

**Internal Revenue Service**

Department of the Treasury  
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Refer Reply To:  
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Date:  
September 4, 2009

**Legend:**

- Exchange =
- Exchange's Predecessor =
- Parent =
  
- Clearinghouse =
- Securities Commission =
- Country =
- State A =
- Province A =
- Commodities =
  
- Exchange Participants =
  
- Treaty =

Date 1 =  
Date 2 =  
Date 3 =  
Date 4 =  
Date 5 =  
Year 1 =

Dear :

This is in reply to a letter dated November 30, 2007, and subsequent correspondence dated March 24, 2008, April 9, 2008, and June 25, 2008, requesting a ruling that Exchange is a “qualified board or exchange” within the meaning of section 1256(g)(7)(C) of the Internal Revenue Code.

**Facts:**

Exchange was founded in Year 1 as a cash market, followed shortly by forward, futures, and option markets. On Date 2, Exchange incorporated under the provisions of The Corporations Act (Province A) as a for-profit, share capital corporation. Exchange is a subsidiary of Parent, a State A publicly traded corporation that was incorporated on Date 1. On Date 5, Exchange converted its trading platform from open outcry to electronic trading.

Exchange is a commodity futures exchange which facilitates trading in futures and options contracts in Commodities. Exchange is governed by The Commodity Futures Act (Province A) (“CFA”), which is under the mandate of the Securities Commission. Under the CFA, Exchange became recognized as a commodity futures exchange and as a self-regulatory organization on Date 3.

Both Exchange and Clearinghouse are registered with and supervised by the Securities Commission to ensure compliance with the CFA. All transactions on Exchange are cleared through Clearinghouse, which is responsible for all matters relating to Exchange contracts and acts as the counterparty to every buyer and seller after the trades are accepted for clearing.

Exchange's annual accounting period is the calendar year and its overall method of accounting is the accrual method.

In a letter dated Date 4, the CTFC granted no-action relief to Exchange's Predecessor, allowing United States members to trade through Exchange's electronic trading and matching system, notwithstanding that Exchange was not designated as a contract market pursuant to sections 5 and 5a of the Commodity Exchange Act. Exchange represents that this no-action relief is in full force and effect with respect to Exchange.

On November 2, 2006, the CFTC published in the Federal Register a Statement of Policy that affirmed the use of the no-action process to permit foreign boards of trade to provide direct access to their electronic trading systems to U.S. members or authorized participants without seeking designation under the Commodity Exchange Act as a contract market. In the policy statement, the CFTC endorsed the scope of the review under the no-action process, which in part, it described as follows:

The scope of review that was established by Commission staff in the DTB no-action letter and refined in subsequent no-action letters focuses on establishing the "bona fide" status of the foreign board of trade and finding that no public interest would be adversely affected by persons in the U.S. directly accessing the foreign board of trade.

In general, staff reviews information and representations provided by the applicant that relate to, among other things, the rules and structure of the applicant exchange (with an emphasis on the exchange's financial integrity, market surveillance, trade practice and rule enforcement regime), various system integrity protections that govern the foreign board of trade's electronic trading system (using as a template the *1990 Principles for the Oversight of Screen-Based Trading Systems*), the system's related clearing and customer default protections, and information concerning the regulatory structure in the applicant's jurisdiction, with a specific emphasis on market regulation. The staff also reviews the adequacy of information sharing with the Commission by the market and its regulator. Based upon its review of the documents and representations submitted by the applicant, and subject to compliance with various conditions (*e.g.*, representations governing access to books and records and the appointment of a U.S. agent for service of process), staff might conclude that granting no-action relief would not be contrary to the public interest.

Essentially, as it has evolved, the staff review seeks to determine that the applicant foreign board of trade is subject to governmental authorization, appropriate rules prohibiting abusive trading practices, and continuing oversight by a regulator that has powers to intervene in the

market and share information with the Commission. This review generally reflects the internationally accepted approaches used by many developed market jurisdictions to govern access to foreign electronic exchanges. These approaches generally are based upon a review of, and ongoing reliance upon, the foreign market's "home" regulatory regime, and are designed to maintain regulatory protections while avoiding the imposition of duplicative regulation.

The Commission finds that the staff review appropriately addresses the Commission's concern that relief will only be granted with respect to *bona fide* foreign boards of trade. The Commission also finds that the staff's review of foreign board of trade representations and the related information submitted with respect to system integrity, clearing procedures and default protections is appropriately focused and respects the prohibitions of section 4(b). Finally, the various terms and conditions that have been imposed in the no-action letters have been reasonably and appropriately tailored to the factual circumstances raised by the applications for no-action relief.

