

**MEMO# 15499**

December 31, 2002

# **COMMENT LETTER ON TEMPORARY AND PROPOSED REGULATIONS ADDRESSING ABUSIVE TAX AVOIDANCE TRANSACTIONS**

[15499] December 31, 2002 TO: ACCOUNTING/TREASURERS MEMBERS No. 55-02 ADVISER DISTRIBUTOR TAX ISSUES TASK FORCE No. 4-02 TAX MEMBERS No. 56-02 UNIT INVESTMENT TRUST MEMBERS No. 41-02 RE: COMMENT LETTER ON TEMPORARY AND PROPOSED REGULATIONS ADDRESSING ABUSIVE TAX AVOIDANCE TRANSACTIONS The Treasury Department ("Treasury") and the Internal Revenue Service ("IRS"), pursuant to an announcement earlier this year of an initiative to combat abusive tax shelter transactions, released amended temporary and proposed regulations under sections 6011 and 6112 of the Internal Revenue Code (the "Code"). These amended regulations provide certain exceptions for regulated investment companies ("RICs") that were suggested by the Institute following issuance of the announcement.<sup>1</sup> In the attached comment letter, the Institute requests a number of revisions to the recently released proposed regulations. As a preliminary matter, the Institute letter expresses concern regarding the apparent breadth of the regulations. Notwithstanding the fact that RICs are specifically exempted from certain reporting obligations under the proposed regulations, they may still require RICs to disclose reportable transactions and maintain records with respect to such transactions in situations where the actual risk that the RIC has engaged in an abusive tax avoidance transaction is minimal. The letter's first request is that certain entities be exempt from loss transactions and significant book-tax difference transactions in the same manner that RICs are excluded from these disclosure requirements. These entities include (1) partnerships held exclusively by RIC partners; (2) investment vehicles that invest exclusively in RICs, such as variable insurance product separate accounts and 529 plans; and (3) certain unit investment trusts registered under the Investment Company Act of 1940. <sup>1</sup> See Institute Memorandum to Accounting/Treasurers Committee No. 49-02, Tax Committee No. 35-02 and Unit Investment Trust Committee No. 25-02, dated November 1, 2002 for a discussion of the regulations; see Institute Memorandum to Tax Committee No. 27-02, dated September 5, 2002 for a discussion of the comments we submitted in response to Treasury's December 2001 initiative. <sup>2</sup> The letter also requests that the regulations define what it means to participate in a reportable transaction and limit participation to situations where (1) the taxpayer knows or should know that the transaction is a reportable transaction and (2) the taxpayer's tax liability is significantly affected by the transaction. The letter also reiterates the Institute's previous request that RICs be exempt from the disclosure requirements with respect to transactions involving brief asset holding periods. Third, the letter requests that the regulations clarify that contractual protection

transactions do not include (1) a bondholder's right to an increased yield on a purported tax- exempt bond if the bond is determined to be taxable or (2) the put feature in a synthetic municipal instrument (of the type described in Revenue Procedure 2002-68) where the put right is intended largely to ensure that the instrument may be held by a tax-exempt money market fund. These two features are intended merely to ensure that an obligation intended to be appropriate for a particular tax-exempt bond fund is appropriate, and should therefore not be subject to the disclosure rules. With respect to the list maintenance requirements, we request that an investment adviser to RICs and other 1940 Act-registered investment vehicles not be treated as a material advisor with respect to investment advice provided to such vehicles in the ordinary course of business so long as the amount of compensation received does not vary based upon the extent of tax advice and is not dependent on the investment producing any specific tax results. In addition, we recommend that an investment adviser to RICs and other 1940-Act registered investment vehicles, which nevertheless is treated as a material advisor, be required to include an investor on a reportable transaction list only if the material adviser knows or has reason to know that the investor is required to disclose that transaction. Finally, the letter requests that Treasury consider these comments on an expedited basis. In addition, we request that Treasury provide sufficient time for RICs and similar entities to comply with the regulations.

Lisa Robinson Assistant Counsel Attachment 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 15499, or call the ICI Library at (202) 326-8304 and request the attachment for memo 15499. Attachment (in .pdf format)

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