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MoFo Tax Talk

Hybrids – An Update on Recent Mega Deals

Issuances of hybrid and other Tier 1 instruments in Q2 have continued at a fast pace, with issuers raising capital in excess of $70 billion so far this calendar year. The deals may be categorized into three baskets: long-term subordinated debt, payments on which are fully deductible by the issuer and taxed at ordinary rates to the holder; equity units which initially are partially tax-deductible to the issuer and fully taxed at ordinary rates to holders; and preferred (and common) stock, payments on which are not tax deductible to the issuer but taxed at preferential rates for U.S. investors.

In the first category, AIG and Liberty Mutual Group separately offered junior subordinated debentures that are fully tax-deductible to the issuer. AIG's $6.9 billion issuance of U.S., Euro, and Sterling denominated securities have a scheduled 50-year and final 60-year maturity and pay interest in the 8—8.625% range, while Liberty Mutual's $1.25 billion private placement of 10.75% securities have a scheduled 50-year and final 80-year maturity. Both are callable after 30 years and both received "Basket D" (75% equity credit) from Moody's Investors Service and "Category 2" (Intermediate/Strong) equity credit from Standard & Poors.

A notable example in the second category was AIG's $5.88 billion issuance of equity units, or mandatory convertible units that represent ownership interests in a forward contract on AIG's common stock with a 2011 settlement date, and junior subordinated debentures due 2041 and callable in 2013. The stock purchase contracts pay quarterly contract adjustment payments between 2.61—2.71% and the debentures pay quarterly interest between 5.67—5.89%. Under Revenue Ruling 2003-97, AIG presumably will deduct interest on the debentures but not the contract adjustment payments. Thus, the equity units effectively are 67%—69% tax deductible. In a similar offering, Wells Fargo issued $2.5 billion of Fixed-to-Floating Rate Preferred Purchase Securities. Here, the forward purchase contract is on Wells Fargo non-cumulative perpetual preferred stock. The securities pay 7.7% semi-annually, consisting of 7.5% interest and 0.2% contract payments, resulting in 97% tax-deductibility to Wells Fargo.

In the third category, in April and June Lehman Brothers offered $4 billion and $2 billion perpetual non-cumulative convertible preferred stock respectively. The $4 billion issuance provides quarterly dividend payments at 7.25% and the stock initially is convertible into approximately 20 shares of common stock, reflecting a conversion price of about $49.87 and a conversion premium of 32.5%. Under the $2 billion issuance, the convertible preferred shares pay 8.75% quarterly dividends until mandatory conversion into approximately 30-35 shares of common stock in 2011. Wachovia also issued $4 billion of 7.5% non-cumulative perpetual convertible preferred stock, with each preferred share initially convertible into approximately 32 shares of common stock, or a conversion price of about $31.20 and a conversion premium of 12.19%. Other examples in this category include issuances of depositary shares. Bank of America, JP Morgan, Citigroup, and Merrill Lynch each separately issued depositary shares that represent fractional interests in non-cumulative preferred stock for $2.7 billion, $6 billion, $6 billion, and $2.55 billion respectively. Bank of America's depositary shares pay quarterly dividends at 8.2%, JP Morgan's shares pay semi-annual dividends at 7.9% and LIBOR plus 3.47% after 2018, Citigroup shares pay quarterly 8.4% dividends and LIBOR plus 4.03% after 2018, and Merrill shares pay quarterly 8.625% dividends per annum. Issuances in this category are intended to raise Tier 1 capital for the issuers. For U.S. federal income tax purposes, dividend distributions on preferred stock are not deductible by issuers. However, the distributions constitute "qualifying dividend income" ("QDI") currently subject to a reduced 15% tax rate in the hands of individual holders. Corporate holders are eligible for the 70% dividends received deduction ("DRD").

A notable issuance in the third category by a foreign financial institution is Deutsche Bank's $1.1 billion issuance of 8.05% trust preferred securities that produce QDI for US investors. Deutsche Bank's offering is not DRD-eligible because it is a non-US issuer. The securities initially pay cumulative distributions and qualify as Upper Tier II regulatory capital, but give Deutsche Bank the right to elect to make the distributions non-cumulative, in which case the securities would qualify as Tier 1 regulatory capital. Distributions payable by foreign issuers do not qualify for the DRD.

