MFA

May 30, 2025

Via Electronic Submission

Internal Revenue Service
Attn: CC:PA:01:PR (Notice 2025-19) Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: Public Recommendations Invited on Items to be Included on the 2025-2026 Priority Guidance Plan

MFA[1] stands ready to work with the U.S. Department of the Treasury, the Internal Revenue Service (the "**IRS**" and, collectively, the "**Treasury**"), and the new Administration to further advance policies that support U.S. economic growth and the financial well-being of all Americans. We believe that the Treasury under the Trump Administration has an opportunity to turn the page by revisiting the prior Administration's policies that have harmed, and better future economic outcomes by adopting policies that support, markets, investors, and the economy.

Pursuant to the President's Presidential Memoranda and Executive Orders, we encourage the Treasury to review and reevaluate rules and agency actions that impose significant, unjustified costs and burdens on investors and other market participants with little to no corresponding benefits.[2] In particular, we urge the Treasury to immediately halt, review, and provide relief from the policies outlined in the first part of the letter below and adopt policies in the second part of the letter below to reduce costs and burdens on market participants and improve the financial markets consistent with the President's Presidential Memoranda and Executive Orders.

Executive Summary

Alternative asset managers are an important investor constituent and can be drivers of economic growth. Along with other market participants, years and layers of inefficient and mismatched regulatory burdens have weighed down the potential benefits alternative asset managers provide to their investors, the markets, and the U.S. economy. In the first part of this letter, we urge the Treasury to:

- Withdraw IRS Advice Memorandum 2023-003 to reverse its harmful effect on publicly-traded American real estate, infrastructure, and energy companies
- Withdraw the 2022 proposed regulations that treat economically comparable and interchangeable over-the-counter and listed foreign currency options differently to enhance FX markets
- Withdraw the 2022 proposed regulations that make passive foreign investment company investments more complex and costly for investors

- Withdraw the IRS's "Self-Employment Contributions Act tax" campaign as the IRS's position exceeds its statutory authority

In the second part of this letter, we urge the Treasury to take the following actions to promote capital formation, improve regulatory efficiency, and reduce waste:

- Issue proposed regulations to make passive foreign investment company investments less complex and costly for investors by aligning the associated tax compliance with investor preferences
- Issue proposed regulations to protect small- and mid-sized U.S. businesses from the Corporate Alternative Minimum Tax
- Issue proposed regulations to update the publicly traded partnership safe harbors to protect investors from duplicative, unnecessary, and costly layers of tax
- Issue proposed regulations to protect convertible bondholders from "phantom" income
- Issue proposed regulations to make derivatives trading less complex and costly for investors

We believe each of these recommendations is consistent with the President's recent Presidential Memoranda and Executive Orders, which are designed to ensure lawful governance and reduce waste, and will go a long way toward reversing past policies that have harmed and advancing new policies that will enhance markets, investors, and the economy.

MFA Recommendations, Part 1: Withdraw Prior Administration Policies[3]

A. Withdraw IRS Advice Memorandum 2023-003 to reverse its harmful effect on publicly-traded American real estate, infrastructure, and energy companies

The prior Administration adopted a policy in IRS Advice Memorandum ("**AM**") 2023-003 that artificially limits investments in publicly-traded American real estate, infrastructure, and energy companies by American institutional investors—pension plans, charitable foundations, and other tax-exempt organizations—which pool their capital in non-U.S. investment funds. AM 2023-003 restricts an investment fund structure's total investment in a publicly-traded American real estate, infrastructure, and energy company to 5%, without regard to a non-U.S. investment fund within the larger investment fund structure's pro rata share of the investment in the publicly-traded American real estate, infrastructure, and energy company. Practitioners have long believed, with substantial justification, that this critical 5%-threshold is applied at the non-U.S. investment fund's pro rata share of the investment.

This policy impedes the development of energy and natural resources and harms the national interest by significantly and unjustifiably impeding infrastructure and economic development. AM 2023-003 artificially limits investments in publicly-traded American real estate, infrastructure, and energy companies which reduces liquidity in those companies and can significantly impact their ability to raise capital, manage costs, and remain solvent in times of financial stress. AM 2023-003 also dampens returns for the beneficiaries of American institutional investors—retirees, philanthropies, and other beneficiaries.

The policy is also contrary to the best reading of the underlying statutory authority. The reasoning of AM-2023-003 is deeply flawed, contrary to the legislative purpose of this critical 5%-threshold, and contrary to comparable statutory frameworks. Accordingly, we recommend that the Treasury reverse AM 2023-003's harmful effect on publicly traded American real estate, infrastructure, and energy companies.

See Appendix A for additional detail.

B. Withdraw the 2022 proposed regulations that treat economically comparable and interchangeable over-the-counter and listed foreign currency options differently to enhance FX markets

The prior Administration proposed regulations that would treat economically comparable and interchangeable over-the-counter ("**OTC**") and listed foreign currency options differently. The proposed regulations would subject OTC foreign currency options to tax at ordinary income tax rates, while listed foreign currency options are subject to annual recognition of gains and losses as capital gains and losses using a ratio of 40% short-term and 60% long-term.

This policy adds to the ever-expanding morass of complicated federal regulation governing the taxation of financial products which impedes the efficiency and integrity of financial markets. Market participants view OTC and listed foreign currency options as interchangeable, and policies that would treat OTC and listed foreign currency options differently distort and make more complex and inefficient the decision between OTC and listed markets, which is traditionally a function of liquidity and execution cost.

The policy is also contrary to the best reading of the underlying statutory authority. The central thrust of legislation addressing the taxation of foreign currency contracts is towards allowing similar tax treatment to apply to economically comparable and interchangeable contracts. The economic comparability and interchangeability of OTC and listed foreign currency options supports the Treasury's discretion to treat OTC foreign currency options as foreign currency contracts. Accordingly, we recommend that the Treasury withdraw the 2022 proposed regulations that treat economically comparable and interchangeable OTC and listed foreign currency options differently.

See Appendix B for additional detail.

C. Withdraw the 2022 proposed regulations that make passive foreign investment company investments more complex and costly for investors

The prior Administration proposed regulations that would make passive foreign investment company ("**PFIC**") tax compliance orders of magnitude more complex and costly by requiring investors, rather than fund managers, to service the compliance burden associated with PFIC investments. The most common PFIC investments include foreign mutual funds, exchange-traded funds, money market funds, other pooled investment vehicles, and investments within foreign insurance products or foreign pension plans not qualified under U.S. income tax treaties.

U.S. investors prefer to rely on fund managers, which tend to be better situated in terms of sophistication, resources, and insight into PFIC investments, to service the compliance burden associated with their investments. Investors also prefer to rely on fund managers in this respect because the fund manager is being paid to manage the investment, including related compliance, and is best positioned to streamline reporting and reduce costs.

This policy adds to the ever-expanding morass of complicated federal regulation governing the taxation of investors and market participants, imposes significant costs upon private parties that are not outweighed by public benefits, and, therefore, weakens the United States' world-leading private and public capital markets and hampers our global competitiveness. Fund managers often face significant resistance from investors with respect to increasingly complex investor-level tax compliance obligations which, as a collateral consequence, tend to have a chilling effect on investment more broadly. Accordingly, we recommend that the Treasury withdraw the 2022 proposed regulations that make PFIC investments more complex and costly for investors.

See Appendix C for additional detail.

D. Withdraw the IRS's "Self-Employment Contributions Act tax" campaign as the IRS's position exceeds its statutory authority

The prior Administration adopted an audit and litigation position in the IRS's "Self-Employment Contributions Act ("**SECA**") tax" campaign that injected substantial and unnecessary uncertainty into the taxation of numerous small, mid-size, and large businesses operating as limited partnerships, in a wide variety of industries. For almost 50 years, the distributive share of income allocated to a partner with limited liability under state law (other than guaranteed payments for services actually rendered) has been understood to be exempt from self-employment tax. The IRS has sought to rewrite the phrase "limited partner" for self-employment tax purposes to exclude limited partners who provide services to partnerships through its SECA tax campaign.

This position implicates matters of economic significance that are not authorized by clear statutory authority and is not based on the best reading of the underlying statutory authority. Prior to the SECA tax campaign, the well-settled understanding of this self-employment tax provision was informed by its purpose and legislative history, and contemporaneous interpretations by both the IRS and the Social Security Administration (the "**SSA**"). The IRS sought its novel rewrite not by asking Congress to amend the statute. Instead, through years of audits, administrative appeals, and litigation, and separately, quietly amending the decades-old definition of "limited partner" in the instructions for the partnership tax return, the IRS has attempted to support its novel rewrite, which is beyond its statutory authority. At the same time, proposed regulations have remained on the Priority Guidance Plan despite not being authorized by clear statutory authority. Accordingly, we recommend that the Treasury withdraw the IRS's "SECA tax" campaign.

See Appendix D for additional detail.

MFA Recommendations, Part 2: Adopt Policies to Promote Capital Formation, Improve Regulatory Efficiency, and Reduce Waste

E. Issue proposed regulations to make passive foreign investment company investments less complex and costly for investors by aligning the associated tax compliance with investor preferences

The new Administration has the opportunity to strengthen the United States' world-leading private and public capital markets. As described above, investors prefer to rely on fund managers to service the compliance burden associated with their PFIC investments. In addition to withdrawing the 2022 proposed regulations that make PFIC investments more complex and costly for investors, the Treasury can issue proposed regulations to make PFIC investments less complex and costly for investors by aligning tax compliance with investor preferences.

Currently, investors which hold PFIC investments through foreign partnerships must make elections and service the related compliance burden of PFIC reporting themselves. Foreign partnerships already have U.S. tax compliance obligations in other contexts to exclusively make U.S. tax elections. Accordingly, we recommend that the Treasury issue proposed regulations to allow foreign partnerships to make elections and service the related compliance burden of PFIC reporting for investors.

However, PFIC reporting is still inordinately complex for fund managers and investors. PFIC investments must be annually reported on Form 8621, *Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund*, for each PFIC investment. The one-PFIC-per-Form 8621 format creates unnecessary information collection burdens and compliance costs. A single, consolidated Form 8621 with a landscape, or horizontal, supporting schedule which lists the relevant information for every PFIC investment would alleviate some of the compliance burden associated with PFIC investments. Accordingly, we recommend that the IRS re-design Form 8621 to allow for disclosure of more than one PFIC investment and the relevant elections in respect of those PFIC investments.

See Appendix E for additional detail.

F. Issue proposed regulations to protect small- and mid-sized U.S. businesses from the Corporate Alternative Minimum Tax

The prior Administration adopted regulatory policies that subject small- and mid-sized U.S. businesses to the brunt of the corporate alternative minimum tax ("**CAMT**") initially promised to be limited to only 150 of the world's largest companies. However, certain investment funds, referred to as "hybrid" funds, engage in multiple investment strategies within a single fund that include active trading of securities in the public markets and acquisitions of controlling stakes in private companies. The portfolio companies—small- and mid-sized U.S. businesses—owned by such investment funds may be aggregated and subject to the CAMT.

These policies create a substantial restraint on our economic growth and ability to build and innovate. These policies also harm the national interest by significantly and unjustifiably impeding economic development. Congress did not intend to subject small- and mid-sized U.S. businesses to the CAMT solely based on the receipt of outside capital from an investment fund, particularly since these portfolio companies are under separate management, usually have unrelated shareholders (including management, employees, and co-investors), do not coordinate business or tax strategies, do not share information with one another, and typically are bought and sold separately after being held for a limited investment period. Accordingly, we recommend that the Treasury protect small- and mid-sized U.S. businesses from the CAMT by excluding portfolio companies owned by investment funds from aggregation for purposes of the CAMT.

