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TAXTALK

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EDITOR'S NOTE

We know 2013 is flying by because it's already time for Tax Talk 6.2. In this issue we bring you updates on what the IRS won't rule on (REIT conversions) and what it will rule on (Mexican land trusts [public ruling], money market funds [notice], and various dividends-received deduction and other tax motivated transactions [private rulings]). While these topics may seem fairly mundane given what is happening with the IRS in Washington (and Cincinnati), as always Tax Talk sticks to the technical. Any insight or comment on the intrigue and drama surrounding the alleged targeting by the IRS of certain political groups applying for tax exempt status is "beyond scope" as the English say. We'll leave that to the press, the FBI, and the Congress. Also, we won't discuss the U.S. Supreme Court's decision in *U.S. v. Windsor*[1] striking down the Defense of Marriage Act other than to remind our readers that, along with last year's Supreme Court decision upholding "Obamacare,"[2] *Windsor* was a tax case.

In a piece of late breaking news after quarter's end, the IRS has pushed back the start date for the Foreign Account Tax Compliance Act ("FATCA") six months to July 1, 2014.[3] When we started preparing Tax Talk 6.2 we had included a riff (just a bit tongue in cheek) about how the blog-announced delay in the Obamacare employer mandate was a harbinger of a possible delay in FATCA's January 1, 2014 implementation date. Lo and behold, on July 12, the IRS proved us right by delaying FATCA for six months. Even so, Tax Talk

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6.2 reports on the latest FATCA activity. Also, be sure to visit our FATCA website (www.KNOWFatca.com) to keep abreast of the ever-evolving FATCA landscape.

In other news, the IRS has temporarily pulled the plug on REIT conversion rulings. This purported REIT conversion moratorium was publicized in recent securities filings by two companies already in the process of converting into a REIT. We'll keep you posted on this developing story as it unfolds.

Finally, we report on a federal appellate decision of first impression. The Third Circuit Court of Appeals in *The Majestic Star Casino LLC v. Barden Development, Inc.* addressed the impact under bankruptcy law of a non-debtor's decision to abandon its classification as an "S" corporation. The court ultimately ruled that status as an "S" corporation did not qualify as "property" under bankruptcy law. The decision may foster interesting – and unintended – consequences, as courts and tax practitioners grapple with whether other tax attributes will be considered property of a bankruptcy estate.

As always, our regular section, MoFo in the News, concludes this issue of Tax Talk.

IRS LEAVES POTENTIAL REIT CONVERSIONS HANGING

Recent federal securities law filings by two companies – one in the document management and storage business,[4] the other an operator of data centers[5] – suggest that the IRS has temporarily suspended REIT conversion rulings while it analyzes the meaning and scope of "real estate" under tax rules governing REITs.

According to one of the filings, the "IRS has convened an internal working group to study what constitutes 'real estate' for purposes of the REIT provisions" and, "pending the completion of the study, the IRS is unlikely to issue PLRs on what constitutes real estate for REIT purposes."[6]

The IRS' moratorium on REIT conversion rulings may come as a surprise to some. Indeed, as a historical matter, the IRS has issued a litany of positive rulings sanctioning numerous non-traditional real estate assets. This expanding definition of a real estate asset beyond the traditional "brick and mortar" concept, and a desire to take advantage of the generous tax rules governing REITs, seem to have whet the market's appetite for REIT conversions.

The IRS hasn't been an unwilling participant. In fact, just this year alone, the IRS has issued three REIT conversion rulings, blessing private correctional facilities as well as a data center.[7] A number of other proposed REIT conversions have been rumored to be in the works, such as businesses involving outdoor advertising, hospitality, cellular towers and solar power generation. The IRS' moratorium, however, may throw a kink in the growing REIT conversion trend. Also, since there has not been a formal announcement of the IRS position, its scope is unclear.

IRS PROPOSES TO RELAX WASH SALE RULES FOR FLOATING NAV MONEY MARKET FUND SHARE REDEMPTIONS

In Tax Talk 5.4 we reported on Securities and Exchange Commission ("SEC") proposals to require certain money market funds to use a floating net asset value for share purchases and redemptions.[8] In Notice 2013-48,[9] the IRS announced a proposed revenue procedure to limit the scope of the wash sale rules under Section 1091 with respect to certain redemptions of money market fund shares. This guidance comes on the heels of proposed regulations issued in June by the SEC that would alter the rules that govern the prices at which certain money market fund shares are issued and redeemed, such that some funds would no longer retain a stable (typically $1.00) share price. The constant share prices had simplified the tax consequences of transactions involving money market fund shares because a shareholder does not realize gain or loss when a share is redeemed for an amount equal to its basis.

Where the price of shares in the money market fund are permitted to float, redemptions of shares may run afoul of the wash sale rules, which generally disallow a loss realized by a taxpayer on a sale or disposition of shares if, within a period beginning 30 days before and ending 30 days after the date of the sale or disposition, the shareholder acquires substantially identical shares.

Notice 2013-48, however, which addresses redemptions of shares in money market funds with a floating share price, contains a proposed revenue procedure that would give some relief for taxpayers if the SEC proposals are adopted. The proposed revenue procedure provides that where a redemption results in a *de minimis* loss, the IRS will not treat the redemption as part of a wash sale. For purposes of the proposal, a

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de minimis loss means a loss realized on a redemption of a share in a money market fund where the loss is not more than 0.50% of the taxpayer's basis in that share. As a result, under Notice 2013-48, losses derived from redemptions of shares, where the redemption price is slightly (50 basis points) less than the taxpayer's basis, will not be disallowed. Of course, the proposed revenue procedure also shows what happens if the *de minimis* rule does not apply and it's not pretty.