The following chart summarizes the principal tax differences of issuing securities in each of the three categories:

	Issuers	Notable Tax Features
Long-Term Subordinated Debt	AIG, Liberty Mutual	Fully tax deductible to the issuer Holders taxed at ordinary rates
Equity Units	AIG, Wells Fargo	Initially partially tax deductible to the issuer Holders taxed at ordinary rates
Preferred Stock	Lehman, Wachovia, Bank of America, Deutsche Bank, JP Morgan, Citigroup	Not tax-deductible to the issuer QDI/DRD Eligible

Hybrids – Revenue Ruling 2003-97 in the News

A recent article in the daily trade publication *Tax Notes Today* suggested that at least one tax practitioner has questioned whether Revenue Ruling 2003-97 should apply to structures such as Morgan Stanley's PEPS and Citigroup's Upper DECS sold to China Investment Corp and Abu Dhabi Investment Authority respectively, each of which has features that are not identical to the instruments described in Revenue Ruling 2003-97. Revenue Ruling 2003-97 holds that interest on the debt piece in an investment unit that contains a five-year debt instrument and a three-year forward contract to purchase common stock is deductible by the issuer, provided certain conditions are met. The recent article, entitled "Practitioners Question Applicability of Revenue Ruling to Recent Transactions," suggests that at least one practitioner may have thought that adding longer-term notes with a call feature or changing remarketing terms other than interest rates in an investment unit may place an issuance beyond the protective bounds of Revenue Ruling 2003-97. In a letter to *Tax Notes Today* the following day, the practitioner stated that the article misinterpreted his statement as constituting a position, rather than comments intended to frame possible issues that may arise under recent offerings. The tax practitioner clarified that he did not think that the unique features in either of the two issuances were "inconsistent with the spirit of the ruling."

Sovereign Wealth Funds – An Update

The IRS has indicated that it is receiving an increasing number of inquiries with respect to the application of Section 892, which provides that a foreign government's income received from certain U.S. investments is exempt from U.S. federal income tax. See MoFo Tax Talk Volume 1, Issue 1 (March 7, 2008) for prior coverage on Section 892. Pursuant to temporary regulations under Section 892, no portion of the net earnings of the foreign government may inure to the benefit of any private person. The IRS has received questions regarding whether this provision is violated if a wealth fund's private investment manager receives contingent performance-based payments from the wealth fund.

Victor Fleischer, a law professor at the University of Illinois, has indicated he is working on a project that looks at the taxation of sovereign wealth funds. He has asserted that, in his opinion, these funds are getting an unfair tax advantage and they should be taxed like foreign private investors. This statement comes in the wake of the Senate Finance Committee's request to the Joint Committee on Taxation to provide an analysis of the U.S. taxation of sovereign wealth funds. The sovereign exemption has been a feature of U.S. tax law since World War I.

Finally, last week the Tax Section of the New York State Bar Association submitted to Congress a proposal recommending changes to Section 892. Recognizing that Section 892 reflects at its core the doctrine of "sovereign immunity," the report proposes amendments that would attempt to "rationalize" the application of Section 892. It recommends that the benefits of Section 892 should be denied to a sovereign-controlled entity only if the entity properly is considered to be fundamentally a commercial enterprise, taking into account all its activities taken as a whole, rather than, as under current law, if the entity is engaged in any commercial activities.

Credit Crunch Results in REMIC Relief

Treasury and the IRS have responded to the credit crunch by issuing two Revenue Procedures (Rev. Proc. 2007-72 and Rev. Proc. 2008-28) that address the modifications of mortgage loans held by a Real Estate Mortgage Investment Conduit ("REMIC"). A REMIC is a mortgage securitization vehicle that qualifies as a pass-through entity for U.S. federal income tax purposes if it meets certain requirements. One requirement is that the entity must hold "qualified mortgages" (in general, a loan that is principally secured by an interest in real estate that has a fair market value of at least 80% of the face amount of the loan). The entity must also be a static vehicle, which means that once a mortgage has been contributed to the REMIC, it must generally stay there. Also, after the first

90 days no new mortgage loans can be contributed to a REMIC. If a loan held by a REMIC is "significantly modified" after the 90-day period, the transaction is considered for tax purposes as a deemed exchange of an old loan for a new loan. This creates a "prohibited transaction" in which any gain on the deemed exchange is subject to a 100% penalty tax. In addition, the "new" loan is not a qualified mortgage and interest on the loan is subject to a 100% penalty tax. If non-qualified mortgages comprise more than 1% of the REMIC's assets, the REMIC loses its pass-through status.

