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The Honorable Lloyd Bentsen
Chairman, Committee on Finance
SH-703 Hart Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

When the President's tax proposals were released, we at J.P. Morgan were surprised and disappointed to see the recommendation that "securities dealers" be forced to mark-to-market a wide range of financial instruments which are treated as inventory held for resale. This is an unjustifiable departure from the basic principle that income is recognized for tax purposes only when it is realized by the taxpayer. I am writing to urge you to reject this proposal.

A mark-to-market rule would force J.P. Morgan and other banking organizations and securities firms to treat stocks, bonds and other securities as if they had been sold for fair market values on the last day of the year. This would produce a significant increase in taxable income attributable to paper profits on the affected inventory assets, unless the company had significant losses to use as offsets. As a result, we and others would be forced to divert funds from other productive uses to pay the resulting increase in our taxes.

Selling the affected assets to generate cash is not an option. If it were, the assets would have been sold prior to year-end. Instead, we would be forced to choose between two other options: we could pay the tax from available cash or other liquid assets, or we could borrow the funds. Either option would reduce funds otherwise available for investment or lending activities.

The proposal's impact is worsened by its application to notional principal contracts (generally called "swaps") and to derivative instruments such as options, commodities and futures contracts. Swaps are individually negotiated contracts which have become indispensable to businesses and governmental entities seeking to manage their interest costs and overall financial

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risks. Our firm and others are "dealers" in swaps, but there is no market or exchange that can readily value each contract that is based in part on the creditworthiness of the particular dealer. For derivatives, the proposal would force a market valuation of all such instruments held by an affected company, without regard to whether such instruments are held for resale as required by the general rule.

When originally presented by the Administration, the mark-to-market proposal was described as an accounting conformity issue. But this characterization ignores two significant facts.

First, financial and tax accounting rules serve very different purposes. Financial statements are intended to present an accurate report of the value of a company's current assets and liabilities and the potential effect of contingencies on future income streams and values. By contrast, tax accounting rules generally are intended to compute realized income and expenses in order to determine income within the annual accounting period. Predictions of possible future income based on asset valuations are not relevant for the current year.

Second, because of their different purposes, there are many substantial differences between the two systems. Depreciation, loss reserves, goodwill and even inventory are just a few of the areas in which tax and financial accounting rules are different. Conformity between the two systems is not necessarily appropriate or desirable.

In summary, we believe that the mark-to-market proposal is a particularly unwise recommendation. It would ignore the income realization principle by taxing paper profits on securities inventories, thereby forcing our firm and others to draw down capital or to borrow to pay higher taxes. While called an accounting conformity issue, the proposal appears to be nothing more than a means to raise a modest amount of additional revenue.

I urge you to set this proposal aside.

Sincerely,

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