Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Date:
December 21, 2012

Attn:

TY:

Legend

Taxpayer	=
Parent Company	=
Common Parent of Target Affiliated Group	=
Dealer 1	=
Dealer 2	=
Disregarded entity 1	=
Disregarded entity 2	=
Disregarded entity 3	=
Disregarded entity 4	=
Delaware Trust 1	=
Delaware Trust 2	=
Date 1	=
Date 2	=
Year 1	=

Dear :

This responds to a letter dated Date 1, that was submitted by Taxpayer, requesting a ruling that each of the Forms FR Y-7N or FR Y-7NS that must be separately filed with the Federal Reserve Board by its dealer entities that are disregarded for federal tax purposes qualifies as an applicable financial statement of the

Taxpayer for purposes of the section 475 valuation safe harbor under Treas. Reg. §1.475(a)-4.

FACTS

Taxpayer is a Delaware corporation and the common parent of an affiliated group that files a consolidated tax return. All of the stock of Taxpayer is held directly or indirectly by Parent Company, a foreign bank. The shares of Parent Company are traded on a foreign exchange. No consolidated financial statement of Parent Company or Taxpayer is required to be filed with the Securities and Exchange Commission (SEC). Prior to Date 2, the members of the Affiliated Group were primarily engaged in U.S. asset management businesses. Taxpayer was engaged in this asset management business through disregarded entities. No members were dealers under section 475.

On Date 2, Taxpayer acquired the assets of Target Affiliated Group, another U.S. affiliated group of Parent Company. The members of the Target Affiliated Group were primarily engaged in U.S. capital market businesses. Dealer 1 and Dealer 2 were members of the Target Affiliated Group and direct subsidiaries of its Common Parent. Taxpayer represents that Dealer 1 and Dealer 2 were dealers in securities under section 475. Taxpayer represents that Dealer 1 is a dealer in US Treasuries, mortgage backed securities, equity securities, municipal bonds, other fixed income securities and derivative products. Taxpayer represents that Dealer 2 is a dealer in commercial and residential mortgages.

After Date 2, the Common Parent of Target Affiliated Group was converted to Disregarded entity 1. Dealer 1 was converted to Disregarded entity 2. Dealer 2 was merged with Disregarded entity 3, a wholly-owned subsidiary of Taxpayer. Each are Delaware limited liability companies that did not elect to be classified as corporations, and therefore are treated as disregarded entities. Dealer 2's portfolio of commercial mortgages was transferred to Disregarded entity 4. Dealer 2's portfolio of residential mortgages was transferred to Delaware Trust 1, which then transferred the portfolio to Delaware Trust 2. Disregarded entity 3 is the beneficiary of Delaware Trust 1. Delaware Trust 1 is the beneficiary of Delaware Trust 2. Both Delaware Trusts are grantor trusts.

As a result of the acquisitions, conversions and mergers, Disregarded entities 1, 2 and 4 and the Delaware Trusts 1 and 2 are each directly or indirectly owned by the Taxpayer and are all disregarded entities of the Taxpayer. Disregarded entity 2 will carry on the dealer business of Dealer 1. Disregarded entity 4 and Delaware Trust 2 will carry on the dealer business of Dealer 2, with Disregarded entity 3 as the beneficiary of the Delaware trusts.

The banking regulator, in this case, the Federal Reserve Board (FRB), requires that every nonbank U.S. subsidiary of a foreign banking organization that is engaged in a specified financial services business and has no primary U.S. regulator other than the

FRB**,** must submit a financial statement to the FRB if it has assets of $50,000,000 or more.[1] The statement is required to be submitted annually unless the subsidiary has more than $1,000,000,000 of assets, in which case a statement must be filed quarterly.[2] Each separate legal entity with reportable activities must file a separate statement, consolidated reporting is not permitted.[3] The statement is the Form FR Y-7N, Financial Statements of U.S. Nonbank Subsidiaries Held by Foreign Banking Organizations. Taxpayer represents that the Form FR Y-7N is prepared in accordance with U.S. GAAP. The Form FR Y-7N includes the following statements: an Income Statement, a Balance Sheet, Changes in Equity Capital, Allowance for Loan and Lease Losses, Loan and Lease Financing Receivables, and memoranda reporting certain key asset and liability classes. If a reporting entity has less than $250,000,000 of assets, an abbreviated form is filed, the Form FR Y-7NS, Abbreviated Financial Statements of US Nonbank Subsidiaries Held by Foreign Banking Organizations.

