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Internal Revenue Service
CC:PA:01:PR (Notice 2026-62)
Room 5503
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Re: Notice 2026-62: Guidance and Other Actions Being Considered Regarding Certain Potentially Abusive Investment Fund Strategies Involving Financial Products

MFA[1] appreciates the opportunity to comment to the Department of the Treasury ("**Treasury**") and the Internal Revenue Service (the "**IRS**") on Notice 2026-62 (the "**Notice**").[2] MFA represents the alternative asset management industry, whose investors include a broad array of U.S. and non-U.S. investors, including pension plans, university endowments, charitable foundations, sovereign wealth funds, and other institutional investors. MFA members have a direct interest in the Notice, which addresses the tax treatment of financial products that investment funds use across a wide range of strategies.

MFA welcomes Treasury and the IRS's engagement with stakeholders on these issues, including their request for public input as they consider substantive guidance concerning the investment fund strategies described in the Notice. MFA is also grateful that the Notice recognizes that any guidance "will target specific abusive transactions, will minimize compliance burdens, and will respect market expectations with respect to conventional, long-established tax planning that is consistent with the intent of Congress." In response to the Notice's request for comments, this letter discusses the operation of relevant rules under current law, provides additional context on how investment funds use the relevant products and rely on the relevant rules in the ordinary course, and evaluates the potential effects of certain approaches to guidance, such that any guidance can be appropriately tailored to minimize compliance burdens, respect market expectations, and prevent adverse effects on markets. This letter addresses only the transactions described in Section 3 of the Notice. It does not address the transactions described in Section 2 of the Notice or in Rev. Rul. 2026-20.

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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] Notice 2026-62, 2026-43 I.R.B. 521.

I. Executive Summary

1. Any guidance should be narrowly tailored, issued through notice-and-comment rulemaking, and applied prospectively. The transactions described in Section 3 of the Notice implicate statutory and regulatory elections and rules that taxpayers and market participants have relied on for decades. Moreover, Section 3 of the Notice addresses rules applicable to financial transactions that are widely used by market participants outside of the "tax-aware" context. Any guidance should address the specific concerns identified in the Notice without disrupting ordinary-course investment activity or established market practices.

2. Treasury's concerns regarding Section 988(a)(1)(B) elections can be addressed through a tailored rule requiring an election to be made before the time that the taxpayer disposes of the position.[3] The use of hindsight identified in the Notice arises when a taxpayer elects capital treatment only after a transaction has expired, or been disposed of or terminated, and the taxpayer knows whether it has realized gain or loss. Treasury and the IRS can address that concern by proposing Regulations providing that the Section 988(a)(1)(B) election must be made before the time that the taxpayer disposes of the position, while avoiding broader restrictions that would burden legitimate ordinary-course use of the election.

3. Mixed-character positions commonly arise in transactions not described in the Notice and do not, standing alone, justify broader changes to the identified straddle rules. The identified straddle rules provide a level of certainty and alleviate adverse tax consequences in an operationally complex area, and mixed-character identified straddles arise in transactions that are commonly used in the market and that do not resemble the transactions described in the Notice. Any guidance addressing the identified straddle transaction described in the Notice should be narrowly tailored and should preserve the ordinary operation of the identified straddle rules in Section 1092(a)(2). For example, guidance providing that basis adjustments under Section 1092(a)(2) require a corresponding change in character or guidance excluding mixed-character straddles from the identified-straddle regime would affect broader transactions and impose significant compliance burdens for market participants engaged in ordinary-course transactions.

4. Changes to the existing rules governing notional principal contracts would have implications that reach well beyond the concerns described in the Notice. Market participants have relied on the current notional principal contract ("**NPC**") rules for decades, and decisions regarding whether and when to terminate a contract are a routine aspect of investment and risk-management activity. Moreover, the NPC market is estimated to be in the hundreds of trillions of dollars. Broad changes to the timing or character rules for NPCs would have significant consequences for the wider financial markets that rely on these contracts.

[3] Except where the context indicates otherwise, references to "Section" herein are to the Internal Revenue Code of 1986, as amended (the "**Code**") or to the Treasury Department regulations promulgated thereunder ("**Regulations**").

