New York State Bar Association

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June 4, 2004

Mr. Gregory F. Jenner
Acting Assistant Secretary (Tax Policy)
Department of the Treasury
Room 3120 MT
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220

The Honorable Mark W. Everson
Commissioner
Internal Revenue Service
Room 3000 IR
1111 Constitution Avenue, N.W.
Washington, DC 20224

Dear Acting Assistant Secretary Jenner and Commissioner Everson:

I am pleased to enclose New York State Bar Association Tax Section Report No. 1062 concerning proposed regulations addressing nonperiodic notional principal contract ("NPC") payments and certain related issues. The proposed regulations represent a novel approach to a very difficult tax accounting issue, and we commend the Treasury and the Internal Revenue Service for their ongoing efforts in this regard.

In general, the Report supports aspects of the proposed regulations, but identifies several areas of concern. First, we do not support the proposed annual payment-schedule redetermination requirement for contingent nonperiodic payment NPCs. The annual redetermination requirement is complex, burdensome, imprecise and an inadequate response to its apparent underlying policy objective of reducing taxpayers' ability to manipulate the character of items with respect to contingent nonperiodic payment NPCs. Rather, we think that this objective can and should be achieved directly, by modifying the rules relating to the character of NPC payments (as we have proposed in a prior report).

As to the proposed regulations' "basic" treatment of contingent nonperiodic payments (*i.e.*, in the absence of an annual redetermination requirement), we do not oppose the use of this regime for many NPCs. However, the report describes several categories of NPCs that should not be subject to this regime, or any amortization method of accounting, including "credit default swaps" that hedge fixed income portfolios (which we believe should be subject to a wait-and-see method) and certain relatively short-dated instruments whose contingent payments are determined by reference to the change in value of one or more capital assets, which we call "capital asset value" swaps, and which should be subject to an "open transaction" method of accounting.

We generally support the proposed regulations' elective mark-to-market regime for contingent nonperiodic payment NPCs (but not for noncontingent nonperiodic payment NPCs), but we do not believe an interest charge should be imposed in the case of credit default swaps and capital asset value swaps. We also strongly oppose the repeal of the anti-abuse rule, given the many types of economically dissimilar transaction that come under the rubric of an "NPC" and the myriad possibilities for taxpayer abuse.

With regard to the preamble to the proposed regulations, I have previously submitted a letter in my own name addressing a number of time-sensitive aspects of this "transition language." In the Report, the Tax Section proposes that guidance be issued clarifying that instruments entered into prior to the issuance of the proposed regulations will not be challenged, except in cases of specific abuse. As to transactions entered into thereafter, guidance should be provided to the effect that such transactions will be subject to a change of accounting method not earlier than the time of finalization of the proposed regulations, if they then remain outstanding. Such guidance should also provide that for transactions entered into after the date of such guidance, taxpayers will be required to use a reasonable amortization method to account for contingent nonperiodic payment NPCs, but will not be allowed to use the wait-and-see or open transaction methods, other than with respect to certain credit default swaps (for which wait-and-see will remain available) and shorter-term capital asset value swaps (for which taxpayers may use the open transaction method.

As always, we would be pleased to provide assistance in any way we can.

Respectfully submitted,

Lewis R. Steinberg
Chair

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