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May 22, 2001

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Room 1334 MT  
Department of the Treasury  
1500 Pennsylvania Avenue, N.W.  
Washington, D.C. 20220

The Honorable Charles O. Rossotti  
Commissioner  
Room 3000 IR  
Internal Revenue Service  
1111 Constitution Avenue, N.W.  
Washington, D.C. 20224

Pamela F. Olson, Esq.  
Deputy Assistant Secretary  
(Tax Policy)  
Room 1334, Main Treasury  
Department of the Treasury  
1500 Pennsylvania Avenue, N.W.  
Washington, D.C. 20220

Eric Solomon, Esq.  
Deputy Assistant Secretary  
Regulatory Affairs  
(Tax Policy)  
Room 1326, Main Treasury  
1500 Pennsylvania Avenue, N.W.  
Washington, D.C. 20220

Richard W. Skillman, Esq.  
Acting Chief Counsel  
Room 3026 IR  
Internal Revenue Service  
1111 Constitution Avenue, N.W.  
Washington, D.C. 20224

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Lon B. Smith, Esq.  
Assistant Chief Counsel  
CC: DOM:FI&P, Room 4300 IR  
Internal Revenue Service  
1111 Constitution Avenue, N.W.  
Washington, D.C. 20224

John Staples  
Assistant Chief Counsel  
Office of Tax Policy, Room 4617 IR  
Department of the Treasury  
1500 Pennsylvania Avenue, N.W.  
Washington, D.C. 20220

Barbara M. Angus  
International Tax Counsel  
Office of Tax Policy, Room 1000  
Department of the Treasury  
1500 Pennsylvania Avenue, N.W.  
Washington, D.C. 20220

Michael Caballero  
Attorney-Advisor  
Office of Tax Policy, Room 4217 IR  
Department of the Treasury  
1500 Pennsylvania Avenue, N.W.  
Washington, D.C. 20220

*Re: Passive Foreign Investment Company Rules*

Ladies and Gentlemen:

The attached Tax Section Report No. 994 expresses our concern that the current passive foreign investment company ("PFIC") rules may result, improperly, in foreign companies engaged in active businesses being classified as passive foreign investment companies. The report proposes regulatory solutions to this perceived problem.

We believe there are at least four types of active businesses that erroneously can be classified as PFICs under the current rules: (i) active companies in a start-up mode for several years (for example, information technology and biotechnology companies); (ii) more established active companies that have raised significant amounts of capital to be used in the foreseeable future in their active businesses; (iii) companies that derive rents, royalties or income from the sale of commodities in the course of their active businesses; and (iv) companies that would not otherwise be classified as PFICs but qualify as a PFIC in a single year as a result of a sale of equity interests in an

operating subsidiary or partnership. We have determined that neither the current exceptions from PFIC classification nor the qualified electing fund (“QEF”) regime provides adequate relief to these companies and their U.S. shareholders.

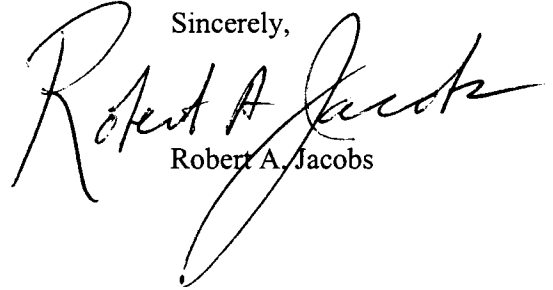
The report suggests regulatory proposals to resolve these problems. These may be summarized as follows: (i) to address start-ups generating small amounts of passive gross income but no net income, we propose a “deemed” QEF election for shareholders and optionholders of any PFIC that has no net earnings; (ii) to address active, profitable companies that would be PFICs solely because they have raised and hold a significant amount of capital (such as through a public offering or private venture capital investments), we propose the liquid assets held for the reasonable needs of an active business (and the earnings thereon) not be treated as passive assets (or passive income); (iii) to address companies that, in the course of an active trade or business, derive rents, royalties or income from sales of commodities classified as “passive” under the subpart F definition of “foreign personal holding company income,” we propose that in the PFIC context, the subpart F regulations be applied by disregarding the “substantially all”/“85 percent test” applicable to commodities gains and instead apply the PFIC look-through rules to take into account activities of employees of subsidiaries and certain other affiliates of the corporation whose income is being tested for PFIC status; (iv) to clarify the treatment of gain recognized from sales of related entities, we propose that where a foreign corporation sells stock in a 25 percent or greater owned subsidiary or an interest in a 25 percent or greater owned partnership, the gain be characterized as if the corporation had held and sold directly its proportionate share of the assets of the subsidiary or partnership; (v) to address the problems for optionholders, who are currently unable to make a QEF election, we propose a modified QEF election be made available to optionholders; (vi) to clarify how a foreign corporation takes into account an interest in a partnership, we propose specifically providing that, if the corporation owns a significant interest in the partnership, the corporation’s proportionate share of the partnership’s income and assets will be treated as if derived and held by the corporation directly; and (vii) we propose modifications to the restrictive requirements for making a retroactive QEF election to make the retroactive QEF election more widely available. We also suggest that broad anti-abuse rules be added to insure that the existing rules and any modifications that are adopted will not be abused. The report also discusses the rules that allocate “excess distributions” among the years in the shareholder’s holding period on a ratable basis for purposes of computing the interest charge on the excess distribution. We suggest the Code be amended to allocate the excess distributions on a yield-to-maturity basis.

We recognize the PFIC rules serve an important tax policy goal, namely preventing U.S. shareholders from deferring or permanently avoiding tax on investment income by making their investments through foreign investment vehicles. Nevertheless, we believe the PFIC rules are unintentionally complicating and frequently have the effect of inhibiting otherwise desirable U.S.

investment in active foreign businesses. We believe this serious and widespread problem is worthy of your attention and correction.

We would be pleased to meet with you at your convenience or discuss by telephone, email or snail mail these issues and proposed solutions.

Sincerely,

A handwritten signature in black ink that reads "Robert A. Jacobs". The signature is written in a cursive style with a large, sweeping initial "R".

Robert A. Jacobs

cc: John Parcell, Esq.  
Joseph M. Mikrut, Esq.  
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