

# TAXTALK

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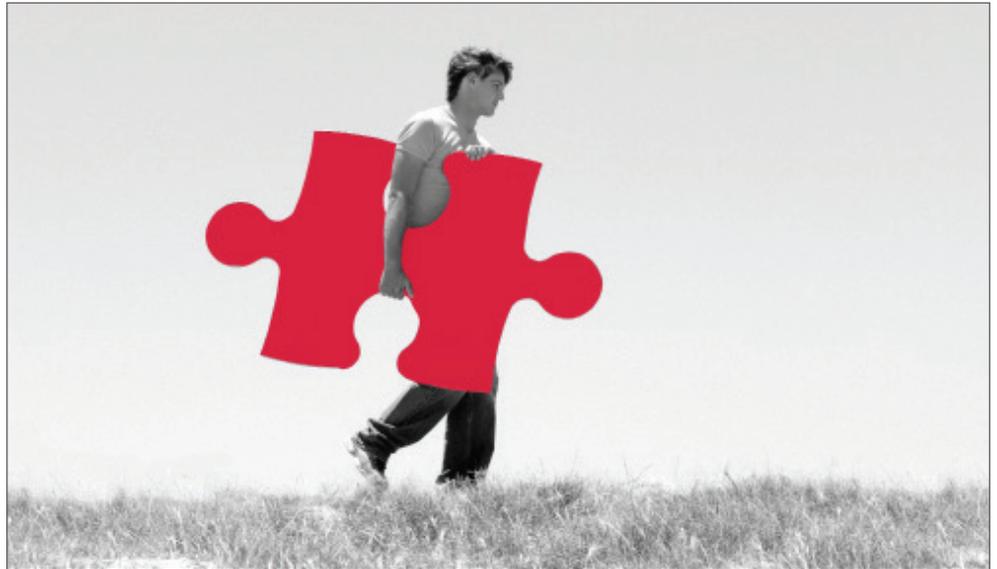
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## EDITOR'S NOTE

We held up this issue of Tax Talk in hopes the November 4 U.S. midterm elections would clear up the political fog surrounding tax policy in Washington, D.C. Alas, it's November 5, the election is over and things seem as murky as ever. Therefore, Tax Talk will have to stick to the technical and leave the cosmic for another day; November 8, 2016, anyone?

The fallout from the elections will of course impact our little corner of the world. With the GOP taking control of the Senate and expanding its House majority (apparently the largest Republican majority since World War II), Republicans now control Congress. This shift in the balance of power and resulting change in leadership (Sen. Orrin Hatch (R., Utah) is now slated to become chairman of the Finance Committee and Rep. Paul Ryan (R., Wis.) is poised to become Chairman of the House Ways and Means Committee) again raises the potential specter of tax reform. While we would never try to predict what may happen inside the Beltway (what did happen to those Camp proposals?), we'll watch with great interest to see whether Congress will be able to put together comprehensive tax reform that President Obama will sign and whether it's too soon to start thinking about the "Ryan-Hatch Tax Reform Act of 2015."

Now gracefully pivoting to the technical, this issue of Tax Talk discusses a pair of recent IRS rulings affecting financial instruments. The first is a private letter ruling addressing "consent payments" made to noteholders to secure permission that would ultimately enable the issuer to proceed with a spinoff

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transaction. The IRS concluded that the payments resulted in a modification of the terms of the notes, necessitating an analysis of whether the payments resulted in a deemed taxable exchange of the notes.

The second, which is really a continuation of a previous topic addressed in our last issue of Tax Talk, covers the IRS's continued focus on "basket options."<sup>1</sup> The IRS ruled that a change in accounting method occurred where the taxpayer switched its method of accounting for interests in certain basket options from an open transaction to a mark-to-market accounting method.

Moving from financial instruments to real estate, this issue of Tax Talk also analyzes a recent Revenue Procedure impacting the REIT world. Specifically, as real estate values began to recover in recent years, REITs faced uncertainty as to how debt secured by distressed real property should be handled for purposes of the REIT asset qualification test. We explain the benefits – and limitations – of this guidance below.

Turning abroad, the IRS recently clarified the scope of the documentation rules that withholding agents have to satisfy in order to claim a reduced withholding rate for portfolio interest. Also on the international front, the IRS reviewed a transaction in which a domestic partnership was converted into a foreign corporation. The IRS concluded that the transaction was a deemed tax-free transfer of the partnership's assets in exchange for common stock and certain preferred equity certificates, followed by a tax-free liquidation of the partnership.

