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June 16, 2015

The Honorable Jacob Lew
Secretary of Treasury
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Secretary Lew:

I am writing to you today to follow up on my request for the Treasury Department and Internal Revenue Service (IRS) to issue guidance expeditiously to shut down a tax shelter in which alternative investment vehicles use a complex financial structure to convert short-term capital gains to long-term capital gains. As you and I have discussed previously, some investment vehicles, such as hedge funds, are using a complex combination of so-called options (commonly referred to as “basket options”) to purportedly allow ultra-high income investors to pay less in taxes than required by current law.

In 2010, the IRS issued an Office of Chief Counsel Internal Revenue Service Memorandum (GLAM 2010-005), an internal memorandum providing that basket options were not options at all and instead simply an account of securities owned by the alternative investment vehicle. Therefore, profits from trades of assets held for less than a year would be subject to the higher short term capital gains rate. Unfortunately, however, this IRS memo has no legal authority and many hedge funds – and the banks that sell these “basket options” – are disregarding the IRS guidance and continue to market this product.

In March 2015, I directed my staff to issue a report titled, “How Tax Pros Make the Code Less Fair and Efficient: Several New Strategies and Solutions,” in which we outlined a number of tax avoidance strategies, including basket options. In addition, last fall, my staff had conversations with Treasury and IRS officials and encouraged the agencies to issue stronger guidance to shut down basket option arrangements. For example, we have suggested that Treasury and IRS issue a tax shelter notice, which would notify taxpayers that this is a tax shelter and taxpayers will be penalized if they continue using this financial structure.

The law is very clear in this area – basket options are a tax shelter. The IRS and Treasury have clear authority to shut down these transactions today. These investment vehicles have avoided over \$1 billion in taxes. It is time to shut down these arrangements once and for all. Therefore, I ask that the Treasury Department and IRS to take regulatory steps expeditiously to shut down basket option arrangements.

Thank you for your consideration of this important matter. If you have any questions or need additional information, please contact me or Kara Getz of my staff at 202-224-4515.

Sincerely,

A handwritten signature in blue ink that reads "Ron Wyden". The signature is written in a cursive, slightly slanted style.

Ron Wyden
Ranking Member