

Part III - Administrative, Procedural, and Miscellaneous

Treatment of Fails Charges for purposes of sections 871, 881, 1441 and 1442

Notice 2009-61

In response to persistent delivery failures in the pay-for-delivery market for U.S. Treasury securities (U.S. Treasuries) during the fall of 2008, a new trading practice governing failed deliveries of U.S. Treasuries has been voluntarily adopted by many market participants (including the Federal Reserve Bank of New York and most dealers, custodians, and asset managers of U.S. Treasuries).

Under the new practice, if one party (the “Failing Party”) fails to deliver U.S. Treasuries to another party (the “Non-Failing Party”) by the date previously agreed to by the parties, the Failing Party will pay an amount (called a “Fails Charge”) to the Non-Failing Party. The Fails Charge accrues daily and, if properly claimed by the Non-Failing Party, is due and payable in the month following the month in which the Failing Party actually delivers the promised U.S. Treasury.¹ The new Fails Charge practice was adopted by market participants to preserve and enhance the efficiency of the secondary market for U.S. Treasuries by reducing the incidence of delivery failures,

¹ More information about this new Fails Charge trading practice can be found at <http://www.newyorkfed.org/tmpg/> or <http://www.ny.frb.org/tmpg/newsandevents.html>

especially in low interest rate environments, where the economic incentive to deliver timely is reduced.

Many market participants have indicated that there is a lack of clarity regarding the treatment of these Fails Charges for purposes of sections 871, 881, 1441, and 1442 of the Internal Revenue Code (the "Code"), which relate to gross-basis taxation of foreign persons not otherwise subject to U.S. net-basis taxation. As a result, these market participants suggest that unless guidance is provided, there may be disruptions in the secondary market for U.S. Treasuries as various withholding agents take various positions with respect to the proper characterization of Fails Charges for those purposes.

This notice announces that the Treasury Department and the Internal Revenue Service (Service) are considering issuing guidance regarding the circumstances, if any, in which Fails Charges are subject to U.S. gross-basis taxation. Any such guidance regarding the treatment of a Fails Charge under sections 871, 881, 1441, and 1442 of the Code will be prospective in effect. In light of the complexity of the issues raised by the proper treatment of Fails Charges for U.S. federal tax purposes and the need for guidance, the Service will not challenge a position taken by a taxpayer or a withholding agent that a Fails Charge that is paid on or before December 31, 2010, is not subject to U.S. gross-basis taxation unless contrary guidance has been issued effective before that date.

DRAFTING INFORMATION

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