

MEMO# 2946

July 18, 1991

INSTITUTE TESTIMONY BEFORE WAYS AND MEANS COMMITTEE ON INTERNATIONAL COMPETITIVENESS

July 18, 1991 TO: BOARD OF GOVERNORS NO. 53-91 TAX MEMBERS NO. 28-91
INTERNATIONAL MEMBERS NO. 3-91 ACCOUNTING/TREASURERS MEMBERS NO. 17-91 RE:
INSTITUTE TESTIMONY BEFORE WAYS AND MEANS COMMITTEE ON INTERNATIONAL
COMPETITIVENESS _____ The Institute
testified yesterday before the House Ways and Means Committee on "New Economic
Challenges: International Competitiveness and the U.S. Mutual Fund Industry." Attached are
both the oral and written testimony. The testimony notes that U.S. mutual funds are an
ideal vehicle for enhancing economic growth since funds can attract foreign investment and
thereby lower the cost of capital without leading to foreign control of domestic business.
However, despite having what SEC Chairman Breeden has described as "the best products
in the world in that area," the foreign sales of U.S. funds have been nominal. The two major
barriers to the sale of U.S. funds abroad, the testimony observes, are foreign securities laws
and U.S. tax laws. The testimony notes that the foreign securities law barriers can be
eliminated through reciprocal sales agreements, such as the one currently being negotiated
between the U.S. and the European Community. U.S. tax law, which is the second barrier
and the focus of the testimony, puts U.S. funds at a significant competitive disadvantage
when a foreign investor decides whether to invest in a U.S. fund or a foreign fund. To
remove this barrier, the Institute proposes three changes to the U.S. tax treatment of
foreign investors in U.S. funds. Specifically, the Institute proposes that U.S. funds be
permitted to flow through to their foreign shareholders the character of interest income and
short-term capital gains. By preserving the character of these types of income, foreign
investors would receive fund distributions attributable to interest income and short-term
capital gains free from U.S. withholding tax to the same extent currently permitted for
foreign funds investing in the U.S. Finally, the Institute proposes the creation of a special
corporation called an IRIC or International Regulated Investment Company, which could
invest only in the shares of a single U.S. mutual fund and would be sold only to foreign
investors. Through the use of the IRIC, which would not be compelled to distribute income
yearly, U.S. funds could compete more effectively with foreign funds which are permitted to
"build-up" or accumulate their income and gains. We will keep you informed of
developments. Keith D. Lawson Associate Counsel - Tax Attachments

should not be considered a substitute for, legal advice.