

MEMO# 28281

July 24, 2014

Treasury and IRS Release Guidance Regarding Floating NAV Money Market Funds

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TO: ACCOUNTING/TREASURERS MEMBERS No. 10-14
BANK, TRUST AND RETIREMENT ADVISORY COMMITTEE No. 33-14
BROKER/DEALER ADVISORY COMMITTEE No. 38-14
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 16-14
MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 13-14
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SEC RULES MEMBERS No. 32-14
SMALL FUNDS MEMBERS No. 18-14
TAX MEMBERS No. 21-14
TRANSFER AGENT ADVISORY COMMITTEE No. 48-14 RE: TREASURY AND IRS RELEASE GUIDANCE REGARDING FLOATING NAV MONEY MARKET FUNDS

The Department of the Treasury and the Internal Revenue Service (“IRS”) have released two pieces of guidance [\[1\]](#) relating to the final rule on money market fund reform recently released by the Securities and Exchange Commission (the “SEC”). [\[2\]](#) The first is a [Notice of Proposed Rulemaking](#) that sets forth a new form of simplified tax accounting for money market funds with a floating net asset value (“NAV”) subject to SEC Rule 2a-7, called the “NAV Method.” The second is a [Revenue Procedure](#) that exempts floating NAV money market funds from the wash sale rule entirely, as the Institute requested.

Proposed Regulations

The proposed regulations described in the Notice of Proposed Rulemaking provide a simplified method of tax accounting for shareholders in a floating NAV money market fund, called the “NAV method,” under section 446 of the Internal Revenue Code. This method determines gain or loss by looking at the change in the aggregate value of the investor’s shares in the money market fund over a specified period. Shareholders, funds, and reporting brokers in a floating NAV money market fund thus would not be required to track individual lots or adjusted cost basis of the fund shares.

Pursuant to the NAV method, gain or loss from shares in a floating NAV money market fund generally would equal (i) the aggregate fair market value of the investor's shares in the money market fund at the end of the computation period, (ii) minus the aggregate fair market value of the investor's shares in the money market fund at the end of the prior period, (iii) minus the investor's "net investment" in the money market fund. "Net Investment" is equal to the aggregate cost of shares purchased during the period (including reinvested dividends) minus the aggregate amount received upon taxable redemptions during the same period. The computation period can be the investor's taxable year or any shorter period (e.g., monthly, quarterly, etc.), provided that the computation periods are of equal duration and contain days from only one taxable year.

The character of the gain or loss would be the same as that of the underlying shares in the hands of the investor. If the character is capital, it would be short-term capital gain or loss. If the shares in the money market fund otherwise would give rise to both ordinary and capital gain or loss, then all gain or loss from the shares in that fund must be treated as capital gain or loss.

The net gain or loss for the investor's computation period must be increased or decreased by any downward or upward adjustments, respectively, to the investor's basis in the shares in the floating NAV money market fund under any provision of the Internal Revenue Code.

An investor may use the NAV method to determine the gain or loss for the taxable year on the investor's shares in each money market fund that, at any time during the taxable year, was a floating NAV money market fund subject to SEC Rule 2a-7, at a time when the investor owned shares in the fund. Once an investor has elected to use the NAV method, it must use that method for all floating NAV money market funds in which it invests, and it cannot change from that method without seeking permission from the IRS. If an investor invests in the same floating NAV money market fund through multiple brokers, it must apply the NAV method separately to each account.

Because gain or loss is determined on an aggregate basis (and not on an individual lot basis), the wash sale rules would not apply if the NAV method is used.

The proposed regulations revise the current information reporting exceptions for money market funds under sections 6045, 6045A and 6045B to clarify that those exceptions continue to apply to all money market funds, including floating NAV money market funds. [\[3\]](#) In other words, floating NAV money market funds would not have an obligation under this proposal to track and report cost basis, provide IRS Forms 1099-B, do transfer reporting, or report corporate actions that affect the basis of the fund shares.

The proposed regulations would apply to taxable years ending on or after the date of publication of final Treasury regulations in the Federal Register. Shareholders of floating NAV money market funds, however, may rely upon the proposed regulations immediately, for taxable years ending on or after the date of publication of the proposed regulations in the Federal Register and beginning before the adoption of final regulations. The proposed rules regarding the reporting of tax information under sections 6045, 6045A, and 6045B apply to sales of shares in calendar years beginning on or after the date of publication in the Federal Register of final regulations. Taxpayers, funds and reporting brokers, however, may rely upon the proposed rules for sales of shares in calendar years beginning before the adoption of final regulations.

The Treasury Department and the IRS have asked for comments on the proposed

regulations, which must be received within 90 days after the publication of the proposed regulations in the Federal Register. [4] The government also has scheduled a hearing on the proposed regulations for November 19, 2014.

Rev. Proc. 2014-45

The Treasury Department and the IRS issued a proposed revenue procedure last year, in conjunction with the SEC's proposed rulemaking, that would have applied a de minimis exception to the wash sale rule for floating NAV money market funds. [5] The Institute argued that such a de minimis exception would not have eased tax compliance burdens, but rather would have made them worse. [6] We asked for a complete exemption from the wash sale rule, given that investments in money market funds should not give rise to the abuses that the wash sale rule is intended to combat. We are pleased to report that the Treasury Department and the IRS have adopted our recommendation. The revenue procedure thus provides that the IRS will not apply the wash sale rule to floating NAV money market funds regulated under Rule 2a-7.

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endnotes

[1] A press release describing the guidance, with links to the documents, can be found [here](#).

[2] The final SEC rule can be found [here](#). A memorandum describing the final SEC rule is forthcoming.

[3] See Treas Reg. § 1.6045-1(c)(3)(vi).

[4] As of the date of the memorandum, the proposed regulations had not yet been published in the Federal Register. The due date for comments likely will be in late October.

[5] See Institute [Memorandum](#) (27356) dated July 5, 2013.

[6] See Institute [Memorandum](#) (27558) dated September 12, 2013.