II. Discussion

A. Any Guidance Should Be Narrowly Tailored, Issued Through an Appropriate Notice-and-Comment Process, and Applied Prospectively

We commend Treasury and the IRS for recognizing that strategies involving the transactions described in Section 3 of the Notice may "carry out bona fide and profitable investment activity," and that labeling a strategy "tax-aware" or "tax advantaged" "does not in and of itself represent cause for concern." It is indeed the case that many "tax-aware" funds and strategies are operated to generate pre-tax returns, and consequently, bear meaningful market risk in doing so. Further, many "tax-aware" funds have investors that are non-U.S. or are otherwise indifferent to the character of U.S. tax items (*e.g.*, tax-exempt investors), and tax-aware and non-tax-aware funds may pursue the same fundamental investment strategies.

The transactions described in Section 3 of the Notice concern the application of established law, including statutory elections expressly authorized by Congress and Regulations that have been in place for decades, and taxpayers and market participants have structured their activities in reliance on those rules. To the extent Treasury and the IRS determine that changes to those rules are warranted, MFA respectfully suggests that any such change would benefit from being:

- narrowly tailored to the specific transactions and concerns identified in the Notice;
- made by proposing Regulations that are subject to notice and comment, rather than through a revenue ruling or other subregulatory guidance; and
- applied only to positions entered into or established after the date either (i) proposed Regulations are published or (ii) such Regulations are finalized.

MFA appreciates that Treasury has articulated a set of principles guiding its approach to tax regulation generally, including that regulations should favor standards and safe harbors over rigid rules where business practices are diverse or evolving, should not be designed around the worst actor at the expense of ordinary-course transactions, should take seriously the scope of statutory authority delegated to Treasury, and should minimize compliance burdens, promote comprehensibility, and respect market expectations and business realities.[4] MFA encourages Treasury and the IRS to apply those same principles to any guidance promulgated under the Notice, consistent with the recommendations below.

The Notice entertains the possibility of identifying certain strategies as transactions of interest or listed transactions. The reportable transaction tool can be a blunt instrument that in many cases results in onerous compliance burdens. This is especially true for taxpayers who reasonably believe that they have not engaged in the relevant abusive or potentially abusive transaction, but are inclined to report the transaction out of an abundance of caution, resulting in unproductive outcomes due to overbroad disclosures. As noted above, the transactions described in Section 3 of the Notice concern the application of established law, including statutory elections expressly authorized by Congress and Regulations that have been in place for decades. Ultimately, MFA welcomes the opportunity to continue its dialogue

[4] Kevin Salinger, Deputy Assistant Secretary for Tax Policy, NYSBA Tax Section Lunch Remarks (Jan. 13, 2026).

with Treasury to provide information about the way in which investment funds execute financial transactions and discuss the scope of any guidance promulgated under the Notice.

B. Section 988(a)(1)(B) Elections

1. The election is an essential congressionally authorized mechanism for ensuring appropriate character for gains and losses from foreign currency derivatives

Under Section 988(a)(1)(A), foreign currency gain or loss on most foreign currency forward contracts is ordinary. Section 988(a)(1)(B) allows a taxpayer to elect capital treatment for gain or loss on a forward contract, futures contract, or option that is a capital asset in the taxpayer's hands and is not part of a straddle. To make the election, the taxpayer must identify the transaction "before the close of the day on which such transaction is entered into (or such earlier time as the Secretary may prescribe)."[5] As the Notice explains, the election permits taxpayers that trade foreign currency through both regulated futures contracts (which generally do not give rise to ordinary income or deduction, absent an election to the contrary)[6] and forward contracts to obtain consistent capital treatment across both types of instruments.

