

MEMO# 10989

May 18, 1999

INSTITUTE COMMENTS ON THE TREATMENT OF PASSIVE FOREIGN INVESTMENT COMPANY STOCK HELD BY CLOSED-END RICS

1 See Institute Memorandum to Tax Members No. 13-99, Unit Investment Trust Committee No. 5-99 and Closed-End Investment Company Committee No. 10-99, dated March 3, 1999. [10989] May 18, 1999 TO: TAX COMMITTEE No. 10-99 UNIT INVESTMENT TRUST COMMITTEE No. 12-99 CLOSED-END INVESTMENT COMPANY COMMITTEE No. 17-99 RE: INSTITUTE COMMENTS ON THE TREATMENT OF PASSIVE FOREIGN INVESTMENT COMPANY STOCK HELD BY CLOSED-END RICS

The Institute has submitted the attached comment letter to the Internal Revenue Service ("IRS") in response to proposed regulations¹ that prescribe when passive foreign investment company ("PFIC") stock held by a US shareholder is treated as "marketable" and, thus, eligible for the mark-to-market election of section 1296 of the Internal Revenue Code. Under the statute, all PFIC stock held directly or indirectly by regulated investment companies ("RICs") that issue redeemable securities (e.g., mutual funds) is treated as marketable. Similar statutory treatment is provided for PFIC stock held by closed-end RICs that publish net asset values ("NAVs") at least annually, except as provided in regulations. The proposed regulations request comments on situations, if any, in which PFIC stock held by closed-end RICs should not be treated as marketable. The Institute's letter recommends that the final PFIC regulations always treat PFIC stock held closed-end RICs as marketable. Specifically, the letter: ! describes generally the structure and operation of RICs, including their extensive regulation by the Securities and Exchange Commission and periodic determination of NAVs; ! explains that the availability of the mark-to-market election is essential for all RICs (including closed-end RICs) to avoid an unintended RIC-level tax and interest charge under the PFIC rules; ! explains that all RICs (including closed-end RICs) have been marking PFIC shares to market since 1992, pursuant to IRS guidance issued prior to the enactment of section 1296; ! urges that no tax policy rationale exists for treating closed-end RICs differently from mutual funds under the PFIC rules; and ! recommends that the final PFIC regulations treat PFIC stock held by all RICs as marketable for purposes of section 1296. Deanna J. Flores Assistant Counsel Attachment

should not be considered a substitute for, legal advice.