Finally, we discuss a grab bag of tax developments, including: an IRS private letter ruling addressing the bankruptcy exception to the Section 382 loss limitation rules, a decision by the Fifth Circuit disallowing over \$1 billion in deductions on the basis that the partnership in which the taxpayer was a partner was a sham and, hot off the press, an IRS notice clarifying key aspects of the codified economic substance doctrine.

As always, our regular section, MoFo in the News, concludes this issue of Tax Talk.

## **IRS CLARIFIES DEADLINE FOR CORRECTING WITHHOLDING DOCUMENTATION**

In CCA 201434021 (the "CCA"), the taxpayer was a withholding agent paying U.S.-source interest to nonresident aliens. In general, such interest payments are characterized as "portfolio interest" (and thus

not subject to U.S. withholding tax), provided that the withholding agent receives documentation (typically, Forms W-8BEN or W-8BEN-E) from the payee establishing the payee's foreign status. In this case, however, the withholding agent did not collect documentation from the payees that would enable the withholding agent to treat the interest payments as portfolio interest. Under Section 1461, any person that is required to withhold tax is made liable for such tax. The withholding agent subsequently discovered its error and collected documentation from the payees sufficient for treating the interest payments as portfolio interest.

At issue in the CCA was whether the withholding agent collected the documentation in time to treat the interest as portfolio interest. Generally, a withholding agent must collect documentation from a payee before the end of the statute of limitation on the payee's time to collect a refund of tax with respect to the interest.<sup>2</sup> The statute of limitations for claiming a refund expires three years from the time a return is filed, or two years from the time the tax is paid, whichever is later.

The IRS concluded that, in the case where a payee had not filed a return or paid any tax with respect to the interest, the period of limitation had not yet begun and the withholding agent could rely on the documentation that it had collected.<sup>3</sup> In the case of another payee that had filed a return and paid the tax due on such income, the IRS concluded that the withholding agent must collect documentation within the appropriate period of limitations; otherwise, the withholding agent would be liable for any deficiency in the amount withheld.

## **CONSENT PAYMENT MODIFYING CONTINGENT PAYMENT DEBT INSTRUMENT MUST BE TESTED FOR SIGNIFICANCE**

In PLR 201431003 (Aug. 1, 2014), the IRS ruled that where a contingent payment debt instrument was modified by paying the instrument's holders an amount of cash in return for the holders giving up a legal right, the applicable test to determine whether the modification was a significant modification that resulted in a taxable exchange was whether the excess of the "go-forward yield" over the "original yield" was more than five percent of the "original yield."

The Taxpayer, the parent of an affiliated group of corporations for federal income tax purposes, owned 100% of Subsidiary, a limited liability

company, disregarded for federal income tax purposes. Subsidiary had outstanding publicly traded exchangeable debentures, which were contingent payment debt instruments. The debentures were issued pursuant to an indenture. The indenture included a provision prohibiting Taxpayer from transferring substantially all of its assets unless the entity to which the assets were transferred assumed Taxpayer's obligations under the indenture (the "Successor Provision").

The Taxpayer planned to spin off certain of Subsidiary's assets in a tax-free transaction. At the time of a prior split-off, holders of the debentures commenced litigation regarding whether that split-off violated the Successor Provision. Although Taxpayer had prevailed, it wanted to avoid litigation in the planned spin-off. Thus, Taxpayer planned to negotiate with the holders of the debentures to modify the Successor Provision in return for a single cash payment to the debenture holders (the "Consent Payment").

The Taxpayer requested several rulings from the IRS regarding guidance on the proper federal tax treatment of the Consent Payment under the Treasury Regulations. First, the IRS ruled that the Consent Payment resulted in a modification of the terms of the debentures. Section 1.1001-3(a) provides rules for whether modification of a debt instrument results in a taxable exchange under Section 1001. Section 1.1001-3(c)(1)(i) includes in the definition of *modification* "any deletion or addition, in whole or in part, of a legal right or obligation of the issuer or holder of a debt instrument." Because the Consent Payment resulted in the debenture holders receiving additional money, the Consent Payment was an alteration of the legal rights or obligations of the holders and issuer, and therefore, was a modification of the debentures.