A regulated futures contract is traded on an exchange and cleared through a central counterparty. A taxpayer generally can close out a futures position at any time by entering into an offsetting purchase or sale, which generally terminates the position for U.S. federal income tax purposes.[7] Foreign currency forwards, by contrast, are bilateral over-the-counter contracts. In general, a forward cannot be terminated for U.S. federal income tax purposes by an offsetting transaction unless the taxpayer derives an "economic benefit."[8] If a taxpayer enters into an offsetting forward, whether with the same counterparty or another, and the taxpayer does not derive an "economic benefit," both contracts generally remain outstanding until settlement unless the parties agree to terminate or net them, subject to certain exceptions.[9] Moreover, because the election is unavailable for any contract that is part of a straddle, the taxpayer may be precluded from making the Section 988(a)(1)(B) election for a contract offset in this manner.

Many investment funds that trade foreign currency derivatives make the Section 988(a)(1)(B) election in the ordinary course. Their strategies use futures contracts and forward contracts based on liquidity, pricing, and execution considerations, and the election produces consistent tax treatment for both types of contracts. Discretionary macro funds also use the election, often trading across currencies, tenors, and venues throughout the day in response to market developments. Many investment funds enter into foreign currency derivatives to hedge other positions, and such positions may give rise to capital gain or loss (*e.g.*, foreign currency denominated equity positions) or ordinary gain or loss (*e.g.*, positions that result solely in foreign currency gain or loss).[10]

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[5] Section 988(a)(1)(B). The Regulations do not prescribe an earlier time for making the election.

[6] *See* Treas. Reg. § 1.988-1(a)(7)(ii).

[7] *See* Treas. Reg. § 1.988-2(d)(2)(ii)(C); *see also* Section 1256(c)(1) (applying the Section 1256 mark-to-market and character rules to the termination of a Section 1256 contract "by offsetting . . . or otherwise").

[8] Treas. Reg. § 1.988-2(d)(2)(ii)(B).

[9] For example, Section 1256(c)(1) may apply separately to an offset of a forward that is also a Section 1256 contract.

[10] *See* Section 988(b)(3) (generally treating all gain or loss from a foreign currency derivative as ordinary).

2. Eliminating post-disposition elections would address Treasury's concerns

The Notice describes a strategy in which an investment fund terminates foreign currency forward contracts and then makes the Section 988(a)(1)(B) election only for contracts with respect to which it realized gain. At that point, the fund knows the final result of each completed transaction and can make the election where it is advantageous.

To the extent that Treasury believes that this type of transaction is inconsistent with the policies underlying the Section 988(a)(1)(B) election, MFA recommends that Treasury address this concern by promulgating proposed Regulations providing that, if a taxpayer disposes of a contract before the close of the day on which it is entered into, the election must be made before the time of disposition. This approach would be modeled on a similar identification rule applicable to identified mixed straddles, which is also required to be made before "the close of the day".[11] Under this approach, a taxpayer would not be permitted to terminate a forward contract for U.S. federal income tax purposes, determine whether it realized gain, and then make the Section 988(a)(1)(B) election with the benefit of hindsight.[12]

In MFA's view, this approach would offer a simple, administrable, and narrowly tailored rule that would prevent taxpayers from using hindsight to achieve effective character electivity. Moreover, as discussed further below, this approach would not have broader ramifications for markets or create undue burdens for market participants that trade foreign currency derivatives.

3. Broader restrictions would burden ordinary-course use of the election

Many market participants hold positions in foreign currency derivatives, either as directional positions or as hedges. In enacting Section 988(a)(1)(B), Congress expressly authorized an election that permits taxpayers to determine which eligible foreign currency derivatives should give rise to capital gain or loss and which should give rise to ordinary income and expense.

MFA respectfully encourages Treasury and the IRS to avoid any alternative approach that would unnecessarily restrict ordinary-course use of the Section 988(a)(1)(B) election.

- A "consistency" rule requiring a taxpayer to either make or not make the Section 988(a)(1)(B) election for qualifying foreign currency derivatives, or for a broad subset thereof, would be in tension with the statutory scheme of Section 988(a)(1)(B), which permits taxpayers to determine whether or not to make the election on a transaction-by-transaction basis.[13] Such an approach may also prohibit taxpayers from being able to match the character of foreign currency derivatives to the character of the positions such derivatives hedge. It would also unnecessarily require taxpayers seeking certainty with respect to foreign currency derivative gains and losses to

[11] Section 1092(a)(2)(B)(i). *See* Treas. Reg. § 1.1092(b)-3T(d)(1) ("If the taxpayer disposes of a position that is part of a section 1092(b)(2) identified mixed straddle before the close of the day on which the straddle is established, such identification must be made at or before the time that the taxpayer disposes of the position.").

