

**MEMO# 17640**

June 8, 2004

## **DRAFT INSTITUTE SUBMISSION ON PROPOSED SWAP REGULATIONS**

[17640] June 8, 2004 TO: TAX COMMITTEE No. 20-04 RE: DRAFT INSTITUTE SUBMISSION ON PROPOSED SWAP REGULATIONS Attached is the Institute's draft submission on Treasury's proposed regulations on the taxation of notional principal contracts ("NPCs" or "swaps") with contingent nonperiodic payments.<sup>1</sup> The proposed regulations would generally treat income and expense from NPCs as ordinary.<sup>2</sup> The regulations would require taxpayers to project and annually accrue income from contingent nonperiodic payments, under a complex "modified noncontingent swap method." Alternatively, RICs could elect to mark NPCs to market annually. The Institute's draft letter suggest that "value payments" should be capital, rather than ordinary, under the modified noncontingent swap method, and that gains or losses under the mark-to-market regime should likewise be capital in character. The letter also suggest that the modified noncontingent swap method is overly complex, and that short-term swaps (of 2 years duration or less) should be excluded from the scope of the modified noncontingent swap method and the mark-to-market election. In addition, the letter suggests that, economically, credit default swaps are substantially different from equity swaps, and therefore should likewise be excluded from the modified noncontingent swap method and the mark-to-market election. To avoid creating any excise tax issues, the Institute's submission requests that Treasury exercise its authority to push post-October adjustments to ordinary income, under either the modified contingent swap method or the mark-to-market election, to the following taxable year. Finally, the letter requests that the final regulations be entirely prospective in application. 1 See Institute Memorandum to Tax Members No. 12-04 [17158], dated March 2, 2004. 2 In a "bullet swap," where all of the parties' obligations are settled at or close to maturity, the final settlement of the parties' obligations would result in capital gain or loss. 2 We will discuss the proposed regulations and the draft submission at the Tax Committee meeting this week. In addition, please feel free to contact the undersigned (at 202/371-5436 or dorlin@ici.org) with any comments or suggestions before June 25, 2004. David Orlin Assistant Counsel Attachment (in .pdf format)

---

**Source URL:** <https://icinew-stage.ici.org/memo-17640>

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.