See Appendix F for additional detail.

G. Issue proposed regulations to update the publicly traded partnership safe harbors to protect investors from duplicative, unnecessary, and costly layers of tax

The new Administration has the opportunity to strengthen the United States' world-leading private and public capital markets. The safe harbors from the publicly traded partnership ("**PTP**") rules protect investors from being subject to duplicative, unnecessary, and costly layers of tax. The redemption and repurchase agreements, private placement, and lack of actual trading safe harbors were intended to ensure that investors in investment partnerships are not subject to corporate income tax where their investment is not publicly tradable. Subjecting investors to an indirect layer of corporate income tax distorts investment decisions by punishing the pooling of capital to achieve economies of scale in investing which, in turn, weakens private and public capital markets.

However, these safe harbors have not been updated since 1995, whereas private and public markets and the laws which govern them have significantly evolved. The redemption and repurchase agreements and lack of actual trading safe harbors do not realistically reflect thresholds above which investments enjoy public market-type liquidity. The private placement safe harbor provides a 100-investor limit which is outdated in the context of the federal securities laws which, for practical purposes, provide a 2,000-investor limit. Accordingly, we recommend that the Treasury modernize the PTP regime by updating these safe harbors to reflect market realities and enhance private and public capital markets.

See Appendix G for additional detail.

H. Issue proposed regulations to protect convertible bondholders from "phantom" income

The new Administration has the opportunity to remove substantial restraints on our economic growth and ability to build and innovate. The convertible bond markets have been hampered by rules that tax bondholders on "phantom" income that may never be received. Specifically, bondholders which receive the benefit of a conversion ratio adjustment ("**CRA**") are subject to a taxable deemed distribution, regardless of whether the convertible feature is in-the-money, or whether the bond is ever converted.

CRAs are a common anti-dilution feature of convertible bonds which protect against erosion in the value of the conversion right by modifying the number of shares into which a bondholder may convert when an issuer pays a dividend to shareholders, to account for the value paid to other shareholders. CRAs are not intended to, nor do they in fact, provide bondholders with economic value equivalent to shareholders which have received a cash dividend, or which have increased their proportionate interest in the corporation, for example, by receiving stock dividends in lieu of a cash dividend. Bondholders often do not have the right to exercise their conversion rights at the time of a CRA and may *never* exercise their conversion rights. As such, bondholders are no better off after the dividend is paid to the other shareholders than the bondholders were prior to the dividend. Notwithstanding this fundamental economic difference, the anti-dilution protection provided by a CRA creates a taxable event for bondholders.

These rules add to the ever-expanding morass of complicated federal regulation governing the taxation of financial products, impose significant costs upon private parties that are not outweighed by public benefits, and, therefore, weaken the United States' world-leading private and public capital markets and hamper our global competitiveness. Accordingly, we recommend that the Treasury issue proposed regulations to protect convertible bondholders from uneconomic deemed distributions.

See Appendix H for additional detail.

I. Issue proposed regulations to make derivatives trading less complex and costly for investors

The new Administration has the opportunity to strengthen the United States' world-leading private and public capital markets. The derivatives markets have been threatened by unimplemented rules that would make tax administration and compliance orders of magnitude more complex and costly. The "substitute dividend payment" rules subject "dividend equivalent payments," paid or deemed paid under certain derivatives, to U.S. withholding tax. In 2015, the Treasury promulgated regulations providing that certain derivatives that have a delta of 0.8 or greater with respect to an underlying U.S. stock would be subject to the substitute dividend payment rules, but the implementation of the non-delta-one standard has presented overwhelming and intractable administrative challenges. As a result of these challenges, the substitute dividend payment rules have never actually applied to non-delta-one transactions—the IRS has delayed application of the rules five times, for a period that covers a decade.

These markets have also been hampered by ill-defined and overbroad rules that have created significant uncertainty for investors which impedes the efficiency and integrity of financial markets. The substitute dividend payment rules further provide that derivatives that reference a "qualified index" will be treated as a single security that is not an "underlying security," rather than treated as referencing any U.S. stocks in the index. Therefore, derivatives that reference a qualified index are provided safe harbor from the substitute dividend payment rules. However, an investor must not hold related short positions (for example, for downside protection, or hedging, purposes, or for purposes of an index convergence strategy) of more than 5% of the value of the long positions in the index, unless the short position relates to the entire index. This short position rule lacks clarity on how to determine whether and to what extent a short position should be treated as entered "in connection with" a long position on an index and unduly punishes common trading strategies which are not designed to avoid U.S. withholding tax on dividend equivalent payments.

These rules add to the ever-expanding morass of complicated federal regulation governing the taxation of financial products, impose significant costs upon private parties that are not outweighed by public benefits, and, therefore, weaken the United States' world-leading private and public capital markets and hamper our global competitiveness. Accordingly, we recommend that the Treasury issue proposed regulations to remove non-delta-one transactions from the scope of the substitute dividend payment rules and remove the short position rule from the qualified index safe harbors.

See Appendix I for additional detail.

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MFA appreciates your consideration of our recommendations. We look forward to working with the Treasury to improve tax policy to protect investors, support U.S. economic growth, and promote capital formation. We would be pleased to discuss our recommendations in further detail. Please do not hesitate to reach out to Joseph Schwartz, Vice President and Senior Counsel, at jschwartz@mfaalts.org.

Respectfully submitted,

/s/ Jennifer W. Han

Jennifer W. Han
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cc: Michael Faulkender, Deputy Secretary of the Treasury & Acting Commissioner of Internal Revenue, U.S. Department of the Treasury
Andrew De Mello, Acting Chief Counsel of the Internal Revenue Service, U.S. Department of the Treasury
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Appendix A: Withdraw IRS AM 2023-003 to reverse its harmful effect on publicly-traded American real estate, infrastructure, and energy companies

Foreign investors are generally not subject to U.S. tax on gains from the sale of U.S. stocks,[4] whereas such investors are subject to U.S. tax on gains treated as effectively connected with a U.S. trade or business ("**ECI**").[5] One exception to these principles applies to gain from the sale of U.S. real property interests ("**USRPIs**") and U.S. real property holding corporations ("**USRPHCs**"), defined as any corporation with U.S. real estate equal to or greater than 50% its worldwide real estate and business assets,[6] the sale of which are treated as ECI.[7] **USRPHCs are frequently publicly-traded American real estate, infrastructure, and energy companies.**[8]

However, Congress carved out the "**Regularly Traded Exception**" under which gain from the sale of USRPHC stock will not be treated as ECI if regularly traded on an established securities market and the foreign investor held 5% or less of such stock (the "**5%-threshold**").[9] "Congress's most likely purpose in enacting [the Regularly Traded Exception] was…to encourage foreign investment in U.S. capital markets while distinguishing small passive foreign portfolio investors from those making substantial direct investments…"[10] Congress espoused a similar purpose in increasing the 5%-threshold to 10% for ownership in a REIT by a foreign investor in the Consolidated Appropriations Act of 2016.[11]

In the context of a partnership with foreign partners, practitioners have long believed, with substantial justification,[12] that the 5%-threshold is tested at the partner-, rather than the partnership-, level. However, in May 2023, without the benefit of notice-and-comment rulemaking which should be required of pronouncements of significant economic consequence, the IRS Office of Chief Counsel took the thinly-reasoned position that the 5%-threshold applies at the partnership-level, meaning that many investment funds (often organized as partnerships) have been, for practical purposes, artificially limited to investing in no more than 5% of publicly-traded American real estate, infrastructure, and energy companies, regardless of its foreign investors' proportionate interest in such companies. Investment funds running afoul of the partnership-level 5%-threshold would push U.S. tax and filing obligations to investors which previously and otherwise would not have been subject to such obligations. **The practical result of AM 2023-003 is dampened investment in publicly-traded American real estate, infrastructure, and energy companies.**

Although described as "foreign investors," the ultimate beneficial owners of the interests of an entity typically structured as a foreign corporation, which is a limited partner of an investment fund, are often American institutional investors—pension plans, charitable foundations, and other tax-exempt organizations. Investment funds with American tax-exempt organization investors are frequently structured so that such organizations are invested in the fund through an entity organized in a foreign jurisdiction and treated as a corporation for federal income tax purposes. Investing through this "foreign feeder" allows American tax-exempt organization investors to avoid incurring unrelated business taxable income ("**UBTI**"). **Accordingly, a further practical result of AM 2023-003 is dampened returns for the beneficiaries of American institutional investors—retirees, philanthropies, and other beneficiaries. Accordingly, we recommend that the IRS Office of Chief Counsel issue a new general legal advice memorandum to reverse AM 2023-003's dampening effect on investments in publicly-traded American real estate, infrastructure, and energy companies.**[13]

Appendix B: Withdraw the 2022 proposed regulations that treat economically comparable and interchangeable OTC and listed foreign currency options differently to enhance FX markets

Taxpayers generally recognize gain or loss in the taxable year in which they sell or dispose of an asset.[14] Special rules apply to the taxation of certain derivatives which are considered "Section 1256 contracts." Under current law, the definition of a Section 1256 contract includes any regulated futures contract, any *foreign currency contract*, any nonequity option,[15] any dealer equity option, and any dealer securities futures contract.[16] The term "foreign currency contract" is defined as a contract that: (1) requires delivery, or the settlement of which depends on the value, of a foreign currency in which positions are also traded through regulated futures contracts, (2) is traded in the interbank market, and (3) is entered into at arm's length at a price determined by reference to the price in the interbank market.[17] A Section 1256 contract held by a taxpayer at the close of the taxable year is treated as sold for its fair market value on the last business day of that taxable year.[18] Adjustment is made in the amount of any gain or loss subsequently realized to take into account the gain or loss previously recognized.[19] Any gain or loss on a Section 1256 contract is treated as 60% long-term capital gain or loss and 40% short-term capital gain or loss.[20]

When enacted in 1981, Section 1256 applied only to regulated futures contracts which require delivery of foreign currency traded on futures exchanges.[21] Section 1256's scope was soon expanded to include similar foreign currency forward contracts that were traded on the interbank market and other OTC markets.[22] According to the legislative history, this expansion was due to the *economic comparability* of trading foreign currency through forward contracts in the interbank market to trading foreign currency through regulated futures contracts and the *interchangeability* of the two types of contracts.[23] The legislative history makes clear that the amendment was intended to eliminate mismatches in timing and character for taxpayers trading in both markets.[24] As further confirmation, in 1988, the IRS concluded that Congress intended to bring OTC forward contracts within the scope of Section 1256 because "they are economically comparable to and used interchangeably with" regulated futures contracts.[25]

Section 1256 was soon again expanded to include foreign currency forward contracts that provide for cash settlement by reference to the value of foreign currency, and the physical delivery of foreign currency was no longer required.[26] Section 1256 was also amended to apply to dealer equity options and nonequity options, which include listed foreign currency options. Only OTC foreign currency options appeared to be excluded, and after inclusion of OTC forward contracts and listed foreign currency options under Section 1256, economically, there was no basis for the exclusion of OTC foreign currency options from the scope of Section 1256. OTC foreign currency options and listed foreign currency options are economically comparable. They are also interchangeable in the eyes of market participants.