[12] Section 988(a)(1)(B) specifies when a taxpayer may make the election and expressly authorizes the Secretary to prescribe the earlier time by which the election must be made.

[13] *See* Section 988(a)(1)(B) (providing that a taxpayer may make the election for "*a* forward contract, *a* futures contract, or option . . . if the taxpayer makes such election and identifies *such* transaction before the close of the day on which *such* transaction is entered into") (emphasis added).

choose between forward contracts and futures contracts purely as a result of such a consistency rule. Such change could also cause a large segment of the industry consisting of trading funds that use a mix of directional foreign exchange strategies and relative value foreign exchange strategies to become unable to make the election on their directional trading.

- The use of hindsight identified in the Notice arises when a taxpayer elects capital treatment only after a transaction has expired. As such, guidance requiring the Section 988(a)(1)(B) election to be made at or around the time the taxpayer enters into the transaction goes well beyond addressing the use of hindsight identified in the Notice. Moreover, many market participants would, as a practical matter, be unable to utilize the election. Many investment funds lack the operational infrastructure to make an election at the moment each trade is executed.[14] For example, a taxpayer executing a foreign currency derivative may simultaneously negotiate terms with multiple potential counterparties and make a last-minute decision about which transaction to execute based on economic, operational, or relationship considerations. Moreover, business personnel typically negotiate and trade foreign currency derivatives, while tax personnel are typically responsible for tax elections. The relevant tax personnel may not learn that the fund has traded a foreign currency derivative until a significant amount of time has elapsed. In cases where a fund trades directional foreign exchange strategies (which generally do not include straddles) and relative value foreign exchange strategies (which generally can include straddles), such personnel generally does not know at the time the trade is entered into which strategy it might be associated with, and whether it might be part of a straddle or not and be eligible or not for a Section 988(a)(1)(B) election. A contemporaneous-election requirement could therefore, as a practical matter, prevent a significant portion of the market from accessing an election that Congress expressly authorized, including taxpayers whose use of the election does not involve completed transactions or post-disposition hindsight.

C. Identified Straddles

1. The identified straddle rules provide certainty in an operationally complex area, and mixed-character identified straddles commonly arise in ordinary-course profit-seeking transactions

Section 1092(a)(1) generally defers a loss on a position that is part of a straddle to the extent of unrecognized gain in any offsetting position. The straddle rules are complex and broad in scope. Positions are offsetting whenever one substantially diminishes the taxpayer's risk of loss from another, and the straddle rules can reach a wide range of positions that investment funds hold in the ordinary course. As a result, determining which positions comprise a straddle, and how much loss is deferred, can be difficult for taxpayers that trade large and frequently changing portfolios.

The identified straddle rules in Section 1092(a)(2) are an essential tool that investment funds widely use to mitigate the adverse tax consequences of the straddle rules. As the Notice explains, the identified straddle rules "were

[14] If Treasury and the IRS adopt MFA's recommendation above and issue guidance providing that the election must be made before the time of disposition if a taxpayer disposes of a contract before the close of the day on which it is entered into, investment funds that trade intraday foreign currency derivatives would be required to ensure that they have the operational infrastructure in place to comply with this requirement. However, the universe of investment funds that trade intraday foreign currency derivatives is likely more limited than the universe of investment funds that enter into non-intraday foreign currency derivatives.

enacted to provide certainty to taxpayers as to which positions are treated as part of a straddle." By clearly identifying the positions making up a straddle by the close of the day the straddle is acquired, taxpayers can generally prevent such positions from creating straddles with positions outside the identified straddle. Under the identified straddle rules, losses realized with respect to one position are generally capitalized into the basis of the offsetting position.[15] Without the ability to identify straddles, taxpayers with large, diversified, and hedged portfolios would be forced to rely on the general facts-and-circumstances, offsetting-position analysis across their entire portfolio, which would require them to continuously monitor and re-evaluate the relationship between every position and every other position to determine whether a straddle exists and, if so, which positions comprise it. Thus, the identified straddle rules are critical to a wide range of investment funds.

