MEMO# 20047

May 12, 2006

Draft Institute Letter Regarding Post-October Losses, Bifurcation and Related Issues

 [20047] May 12, 2006 TO: TAX COMMITTEE No. 17-06 RE: DRAFT INSTITUTE LETTER REGARDING POST-OCTOBER LOSSES, BIFURCATION AND RELATED ISSUES Attached for your review is a draft Institute letter to the Internal Revenue Service regarding post-October short-term losses, bifurcation, and related issues. If you have any comments regarding this letter, please contact Keith Lawson (202-326-5832 or lawson@ici.org) or the undersigned (202- 371-5432 or klau@ici.org) by 5:00 p.m. EST on Thursday, May 18, 2006. The draft letter first sets forth the Institute's request for regulations under Code section 871(i)(2) regarding post-October short-term losses. Specifically, the Institute recommends that the Service issue regulations that would permit RICs to defer post-October short-term losses for taxable income purposes, regardless of whether such RICs designate short-term gain dividends. The draft letter then reiterates several recommendations regarding bifurcation and related issues made by the Institute in prior submissions to the Treasury Department and the Service.1 The draft letter does not address all of the recommendations included in the prior submissions; rather, this letter focuses on regulatory and administrative changes that we believe the government can make relatively quickly and without a significant commitment of resources. Specifically, the draft letter makes the following recommendations: • Bifurcation should be required only if a RIC has a post-October loss in some category. • The Service should clarify that bifurcation is permissible for both designation and taxable income purposes. • The Service should clarify that the bifurcation rules do not apply to RICs that are exempt from section 4982. 1 See Institute Memorandum (No. 9979) to Tax Committee No. 19-98, dated May 29, 1998; Institute Memorandum (No. 15457) to Accounting/Treasurers Members No. 52-02, Closed-End Investment Company Members No. 67-02, Tax Members No. 52-02, and Unit Investment Trust Members No. 39-02, dated December 17, 2002; Institute Memorandum (No. 16586) to Tax Members No. 50-03, dated September 30, 2003. 2 • Capital loss carryovers should be deemed to arise on the first day of the taxable year to which they are carried. • Bifurcation should be permitted when a RIC has net short-term capital gain for the pre-November period even if there is no net capital gain for such period. • The Service should exercise its regulatory authority under section 852(b)(10) and issue guidance allowing RICs to defer for taxable income purposes post-October losses attributable to stock in passive foreign investment companies ("PFICs"). • Ordinary losses falling in one calendar year should not reduce the earnings and profits of a RIC created by ordinary income that arises in the same taxable year but in a different calendar year. • The Service should allow

RICs that are exempt from section 4982 to make an election under section 4982(e)(4), thereby permitting such RICs to avoid application of the post-October loss rules of section 852. Karen Lau Assistant Counsel Attachment (in .pdf format)
