

MEMO# 22730

July 25, 2008

ICI Draft Letter Requesting Guidance Clarifying Preferential Dividend Rule; Conference Call Scheduled

[22730]

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TO: TAX COMMITTEE No. 26-08 RE: ICI DRAFT LETTER REQUESTING GUIDANCE
CLARIFYING PREFERENTIAL DIVIDEND RULE; CONFERENCE CALL SCHEDULED

Attached for your review is a draft letter to the Treasury Department and the Internal Revenue Service ("IRS") requesting guidance clarifying how the preferential dividend rule of Code section 562(c) applies to publicly-offered regulated investment companies ("RICs").

Proposal

The draft letter urges administrative guidance providing publicly-offered RICs with a simple and administrable "self-correction" procedure to obtain automatic relief (with appropriate penalties) for inadvertent violations of the preferential dividend rule. If a RIC voluntarily complies with the requirements of the proposed self-certification procedure, then (i) inadvertent violations would not be treated as preferential dividends; and (ii) any corrective distributions made to comply with the self-correction procedure also would not be treated as preferential.

The proposal's first requirement is that the variance in the dividends paid to different shareholders or groups of shareholders be: (1) unintentional; (2) based upon a reasonable belief that the variance was not preferential; or (3) made by the RIC or its adviser to correct an impermissible variance.

The second requirement under our proposal is that the variance be disclosed to the IRS and addressed pursuant to the following procedures:

1. Disclosure to the IRS within [90] days after determining preferential dividend paid;
2. Corrective distribution made if the RIC and/or its board determines that a distribution is necessary to protect shareholder interests. Any corrective distribution also must be disclosed to the IRS (within [90] days after made).
3. Penalty regime:
 - a. If no other failure within lesser of past five years or since fund's inception -- no penalty.
 - b. If another failure within past five years or since fund's inception -- sliding scale penalty regime:
 - i. for *de minimis* failures [defined as lesser of \$25,000 or one-tenth of one percent of the RIC's total net assets] -- no penalty;
 - ii. for a first larger failure -- penalty is [the lesser of \$10,000 or 25% of the preferential dividend];
 - iii. for every additional larger failure -- penalty is [the lesser of \$25,000 or 50% of the preferential dividend].

A conference call is scheduled for Thursday, August 7, 2008 at 2:00 p.m. (Eastern) to discuss the draft letter. To participate in the call, please complete the attached response form and return it to Ezella Wynn by e-mail (ewynn@ici.org) or fax (202-326-5841) no later than 2:00 p.m. on Wednesday, August 6, 2008. The dial-in number for the call is 888-928-9122 and the passcode is 69765.

During the call, we will discuss the types of errors that may cause preferential dividends and develop further the proposal to be advanced. The letter states that detailed examples of various types of errors will be described in an attachment. Please feel free to provide these examples, and your thoughts on the proposal, before the conference call.

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Associate Counsel

[Attachment](#)

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