In many of these ordinary-course straddle identifications,[16] the positions in the straddle have different character. Investment funds commonly hold a mix of ordinary positions (*e.g.*, foreign currency derivatives for which no Section 988(a)(1)(B) election is made), Section 1256 contracts that give rise to 60% long-term capital gain or loss and 40% short-term capital gain or loss ("**60/40**"), and positions that give rise to capital gain or loss (*e.g.*, trading positions in securities if the fund does not make a Section 475(f) election). Among many other examples:

- Funds that trade securities and that have made a Section 475(f)(1) election frequently enter into Section 1256 contracts that are not hedges of their securities positions (but which may nonetheless constitute a straddle with respect to a securities position).
- Funds that arbitrage pricing differences between foreign currency futures and forward markets may enter into futures contracts that produce 60/40 character and offsetting foreign currency forward contracts that produce ordinary gain or loss under Section 988 (absent a Section 988(a)(1)(B) election).

2. Any changes to the identified straddle regime should be narrowly tailored and preserve the ordinary operation of Section 1092(a)(2)

As discussed above, the identified straddle rules are an essential tool for investment funds to mitigate the harsh and potentially far-reaching results of the straddle rules, and it is common for investment funds to hold positions that give rise to ordinary, 60/40, and capital gains and losses. Any change to the identified straddle regime must be carefully considered to ensure that it does not vitiate the fundamental function of the rule. Moreover, MFA requests that Treasury consider the administrability of any rules promulgated to address the Notice's concern regarding certain identified straddle transactions to avoid imposing undue compliance burdens on taxpayers.

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[15] *See* Section 1092(a)(2)(A).

[16] The Notice expresses concern with "strategies that seek to create a pattern of generating capital gain and ordinary loss in similar amounts from economically offsetting transactions." Such strategies may generate limited pre-tax profits because they merely generate roughly equal gross gains and losses, and a principal benefit of these strategies may be the favorable tax character of the gross items. MFA recognizes that Treasury and the IRS are understandably concerned about such non-economic strategies. However, identified straddles under Section 1092(a)(2) are regularly used in the pursuit of profit-making strategies—such strategies do not involve taxpayers entering into contracts from the outset as "bull-bear" transactions with little or no risk and no opportunity for profit.

For example, a rule that "preserves" the character of the loss capitalized into the basis of an offsetting position could have a significant adverse impact for many investment funds acting in the ordinary course. As discussed above, mixed-character identified straddles commonly arise for reasons unrelated to the transactions described in the Notice. For example, assume a fund that is not engaged in the transactions described in the Notice holds offsetting positions, one of which produces capital gains and losses and one of which produces ordinary gains and losses. The fund appropriately identifies the straddle under Section 1092(a)(2). When the fund terminates the capital position and realizes loss, the loss would be capitalized into the basis of the ordinary position. When the fund subsequently disposes of the ordinary position, it should recognize ordinary income or loss, including to the extent of any basis capitalized into the position under Section 1092(a)(2). If a "character-follows-basis" rule applied, the fund may be surprised to discover that it is required to recognize a "gross" capital loss and offsetting "gross" ordinary income, which could impose significant compliance burdens on taxpayers that would be required to track and account for character differences across large trading portfolios. It would also change the function of Section 1092(a)(2), which preserves a loss through a basis adjustment but does not provide that the loss's character carries over with that adjustment.[17] Consistent with that statutory structure, the Notice describes the identified straddle rules as timing rules. Congress and Treasury have addressed character coordination separately through specifically tailored regimes, including the identified mixed straddle and mixed straddle account rules.[18]

Other broadly drafted approaches would present similar concerns. Excluding all mixed-character straddles from the identified straddle regime would deny ordinary-course taxpayers the certainty that Congress intended the regime to provide. More generally, changing the tax treatment of every identified straddle containing positions subject to different character regimes would use mixed character as a proxy for the transactions of concern, even though mixed character alone does not produce the result described in the Notice.

