

MEMO# 28814

March 11, 2015

Supplemental Letter to IRS and Treasury Regarding Money Market Fund Reform Tax Guidance

[28814]

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TO: ACCOUNTING/TREASURERS MEMBERS No. 5-15
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VARIABLE INSURANCE PRODUCTS ADVISORY COMMITTEE No. 2-15 RE: SUPPLEMENTAL
LETTER TO IRS AND TREASURY REGARDING MONEY MARKET FUND REFORM TAX GUIDANCE

The Institute has submitted the attached letter to the Treasury Department and the Internal Revenue Service (the “IRS”), providing additional information in response to questions raised by the government at the public hearing on recently proposed regulations regarding the taxation of money market funds with floating net asset values (“NAVs”). [\[1\]](#)
Specifically, this letter addresses:

- Permitting use of the NAV method on an account-by-account basis;
- Use of the NAV method by regulated investment companies (“RICs”) for excise tax purposes;
- Clarifying the definition of “fair market value” for purposes of the NAV method; and
- Permitting existing money market funds with both retail and institutional investors to separate into two separate funds in a tax-free manner.

The letter notes that the Institute plans to ask for additional guidance that was not requested in our original comment letter. We understand that some investment advisors are discussing the possibility of making payments to existing institutional money market funds to bring the NAV up to \$1.0000 before the compliance date for the final Securities and Exchange Commission (“SEC”) money market fund rule. The Institute plans to seek

guidance regarding the proper tax treatment of such payments. Given the time sensitivity of the issues described above, however, the Institute plans to submit a separate letter in the near future regarding advisor contributions.

Application of the NAV Method on an Account-by-Account Basis

In the Institute's original comment letter on the proposed regulations, [\[2\]](#) we asked the Treasury Department and the IRS to permit money market fund shareholders to apply the NAV method on an account-by-account basis. We understand that some fund complexes and intermediaries are considering providing basis information to floating NAV money market funds on a voluntary basis; shareholders who receive such information otherwise would not be permitted to use it if they have chosen to apply the NAV method with respect to other money market fund accounts. At the public hearing, the IRS asked whether it has the authority to permit use of the NAV method on an account-by-account basis, as it is a method of accounting under section 446.

The Institute's supplemental letter concludes that there is support in the Internal Revenue Code, the Treasury regulations, and the case law for applying different methods to two distinct items, notwithstanding any factual similarities. We argue that this rationale should be applied to floating NAV money market funds. Not only are different money market funds separate and distinct from one another, but shares of the same fund held in different accounts also are separate and distinct. This should justify permitting taxpayers to apply the NAV method on an account-by-account basis.

Applying the NAV Method for Excise Tax Purposes

In our initial comment letter and at the public hearing, the Institute asked the IRS and Treasury Department to confirm that, when a RIC invests in a floating NAV money market fund, the computation period for purposes of applying the NAV method to the section 4982 excise tax could be the one-year period ending on October 31. The government asked at the hearing for further insight as to how to ensure that application of the NAV method by RICs would align for income tax and excise tax purposes.

The supplemental letter states that current law and the proposed regulations should permit a RIC to use the one-year period ending October 31 as the computation period for excise tax purposes while using the RIC's tax year as the computation period for income tax purposes. Alternatively, a RIC could choose to use monthly (or daily) computation periods for both income and excise tax purposes, which clearly is permitted under the proposed regulations. Both methods should ensure that RICs recognize and distribute the proper amounts for both income tax and excise tax. The letter then gives an example illustrating the amounts of gain a RIC would recognize and distribute using both methods. We reiterate our original request that the IRS and the Treasury Department confirm that the one-year period ending on October 31 may be used as the computation period for excise tax purposes, even if the fund uses a different calculation period for tax purposes.

Definition of Fair Market Value

At the public hearing, the government asked for the Institute's views on comments made by one of our members regarding the definition of "fair market value" in the proposed regulations. Specifically, that comment letter recommended that the final regulations clarify that the fair market value of a money market fund for purposes of the NAV method should be determined based on the published NAV per share as of the end of the relevant day (or the next trading day if the day in question is not a trading day).

The Institute's supplemental letter agrees with this clarification, with one important change. We understand that, in order to accommodate same-day settlement in money market funds with floating NAVs, institutional funds are considering striking several NAVs throughout the day. Therefore, we recommend that "fair market value" for purposes of the NAV method be defined as the next published NAV per share. This should provide flexibility for funds that choose to publish more than one NAV per day while providing certainty as to the meaning of "fair market value" for purposes of the NAV method.

Tax-Free Divisions of Money Market Funds

The Institute recommended in our original comment letter that the Treasury Department and the IRS issue guidance permitting a non-government money market fund with both retail and institutional shareholders to divide into separate retail-only and institutional funds on a tax-free basis prior to the compliance date of the floating NAV provisions of the new SEC money market fund rule. At the public hearing, the IRS requested that the Institute make an additional written submission to supplement the October letter and the November testimony and outline the associated reasoning.

The attached letter first describes why existing money market funds may need to separate, in order to accommodate the new SEC requirements, and walks through the mechanics of how such a split-off might occur. The letter then describes the tax consequences of the various steps to both the funds and the shareholders. These tax consequences may vary depending on whether the IRS and the Treasury Department treat the split-off transaction as tax-free.

The Institute notes that the simplest means for facilitating a tax-free split-off transaction, from the taxpayers' standpoint, would be for the IRS and the Treasury Department to provide guidance permitting such transactions to qualify under sections 368(a)(1)(D) and 355. We recognize, however, that the government historically has had concerns as to whether RICs can satisfy the "active trade or business requirement" of section 355. Therefore, if the government is not comfortable with that conclusion, or it does not believe that it can issue the immediate guidance that is needed in this context, then the Institute recommends that the IRS issue a Revenue Procedure providing a safe harbor under which the IRS will not challenge taxpayers who treat a money market fund split-off transaction as having the following tax consequences:

1. No gain or loss is recognized by the existing money market fund or the new money market fund upon the contribution of assets by the existing money market fund to the new money market fund in exchange for all of the new money market fund shares;
2. The existing money market fund's basis and holding period in its assets carry over to the new money market fund;
3. No gain or loss is recognized by the existing money market fund upon the distribution of the new money market fund shares to the applicable category of its shareholders (i.e., the retail or institutional shareholders) in redemption of their existing money market fund shares;
4. No gain or loss is recognized by the redeemed shareholders upon their receipt of the new money market fund shares in redemption of their existing money market fund shares;
5. The redeemed shareholders' basis in the new money market fund shares that they receive will be the same as their basis in the existing money market fund shares they surrender; and
6. The redeemed shareholders' holding period in their existing money market fund

shares carries over to the new money market fund shares that they receive.

Finally, the IRS asked at the public hearing whether and how a RIC could satisfy the active trade or business requirement of section 355. The letter contains a brief discussion of why the government should consider RICs to be engaged in an active trade or business. We note, however, that the IRS and the Treasury Department can provide the guidance that we seek without reaching that conclusion.

Karen Lau Gibian
Associate General Counsel

[Attachment](#)

endnotes

[1] See Institute [Memorandum](#) (28281) dated July 24, 2014.

[2] See Institute [Memorandum](#) (28478) dated October 23, 2014.

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