

MEMO# 14661

April 22, 2002

INSTITUTE LETTER TO TREASURY AND IRS URGING ADDITIONAL GUIDANCE ON TAXATION OF SYNTHETIC TAX-EXEMPT SECURITIES

[14661] April 22, 2002 TO: FIXED-INCOME ADVISORY COMMITTEE No. 5-02 MONEY MARKET FUNDS ADVISORY COMMITTEE No. 1-02 TAX COMMITTEE No. 12-02 RE: INSTITUTE LETTER TO TREASURY AND IRS URGING ADDITIONAL GUIDANCE ON TAXATION OF SYNTHETIC TAX-EXEMPT SECURITIES As we previously informed you,¹ Internal Revenue Service (the "Service") recently issued Revenue Procedure 2002-16 (the "Revenue Procedure") pursuant to which a tax-exempt money market fund organized as a regulated investment company ("RIC") may take into account each month its allocable share of tax-exempt income from certain synthetic variable rate tax-exempt securities. In order for partners to qualify for monthly inclusion, the partnership must satisfy certain reporting requirements. As issued, the Revenue Procedure is effective on January 1, 2002, and includes a transition rule that provides that "for the period prior to January 1, 2003, the Service will not challenge a money market fund's monthly inclusion of its distributive share of partnership items . . . in a manner similar to that described [in the Revenue Procedure, provided certain conditions are met]." In response to member concerns regarding the Revenue Procedure, the Institute has submitted the attached letter to the Treasury Department ("Treasury") and the Service. The letter explains the importance of these synthetic tax-exempt instruments to the mutual fund industry and describes the industry's two primary concerns with respect to the Revenue Procedure: first, the financial and administrative burden of complying with the reporting requirements and second, the inability of long-term bond funds to qualify for monthly inclusion under the Revenue Procedure. The letter urges Treasury and the Service to open an expedited guidance project with respect to the tax treatment of such investments and requests that the Revenue Procedure's transition rule be expanded to cover all mutual funds and extended until January 1, 2004. Catherine Barre Assistant Counsel Attachment (in .pdf format) 1 See, Institute memorandum to Tax Committee 6-02, dated February 22, 2002.