IRS CONFIRMS MEXICAN LAND TRUST IS NOT TRUST UNDER U.S. TAX LAW

In Revenue Ruling 2013-14, the IRS ruled that a Mexican Land Trust ("MLT") did not constitute a trust under U.S. tax law. This recently released public guidance confirms a prior private ruling,[10] providing comfort to taxpayers at large that an MLT would not require them to comply with various (and potentially onerous) U.S. tax rules governing foreign trusts.

By way of background, the Mexican Federal Constitution prohibits non-Mexican persons from directly holding title to residential real property in certain areas of Mexico ("restricted zones"). Non-Mexican persons, however, may hold residential real property located in the restricted zones through an MLT with a Mexican bank after obtaining a permit from the Mexican Ministry of Foreign Affairs.

The ruling describes three factual scenarios of ownership of property located in a designated restricted zone.

In the first scenario, the property is held by the MLT through an arrangement with an LLC organized under state law, which the taxpayer has opted to treat as a disregarded entity. The second situation is the same as the first, but the MLT holds legal title on behalf of a U.S. corporation. Finally, in the third iteration, the taxpayer deals directly with the MLT in its capacity as an individual; no entity is interposed.

Under each scenario, the IRS ruled that the MLT did not constitute a trust under U.S. tax law, which generally defines a trust as an arrangement created by a will or by an inter vivos declaration under which a trustee takes title to property for the purpose of protecting or conserving it for the beneficiaries,[11] because the MLT merely held legal title to the property.

Indeed, central to the IRS' ruling was the fact that the MLT held only legal title to the real property. Upon sale of the property, the MLT was simply required to transfer title, nothing more. On the other hand, the MLT agreement provided that the taxpayer retained exclusive control of the management, operation, renting and selling of the real property, together with an exclusive right to the earnings and proceeds from the real property. The MLT further required the taxpayer to file all tax returns, pay all taxes and satisfy any other liabilities with respect to the real property. Finally, the MLT disclaimed all responsibility for the real property, and it was not required to maintain or defend it.

In short, because the taxpayer retained management and control of the real property, the trustee of the MLT (*i.e.*, the Mexican bank) was a mere agent for the holding and transfer of title to the real property, and the taxpayer retained direct ownership of the real property for U.S. federal income tax purposes.

THIRD CIRCUIT: S CORP FLOW-THROUGH TAX TREATMENT NOT PROPERTY OF DEBTOR UNDER THE BANKRUPTCY CODE

On May 21, 2013, the Court of Appeals for the Third Circuit held that a bankrupt entity's flow-through tax status as a qualified subsidiary of an "S corporation" was not its property and, therefore, was not entitled to bankruptcy court protection.

In *The Majestic Star Casino LLC v. Barden Development, Inc.*, an individual held a 100% interest in Barden Development, Inc. ("BDI"), an Indiana corporation that elected to be treated as an S corporation. In general a corporation that files an "S election" is eligible for passthrough treatment and is not subject to tax at the corporate level. An S corporation can also elect to treat a qualifying 100%-owned subsidiary as a qualified subchapter S subsidiary (a "QSub"), with the result that the subsidiary is disregarded for federal income tax purposes. In this case, BDI indirectly held a 100% interest in Majestic Star Casino II ("MSC II"), a Delaware corporation, and elected to treated MSC II as a QSub. On November 23, 2009, MSC II and other BDI subsidiaries filed for bankruptcy protection under Chapter 11 of the Bankruptcy Code. BDI, however, did not file for bankruptcy, and at the petition date, BDI remained an S corporation and MSC II remained a QSub.

Following the petition date, BDI filed a notice with the IRS to revoke its status as an S corporation, which had

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the collateral effect of terminating MSC II's status as a QSub. According to MSC II, this revocation resulted in a $2.26 million tax bill in the state of Indiana. MSC II subsequently filed an adversary complaint against both BDI and the Internal Revenue Service ("IRS") to restore BDI's status as an S corporation and MSC II's status as a QSub on the theory that the QSub status of MSC II was property of the debtor's estate and, therefore, its transfer was a violation of the automatic stay. The IRS and BDI responded that MSC II's QSub status was not property, that even if it were property, it was not property of MSC II, and that no "transfer" of property occurred when BDI terminated its S election and triggered the loss of MSC II's QSub status.

The bankruptcy court held that MSC II's status as a QSub was property of MSC II and revocation of BDI's S corporation status was void and of no effect.[12] The court ordered BDI and the IRS to take all actions necessary to restore the status of MSC II as a QSub.

The Third Circuit overturned the bankruptcy court on two theories. First, the Third Circuit called into question the decisions of other courts concluding that an election to be treated as an S corporation is property of the debtor.[13] These decisions, the court noted, were based on case law holding that net operating losses ("NOL") of the debtor are part of the debtor's estate. The Third Circuit found the extension of the NOL precedents to the S election untenable and distinguished the two based on the fact that the tax status of an entity is contingent in a way that NOLs are not, and that the value of an S election is dependent upon it not being revoked by its shareholders. Ultimately, the court found that "capacious as the definition of 'property' may be in the bankruptcy context, we are convinced that it does not extend so far as to override rights statutorily granted to shareholders to control the tax status of the entity they own." Finding that status as an S corporation is not "property" for purposes of the Bankruptcy Code, the court concluded that arguing that QSub status is "property" is an even weaker claim.

