

MEMO# 7936

June 5, 1996

DRAFT SUBMISSION TO IRS ON PREFERENTIAL DIVIDENDS

1 See Institute Memorandum to Tax Committee No. 23-95 and Accounting/Treasurers Committee No. 22-95, dated June 16, 1995. ACTION REQUESTED June 5, 1996 VIA FAX TO: TAX COMMITTEE No. 20-96 RE: DRAFT SUBMISSION TO IRS ON PREFERENTIAL DIVIDENDS

Attached for your review is a draft revenue procedure on multi-class mutual funds that was prepared by the Institute for submission to the IRS. The draft is based on a proposal that the Institute previously submitted to the IRS for the issuance of published guidance for multi-class funds. As you may recall,¹ the proposal urged the IRS to issue a revenue procedure providing that the IRS would not assert that dividends paid by a multi-class fund are preferential if: (1) each class has a different arrangement for the distribution of its shares or for the provision of shareholder services, or both; (2) each class is bona fide, which means that each class is either publicly offered or has at least 500 beneficial owners; (3) expenses of the different arrangements for distribution of shares or shareholder services are allocated to the class to which the arrangement applies; (4) expenses that are otherwise associated with the class (either because they relate to a class-specific service provided to that class or because they represent the incremental cost of providing a common service to the class) may be either allocated to the class or treated as a fund-wide expense; and (5) advisory expenses, custodial expenses and other expenses associated with the fund's portfolio must be treated as fund-wide expenses and allocated proportionately to all of the fund's shareholders. In addition, the draft revenue procedure provides that: (1) each class must have exclusive voting rights on any matter submitted to shareholders that relates solely to a distribution or shareholder services arrangement for that class; (2) each class must have separate voting rights on any matter submitted to shareholders in which the interests of the class differ from the interests of any other class or classes; (3) any payments under a distribution or shareholder services arrangement must be made pursuant to a written plan setting forth the separate arrangement and the expense allocation of each class; and (4) the classes must be separate state-law classes. These requirements are included in the draft to address concerns expressed by the IRS regarding whether a funds classes should be treated as separate classes for purposes of the preferential dividend rules. The first three requirements also are required by the SEC pursuant to Rule 18f-3. 2 See Institute Memorandum to Tax Committee No. 16-96, dated May 24, 1996. At the special meeting of the Tax Committee on Monday, June 10 at 2:00 p.m., we will discuss this draft revenue procedure. We plan to focus primarily on the question of whether the revenue procedure should address the effect of expense limitations (e.g., waivers and reimbursements) in a multi-class context and, if so, what the guidance should say.² The draft revenue procedure includes a proposal being considered to provide guidance on expense limitations. Please review the proposal on expense limitations to

determine whether it will provide sufficient flexibility regarding expense limitation arrangements. IRS representatives have asked us for "real-world" examples of situations involving expense limitations, such as waivers, reimbursements and/or caps of a fund's expenses, so please be prepared to discuss this at the meeting on June 10. Specifically, the IRS asked for information on the following: (1) the types of expenses that are involved; (2) the reasons for expense limitations; (3) definitions of the terms "waiver," "reimbursement" and "cap"; and (4) the identities and relationships of the parties involved in expense limitation arrangements. If you have comments on the draft, but will not be attending the June 10 meeting, please call me by June 10 with your comments. Anne M. Barr Assistant Counsel - Tax Attachment

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