

MEMO# 9979

May 29, 1998

REQUEST FOR CAPITAL GAINS GUIDANCE

1 See Institute Memorandum to Tax Members No. 45-97 (among others), dated November 12, 1997. While IRS originally may have anticipated issuing capital gains guidance during 1998, the 1998 IRS Business Plan states that this guidance is not expected to be published until 1999. See Institute Memorandum to Tax Committee No. 8-98 (among others), dated March 4, 1998. 2 See Institute Memorandum to Tax Members No. 27-97 (among others), dated August 1, 1997. [9979] May 29, 1998 TO: TAX COMMITTEE No. 19-98 RE: REQUEST FOR CAPITAL GAINS GUIDANCE

The Institute has submitted to IRS the attached memorandum responding to IRS Notice 97-64,¹ which requested comments regarding changes made by the Taxpayer Relief Act of 1997 to the capital gains rules. The memorandum addresses both issues raised specifically by the Notice, such as the new “bifurcation adjustment,” and other long-standing issues relating to the interaction between the income tax rules of Subchapter M and the excise tax rules of section 4982.

1. Issues Relating to the “Bifurcation Adjustment” Described in the Notice. The Institute’s submission recommends several clarifications/modifications to the “bifurcation adjustment” described in the Notice. Specifically, we recommend that: (a) IRS clarify that the bifurcation adjustment applies for both designation purposes and taxable income purposes; (b) capital loss carryovers be deemed to arise on the first day of the taxable year to which they are carried; and (c) bifurcation not apply if the RIC has no post-October loss in any category. This last recommendation would help ensure that bifurcation applies only where necessary to “protect” the character of capital gain distributions made for excise tax purposes.

2. Recharacterization of Loss Under Section 852(b)(4)(A). Second, we recommend that any short-term loss recharacterized under section 852(b)(4)(A) as a “long-term” loss be treated as a 20 percent rate loss. This recommendation avoids the difficulties that would arise for shareholders under any approach that attempts to recapture the specific types of long-term gain included in the capital gain dividend.

3. Interaction of Sections 1259 and 4982. Third, we recommend that IRS regulations (a) clarify that the constructive sale rules of section 1259 (including the closed transaction exception) apply on the basis of a RIC’s taxable (fiscal) 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. In particular, we recommend that this election be made transaction by transaction and documented on an excise tax return for the period during which the income subject to the election arises. Any RIC making this election out of the closed transaction exception for a particular constructive sale would have income for excise tax and income tax purposes as of the date the constructive sale was entered into.

4. Additional Technical Modifications to Improve the Interaction Between the RIC Income Tax and Excise Tax Regimes. Finally, we recommend the so-called “glitch fixes” to resolve long-standing technical issues arising from the interaction between the income tax and excise tax regimes. The glitch fixes address issues attributable to: (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. Keith D. Lawson Senior Counsel
Attachment

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