

Part III

Administrative, Procedural, and Miscellaneous

26 CFR 601.601: Rules and regulations.
(Also Part I, §§ 61, 1001)

Rev. Proc. 2008-58

SECTION 1. PURPOSE

This revenue procedure provides guidance regarding the treatment of taxpayers receiving certain offers relating to auction rate securities.

SECTION 2. BACKGROUND

.01 In general, an auction rate security is a security in which the payment rate is reset periodically (typically every seven to 28 days), pursuant to an auction rate-setting process or a similar remarketing agent rate-setting process that is designed to produce the minimum payment rate necessary to enable all interested sellers to sell the security to willing buyers at a price equal to the par amount of the security, plus accrued but unpaid periodic payments. A “failed” auction or remarketing occurs if the auction or remarketing fails to produce buyers for all interested sellers at a payment rate that is at or below the maximum payment rate specified by the terms of the auction rate security. Upon a failed auction or remarketing, the periodic payment rate is reset at a prescribed

maximum rate until the next auction or remarketing. In addition, in the case of some issues of auction rate securities, the periodic payment rate may escalate further to prescribed increasing maximum rates based on the continued occurrence of failed auctions or remarketings for increasing periods of time. See, e.g., Notice 2008-55, 2008-27 I.R.B. 11.

.02 On February 12, 2008, auctions with respect to auction rate securities began to fail. Thereafter, as a result of auction failures, many taxpayers were unable to sell auction rate securities for the par amount of the securities.

.03 Taxpayers may assert legal claims against another person (hereinafter, “Corporation X”) for its conduct as it relates to auction rate securities. For example, a taxpayer might allege that Corporation X improperly failed to disclose (1) at the time of the taxpayer’s purchase, the potential that the auction rate security could become illiquid, or (2) subsequent to the taxpayer’s purchase, information relating to the market for auction rate securities which might have suggested it would soon become illiquid.

.04 Corporation X may make an offer (the “Settlement Offer”) to affected taxpayers. Pursuant to the terms of the Settlement Offer, the taxpayer will have the right during a specified period (the “Window Period”) to cause Corporation X to buy the taxpayer’s auction rate securities for the par amount of the securities, upon the taxpayer’s giving notice to Corporation X. If the taxpayer receives the Settlement Offer, subject to the possible existence (and exercise) of the mitigation provision described in section 2.06 of this revenue procedure, so long as auctions continue to fail (and the taxpayer does not direct Corporation X to purchase the security), the taxpayer will continue to receive the maximum payment rate specified by the terms of the auction rate security.

.05 In the event the auction rate-setting process begins to succeed during the Window Period, so long as the taxpayer does not direct Corporation X to purchase the security (and the taxpayer does not sell in the auction), the taxpayer's return will fluctuate with that process, such that as the reset rates go up or down, this variation directly affects the taxpayer's economic return. If the taxpayer continues to hold the security after the Window Period, the taxpayer's entitlements are determined exclusively under the provisions of the auction rate security (e.g., if rates go up or down, or the security becomes worthless, the taxpayer experiences the full economic impact). During the Window Period (and thereafter, if Corporation X does not purchase the security during the Window Period), the taxpayer is entitled to (1) exercise all voting rights associated with the security, and (2) sell the security to a third party. By its terms, the auction rate security is not redeemable on a fixed date (or, if it is, the redemption date is at least two years later than the end of the Window Period).

.06 The Settlement Offer may also contain a provision which has the effect of allowing Corporation X to mitigate its potential economic losses during the Window Period. If the taxpayer accepts a Settlement Offer with such a provision, Corporation X will be authorized to effect sales or dispositions of the security to the market during the Window Period (so long as the taxpayer receives the par amount of the security upon the sale or disposition). Thus, for example, if, during the Window Period, Corporation X finds a person willing to purchase an auction rate security with a par amount of \$100x for \$99x, Corporation X can purchase the security from the taxpayer for \$100x, sell the security for \$99x, and limit its economic loss to \$1x (rather than risk a larger, or smaller,

loss). If Corporation X buys the security under this provision, it will not hold the security for investment purposes.

.07 The Settlement Offer may also permit the taxpayer to elect to “borrow” (in form) the par amount of the auction rate security from Corporation X before the Window Period begins (or during the Window Period). In this case, the taxpayer’s obligation to return the cash amount advanced by Corporation X in the form of a “loan” is secured (in form) by the auction rate security. Taxpayers who accept the Settlement Offer are not required to make this election or otherwise participate in this feature of the Settlement Offer.

SECTION 3. SCOPE

This revenue procedure applies to taxpayers who, before June 30, 2009, receive Settlement Offers generally described in section 2 of this revenue procedure that (1) include Window Periods that do not extend beyond December 31, 2012, and (2) require that the taxpayer deliver an auction rate security that the taxpayer purchased on or before February 13, 2008.

SECTION 4. APPLICATION

For taxpayers within the scope of this revenue procedure, the Internal Revenue Service will not challenge the following positions:

.01 The position that the taxpayer continues to own the auction rate security upon receiving or accepting (or “opting into”) the Settlement Offer (but not after tendering the security).

.02 The position that the taxpayer does not realize any income as a result of receiving or accepting (or “opting into”) the Settlement Offer and does not reduce the

basis of the auction rate security from its original purchase price.

.03 The position that the taxpayer's amount realized from the sale of the auction rate security during the Window Period to the person offering the settlement (Corporation X in this revenue procedure) is the full amount of the cash proceeds received from that person.

SECTION 5. NO INFERENCE

This revenue procedure provides administrative guidance in light of the significant number of taxpayers affected by auction failures and the potential litigation resulting therefrom. Except with respect to the administrative guidance expressly provided in this revenue procedure, no inferences should be drawn from this revenue procedure in any other context regarding the ownership of any other security (or the effect of a loan secured by such security), the application of the replacement or restoration of capital doctrine, or any other federal tax issues.

SECTION 6. CONTACT INFORMATION

For further information regarding this revenue procedure, contact William E. Blanchard of the Office of Associate Chief Counsel (Financial Institutions and Products) at (202) 622-3950 or Andrew J. Keyso of the Office of Associate Chief Counsel (Income Tax and Accounting) at (202) 622-4800.