

MEMO# 30013

July 5, 2016

Draft Letter on Section 305(c) Proposed Regulations - Comments Requested by July 11

[30013]

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TO: TAX COMMITTEE No. 19-16 RE: DRAFT LETTER ON SECTION 305(C) PROPOSED REGULATIONS - COMMENTS REQUESTED BY JULY 11

Attached for your review is a draft letter to the Internal Revenue Service (“IRS”) and the Treasury Department providing comments on the recently proposed regulations under section 305(c) regarding deemed distributions on convertible debt. [\[1\]](#) The Institute’s letter requests clarification of two issues of importance to the mutual fund industry. It also provides suggestions for improving the reporting and valuation requirements.

First, the Institute asks the IRS and Treasury Department to clarify in the final regulations that a deemed distribution under section 305(c) can qualify as qualified dividend income, or “QDI,” under section 1(h)(11), provided that the holder of the convertible bond satisfies the holding period requirements in section 1(h)(11)(B)(iii) with respect to the debt instrument.

Second, the comment letter asks the government to address whether tax accounting for deemed distributions is a method of accounting under section 446. Specifically, we ask for clarification as to whether a taxpayer that has not been recognizing deemed distributions under section 305(c), but begins to do so, has a change in method of accounting for which IRS consent is required.

Finally, the Institute asks the government to provide rules that will assist holders of convertible debt if the issuer fails to properly report the amount of a deemed distribution on Form 8937, or if a holder disagrees with the issuer’s valuation. We thus suggest that the final regulations provide that:

1. If an issuer fails to properly report a deemed distribution resulting from an applicable adjustment under section 305(c), the holder of the convertible security is not liable for any tax on the deemed distribution until the issuer reports such distribution on Form 8937, unless the holder knows that an applicable adjustment has occurred;
2. A holder of a convertible security on which a deemed distribution occurs may make its

own determination of the value of the deemed distribution when the holder first becomes aware of an applicable adjustment, even if the issuer has not yet provided a Form 8937, provided that the holder uses a reasonable method for determining such value;

3. If the issuer provides a Form 8937, the holder may rely upon the issuer's valuation, so long as the holder does not have reason to believe that the issuer's valuation is incorrect; and
4. If the holder disagrees with the issuer's valuation of the deemed distribution, the holder may use its own valuation, provided that the holder documents its methodology and discloses the use of its own valuation to the IRS.

Please provide any comments on the draft letter to me (kgibian@ici.org or 202/371-5432) no later than the opening of business on **Monday, July 11, 2016**.

Karen Lau Gibian
Associate General Counsel

[Attachment](#)

endnotes

[\[1\]](#) See Institute Memorandum ([29836](#)) dated April 14, 2016.

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