The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 31131

March 15, 2018

ICI Letter on Application of New Transition Tax to RICs

[31131]

March 15, 2018 TO: ICI Members
Tax Committee SUBJECTS: Tax RE: ICI Letter on Application of New Transition Tax to RICs

The Institute has submitted the attached letter to the Treasury Department and the Internal Revenue Service (IRS) requesting guidance on the application of the new transition tax on certain foreign income to regulated investment companies (RICs).

The recently enacted tax legislation[1] provides rules intended to transition taxpayers from the current worldwide system of taxation to a participation exemption system. Amended section 965 generally requires a US shareholder (including a RIC) that owns 10 percent or more of a foreign corporation to include as current income (specifically, as a "subpart F inclusion" under section 951(a)(1)) its pro rata share of the foreign corporation's post-1986 undistributed accumulated earnings and profits for its last taxable year beginning before January 1, 2018. This mandatory subpart F inclusion is subject to a participation exemption, resulting in tax on the inclusion at rates of 15.5 percent, if attributable to the foreign corporation's cash position, or 8 percent, if attributable to the foreign corporation's other positions. US shareholders are permitted to pay the net tax liability resulting from the subpart F inclusion over an eight-year period.

Amended section 965(m) provides special rules for real estate investment trusts (REITs). Any deferred foreign income that must be included in income under this provision is not taken into account for purposes of the REIT gross income qualification test under Subchapter M. REITs also may elect to include such income over the eight-year period available to other taxpayers, thus permitting REITs to distribute the income to the REIT shareholders over the same period.

RICs, as corporations, are subject to the new rules to the extent that they own 10 percent or more of a foreign corporation. The legislation, however, does not address how such deferred foreign income impacts a RIC's qualification tests and distribution requirements under Subchapter M or the application of the excise tax rules under section 4982.

If these rules are not clarified, the consequences to RICs and their investors could be significant, resulting in entity-level income and excise tax as well as increased taxable ordinary and capital gain dividends to shareholders. The Institute thus asks the Treasury

Department and the IRS to address the application of section 965 to RICs. Specifically, the guidance should:

1. Clarify that any deferred foreign income should be ignored or treated as qualifying income for purposes of the RIC qualification requirements in Subchapter M, as it is for REITs;
2. Permit RICs to elect to include such income over the eight-year period available to REITs, for both income and excise tax purposes, thus spreading the required distribution of such amounts to RIC shareholders over the same period;
3. Clarify that a RIC's share of deferred foreign income from a calendar year-end specified foreign corporation is treated as arising on January 1, 2018, for purposes of section 4982 and thus is included in excise tax calculations for 2018, not for 2017; and
4. Provide relief for all taxpayers that are US shareholders, including RICs, who have used reasonable efforts to gather the information necessary to determine their section 965 Subpart F inclusion amounts, if such amounts later are determined to be incorrect.

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Attachment

endnotes

[1] *See* Institute Memorandum No. 30991, dated December 21, 2017, which can be found at: https://www.ici.org/my_ici/memorandum/memo30991.
