

January 23, 2026

Via Electronic Mail

Kevin Salinger
Deputy Assistant Secretary of the Treasury for
Tax Policy
U.S. Department of the Treasury
1500 Pennsylvania Ave., NW
Washington, D.C. 20220

D. Peter Merkel
Branch Chief, Branch 5, Associate Chief Counsel
(International)
Internal Revenue Service
111 Constitution Ave., NW
Washington, D.C. 20224

Re: Notice 2025-63, Source of Certain Borrow Fees

MFA¹ appreciates the opportunity to provide comments to the Department of the Treasury (“**Treasury**”) and the Internal Revenue Service (the “**IRS**”) on the notice announcing the intent to issue proposed regulations providing that payments referred to as borrow fees or negative rebate with respect to securities lending transactions or sale-repurchase (“**repo**”) transactions are sourced based on the residence of the recipient.²

We commend Treasury and the IRS for providing much-needed clarity of current law to non-U.S. securities lenders and repo sellers and, importantly, U.S. payors of borrow fees and negative rebate which, in the absence of guidance, may withhold tax on those fees. The dearth of guidance on the source of such fees,³ and any resulting withholding by U.S. counterparties to avoid liability as withholding agents, tends to disadvantage U.S. borrowers (often major U.S. financial institutions, such as securities dealers, prime brokers, investment banks, and other asset managers) in these short-term financing markets.

For example, the imposition of withholding tax may upset the fundamental economics non-U.S. securities lenders and repo sellers expect where U.S. counterparties borrow securities to remedy failures-

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 Notice 2025-63, 2025-46 I.R.B. 709.

³ Over 30 years ago, Treasury and the IRS invited “comments...concerning the source, character, and income tax treaty treatment of fees paid to a lender of securities.” Certain Payments Made Pursuant to a Securities Lending Transaction, 57 Fed. Reg. 860, 861 (Jan. 9, 1992). The scope of final regulations was not expanded to provide an answer. *See* 62 Fed. Reg. 53,498 (Oct. 14, 1997).

Washington, DC
1301 Pennsylvania Ave NW
Suite 350
Washington, DC 20004

New York
600 Lexington Ave
17th Floor
New York, NY 10022

Brussels
Rond Point Schuman 11
1040 Brussels, Belgium

London
14 Hanover Square, Mayfair,
London, United Kingdom, W1S 1HT

to-deliver and avoid fails charges,⁴ cover short sales, or cover a hedge of a position. Prior to the IRS reevaluating its position on the sourcing of borrow fees and negative rebate,⁵ this result would likely have followed from the initial Chief Counsel Advice (“**CCA**”), concluding that such fees should be sourced to the residence of the payor,⁶ and caused non-U.S. securities lenders and repo sellers to shift their lendable assets from U.S. to non-U.S. financial institutions.

Moreover, further lending (or re-use) of collateral (including, for example, U.S. broker-dealers rehypothecating non-U.S. client assets) also serves important market functions by enhancing the collateral’s underlying market liquidity and reducing transaction costs for U.S. borrowers. The initial CCA would also likely have drastically reduced U.S. financial institutions’ participation in these short-term financing markets, placing U.S. financial institutions at a disadvantage to their non-U.S. counterparts and increasing transaction costs for U.S. borrowers.

As Treasury and the IRS develop the forthcoming proposed regulations, **we recommend that the rule providing that the residence of the recipient is determined in the same manner as under Section 988(a)(3)(B) explicitly incorporate the Treasury Regulations promulgated thereunder.**⁷ Specifically, Treasury and the IRS should ensure that it is well understood that Regulation section 1.988-4(d)(3)—providing that “[t]he determination of residence shall be made at the partner level...in the case of partners in a partnership that are not engaged in a U.S. trade or business by reason of section 864(b)(2)” —applies for this purpose.

