

MEMO# 1236

June 30, 1989

REVENUE RULING ON \$10 MILLION INITIAL INVESTMENT EXCEPTION TO PREFERENTIAL DIVIDEND RULES

June 30, 1989 TO: TAX MEMBERS NO. 19-89 CLOSED-END FUND MEMBERS NO. 26-89 UNIT
INVESTMENT TRUST MEMBERS NO. 32-89 RE: REVENUE RULING ON \$10 MILLION INITIAL
INVESTMENT EXCEPTION TO PREFERENTIAL DIVIDEND RULES

The attached IRS Revenue Ruling addresses the question of whether the term "shareholder" in the Code Section 562(c) \$10 million initial investment exception to the preferential dividend rules refers to the legal owner or the beneficial owner of the regulated investment company (RIC) shares. As you know, the 1986 Tax Reform Act amended Code Section 562(c) to provide that "[i]n the case of a distribution by a regulated investment company to a shareholder who made an initial investment of at least \$10,000,000 in such company, such distribution shall not be treated as not being pro rata or as being preferential solely by reason of an increase in the distribution by reason of reduction in administrative expenses of the company." The RIC in the Revenue Ruling has shareholders who are fiduciaries maintaining master shareholder accounts. Each master shareholder account holds shares of the RIC in the name of the fiduciary as legal owner on behalf of numerous trusts, estates and other participants, the beneficial owners. The initial investments in the RIC by the fiduciaries sometimes equal or exceed \$10 million per account. For purposes of determining the initial investment in an account, the RIC treats the fiduciary as the shareholder of the master shareholder accounts. As a result of the RIC's expense allocation formula and its determination of who is the shareholder, the RIC pays a higher per-share dividend to beneficial owners of shares where the fiduciary of the master shareholder account meets the \$10 million initial investment threshold, regardless of whether the beneficial owners themselves made \$10 million initial investments, than it pays to other shareholders. The Revenue Ruling concludes that, although the term shareholder when used in the Code generally refers to the beneficial owner of shares, interpreting that term for purposes of section 562(c) to refer to the legal owner of the shares is consistent with the purpose of that section. Thus, in determining whether a \$10 million initial investment has been made for purposes of section 562(c), RICs may treat the fiduciary rather than the beneficial owner of the shares as the shareholder. We will keep you informed of developments. Keith D. Lawson Assistant General Counsel
Attachment

should not be considered a substitute for, legal advice.