

**MEMO# 16440**

August 19, 2003

## **DIVERSIFICATION GUIDANCE FOR REFUNDED BONDS**

[16440] August 19, 2003 TO: TAX MEMBERS No. 45-03 SEC RULES MEMBERS No. 109-03 FIXED-INCOME ADVISORY COMMITTEE No. 14-03 MONEY MARKET FUNDS ADVISORY COMMITTEE No. 15-03 RE: DIVERSIFICATION GUIDANCE FOR REFUNDED BONDS We are pleased to inform you that the Internal Revenue Service ("IRS") has issued the attached guidance (Revenue Ruling 2003-84)<sup>1</sup> requested by the Institute<sup>2</sup> regarding the Subchapter M diversification status of a refunded bond held by a regulated investment company ("RIC") that invests primarily in state and local obligations. The refunding transaction at issue involves US government securities (treated as "Government Securities" under section 2(a)(16) of the Investment Company Act of 1940 (the "1940 Act")) that are irrevocably placed in escrow to make all future payments of principal and interest on the refunded bond.<sup>3</sup> The IRS ruling notes that the Securities and Exchange Commission ("SEC") has concluded, under Rule 5(b)-3, that the RIC's investment in the refunded bond should be treated as an investment in Government Securities for purposes of the diversification requirements of the 1940 Act.<sup>4</sup> In Rev. Rul. 2003-84, the IRS announces that it will follow the SEC's conclusion for purposes of the tax diversification requirements of section 851(b)(3). Specifically, the ruling 1 Rev. Rul. 2003-84 is attached to the electronic version of this memorandum. <sup>2</sup> See Institute Memorandum (No. 14923) to Tax Members No. 30-02, dated July 15, 2002. <sup>3</sup> The escrow agreement may permit certain limited substitutions of securities that also are Government Securities. <sup>4</sup> See Institute Memorandum (No. 13722) to SEC Rules Members No. 54-01, dated July 12, 2001. See also, SEC Release No. IC-25058 (July 11, 2001). Note: Not all recipients receive the attachment. To obtain a copy of the attachment, please visit our members website (<http://members.ici.org>) and search for memo 16440, or call the ICI Library at (202) 326-8304 and request the attachment for memo 16440. 2 holds that the RIC may treat its investment in the refunded bond as an investment in government securities to the extent that the Securities and Exchange Commission treats the refunded bond as a government security for purposes of Rule 5b-3. Catherine Barré Assistant Counsel Attachment (in .pdf format)