive income for PFIC purposes).

12 Section 6501(c)(8). If the taxpayer has reasonable cause for failing to disclose an item, the statute of limitations remains open for that item. The legislative history of this provision states that the taxpayer must demonstrate adequate measures for compliance with the law in order to have reasonable cause.

burdens on those taxpayers while providing no practical benefit to the IRS. We request that the Regulations be modified to exempt securities that are marked to market under section 475, including in the hands of controlled foreign corporations, from any reporting obligations under section 1298(f). Because the new PFIC reporting requirements apply to taxable years ending on or after December 31, 2013, we request that any exemption be issued within a reasonable period of time in order to assist calendar-year section 475 taxpayers in the preparation of their 2013 tax returns.

We appreciate your consideration of our views and concerns. Please do not hesitate to contact me at (202) 962-7300 or ppeabody@sifma.org or our outside counsel, Erika W. Nijenhuis at Cleary Gottlieb Steen & Hamilton, at (212) 225-2980, with any questions.

Sincerely,

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Securities Industry and Financial Markets Association