Next, pursuant to Section 1.1001-3(b), a modification that is not a significant modification is not a taxable exchange under Section 1001. Section 1.1001-3(e)(1) provides that a *significant modification* is generally determined by a facts and circumstances test as to whether the modification is economically significant, except that Sections 1.1001-3(e)(2) through 1.1001-3(e)(6) describe specific circumstances that are not economically significant. Section 1.1001-3(e)(2) explains whether a change in yield is economically significant. In general, a change in yield is economically significant if the annual yield on a debt instrument with an issue price adjusted by the modification varies from the annual yield on the unmodified debt instrument by more than the greater of: (i) 25 basis points or (ii) five percent of the annual yield of the unmodified debt instrument.

The Consent Payment resulted in a change in yield because the debenture holders received additional payments beyond the terms of the debentures. Section 1.1001-3(e)(2) does not apply to contingent payment debt obligations, so the yield on the debentures was instead tested under the general facts and circumstances test of Section 1.1001-3(e)(1). However, the debentures used the noncontingent bond method of accounting under Section 1.1275-4(b), in which interest accrued by reference to a comparable yield and projected payment schedule. Thus, the IRS ruled it is appropriate to test the change in yield under Section 1.1001-3(e)(2).

Pursuant to Section 1.1001-3(e)(2), the taxpayer must compare the "go-forward yield" to the "original yield" of the debenture. The go-forward yield is a hypothetical yield as if a new debenture is created on the date of the modification of the original debenture, with an issue price equal to the adjusted issue price of the original debenture reduced by the Consent Payment, and a projected payment schedule of the outstanding payments on the original debenture. The original yield is the yield on the original debenture calculated using the noncontingent bond method. If the go-forward yield is not more than five percent greater than the original yield, then there is no significant modification of the debentures.

Furthermore, Section 1.1001-3(e)(6) states that a modification that adds, deletes, or alters customary accounting or financial covenants is not a significant modification. If the Consent Payment did not result in a significant modification of the debentures under Section 1.1001-3(e)(2), and any other modification to the debentures did not result in a significant modification under Section 1.1001-3(e)(6), then the modifications would not collectively result in a significant modification.

Finally, Pursuant to Section 1.1275-4(b)(6)(i), the noncontingent bond method instructs holders of contingent payment debt instruments to adjust projected payments by the amount of payments received. The IRS ruled that the Consent Payment was a payment in excess of a projected payment of zero, so taxpayers should treat the Consent Payment as a positive adjustment under the noncontingent bond method. Because the IRS ruled the Consent Payment was a positive adjustment under the noncontingent bond method, the Consent Payment was treated as interest.<sup>4</sup> An outstanding question not addressed in the CCA is whether, for payment to non-U.S. holders, the Consent Payment should be exempt from withholding under the portfolio interest exemption.

# IRS CONCLUDES CORRECTION OF ERROR AN ACCOUNTING CHANGE

In CCA 201432016 (the “CCA”), the IRS revisited the tax treatment of a “basket option contract.” Briefly, a basket option contract is a contract between an investor and a bank where the investor nominally purchases an option from the bank over a basket of equities. However, the equities underlying the option are not static and the investor is permitted to change the contents of the basket over the life of the option. At maturity, the investor receives a cash settlement payment based on the performance of the basket. In AM 2010-005, the IRS concluded that the basket option described in that ruling should be characterized as direct ownership of the underlying securities. The IRS was concerned with taxpayers (i) deferring income from trading the securities until the expiration of the option, and (ii) converting short-term trading capital gains into long-term capital gains.<sup>5</sup>

The taxpayer in the CCA entered into a basket option contract with a bank and took the positions that the IRS was concerned about: deferral of income and conversion to long-term capital gain.<sup>6</sup> However, in this case, the taxpayer was also a trader in securities that made an election under Section 475(f)(1) to mark-to-market its positions in securities. During the term of the basket option contract, the taxpayer did not mark-to-market its position in the option apparently due a mistaken interpretation of Section 475(f)(3) that the election could be made separately with respect to each trade or business of the taxpayer. The taxpayer acknowledged upon audit that separate elections could not be made for different lines of trading businesses.

