Part III - Administrative, Procedural, and Miscellaneous

Timing, Character, Source and Other Issues Respecting Prepaid Forward Contracts and Similar Arrangements

Notice 2008-2

SECTION 1. PURPOSE

The purpose of this notice is to request comments from the public with respect to issues that arise in connection with certain financial transactions frequently referred to in the marketplace as prepaid forward contracts (or in certain circumstances as exchange traded notes).

SECTION 2. BACKGROUND

The Internal Revenue Service and the Treasury Department are considering the tax policy issues raised by certain financial transactions frequently referred to in the marketplace as prepaid forward contracts (or in certain circumstances as exchange traded notes). These transactions resemble typical forward contracts (that is, bilateral, executory contracts in which one party agrees to purchase an asset on a future date for a specific forward purchase price, payable at that future time), but the purchase price is paid in advance of future delivery or cash settlement. Thus, these transactions typically involve an initial payment by one party in exchange for a promise of either (i) a future delivery of a particular asset or group of assets (for example, stocks or commodities), or (ii) a future payment determined exclusively by reference to the value of such assets.

In particular, the Internal Revenue Service and the Treasury Department are considering whether the parties to such a transaction should be required to accrue income/expense during the term of the transaction, if the transaction is not otherwise indebtedness for U.S. federal income tax purposes. See Rev. Rul. 2008-1, 2008-2 I.R.B., dated January 14, 2008 (holding that an instrument resembling, in form, a prepaid forward contract is debt). The Internal Revenue Service and the Treasury Department are also considering a number of other issues associated with these transactions, including:

•The appropriate methodology for accruing income or expense, if that is deemed appropriate (for example, a mark-to-market methodology or a method resembling the noncontingent bond method set forth in §1.1275-4 of the Income Tax Regulations);

•How an accrual regime might be designed so that it does not inappropriately or inadvertently cover routine commercial transactions involving property sales in the ordinary channels of commerce;

•The appropriate character (capital vs. ordinary, and if ordinary, whether interest) of any income accruals required under such an accrual regime, as well as the character of amounts less than, or in excess of, these accruals;

•Whether the tax treatment of the transactions should vary depending on the nature of the underlying asset (for example, stocks vs. commodities);

•Whether the tax treatment of the transactions should vary depending on whether the transactions are (i) executed on a futures exchange (and are not otherwise subject to section 1256 of the Internal Revenue Code), or (ii) memorialized in an instrument that is traded on a securities exchange;

•Whether the transactions should be treated as indebtedness pursuant to regulations issued under section 7872;

•Whether section 1260 applies, or should apply, to prepaid forward contracts and similar transactions;

•The degree to which such transactions (and any income accruals that may be mandated) should be taxed under sections 871 and 881;

•How the income with respect to such instruments should be treated for purposes of section 954 (for example, as income equivalent to interest or gains from property that does not give rise to income);

•How investments in such contracts should be treated under section 956;

•Whether there are other issues that should be considered with respect to these transactions (for example, whether short term transactions should be subject to the accrual regime);

•Identifying arrangements similar to prepaid forward contracts that should be accorded tax treatment similar to that of prepaid forward contracts; and

•Appropriate transition rules and effective dates.

SECTION 3. REQUEST FOR COMMENTS

The Internal Revenue Service and the Treasury Department request public comments with respect to the issues described in Section 2 of this Notice. Comments must be submitted by May 13, 2008. All materials submitted will be available for public inspection and copying. Comments may be submitted to Internal Revenue Service, CC:PA:LPD:RU (Notice 2008-2), Room 5203, PO Box 7604, Ben Franklin Station, Washington, D.C. 20044. Submissions may also be hand-delivered Monday through Friday between the hours of 8:00 a.m. and 4:00 p.m. to the Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224, Attn: CC:PA:LPD:RU (Notice 2008-2), Room 5203. Submissions may also be sent electronically via the internet to the following email address: Notice.Comments@irscounsel.treas.gov. Include the notice number (Notice 2008-2) in the subject line.

DRAFTING INFORMATION

The principal author of this notice is John W. Rogers III of the Office of the Associate Chief Counsel (Financial Institutions & Products). For further information regarding this notice, contact Mr. Rogers at (202) 622-3950 (not a toll-free call).