Boards of Trade Located Outside of the United States and No-Action Relief From the Requirement To Become a Designated Contract Market or Derivatives Transaction Execution Facility, 71 Fed. Reg. 64,443, 64,446-47 (Nov. 2, 2006) (footnotes omitted).

Exchange makes the following representations.

- (1) Exchange has satisfied, and continues to satisfy, all CFTC conditions necessary to retain its no-action relief from contract market designation.
- (2) All Exchange contracts are subject to a system of marking to market whereby gains are credited to accounts and losses are subjected to margin calls on a daily basis.
- (3) Under Article XXVII of the Treaty, the Internal Revenue Service (the Service) may gain access to information held by Exchange with respect to U.S. taxpayers.
- (4) Exchange will maintain an agent for service within the United States, to receive and accept any request for information, summons or subpoena from the Service or from any grand jury properly convened within the United States, which is related to the taxation of transactions in futures contracts traded on Exchange by any person.
- (5) The supplying by the Exchange of its records to a U.S. grand jury or to the Service will not be a violation of, or inconsistent with, the law of Country.

(6) Exchange will retain its records respecting derivatives trading on Exchange for a minimum of five years.

(7) Exchange will collect from all Exchange Participants that either have or are required to have United States taxpayer identification numbers their United States taxpayer identification numbers and, on request, will provide such information to the Service.

(8) Exchange will identify a senior management contact of each Exchange Participant and, on request, will make such information available to the Service. On request, the Exchange will ask Exchange Participants to identify their other executive officers to the Service.

(9) Exchange will provide such further information and assurances as may from time to time be requested by the Service in order to verify Exchange's entitlement to the determination under section 1256(g)(7)(C) of the Code.

(10) The Exchange Rulebook has been amended, approved, and will be maintained to require the following:

a) Exchange Participants who are subject to the reporting requirements of brokers under section 6045 of the Code and the Treasury Regulations thereunder shall comply with such requirements, as amended from time to time, with respect to transactions effected on, or otherwise subject to the Rules of, the Exchange in the manner prescribed by section 6045 of the Code, the regulations thereunder, and such other provisions of the Code and regulations that are pertinent thereto. Failure of an Exchange Participant to comply with this provision will result in immediate suspension of such Participant's privileges on Exchange (and the privileges of any successor to such Participant) until the Participant complies with these reporting requirements in all respects. Such compliance includes the filing of all returns that were required to have been filed under section 6045 but were not filed or were filed improperly.

b) In addition to the requirements of the Exchange Rulebook, upon request by Exchange, Exchange Participants (with respect to transactions occurring on Exchange) will supply to Exchange or directly to the Service or any grand jury properly convened within the United States all books, papers, records, or other data as described in section 7602 of the Code and the Treasury Regulations thereunder (hereinafter collectively referred to as "records"). Such requests will be made by Exchange whenever Exchange receives a written request, summons or subpoena to produce such records from the Service or from any grand jury. Failure of an Exchange Participant to comply with this provision will result in immediate

suspension of such Participant's privileges on Exchange (and the privileges of any successor to such Participant) until the Participant complies with these reporting requirements in all respects.

### **Law and Analysis:**

Section 1256(a) of the Code provides, in general, when gain or loss on section 1256 contracts will be recognized and how such gain or loss will be treated for federal income tax purposes.

Section 1256(b) of the Code provides, in part, that for purposes of this section, the term "section 1256 contract" means any regulated futures contract.

Section 1256(g)(1) of the Code provides that the term "regulated futures contract" means a contract (A) with respect to which the amount required to be deposited and the amount which may be withdrawn depends on a system of marking to market, and (B) which is traded on or subject to the rules of a qualified board or exchange.

Section 1256(g)(7) of the Code provides that the term "qualified board or exchange" means –

- (A) a national securities exchange which is registered with the Securities and Exchange Commission,
- (B) a domestic board of trade designated as a contract market by the Commodity Futures Trading Commission, or
- (C) any other exchange, board of trade, or other market which the Secretary determines has rules adequate to carry out the purposes of this section.

Based on the foregoing and the facts in the CFTC Date 4 letter to Exchange, we determine that Exchange has rules adequate to carry out the purposes of section 1256 of the Code and is thus a qualified board or exchange within the meaning of section 1256(g)(7)(C). This ruling is conditioned on the representations set forth above and compliance therewith.

Except as specifically ruled upon above, no opinion is expressed or implied concerning the federal tax consequences relating to the facts discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of this request for ruling, it is subject to verification on examination.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

David B. Silber  
David B. Silber  
Chief, Branch 2  
Office of Associate Chief Counsel  
(Financial Institutions and Products)