INVESTMENT COMPANY INSTITUTE

MEMO# 11429

November 24, 1999

INSTITUTE PROPOSAL TO IRS FOR GUIDANCE PROVIDING 5-YEAR AMORTIZATION FOR CERTAIN NEW FUND CREATION COSTS

1 See Institute Memorandum to Tax Committee No. 10-91 and Members - One Per Complex No. 16-91, dated April 15, 1991. 2 See Institute Memorandum to Accounting/Treasurers Members No. 10-94, Members - One Per Complex No. 22-94 and Tax Members No. 11-94, dated March 30, 1994. 3 See Institute Memorandum to Accounting/Treasurers Members No. 14-98, Primary Contacts - Member Complex No. 59- 98, Tax Members No. 17-98 and the Task Force on Adviser/Distributor Tax Issues, dated June 25, 1998. 4 See Institute Memorandum to Tax Committee No. 2-99 and the Task Force on Adviser/Distributor Tax Issues, dated January 29, 1999. 5 See Institute Memorandum to Accounting/Treasurers Committee No. 6-99 and Tax Committee No. 4-99 (among others), dated March 11, 1999. [11429] November 24, 1999 TO: ACCOUNTING/TREASURERS COMMITTEE No. 45-99 TAX COMMITTEE No. 33-99 TASK FORCE ON ADVISER/DISTRIBUTOR TAX ISSUES RE: INSTITUTE PROPOSAL TO IRS FOR GUIDANCE PROVIDING 5-YEAR AMORTIZATION FOR CERTAIN NEW FUND CREATION COSTS

____ The controversy between the fund industry and the Internal Revenue Service ("IRS") regarding the proper tax treatment of the costs incurred by fund sponsors in creating new funds has been ongoing since at least 1991, when an IRS "industry specialist" proposed that the IRS National Office issue a "coordinated issue paper" asserting that these costs must be capitalized.1 In 1994, after the IRS approved this coordinated issue paper,2 IRS agents began offering to settle this "coordinated issue" by permitting the identified new fund costs to be capitalized over 15 years. In 1998, in the first (and so far only) court decision to address this issue, the U.S. Tax Court held that a fund sponsor was required to capitalize certain new fund creation costs and could not amortize them over any period.3 In an attempt to resolve this issue, the Institute earlier this year requested that the 1999 IRS/Treasury Priority Guidance Plan (also known as the "business plan") include guidance on the treatment of costs incurred by fund sponsors to create new funds.4 The IRS adopted our suggestion by including "mutual fund launch costs" on the business plan's list of several "capitalization" issues to be addressed over a two-year period.5 Today, the Institute submitted the attached memorandum to the IRS National Office setting forth our proposal for industry-wide guidance. Under our proposal, sponsors of new funds would be permitted to (1) capitalize new fund creation costs, as determined using a formula based on legal and accounting costs incurred in the new fund creation process, and (2) amortize those costs over a five-year period. We believe that the proposal's adoption would efficiently and permanently resolve the new fund creation cost issue and provide significant, long-term benefits to both the industry and the Service. Keith Lawson Senior Counsel Naomi Gendler Camper Assistant Counsel Attachment