However, in July 2022, the former Treasury proposed regulations which would treat OTC foreign currency options as being excluded from the definition of Section 1256 contracts, while listed foreign currency options are included, and therefore apply inconsistent tax treatment to economically comparable and interchangeable contracts.[27] **The proposed regulations were at odds with an essential rationale of Section 1256—allowing similar tax treatment to apply to economically comparable and interchangeable contracts which improves the efficiency and integrity of the financial markets.**[28]

The former Treasury first attempted to drive a wedge between the tax treatment of OTC and listed foreign currency options by suggesting that "option contracts will not always result in settlement (either by physical delivery or delivery of the cash equivalent value)."[29] However, the current definition of foreign currency contract refers to contracts which require delivery, or the settlement of which depends on the value, of a foreign currency in which positions are also traded through regulated futures contracts. The legislative history does not indicate that the occurrence of settlement was required. Rather, the legislative history focuses on the contract simply providing for a settlement determined by reference to the value of the foreign currency. As the Sixth Circuit has noted, the plain language of Section 1256 provides that a "foreign currency contract" is a contract "the settlement of which depends" upon the value of a foreign currency and does not require that contract mandate that any such settlement actually occur.[30]

The second attempt was to read the definition of foreign currency contract as narrowly as possible by baldly asserting that "[n]othing in the legislative history indicates Congress intended to include option contracts, which are not generally economically comparable to regulated futures contracts."[31] But this view is needlessly myopic. The definition of nonequity option in Section 1256(g)(3) includes any listed option which is not an equity option, and the central thrust of every legislative enactment of Section 1256 is towards allowing similar tax treatment to apply to economically comparable and interchangeable contracts. The current definition of foreign currency contract under Section 1256(g)(2) should not require OTC foreign currency options to be economically comparable to regulated futures contracts insofar as they are economically comparable to another Section 1256 contract—listed foreign currency options. The legislative history also indicates that Congress gave the Treasury the authority to treat other instruments (for example, options) as Section 1256 contracts.[32] Therefore, it is sound public policy and consistent with the purpose of Section 1256 for the Treasury to allow OTC foreign currency options to be treated as foreign currency contracts under Section 1256.

The final attempt was to invoke tax avoidance transactions that relied upon treating OTC foreign currency options as foreign currency contracts under Section 1256(g)(2).[33] However, the former Treasury obscured the fact that these tax avoidance transactions were indefensible on grounds wholly unrelated to the treatment of OTC foreign currency options as foreign currency contracts. Ultimately, the U.S. Tax Court, on remand from the Sixth Circuit, held with respect to tax avoidance transactions involving OTC foreign currency options that, "[e]ven if the assignment occurred and caused the [taxpayers] to recognize a loss under section 1256, section 165(c)—a limitation on loss deductibility applicable to individuals—prevents the [taxpayers] from deducting the loss."[34] Indeed, "[S]ection 165(c)(2) requires a primary profit motive if a loss from a particular transaction is to be deductible."[35] Accordingly, these tax avoidance transactions were unable to effect the artificial loss which was intended because the transactions did not have a *bona fide* profit motive. **Therefore, the exercise of regulatory authority to exclude OTC foreign currency options from the definition of foreign currency contract under Section 1256(g)(2) would have been inappropriate and, in any case, is unnecessary at this time. Accordingly, we recommend that the Treasury withdraw the 2022 proposed regulations defining "foreign currency contract" under Section 1256 which result in different tax treatment for economically comparable and interchangeable contracts—OTC and listed foreign currency options.**

Appendix C: Withdraw the 2022 proposed regulations that make PFIC investments more complex and costly for investors

PFICs are foreign corporations that generate 75% or more of their gross income from passive sources or that own assets that are primarily held for the production of passive income.[36] The prototypical example of a PFIC investment is an investment in a foreign mutual fund. U.S. taxpayers making PFIC investments may be subject to the punitive tax consequences of the default PFIC regime under which excess distributions received from PFICs are allocated pro rata to each day in the investor's holding period and are subject to interest charges on taxes deemed to be owed in preceding years.[37] U.S. taxpayers can make timely elections in respect of PFIC investments—for treatment as a qualified electing fund ("**QEF**") or for mark-to-market ("**MTM**") treatment of marketable stock—to avoid the punitive default regime.[38]

Identifying PFIC investments can be complex. The most common PFICs include foreign mutual funds, exchange-traded funds, money market funds, other pooled investment vehicles, and investments within foreign insurance products or foreign pension plans not qualified under U.S. income tax treaties. However, foreign start-up companies and other foreign operating companies with outsized passive income or passive assets may also qualify as PFICs. Moreover, foreign corporations owning sufficient interests in other corporations may also unwittingly qualify as PFICs because they are treated as holding a proportionate share of the assets and receiving a proportionate share of the income of other corporations.[39]

U.S. taxpayers' knowledge of an investment's status as a PFIC is, of course, irrelevant. If an investor fails to make a timely QEF or MTM election, the punitive default regime will apply, even if the PFIC ceases to fall within the definition of a PFIC, because of the "once-a-PFIC, always-a-PFIC" rule.[40] U.S. taxpayers may make retroactive QEF or MTM elections, but retroactive elections are allowed in very limited circumstances.[41] Accordingly, U.S. taxpayers, who may be unaware of an investment's PFIC status or may not have had access to information necessary to make QEF or MTM elections, are left with few options.

Once identified, determining the status of a PFIC investment is challenging even for the most sophisticated investors, the complexity of which is compounded by "regulations issued under now-renumbered Code sections containing erroneous cross-references."[42] U.S. taxpayers may make QEF elections in years subsequent to acquisition of PFIC stock but doing so makes the PFIC an "unpedigreed" QEF subject to both the QEF and punitive default regimes. An investor will still need to "purge" the PFIC taint. If the foreign corporation remains a PFIC and has not ceased to fall within the definition a PFIC, the investor may make a deemed-sale election or, if the PFIC is a controlled foreign corporation ("**CFC**"), a deemed-dividend election.[43] If the foreign corporation has ceased to be a PFIC, the investor may make a deemed-sale election under rules similar to the "continuing PFIC" deemed-sale election.[44] These are the most common "purging elections," but in theory, there are eight possible purging elections addressing various circumstances.[45]

The PFIC reporting regime is also inordinately complex. U.S. taxpayers making PFIC investments must file an annual report with respect to each PFIC on Form 8621, *Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund*, if the investor is (i) a direct PFIC shareholder, (ii) an indirect PFIC shareholder that holds any interest in the PFIC through one or more foreign entities, or (iii) an indirect PFIC shareholder that is treated as the owner of any portion of a domestic grantor trust that owns stock of a PFIC directly or through one or more foreign entities.[46] U.S. taxpayers making PFIC investments indirectly may also be required to file Form 8621 if the investor is (i) subject to the punitive default regime and treated as receiving an excess distribution with respect to a PFIC, (ii) treated as recognizing gain that is treated as an excess distribution as a result of a disposition of a PFIC, (iii) required to directly recognize QEF inclusions, (iv) required to directly include or deduct MTM amounts, or (v) required to report the status of an election to defer tax, with an interest charge, on undistributed QEF inclusions.[47]

U.S. taxpayers are offered one important reprieve from the information collection burdens of the PFIC reporting regime. U.S. taxpayers that hold PFIC stock indirectly through a domestic partnership or S corporation and for which QEF or MTM elections have been made are generally not required to file Form 8621 if the domestic partnership or S corporation timely files Form 8621.[48] Accordingly, fund managers of investment funds organized as domestic partnerships uniformly service the compliance burden of the PFIC reporting regime rather than investors which are indirect PFIC shareholders. In practice, investors prefer to rely on fund managers, which tend to be better situated in terms of sophistication, resources, and insight into PFIC investments, to service the compliance burden associated with their investments. Investors also prefer to rely on fund managers in this respect because the fund manager is being paid to manage the investment, including related compliance, and is best positioned to streamline reporting and reduce costs. In fact, fund managers often face significant resistance from investors with respect to increasingly complex investor-level tax compliance obligations which, as a collateral consequence, tend to have a chilling effect on investment more broadly. Separate from compliance costs, investors also uniformly prefer fund managers to make QEF and MTM elections to avoid the punitive default regime.

In January 2022, the former Treasury proposed regulations providing that domestic partnerships and S corporations would no longer be able to make QEF or MTM elections or service the related compliance burden of the PFIC reporting regime for investors.[49] Instead, investors would be required to make QEF and MTM elections, determine QEF inclusions and MTM amounts, make purging elections, and file Forms 8621 as if investors directly held their shares of PFIC stock held by an investment fund. Investors would also be required to notify investment funds of their elections within 30 days of filing the return in which the election is made.

Investors would be required to interpret the detailed computational elements of Schedule K-3 which are not currently required to the extent the investment fund has elected to treat a PFIC as a pedigreed QEF or made an MTM election. Even with Schedule K-3 details, additional information not currently furnished to investors receiving Schedule K-3, which is either uncertain or difficult to track, would need to be provided, including the investors' pro rata share of the purchase cost of PFIC stock and the percentage of PFIC stock disposed. By the former Treasury's own admission, an investor may be required to file its return on which it makes a QEF election and recognizes a QEF inclusion *before* the deadline for the investment fund to provide the investor with Schedule K-3 because of nonconforming tax years between the investor and the investment fund.[50] **Accordingly, we recommend that the Treasury withdraw these proposed regulations which run counter to the tax compliance preferences of investors and the complexity of which impose substantial costs on investors and market participants without any corresponding public benefit.**

Appendix D: Withdraw the IRS's "SECA tax" campaign as the IRS's position exceeds its statutory authority

Individual taxpayers are generally subject to self-employment tax on their "net earnings from self-employment, inclusive of a partner's distribute share of partnership income or loss.[51] In 1977, Congress amended Section 1402 to add the "limited partner exception" which expressly excludes from net earnings from self-employment "the distributive share of any item of income or loss of a limited partner, as such, other than guaranteed payments…to that partner for services actually rendered to or on behalf of the partnership."[52]

The limited partner exception originated not as a standalone tax provision defining the scope of self-employment tax, but instead as a conforming amendment accompanying a change to limit social security benefits. Prior to 1977, "each partner's share of partnership income [was] includible in his net earnings from self-employment for social security purposes, irrespective of the nature of his membership in the partnership.[53] Congress "bec[a]me increasingly concerned about situations in which certain business organizations solicit[ed] investments in limited partnerships as a means for an investor to become insured for social security benefits."[54] The solicitations were "directed mainly toward public employees whose employment [was] covered by public retirement systems and not by social security."[55] To prevent double-dipping in both retirement systems, Congress broadly excluded the (non-guaranteed payment) distributive share income of all limited partners from the calculation of social security benefits.

Specifically, Congress excluded "the distributive share of any item of income or loss of a limited partner, as such, other than guaranteed payments…for services actually rendered" from net earnings from self-employment that could be used to qualify for socials security benefits.[56] Having excluded, as the legislative heading suggested, "Certain Limited Partnership Income" from calculation of social security benefits, Congress proceeded to conform the Internal Revenue Code to exclude the same "Certain Limited Partnership Income" from the definition of net earnings from self-employment for self-employment tax purposes.[57] For almost 50 years thereafter, the plain text of the statute has been understood to exempt from both social security benefits and self-employment tax the distributive share of income allocated to a partner with limited liability under state law (other than guaranteed payments for services actually rendered). This well-settled understanding is informed by the social security benefits and self-employment tax provisions' context in the Social Security Amendments of 1977, their purpose and legislative history, and contemporaneous interpretations by both the IRS and the SSA.

