

MEMO# 30067

July 20, 2016

ICI Comment Letter on Section 305(c) Proposed Regulations

[30067]

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TO: TAX MEMBERS No. 13-16

ICI GLOBAL TAX COMMITTEE No. 11-16 RE: ICI COMMENT LETTER ON SECTION 305(C)
PROPOSED REGULATIONS

The Institute has submitted comments (attached) on the recently proposed regulations under section 305(c) regarding deemed distributions on convertible securities. [\[1\]](#) Specifically, the Institute's letter asks the Internal Revenue Service ("IRS") and the Treasury Department to address two issues of importance to the mutual fund industry. First, the proposed regulations do not clarify whether deemed distributions on convertible securities can qualify as "qualified dividend income" ("QDI") or for the dividends received deduction ("DRD"). The Institute believes that deemed distributions should be eligible for treatment as QDI and for the DRD and ask the government to clarify this in the final regulations. Second, the proposed regulations do not specify whether a change in method of accounting has occurred when a taxpayer who has not been accounting for deemed distributions under section 305(c) on convertible securities begins to do so. We also urge the IRS and the Treasury Department to answer this critical question.

Additionally, we ask the government to address certain challenges that the proposed regulations present for holders in general, and mutual funds in particular, with respect to the determination of the amount of the deemed distribution and the timing of the inclusion of that deemed distribution in income. In particular, we suggest that the final regulations provide that:

1. The amount of the deemed distribution is simply the fair market value of the right to acquire the additional shares provided by the conversion ratio adjustment;
2. The holder of the convertible security is not required to recognize a deemed distribution as income unless and until the issuer reports such distribution on Form 8937 or the holder has actual knowledge that a deemed distribution has occurred;
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 unreasonable; and
4. Any deemed distribution that properly would be recognized by a regulated investment company (a "RIC") as income during the portion of the calendar year after October 31

is treated as arising on January 1 of the following calendar year for purposes of determining the RIC's required distribution for excise tax purposes under section 4982.

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[Attachment](#)

endnotes

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

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