In practice, where the conclusion to source borrow fees and negative rebate based on the residence of the recipient is reached by comparison and analogy to classes of income⁸—principally, notional principal contact payments⁹ and qualified fails charges¹⁰—for which the source rules are specified in the Treasury Regulations, substantial uncertainty persists as to how certain domestic partnerships with foreign partners should source such fees. That is, Section 988(a)(3)(B)(i) provides that the residence of any domestic

⁴ See Letter from Securities Industry and Financial Markets Association (SIFMA) to Treasury and the IRS (Aug. 1, 2012) (describing a hypothetical non-U.S. hedge fund refusing to lend its U.S. Treasuries to U.S. counterparties or effectively grossing up the rebate rate for withholding tax in excess of a fails charge, in footnote 39).

⁵ See C.C.A. 2025-48-004 (Oct. 23, 2025).

⁶ See C.C.A. 2025-48-005 (July 18, 2025).

⁷ Unless otherwise indicated, all “section” references are to the Internal Revenue Code of 1986, as amended (the “**Code**”), or the Treasury Regulations promulgated thereunder.

⁸ See *Bank of America v. U.S.*, 680 F.2d 142, 147 (Ct. Cl. 1982) (“When an item of income is not classified within the confines of the statutory scheme nor by regulation, courts have sourced the item by comparison and analogy with classes of income specified within the statutes.”).

⁹ See Regulation section 1.863-7(b)(1).

¹⁰ See Regulation section 1.863-10(a).

partnership is the U.S., and any foreign partnership is a country other than the U.S. Clause (iii) contemplates that the Treasury Regulations thereunder may provide circumstances under which the determination of residence should be made at the partner level. However, without an explicit incorporation of Section 988(a)(3)(B)(iii) and, thereby, Regulation section 1.988-4(d)(3), or as a result of an inadvertently narrow reference to clause (i) (rather than the more inclusive subparagraph (B)) of the statute, it is unclear whether the determination of residence should be made at the partner level for partners in a partnership that rely on the Section 864(b)(2) trading safe harbors. Accordingly, some tax advisors may caution against domestic partnerships serving as the vehicles through which securities lending and repo transactions are conducted, although the distinction drawn by this conservative advice is largely artificial and lacks a clear policy basis.

Building upon this recommendation, **we also recommend that the rule further clarifies that the determination of residence should be made at the partner level for partners in a partnership not engaged in a U.S. trade or business but that do not rely on the Section 864(b)(2) trading safe harbors.** Following passage of the Tax Reform Act of 1986,¹¹ introducing Section 988, and the Technical and Miscellaneous Revenue Act of 1988,¹² adding the grant of regulatory authority for partner level source rules in clause (iii) of the statute, the preamble to the proposed and temporary regulations promulgated under Section 988(a)(3)(B) discussed the special rules mandating that the determination of residence be made at the partner level. Treasury and the IRS wrote that these “[s]pecial rules are provided in the case of a partnership formed or availed of to avoid tax by altering the source of exchange gain or loss,”¹³ describing the generic anti-abuse rule currently found in the flush language of Regulation section 1.988-4(d)(1)(iii). The proposed and temporary regulations contained no other partner level source rule or reference to the Section 864(b)(2) trading safe harbors. Two-and-a-half years later, when Treasury and the IRS finalized the proposed and temporary regulations, Regulation section 1.988-4(d)(3), as it exists today, was added without any further discussion in the preamble to the final regulations.¹⁴

Whether a partnership should be treated as an aggregate of its partners, requiring partner level determinations for a particular provision of the Code, or respected as separate and distinct from its partners, requiring partnership level determinations for the same, in the absence of clear statutory

¹¹ Pub. L. No. 99-514, 100 Stat. 2085, 2587.

¹² Pub. L. No. 100-647, 102 Stat. 3342, 3530.

¹³ Taxation of Gain or Loss From Certain Nonfunctional Currency Transactions (Section 988 Transactions), 54 Fed. Reg. 38,816, 38,821 (Sep. 21, 1989).