At issue in the CCA was whether the change in the taxpayer’s treatment of the basket option contract transactions, from open transaction treatment to mark-to-market treatment, was a change in accounting method or merely a correction of an error.<sup>7</sup> The distinction is important because a change in accounting method would require the taxpayer to recognize an adjustment under Section 481, which would eliminate distortion (i.e., duplication or omission of income or deduction) caused by the accounting change. If the change in treatment were properly characterized as a change in accounting method, the IRS would be able to recoup tax for years closed by the statute of limitations.

In the CCA, the IRS reasoned that, where a taxpayer fails to apply an accounting method consistently, the treatment of the correction depends on whether the divergent treatment is a timing practice that is used on

a consistent basis. If so, then the correction (by abandoning the divergent treatment) is characterized as an accounting method change. On the other hand, if the divergent treatment is either not a timing practice, or is not used on a consistent basis, then conforming the divergent treatment is the correction of an error. The IRS concluded that the correction analyzed in the CCA was a material item employed by the taxpayer over many years. As a result, the IRS treated the adjustment as an accounting method change.

## REV. PROC. 2014-51 RELAXES REIT 75% ASSET TEST SAFE HARBOR FOR DISTRESSED MORTGAGES

Effective for all calendar quarters and all taxable years, Rev. Proc. 2014-51 relaxes the 75% asset test safe harbor relating to distressed mortgages for taxpayers seeking to qualify as a real estate investment trust (a “REIT”). In order to qualify as a REIT, a corporation must satisfy certain requirements including a 75% asset test (the “75% Asset Test”) which generally provides that at the close of each quarter of the taxable year, at least 75% of the value of the taxpayer’s total assets must consist of REIT qualifying assets, including interests in real property and interests in mortgages on real property.

Previously, in Rev. Proc. 2011-16 (“2011 Rev. Proc.”), the IRS provided a safeharbor where the amount of a loan that may be treated as a real estate asset for purposes of the 75% Asset Test is an amount equal to the lesser of (1) the value of the loan or (2) the value of the underlying property on the date at which the commitment to purchase the loan was binding. Rev. Proc. 2014-51 relaxes this safe-harbor by providing that the amount of a loan that may be treated as a real estate asset under the 75% Asset Test is an amount equal to the lesser of (1) the value of the loan (i.e., same as under the 2011 Rev. Proc.) or (2) the greater of (a) the current value of the real property securing the loan; or (b) the value of the underlying property on the date at which the commitment to purchase the loan was binding.

It is important to note that while Rev. Proc. 2014-51 relaxes the 75% Asset Test safe harbor, it does not address (or relax) the companion 75% income test. Consequently, it appears that while a subsequent increase in value of real property securing a loan may now result in a greater portion of that loan being

treated as a real estate asset for purposes of the 75% Asset Test, REITs may not realize that same benefit with respect to income generated by the loan for purposes of satisfying the 75% income test.

## **CONSOLIDATED GROUP TREATED AS SINGLE ENTITY FOR PURPOSES OF IRC § 382(L)(5) BANKRUPTCY EXCEPTION**

In a piece of private guidance,<sup>8</sup> the IRS addressed the scope of the Section 382(l)(5) bankruptcy exception in the context of a consolidated group of corporations. By way of brief background, Section 382(l)(5) generally turns off the operative provisions of Section 382 that restrict the ability of a so-called “loss corporation” to use its net operating losses following an ownership change.

To fit within the scope of Section 382(l)(5), the corporation must meet two basic requirements. The first is that the corporation must be in Title 11 bankruptcy immediately before the ownership change occurs. The second, less obvious requirement is that the shareholders and creditors of the bankrupt corporation must end up owning at least 50% (by vote and value) of stock of the reorganized corporation.

One of the key issues the taxpayer sought comfort on from the IRS involved which shareholders and creditors of the consolidated group of corporations must meet the second requirement discussed above, the 50% ownership requirement. The specific wrinkle at issue was that the parent corporation and a large majority of its subsidiaries – but not all – were in bankruptcy. Evidently, the taxpayer wanted to know whether shareholders and creditors of all of the entities had to end up with at least 50% of the shares (by vote and value) in the reorganized parent corporation, or only those shareholders and creditors of the bankrupt entities.

