MEMO# 2814

June 4, 1991

INSTITUTE RESPONSE TO IRS PROPOSED COORDINATED ISSUE PAPER ON DEDUCTIBILITY OF 12B-1 COMMISSION EXPENSES

June 4, 1991 TO: BOARD OF GOVERNORS NO. 38-91 TAX COMMITTEE NO. 14-91 12b-1 AD HOC COMMITTEE RE: INSTITUTE RESPONSE TO IRS PROPOSED COORDINATED ISSUE PAPER ON DEDUCTIBILITY OF 12b-1 COMMISSION EXPENSES ____ As you may know, the IRS Industry Specialist for the mutual fund industry has recently prepared a proposed coordinated issue paper that would require mutual fund distributors to capitalize the 12b-1 commission expenses incurred in connection with the sale of fund shares. (See Institute memorandum to 12b-1 Ad Hoc Committee, dated February 27, 1991.) Attached is the Institute's response to the IRS proposal. The Institute's paper describes the economics of mutual fund distribution and notes that distributors of certain 12b-1 funds incur commission expenses every day in their business of selling the fund shares. Moreover, these recurring expenses are essential to the preservation and expansion of the distributor's fee income as well as the fee income of the adviser, which is typically an affiliate of the distributor. The IRS contention that the income stream received by the distributor is a separate and distinct asset for purposes of the capitalization requirement of Code section 263 is disputed in the Institute's submission. Neither the amount nor the timing of the income received by the distributor under the 12b-1 plan can be determined, and the distributor is required to continue to perform services in the future in order to receive future income. Procedurally, both the IRS paper and the Institute's response will be submitted to the IRS National Office for consideration. We will keep you informed of further developments on this matter. Catherine L. Heron Vice President - Tax & Pension Attachment