Second, the court held that, even if QSub status were "property," the property would belong to the S corporation parent, not the QSub debtor because "the corporation retains no real benefit from its tax-free status in that, while there is no entity-level tax, all of its pre-tax income is passed on to its shareholders." The court also noted that "because the desirability of a Subchapter S election depends on the individual tax considerations of each shareholder, the final determination of whether there is to be an election should be made by those who would suffer the tax consequences of it."

Accordingly, the Third Circuit vacated the bankruptcy court's decision.

TREASURY SIGNS FATCA IGAS WITH SPAIN, GERMANY AND JAPAN

In Q2, the U.S. Treasury has again been busy making good on its promise to conclude intergovernmental agreements ("IGAs"). These IGAs represent an intergovernmental approach to implementing FATCA.

In May, the U.S. Treasury signed so-called "Model I" agreements with Spain and Germany. Model I IGAs generally permit a financial institution in the FATCA partner country to provide information on U.S. account holders to its own government, which, in turn, will pass that information to the IRS. In this way, German and Spanish financial institutions will generally not be required to enter into agreements – referred to as an "FFI Agreement" in FATCA parlance – with the IRS (although they will still be required to register their FATCA status with the IRS via an online registration portal, which is supposed to be accessible August 19, 2013).

Moreover, in June, the U.S. Treasury signed a "Model II" agreement with Japan. In contrast to a Model I IGA, the "Model II" IGA between the U.S. and Japan, styled as a "Statement of Mutual Cooperating and Understanding," requires Japanese financial institutions to enter into FFI Agreements with the IRS. The FFI Agreements will generally require Japanese financial institutions to conduct due diligence and report information related to their U.S. accounts directly to the IRS, in order to avoid withholding.

Finally, the U.S. and Switzerland signed a Memorandum of Understanding ("MOU") supplementing the FATCA agreement they signed in February. The MOU generally summarizes the obligations of Swiss financial institutions, states the relationship with the qualified intermediary system and confirms the simplified self-declaration for exempt Swiss beneficial owners under the FATCA agreement.

For copies of the agreements with Japan, Germany, Spain and Switzerland; updated withholding forms (Forms W-8); and a wealth of other FATCA-related resources, see our FATCA website, KNOWFatca (www.KNOWFatca.com).

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STRUCTURED FINANCE TRANSACTION TREATED AS "CONVERSION TRANSACTION," TAXED AS STRADDLE

It should be no surprise that many U.S. taxpayers are looking high and low for "capital gain generators" to offset capital losses suffered during the Financial Crisis. In fact, for taxpayers that recognized their capital losses in 2008, time is running out: corporate taxpayers can only carry over capital losses for five years under Section 1212. A recent IRS Field Attorney Advice ("FAA") shows how one taxpayer tried to address its expiring capital loss problem. From Tax Talk's perspective, the FAA is important because it focuses on tax deductions for payments made pursuant to credit-linked notes ("CLNs") and whether prepaid forward contracts can be recast as "conversion transactions" under Section 1258, resulting in capital gains being recharacterized as ordinary income.

To greatly simplify the facts, the taxpayer ("Parent") and a bank ("Bank") formed a special purpose vehicle ("SPV") that was a U.S. corporation for federal income tax purposes. The Parent owned 80% of the SPV's common stock, which would permit it to include the SPV in its consolidated tax group. The Bank owned the remaining 20% of the SPV's common stock and 100% of its preferred stock. The Bank's ownership of the preferred stock entitled it to consolidate the SPV for financial accounting purposes. The Bank also had a call option to purchase the Parent's 80% stake.

The SPV loaned its capital to one of the Parent's domestic subsidiaries. The loans were in the form of CLNs, each with a 5-year maturity and a floating interest rate. The terms of the CLNs permitted the subsidiary to repay the notes with cash or a specified portfolio of debt instruments ("Reference Portfolio"). On its tax return, the subsidiary deducted the interest payments on the CLNs. The SPV would include the income from the CLNs so that the CLNs' deductions and income were a "wash" under the consolidated return regulations.

The domestic subsidiary took the CLNs' proceeds and entered into prepaid forward contracts with one of the Parent's foreign subsidiaries. At maturity, which coincided with the 5-year term on the CLNs, the domestic subsidiary was entitled to receive a basket of investment-grade debt securities – assets that largely overlapped the Reference Portfolio. The domestic subsidiary did not include income currently on the prepaid forward contracts, relying on the general tax treatment of forward contracts as open transactions. And, when the domestic subsidiary terminated the prepaid forward contracts, it reported a capital gain.

The point of the structure was to generate a capital gain in the domestic subsidiary through termination of the prepaid forward contracts, which would be offset by the Parent consolidated group's expiring capital losses. The SPV would earn a return on the CLNs that would wind up as cash (or the reference debt instruments) when the CLNs were retired. Then, the Bank could buy the Parent's common stock in SPV pursuant to the option. At that point, the Bank could leave SPV in place forever or liquidate it under Section 332.

The IRS concluded that the long forward contract and the embedded short position in the CLNs was a Section 1092 straddle. (Presumably, the underlying reference assets were actively traded.) Thus, the IRS reasoned if the domestic subsidiary received the Reference Portfolio pursuant to the forward contract, it could use the Reference Portfolio to pay off the CLNs. If the forward contract lost value (*i.e.*, the reference assets diminished in value), the domestic subsidiary was protected in that it could take delivery of the assets to pay off the CLNs. As to the interest rate swap with the parent, the IRS reasoned that the domestic subsidiary was protected from rising interest rates (which would cause the floating rate on the CLNs to rise and the forward's reference property to lose relative value). As a result, the domestic subsidiary's risk of loss in the underlying portfolio assets was substantially diminished. Based on these conclusions, the IRS disallowed any deduction for payments on the CLNs and interest rate swaps under Section 263(g).

The FAA next concludes that the forward contract plus CLNs represented a Section 1258 "conversion transaction" as to domestic subsidiary. It reasons that gain on the forward would be offset by a loss on repayment of the CLN, leaving the domestic subsidiary net a time value of money return.

Under the terms of the forward contracts, the domestic subsidiary was entitled to receive interest on the underlying portfolio of assets, as well as the portfolio of assets itself on settlement. Likewise, the SPV was entitled, interest payments and, if the domestic subsidiary chose, delivery of a basket of investment-grade assets. In both cases, the IRS pointed out, the long party was entitled to receive an annual return based on the time value of money and the right to receive a portfolio of securities five years in the future that was equal in value to the amount of money initially transferred at the opening of the transaction. As a result,

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the prepaid forward contracts were recharacterized as conversion transactions, and the capital gain recognized converted to ordinary income.

If the IRS' position were ultimately upheld, the net effect of the FAA seems to be that the taxpayer's capital losses would expire, and the consolidated group would recognize ordinary income from the prepaid forward and interest income on the CLNs. Of course, the FAA cannot be used or cited as precedent and only represents the government's opinion, which the taxpayer is free to dispute.

IRS LIMITS TAXPAYER'S HOLDING PERIOD, DENIES DRD

U.S. corporate taxpayers from time to time enter into stock programs where they acquire a basket of dividend paying stocks and then attempt to enter into a "portfolio hedge" with respect to the basket. The trick is to obey the rules in Regs. Section 1.246-5 that tell taxpayers when the hedge will be treated as an offsetting position that kills the taxpayer's holding period (and eliminates its ability to claim the 70% dividends-received deduction). In recent private guidance,[14] the IRS addressed one aspect of what appears to be such a program.

The taxpayer ("X") and its four consolidated subsidiaries held portfolios of equity securities that paid dividends to X and its subsidiaries. To protect against a downturn in the equity markets, X wrote and purchased cash-settled put and call options on the S&P 500 Index. These positions limited the gains on the equity portfolio but also protected X and its subsidiaries from loss.

Generally, a corporation is entitled to a dividends-received deduction ("DRD") with respect to dividends it receives from domestic corporations subject to income tax. However, no deduction is available if the stock is held for 45 days or less in the 91-day period beginning on the day that is 45 days before the date on which the shares become ex-dividend. Any period during which the risk of loss on the stock is diminished by "holding one or more other positions with respect to substantially similar or related property" does not count toward the holding period requirement. Furthermore, Treasury regulations provide that positions held by parties related to the taxpayers are considered held by the taxpayer "if the positions are held with a view to avoiding the application of [the holding period requirement]." At issue was whether X's position in the S&P options could be treated as held by its subsidiaries, reducing the holding period of the subsidiaries in its equity portfolio and therefore disqualifying the subsidiaries from taking a DRD with respect to the dividends. (Unfortunately, X had already conceded that the S&P options constituted an offsetting position with regard to "substantially similar or related property."[15]

X sought to demonstrate that the S&P option positions were not held "with a view to avoiding" the holding period requirement by presenting evidence that tax considerations were not considered in the establishment of the option program. Furthermore, in redacted text, X presented business reasons for the program.

The IRS, however, found that, notwithstanding any business reasons for entering into the hedging strategy, X knew about the offsetting positions and entered into the hedges in order to diminish the risk of loss on the equity portfolios held by it and its subsidiaries. The IRS concluded that this was sufficient to demonstrate that the positions were held with a view to avoiding the application of the holding period requirement.

IRS DISALLOWS DRD ON SUBSTANCE OVER FORM GROUNDS

CCA 201320014 exposes an oft-forgotten (even by Tax Talk) tax rule: section 245. That section provides that a U.S. corporation is entitled to a dividends-received deduction for dividends received from a foreign corporation in certain circumstances. For the special rule to apply, (i) the U.S. corporation must own at least 10 percent of the foreign corporation's stock by vote or value, and (ii) only the U.S. source portion of the dividend qualifies for the DRD. The U.S. source portion is the percentage of the foreign corporation's earnings either (i) effectively connected with a U.S. trade or business or (ii) consisting of dividends received from a U.S. corporation 80% owned by the foreign corporation. It seems the taxpayer in CCA 201320014 tried to exploit this latter provision by using a "flow through" U.S. corporation whose dividends were not subject to U.S. withtholding tax.

The taxpayer in the CCA was the common parent of a consolidated group. As part of its business, the taxpayer's operating subsidiary received significant amounts of cash collateral from its customers. Prior to the transactions at issue, the subsidiary would routinely invest the collateral in high-grade liquid assets and would retain the difference between the amounts earned on the investments and the amounts payable to customers.

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According to the CCA, the taxpayer decided that it could earn a better after-tax return on these investments if it routed the money through a series of entities, the increase in yield equaling the amount of U.S. tax savings. What it did was invest the money in a controlled foreign corporation ("CFC") that in turn invested the money in stock of a U.S. regulated investment company ("RIC"). The CFC owned at least 80% of the RIC's stock. To avoid current inclusion of the income under subpart F, the taxpayer sold the CFC's stock before the end of the taxable year. Gain on the sale was treated as a dividend under section 1248.

This structure, if respected, would reduce the tax liability on the interest attributable to the high-grade securities by 80 percent, the amount of the DRD generated by the distribution, without giving rise to any additional tax. Importantly the RIC's dividends to the foreign subsidiary would be free of withholding tax. Generally, a dividend by a U.S. corporation to a foreign shareholder is subject to a 30 percent withholding tax. However, there is an exception to this withholding tax for interest-related dividends paid by RICs to foreign shareholders. This exception exists because interest earned by foreign shareholders is generally free from U.S. withholding tax, and the Code seeks to put foreign shareholders in a RIC that invests in debt in the same position as if the foreign shareholders had invested in the debt directly.

The CCA concludes that the taxpayer was not entitled to the DRD on substance over form grounds, arguing that the transaction lacked a valid business purpose. Notably, the IRS did not argue in the CCA that the transaction was outside the literal meaning of the Code. Instead, the IRS determined that the transaction circumvented the intent of the CFC, DRD and RIC rules and found that the transaction lacked a valid business purpose: "Although investing the Customer Funds served a business purpose, routing the investment and investment returns through [the foreign subsidiary] and RIC did not serve a meaningful business purpose. Rather, the indirect investment strategy was a contrivance to avoid U.S. federal income tax."

ACQUISITION OF MEDIUM TERM NOTES BY FOREIGN BANK'S U.S. BRANCH ELIGIBLE FOR "10% RULE"

A recent IRS technical advice memorandum ("TAM") addressed the source of interest from medium term notes ("MTNs"), which were acquired by the U.S. branch of a foreign bank solely to be posted as collateral to access the Federal Reserve Bank Discount Window and secure funding for its U.S. banking business.[16]

In the TAM, a foreign bank, through its domestic branch, engaged in a banking business in the United States. As part of its business, the branch made loans to the public, which the foreign bank held for its own accounts and not for sale. The branch also solicited and negotiated various liquidity and credit-support commitments with U.S. counterparties. To maintain these commitments, the foreign bank was required to provide liquidity and credit support to the counterparties. The outstanding commitments, however, exposed the foreign bank to significant liquidity risk. To manage these risks, the foreign bank's domestic branch was required to maintain access to the Federal Reserve Bank Discount Window. It did so by posting collateral in the form of MTNs acquired from various commercial banks on the interbank market.

The key question the IRS analyzed was whether the entire amount of interest derived from the MTNs was effectively connected with the conduct of a U.S. banking business, or whether the interest income could be allocated between effectively connected and non-effectively connected income under the so-called "10% rule."[17] Under U.S. tax law, income earned in connection with a U.S. trade or business is generally subject to U.S. taxation. On other hand, income that is not effectively connected with a U.S. trade or business is subject to 30% withholding, which is usually substantially reduced, either by treaty or, in this case, possibly the exemption from withholding for portfolio interest.

As a threshold matter, the IRS determined that the foreign bank, through its domestic branch, had engaged in a banking business in the U.S. However, to determine whether the income earned on the MTNs was effectively connected with this business, the IRS had to first assess whether the MTNs were acquired, (1) as a result of, or in the course of making loans to the public; (2) in the course of distributing them to the public; and (3) for the purpose of satisfying the reserve requirements established by the U.S. banking authorities. If the answer to each of these questions was no (*i.e.*, the MTNs did not fall into any of the three categories), then the interest income would be allocated under the residual 10% rule. As such, only a portion of the interest would be effectively connected income and subject to U.S. taxation.

The IRS ultimately concluded that the income could be allocated under the 10% rule. In reaching this conclusion, the IRS found that the MTNs had been purchased solely as collateral, not in the course of making loans to the public. The IRS also concluded

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that the MTNs were not purchased for the purpose of distribution to the public, as the foreign bank did not act as an underwriter or market maker with respect to the MTNs and, after purchasing them, did not distribute them. Finally, the IRS ruled that the MTNs could not satisfy the reserve requirements under applicable banking regulations and, as a result, the MTNs were not acquired for the purpose of meeting such reserve requirements. Thus, the MTNs fell into the residual category and any interest could be allocated under the 10% rule.

U.S. DISTRICT COURT FINDS TAX OPINION CONDITION COULD NOT HAVE BEEN MET IN MBIA V. PATRIARCH PARTNERS

Many contracts require tax opinions as a precondition for a party to take an action or refrain from taking an action. On June 10, 2013, the U.S. District Court for the Southern District of New York decided *MBIA v. Patriarch Partners*[18] in part on whether a debt-equity tax opinion could have been rendered. The case involved a complicated securitization transaction where Patriarch (an investment manager) agreed to manage a series of collateralized debt obligation ("CDO") trusts whose bonds were insured by bond insurer MBIA. In exchange, Patriarch agreed to contribute subordinated notes (the so-called Class B Notes) from a new Patriarch-sponsored CDO to one or more of the CDO trusts but only if certain conditions were met. The conditions included that the Class B Notes be rated at least investment grade and that they "shall" be treated as debt for federal income tax purposes. The district Court found, in a 151-page opinion after a two week trial involving 13 witnesses, that neither condition was met.

MOFO IN THE NEWS

MoFo partner Jeremy Jennings-Mares and MoFo senior counsel Jerry Marlatt spoke at the IFLR European Capital Markets Forum 2013 in London on April 9, 2013. This forum provided a fundamental platform for discovering new opportunities, while conveying key information to a market that is hungry to keep up with rule-making. Jeremy Jennings-Mares chaired a panel called "Roundtable: Regulation in 2013/2014" and Jerry Marlatt chaired a panel called "Securitisation: Winning Back Confidence."

On April 10, 2013, MoFo counsel Melissa Beck, MoFo senior counsel Jerry Marlatt and MoFo partner Anna Pinedo gave a West LegalEd webcast titled "Foreign Banks Issuing Covered Bonds into the U.S." The webcast discussed how, despite the sovereign crisis and heightened volatility, the covered bond market remains very attractive and foreign banks continue to access the U.S. markets with covered bond offerings. The webcast addressed the market environment, the legal and regulatory considerations and the process for an exempt offering by a foreign issuer in the fourth and final briefing of a four-part series on international banking.

MoFo partners Anna Pinedo, James Tanenbaum, Thomas Humphreys, Oliver Ireland, Remmelt Reigersman and David Kaufman gave a seminar in Charlotte titled "Financial Services: A Glimpse into the Future" on April 11, 2013. This seminar was comprised of four different sessions and featured the following topics: "Capital Developments and Developments Related to Financing Financial Institutions," "Title VII Derivatives Update," "Tax Developments Affecting Financial Products" and "Regulatory and Enforcement Trends."

On April 15, 2013, MoFo partners Anna Pinedo and David Lynn spoke at PLI's "Private Placements & Other Financing Alternatives 2013." At the talk, a faculty of leading practitioners and regulators analyzed current developments in private placements and hybrid financing transactions, including changes brought about by the adoption of the JOBS Act. Anna Pinedo, who was the program chair, gave an introduction to private placements and hybrid financings and partner David Lynn spoke on a panel titled "Staying Private, Private Secondary Markets and Using the Internet."

At a BBA Seminar on April 15, 2013 titled "FATCA for Small Banks – Breakfast Briefing," MoFo partner Thomas Humphreys and MoFo associate Sonia Girgis spoke on how the U.S. Foreign Account Tax Compliance Act will take effect from January 2014, making substantial changes to information reporting and compliance requirements for offshore accounts. This focused briefing enabled small banks to effectively address FATCA's most critical challenges before the rules take effect and provided an update on the regulation and guidance on what FATCA compliance involves.

MoFo partner Anna Pinedo gave an IFLR webcast titled "New Bank Capital Rules–Are CoCos the Answer?" on April 17, 2013. The webcast discussed how financial institutions in Europe and the U.S. are considering a range of products to address their funding needs in an environment in which it is still not known which products will receive beneficial regulatory capital treatment. The

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webcast also addressed guidance provided by national regulators on additional or so-called buffer capital, as well as contingent capital products.

On April 18, 2013, MoFo partners Anna Pinedo, Ze'-ev Eiger and David Lynn gave a West LegalEd webcast titled "Foreign Banks Registering with the SEC." The webcast discussed how foreign banks seeking to diversify their financing opportunities may consider SEC registration. The session focused on the registration process; disclosure considerations for financial institutions; and compliance, governance and ongoing reporting.

MoFo senior counsels Kenneth Kohler and Jerry Marlatt and MoFo counsel Melissa Beck gave a webcast titled "U.S. Issuances of Asset Backed Securities by Non-U.S. Issuers" on April 24, 2013. The webcast discussed how, as the U.S. capital markets continue to gain relative strength and long-standing regulatory uncertainties are resolved, non-U.S. ABS and covered bond issuers are increasingly inquiring about the prospects for selling their securities into the U.S. For some issuers, this would be their first foray into the U.S. markets; for many, it would represent a return to the U.S. after a long hiatus occasioned by the financial crisis.

On May 1, 2013, MoFo partner Anna Pinedo spoke at the SVO Educational Seminar for the Valuation of Securities Task Force. Anna Pinedo gave a presentation to the NAIC's Valuation of Securities Task Force that focused on Dodd-Frank and systemic risk. The presentation addressed the current status of the Dodd-Frank Act and whether or not managing systemic risk in relation to financial institutions is an attainable possibility.

MoFo counsel Jim Schwartz and Bank of America's Robert Dilworth gave a PLI webcast titled "SEC's Extension of Exemptions for Security-Based Swaps." Among its many important changes to the legal landscape, the Dodd-Frank Act defined the term "security" to include security-based swaps. The SEC has taken a deliberative approach in relation to the effects of this change and recently extended until February 2014 the expiration date of certain temporary exemptions and interim final rules that the SEC previously promulgated in relation to the regulation of security-based swaps as securities.