¹⁴ See Taxation of Gain or Loss from Certain Nonfunctional Currency Transactions (988 Transactions), 57 Fed. Reg. 9172 (March 17, 1992). Under the heading “Section 1.988-4 Source of Exchange Gain or Loss Realized on a Section 988 Transaction,” Treasury and the IRS merely write, “The Service is studying and solicits comments on the proper method of attributing liabilities and hedges to a U.S. branch of a foreign corporation.” 57 Fed. Reg. at 9175.

language compelling one approach over the other,¹⁵ “depends upon which approach more appropriately serves the Code provision at issue.”¹⁶ In the case of partners in a partnership not engaged in a U.S. trade or business but that do not rely on the Section 864(b)(2) trading safe harbors, as in the case of partners in a partnership that do so rely, there appears to be no less a reason to make the determination of residence at the partner level. Indeed, the legislative and regulatory histories behind the source rules for Section 988 transactions and notional principal contract payments, which generally incorporate Section 988(a)(3)(B)(i) and to which borrow fees and negative rebate are often compared and analogized to reach the conclusion to apply similar source rules, fail to provide such a reason. The source rules for notional principal contract payments pre-dated (and, therefore, could not have contemplated) Regulation section 1.988-4(d)(3) as it exists today.¹⁷ And, as discussed above, the proposed and temporary regulations promulgated under Section 988(a)(3)(B) would have failed to foreshadow the partner level source rule for partners in a partnership not engaged in a U.S. trade or business by reason of the Section 864(b)(2) trading safe harbors. Notice 87-4,¹⁸ which outlined the early source rules for interest rate swaps and informed subsequent proposed and temporary regulations incorporating Section 988(a)(3)(B)(i),¹⁹ pre-dated even the addition of Section 988(a)(3)(B)(iii).

Accordingly, in the absence of any persuasive reason to limit the application of the partner level source rule to partners in a partnership not engaged in a U.S. trade or business by reason of the Section 864(b)(2) trading safe harbors (*i.e.*, “traders”) specifically, but not partners in a partnership not engaged in a U.S. trade or business by reason of facts and circumstances which reflect activities of insufficient “continuity and regularity” (*i.e.*, “investors”),²⁰ Treasury and the IRS should provide that Regulation section 1.988-4(d)(3) applies for the purpose of determining the residence of the recipient, in the case of partners in a partnership not engaged in a U.S. trade or business, notwithstanding reliance on the Section 864(b)(2) trading safe harbors.

Finally, as a clarification of current law on which taxpayers may rely with respect to securities lending and repo transactions entered into before the forthcoming proposed regulations are published, **we**

¹⁵ See *Grecian Magnesite Mining, Indus. & Shipping Co. v. Commissioner*, 149 T.C. No. 3 (July 13, 2017), *aff'd*, 926 F.3d 819 (D.C. Cir. 2019).

¹⁶ *Coggin Auto. Corp. v. Commissioner*, 115 T.C. 349 (2000), *rev'd*, 292 F.3d 1326 (11th Cir. 2002).

¹⁷ See Allocation of Income Attributable to Certain Notional Principal Contracts Under Section 863(a), 56 Fed. Reg. 1361 (Jan. 14, 1991).

¹⁸ Notice 87-4, 1987-1 C.B. 416.

¹⁹ See Allocation of Income Attributable to Certain Notional Principal Contracts Under Section 863(a), 54 Fed. Reg. 31,708 (Aug. 1, 1989).

²⁰ See, *e.g.*, *Commissioner v. Groetzinger*, 480 U.S. 23, 35 (1987) (“[T]o be engaged in a trade or business, the taxpayer must be involved in the activity with continuity and regularity.”); *Higgins v. Commissioner*, 312 U.S. 212 (1941).

recommend that the IRS clarify the type of documentation needed to support refunds of prior years' withholding tax. We note, for example, that there is not a specific code for borrow fees and negative rebate on Form 1042-S, *Foreign Person's U.S. Source Income Subject to Withholding*, and U.S. counterparties as withholding agents are under no obligation to assist taxpayers with obtaining refunds from historic transactions. We believe that the IRS could provide clarity by offering soft guidance, such as FAQs, on the type of documentary support required for a refund claim, for example, a letter from the withholding agent detailing and certifying the amounts of withholding tax imposed on borrow fees and negative rebate in prior years.

* * * * *

We appreciate the opportunity to provide comments to Treasury and the IRS on the forthcoming proposed regulations, and we would be pleased to meet with Treasury and the IRS to discuss our comments in further detail. If Treasury and the IRS have questions or comments, 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
Chief Legal Officer & Head of Global Regulatory Affairs
Managed Funds Association