The IRS ruled, without providing any in-depth analysis or supporting legal authority, that the consolidated group would be treated as a single entity. Thus, the applicability of the Section 382(l)(5) bankruptcy exception did not depend on whether qualified creditors of any single debtor corporation/member of the consolidated group received stock of the reorganized parent, but on whether the shareholders and qualified creditors of the entire consolidated group received the requisite amount of stock of the reorganized parent.

## **DOMESTIC PARTNERSHIP CONVERTED TO FOREIGN CORPORATION DEEMED TAX-FREE TRANSFER OF ASSETS**

In PLR 201437007 (Sept. 12, 2014), the IRS reviewed a transaction within a corporate group in which, for federal tax purposes, a domestic partnership was converted into a foreign corporation. The IRS concluded that the transaction was a deemed tax-free transfer of the partnership’s assets to the foreign corporation in exchange for common stock and voting and nonvoting preferred equity certificates (“PECs”), followed by a tax-free liquidation of the partnership.

The taxpayer, a U.S. parent of a consolidated group (“Parent”), owned directly and indirectly through two U.S. subsidiaries 100% of a limited liability company, classified as a partnership for federal income tax purposes (“Partnership”).

For valid business reasons, Parent proposed a two-step plan of reorganization. In the first step (“Step 1”), Partnership converted into a foreign entity, classified as a corporation for federal income tax purposes (“Newco”). Pursuant to the migration statutes of Partnership’s state and Newco’s country, partners were not required to actually transfer Partnership’s interest or assets. Each partner received shares of Newco common stock, potentially including voting PECs, treated as common stock for federal income tax purposes, and nonvoting PECs.

In the second step (“Step 2”), a U.S. corporate subsidiary of Parent (“S2”) transferred all of the equity of its wholly owned U.S. corporate subsidiary (“S3”) to Newco in exchange for common stock, potentially including voting PECs, treated as common stock for federal income tax purposes, and nonvoting PECs.

The IRS ruled that the conversion in Step 1 is treated as if Partnership first contributed all of its assets to Newco for Newco common stock, voting PECs, and nonvoting PECs, in a deemed Section 351 transaction, and then Partnership liquidated, distributing the Newco common stock, voting PECs, and nonvoting PECs to its members. Thus, Partnership recognized no gain or loss in its deemed exchange of assets for Newco stock and PECs. The basis in the Newco stock and PECs was the basis in the assets deemed exchanged. The holding period in the Newco stock and PECs was the holding period of the assets deemed exchanged, so long as Partnership held the assets as capital assets. Additionally, Newco recognized no gain or loss on receipt of Partnership

assets in exchange for issuing Newco stock and PECs. Newco held the assets with the same basis and holding period as in the hands of Partnership prior to the deemed exchange.

Furthermore, the IRS ruled that the contribution in Step 2 is treated as a Section 351 transaction. Thus, S2 recognized no gain or loss upon transferring its S3 stock to Newco in exchange for Newco common stock and PECs. The basis in the Newco stock and PECs received by S2 was the basis in S3 stock exchanged. The holding period in the Newco stock and PECs was the holding period of the S3 stock exchanged, so long as S2 held the stock as a capital asset. Finally, Newco recognized no gain or loss on receipt of S3 stock in exchange for issuing Newco stock and PECs. Newco held the S3 stock with the same basis and holding period as in the hands of S2 prior to the exchange.

Finally, the PLR did not include analysis of the transaction under Section 367. Section 367 typically causes a taxpayer to recognize gain on transfer of property to a foreign corporation in an otherwise tax-free exchange. The Section 367 Treasury Regulations provide a procedure for avoiding Section 367 gain if the taxpayer enters into a gain recognition agreement. Although Parent represented that it will file gain recognition agreements in accordance with the Section 367 Treasury Regulations, the IRS included a caveat in the PLR that it did not express or imply an opinion regarding the treatment of the transaction under the international provisions of the Code, including Section 367.

## **FIFTH CIRCUIT REJECTS PARTNERSHIPS AS SHAMS, DISALLOWS \$1 BILLION IN DEDUCTIONS AND REMANDS FOR CONSIDERATION OF PENALTIES**

The taxpayers in *Chemtech Royalty Associates, L.P. v. United States*<sup>9</sup> entered into various transactions designed to generate deductions from patent royalty expenses and depreciation of a chemical plant. In general, the transactions involved purported partnerships between The Dow Chemical Company and several foreign banks. To form the partnership, Dow contributed a portfolio of patents with low, or no, tax basis, cash and some stock to several subsidiaries, which, in turn, contributed those assets to the partnership. The foreign banks, on the other hand, contributed only cash. Finally, in connection with the transactions, Dow and the foreign banks entered

into a partnership agreement, license agreement and an indemnity agreement, under which Dow agreed to indemnify the foreign banks for any tax risk, as well as any liabilities arising from the contributed assets.