Prior to the conversion of Dealer 1 and the merger of Dealer 2, both had separately filed with the FRB, the Form FR Y-7N on a quarterly basis. After the conversion and merger, Disregarded entities 2 and 4 also filed separately with the FRB, the Form FR Y-7N, on a quarterly basis. Delaware Trust 2, because it had assets with a value less than $250,000,000, was not required to file a quarterly report, but did file the abbreviated Form FR Y-7NS on an annual basis.

Taxpayer does not produce an audited consolidated financial statement that includes all of its disregarded entities. The separate financial statements of the taxpayer filed with the FRB will not consolidate the results of the subsidiaries, including the disregarded entities, and therefore there will not be one financial statement that reflects all the values of the securities held by taxpayer and its disregarded entities. There is no financial statement that reports the positions of the dealer disregarded entities that is required to be filed with the SEC or any other agency of the Federal Government other than the FRB.

LAW AND ANALYSIS

Requirements for the Section 475 Valuation Safe Harbor Election

Under Treas. Reg. § 1.475(a)-4, the valuation safe harbor regulations, a taxpayer can elect to use the valuations reported for certain securities on its financial statements as the appropriate valuations to be used for section 475 purposes, if all the necessary conditions and requirements set forth in the safe harbor are met. Treas. Reg. § 1.475(a)-4(b)(1) provides that if an eligible taxpayer uses an eligible method for the valuation of an eligible position on its applicable financial statement and the eligible

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[1] 12 U.S.C. §§ 601-604(a), 611-631, 1844, 3106; 12 C.F.R. § 225.5(b).

[2] See Instructions for Preparation of Financial Statements of U.S. Nonbank Subsidiaries Held by Foreign Banking Organizations- FR Y-7N and FR Y-7NS, GEN-1 (Dec. 2009).

[3] Form Instructions, GEN-1, See Agency Information Collection Activities: Announcement of Board Approval Under Delegated Authority and Submission to OMB, 67 Fed. Reg. 72,954 (December 9, 2002).

taxpayer is subject to the election in paragraph (f) of that section, then the value that the eligible taxpayer reports for its eligible securities on its applicable financial statement must be used as the fair market value for section 475 purposes. Before taxpayer makes the safe harbor election, it is seeking a ruling that its separate FR Y-7N and FR Y-7NS statements for its disregarded dealer entities can all be considered as the "applicable financial statement" described in section 1.475(a)-4(h). Taxpayer is making this request because of the language in the regulations that there can only be one applicable financial statement.

An eligible taxpayer is a dealer in securities as defined in section 475(c)(1). See Treas. Reg. § 1.475(a)-4(c). In this case, taxpayer represents that it is an eligible taxpayer because of the dealer business conducted by three of its disregarded entities, Disregarded entities 2 and 4 and Delaware Trust 2. Disregarded entity 2 is in the capital markets business. Disregarded entity 4 and Delaware Trust 2 are involved with commercial and residential mortgages, respectively.

An eligible method is a mark-to-market method that is sufficiently consistent with the requirements of a mark-to-market method under section 475. To be sufficiently consistent with the requirements of a mark-to-market method under section 475, the eligible method must satisfy all of the requirements of paragraph (d)(2) and paragraph (d)(3) of the section 475 valuation safe harbor. Taxpayer represents that the valuation methods used by the disregarded entities 2 and 4 and Delaware Trust 2 are eligible methods. Such a representation means that all valuation changes flow through the income statements of these entities; that the taxpayer did not use a bid-ask methodology and that any valuations were closer to the mid-market than the bid or ask values. It also means that valuations are made as of the last business day of each taxable year and that they must arrive at fair value in accordance with US GAAP.

Treas. Reg.§ 1.475(a)-4(f) (1) provides that an eligible taxpayer makes an election under the valuation safe harbor regulations by filing with the Commissioner a statement declaring that the taxpayer makes the safe harbor election for all eligible positions for which there is an eligible method. The statement must describe the taxpayer's applicable financial statement for the first taxable year for which the election is effective and must state that the taxpayer agrees to provide upon request of the Commissioner all information, records, and schedules in the manner required by paragraph (k) of the valuation safe regulations. This statement must be attached to a timely filed Federal income tax return (including extensions) for the taxable year for which the election is first effective. Taxpayer represents that it will do so if it is determined that these separate FR Y-7N and FR Y-7NS statements are accepted as applicable statements for taxpayer.