Rev. Proc. 2007-72 and Rev. Proc. 2008-28 set out certain conditions under which the IRS will not challenge the qualification of the REMIC or claim that certain loan modifications by a REMIC are prohibited transactions under the REMIC rules. As things currently stand, Rev. Proc. 2008-28 applies to determinations made by the IRS on or after May 16, 2008 with respect to loan modifications that are effected on or before December 31, 2010. However, the IRS has requested comments from the public as to whether the provisions of this Revenue Procedure should be extended to loan modifications that are effected after 2010. In effect, the IRS has waived the REMIC rules in order to encourage loan modifications rather than foreclosures.

Auction Rate Securities – The IRS Provides For Liquidity?

Since the 1980s, closed-end funds, corporations, municipal authorities and student loan organizations have issued auction-rate securities ("ARS"), typically in the form of bonds with long-term maturities or as preferred stock. The interest or dividend rate on ARS is determined by a Dutch auction mechanism through which investors already holding ARS and investors seeking to acquire ARS indicate their interest in holding, purchasing or selling the ARS at specified rates. Auctions are typically held every seven, twenty-eight, thirty-five or forty-nine days, but with respect to some ARS the auctions can occur daily or at longer intervals such as every six months. For issuers, ARS are beneficial as they can provide financing at rates that are lower than variable rate debt instruments. To investors, ARS are attractive as their yield is typically higher than the yield on deposits or money market funds. The ARS market currently has an estimated size of a few hundred billion dollars.

Lately, as a result of the current credit crunch, there has been little or no interest in purchasing ARS resulting in whole-sale auction failures. Upon an auction failure, the interest or dividend rate on the ARS defaults to a maximum rate which, generally, is intended to be an above-market rate at original issuance that is intended to compensate holders of the ARS for the illiquidity of the securities. However, due to the credit crisis, some of these rates are now viewed as below market, causing ARS to become even more illiquid.

The IRS has issued Notices 2008-27 and 2008-41 providing guidance to issuers of tax-exempt bonds that wish to either convert their outstanding bonds from ARS to bonds with a fixed or floating interest rate to maturity or to purchase their own ARS from the market. Pursuant to these notices, under certain limited circumstances, the conversion of a tax-exempt ARS to a bond with a fixed or floating interest rate will not result in a reissuance for U.S. federal income tax purposes, and, in applying the tax-exempt bond rules, an issuer may purchase its own tax-exempt ARS without such purchase resulting in a retirement of the bonds for U.S. federal income tax purposes. The treatment of a conversion as a reissuance could result in adverse tax consequences to the issuer.

With respect to ARS issued as preferred stock, in order to preserve their status as "equity" for tax purposes, it is particularly important that investors not be viewed as having the right to put the ARS to the issuer on demand. Notwithstanding, some had proposed that holders of such ARS be permitted to sell, pursuant to a liquidity facility agreement, their shares to a liquidity provider upon a failed auction. This would broaden the market for potential

ARS investors as tax exempt money market funds (frequently referred to as 2a-7 funds) would subsequently be allowed to purchase ARS under the ’40 Act from issuers that are themselves RICs. Under the proposal, the liquidity provider would try to sell the ARS (including by participating in subsequent auctions). Further, the issuer would be required to redeem the stock after a specified period of time if the liquidity provider is unable to sell the ARS. The proposal was designed to permit new investors to invest in ARS. In response, last week the IRS issued Notice 2008-55 in which the IRS confirms that it will not challenge the equity characterization of the ARS if a liquidity facility agreement such as the one described above were entered into. As a result, payments on the ARS should still be characterized as exempt-interest dividends (to the extent of the issuer’s exempt interest) and not as taxable interest which would have been the consequence if the ARS were instead treated as debt for U.S. federal income tax purposes. In general, the notice only applies if, among other requirements, the ARS are issued by closed-end funds that are RICs and that invest exclusively in taxable or tax-exempt bonds, the ARS were outstanding on February 12, 2008 (or issued after that date to refinance ARS that were outstanding on that date) and the liquidity provider is unrelated to the issuer.

MoFo in the News

For further information on any of the items discussed below, or for copies of any presentation materials, please contact MoFo’s Michelle Paitich at 212-336-4167 or mpaitich@mofo.com.