Throughout the duration of the arrangement, royalty payments served as the partnership's primary source of income. However, this income was sheltered in part by royalty expense deductions. The remaining profits were allocated in large part to the foreign banks. In short, Dow benefited from the partnership's deductions, but it did not take into account the bulk of the income. When the first partnership was wound down, Dow planned a second, similar transaction.

The IRS attacked the transactions on the basis that the partnerships were shams. Specifically, the IRS contended that the partnerships lacked economic substance and that the interests in the partnership held by the foreign banks were debt, not equity. Dow contested the IRS's arguments in the district court and lost. On appeal, the Government restated its argument that no partnership existed for federal tax purposes because essentially all of the economic risk was allocated to Dow, and the parties' agreements effectively shifted any management responsibility with respect to the partnerships' assets from the foreign banks.

In sum, the Fifth Circuit ultimately agreed with the Government. Central to the court's decision was the lack of evidence showing intent to share profits and losses in a business venture, the hallmark of a partnership. Indeed, the Fifth Circuit concluded that not only did Dow bear all material risks, but that the parties' agreements were tailored to ensure that the foreign banks would neither share in the upside of the venture in any meaningful capacity, nor lose their initial investment.<sup>10</sup>

## **NOTICE 2014-58 – ADDITIONAL GUIDANCE UNDER THE CODIFIED ECONOMIC SUBSTANCE DOCTRINE AND RELATED PENALTIES**

The Health Care and Education Affordability Act of 2010 enacted Section 7701(o) of the Code which codified the judicial economic substance doctrine. Section 7701(o) generally provides that where the economic substance doctrine is relevant, such "transaction" shall be treated as having economic substance only if, apart from federal income tax

effects, the transaction changes in a meaningful way the taxpayer's economic position and the taxpayer has a substantial purpose for entering into such transaction. Section 7701(o)(5)(D) provides that the term "transaction" includes a series of transactions. Notice 2014-58 clarifies the IRS's position on when a series of steps to a transaction should be aggregated and when a series of steps to a transaction should be disaggregated. In general, when a plan involves a series of interconnected steps with a common objective, the IRS will aggregate such transactions. But, according to Notice 2014-58, where a series of steps includes a tax-motivated step that is not necessary to achieve a non-tax objective, the IRS will disaggregate the steps and the "transaction" will only include the tax-motivated step that is not necessary to accomplish the non-tax goals. As a result, according to the IRS, the economic substance test must be applied to the disaggregated step separately.

The companion provision to Section 7701(o), Section 6662(b)(6), imposes a penalty on any disallowance of claimed tax benefits by reason of a transaction lacking economic substance or failing to meet the requirements of a "similar rule of law." Notice 2014-58 provides that "similar rule of law" means a rule or doctrine that applies the same factors and analysis that is required under Section 7701(o) even if a different term or terms are used to describe the rule or doctrine (such as the sham transaction doctrine) but does not include other judicial doctrines (such as substance over form or step transaction).

### **MoFo in the News**

On July 14, Of Counsel Julian Hammar participated in the American Gas Association Legal Forum. The Thirty-Seventh Annual Legal Forum focused on the impact of the changes taking place in the industry and the new legal challenges facing lawyers and their clients. The Forum featured presentations and panel discussions on topics of vital interest to natural gas industry attorneys. Of Counsel Julian Hammar spoke on the topic: "CFTC Reporting and Recordkeeping Obligations: What General Counsels Need to Know."

On July 22, Partner Peter Green and Of Counsel James Schwartz participated in a webinar titled "Meeting the Challenges of Risk Data Aggregation, Reporting and Record Keeping in your Enterprise." The webinar provided an overview of the challenges banks will face in meeting the Basel Committee's new Principles for Effective Risk Data Aggregation and Risk Reporting, the Financial Stability Board's recommendations for the development and implementation of a Global Legal

Entity Identifier (LEI) System, and the EMIR and CFTC's regulations to facilitate counterparty risk and swaps data repository aggregation in the derivatives markets. It discussed reporting and recordkeeping requirements and leading edge techniques and approaches that will help you meet these challenges and achieve compliance.