These approaches would also create significant compliance burdens for taxpayers unrelated to the transactions at issue. For example, a character "preservation" rule, such as the one described above, would require taxpayers to trace character through multiple offsetting positions, partial dispositions, and subsequent basis adjustments.

D. Notional Principal Contracts

1. The NPC rules are longstanding and have created significant reliance interests with respect to an enormous market

The timing of income and deductions from NPCs is governed by Treas. Reg. § 1.446-3, which was finalized as part of Regulations promulgated in 1993 (the "**1993 Regulations**").[19] The 1993 Regulations classify payments as periodic, nonperiodic, or termination payments.[20] Periodic payments generally are recognized ratably over the period to which

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[17] MFA notes that, in the case of the identified straddle trade discussed in the Notice involving foreign currency forward and futures contracts, the character rules of Sections 988 and 1256 apply broadly within the Code and may bear on the scope of any guidance addressing the character of positions in an identified straddle.

[18] *See* Section 1092(b)(2); Treas. Reg. §§ 1.1092(b)-3T and 1.1092(b)-4T; *see also* Section 1256(d).

[19] T.D. 8491, 58 Fed. Reg. 53125 (Oct. 14, 1993).

[20] Treas. Reg. § 1.446-3(e), (f), (h).

they relate, and nonperiodic payments generally are recognized over the term of the contract in a manner that reflects the economic substance of the contract. A termination payment is a payment made or received to extinguish or assign all or a proportionate part of a party's remaining rights and obligations under the contract, and it is taken into account in the year the contract is extinguished, assigned, or exchanged.[21]

Periodic and nonperiodic payments generally give rise to ordinary income or expense. This treatment has a long regulatory history, with roots that reach back to core principles distinguishing payments made during the life of a financial instrument from payments made upon its disposition. In Technical Advice Memorandum 9730007 (the "**TAM**"), the IRS concluded that periodic payments pursuant to a commodity swap are ordinary, while termination payments are capital. The swap was issued prior to the effective date of the 1993 NPC Regulations, but as the IRS noted in the TAM, the 1993 Regulations address timing, not character, and the IRS's conclusions therefore did not depend on the application of the 1993 Regulations. Instead, the IRS looked to Section 1222 and analogized periodic payments to dividends and interest.[22] In 2004, consistent with the reasoning in the TAM, Treasury and the IRS proposed Regulations (the "**2004 Proposed Regulations**") explaining that periodic and nonperiodic payments on an NPC are properly treated as ordinary because neither type of payment, whenever made, involves a "sale or exchange" within the meaning of Section 1222.[23] By contrast, under Section 1234A, gain or loss attributable to the termination of a contract involving property that is, or would be, a capital asset in the taxpayer's hands generally is capital. The 2004 Proposed Regulations would confirm that termination payments give rise to gain or loss from the termination of an NPC, while scheduled payments do not.[24] The distinction between holding and terminating a contract is therefore embedded in the existing statutory and regulatory framework and is a product of deliberate policy choices articulated by Congress and Treasury and left unchanged for more than 20 years.

NPCs are widely used in U.S. and global financial markets. The swap market is enormous—sources estimate that the total notional outstanding in interest rate swaps *alone* is in the hundreds of trillions of dollars.[25] A broad range of market participants, including investment funds, pension plans, insurance companies, operating companies, and dealers, use NPCs for risk management, financing, and taking directional positions with respect to reference assets. For approximately 30 years, market participants have relied on the rules described above and have built their trading systems, contract documentation, pricing models, and tax reporting processes around them.

2. The decision to terminate an NPC is a routine exercise of judgment consistent with ordinary tax planning

Every holder of an NPC must decide whether to hold the contract to its scheduled maturity or terminate it early. That decision may depend on changes in market conditions, the holder's investment outlook, risk-management needs,

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[21] Treas. Reg. § 1.446-3(h)(1), (2).

[22] TAM 9730007 (Apr. 10, 1997).

[23] 69 Fed. Reg. 8886, 8888 (Feb. 26, 2004).

