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June 3, 2013

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Re: Report on Subpart F Issues Involving Currency Gain and Loss

Dear Messrs. Mazur, Werfel and Wilkins:

I am pleased to submit the enclosed New York State Bar Association Tax Section Report, which comments on the treatment of currency gain as "subpart F income," and related issues, under selected circumstances. In particular, we understand that in a variety of commonplace circumstances, when a "controlled foreign corporation" (a "CFC") engages in certain "treasury center" and other routine hedging activities, the subpart F rules relating to currency gain and loss (together with related rules) frequently produce U.S. federal income tax results for the U.S. owner of the CFC that are inconsistent with its economic position. Because of this potential divergence between the tax consequences and the economic consequences, these routine, economically neutral, business-driven transactions are often accompanied by significant tax uncertainty and potentially problematic tax consequences.

The Report investigates whether the subpart F regime (and other rules discussed in the Report) can be interpreted under current law ("as is" or with minimal interpretive guidance from Treasury and the IRS) to eliminate or minimize potential unpredictable and/or adverse consequences resulting from customary treasury center and hedging activity, or whether instead one or more of these

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regimes should be modified (and if so how) to make clear, or clearer, that certain activity does not produce unpredictable or unreasonable tax consequences.

Broadly, the Report comments on three simplified fact patterns:

A CFC that is a member of a U.S. multinational group acts as a financing entity for other group members (a “**TCFC**”), typically by borrowing from banks in various currencies (often not the TCFC’s own functional currency) and “on-lending” those amounts to other group members that require funding (what we call “**back-to-back loans**”).

A CFC hedges its investment in a subsidiary CFC that operates in a different functional currency from that of the parent CFC (often called a “**net investment hedge**” or a “*Hoover hedge*”).

A CFC hedges its exposure to ordinary property held by a qualified business unit of the CFC (a “**QBU**”)¹ that operates in a different functional currency from that of the CFC (a “**QBU Hedge**”).

Regarding the first fact pattern (“**back-to-back loans**”), we conclude that there are a number of ways of efficiently minimizing tax volatility, all of which would likely require regulatory modifications or at least administrative clarifications of current law. We highlight alternatives we believe would be effective in addressing the issues without causing “collateral damage”.

One such alternative would permit TCFCs to (1) identify non-functional currency borrowings as “Section 475 hedges” of their loan assets and (2) allocate currency gain or loss from those borrowings to subpart F and non-subpart F income in the same way that currency gain or loss from the relevant loan assets is allocated, at least to the extent of such gain or loss.

A second alternative would permit TCFCs to “bifurcate” a non-functional currency borrowing into a functional currency borrowing and a “currency swap,” with the tax items resulting from the currency swap being “matched” with the tax items resulting from the related loan asset in one of several alternative ways.

Our conclusion relating to the second fact pattern (“*Hoover hedges*”) is that it is very unlikely that the currency gain or loss arising from a *Hoover* hedge can be excluded from the computation of subpart F income under current law, although it would be reasonable to modify the law to permit this result.

Our conclusion relating to the third fact pattern (“**QBU hedges**”) is that, while the technical issues involved in the analysis are quite complex and somewhat unclear, it is likely appropriate under current law for a CFC to treat currency gain or loss items arising from an identified hedge of ordinary property of its non-functional currency QBU as excluded from the computation of subpart F income under the “business

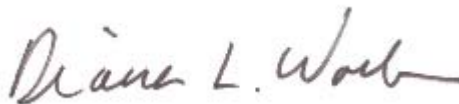
¹ Under the Internal Revenue Code, if a business unit of a CFC qualifies as a QBU, that business unit is permitted to have a “functional currency” different from that of the CFC.

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needs exception” in Section 954(c)(1)(D) of the Internal Revenue Code and the regulations thereunder. However, because of the significant complexity and the unfavorable consequences that can arise from erroneously identifying, or failing to identify, a position as a hedge, we recommend that guidance be issued clarifying the point.

In general, we think it a worthwhile endeavor to attempt to minimize the unpredictability and “tax volatility” associated with the fact patterns described in the report, and we support efforts to do so. There are a number of ways to achieve each of those objectives, and we have attempted to set forth the pros and cons of some of the more obvious ones in the report. We would of course be happy to assist you in further considering all or any of our suggested approaches.

Respectfully submitted,

A handwritten signature in dark ink, appearing to read "Diana L. Wollman". The signature is fluid and cursive, with the first name "Diana" being more prominent.

Diana L. Wollman
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Enclosure

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