On July 24, Partner Anna Pinedo spoke at PLI's "Understanding Securities Laws Summer 2014." The panel on derivatives, structured notes and other alternatives to traditional securities offerings, focused on derivatives transactions related to securities, including new reporting and clearing obligations; structured notes and medium-term note programs; spin-offs, carve outs and reverse mergers to go public; PIPES – private investments in public equity; registered direct offerings and block trades; DRIPs – dividend reinvestment plans; and registration rights agreements.

On July 29, 2014, Senior Of Counsel Jerry Marlatt, Partner Oliver Ireland and Of Counsel James Schwartz presented on "U.S. Banking and Capital Markets Developments for Canadian Issuers." The presentation consisted of three complimentary sessions addressing key issues for Canadian firms doing business in the United States. These included key developments for Canadian banks in U.S. bank regulation, Canadian banks and the U.S. capital markets: opportunities and issues, and current issues in implementing Dodd-Frank Title VII.

On August 11, 2014, Partners Jay Baris and Oliver Ireland participated in a webinar titled "SEC Adopts Money Market Fund Reform Rules." This briefing focused on the implications and effects of the new money market reform rules, which a divided Securities and Exchange Commission adopted on July 23, 2014.

On August 12, 2014, Partners Anna Pinedo and Lloyd Harnetz and Of Counsel Brad Berman spoke during a seminar titled "Structured Products: A Compliance Bootcamp." The seminar covered a comprehensive review of the most pressing compliance and regulatory issues for issuers, underwriters and distributors of structured products.

On August 12, 2014, Partners Anna Pinedo and Of Counsel Julian Hammar participated in a webcast titled "Derivative Regulatory Update." The webinar discussed derivatives regulation under Dodd-Frank's Title VII, as well as the latest rule-making developments at the SEC and CFTC.

On September 3, 2014, Of Counsel Julian Hammar and James Schwartz spoke on a webinar titled "SEC Adopts Final Rules for Cross-Border Security-Based Swap Dealers and Major Security-Based Swap Participants."

The webcast examined the final rules adopted by the SEC in its June 25 adopting release address, and further discussed compliance date; SEC jurisdiction and approach to rulemaking compared to CFTC; U.S. persons; conduit affiliates of U.S. persons; non-U.S. persons; aggregation; transactions between non-U.S. persons conducted within the United States; substituted compliance procedural rule; and antifraud rules.

On September 9, 2014, Partners Marty Dunn, David Lynn and Scott Lesmes participated in a webinar titled “SEC Offers Guidance Regarding Investments Advisers and Proxy Advisory.” This program took a close look at the joint guidelines and their related impact on compliance with fiduciary duty; voting every proxy not required; selecting a proxy advisory firm; ongoing oversight of proxy advisory firms; application of proxy rules to proxy advisory firms; rule 14a-2(b)(1); and rule 14a-2(b)(3).

On September 10, 2014 Senior Of Counsels Ken Kohler and Jerry Marlatt and Partner Donald Lampe participated in a webinar titled “The Future of Housing Finance, the Mortgage Market and Securitization.” The webinar discussed a number of regulatory developments that continue to affect and bring about significant change in the U.S. mortgage market. The panelists provided their perspective on developments affecting the housing finance and mortgage market.

On September 16, 2014, Partners Peter Green and Jeremy Jennings-Mares participated in a webinar titled “Shadow Banking Reforms: Are the Shadows Lengthening or Shortening?” The presentation considered the reforms and proposed reforms of the shadow banking sector to date and explained how regulators intend to monitor and minimize the potential systemic risks posed by finance activity outside the traditional banking model.

On September 17, 2014, Partner Anna Pinedo participated in a seminar titled “10th Annual SEC Reporting & FASB Forum for Mid-Sized & Smaller Companies.” Pinedo spoke on a panel entitled “Simplifying the World of Complex Financing,” and discussed popular debt and equity financing transactions, and new creative structures; the evolving design of financial instruments – why and how to keep up; the devil is in the details – understanding the accounting ramifications and judgmental areas.

