

US

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New tax rules for transfer and assignment of derivative contracts

As a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act, certain books of derivative contracts must be transferred to other dealers.

For US federal income tax purposes, gain or loss is recognised upon the exchange of property for other property differing materially either in kind or extent.

Therefore, the non-assigning counterparty to any derivative contracts subject to a transfer may be treated as recognising gain or loss.

Since existing US Treasury regulations only address the transfer and assignment of derivatives that qualify as “notional principal contracts” for US federal income tax purposes, many in the public domain have commented that such regulations were too narrowly drawn, especially for the post-Dodd Frank world.

In response to these comments, the US Internal Revenue Service has expanded the regulations by issuing temporary and proposed regulations addressing the transfer and assignment of a broader set of derivative contracts.

The newly-issued temporary and proposed US Treasury regulations expand the current regulations by providing that there is no exchange to the non-assigning counterparty for US federal income tax purposes, provided: (i) both the transferring or assigning party and the party to which the rights and obligations are transferred or assigned are either a dealer or a clearinghouse; (ii) the terms of the derivative contract permit the transfer or assignment of the contract (whether or not the consent of the non-assigning counterparty is required for the transfer or assignment to be effective); and (iii) the terms of the derivative contract are not otherwise modified in a manner that results in a taxable exchange.

The definition of derivative contract has been expanded to not only include notional principal contracts but also an interest in, or a derivative financial instrument in, stock, a partnership, note, bond, other evidence of debt or certain hedges.

In addition, if any consideration passes between the assignor and assignee in connection with the transfer or assignment, this will not affect the treatment of the non-assigning counterparty.

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