Despite the history and parallelism between these adjacent provisions in the same section of the statute, the IRS continues to take the audit and litigation position that the words "limited partner" in the statute require a "functional analysis" which should focus on whether the partner was acting as a true "passive investor"—even where the partner was indisputably a limited partner under state law. In doing so, the IRS has sought to rewrite the phrase "limited partner" for self-employment tax purposes to exclude limited partners who provide services to partnerships. The IRS did not do so by asking Congress to amend the statute. Instead, through years of audits, administrative appeals, and litigation, and separately, quietly amending the decades-old definition of "limited partner" in the instructions for the partnership tax return,[58] the IRS has attempted to support its novel rewrite, which is beyond its statutory authority. At the same time, proposed regulations have remained on the Priority Guidance Plan despite not being authorized by clear statutory authority. **The IRS has injected substantial and unnecessary uncertainty into the taxation of numerous small, mid-size, and large businesses operating as limited partnerships, in a wide variety of industries, including local stores, manufacturing, construction and service businesses, real estate management companies, and other investment management businesses.**

The IRS's audit and litigation position overreaches on several grounds. First, the language and structure of this provision are clear. Congress broadly excluded limited partners' distributive shares from the calculation of social security benefits, with one explicit exception—guaranteed payments for services actually rendered. Had Congress intended to exclude only limited partners who were passive investors and provided no services to the partnership, it could and would have used words to that effect.[59] Moreover, had Congress done so, there would have been no need to exclude guaranteed payments, which since 1954, Congress has defined as "payments to a partner *for services* or the use of capital" that are "determined without regard to the income of the partnership."[60] By definition, a partner receiving a *guaranteed payment for services* rendered to a partnership is not a mere passive investor. The Supreme Court recently clarified that "statutes, no matter how impenetrable, do—in fact, must—have a single, best meaning."[61] Should Congress wish to amend the balance it struck between the social security benefits and self-employment tax provisions, it has ample authority to do so. The IRS, however, has no such authority and is bound to the best meaning of the underlying statutory authority.

Second, these adjacent social security benefits and self-employment tax provisions in the same section of the statute should be construed identically.[62] Moreover, reading these adjacent provisions consistently "promotes a symmetrical parallel between the social security eligibility provisions for self-employed persons and the corresponding income tax provisions for taxing self-employed persons for social security purposes," a long-standing congressional policy recognized and adopted by the U.S. Tax Court.[63] The congressional focus on limiting social security qualification, combined with the use of identical phrasing in adjacent subsections of the statute, highlight the textual and structural problem with the IRS's functional analysis test. There is no indication whatsoever in the text or structure of the Social Security Amendments of 1977 that Congress intended to allow limited partners to continue to use their limited partnership income to qualify for social security benefits as long as they could prove under a functional analysis test that they were acting as more than passive investors. In fact, the text demonstrates precisely the opposite. Given the parallelism between the adjacent social security benefits and self-employment tax provisions, there is no basis for reading a functional analysis test into the self-employment tax provision. **Accordingly, we recommend that the IRS withdraw the SECA tax campaign and any associated audits, appeals conferences, and litigation.**

Appendix E: Issue proposed regulations to make PFIC investments less complex and costly for investors by aligning the associated tax compliance with investor preferences

As described above, in *Appendix C*, identifying PFIC investments can be complex. U.S. taxpayers' knowledge of an investment's status as a PFIC is irrelevant, and if an investor fails to make a timely QEF or MTM election, the punitive default regime will apply, even if the PFIC ceases to fall within the definition of a PFIC, because of the "once-a-PFIC, always-a-PFIC" rule. U.S. taxpayers, who may be unaware of an investment's PFIC status or may not have had access to information necessary to make QEF or MTM elections, are left with few options.

The PFIC reporting regime is also inordinately complex. U.S. taxpayers making PFIC investments must file an annual report with respect to each PFIC on Form 8621, *Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund*. The one-PFIC-per-Form 8621 format creates unnecessary information collection burdens and compliance costs. **Accordingly, we recommend that the Treasury take the following actions to make PFIC investments less complex and costly for investors by aligning the associated tax compliance with investor preferences.**

i. Issue Proposed Regulations to Allow Foreign Partnerships to Service the Tax Compliance Preferences of Investors

In furtherance of the goal of aligning the PFIC reporting regime with the tax compliance preferences of investors and reducing complexity which imposes substantial costs on investors and market participants without any corresponding benefit, we recommend that the Treasury issue proposed regulations to allow foreign partnerships to make QEF and MTM elections and service the related compliance burden of the PFIC reporting regime for investors. Currently, investors which are indirect PFIC shareholders through foreign partnerships must make QEF and MTM elections and service the related compliance burden of the PFIC reporting regime themselves.

To the extent a foreign partnership makes QEF and MTM elections for its investors, the foreign partnership should be required to file a U.S. federal income tax return (Form 1065, *U.S. Return of Partnership Income*), even if the partnership does not receive any items of U.S.-source income or otherwise have a U.S. filing obligation. Foreign partnerships already have U.S. filing obligations in other contexts to exclusively make U.S. tax elections. Generally, such U.S. filing obligations consist of a written statement, listing the name and address of the partnership making the election, and clearly identifying the specific election being made.[64] **Accordingly, we recommend that the Treasury issue proposed regulations to allow foreign partnerships to make QEF and MTM elections and service the related compliance burden of the PFIC reporting regime for investors.**

ii. Re-Design Form 8621 to Allow Reporting of More Than One PFIC and Related Elections

In pursuit of further reducing compliance costs without any corresponding benefits, we recommend that the IRS re-design Form 8621 to allow for disclosure of more than one PFIC and the relevant elections in respect of PFICs. We reasonably foresee the number of Form 8621 filings continuing to increase in the years to come. Anti-hybrid rules in non-U.S. jurisdictions (*e.g.*, Anti-Tax Avoidance Directive II) have generally led to an increased number of PFICs in investment structures. Entities are frequently "checked closed" for federal income tax purposes to remove hybridity concerns in non-U.S. jurisdictions, so that such entities are treated as corporations for both U.S. and non-U.S. tax purposes. Moreover, commercial tax return preparation software may restrict electronic filing capabilities where the total number of Forms 8621 exceeds a prescribed limit.

A consolidated Form 8621 with a landscape, or horizontal, supporting schedule which lists the relevant information for each PFIC would alleviate some of the compliance burden associated with PFIC investments. Where detailed computations related to the punitive default regime are required, separate supporting schedules could satisfy the reporting requirements. A consolidated Form 8621 also seems consistent with the shift towards centralized and uniform reporting on Schedules K-2 and K-3. **Accordingly, we recommend that the IRS re-design Form 8621 to allow for disclosure of more than one PFIC and the relevant elections in respect of PFICs.**

Appendix F: Issue proposed regulations to protect small- and mid-sized U.S. businesses from the CAMT

For purposes of determining whether a corporation is an "applicable corporation" to which the CAMT applies, "all adjusted financial statement income of persons treated as a single employer with such corporation under subsection (a) or (b) of section 52 shall be treated as adjusted financial statement of income of such corporation..."[65]

In the typical case of an investment fund that is organized as a partnership and that is not itself engaged in any trade or business, there is no aggregation of separate portfolio companies owned by the fund for purposes of the average annual adjusted financial statement income test ("**Income Test**"). However, it is not uncommon for an investment fund (such as a fund trading in the public markets) to be engaged in some trade or business activities as a result of its active trading activities. In addition, an investment fund may receive fees that are closely related to, ancillary, or incidental to its functions as an investment vehicle, such as commitment fees, break-up fees, or similar fees that are customary in, and incidental to, its activities as an investor or trader in stocks and securities.

Certain investment funds, referred to as "hybrid" funds, engage in multiple investment strategies within a single fund that include active trading of securities in the public markets (which cause the fund to be engaged in a trade or business) and acquisitions of controlling stakes in private companies. Such investment funds have attracted greater interest from fund managers looking to broaden their appeal and investors looking for illiquid diversifiers and other private market opportunities. **In the absence of guidance, the portfolio companies—small- and mid-sized U.S. businesses—owned by such investment funds would need to be aggregated for purposes of the Income Test.**

Also, as described above, certain investment funds organize a "foreign feeder" or "blocker corporation" to facilitate investment into the fund by American tax-exempt organization and foreign investors. Specifically, it is common for investment funds to use a "master-feeder structure," where all investments are held in a single "master" partnership and American tax-exempt organization and foreign investors generally participate in that partnership through a single foreign feeder. In the absence of guidance, if a foreign feeder or blocker corporation owns (directly or indirectly) more than 50% of the portfolio companies in which the investment fund invests, those portfolio companies would need to be aggregated for purposes of the Income Test, even if these fund vehicles are not engaged in any trade or business activities.

The legislative history of the CAMT, as well as broader policy considerations, supports the view that the separate portfolio companies owned by a fund vehicle in the fact patterns described above should not be aggregated for purposes of the Income Test. Investment funds frequently invest in small- and mid-sized (commonly referred to as "middle market") U.S. companies whose income, considered in isolation, would be insufficient to trigger the CAMT. U.S. middle market businesses count their numbers in the hundreds of thousands, represent one-third of private sector gross domestic product ("**GDP**"), and employ approximately 48 million people.[66] The middle market is attractive to investors—it is historically resilient in times of uncertainty;[67] its lower starting valuations offer opportunities for companies to grow organically and through acquisitions; and its flexibility offers more scope for operational enhancement and better positioning to adapt quickly, embrace innovation, and capture market share.

Congress did not intend to subject U.S. middle market businesses to the CAMT solely based on the receipt of outside capital from an investment fund, particularly since these portfolio companies are under separate management, usually have unrelated shareholders (including management, employees, and co-investors), do not coordinate business or tax strategies, do not share information with one another, and typically are bought and sold separately after being held for a limited investment period. On the contrary, Congress intended to ensure that their large-cap counterparts with $1 billion or more in average annual earnings, calculated over a three-year period, would pay a total tax (regular corporate income tax plus the CAMT in excess thereof) at a rate of 15% of such annual earnings. Congress further contemplated that the CAMT would only apply to approximately 150 of the world's largest companies.[68] Importantly, while the legislation containing the CAMT was under consideration on the Senate floor, a bipartisan vote adopted an amendment rejecting proposed language that would have required "unrelated companies of any size held by *funds or partnerships* to combine their otherwise unrealized income to determine if they meet an aggregate $1 billion income threshold."[69] **Subjecting small- and medium-sized U.S. businesses, whose adjusted financial statement income is far less than $1 billion, to the CAMT would impede private enterprise and entrepreneurship, economic growth, and the ability to build and innovate. Accordingly, we recommend that the Treasury issue guidance to exclude the income of separate portfolio companies and fund vehicles owned by an investment fund from aggregation for CAMT purposes.**

Appendix G: Issue proposed regulations to update the PTP safe harbors to protect investors from duplicative, unnecessary, and costly layers of tax

Generally, a partnership is not subject to entity-level federal income tax. Instead, each partner reports its allocable share of the partnership's income, gain, loss, deduction, and credit in its income for each year,[70] and similarly, the character of partnership income, gain, loss, deduction, and credit passes through to its partners.[71] For this reason, investment funds are often organized as partnerships to avoid entity-level taxation associated with classification as a corporation, permit investors to benefit from any favorable tax rates or character applicable to fund income or loss, and maintain relative tax neutrality. However, a partnership that is classified as a PTP will instead be taxable as a corporation.[72]

A partnership is a PTP if its interests are traded on an established securities market or are readily tradable on a secondary market or the substantial equivalent thereof.[73] There is relative clarity over what constitutes an "established securities market." Generally, this term encompasses a securities exchange or OTC market.[74] Although an investment fund can usually avoid having its interests trade on an established securities market, the determination of whether its interests are readily tradable on a secondary market, or the substantial equivalent thereof, is less certain.

