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March 8, 2010

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Honorable Douglas H. Shulman
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Re: Report on Select Issues with Respect to the Passive Foreign Investment Company Rules

Gentlemen:

We write to comment on certain aspects of the passive foreign investment company ("PFIC") rules. We have prepared our report in response to an informal request for comments from the Internal Revenue Service. The report focuses on the PFIC regime as applied to banking and financial institutions and on the changes that we recommend be made to Proposed Treasury Regulations section 1.1296-4 (the "Banking Regulations") before they are finalized. We also address other issues that arise under the existing PFIC regime that we believe should also be addressed.

Generally, we believe that, within the constraints of the applicable statutory provisions, the goal should be to narrow the entities that are unnecessarily treated as PFICs and to maximize the ability of holders to make qualified electing fund ("QEF") or mark-to-market elections. We believe that our recommendations, if implemented, will help to achieve that goal. We believe, moreover, that our suggested changes to the PFIC regime should and can be implemented through Treasury regulations.

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With respect to the Banking Regulations, our principal proposals may be summarized as follows:

1. with respect to the deposit taking requirement, (i) to add a "safe harbor" to the existing "substantiality" test for foreign banks which have deposits equal to at least 30 percent of their total liabilities; (ii) to confirm that interbank deposits from other banks are treated as deposits; (iii) to remove as a fact or circumstance to be considered the comparison to the funding sources of other banks in the same jurisdiction; and (iv) to reconsider the requirement that only the deposits by residents of the country or countries in which the foreign bank or its branches is licensed or authorized to engage in a banking business are considered for purposes of satisfying the deposit taking requirement;
2. with respect to the lending requirement, (i) to specify that interbank deposits with both related and unrelated parties are to be treated as loans; and (ii) to permit debt instruments and other securities held by a foreign bank, as a result of its direct or indirect broker-dealer activities, to be treated as part of a lending business;
3. to eliminate the concept of restricted reserves and allow a banking entity to maintain liquid assets in order to meet its liquidity needs;
4. with respect to the list of banking activities that generate "good" banking income, (i) to confirm that such list has non-exhaustive character; and (ii) to include activities such as investment banking activities as well as securities dealing;
5. if section 954(h) is not considered generally applicable for purposes of section 1297(b), to relax the license requirement by treating bank-like activities or services performed by foreign corporations that are not licensed or authorized to accept deposits as activities that give rise to active income, provided that the corporation satisfies requirements analogous to those under section 954(h) (a substantial minority of our Executive Committee would not relax the rules for such corporations even under such circumstances); and
6. to clarify whether, for purposes of section 1297(b), section 954(c) should be treated as incorporating all the exceptions to passive income that are not within section 954(c) itself.

With respect to other aspects of the PFIC regime, our principal proposals may be summarized as follows:

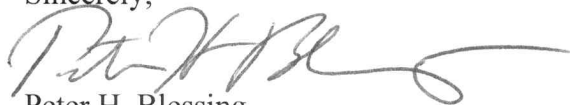
1. to treat working capital if held for use in an active trade or business as a nonpassive asset so long as the amount is reasonable;

2. with respect to the mark-to-market election, (i) to make clear that if such election is made with respect to the stock of a top-tier PFIC in a tiered PFIC structure, the mark-to-market election covers all assets of the top-tier PFIC; and (ii) to provide guidance with respect to which foreign exchanges will be treated as "qualified exchange or other market;"
3. with respect to the 25 percent look-through rule under section 1297(c), (i) subject to specific exceptions, to make clear that the character of income and assets should generally be tested at the level of the subsidiary; (ii) for purposes of the income and asset tests, to proportionally disregard transactions (a) between a parent and its 25 percent-owned subsidiaries and (b) among such subsidiaries; and (iii) to make clear that gain recognized upon the disposition of an interest in a 25 percent-owned subsidiary should be characterized as if the corporation had sold a proportionate share of the subsidiary's assets;
4. with respect to tiered PFIC structures, (i) to provide appropriate tax basis adjustments for corresponding QEF inclusions at the intermediate levels of such structures; and (ii) to adopt certain rules to prevent inappropriate recognition of gain in tiered PFIC structures;
5. with respect to the own employees tests under Treasury regulations under section 954, to provide that, in certain cases, such tests should be applied by attributing to the foreign corporation the relevant employee activities (and employee compensation expenses) of any person whose income is attributed to the foreign corporation under the 25 percent look-through rule;
6. with respect to reorganizations, (i) to finalize Proposed Treasury Regulations section 1.1291-6 with a number of modifications; and (ii) to provide guidance on the applicability and effect of section 1291(e);
7. with respect to the income and asset tests, to allow certain minority shareholders in a foreign corporation to use the foreign corporation's financial statements as the basis for making the determination of whether such corporation is a PFIC;
8. with respect to the QEF election, (i) to relax some of the requirements to make a "preferred" QEF election; and (ii) to allow United States persons that have made a QEF election to compute their pro rata share of the income of a PFIC based on the financial statements of such PFIC;
9. with respect to a person holding an option to acquire stock in a PFIC, (i) to allow such person to make a QEF or, if the option is with respect to marketable stock, a mark-to-market election (alternatively, such person should not be subject to the interest charge under section 1291 and/or should be allowed to make a purging election upon exercise of the option provided such options meet certain

requirements); (ii) to define the term "option to acquire stock" for purposes of section 1298(a)(4); and (iii) to exclude compensatory stock options from such definition.

We appreciate your consideration of our comments. Please let us know if you would like to discuss these matters further or if we can assist you in any other way.

Sincerely,



Peter H. Blessing
Chair

cc: Ethan A. Atticks
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