[24] Prop. Treas. Reg. § 1.1234A-1 (REG-166012-02), 69 Fed. Reg. 8886 (Feb. 26, 2004).

[25] Int'l Swaps & Derivatives Ass'n, *Key Trends in the Size and Composition of OTC Derivatives Markets in the Second Half of 2025*, at 6 (July 2026), https://www.isda.org/a/rGkiE/Key-Trends-in-the-Size-and-Composition-of-OTC-Derivatives-Markets-in-the-Second-Half-of-2025.pdf (estimating the year-end 2025 notional amount of interest rate swaps outstanding to be $545 trillion).

liquidity, and counterparty considerations. Like any taxpayer holding a capital asset, the holder may also consider the tax consequences of when and how it disposes of a position. Considering those consequences is ordinary and prudent tax management, no different in principle from a taxpayer holding a capital asset long enough to qualify for long-term capital-gain treatment or selling a position with an unrealized loss before year-end. The Notice itself identifies the latter as a long-standing, well-established technique consistent with congressional intent. As a result, the decision to terminate an NPC early—even if influenced by the objective of maximizing after-tax returns—is consistent with routine tax planning. The mere fact that a fund may trade a significant number of NPCs does not vitiate this conclusion.

3. The character of various types of NPC payments is consistent with the Code

The treatment of periodic and nonperiodic payments as ordinary, and of termination payments as capital, reflects the basic nature of those payments. Periodic and nonperiodic payments generally do not give rise to capital gain or loss because they do not involve a sale or exchange, whereas termination payments are made to dispose of an NPC and therefore give rise to capital gain or loss, consistent with Section 1234A. This distinction reflects a fundamental principle in the taxation of financial instruments generally: payments made over the life of an instrument (such as dividends or interest) generally are ordinary, while amounts received upon a disposition of the instrument generally are capital.

This principle is reflected in Section 1234A, which dictates the character of termination payments, and in Section 1222, which provides that capital gain or loss results only from the "sale or exchange" of a capital asset. These statutory rules imply that periodic and nonperiodic payments are ordinary in character because such payments do not involve an actual or deemed sale or exchange.

4. Changes to the NPC rules would have implications that reach well beyond the concerns described in the Notice

Because NPCs are widely used, changes to the rules governing the timing or character of NPC payments would affect not merely the transactions described in the Notice but the entire multi-hundred-trillion-dollar swap market. Market participants with no connection to the NPC transactions described in Section 3 of the Notice would be required to modify their systems, including pricing and valuation models, contract documentation and confirmation templates, and tax reporting and booking processes. Such changes would be inconsistent with the Notice's stated intent to "minimize compliance burdens" and "respect market expectations."

Some approaches could present particular administrability challenges. For example, finalizing the contingent-payment accrual rules in the 2004 Proposed Regulations would require taxpayers to project and accrue contingent nonperiodic payments whose amount, and potentially direction, cannot be known until settlement, and to revise those projections as circumstances change. Commentators have raised concerns about the complexity of those rules, which have remained in proposed form for more than 20 years.[26]

[26] *See, e.g.*, William L. McRae, *Character and Timing Rules in the Proposed Contingent Swap Regulations: First, Do No Harm*, J. TAX'N & REGUL. FIN. INSTS. (Mar.–Apr. 2005); David C. Garlock, *The Proposed Notional Principal Contract Regulations: What's Fixed? What's Still Broken?*, 102 TAX NOTES 1515 (2004).

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MFA is grateful that Treasury and the IRS are committed to narrowly tailored solutions that will not disrupt markets, and we appreciate the opportunity to provide our comments to Treasury and the IRS on the Notice. We would be pleased to meet with Treasury and the IRS to discuss our comments and would welcome the opportunity to provide additional information regarding the Section 988(a)(1)(B) election, the identified straddle rules, and the NPC rules, as well as to discuss the effects of any potential guidance.

If Treasury or the IRS has questions or comments, please do not hesitate to contact Bryson Kern, Vice President & Senior Counsel, Regulatory Affairs, at bkern@MFAalts.org, or the undersigned at jhan@MFAalts.org.

Respectfully submitted,

/s/ Jennifer W. Han

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