On April 29, 2008, Morrison & Foerster hosted a presentation by MoFo partners Thomas Humphreys, Anna Pinedo and Marco Adelfio entitled “ETNs, ETFs: What’s the Difference? Have all the Lines Been Blurred?” The first portion of the presentation discussed the non-tax aspects of ETNs and ETFs with a focus on regulatory differences. At the end of 2006, there were $422 billion in assets in ETFs. By the end of 2007, ETF assets approached $600 billion. ETFs are registered investment companies under the ‘40 Act and an ETF investor owns an interest in the ETF’s portfolio of securities to which the investor has recourse. The SEC recently proposed rules under the ’40 Act to, among other things, permit certain ETFs to operate without exemptive relief, which can be expected to contribute to additional growth of these investment vehicles. In contrast to ETFs, an ETN is a debt security that is registered under the ‘33 Act and held by an investor that owns a senior unsecured debt claim of the issuer and is subject to the issuer’s credit risk. An investor in an ETN does not otherwise have access to, or have an interest in, the reference index that the ETN tracks. The presentation then covered the differences in tax treatment of ETNs and ETFs. ETFs are treated as pass-throughs and distributions are taxed as ordinary income on a current basis. Under current law, holders of ETNs, on the other hand, may defer income and enjoy capital gain treatment upon disposition. (See our March 2008 issue for prior coverage of the taxation of ETFs and ETNs.) The presentation triggered a discussion as to whether the credit rating of an ETN issuer impacts its price. One attendee argued that a change in the credit rating of the issuer would only impact ETNs issued after the ratings change. If true, this would seem to create arbitrage opportunities.

On June 3, 2008, Morrison & Foerster hosted a presentation on covered bonds, an instrument much older than either ETNs or ETFs. In a panel discussion entitled “Covered Bonds: An Alternative to Securitization,” speakers across the industry discussed the importation of the 220-year old European instrument as a viable tool to raise capital in the U.S. markets. In general, a covered bond is a debt instrument that has double recourse. First, the covered bond holder has bankruptcy recourse to the issuing entity, or an affiliated group of the issuing entity, or to both the issuing entity and the affiliated entity. Next, the covered bond holder also has recourse to a pool of collateral (the cover pool) usually consisting of high quality assets, such as residential-mortgage backed securities, public debt, or ship loans. During the presentation, Anna Pinedo and Thomas Humphreys, panelists from

Morrison & Foerster, pointed out major differences between a securitization structure and covered bonds. While a mortgage-backed security is taken off-balance sheet and is subject to prepayment risk, a covered bond remains on the balance sheet and is not subject to prepayment risk. Also, assets within the cover pool under a covered bond transaction may be replaced provided they comply with stringent collateral qualifying criteria, while this may not always be true in case of a securitization transaction. (See our REMIC discussion above for a description of some limited temporary tax relief in this regard.)

Other panelists at the presentation provided varying perspectives from different industries. From Bank of New York Mellon, Karon Greene and Melissa Adelson pointed out that issuers of covered bonds benefit by receiving higher credit ratings and lower structuring costs, while investors benefit by receiving higher yields and lower risk investments. Speaking from a ratings agency perspective, Yehudah Forster and Ariel Weil from Moody's Investors Service described Moody's approach to rating covered bonds as an evaluation of the sponsor's credit strength and evaluating the cover pool upon sponsor insolvency, looking to credit quality, refinancing risks, and interest/currency risks. From the bank regulatory perspective, Oliver Ireland from Morrison & Foerster discussed the impact of the new interim-final FDIC policy statement regarding expedited access to collateral pledged for certain covered bonds in receivership or conservatorship.

From a federal income tax standpoint, the tax rules governing covered bond issuances are fairly straightforward, although the application of those rules to any particular issuance can get extremely complicated. The covered bond issuer is typically a trust, treated as a pass-through for tax purposes. Holders of covered bonds are treated as owning their pro rata share of the issuer trust's assets, *i.e.*, the mortgage-backed securities and any derivatives entered into by the trust to calibrate currency and interest rate exposure.

It should be noted that other jurisdictions are actively addressing the covered bond markets. See http://www.mofo.com/news/updates/files/13654.html for recent coverage by MoFo UK partners Jeremy Jennings-Mares and Peter Green on regulatory changes in the UK that can be expected to accelerate growth in the UK covered bond market.

