NEW YORK STATE BAR ASSOCIATION
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June 9, 2011

Honorable Emily McMahon
Acting Assistant Secretary
(Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

Honorable William J. Wilkins
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue
Washington, D.C. 20224

Honorable Douglas H. Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue
Washington, D.C. 20224

Re. Report On the Taxation of Securities Loans and the Operation of Section 1058

Dear Ms. McMahon, Mr. Wilkins and Mr. Shulman:

I am pleased to submit the New York State Bar Association Tax Section Report No. 1239 which requests guidance under section 1058 on the tax treatment of securities loans. The impetus for this report is three relatively recent Tax Court decisions — *Samueli, Anschutz* and *Calloway* — that interpret section 1058 in situations where securities loans were part of larger, more complicated transactions, each one raising its own specific set of tax policy concerns that extend beyond section 1058. Although we have no wish to comment on the ultimate decisions reached in those cases, the

three cases have created some uncertainty as to their potential scope and how they might be applied to deny section 1058 nonrecognition treatment to market-standard securities loans that do not raise the issues that were present in those cases.

Accordingly, the primary recommendation of the report is that Treasury and the IRS issue guidance as to their view of the proper scope of these decisions. First, in response the *Samueli* (and to some degree, to *Calloway*), we believe that it would be appropriate for Treasury and the IRS to clarify whether they view all securities loans with fixed terms as ineligible for nonrecognition treatment under section 1058, and to consider allowing a "safe harbor" under section 1058 for relatively short-term transactions (*e.g.,* three months or less). We believe that such a safe harbor would be consistent with the policies underlying section 1058, because it would facilitate ordinary-course securities lending that does not raise any of the issues that were present before the *Samueli* court.

In addition, in response to *Anschutz*, we believe that it would be useful for Treasury and the IRS to issue guidance as to when they believe a securities loan properly should be integrated with a hedge of the underlying security for purposes of determining when the loan fails to meet the requirement of section 1058(b)(3) (*i.e.,* the requirement that loan neither reduce the lender's opportunity for gain or risk of loss with respect to the underlying security). We recommend a standard that looks to whether ancillary agreement between a securities lender and borrower have the practical effect of turning what is formally documented as a securities loan into a permanent disposition of the underlying securities, rather than a mere temporary transfer. In other words, under our recommended standard, a hedge of a loaned security would not be integrated with the loan to create a violation of the requirement of section 1058(b)(3) if the hedge does not prevent the lender from receiving back the loaned security and exercising full rights of disposition over the loaned security. We believe that such a standard would be consistent with *Anschutz*, at least as the Tax Court interpreted the facts of that case.

The report also makes several recommendations regarding section 1058 that are not directly related to the three Tax Court cases. Among other matters, the report suggests that the definition of "securities" under section 1058 be broadened to include instruments that currently are actively traded and capable of being lent and borrowed, but that were not prevalent when section 1058 was first enacted in 1978. The report recommends that Treasury and the IRS consider a regime whereby lenders of securities would be required to include in income in respect of loaned securities that has accrued but that did not give rise to a distribution or other payment during the term of the securities loan. The report also recommends that section 1058 be treated as a "safe harbor," so that the failure, for example, of a stock loan to meet the requirements of section 1058 would not necessarily prevent the loan from qualifying for tax free treatment under section 1036.

Finally, the report contains suggestions for updating the regulations that were issued in proposed form in 1983, but that have yet to be finalized or withdrawn.

We appreciate your consideration of our recommendations. If you have any questions or comments regarding this report, please do not hesitate to contact us.

Sincerely,

Jodi J. Schwartz

cc:

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