

MEMO# 5894

May 17, 1994

HOUSE APPROVES TAX SIMPLIFICATION LEGISLATION

1 See Institute Memorandum to Tax Members No. 5-93, Accounting/Treasurers Members No. 3-93, Closed-End Fund Members No. 4-93, Operations Members No. 4-93, Unit Investment Trust Members No. 4-93, International Members No. 4-93 and Transfer Agent Advisory Committee No. 3-93, dated January 13, 1993. 2 See Institute Memorandum to Tax Members No. 65-92, Accounting/Treasurers Members No. 37-92, Closed-End Fund Members No. 37-92, Operations Members No. 37-92, Unit Investment Trust Members No. 50-92, International Members No. 22-92 and Transfer Agent Advisory Committee No. 58-92, dated October 8, 1992; and to Board of Governors No. 19-92, Tax Members No. 15-92, Closed-End Fund Members No. 13-92, Unit Investment Trust Members No. 20-92, Accounting/Treasurers Members No. 12-92, Operations Members No. 11-92, International Committee No. 7-92, Institutional Funds Committee No. 3-92 and Transfer Agent Advisory Committee No. 14-92, dated March 23, 1992. May 17, 1994 TO: ACCOUNTING/TREASURERS MEMBERS NO. 14-94 CLOSED-END FUND MEMBERS NO. 14-94 INTERNATIONAL MEMBERS NO. 3-94 OPERATIONS MEMBERS NO. 22-94 PENSION MEMBERS NO. 14-94 TAX MEMBERS NO. 23-94 TRANSFER AGENT ADVISORY COMMITTEE NO. 24-94 UNIT INVESTMENT TRUST MEMBERS NO. 20-94 RE: HOUSE APPROVES TAX SIMPLIFICATION LEGISLATION

Today, the House of Representatives approved by a voice vote H.R. 3419, the Tax Simplification and Technical Corrections Act of 1993. The provisions of interest to regulated investment companies ("RICs") and their shareholders are similar to provisions contained in the tax simplification and technical corrections bills introduced in 1993¹ and in the two tax bills vetoed in 1992.² Attached are copies of statutory bill language and the House Ways and Means Committee Report's explanation for several of the provisions. Anyone interested in obtaining copies of materials for other provisions may do so by calling Theresa Brice at (202) 326-5833. - 2 - I. Mutual Fund Tax Simplification A. 30 Percent Test Repeal H.R. 3419 would repeal the 30 percent test of Internal Revenue Code Section 851(b)(3) for taxable years ending after the date of enactment. (See Attachment A.) B. Shareholder Basis Reporting H.R. 3419 also would require funds and brokers to provide shareholders and the Internal Revenue Service with average cost basis information for shares redeemed. (See Attachment B.) As under previous bills, the reporting would be done on an account- by-account basis and the taxpayer could elect whether or not to use the information for each account. The provision would apply to accounts opened on or after January 1, 1995, but would not apply to accounts in which shares were acquired other than through purchase. Two significant changes are made by H.R. 3419 to the shareholder basis reporting provisions contained in the bill that was introduced in January 1993. First, a de minimis exception would be added to the wash sale rule of Code section 1091. Under the provision, as amended, losses not exceeding \$25 from dispositions during December of shares from a covered account would

be allowed, even though shares in the same fund are acquired during January of the following calendar year and within 30 days of the redemption date(s) and the losses on the December redemptions would otherwise be disallowed under the wash sale rule. For example, if a shareholder redeems ten shares with a cost basis of \$100 and value of \$90 on December 20 and purchases ten shares on January 6, the \$10 loss that would otherwise be disallowed by Code section 1091 would be allowed. Second, the sales load basis deferral rule of Code section 852(f) would be amended to provide that if (1) Load Fund A shares are purchased and redeemed within 90 days and (2) Load Fund B shares are purchased after December 31 of the year of the redemption, and the load on the Fund B shares is reduced or waived because of a "reinvestment right", the amount of the load paid on the Fund A shares would (1) not be subtracted from the basis of the previously-sold Fund A shares, (2) be included in the shareholder's gross income as short-term capital gain in the year the reinvestment right is exercised and (3) be included in the basis of the Fund B shares. - 3 -

C. Bank Common Trust Fund Conversions In addition, H.R. 3419 would permit the tax-free conversion of bank common trust funds into RICs. (See Attachment C.) Unlike the bills vetoed in 1992, H.R. 3419 would not permit RICs to convert tax free to bank common trust funds.

II. Foreign Investment Provisions

A. Simplified Foreign Tax Credit Reporting H.R. 3419 would allow individuals with no more than \$200 of creditable foreign taxes (\$400 in the case of a joint return) and no other foreign source income to elect a simplified method for claiming the foreign tax credit. The provision would apply to taxable years beginning after December 31, 1993.

B. Passive Foreign Corporations In addition, H.R. 3419 would modify the passive foreign investment company ("PFIC") rules. Under the bill, all shares of passive foreign corporations ("PFCs") held by RICs would be marked to market each year at October 31 for excise tax purposes and at the RIC's fiscal year-end for income tax purposes, unless a "qualified electing fund" election had been made by the RIC to currently include in its income the PFC's income. Under a transition rule, a RIC would be required to (1) mark to market all PFC stock in its portfolio on the first day of the RIC's first taxable year beginning after December 31, 1993, (2) pay a nondeductible interest charge on the tax that would have been collected had the PFC shares been marked to market in the prior years and (3) distribute the mark-to-market gains to its shareholders.

III. Pension Provisions The legislation also includes design-based safe harbors for section 401(k) nondiscrimination testing, expansion of the availability of salary reduction simplified employee pensions (SEPs) to employers with 100 or fewer employees, and elimination of the 50 percent participation requirement for salary reduction SEPs. H.R. 3419 also includes technical corrections to the Omnibus Reconciliation Act of 1993 relating to the calculation of cost-of-living adjustments to the \$150,000 limitation on the compensation that can be taken into account under retirement plans under section 401(a)(17) of the Internal Revenue Code. (See Attachment D.) - 4 -

* * * We will keep you informed of developments. Keith D. Lawson Associate Counsel - Tax Kathy D. Ireland Associate Counsel - Pension Attachments