The primary PTP regulation, promulgated in 1995 and never since amended, provides that a secondary market, or the substantial equivalent thereof, exists if, taking into account all of the facts and circumstances, the partners are readily able to buy, sell, or exchange their partnership interests in a manner that is economically comparable to trading on an established securities market.[75]

The legislative history instructs that a regular plan of redemptions of partnership interests such that holders of the interests have readily available opportunities to dispose of their interests could result in the partnership interests being deemed to be readily tradable.[76] However, the legislative history also provides that occasional and irregular repurchases or redemptions by a partnership of partnership interests would not cause the partnership to be a PTP.[77] Accordingly, the PTP regulation deems a partnership's interests to be readily tradable in any of the following situations: (i) if a market maker provides regular quotes for the interests; (ii) if any person regularly provides firm quote prices; (iii) if there is a readily available, regular, and ongoing opportunity to sell interests through a public medium for obtaining or providing information about offers to buy, sell, or exchange the partnership interests; or (iv) if the partnership interests can be otherwise transferred in a manner comparable to the prior situations.[78]

The PTP regulation provides several safe harbors which allow a partnership to disregard certain transfers in determining whether its interests are readily tradable. *Redemption and Repurchase Agreements Safe Harbor*. A partnership's agreement may provide its partners with a right to redeem and cause the partnership to repurchase its interests. The PTP regulation provides that certain transfers made pursuant to a redemption and repurchase agreement are disregarded for purposes of determining whether interests in a partnership are readily tradable. For a transfer to qualify, it must meet the following requirements: (i) the agreement requires the redeeming partner to provide at least 60 days' notice prior to the redemption or repurchase; (ii) either (a) the agreement requires that the redeeming partner provide at least 60 days' notice prior to the establishment of the repurchase price or (b) the repurchase price is established at most four times during the partnership's taxable year; and (iii) the total percentage interest in partnership capital or profits transferred during the partnership's taxable year does not exceed 10% of the total interests in partnership capital or profits (the "**Open-End Redemption Safe Harbor**").[79]

Private Placement Safe Harbor. The PTP regulation provides that interests in a partnership are not readily tradable for any taxable year of the partnership in which the partnership has 100 or fewer partners at all times during the year, and the offering and sale of the partnership's interests was not required to be registered under the Securities Act of 1933[80] (the "**Securities Act**").[81] Prior to the adoption of the PTP regulation in 1995, a private placement safe harbor was provided by administrative pronouncement.[82] Notice 88-75 provided that interests in a partnership would not be considered readily tradable if either (i) the partnership did not have more than *500* partners, or (ii) the smallest unit of interest in the partnership that could be issued, or subsequently transferred, had an offering price of at least $20,000.[83] The PTP regulation superseded this safe harbor.[84]

Lack of Actual Trading Safe Harbor. The PTP regulation provides that interests in a partnership are not readily tradable if the sum of the percentage interests in partnership capital or profits transferred during the taxable year of the partnership does not exceed 2% of the total interests in partnership capital or profits.[85]

The PTP regulation is severely outdated. When the PTP regulation was issued in 1995, most privately placed investment funds operated under the "section 3(c)(1) exemption" from registration under the Investment Company Act of 1940 (the "**'40 Act**"),[86] which generally applied to entities which had no more than 100 investors. Given the investor count in these entities, there was little need to consider a higher investor threshold for purposes of the PTP regulation's safe harbor. Likewise, following the Great Financial Crisis, redemption gates have been more commonly employed as a liquidity risk management tool. Today, more regular investor- and fund-level gates set forth market-standard terms for investor redemptions. **As a general matter, market developments should continue to inform the propriety of regulations affecting alternative asset managers. Accordingly, we recommend that the Treasury take the following actions to modernize the PTP regime.**

i. Modernize the Redemption and Repurchase Agreements Safe Harbor

The Open-End Redemption Safe Harbor requires, in part, that the total percentage interest in partnership capital or profits transferred during the partnership's taxable year does not exceed 10% of the total interests in partnership capital or profits. In practice, this requirement is unduly restrictive and practically unworkable for most open-end investment funds. The liquidity restrictions of the Open-End Redemption Safe Harbor, on their own, prevent partnership interests from trading in a manner equivalent to that of a secondary market and should be sufficiently "occasional and irregular" to lack the attributes of regular trading on a secondary market, even without placing a cap on trading volume.

Moreover, redemption gates partially limit the ability of investors to redeem from an investment fund. Redemption gates are a liquidity risk management tool designed to reduce the impact of redemptions on the value, liquidity, and concentration of an investment fund's portfolio. The liquidity restrictions of the Open-End Redemption Safe Harbor are inconsistent with market-standard redemption gates which typically allow greater liquidity. **Accordingly, we recommend that the Treasury eliminate the requirement that the total percentage interest in partnership capital or profits transferred during the partnership's taxable year not exceed 10%.**

Separately, the Open-End Redemption Safe Harbor also requires, in part, at least 60 days' notice to the partnership. In the case of an investment fund which provides quarterly liquidity, an investor who may wish to withdraw at the end of a fiscal quarter would be required to make that decision before financial reports from the first month of the quarter have been generated. An investor who has decided to withdraw after that first month will not be able to do so until the end of the next quarter, five months later. **Accordingly, we recommend that the Treasury also reduce the notice period to 30 days to give investors the ability to better respond to the performance of the investment fund without allowing them to enjoy public market-type liquidity.**

Alternatively, we recommend that the Treasury provide investment funds with the ability to designate quarterly periods within which transfer of its nonredeemable partnership interests will be disregarded for purposes of determining whether interests in the partnership are readily tradable, to align the Open-End Redemption Safe Harbor with quarterly redemptions. Although not uniform in the market, basing the Open-End Redemption Safe Harbor on quarterly redemptions would provide the market with greater certainty as to what degree of liquidity breaches the readily tradable standard.

Moreover, basing the Open-End Redemption Safe Harbor on quarterly redemptions would provide investment funds which own "side-pocketed" investments, with respect to which no redemptions are permitted, greater certainty. In practice, investors who have otherwise fully redeemed from investment funds may retain interests in the fund, evidencing their participation in these side-pocket assets, with respect to which there are no redemption rights. Although the redeemed investors may be willing to sell these stub interests to other investors, these transactions are frequently not permitted because of the constraints of the PTP rules. Allowing infrequent trading in these interests (for example, not more than quarterly) would allow these investors an idiosyncratic ability to liquidate their investment in the fund without providing them with the ability to trade interests with public market-type liquidity. Because the PTP rules apply only where the partnership interests are readily tradable, the PTP rules should except these transactions because of the infrequent opportunities to trade these interests.

As a further alternative, we recommend that the Treasury reconsider the comments of several respondents to the then-proposed PTP regulation which "suggested that redemptions by an investment partnership for the net asset value of the redeemed interest should not be treated as a transfer…because these transfers do not involve a third party broker or a commission or mark-up."[87] At the time, the Treasury summarily rejected these comments without explanation, despite the compelling rationale that the involvement of a third-party broker or other agent which may charge a commission or mark-up to intermediate the transfer of the partnership interest is the strongest indicia that the partnership interests are readily tradable on a secondary market or the substantial equivalent thereof.

ii. Modernize the Private Placement Safe Harbor

As described above, in 1995, there was little need to consider a higher investor threshold for purposes of the PTP regulation's private placement safe harbor. However, in 1996, Congress added the "section 3(c)(7) exemption" from registration under the '40 Act, under which an entity is exempt from registration if its investors are limited to "qualified purchasers," regardless of the total number of investors. As a result, a significant number of investment funds today, relying on this "section 3(c)(7) exemption," have investor counts in excess of 100 and can no longer rely on the PTP regulation's safe harbor.

Further, investment funds generally limit the number of partners so as not to become subject to the public reporting requirements of the Securities Exchange Act of 1934 (the "**Exchange Act**").[88] Under Section 12(g) of the Exchange Act, an issuer whose securities are owned by 2,000 or more persons generally must register under the Exchange Act and make public filings, even though the issuer may not have sold its securities publicly under the Securities Act.

Accordingly, we recommend that the Treasury conform the investor threshold of the private placement safe harbor to the registration threshold in Section 12(g) of less than 2,000 persons. The registration threshold in Section 12(g) is intended to ensure that issuers that have sufficiently active trading markets are subject to the same periodic disclosure requirements as securities registered on an exchange.[89] Thus, the purpose of Section 12(g) is to determine a threshold of off-exchange trading activity at which point issuers should be subject to similar disclosure rules as issuers whose securities are registered on an exchange. The threshold in Section 12(g), therefore, provides a useful measurement to determine when the amount of secondary market trading is sufficiently robust that issuers should be subject to rules applicable to issuers whose securities are registered on an exchange.

Alternatively, we recommend that the Treasury restore a limit on the initial offering value of partnership interests that can be transferred as was in effect under Notice 88-75, given the limited application of the existing 100-partner safe harbor in the era of the "section 3(c)(7) exemption."

iii. Modernize the Lack of Actual Trading Safe Harbor

For the same reasons described above with respect to the Open-End Redemption Safe Harbor, the lack of actual trading safe harbor, which allows no more than 2% of the total interests in partnership capital or profits to be transferred per taxable year, is inconsistent with market-standard redemption gates. **Accordingly, we recommend that the Treasury, in consultation with industry, expand the liquidity restrictions of the lack of actual trading safe harbor.**

Appendix H: Issue proposed regulations to protect convertible bondholders from "phantom" income

Generally, a distribution by a corporation of its stock to its shareholders with respect to their stock is a non-taxable event,[90] other than to the extent an actual distribution is specifically excepted as taxable.[91] Congress intended to address tax-motivated arrangements to avoid the primary exception to the tax-free treatment of stock dividends—taxing stock dividends that a shareholder could elect to receive in cash.[92] Absent anti-avoidance rules, the exception could be avoided with the economically similar transaction of paying cash dividends and increasing the conversion rate on convertible bonds that may be converted into the same stock. Congress, therefore, authorized the Treasury to issue regulations under which certain transactions not involving an actual distribution, including "a change in conversion ratio," are to "be treated as a distribution with respect to any shareholder *whose proportionate interest in the earnings and profits or assets of the corporation is increased by such change*."[93]

Such a deemed distribution is, however, subject to tax as a dividend only to the extent specifically excepted as taxable. For example, taxable dividend treatment would apply under an exception for disproportionate distributions if the result of the deemed distribution is that some shareholders receive property such as cash and other shareholders receive an increase in their proportionate interests in the assets or earnings and profits of the distributing corporation (*e.g.*, a change in conversion ratio of stock or securities accompanied by distribution of a cash dividend to other shareholders).[94]

Special rules address situations in which certain changes in conversion ratios that are intended to offset dilution arising from other transactions (*e.g.*, sales of stock at prices below the conversion price or return-of-capital distributions) are not treated as deemed distributions.[95] However, an adjustment made to compensate for a taxable distribution of cash or property to other shareholders is not considered as made pursuant to such a bona fide, reasonable, adjustment formula for anti-dilution purposes.[96] Thus, the IRS has ruled that if shareholders receive cash and there is a contemporaneous change in the conversion ratio of convertible bonds with respect to that stock, bondholders receive a taxable, disproportionate deemed distribution of stock.[97] **Accordingly, taxable deemed distributions seem to reach all CRAs occasioned by a taxable distribution to other shareholders, regardless of whether the convertible feature is in-the-money, or whether the bond is ever converted.**

Following a CRA, a bondholder receives a taxable deemed distribution, rather than what would have otherwise been a non-taxable event (for example, in the case of a conversion into stock) or a transaction resulting in recognition of capital gain, to the extent that there is sufficient earnings and profits in the corporation. The deemed distribution would increase a domestic bondholder's basis in the convertible bond, but upon conversion into cash, the bondholder may have been disadvantaged by the recognition of ordinary dividend income and, then, reduced capital gain or increased capital loss (the deductibility of which may be limited). Similarly, American institutional investors—pension plans, charitable foundations, and other tax-exempt organizations—which pool their capital in non-U.S. investment funds may be subject to U.S. withholding tax, rather than what would have otherwise been a non-taxable event or result in non-U.S.-source capital gain not subject to U.S. tax. **Convertible bondholders which receive the benefit of a CRA, therefore, are subject to uneconomic deemed distributions which impair the value of outstanding convertible bonds by taxing the bondholder on "phantom" income that may never be received.**

CRAs became a common feature in the convertible bond market around 2004 to protect convertible bondholders against erosion in the value of embedded call options in a convertible bond that occurs when an issuer pays a dividend to shareholders. CRAs are not intended to, nor do they in fact, provide convertible bondholders with economic value equivalent to shareholders which have received a cash dividend, or which have increased their proportionate interest in the corporation, for example, by receiving stock dividends in lieu of a cash dividend.

