

MEMO# 5960

June 14, 1994

JUNE 21 MEETING TO DISCUSS IRS RULING ON REGULATED INVESTMENT COMPANY INVESTMENTS IN PARTNERSHIPS

June 14, 1994 TO: ACCOUNTING/TREASURERS COMMITTEE NO. 30-94 TAX COMMITTEE NO. 21-94 RE: JUNE 21 MEETING TO DISCUSS IRS RULING ON REGULATED INVESTMENT COMPANY INVESTMENTS IN PARTNERSHIPS

As we previously informed you, the IRS recently issued Revenue Ruling 94-40 clarifying the application of the excise tax minimum distribution rules of Internal Revenue Code section 4982 to a regulated investment company ("RIC") holding an interest in a partnership. (See Institute Memoranda to Accounting/Treasurers Members No. 15-94, Closed-End Fund Committee No. 14-94 and Tax Members No. 25-94, dated June 10, 1994). The ruling states that a RIC partner in a partnership must determine its required distribution under section 4982 by taking into account its share of partnership gain or loss as if the RIC had owned directly its share of the partnership's assets. The ruling applies to all RIC partnership investments. The ruling raises substantial concerns regarding the ability of RICs holding partnership investments to make distributions that satisfy the section 4982 requirements. The ruling states that, for purposes of section 4982, a RIC is to recognize income earned by the partnership at the time the RIC would have recognized the income had it owned its share of the partnership's assets directly. For purposes of determining a RIC's earnings and profits, however, the RIC recognizes its share of the partnership's income on the last day of the partnership's taxable year. Therefore, the RIC could have income for purposes of the required minimum distribution rule, but not have earnings and profits to support the required distribution. In addition, the ruling raises substantial issues concerning the application of special tax accounting rules and tax elections to assets held by such partnerships. For example, under the special RIC tax accounting rule of section 852(b)(9), it appears that a RIC partner would recognize dividend income on stock held by the partnership on the date the stock goes ex-dividend, even though the partnership would not recognize the dividend income until the payment date. Similarly, the partnership and the RIC may have different elections concerning the amortization of bond premium, the treatment of section 1256 contracts or the treatment of foreign currency gains and losses under section 988. Such differences could result in mismatches between the timing and amount of income recognized by the partnership and the RIC for purposes of section 4982. The IRS has asked for comments concerning possible exceptions to the application of the ruling. The Institute has scheduled a meeting on June 21, 1994 to discuss the ruling and develop industry comments. If possible, persons attending the meeting should be prepared to provide specific information

concerning the nature and size of current RIC partnership investments, including both information regarding 1) the percentage of each RIC's assets invested in a single partnership and in all its partnership holdings; and 2) the percentage of each partnership held by a single RIC. In addition, attendees should be prepared to consider how application of tax accounting rules and elections, particularly elections or treatment that differ between the partnership and a RIC partner, would affect a RIC's minimum distribution requirement under section 4982 and its ability to make qualifying distributions. The meeting will be held on Tuesday, June 21, 1994 at 10:00 a.m. in the 12th Floor Conference Room at the Institute's office at 1401 H Street, N.W., Washington, D.C. Lunch will be served following the meeting. Please indicate on the attached form if you plan to attend. Peter Cinquegrani Assistant Counsel - Tax Attachment Please fax this portion to Michelle Nasuti, Investment Company Institute, 202-326-5841. Meeting to Discuss Ruling Concerning RIC Partnership Investments 10:00 a.m., Tuesday, June 21, 1994 Investment Company Institute I (We) plan to attend the Meeting ATTENDEE(S) COMPANY NAME

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.