

MEMO# 2904

July 1, 1991

BILL INTRODUCED TO REPEAL 30 PERCENT TEST, PROVIDE SHAREHOLDER BASIS REPORTING AND CLARIFY TREATMENT OF REIMBURSED EXPENSES

July 1, 1991 TO: TAX MEMBERS NO. 24-91 OPERATIONS MEMBERS NO. 16-91 ACCOUNTING/TREASURERS MEMBERS NO. 15-91 RE: BILL INTRODUCED TO REPEAL 30 PERCENT TEST, PROVIDE SHAREHOLDER BASIS REPORTING AND CLARIFY TREATMENT OF REIMBURSED EXPENSES _____ The attached bill to (1) repeal the 30 percent test of Internal Revenue Code section 851(b)(3), (2) provide shareholder basis reporting and (3) clarify the treatment of reimbursed expenses under Code section 851(b)(2) was introduced late yesterday by Chairman Rostenkowski of the House Ways and Means Committee and several others, including the ranking minority member on the Committee, Congressman Archer. Also attached is Chairman Rostenkowski's statement upon introduction of the bill, which includes a description of the bill's provisions. Section 1 of the bill would repeal the 30 percent test of Code section 851(b)(3) for taxable years ending after the bill's date of enactment. Section 2 of the bill would amend the reporting requirements of Code section 6045 to impose upon mutual funds and brokers, that are presently required to report gross proceeds on sales or exchanges of mutual fund shares, the obligation to provide to shareholders and the Internal Revenue Service ("IRS") average cost basis information for shares redeemed. Consistent with the current reporting requirements of Code section 6045, basis information would be provided to shareholders by January 31, and to the IRS by the last day in February, of the year following the year of redemption. This reporting requirement would apply, however, only to accounts opened on or after January 1, 1993. The average cost information would be provided using the "single-category" method, which computes the average cost for all of the taxpayer's shares and then determines the holding period of shares sold on a first-in, first-out basis. Regulatory authority is provided to determine the manner in which basis and holding periods would be reported. Such authority would include - 2 - the authority to require funds and brokers to take into account wash sales, return of capital distributions and other events that might affect a basis calculation. All basis calculations would be done on an account-by-account basis. Funds and brokers would not be required to provide average cost information for any account that contains shares acquired other than by purchase (such as by gift or inheritance). Any broker that holds fund shares as a nominee for another person and transfers the shares to another broker would, however, be required to provide cost basis information to the second broker. The cost basis provisions of Code section 1012 would be amended to require fund shareholders to use the cost basis information provided in calculating gain or loss on the sale of fund shares, unless the

shareholder elected in the year of the first redemption from the account to use another cost basis method (either first-in, first-out or specific identification). Under the bill, shareholders could elect different cost basis methods for different accounts in the same fund. Special rules are also provided regarding the information reporting penalty provisions of Code sections 6721 through 6724. First, the bill provides that the amount "required to be reported" for purposes of determining the penalty for intentional disregard of reporting requirements would be computed without regard to basis amounts reported. Second, the explanation of provisions indicates that the reasonable cause exception of Code section 6724 is intended to prevent funds from being penalized for filing information reports by January 31 that contain basis information that must be "corrected" because of certain wash sales. Specifically, where the redemption of fund shares occurs in December and the acquisition of fund shares occurs in January of the subsequent year, the reasonable cause waiver will apply so long as "corrected" information returns are provided to the shareholder no later than the last day of February (which is also the date by which the information must be filed with the IRS). Section 3 of the bill would amend the 90 percent qualifying income test of Code section 851(b)(2) to provide that any reimbursement (or other payment) with respect to the fund's expenses will be disregarded in determining qualification under that section. Thus, under the bill, a fund would not be disqualified under Code section 851(b)(2) whether fees are limited by expense reimbursements or by an advance negotiation which does not result in any gross income to the fund. The accompanying explanation to the bill indicates that no inference is intended with respect to the treatment of reimbursed expenses under present law. This provision would apply to taxable years ending after the bill's date of enactment. - 3 - We will keep you informed of developments regarding this legislation. Keith D. Lawson Associate Counsel - Tax Attachments