On May 19, 2008, Thomas Humphreys of Morrison & Foerster presented a paper to The Tax Club entitled "Tales from the Credit Crunch: Selected Issues in the Taxation of Financial Instruments and Pooled Investment Vehicles." The paper catalogues the assortment of tax issues faced by players in this year's credit market debacle, including the homeowner, the REMIC, the REMIC residual holder, the mutual fund, the auction rate security issuer, and the offshore distressed debt fund. Tom also presented a framework for tax policy responses to the credit crunch, providing legal insight from old precedent to the newest relief provisions, including the REMIC relief regulations mentioned above. Of particular note, the paper concludes by exploring the question of when the tax law on financial instruments should be modified to respond to market pressures such as the credit crunch. Tom argued that the tax rules relating to financial instruments should not be tightened in a way that adds stress to the credit crunch; Treasury should clarify the tax laws when necessary, but only under an approach that would mirror that taken during economically prosperous times; temporary relaxation of rules should be used as a last resort; and certain remedies must be kept beyond the powers of Treasury and the IRS and left to Congress.

Finally, looking forward, in October 2008, Morrison & Foerster expects to host a targeted "tax college" seminar devoted to practical tax issues arising in capital markets transactions. The seminar will be offered free of charge and is expected to include faculty from MoFo and external experts. Watch this space in our September 2008 issue for further details.

The Learning Annex: Demystifying Section 1260 (Constructive Ownership Transactions)

Section 1260 was enacted in 1999 in response to a specific targeted tax planning strategy that involved writing derivatives on hedge funds. Hedge funds generally adopt investment strategies that involve frequent trading, resulting in short-term capital gains and losses. The funds generally are treated as partnerships for U.S. federal income tax purposes, or entities that pass through trading gains and losses to their investors on a current basis. Thus, direct investors in the funds are taxed on a current basis on their distributive share of gains at rates applicable to short-term capital gains. To plan around this result, investment bankers structured derivative products, such as forwards and swaps, that provided investors with substantially all of the economic exposure to hedge funds without actually owning the fund interests. Prior to the enactment of Section 1260, investors took the position that income on these derivatives, if properly structured, was recognized only upon a sale or termination of the derivative – *i.e.*, on a deferred basis – and that such gains were long-term capital gains if the derivative was held for more than one year. Section 1260 was enacted to rectify this perceived abuse, *i.e.*, the conversion of short-term capital gains taxable on a current basis into long-term capital gain taxable on a deferred basis.

Under Section 1260, if a taxpayer has long-term capital gain from a "constructive ownership transaction" (generally, a derivative such as a swap or a forward contract, or in some cases, deep in the money options that provide exposure to substantially all of the economics of owning the underlying) with respect to certain financial assets (generally pass-through entities such as hedge funds and other partnerships, mutual funds, ETFs and other trusts) then such gain is recharacterized as ordinary income to the extent it exceeds the long-term capital gain that the taxpayer would have recognized had the taxpayer owned the underlying directly.

In addition, Section 1260 imposes an interest charge on the deferral of gain recognition. It requires the taxpayer to allocate the recharacterized gain to each of the prior taxable years on the basis that the gain accrued during each year at the applicable federal rate. The taxpayer then must pay an interest charge on the underpaid tax on the gain allocated to each period.

For example, suppose that the taxpayer entered into a three-year forward contract on an ETF, and suppose that the taxpayer had a net gain at the end of the three-year period of $110. Assume that the taxpayer would have had only $10 of long-term capital gain if he had held the ETF directly. Section 1260 applies as follows: (i) $100 of the taxpayer's gain is treated as ordinary income; (ii) the taxpayer is required to allocate the $100 recharacterized gain to each of the prior three years. Assuming an AFR of 4%, the amount will be $32.04 to Year 1, $33.32 to Year 2 and $34.65 to Year 3; and (iii) the taxpayer must pay the underpaid tax for each year as well as an underpayment penalty generally imposed on underpayments of taxes.

Developments in the Samurai Market

In the past, U.S. issuers raised debt capital in the Japanese market (offering so-called Samurai bonds) which were bearer instruments that complied with the TEFRA-D rules. In 2006, the Japan Securities Depository Center ("JASDEC") – the depository through which Samurai bonds are held – introduced a new system, under which all bonds are held in dematerialized form (*i.e.*, the bonds exist only through a computer entry within the JASDEC system). In addition, under the new system, holders were permitted to obtain definitive bearer bonds only if JASDEC ceased to operate. The introduction of the new system raised the question of whether the bonds would be considered to be in "registered form" for U.S. federal income tax purposes, a result that would effectively require the imposition of a U.S. withholding tax. The IRS confirmed this adverse result in Notice 2006-99, which held that “a dematerialized bond that can be held and transferred only through a book-entry system and where a holder may only obtain a physical certificate in bearer form only if the clearing organization goes out of business are treated as being in registered form.” At the same time, Notice 2006-99 provided that the rules for “foreign targeted registered obligations” (“FTRO”), which in certain circumstances allowed registered issuances into a foreign market without obtaining tax certifications from each investor, would be eliminated after 2008.