Convertible bondholders often do not have the right to exercise their conversion rights at the time of a CRA and may never exercise their conversion rights. Indeed, many times the conversion right is never exercised, which means the CRA did not provide the convertible bondholder economic value similar to a shareholder's proportionate interest in the corporation. Moreover, the convertible bondholder does not have any right to receive cash in lieu of the adjustment to the conversion ratio. Rather, CRAs provide the convertible bondholder with protection against an erosion in value of the convertible bond's embedded call option that would otherwise occur when the convertible bond's issuer pays a dividend to its shareholders.

The anti-dilution protection received by a convertible bondholder from a CRA is fundamentally different than the economic value received by a shareholder which receives a cash dividend or a stock dividend in lieu of a cash dividend. As such, the convertible bondholder is no better off after the cash dividend is paid to shareholders than the bondholder was prior to the cash dividend. Notwithstanding this fundamental economic difference, the anti-dilution protection provided by a CRA creates a taxable event for the convertible bondholder.

In April 2016, the former Treasury proposed regulations "only to clarify the amount and timing of such deemed distributions, *not the fact of their occurrence*," which the former Treasury asserted, without more, "is clear under current law."[98] Rather than address the fundamental question of whether the anti-dilution protection provided by a CRA is an appropriate basis to tax bondholders, the former Treasury chose to focus on the measure of the taxable deemed distribution. Although the proposed regulations viewed the deemed distributions more favorably as a distribution of additional rights, rather than a deemed distribution of stock without regard to whether the convertible feature was in-the-money, or whether the bond was likely to be converted, as had previously been set out in private letter rulings by the IRS,[99] the former Treasury ignored that Congress did not mandate taxable deemed distributions in all cases.

The legislative history suggests that, in 1969,[100] prior to convertible bonds with CRAs, Congress intended to provide the Treasury with a flexible tool to combat tax-motivated attempts to defeat the purposes of distributions specifically excepted as taxable, including the "disproportionate distribution" rule, through transactions that do not involve an actual distribution. The legislative history instructs that "it was not clear under prior law to what extent increases of this kind would be considered distributions of stock or rights to stock," and "in order to eliminate uncertainty, the Act authorize[d] the Secretary or his delegate to prescribe regulations governing *the extent to which such transactions shall be treated as taxable distributions*."[101]

First, the purpose of a CRA is to avoid the dilutive effect that the payment of an increased level of ordinary cash dividends to shareholders would otherwise have on the value of the option embedded in a convertible bond. From an economic standpoint, the dilutive effect of such a cash dividend is not different in any material way from that produced by the transactions expressly excepted from deemed distribution treatment under the current regulations (*i.e.*, sales of stock subject to the conversion option at a price below the conversion price).

Second, in some cases, the option embedded in a convertible bond may not, under the terms of the instrument, be exercisable at the time of the CRA, and the embedded option may, for a variety of reasons, never be exercised. In such cases, the bondholder would never realize any economic income and would instead continue to have no shareholder-type interest in the assets or earnings and profits of the corporation. Additionally, in many cases, when the underlying stock price of the convertible bond issuer is low relative to the convertible bond's strike price, a cash dividend can be punitive to the convertible bondholder. In these circumstances, the enterprise value of the corporation has decreased by the amount of the cash dividend, leading to a higher required discount rate and, concurrently, a lower valuation of the convertible bond. Accordingly, rather than economic income, a CRA is instead best viewed as an adjustment of the original purchase price of the bond and, therefore, differs in principle from situations where the bondholder receives an actual distribution as an anti-dilution remedy. **Accordingly, the Treasury should re-propose regulations to prevent convertible bondholders which receive the benefit of a CRA from being subject to uneconomic deemed distributions.**

Appendix I: Issue proposed regulations to make derivatives trading less complex and costly for investors

Prior to the enactment of the Section 871(m) "substitute dividend payment" rules, the source of income paid with respect to derivatives referencing U.S. stocks followed the source rule for the sale of U.S. stocks themselves—by reference to the residence of the payee. By contrast, dividends paid by U.S. corporations are treated as U.S.-source income and subject to U.S. withholding tax.[102] Taken together, non-U.S. persons could enter into derivatives providing full economic exposure to U.S. stocks (including dividends) without being subject to U.S. withholding tax. To combat this perceived abuse, the substitute dividend payment rules treat "dividend equivalent payments," paid or deemed paid under certain derivatives and securities lending transactions, as U.S.-source income subject to U.S. withholding tax if deemed paid to a non-U.S. person.

In 2015, the Treasury promulgated regulations providing that certain derivatives that have a delta of 0.8 or greater with respect to an underlying U.S. stock would be subject to the substitute dividend payment rules.[103] **The implementation of the substitute dividend payment rules has presented overwhelming and intractable administrative challenges due to their complexity.**

The substitute dividend payment rules further provide that derivatives that reference a "qualified index" will be treated as a single security that is not an "underlying security," rather than treated as referencing any U.S. stocks in the index.[104] Therefore, derivatives that reference a qualified index are provided safe harbor from the substitute dividend payment rules.[105]

A qualified index is an index that satisfies one of two tests. The first test provides that an index is a qualified index if the index: (i) references at least 25 component securities; (ii) references only long positions (other than short positions with respect to the entire index or that represent no more than 5% of the aggregate value of the index's long positions); (iii) does not contain any single U.S. stock that represents more than 15% of its weighting or any collection of 5 or fewer U.S. stocks that together represent more than 40% of its weighting; (iv) is modified or rebalanced only according to public, predefined criteria; (v) did not provide a dividend yield in the immediately preceding calendar year from U.S. stocks in the index that exceeded 150% of the annual dividend yield reported on the S&P 500 Index ("**SPX**") for that year; and (vi) is referenced by futures or options that trade on a national securities exchange, designated contract market, or certain foreign exchanges or boards of trade (provided that U.S. stocks comprise less than 50% of the weighting of the component securities in the index).[106]

The second test provides that an index is a qualified index if (i) the underlying U.S. stocks in the index represent 10% or less of the value of all of the component securities in the index; (ii) the index is widely traded; and (iii) the index was not formed with a principal purpose of avoiding U.S. withholding tax.[107]

The two qualified index tests are cumulative with other requirements. First, the index must be a qualified index on the first business day of the calendar year in which the derivative potentially subject to the substitute dividend payment rules is entered.[108] Second, the index must be a "passive" index that is based on a "diverse basket of publicly-traded securities" and that is "widely used by numerous market participants."[109] Third, the foreign investor must not hold related short positions of more than 5% of the value of the long positions in the index, unless the short position relates to the entire index (the "**short position rule**").[110] **The short position rule's ill-defined criteria and overbreadth has created significant uncertainty for investors and withholding agents which erodes the efficiency and integrity of the financial markets. Accordingly, we recommend that the Treasury take the following actions to make the substitute dividend payment rules fit for purpose.**

i. Issue Proposed Regulations to Remove Non-Delta-One Transactions from the Scope of the Substitute Dividend Payment Rules

The implementation of the substitute dividend payment rules has presented administrative challenges due to their complexity, as described above. Among other difficulties, brokers, dealers, and other short parties are required to determine and report whether a derivative is a "simple contract" or a "complex contract," its delta (which may need to be calculated on multiple dates) or substantial equivalence, respectively, whether any reference index is a qualified index, the amount of any dividend equivalent payment, and the timing and amount of any U.S. withholding tax. Issuers of structured products and other derivatives held at the Depository Trust & Clearing Corporation (the "**DTCC**") may not know the identity of their ultimate customers to which the substitute dividend payment rules would apply because the ultimate customers purchase these products through brokers that face the DTCC. The complex communication channels required to implement the substitute dividend payment rules between issuers, clearing systems, brokers, and customers, in this context, do not exist.

Moreover, the substitute dividend payment rules may result in multiple impositions of U.S. withholding tax on the same streams of dividends, commonly referred to as "cascading" withholding, for example, where an issuer of a structured product or other derivative hedges by purchasing the underlying U.S. stock and is subject to U.S. withholding tax on the dividend paid on the underlying U.S. stock and on the dividend equivalent payment from the structured product or other derivative. As a result of these challenges, the substitute dividend payment rules have never actually applied to non-delta-one transactions—the IRS has delayed application of the rules five times, for a period that covers a decade.[111] **Accordingly, we recommend that the Treasury issue proposed regulations to remove non-delta-one transactions from the scope of the substitute dividend payment rules.**

ii. Issue Proposed Regulations to Remove the Short Position Rule from the Qualified Index Safe Harbors

The short position rule lacks clarity on how to determine whether and to what extent a short position should be treated as entered "in connection with" a long position on an index for purposes of potentially disqualifying a derivative that references an otherwise qualified index. In the separate context of transactions entered "in connection" with one another which must be combined to determine whether they satisfy the delta threshold and, thus, are subject to the substitute dividend payment rules, withholding agents may rely on a rebuttable presumption that two transactions are *not* entered in connection with one another if either (i) the long party holds the transactions in a separate account or (ii) the transactions were entered into more than 2 business days apart.[112] These rebuttable presumptions are not available in the short position rule context, however. Additionally, the short position rule is unclear on when its 5%-test is calculated (*i.e.*, initially or at all times in which the position is held open), whether the "in connection with" standard requires that the foreign investor enter into the short and long positions as a concerted strategy or that the short and long positions are merely economically related, and the extent of withholding agents' "reasonable diligence" obligations.[113]

As a more general matter, the application of the substitute dividend payment rules to an entire long position on an index that would be a qualifying index *but for* a short position which runs afoul of the short position rule is unduly punitive. For example, if a foreign investor is long SPX futures and short SPX futures, then the investor can rely on the qualified index safe harbor because the investor is short the entire index. Similarly, if an investor uses an index convergence strategy, the investor can be long Dow Jones Industrial Average ("**DJI**") futures, and short SPX futures, and the investor should be able to rely on the qualified index safe harbors because the investor is implicitly short DJI futures in its entirety, because all Dow stocks are in the S&P 500. However, if the investor is long SPX futures and short DJI futures, then this transaction will result in the SPX futures being subject to U.S. withholding tax because the qualified index safe harbors would not apply. This type of transaction does not seem to present the tax abuse concerns that the substitute dividend payment rules were intended to address but rather presents an example of their punitive overbreadth.

