

**MEMO# 10145**

July 24, 1998

## **INSTITUTE SUBMISSION TO IRS ON DISTRIBUTOR 12B-1 TAX ISSUES**

1 See, e.g., Institute Memorandum to Tax Committee No. 21-98 and to the Adviser/Distributor Task Force, dated June 12, 1998. 2 See Institute Memorandum to Board of Governors No. 38-91, Tax Committee No. 14-91 and 12b-1 Ad Hoc Committee, dated June 4, 1991. 3 See Institute Memorandum to Accounting/Treasurers Members No. 35-93 and Tax Members No. 38-93, dated November 15, 1993. [10145] July 24, 1998 TO: TAX COMMITTEE No. 25-98 ADVISER/DISTRIBUTOR TASK FORCE RE: INSTITUTE SUBMISSION TO IRS ON DISTRIBUTOR 12b-1 TAX ISSUES

\_\_\_\_\_ As you know, IRS examining agents have been raising issues regarding the tax consequences to a distributor of the sale of mutual fund "B" shares.<sup>1</sup> The agents' contentions are inconsistent with conclusions reached several times by the IRS National Office. In 1993, for example, following consideration of these issues in the context of a proposed coordinated issue paper that was opposed by the Institute<sup>2</sup> and later withdrawn, the National Office issued Technical Advice Memorandum ("TAM") 9345003; this TAM held that a mutual fund distributor (1) may deduct (as a dealer) commission payments to brokers under Treas. Reg. sec. 1.263(a)-2(e) and (2) does not include in income at the time of sale an estimate of the 12b-1 fees that may be earned in future years with respect to "B" shares sold.<sup>3</sup> The Institute today submitted to the IRS National Office the attached memorandum urging them to reconfirm their prior position and to reject IRS' examining agents' efforts to reopen these issues. Specifically, the submission: \* expresses the Institute's concerns about reconsidering the propriety of the industry's method of accounting in the context of IRS audits; \* describes the relevant facts; \* demonstrates that the income accrual rules of Code section 451 do not require a fund distributor to include an estimate of future distribution fees and contingent deferred sales loads in income at the time the "B" shares are sold because (1) the distributor's right to such future income is not fixed in the year the shares are sold and (2) the amount of such income is not ascertainable with reasonable accuracy; and \* demonstrates that the IRS cannot reject the industry's method of accounting as failing to clearly reflect income under Code section 446(b) because (1) the industry's accounting method does clearly reflect income, (2) the current deduction of commission expenses is a specific method explicitly permitted by Treas. Reg. sec. 1.263(a)-2(e), and (3) income would not be reflected clearly by the inclusion in income of estimated amounts that cannot be accrued under Code section 451. Keith D. Lawson Senior Counsel Attachment

should not be considered a substitute for, legal advice.