MEMO# 2900

July 2, 1991

INSTITUTE RESPONSE TO IRS PROPOSED COORDINATED ISSUE PAPER ON START-UP EXPENSES

July 2, 1991 TO: BOARD OF GOVERNORS NO. 49-91 TAX MEMBERS NO. 25-91 ACCOUNTING/TREASURERS MEMBERS NO. 16-91 RE: INSTITUTE RESPONSE TO IRS PROPOSED COORDINATED ISSUE PAPER ON START-UP EXPENSES ____ As you may know, the IRS industry specialist for the mutual fund industry recently prepared a proposed coordinated issue paper that would require mutual fund advisers to capitalize the expenses they incur in connection with entering into advisory contracts with funds. (See Institute memorandum to Tax Committee No. 10-91 and Members - One Per Complex No. 16-91, dated April 15, 1991.) If approved by the IRS National Office, mutual fund advisers could be targeted for audit with respect to the coordinated issue, and IRS agents would be unable to settle the audits on terms different from the coordinated issue paper, without express permission from the IRS industry specialist responsible for the issue. Attached is a copy of the Institute's response to the IRS proposal. Both the Institute's response and the industry specialist's paper will be submitted to the IRS National Office. The Institute's paper explains that mutual fund advisers are constantly seeking new ways to make their advisory services available to investors, often through the creation of new mutual funds. The expenses incurred in connection with entering into new advisory contracts are ordinary and necessary business expenses of the adviser which must be incurred to preserve existing advisory fees and to compete with other financial service providers for additional revenue. The paper further contradicts the IRS argument that advisory contracts are separate and distinct assets for purposes of the capitalization requirement of Code section 263. The contracts have no ascertainable value at the time they are entered into and merely permit the adviser to be compensated for its advisory services to the fund, which may or may not be profitable. We will keep you informed of developments on this matter. Catherine L. Heron Vice President - Tax & Pension