Internal Revenue Service

Department of the Treasury

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LEGEND

Taxpayer	=
Trustee	=
Broker	=
Stock	=
State A	=
State B	=
Date 1	=
Date 2	=
X	=
Y	=
Amount 1	=
Amount 2	=

Dear

This is in reply to a letter dated April 5, 2002, submitted by your authorized representative, requesting a ruling that certain identified short sales with respect to Stock will continue to fall within the exception to section 1259 of the Internal Revenue Code provided in section 1001(d)(2) of the Taxpayer Relief Act of 1997 (Public Law 105-34).

FACTS

Taxpayer is a limited partnership organized under the laws of State A to engage in investment activities. Taxpayer has sought to protect its assets by, among other things, diversifying its assets. In order to help achieve diversification, Taxpayer executed short against the box transactions with respect to Stock held by Taxpayer.

During the period beginning on Date 1 and ending on Date 2, Taxpayer executed X separate short sales in respect of Y shares of Stock (the Short Sales). These transactions were short against the box transactions because Taxpayer also owned Y shares of Stock at the time it entered into the Short Sales. Trustee, a banking organization chartered under the laws of State B that engages in the trust business, held the Y shares owned by Taxpayer in a custody account maintained on behalf of Taxpayer. Taxpayer represents that before the close of the 30-day period beginning on August 5, 1997, Trustee, as investment manager and on behalf of Taxpayer, clearly

identified the Y shares of Stock and the Short Sales in its books and records as offsetting positions. Trustee continues to hold the Y shares of Stock on behalf of Taxpayer and Taxpayer has not delivered shares to close the Short Sales.

In order to effect the Short Sales, Taxpayer established a securities trading account (Margin Account) with Broker so that Taxpayer could execute purchases and sales of securities through Broker and borrow cash on margin from the Broker. Broker charges interest on any borrowings by Taxpayer from the Margin Account.

Broker, acting at the direction and on behalf of Taxpayer, entered into a series of securities lending agreements with third parties (the Lenders) for the total Y shares of Stock that were sold short. Cash collateral in an amount equal to the current fair market value of the borrowed shares had to be posted with the Lenders. On behalf of Taxpayer, Broker posted the required cash collateral with the Lenders. Broker received the Lender's Rebate on the collateral posted and then credited Taxpayer with the Rebate less an amount retained by Broker as a fee. (Taxpayer was also required to post with Broker the same number of shares as were sold short. This was accomplished by having Taxpayer transfer the shares to the custody account maintained on behalf of Taxpayer by Trustee.)

After the shares were transferred from the securities lender to Broker, Broker sold the shares in the capital markets and deposited the short sale proceeds in the Margin Account. If at any time the Lenders require more collateral, Broker must post the collateral on behalf of Taxpayer. If, at the time the collateral is posted, the amount of required collateral is more than the cash in the Margin Account, the difference is deemed a loan by the parties from Broker to Taxpayer. As noted above, Broker charges interest on such loans.

Broker proposes to change the interest rate on the Margin Account borrowings as well as the fee Broker retains from the Lender's Rebate. Broker has proposed to fix the interest charged on margin borrowings at the federal funds rate less Amount 1 basis points and to pass along the Lender's Rebate based on the federal funds rate less Amount 2 basis points.

LAW AND ANALYSIS

Section 1001(d)(2) of the Taxpayer Relief Act of 1997 (the effective date provision) provides an exception to section 1259 for sales of positions, etc. held before June 9, 1997 if, before June 9, 1997, the taxpayer entered into any transaction which is a constructive sale of any appreciated financial position, and before the close of the 30-day period beginning on August 5, 1997, such transaction and position are clearly identified in the taxpayer's records as offsetting. The exception ceases to apply as of the date such transaction is closed or the taxpayer ceases to hold the position. The legislative history of section 1259 explains that the effective date provision prevents any identified transaction or position from being taken into account in determining whether a

constructive sale after June 8, 1997 has occurred. S. REP. NO. 949, 105th Cong., 1st Sess. 122 (1997), H. R. REP. NO. 2014, 105th Cong., 1st Sess. 438 (1997).

Section 1.1233-1(a) of the Income Tax Regulations provides that a short sale is not deemed to be consummated until delivery of property to close the short sale.

Taxpayer represents that it identified both the Y shares of Stock and the Short Sales as offsetting positions as of the date indicated in the effective date provision. At this time, Trustee still holds the Y shares of Stock on behalf of Taxpayer and Taxpayer has not delivered shares to close the Short Sales.

Because Taxpayer has not closed the Short Sales and Trustee continues to hold the Y shares of Stock on behalf of Taxpayer, the Short Sales and the Y shares of Stock still fall within the effective date provision of section 1259. The changes to the interest rate charged on the Margin Account and the fee retained by the Broker will not cause either the Y shares of Stock or the Short Sales to be taken into account in determining whether a constructive sale has occurred under section 1259.

CONCLUSION

Based on the facts submitted and representations made by Taxpayer, the Short Sales will continue to fall within the exception to section 1259 provided in section 1001(d)(2) of the Taxpayer Relief Act of 1997.

Except as specifically ruled upon, no opinion is expressed as to the federal tax treatment of the above transaction.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) 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 Taxpayer's authorized representative.

Sincerely yours,
PATRICK E. WHITE
Assistant to the Chief, Branch 1
Office of Associate Chief Counsel
(Financial Institutions & Products)

Enclosures:
Copy of this letter
Section 6110 Copy