Following the publication of Notice 2006-99, JASDEC revised its regulations to allow U.S. financial institutions to take advantage of the FTRO rules during the two-year window, and a number of U.S. financial institutions issued bonds into the Samurai market in accordance with the FTRO rules, while the basic JASDEC issue remained unaddressed. JASDEC then responded to the developments in the U.S. by revising its regulations so that a holder of Samurai bonds held through the JASDEC system can obtain definitive bonds by filing a request to exchange dematerialized bonds for definitive bearer bonds. For tax purposes, an obligation in registered form that is convertible into bearer form is considered to be in bearer form. Thus, U.S. issuers began once again issuing TEFRA-D compliant Samurai bonds under the revised JASDEC regulations.

Variable Prepaid Forward Contracts Plus Share Loans – What if the IRS is Right?

In our previous issue, we discussed the “coordinated issue paper” published by the IRS in which the IRS asserts that variable prepaid forward contracts (“VPFC”) coupled with stock loans result in a sale of the underlying shares for U.S. federal income tax purposes upon entering into the VPFC. What are the tax consequences under the IRS approach? Under the VPFC, the taxpayer agrees to deliver a variable number of shares at maturity to the counterparty in exchange for an up-front cash payment, which generally represents approximately 80% of the current fair market value of the stock. Assume that taxpayer holds 100 shares of common stock in Y with each share having a value of $100. At settlement, the taxpayer delivers (i) if Y’s stock price decreased below $100, all 100 Y shares; (ii) if Y’s stock price was at least $100 but not more than $125, an amount of Y shares equivalent to $10,000; and (iii) if Y’s stock price exceeded $125, 80 Y shares. Taxpayer received an up-front cash payment of $8,000. Apparently, the IRS is arguing in these situations that the taxpayer, upon entering into the VPFC, has sold 100 Y shares of Y stock for $10,000 on day one. The taxpayer, however, only received $8,000. Does this mean the taxpayer is deemed to have received a contingent right entitling it to a variable number of shares of Y stock that has a value of $2,000 on day one? Clearly, if the value of Y stock upon settlement of the VPFC exceeds $125 per share, the taxpayer would end up with 20 shares of Y stock. If the value of Y stock upon maturity of the VPFC is anywhere between $100 and $125, the taxpayer would end up with anywhere between 0 and 20 shares of Y stock. Assuming the Y stock appreciates, the taxpayer could potentially sell its contingent right and realize long term capital gain (if the sale of the contingent right occurs more than one year after entering into the VPFC). Absent a sale of the contingent right, however, upon a settlement of the VPFC, the taxpayer, depending on the value of Y stock, would either take an aggregate basis of $2,000 in the shares of Y stock it retains, if any, or would realize a $2,000 loss as a result of the lapse of the contingent right (which loss would typically be a long-term capital loss).

Press Corner

An article in *The Wall Street Journal’s* May 9, 2008 edition titled “AIG Posts Record Loss, As Crisis Continues Taking Toll” mentions how certain of AIG’s cross-border financing transactions generating foreign tax credits are being attacked by the IRS. The transactions that are being challenged by the IRS date from 1997 to 1999, but AIG has indicated that the IRS might also challenge similar transactions entered into in later years. This, together with the Foreign Tax Credit TAM that we discussed in our previous issue, shows that the IRS is indeed very serious about pursuing foreign tax credit transactions even though there has been no indication as to when the proposed foreign tax credit regulations will be finalized.

The Wall Street Journal, in a May 29, 2008 piece, also reported that Netherlands-based Rabobank has participated in a large number of transactions aimed at lowering its counterparties' U.S. tax bill. As reported by The WSJ, one of Rabobank's former employees has contacted the IRS and informed them of the details of various transactions and the parties involved through a "whistleblower claim." Pursuant to Section 7623, a whistleblower could receive as an award an amount between 15% and 30% of the collected proceeds resulting from his action. To apply for such an award, a whistleblower uses IRS Form 211 "Application For Award For Original Information." Based on the number of transactions and the estimate of taxes saved and if the IRS is successful in pursuing these transactions, Rabobank's former employee could receive a hefty contribution towards his savings account.

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