

MEMO# 22845

September 4, 2008

Revised ICI Draft Letter Requesting Guidance Clarifying Preferential Dividend Rule; Comments Requested

[22845]

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TO: TAX COMMITTEE No. 29-08 RE: REVISED ICI DRAFT LETTER REQUESTING GUIDANCE
CLARIFYING PREFERENTIAL DIVIDEND RULE; COMMENTS REQUESTED

Attached for your review is a revised (including a redlined version showing changes to the draft distributed on July 25 [\[1\]](#)) draft of the Investment Company Institute's letter to the Treasury Department and the Internal Revenue Service ("IRS") requesting guidance clarifying how the preferential dividend rule of Code section 562(c) applies to publicly-offered regulated investment companies ("RICs"). Please provide any comments by 5:00 pm (Eastern) on Monday, September 8, 2008.

Proposal

The draft letter urges administrative guidance providing publicly-offered RICs with a simple and administrable "self-correction" procedure to obtain automatic relief (with appropriate penalties) for inadvertent violations of the preferential dividend rule. If a RIC voluntarily complies with the requirements of the proposed self-certification procedure for material variances, then the preferential dividend rule would not apply to inadvertent violations or to corrective distributions made to comply with the self-correction procedure.

The proposal's first requirement is that the variance in the dividends paid to different shareholders or groups of shareholders be unintentional or made by the RIC or its adviser to

correct an impermissible variance.

The second requirement under our proposal is that all material variances (e.g., the greater of one penny or one-half of one percent of NAV) be disclosed to the Internal Revenue Service and addressed pursuant to the penalty regime described below. The reporting format we recommend would accommodate voluntary reporting of immaterial variances.

We propose that a RIC that has not experienced a material variance within the past five years or (for a RIC less than five years old) since the RIC's inception incur no penalty for the first failure. For additional failures, we recommend the following sliding scale penalty regime:

1. for de minimis failures (which we would define as the lesser of \$25,000 or one-tenth of one percent of the RIC's total net assets), no penalty should be imposed;
2. for the first non-de minimis failure, the penalty should be the lesser of \$10,000 or 25% of the preferential dividend; and
3. for every additional non-de minimis failure, the penalty should be the lesser of \$25,000 or 50% of the preferential dividend.

Lisa Robinson
Associate Counsel

[Attachment](#)

endnotes

[\[1\]](#) See Institute Memorandum ([22730](#)) to Tax Committee No. 26-08, dated July 25, 2008.

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