On September 18, 2014, Partner Geoff Peck spoke during a webinar titled “New Lending Trends, SME Lending and Other Developments.” The webinar discussed new lending trends that have developed for small and midsized companies following the financial crisis and increasingly popular tailored financing options

such as mezzanine financing, PIK features, equity kickers, second lien loans and unitranche loans.

On September 19, 2014, Senior Of Counsels Jerry Marlatt and Kenneth Kohler participated in a webinar titled “Regulation AB II Overview.” The webinar provided an overview of the new Regulation AB II rules and their impact on ABS and MBS issuers, as well as investors in the U.S. The session also discussed the history of Regulation AB II proposals, new forms SF-1 and SF-3, investor communication, and proposals not adopted by the SEC.

On September 23, 2014, Partners Oliver Ireland and Jay Baris spoke on a webcast titled “SEC Approves New Rule on Money Market Funds following Split Vote.” The program analyzed the new rules and restrictions, as well as the split vote and lingering frustrations from money market funds and Financial Stability Oversight Council (FSOC). The presentation also discussed the prevention of future runs on the market; and vital considerations for financial institutions and investors.

On September 24, 2014, Partner Daniel Nathan led a webinar titled “Fixed Income Pricing and Markups.” The presentation reviewed the regulatory landscape regarding fixed income pricing, and provided practical suggestions of how to demonstrate to the examiners and enforcers that pricing was fair.

On September 24, 2014, Partners Hillel Cohn and Jay Baris participated in a webinar titled “Broker-Dealer Issues for Private Equity Funds and their Advisers.” The webinar discussed broker-dealer basics: what activity requires registration as a broker-dealer?; solicitation, negotiation, execution; and transaction-based compensation. The webinar also looked at the consequences of violating such registration requirements.

On September 28-30, 2014, Partner Donald Lampe, Thomas Noto, Andrew Smith and Associate Angela Kleine participated in the “Mortgage Bankers Association’s Regulatory Compliance Conference.” The conference detailed the most comprehensive updates available on new rules, and new interpretations of previously released rules, including practical tips and guidance. Additional topics included CFPB examinations, compliance management, and social media and advertising.

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- 1 See <http://www.mofo.com/~media/Files/Newsletter/2014/07/140729TaxTalk.pdf>, at page 4 (IRS Concludes Change from Treating Securities as Options Is an Accounting Method Change Requiring Adjustment).
  - 2 Treas. Reg. 1.871-14T(c)(3)(i).
  - 3 However, a withholding agent that does not rely on valid documentation when a payment is made, but rather relies on documentation received after a payment is made to show that no withholding tax was required to be collected, is required to provide additional documentation to support its claim. See Treas. Reg. 1.1441-1(b)(7)(ii).
  - 4 In a previous issue of Tax Talk (Volume 4, No. 1, April 2011, available at <http://media.mofo.com/files/Uploads/Images/110418-MoFo-Tax-Talk.pdf>), we discussed an earlier IRS ruling addressing consent fees paid to noteholders. In PLR 201105016, the IRS ruled, in part, that certain amounts paid as consent fees to modify the notes were first treated as payments of accrued interest, to the extent of any accrued and unpaid interest, and second as payments of principal on the notes.
  - 5 For a discussion of AM 2010-005, see our client alert, available at <http://media.mofo.com/files/Uploads/Images/101115-Knock-Out-Option.pdf>
  - 6 An IRS audit of the taxpayer resulted in a challenge to the taxpayer's treatment of the basket option contracts consistent with AM 2010-005, i.e., a recharacterization of the option to direct ownership of the underlying securities. As a result, the taxpayer was required to mark-to-market the securities underlying the basket option contracts.
  - 7 Although the IRS's analysis was based on an argument that the basket option contracts should be recharacterized as direct ownership of the underlying securities, the CCA also addressed the possibility that a court would reject the recharacterization. In that case, the CCA concludes that the taxpayer would be required to mark-to-market the basket contract option itself and the resulting analysis would be the same as if the option were recharacterized.
  - 8 PLR 201435003 (Aug. 29, 2014).
  - 9 *Chemtech Royalty Associates, L.P. v. United States*, 114 AFTR 2d 2014-5940 (5th Cir. Sept. 10, 2014).
  - 10 *Id.* at 2014-5945.

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## ABOUT MORRISON & FOERSTER

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Because of the generality of this newsletter, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations.