

**MEMO# 13207**

February 26, 2001

## **MARCH 14 MEETING TO REVISE INSTITUTE POSITION ON START-UP EXPENSES; INSTITUTE'S REQUEST FOR IRS BUSINESS PLAN GUIDANCE**

[13207] February 26, 2001 TO: TAX COMMITTEE No. 9-01 TASK FORCE ON ADVISER/DISTRIBUTOR TAX ISSUES RE: MARCH 14 MEETING TO REVISE INSTITUTE POSITION ON START-UP EXPENSES; INSTITUTE'S REQUEST FOR IRS BUSINESS PLAN GUIDANCE

Introduction As those attending the February 8, 2001 meeting of the Tax Committee already know, a significant portion of the meeting was spent discussing the Institute's tax regulatory priorities for 2001 and, in particular, the Institute's ongoing effort to obtain industry-wide guidance on the treatment of costs incurred by a mutual fund sponsor in starting up new funds. This memorandum (1) announces a meeting to be held on March 14 on the start-up issue and (2) summarizes the decisions reached by the Tax Committee regarding the Institute's tax regulatory priorities, which are reflected in the attached letter to the Internal Revenue Service ("IRS") and Treasury Department suggesting items for inclusion in their 2001 IRS/Treasury Priority Guidance Plan (also known as the "business plan").

March 14 Meeting A meeting of the Tax Committee and the Task Force on Adviser/Distributor Tax Issues will be held on Wednesday, March 14, to discuss options for revising the Institute's 1999 proposal<sup>1</sup> to the IRS for the tax treatment of costs incurred by mutual fund sponsors in starting new funds. The meeting will begin at 2:00 p.m., in the Institute's David Silver Conference Room, on the 12th floor of our offices at 1401 H Street, NW, Washington DC 20005. Light refreshments (cookies and sodas) will be available during the meeting. If you plan to attend the meeting, please complete the attached meeting response form and return it to the Institute's Ezella Wynn by fax (202/326-5841) or e-mail (ewynn@ici.org). At the meeting, we will review recent developments in the capitalization area and consider various alternative proposals that could be submitted to IRS reflecting the industry's reaction these developments. As noted in the attached ICI letter on the business plan, many fund industry professionals now doubt that a significant portion of the industry would elect into industry-wide guidance (similar to Rev. Proc. 2000-38, which successfully resolved the 12b-1 See Institute Memorandum to Accounting/Treasurers Committee No. 45-99, Tax Committee No. 33-99 and Task Force on Adviser/Distributor Tax Issues, dated November 24, 1999. 21 issue) unless the guidance required less capitalization, particularly with respect to internal mutual fund launch costs, than would have been required under our 1999 submission. An agenda will be distributed in advance of the meeting to everyone planning to attend the meeting and to anyone else expressing interest.

Business Plan Letter The Institute has submitted the attached letter to the IRS and Treasury requesting that the 2001 business plan include several items of interest to

regulated investment companies (“RICs”) and their shareholders. The items are: (1) industry-wide guidance regarding the proper treatment of costs incurred by mutual fund sponsors in creating new funds; (2) guidance regarding the identification of passive foreign investment companies (“PFICs”) and the interaction of the PFIC rules with the income tax rules of Subchapter M of the Code and the excise tax minimum distribution requirements of section 4982; (3) guidance regarding the interaction between the income tax rules of Subchapter M of the Code and the excise tax minimum distribution requirements of section 4982,2 including: (a) promulgation of “bifurcation adjustment” regulations; (b) guidance that would clarify that short-term losses subject to section 852(b)(4)(A) are “recharacterized” as 20 percent rate losses; (c) guidance that would address the interaction between the constructive sale rules of section 1259 and the excise tax rules;3 and (d) guidance that would resolve long-standing technical issues arising from the interaction between the income tax and excise tax regimes;4 (4) guidance regarding the definition of a government security for RIC diversification purposes; and 2 These “interaction” issues were addressed in the Institute’s May 1998 submission to IRS. See Institute Memorandum to Tax Committee No. 19-98, dated May 29, 1998. 3 The requested guidance would (a) clarify that the constructive sale rules (including the closed transaction exception) apply on the basis of a RIC’s taxable year only and (b) provide, to any RIC seeking certainty as to the includability of constructive sale income for excise tax purposes, an election not to apply the closed transaction exception. 4 These issues include: (a) pre-January ordinary losses; (b) post-December ordinary losses; (c) the automatic deferral of post-October losses for dividend designation purposes; (d) post-October net short-term capital losses; (e) ordinary income and loss on dispositions of capital assets; and (f) application of the post-October loss rules to RICs exempt from section 4982. 3(5) guidance updating the regulations under section 853 pursuant to which RICs flow through foreign tax credits to their shareholders.5 Keith D. Lawson Senior Counsel Attachments Attachment no. 1 (in .pdf format) 5 Among other things, the regulations should clarify that RICs no longer need to provide shareholders with foreign tax credit information calculated on a country-by-country basis, as the statutory requirement for such reporting was repealed in 1976.