Applicable Financial Statement

Treas. Reg. § 1.475(a)-4(h)(1) provides that an applicable financial statement is defined as a taxpayer's primary financial statement for a year if the primary financial

statement is described in paragraph(h)(2)(i) of that section (concerning statements to be filed with the SEC) or if that primary financial statement both meets the requirements of paragraph (j) of that section (concerning significant business use) and is described in either paragraph (h)(2)(ii) or (iii) of that section. Otherwise, if a taxpayer does not have a primary financial statement for the taxable year, the taxpayer does not have an applicable financial statement for the taxable year.

Primary financial statement is defined in Treas. Reg. § 1.475(a)-4(h)(2) as the financial statement, if any described in one or more paragraphs, (h)(2)(i), (ii), and (iii) of that section. If more than one financial statement of the taxpayer for the year is so described, the primary financial statement is the one first described in paragraphs (h)(2)(i), (ii) and (iii) of that section. A taxpayer has only one primary financial statement for any taxable year. The specific statements under paragraphs (h)(2) are as follows:

(i) - Statement required to be filed with the Securities and Exchange Commission (SEC).- A financial statement that is prepared in accordance with U.S. GAAP and that is required to be filed with the SEC, such as the 10-K or the Annual Statement to Shareholders.

(ii) - Statement filed with a Federal agency other than the Internal Revenue Service.- A financial statement that is prepared in accordance with U.S. GAAP and that is required to be provided to the Federal government or any of its agencies other than the Internal Revenue Service (IRS).

(iii) - Certified audited financial statement.- A certified audited financial statement that is prepared in accordance with U.S. GAAP; that is given to creditors for purposes of making lending decisions, given to equity holders for purposes of evaluating their investments in the eligible taxpayer, or provided for other substantial non-tax purposes; and that the taxpayer reasonably anticipates will be directly relied on for the purposes for which it was given or provided.

In this case, taxpayer represents that the FR Y-7N and FR Y-7NS statements that it submits to the FRB are prepared in accordance with U.S. GAAP and fall within (h)(2)(ii). We agree that these statements are statements that are required to be filed with the Federal government or one of its agencies.

Treas. Reg. § 1.475(a)-4(h)(4) provides that if the rules of paragraph (h)(2) of this section cause two or more financial statements to be of equal priority, then the statement that results in the highest aggregate valuation of eligible positions being marked to market under section 475 is the primary financial statement.

Treas. Reg. § 1.475(a)-4(h)(5) provides that if the taxpayer is a member of an affiliated group that files a consolidated return, the primary financial statement of the taxpayer's is the primary financial statement, if any, of the common parent (within the meaning of section 1504(a)(1)) of the consolidated group.

Because all of the stock of Taxpayer is owned by a foreign bank**,** the shares of which are traded on a foreign exchange, Taxpayer does not have to file a consolidated financial statement with the SEC and it does not prepare an audited consolidated financial statement.

Treas. Reg. § 1.475(a)-4(j)(1) provides that a financial statement meets the significant business use requirement of that section if:

(i) the financial statement contains values for eligible positions;

(ii) the eligible taxpayer makes significant use of the financial statement values in most of the significant management functions of its business; and

(iii) the use is related to the management of all or substantially all of the eligible taxpayer's business.

Taxpayer asserts that section (h) of the valuation safe harbor regulations does not address the situation that is presented in this case. Here, the taxpayer does not have one financial statement that picks up all the securities that should be marked under section 475. Rather it has separate financial statements for the relevant entities that would qualify under (h)(2)(ii), but because there is not a consolidated financial statement filed that includes these disregarded entities, there are three different statements that together will establish the values of all the securities subject to marking under section 475. The valuation safe harbor regulations only considered the situation where a taxpayer had more than one applicable statement that included all the values of the taxpayer's securities, and then addressed the priority to be used in selecting the one applicable financial statement. Taxpayer further asserts that it satisfies the "significant use" test of section (j) of the regulations, even though it does not use the separate financial statements in the management of its asset management business, since it does make significant use of those statements in its management of all its securities dealer businesses**.** We do not think that the rules as set forth in sections (h) and (j) of the regulations preclude the Service from accepting the separate statements of the disregarded dealer entities to determine the fair market values of the securities for section 475 purposes.

CONCLUSION

Because this taxpayer is not required to file any statement with the SEC, it does not have a consolidated financial statement that will include all of its entities, including the disregarded dealer entities. If Taxpayer makes the section 475 valuation safe harbor election, and assuming it meets all the requirements of the election, the separate statements of the disregarded dealer entities filed with the FRB may be considered together as the applicable financial statement. This combined applicable financial statement may be used for reporting the section 475 fair market values for tax purposes.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Robert B. Williams
Senior Counsel, Branch 3
(Financial Institutions & Products)

cc: