STRUCTURED FINANCE ASSOCIATION

On November 25, SFA submitted comments to the "Guidance on the Transition from Interbank Offered Rates to Other Reference Rates," published by the Department of Treasury ("Treasury") and the Internal Revenue Service (the "IRS") in the Federal Register on October 9, 2019 (the "Proposed Regulations").

The Proposed Regulations provide guidance on the tax consequences of the transition to the use of reference rates other than interbank offered rates ("IBORs") in debt instruments and non-debt contracts. Under the Proposed Regulations, an alteration of the terms of a debt instrument to replace a rate referencing an IBOR with a "qualified rate" and any "associated alteration" is not treated as a modification, and therefore does not result in an exchange of the debt instrument for purposes of Treas. Reg. § 1.1001-3. Similarly, a modification of the terms of a non-debt contract to replace a rate referencing an IBOR with a "qualified rate" and any "associated modification" is not treated as a deemed exchange of property for other property differing materially in kind or extent for purposes for purposes of Treas. Reg. § 1.1001-1(a).

SFA used the opportunity for comment on these important Proposed Regulations to request that Treasury and the IRS provide the following:

- Further clarification that the activation of fallback rates will avoid taxable exchange treatment under Section 1001 of the Code;

- Clarification of the application of the Substantial Equivalence Requirement in Prop. Treas. Reg. § 1.1001-6(b)(2), including the application of the Historical Average Safe Harbor and the Arm's Length Safe Harbor;

- Clarification on the application of the Substantial Equivalence Requirement to one-time payments;

- Further clarification on the character and source of one-time payments, specifically: (a) explicitly providing that one-time payments by U.S. issuers are exempt from U.S. federal withholding tax; and (ii) whether the payment is treated first as payment of accrued interest and then as a return of principal, or whether the payment would be accounted for as OID over the remaining post-transition term of the instrument; and

- Further clarification regarding REMICs.

While a large number of very important issues remain to be addressed as the markets evolve away from LIBOR, SFA is hopeful that this guidance is one small but helpful step of the transition.