On May 2-3, 2013, MoFo partner Anna Pinedo spoke at the Structured Products Americas Conference in Miami. Anna Pinedo participated in a roundtable that dealt with the following questions: What is the outlook for volatility in the U.S.? Which have been the preferred underlyings? Capital at risk – Are some issuers still preferred because their credit is weaker/lower-rated/wider? How has regulation affected the way you do business?

On May 7, 2013, MoFo partner Remmelt Reigersman led a Structured Thoughts Master Class in New York on Taxation. This class focused on the taxation of structured products and emerging tax developments.

MoFo partner Jay Baris, MoFo counsel Kelley Howes and Bank of America's Lauren Mullen gave a seminar on May 14, 2013 entitled "Exchange-Traded Funds: Issues for 2013." This seminar was designed as a primer on exchange-traded funds.

On May 21, 2013, MoFo counsel Brad Berman gave a Structured Thoughts Master Class in New York on ETNs. The class focused on procedures necessary for setting up an ETN platform.

MoFo partners Anna Pinedo and David Kaufman gave an IFLR webcast on May 21, 2013 titled "Dodd-Frank Act Title VII Update." As we near the third anniversary of the passage of the Dodd-Frank Act, many of the principle elements of the regulatory framework for OTC derivatives in the United States have been finalized. Given the need for many interpretive releases and no-action or exemptive relief, and various implementation delays, market participants are still grappling with new requirements. This presentation provided an update on these topics.

MoFo was a sponsor of ICMA's Annual General Meeting and Conference 2013 on May 22-24, 2013, in Copenhagen, Denmark. The International Capital Markets Association's Annual General Meeting and Conference is a long-established and internationally respected event for the global debt capital markets, bringing together the global financial community to discuss market and regulatory developments.

MoFo partner Anna Pinedo spoke at the mtn-i Americas Structured Note Showcase & Awards on May 23, 2013, in Miami. Anna Pinedo participated in the Structured Note Leadership Forum and hosted "Regulation Round-Up," a presentation focusing on the latest developments in regulation of structured products.

MoFo partners Jay Baris, Anna Pinedo and David Lynn gave a seminar on May 28, 2013, titled "Use of Social Media for Issuers, Broker-Dealers and Advisers, and Investment Companies." Recently, regulators provided some additional guidance regarding the use of social media channels to disseminate issuer information. FINRA and the Commission also have been focused on the use of social media by registered broker-dealers, and by investment advisers. This session attempted to provide

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some clarity as to the recent guidance from regulators about financial institutions' use of social media.

On May 30, 2013, MoFo partner Charles Horn and MoFo counsel Jim Schwartz gave a PLI webcast titled "Basel III and Derivatives Exposures: Understanding the Regulatory Capital Effects." This program focused on the treatment of derivatives and related counterparty exposures under expected new capital rules.

MoFo partner Jay Baris, MoFo senior counsel Jerry Marlatt and MoFo counsel Jim Schwartz led a West LegalEdcenter webcast on June 4, 2013, titled "Are You a Commodity Pool Operator? And, is it Curable?" The Dodd-Frank Act amended the definition of "commodity pool" making it broader by including any enterprise operated for the purpose of trading in swaps. The CFTC has issued various interpretive letters clarifying that certain entities (such as business development companies, family offices, equity REITs, etc.) that might inadvertently be included within the "commodity pool" definition should not be considered commodity pools to the extent that these entities satisfy specified CFTC conditions for relief. This session focused on providing an update as to CPOs and Title VII of Dodd-Frank.

On June 5, 2013, MoFo partners Anna Pinedo and David Lynn spoke in New York City at PLI's Global Capital Markets & the U.S. Securities Laws 2013: Raising Capital in an Evolving Regulatory Environment. This program focused on domestic and international regulatory and market developments, bringing together an engaging group of expert practitioners and senior regulators for an in-depth look at how the U.S. securities laws work in the context of a rapidly evolving global regulatory environment. David Lynn chaired the program and Anna Pinedo spoke on a panel titled "Hot Topics in Capital Markets."

At the 24th Annual Conference on the Globalisation of Investment Funds in Boston on June 9-11, 2013, MoFo partner Jay Baris spoke on a panel entitled "At What Cost Do We Achieve Investor Protection?"

MoFo partners Lloyd Harmetz and Remmelt Reigersman spoke at the 2nd Annual North American Structured Products Conference in Boston on June 12, 2013. Remmelt Reigersman led a breakfast briefing focusing on the taxation of financial products. Lloyd Harmetz delivered a presentation titled "Disclosure of Estimated Value of Structured Notes at Issuance: Where Do We Stand Now?"

On June 12, 2013, MoFo senior counsel Jerry Marlatt and Ben Colice of RBC Capital Markets spoke at the 2013 California Association of County Treasurers and Tax Collectors Annual Conference in Monterey on a panel entitled "Covered Bonds, Asset Backs and the State of the GSE's/Regulations."

On June 13, 2013, MoFo partner Peter Green spoke in London at EMIR Implementation: Theoretical and Practical Guidance. The seminar focused specifically on updates relating to implementing central clearing for standardized derivative products, execution on multilateral trading facilities/swap execution facilities and reporting to trade repositories/swap data repositories. Peter Green lead a session titled "Regulatory Reporting Obligations." He also spoke on a panel titled "Are Clearing Houses Too Big to Fail?"

