

MEMO# 15245

October 9, 2002

SUPPLEMENTAL GUIDANCE ON TAXATION OF SYNTHETIC TAX-EXEMPT SECURITIES

[15245] October 9, 2002 TO: TAX COMMITTEE No. 30-02 MONEY MARKET FUNDS ADVISORY COMMITTEE No. 5-02 FIXED-INCOME ADVISORY COMMITTEE No. 11-02 RE: SUPPLEMENTAL GUIDANCE ON TAXATION OF SYNTHETIC TAX-EXEMPT SECURITIES We are pleased to inform you that the Internal Revenue Service (the "Service")--in response to comments submitted by the Institute¹ and others--has released the attached Revenue Procedure 2002-68 (the "new Revenue Procedure") modifying and superceding Revenue Procedure 2002-16 (the "old Revenue Procedure")² relating to the taxation of synthetic variable rate tax-exempt securities. The old Revenue Procedure provided a reporting mechanism pursuant to which a money market fund could take into account each month its allocable share of tax-exempt income from certain synthetic variable rate tax-exempt securities. The new Revenue Procedure follows the general structure of the old Revenue Procedure, but makes several important changes including: broadening the scope of the guidance to include all partners of "eligible partnerships;" eliminating the monthly reporting statement requirements set out in the old Revenue Procedure; and extending the transition relief date of the Revenue Procedure. The new Revenue Procedure also requests comments regarding "the establishment of modified income tax reporting procedures for eligible partnerships and consenting partners." Scope of the Guidance / Eligible Partners Under the old Revenue Procedure, only money market funds partners were eligible for the monthly closing election. The new Revenue Procedure extends the monthly closing election to all partners of an eligible partnership. Accordingly, any long-term bond fund investing in an eligible partnership would be eligible for the monthly closing election. 1 See, Institute Memorandum to Fixed-Income Advisory Committee No. 5-02, Money Market Funds Advisory Committee No. 1-02, and Tax Committee No. 12-02, dated April 22, 2002. 2 See, Institute Memorandum to Tax Committee No. 6-02, dated February 22, 2002. 2 Reporting Issues The new Revenue Procedure eliminates the monthly statement requirements set out under the old Revenue Procedure. With respect to partnership tax returns, the new Revenue Procedure indicates the Service's view that these partnerships "do not meet the requirement of 1.761-2(a)(1)" and accordingly are subject to the reporting requirements of subchapter K. However, the new Revenue Procedure requests comments regarding "the establishment of modified income tax reporting procedures for eligible partnerships and consenting partners." Effective Date While the new Revenue Procedure is effective October 7, 2002, it extends the date of the transition relief provided under the old Revenue Procedure. Specifically, "[f]or any taxable year beginning before January 1, 2004, the Service will not challenge a partnership's or a partner's tax treatment that is consistent with an election to be excluded from the provisions of subchapter K under 761(a), provided

the partnership would be an eligible partnership as defined in this revenue procedure and the partners' inclusion of income, gain, loss, deduction and credits is consistent with that permitted under this revenue procedure." ACTION REQUESTED Comments on the new Revenue Procedure are due to the IRS on December 6, 2002. Please contact the undersigned (cbarre@ici.org or 202/326/5821) by November 8, 2002, if you have any comments. Catherine Barre Assistant Counsel Attachment (in .pdf format)

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