

Part III

Administrative, Procedural, and Miscellaneous

[26 CFR 1.601.204]: Changes in accounting periods and in methods of accounting.
(Also Part 1:§§ 446, 475; 1.475(a)-4)

Rev. Proc. 2007-41

SECTION 1. PURPOSE

Section 1.475(a)-4 of the Income Tax Regulations (the safe harbor valuation regulations) permits dealers in securities and dealers in commodities to elect to use the values of eligible positions reported on certain financial statements as the fair market values of those positions for purposes of section 475 of the Internal Revenue Code (Code). This revenue procedure designates the securities and commodities that are eligible positions for purposes of the safe harbor valuation regulations. This revenue procedure also illustrates the application of the safe harbor to taxpayers who are both dealers and traders.

SECTION 2. BACKGROUND

.01 Section 475(a) of the Internal Revenue Code requires dealers in securities to value their securities at fair market value as of the last business day of the year.

Section 475(e) allows dealers in commodities to elect this same mark-to-market treatment for their commodities. Section 475(f) allows traders in securities (and traders in commodities) to elect mark-to-market treatment for positions held in connection with the taxpayer's securities trading business (or commodities trading business, as the case may be).

.02 Section 475(c)(2) defines security as any- -

- (A) share of stock in a corporation;
- (B) partnership or beneficial ownership interest in a widely held or publicly traded partnership or trust;
- (C) note, bond, debenture, or other evidence of indebtedness;
- (D) interest rate, currency, or equity notional principal contract;
- (E) evidence of interest in, or a derivative financial instrument in, any security described in subparagraph (A), (B), (C), or (D) [of section 475(c)(2)], or any currency, including any option, forward contract, short position, and any similar financial instrument in such a security or currency; and
- (F) position which –
 - (i) is not a security described in subparagraph (A), (B), (C), (D), or (E) [of section 475(c)(2)];
 - (ii) is a hedge with respect to such a security, and;

- (iii) is clearly identified in the dealer's records as being described in [subparagraph (F) of section 475(c)(2)] before the close of the day on which it was acquired or entered into (or such other time as the Secretary may by regulations prescribe).

Subparagraph (E) [of section 475(c)(2)] shall not include any contract to which section 1256(a) applies.

.03 Section 475(e)(2) defines commodity as:

- (A) any commodity which is actively traded (within the meaning of section 1092(d)(1));
- (B) any notional principal contract with respect to any commodity described in subparagraph (A) [of section 475(e)(2)];
- (C) any evidence of an interest in, or a derivative instrument in, any commodity described in subparagraph (A) or (B) [of section 475(e)(2)], including any option, forward contract, futures contract, short position, and any similar instrument in such a commodity; and
- (D) any position which –
 - (i) is not a commodity described in subparagraph (A), (B), or (C) [of section 475(e)(2)],
 - (ii) is a hedge with respect to such a commodity, and
 - (iii) is clearly identified in the taxpayer's records as being described in [subparagraph (D) of section 475(2)(2)] before the close of the day on which it was acquired or entered into (or such other time as the Secretary may by regulations prescribe).

.04 Section 475(g) provides that the Secretary shall prescribe regulations as may be necessary or appropriate to carry out the purposes of § 475. The legislative history of § 475 indicates that, under this regulatory authority, the Secretary may issue regulations to permit the use of valuation methodologies that reduce the administrative

burden of compliance on taxpayers but that nevertheless clearly reflect income for federal income tax purposes. H.R. Rep. No. 213, 103d Cong., 1st Sess. 616 (1993), 1993-3 C.B. 494.

.05 On June 12, 2007, the Internal Revenue Service and the Treasury Department published the safe harbor valuation regulations in the **Federal Register** (TD 9328). These regulations provide an elective safe harbor method for valuation under § 475 for dealers in securities and dealers in commodities. Under the safe harbor in § 1.475(a)-4, an eligible taxpayer (as defined in § 1.475(a)-4) may elect that, if certain conditions and limitations are met, the values reported for certain eligible positions for financial reporting purposes are treated as those positions' fair market values for purposes of § 475.

.06 Section 1.475(a)-4(c) defines an eligible taxpayer as “(1) a dealer in securities, as defined in section 475(c)(1) and the regulations thereunder; or (2) a dealer in commodities, as defined in section 475(e) and any regulations thereunder, that is subject to an election under section 475(e).”

.07 Section 1.475(a)-4(g) states, “For any taxpayer, an eligible position is any security or commodity that the Commissioner in a revenue procedure or other published guidance designates with respect to that taxpayer as an eligible position for purposes of this safe harbor.”

SECTION 3. SCOPE

This revenue procedure designates eligible positions under § 1.475(a)-4(g) for electing eligible taxpayers under § 1.475(a)-4(c).

SECTION 4. ELIGIBLE POSITIONS FOR SAFE HARBOR

Pursuant to § 1.475(a)–4(g), the following are designated as eligible positions for purposes of the safe harbor valuation regulations:

.01 With respect to an eligible taxpayer described in § 1.475(a)–4(c)(1), any security within the meaning of § 475(c)(2) and the regulations thereunder.

.02 With respect to an eligible taxpayer described in § 1.475(a)–4(c)(2), any commodity within the meaning of § 475(e)(2) and any regulations thereunder

SECTION 5. EXAMPLES

The following examples illustrate the application of this revenue procedure:

.01 Example 1.

X is both a dealer in securities and a dealer in physical commodities. In a business unrelated to its commodities dealing business, X is a trader in commodity derivatives. With respect to the commodity trading business, X has made a mark-to-market election under § 475(f)(2) but has not made the commodity dealer election under § 475(e). X makes the valuation safe harbor election under § 1.475(a)–4.

Because X is a dealer in securities, X is an eligible taxpayer within the meaning of § 1.475(a)–4(c)(1). Accordingly, X's securities are eligible positions with respect to X, and, if all other requirements are met, may be covered by the valuation safe harbor.

Because X has not made the election under § 475(e), however, X is not described in § 1.475(a)–4(c)(2). For that reason, X's commodity positions are not eligible positions

with respect to X, and the positions in the commodity trading business (which are marked to market pursuant to § 475(f)) are not covered by the valuation safe harbor.

.02 Example 2.

Y is a dealer in commodities and is a trader in securities but is not a dealer in securities. Y makes the elections under § 475(e) (the commodity dealer election), under § 475(f) (the election to apply § 475 to its securities trading business), and under § 1.475(a)–4 (the valuation safe harbor election).

Because Y is an eligible taxpayer described in § 1.475(a)–4(c)(2), Y's commodity positions are eligible positions with respect to Y. Although Y also marks to market the securities held in connection with Y's securities trading business, those securities are not eligible positions with respect to Y because Y is not an eligible taxpayer described in § 1.475(a)–4(c)(1).

SECTION 6. EFFECTIVE DATES

This revenue procedure is effective on June 12, 2007.

SECTION 7. DRAFTING INFORMATION

The principal author of this revenue procedure is Marsha Ann Sabin or John W. Rogers III of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue procedure contact Marsha Ann Sabin or John W. Rogers III at (202) 622-3950 (not a toll free call).