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August 27, 2009

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Honorable Douglas H. Shulman  
Commissioner  
Internal Revenue Service  
1111 Constitution Avenue, NW  
Washington, DC 20224

Re: Report on the Application of Anti-Conduit Regulations to  
Hybrid Entities and Instruments

Dear Sirs:

I am enclosing a report providing comments on proposed regulations amending Treasury Regulation section 1.881-3 (the "Anti-conduit Regulations") issued on December 22, 2008 (the "Proposed Regulations").

Under the Anti-conduit Regulations, for withholding tax purposes, the Internal Revenue Service may disregard the participation of a conduit entity and recharacterize ostensibly separate financing transactions to which a conduit is a party as a direct financing between the ultimate provider and ultimate recipient of the financing. Generally, the Regulations apply to back-to-back debt transactions through a conduit entity, if specified conditions are satisfied.

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The Proposed Regulations provide that “disregarded entities” whose separate existence is ignored for most other federal income tax purposes will be treated as regarded “persons” for purposes of the Anti-conduit Regulations. The change would take effect once final regulations are issued, but may apply to payments made following the effective date under arrangements entered into prior to the effective date. We strongly support this proposed change to the Anti-conduit Regulations and agree with the proposed effective date for this change.

The preamble to the Proposed Regulations states that separate guidance may be issued to address certain hybrid instruments, specifically instruments treated as debt under the tax laws of the foreign jurisdiction in which the issuer of the instrument is resident that are treated as equity for U.S. federal tax purposes. Currently, financing arrangements involving instruments that are equity for U.S. federal income tax purposes are not subject to the Anti-conduit Regulations except under very limited circumstances, even if the instrument is debt for foreign tax law purposes. The preamble suggests two possible approaches to these instruments. One alternative proposed is to treat any hybrid instrument classified as debt for local law purposes as a “financing transaction” for purposes of the anti-conduit rules. The other alternative proposed is to expand the factors that determine when equity in a corporation (or similar interests in a partnership or trust) constitutes a “financing transaction” in order to reach instruments that, while not redeemable or debt-like solely from the standpoint of the legal terms of the instrument, are structured to be, in practice, substantively very similar to arrangements

We do not support revising the Anti-conduit Regulations to expand the definition of “financing transaction” to reach hybrid instruments generally. We do not think the need to prevent specific abusive transactions justifies the resulting complexity and increased administrative burden, in particular, for unrelated withholding agents. Instead, we recommend that specific abusive transactions not reached by the current regulations be addressed by describing and recharacterizing specific transactions of concern in the regulations and other guidance. The report describes one particular fact pattern – a “rent-a-conduit” transaction – that we think deserves guidance of this kind.

However, if Treasury and the Internal Revenue Service are determined to expand the definition of a “financing transaction” to reach hybrid instruments generally, we have no strong preference as between the two approaches described in the preamble. Both approaches have advantages and disadvantages, which we discuss in the report. To the extent the approach of expanding the factors that determine when non-debt is treated as a “financing transaction” is adopted, however, we recommend that the indicia adopted be objective because an approach that makes the definition of a “financing transaction” depend on the intent of the parties will be very difficult for taxpayers to administer.

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We appreciate your consideration of our comments. Please let us know if you would like to discuss these matters or if we can assist you in any other way.

Respectfully submitted,



Erika W. Nijenhuis  
Chair

Enclosure

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