

Client Update

The IRS Identifies Certain Basket Derivatives as Reportable Transactions

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Burt Rosen
brosen@debevoise.com

Robert S. Staffaroni
rjstaffaroni@debevoise.com

Ben Lee Friedman
blfriedman@debevoise.com

On July 8, 2015, the IRS issued Notices 2015-47 and 2015-48, which identify as reportable transactions certain derivative contracts that reference a basket of assets and give one of the parties the right to change the reference assets. The Notices indicate that the parties to such a contract are taking the position that trading gains, interest, dividends and other income from the reference assets are deferred until the contract terminates. The IRS is concerned that the parties are using these contracts to claim such deferral, convert ordinary income and short-term capital gain into long-term capital gain, and avoid U.S. withholding taxes.

NOTICE 2015-47

Notice 2015-47 identifies a transaction that has all of the following characteristics as a “listed transaction”:

- the contract is called an “option”;
- the option references a basket of assets substantially all of which are “actively traded personal property” (generally any property for which there is an established financial market);
- the purchaser of the option or a designee named by the purchaser has the right, as a legal or practical matter, to either (i) determine the assets in the reference basket (both initially and periodically over the term of the contract) or (ii) select or use a specified trading algorithm under the purchaser’s control to determine such assets; and
- the purchaser of the option (or its designee) or the trading algorithm actually changes one or more of the assets in the reference basket during the term.

Notice 2015-47 applies to contracts with the above characteristics that are in effect on or after January 1, 2011.

NOTICE 2015-48

Notice 2015-48 identifies the following broader class of transactions as “transactions of interest”:

- the contract is any type of derivative (not limited to options) that references a basket of assets (whether or not any of the assets are actively traded (including, e.g., interests in private investment funds)); and
- the purchaser of the derivative or a designee named by the purchaser has the right, as a legal or practical matter, to either (i) determine the assets in the reference basket (both initially and periodically over the term of the contract) or (ii) select or use a specified trading algorithm under the purchaser’s control to determine such assets.

Notice 2015-48 applies to contracts with the above characteristics that (i) were entered into on or after November 2, 2006 and (ii) are in effect on or after January 1, 2011.

ACTION REQUIRED

Any party to a derivative contract to which either Notice applies (as well as a general partner of a partnership or a managing member of a limited liability company that purchased such a contract) is subject to reporting and document retention obligations under Treas. Reg. §1.6011-4 for each taxable year in which the party participated in the transaction, so long as the period of limitations for assessment of tax for such year had not ended on or before July 8, 2015. For years with respect to which a party has already filed a federal income tax return, reporting is required within 120 days after the date of issuance of the Notices.

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Please do not hesitate to contact us with any questions.