MoFo partner Anna Pinedo and MoFo counsel Jim Schwartz gave a PLI webcast titled "Considerations for End-Users of Derivatives" on June 20, 2013. The webcast discussed how derivatives market participants are becoming subject to a series of regulatory requirements related to clearing, trade reporting and record-keeping and how even occasional corporate end-users of derivatives will have to prepare to comply with certain of these new obligations.

On June 26, 2013, MoFo senior counsels Jerry Marlatt and Kenneth Kohler gave a PLI webcast titled "The Return of Structured Finance and Residential MBS." The webcast discussed how, as the U.S. capital markets continue to gain relative strength and long-standing regulatory uncertainties are resolved, ABS and MBS issuers are increasingly inquiring about the prospects for entering these markets once again. The years since the financial crisis have brought sweeping changes in the rules affecting structured finance in the U.S., and more changes are on the way. This program provided an overview of the principal U.S. regulatory and market developments for ABS and MBS issuers in the U.S.

AWARDS

On April 16, 2013, Morrison & Foerster was recognized for its leadership in financial regulatory matters and named Law Firm of the Year by *Operational Risk & Regulation* magazine. The firm was recognized for the breadth of its financial services and regulatory expertise. The firm's ability to assist North American, European and Asian financial institutions with domestic and European regulatory issues was noted in the editorial. The magazine noted that, "Clients describe Morrison & Foerster as 'totally tied in' to what's happening in Washington and around the world. Its FranknDodd.com website has given clients a resource that they can log into at any time to get the most recent updates on US regulation."

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On May 13, 2013, mtn-i announced that Morrison & Foerster was awarded the honor of "Legal Leader" at its 2013 Americas Awards. In connection with the award, mtn-i commended Morrison & Foerster for its commitment to the structured products industry and for its innovation in product development. The award also recognized the firm's long-standing commitment to education, citing the development of various client websites, publications and other thought leadership materials, all of which assist financial institution clients address the challenges posed by recent regulatory reforms.

On June 13, 2013, Morrison & Foerster was recognized for its leadership and innovation in the structured products industry by *StructuredRetailProducts.com*, which awarded the Firm "Best Law Firm in the Americas" for the second straight year at the 2nd Annual North American Structured Products Conference in Boston. Morrison & Foerster was honored for its service to the structured products industry, both through development of new, innovative products on behalf of clients, as well as educating the industry on developing trends and regulatory issues.

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1 2013 U.S. LEXIS 4935.

2 *National Federation of Independent Business v. Sebelius*, 132 S. Ct. 2566 (2012).

3 Please see our client alert at http://www.mofo.com/files/Uploads/Images/130712-IRS-Delays-FATCA-Implementation.pdf

4 *See* Form 8-K of Iron Mountain Incorporated (June 6, 2013), at http://www.sec.gov/Archives/edgar/data/1020569/000110465913047462/a13-14537_18k.htm.

5 *See* Form 8-K of Equinix, Inc. (June 6, 2013), at http://www.sec.gov/Archives/edgar/data/1101239/000119312513250426/d550972d8k.htm.

6 *See* Form 8-K of Equinix, Inc. (June 6, 2013), at http://www.sec.gov/Archives/edgar/data/1101239/000119312513250426/d550972d8k.htm.

7 *See* PLR 201317001 (April 26, 2013), PLR 201320007 (May 17, 2013), PLR 201314002 (April 5, 2013).

8 http://www.mofo.com/files/Uploads/Images/130125-MoFo-Tax-Talk.pdf

9 Notice 2013-48, 2013-31 I.R.B. 1.

10 PLR 201245003 (July 30, 2012).

11 Treas. Reg. section 301.7701-4(a).

12 *The Majestic Star Casino, LLC v. Barden Development, Inc.*, 466 B.R. 666 (Bankr. D. Del. 2012).

13 *See, e.g., In re Trans-Lines West*, 203 B.R. 653 (Bankr. E.D. Tenn. 1996).

14 Internal Revenue Service Memorandum, Release Number 20131902F.

15 *See* Treas. Reg. 1.246-5; 1.246-5(c).

16 TAM 201325012 (June 21, 2013).

17 *See* Treas. Reg. § 1.864-4(c)(5)(ii)(b)(3). In short, the 10% rule requires a foreign taxpayer to multiply its U.S. source interest (*e.g.*, interest from the MTNs) by a fraction to determine the amount of interest treated as income effectively connected with its U.S. banking business. The fraction's numerator is 10%, hence the "10% rule." The denominator, however, is a percentage, comprised of the ratio of the monthly average for the taxable year of the book value of the total securities held by the U.S. branch to the book value of the total assets of the U.S. branch.

18 2013 U.S. Dist. LEXIS 81473.

About Morrison & Foerster

We are Morrison & Foerster — a global firm of exceptional credentials. Our clients include some of the largest financial institutions, investment banks, Fortune 100, technology and life science companies. We've been included on *The American Lawyer*'s A-List for 10 consecutive years. *Chambers Global* named MoFo its 2013 USA Law Firm of the Year. Our lawyers are committed to achieving innovative and business-minded results for our clients, while preserving the differences that make us stronger.

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Because of the generality of this newsletter, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations.

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