Although unspecified, the short position rule was most likely intended to preclude a foreign investor from using the qualified index safe harbors to avoid U.S. withholding tax by entering into a long position referencing a qualified index and a short position with respect to the underlying U.S. stocks to which the investor does not want economic exposure, rather than simply entering into a derivative referencing a basket of U.S. stocks to which it *does* want economic exposure but would otherwise be exposed to the substitute dividend payment rules and, therefore, U.S. withholding tax. In many cases, however, such an arrangement would bear hedging costs and operational inefficiencies in excess of the value of U.S. withholding tax savings and, in any case, would be vulnerable to the broad anti-abuse rule.[114] **Accordingly, we recommend that the Treasury issue proposed regulations to remove the short position rule from the qualified index safe harbors.**

Endnotes

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[1] Managed Funds Association (MFA), based in Washington, D.C., New York City, Brussels, and London, represents the global alternative asset management industry. MFA's mission is to advance the ability of alternative asset managers to raise capital, invest it, and generate returns for their beneficiaries. MFA advocates on behalf of its membership and convenes stakeholders to address global regulatory, operational, and business issues. MFA has more than 180 fund manager members, including traditional hedge funds, private credit funds, and hybrid funds, that employ a diverse set of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors diversify their investments, manage risk, and generate attractive returns throughout the economic cycle.

[2] The President's Presidential Memoranda and Executive Orders mandate, in part:

- the identification of "burdensome and ideologically motivated regulations…imped[ing] the development of [energy and natural] resources," Exec. Order No. 14,154, 90 Fed. Reg. 8353 (Jan. 29, 2025) ("Unleashing American Energy"),
- the identification of "[t]he ever-expanding morass of complicated Federal regulation impos[ing] massive costs on the lives of millions of Americans, creat[ing] a substantial restraint on our economic growth and ability to build and innovate, and hamper[ing] our global competitiveness," Exec. Order No. 14,192, 90 Fed. Reg. 9065 (Feb. 6, 2025) ("Unleashing Prosperity Through Deregulation"),
- "[w]elcoming foreign investment and strengthening the United States' world-leading private and public capital markets." Memorandum of Feb. 21, 2025, America First Investment Policy (Feb. 21, 2025),
- the identification of "(i) unconstitutional regulations…; (ii) regulations that are based on unlawful delegations of legislative power; (iii) regulations that are based on anything other than the best reading of the underlying statutory authority…; (iv) regulations that implicate matters of…economic significance that are not authorized by clear statutory authority; (v) regulations that impose significant costs upon private parties that are not outweighed by public benefits; (vi) regulations that harm the national interest by significantly and unjustifiably impeding technological innovation, infrastructure development,…research and development, economic development, energy production, land use, and foreign policy objectives; and (vii) regulations that impose undue burdens on small business and impede private enterprise and entrepreneurship," Exec. Order No. 14,219, 90 Fed. Reg. 10,583 (Feb. 25, 2025) ("Ensuring Lawful Governance and Implementing the President's 'Department of Government Efficiency' Deregulatory Initiative"), and
- "the repeal of any regulation, or the portion of any regulation, that clearly exceeds the agency's statutory authority or is otherwise unlawful." Memorandum of April 9, 2025, Directing the Repeal of Unlawful Regulations (April 9, 2025).

[3] Unless otherwise indicated, all "section" references are to the Internal Revenue Code of 1986, as amended, or the Treasury Regulations promulgated thereunder.

[4] Section 865(a).

[5] Sections 871(b) & 881(a).

[6] Section 897(c)(2).

[7] Section 897(a).

[8] Full Text Search for "United States Real Property Holding Corporation," EDGAR, https://www.sec.gov/edgar/search/#/q=%2522united%2520states%2520real%2520property%2520holding%2520corporation%2522.

[9] Section 897(c)(3).

[10] Joshua R. Williams & Douglas Scott, *FIRPTA 5 Percent Exception Should Be Tested at the Partner Level*, TAX NOTES FED. (TA) (Nov. 20, 2023).

The broader statutory compilation, the Foreign Investment in Real Property Tax Act of 1980, or "FIRPTA," "was actually passed…in response to international investors buying US farmland." Hui-yong Yu, *U.S. Eases 35-Year-Old Real Estate Tax on Foreign Investors*, BLOOMBERG (Dec. 18, 2015), https://www.bloomberg.com/news/articles/2015-12-18/u-s-poised-to-lift-35-year-old-real-estate-tax-on-foreigners.

[11] Pub. L. No. 114-113, 129 Stat. 2242 (2016); *see* JANE G. GRAVELLE, CONG. RESEARCH SERV., R44421, REAL ESTATE INVESTMENT TRUSTS (REITS) AND THE FOREIGN INVESTMENT IN REAL PROPERTY TAX ACT (FIRPTA): OVERVIEW AND RECENT TAX REVISIONS 1 (July 14, 2016) ("Another issue concerning REITs is that provisions in FIRPTA have been discouraging foreign investors from purchasing REIT shares by taxing investments that exceed 5% of the REIT's shares.").

[12] *See* Joshua R. Williams & Douglas Scott, *FIRPTA 5 Percent Exception Should Be Tested at the Partner Level*, Tax Notes Fed. (TA) (Nov. 20, 2023); *see also* New York City Bar, Comm. on Taxation of Bus. Entities, *New York City Bar Association Report Requesting Guidance on Application of the FIRPTA Exception for Publicly Traded Stock in the Partnership Context* (Feb. 5, 2016) ("The Committee specifically requests that guidance be issued which provides that the ownership test is applied at the partner level and not at the partnership level. Such clarification…would mirror similar look-through provisions in other related areas of the tax law, such as the portfolio interest rules[] and would be consistent with recent legislation aimed at encouraging investment in U.S. real property and infrastructure."); Kimberly S. Blanchard, *FIRPTA in the 21st Century – Installment Two: The 5 Percent Public Shareholder Exception*, 37 INT'L J. 4 (BNA) (Jan. 11, 2008) ("Regulations should be issued providing a look-through rule for [5%-threshold purposes], similar to the look-through rule provided under the portfolio interest exemption.").

[13] I.R.M. 33.1.2.2.3.5(9) ("A subsequent decision to adopt a different position on the same or a similar issue will…not require the withdrawal or revocation of the prior legal advice memorandum. Instead, a new memorandum setting out the current advice should be issued.").

[14] Section 1001.

[15] Section 1256(g)(3) defines the term nonequity option as any listed option (generally, an option traded on or subject to the rules of a qualified board or exchange) that is not an equity option.

[16] Section 1256(b)(1).

[17] Section 1256(g)(2)(A).

[18] Section 12561(a)(1).

[19] Section 1256(a)(2).

[20] Section 1256(a)(3).

[21] Economic Recovery Tax Act of 1981, Pub. L. No. 97–34, § 503(a), 95 Stat. 172, 327-28 (1981)

[22] Technical Corrections Act of 1982, Pub. L. No. 97–448, § 105(c)(5)(B) & (C), 96 Stat. 2365, 2386 (1983).

[23] H.R. REP. NO. 97-794, at 23 (1982) ("Prior to [the Economic Recovery Tax Act of 1981], taxpayers who used both the futures exchanges and the interbank market to conduct short-term trading in foreign currency were subject to

substantially comparable tax treatment for both types of contract[s]. Although bank forward contracts differ from regulated futures contracts, the volume of trading through forward contracts in foreign currency in the interbank market is substantially greater than foreign currency trading on futures exchanges, and prices are readily available. Such contracts are economically comparable to regulated futures contracts in the same currencies and are used interchangeably with regulated futures contracts by traders.").

[24] *See* S. REP. NO. 97-592, at 25-28 (1982); H.R. REP. NO. 97-986, at 24-26 (1982) (Conf. Rep.).

[25] *See* P.L.R. 8818010 (Feb. 4, 1988).

[26] Deficit Reduction Act of 1984, Pub. L. No. 98–369, § 102(a)(3), 98 Stat. 494, 620 (1984); *see* H.R. REP. NO. 98-432 (Part 2), at 1646 (1984) ("Because certain contracts may call for a cash settlement by reference to the value of the foreign currency rather than actual delivery of the currency, the bill provides that the delivery of a foreign currency requirement is met where the contract provides for a settlement determined by reference to the value of the foreign currency.").

[27] Definition of Foreign Currency Contract Under Section 1256, 87 Fed. Reg. 40,168 (July 6, 2022).

[28] We note that OTC foreign currency options and listed foreign currency options are subject to the same set of rules in other areas, such as Section 988(a)(1)(B).

[29] 87 Fed. Reg. at 40,169.

[30] *Wright v. Comm'r,* 809 F.3d 877 (6th Cir. 2016).

[31] 87 Fed. Reg. at 40,169.

[32] H.R. REP. NO. 100-1104 (Vol. 2), at 189 (1988) (Conf. Rep.).

[33] These "major-minor" transactions involved the taxpayer purchasing call and put options in a foreign currency in which regulated futures contracts are traded (a "major" currency) and writing call and put options in a foreign currency in which regulated futures contracts are not traded (a "minor" currency). The taxpayer would select currencies with a historically high, positive correlation such that the taxpayer could be reasonably certain to have offsetting gain and loss in the options. The taxpayer would assign the major currency option with unrealized loss and the appreciated minor currency option with unrealized gain to a charity. The taxpayer would treat the assignment of the major currency option as a recognition event under Section 1256(c)(1) and claim a loss, *see Greene v. U.S.*, 79 F.3d 1348, 1353-58 (2d Cir. 1996) (holding that donation of regulated futures contract to charity is a recognition event), whereas the taxpayer would not treat the assignment of the minor currency option with unrealized gain as a recognition event because it is not a Section 1256 contract. The taxpayer and its counterparty would terminate the unassigned options so that the gain and loss on the unassigned options offset. The taxpayer would be left, *in theory*, with a large tax loss with minimal economic risk, and because the options are offsetting and cash-settled, and any premiums are retained, the nominal amounts of foreign currency could exceed the economic means of the parties.

[34] *Wright v. Comm'r*, No. 30957-09, T.C. Memo. 2024-100 (U.S. Tax Court Oct. 30, 2024).

[35] *Id.*

[36] Section 1297(a).

[37] Section 1291(a).

[38] *See* Sections 1293-1295 (QEF) & 1296 (MTM).

[39] *See* Section 1297(c).

[40] *See* Section 1298(b)(1).

[41] Regulation section 1.1295-3 provides three exclusive circumstances under which retroactive QEF elections are allowed: (1) where the shareholder filed a protective statement and a reasonable belief statement with an original return; (2) where the shareholder is a "qualified shareholder" (a less-than-2% owner which relied on a statement from the foreign corporation that it reasonably believes that it is not a PFIC); and (3) where special consent is granted by the IRS. So-called "9100 Relief" providing an extension of time to make a regulatory election under Regulation section 301.9100 is not available. These limitations have led the Treasury to observe that, "there are large individual and administrative costs under current law for the existing special consent procedure. The existing procedure requires a taxpayer to file a ruling request with the IRS and pay a user fee that is currently several thousand dollars." U.S. DEP'T OF THE TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2025 REVENUE PROPOSALS 50-51 (2024).

