

MEMO# 10009

June 12, 1998

DRAFT INSTITUTE SUBMISSION ON DISTRIBUTOR 12B-1 TAX ISSUES

1 See Institute Memorandum to Tax Committee No. 20-98 and Adviser/Distributor Task Force, dated June 9, 1998. 2 See Institute Memorandum to Board of Governors No. 38-91, Tax Committee No. 14-91 and 12b-1 Ad Hoc Committee, dated June 4, 1991. 3 See Institute Memorandum to Accounting/Treasurers Members No. 35-93 and Tax Members No. 38-93, dated November 15, 1993. [10009] June 12, 1998 TO: TAX COMMITTEE No. 21-98 ADVISER/DISTRIBUTOR TASK FORCE RE: DRAFT INSTITUTE SUBMISSION ON DISTRIBUTOR 12b-1 TAX ISSUES

Attached for your review is a draft Institute submission to the IRS National Office regarding the tax consequences to a distributor of the sale of mutual fund "B" shares. As we previously informed you,¹ this submission will be discussed at the June 30 meeting to be held in the Institute's David Silver Conference Room. The submission has been prepared because IRS examining agents continue to raise issues that have been considered and rejected by the IRS National Office. For example, in 1993 the IRS withdrew a proposed coordinated issue paper that was opposed by the Institute² and issued Technical Advice Memorandum 9345003, in which IRS concluded that a mutual fund distributor (1) may deduct (as a dealer) commission payments to brokers under Treas. Reg. sec. 1.263(a)-2(e) and (2) does not include in income at the time of sale an estimate of the 12b-1 fees that may be earned in future years with respect to "B" shares sold.³ The draft submission urges the IRS National Office to reconfirm its prior position and to reject the IRS examining agents' efforts to reopen these issues. More specifically, the submission: * expresses the Institute's concerns about reconsidering the propriety of the industry's method of accounting in the context of IRS audits; * describes the relevant facts; * demonstrates that the income accrual rules of Code section 451 do not require a fund distributor to include an estimate of future distribution fees and contingent deferred sales loads in income at the time the "B" shares are sold because (1) the distributor's right to such future income is not fixed in the year the shares are sold and (2) the amount of such income is not ascertainable with reasonable accuracy; and * demonstrates that the IRS cannot reject the industry's method of accounting as failing to clearly reflect income under Code section 446(b) because (1) the industry's accounting method does clearly reflect income, (2) the current deduction of commission expenses is a specific method explicitly permitted by Treas. Reg. sec. 1.263(a)-2(e), and (3) income would not be reflected clearly by the inclusion in income of estimated amounts that cannot be accrued under Code section 451. ACTION REQUESTED Please review the draft submission before the June 30 meeting. If you cannot attend the meeting and have comments regarding the draft, please call the undersigned, before June 30, at 202-326- 5832. Keith D. Lawson Senior Counsel Attachment

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