[42] The complexity of purging elections led the author of the Bloomberg Portfolio on PFICs to write: "Warning: The existing regulatory framework relating to purging elections is a minefield of confusion, owing to piecemeal regulation issued over a long period of time that include regulations issued under now-renumbered Code sections containing erroneous cross-references." Kim Blanchard, 6300 T.M., *PFICs*, at X.B.2.c. The same author separately noted that, "[v]irtually all of the defined terms and verbiage used in the regulations are arcane and difficult to understand without understanding the history of the PFIC rules going back to 1986." Kim Blanchard, *Comments on T.D. 9360: PFIC Purging Elections*, 50 TAX MGMT. INT'L PORT. (BNA) No. 12 (2021).

[43] *See* Section 1291(d)(2).

[44] *See* Section 1298(b)(1).

[45] "First, there is a deemed sale plus QEF election under § 1291(d)(2)(A) for continuing PFICs. That election is governed by Reg. § 1.1291-10, promulgated in 1996. The second election is also under § 1298(b)(1) and is set out at Reg. § 1.1298-3(b). It is a deemed sale election for former PFICs. This election was adopted in 2005 and amended by T.D. 9360 in 2007. Third is the deemed dividend plus QEF election for PFICs that continue to be PFICs but are excluded as a result of being CFCs. The election is made under Reg. § 1.1291-9, which was originally promulgated in 1996…[T]his regulation has been amended several times…A fourth election is a deemed dividend election for former PFICs that are CFCs, at Reg. § 1.1298-3(c)…Fifth and sixth, Reg. § 1.1297-3(b) and § 1.1297-3(c) contain two elections – a deemed sale and deemed dividend election…The last two types of elections are referred to generically as late elections. One type of late election is available to inclusion shareholders of CFCs under Reg. § 1.1297-3(e). The other is available for former PFICs and is set out at § 1.1298-3(e)." *See* Kim Blanchard, *Comments on T.D. 9360: PFIC Purging Elections*, 50 Tax Mgmt. Int'l Port. (BNA) No. 12 (2021).

[46] Regulation section 1.1298-1(b)(1).

[47] Regulation section 1.1298-1(b)(2)(i).

[48] Regulation section 1.1298-1(b)(2)(ii).

[49] Guidance on Passive Foreign Investment Companies and Controlled Foreign Corporations Held by Domestic Partnerships and S Corporations and Related Person Insurance Income, 87 Fed. Reg. 3890 (Jan. 25, 2022).

[50] 87 Fed. Reg. at 3895.

[51] Section 1402(a).

[52] Section 1402(a)(13).

[53] H.R. REP. NO. 95-702 (Part 1), at 40 (1977).

[54] *Id.* at 40-41.

[55] *Id.* at 41.

[56] Social Security Amendments of 1977, Pub. L. No. 95-213, § 313(a), 91 Stat. 1509, 1535 (1977) (codified at 42 U.S.C. § 411(a)(12)).

[57] § 313(b), 91 Stat. at 1536 (now codified at Section 1402(a)(13)).

[58] *Compare* IRS, *Instructions for Form 1065*, at 3, 39 (2021), https://www.irs.gov/pub/irs-prior/i1065--2021.pdf (adding new language in the "limited partner" definition in the 2021 instructions stating, "However, whether a partner qualifies as a limited partner for purposes of self-employment tax depends upon whether the partner meets the definition of limited partner under section 1402(a)(13).") *with* IRS, *Instructions for Form 1065*, at 3, 40 (2020), https://www.irs.gov/pub/irs-prior/i1065--2020.pdf.

[59] In other circumstances, Congress did make the definition of net earnings from self-employment dependent on whether a partner had provided services to the partnership. In two parallel provisions, 42 U.S.C. § 411(a)(9) and Section 1402(a)(10), Congress excluded from social security benefit calculations and from self-employment tax certain payments to retired partners if, among other requirements, "such partner rendered no services with respect to any trade or business carried on by such partnership."

[60] Section 707(c) (emphasis added).

[61] *Loper Bright Enters. v. Raimondo*, 144 S. Ct. 2244, 2266 (2024).

[62] *See generally* Antonin Scalia & Bryan A. Garner, READING LAW: THE INTERPRETATION OF LEGAL TEXTS 170-73 (2012) (discussing the Presumption of Consistent Usage and citing *Mohasco v. Silver*, 447 U.S. 807, 826 (1980), approvingly for refusing to "unreasonably giv[e] the word 'filed' two different meanings in the same section of the statute").

[63] *Johnson v. Comm'r*, 60 T.C. 829, 833 (1973).

[64] Regulation section. 1.6031(a)-1(b)(5).

[65] Section 59(k)(1)(D).

[66] *Year-End 2024 Middle Market Indicator*, NAT'L CTR. FOR THE MIDDLE MARKET 2 (2024), https://www.middlemarketcenter.org/Media/Documents/MiddleMarketIndicators/2024-Q4/FullReport/NCMM_MMI_YEAR-END_2024_web.pdf.

[67] *Id.* ("These businesses outperformed through the last financial crisis (2007 – 2010 period) by adding 2.2 million jobs across major industry sectors and U.S. geographies, demonstrating their importance to the overall health of the U.S. economy.").

[68] *See* Letter from Thomas A. Barthold, Chief of Staff, J. Comm. on Tax'n, to Sen. Ron Wyden, Senate Fin. Comm. (Aug. 1, 2022), https://www.finance.senate.gov/imo/media/doc/CAMT%20JCT%20Data.pdf; *see also* Letter from Thomas A. Barthold, Chief of Staff, J. Comm. on Tax'n, to Sen. Ron Wyden, Senate Fin. Comm. (Aug. 4, 2022), https://www.finance.senate.gov/imo/media/doc/8.4.22%20JCT%20Effective%20Tax%20Rate.pdf.

[69] 168 CONG. REC. S4200 (daily ed. Aug. 6, 2022) (statement of Sen. John Thune) (emphasis added), https://www.congress.gov/117/crec/2022/08/06/168/133/CREC-2022-08-06.pdf.

[70] Sections 701 & 702.

[71] Section 702(b).

[72] Section 7704(a).

[73] Section 7704(b).

[74] *See* Regulation section 1.7704-1(b).

[75] Regulation section 1.7704-1(c).

[76] H.R. REP. NO. 100-391 (Part 1) (1987).

[77] *Id.* at 1070.

[78] Regulation section 1.7704-1(c)(2).

[79] Regulation section 1.7704-1(f). Separately, certain "private transfers" are disregarded in determining whether a partnership's interests are readily tradable, including transfers pursuant to a "closed end" redemption plan under which (i) the partnership does not issue any interest after the initial offering and (ii) no partner or related person provides contemporaneous opportunities to acquire interests in similar or related partnerships which represent substantially identical investments (the "**Closed-End Redemption Safe Harbor**"). Regulation section 1.7704-1(e)(1)(viii) & (4).

[80] 15 U.S.C. § 77a *et seq.*

[81] Regulation section 1.7704-1(h). For purposes of determining the numbers of partners in the partnership, a flow-through entity (such as a partnership) that owns a partnership interest is treated as a single partner unless both (i) the flow-through entity's interest in the partnership represents substantially all of the value of the flow-through entity and (ii) a principal purpose of the tiered arrangement is to enable the partnership to satisfy the 100-partner limitation. Regulation section 1.7704-1(h)(3).

[82] *See* Notice 88-75, 1988-2 C.B. 386.

[83] *Id.* at II.A. For purposes of the 500-partner test, indirect investors through flow-through entities were counted as partners in the partnership.

[84] Certain Publicly Traded Partnerships Treated as Corporations, 60 Fed. Reg 62,026 (Dec. 4, 1995).

[85] Regulation section. 1.7704-1(j). Prior to the adoption of the PTP regulation in 1995, a lack of actual trading safe harbor was also provided by administrative pronouncement. *See* Notice 88-75, 1988-2 C.B. 386. Notice 88-75 provided that interests in a partnership would not be considered readily tradable if the sum of the percentage interests in partnership capital or profits represented by partnership interests that are sold or otherwise disposed (including redemptions) during the taxable year did not exceed 5% of the total interests in partnership capital or profits. *Id.* at II.C.1. Each sale or other disposition of the beneficial ownership in a partnership interest included in the total interest in partnership capital and profit was taken into account, regardless of whether such interest had been transferred previously during the taxable year. *Id.* Separately, Notice 88-75 also provided that interests in a partnership would not be considered readily tradable if the 5%-lack of actual trading safe harbor would have been satisfied if (i) transfers that met the "matching services" and "redemption and repurchase agreements" safe harbors were disregarded and (ii) "2%" was substituted for "5%" as the maximum permitted sum of interests in partnership capital or profits that may be sold or otherwise disposed of under this safe harbor. *Id.* at II.C.2. The PTP regulation retained only the 2%-lack of actual trading safe harbor.

[86] 15 U.S.C. § 80a-1 *et seq.*

[87] 60 Fed. Reg. at 62,027.

[88] 15 U.S.C. § 78a *et seq.*

[89] *See* Exemption of Compensatory Employee Stock Options from Registration Under Section 12(g) of the Securities Exchange Act of 1934, 72 Fed. Reg. 69,554 (Dec. 7, 2007).

[90] Section 305(a).

[91] Section 305(b).

[92] H.R. REP. NO. 91-413, at 112 (1969).

[93] Section 305(c) (emphasis added).

[94] Section 305(b)(2).

[95] *See* Regulation section 1.305-7(b)(1).

[96] *See* Regulation section. 1.305-7(b).

[97] Rev. Rul. 75-513, 1975-2 C.B. 114.

[98] Deemed Distributions Under Section 305(c) of Stock and Rights to Acquire Stock, 81 Fed. Reg. 21,795, 21,796 (April 13, 2016) (emphasis added).

[99] *See*, *e.g.*, P.L.R. 201446013 (Nov. 25, 2013), P.L.R. 201312028 (Dec. 20, 2012), & P.L.R. 201247004 (Aug. 22, 2012).

[100] Tax Reform Act of 1969, Pub. L. No. 91-172, § 421, 83 Stat. 487, 614 (1969).

[101] STAFF OF THE JOINT COMM. ON TAX'N, 91ST CONG., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1969 135 (1970).

[102] Section 861(a)(2).

[103] Regulation section 1.871-15(c); *see* Dividend Equivalents From Sources Within the United States, 80 Fed. Reg. 56,866 (Sep. 18, 2015).

[104] Regulation section 1.871-15(l).

[105] Derivatives that reference the performance of a U.S. stock (such as in an exchange traded fund ("**ETF**")) that tracks the performance of a qualified index will also be treated as referencing the qualified index and will be provided safe harbor from the substitute dividend payment rules. Regulation section 1.871-15(l)(7).

[106] Regulation section 1.871-15(l)(3).

[107] Regulation section 1.871-15(l)(4).

[108] Regulation section 1.871-15(l)(2).

[109] Regulation section 1.871-15(l)(1).

[110] Regulation section 1.871-15(l)(6).

[111] *See* Notice 2024-44, 2024-25 I.R.B. 1737; Notice 2022-37, 2022-37 I.R.B. 234; Notice 2020-2, 2020-3 I.R.B. 327; Notice 2018-72, 2018-40 I.R.B. 522; Notice 2017-42, 2017-34 I.R.B. 1.

[112] Regulation section 1.871-15(n)(3).

[113] *See* Regulation section 1.871-15(p)(1).

[114] *See* Regulation section 1.871(o).