

**MEMO# 11608**

February 7, 2000

## **RECENT INTERNAL REVENUE SERVICE CAPITALIZATION RELEASES**

1 The Investment Company Institute is the national association of the American investment company industry. Its membership includes 8,018 open-end investment companies ("mutual funds"), 495 closed-end investment companies and 8 sponsors of unit investment trusts. Its mutual fund members have assets of about \$6.802 trillion, accounting for approximately 95% of total industry assets, and over 78.7 million individual shareholders. 2 See Memo 33-99, dated November 24th, 1999, "Institute Proposal to IRS for Guidance Providing 5-Year Amortization for Certain New Fund Creation Costs." [11608] February 7, 2000 TO: TAX COMMITTEE No. 4-00 RE: RECENT INTERNAL REVENUE SERVICE CAPITALIZATION RELEASES

The Internal Revenue Service has recently issued the attached two releases in the capitalization area. While neither release is of significant direct applicability to the fund industry, each provides some insight into the IRS' current thinking on capitalization issues generally and its view of various authorities cited and arguments advanced by the Institute<sup>1</sup> in our proposal<sup>2</sup> submitted to the IRS to resolve the start-up issue. In that submission, we argued that the Tax Court's decision in *FMR v. Commissioner*, 110 T.C. 402 (1998), requiring capitalization without amortization of new fund creation costs, was incorrect, and requested that industry-wide guidance be issued to avoid protracted litigation over the issues presented by the *FMR* case. Revenue Ruling 2000-4 rules that costs incurred by a taxpayer to obtain, maintain and renew an international quality certification ("ISO 9000") are deductible as ordinary and necessary business expenses under section 162 of the Internal Revenue Code, except to the extent that such expenditures result in the creation or acquisition of an asset, such as a quality manual, having a useful life substantially beyond the taxable year. The ruling determines that the quality certification at issue did not give rise to significant future benefits, but rather to incidental benefits analogous to benefits derived from advertising, training and similar expenditures incurred to maintain or improve an existing business. Accordingly, the Service reasons, such costs are deductible as ordinary and necessary business expenses under Code section 162. Notably, the ruling cites *Briarcliff Candy Corp. v. Commissioner*, 475 F.2d 775 (2d Cir. 1973) to support its reasoning that costs incurred to expand an existing business into new markets do not necessarily result in capitalizable future benefits. The Service distinguishes the *FMR* case by reasoning that costs to launch mutual funds are less speculative because they result in long-term management contracts and accordingly must be capitalized. The IRS' second capitalization release, Technical Advice Memorandum 199952069, concludes that amounts incurred by a business for employee compensation and travel in connection with soliciting, evaluating, and negotiating long-term service contracts are capitalizable under Code section 263, because the costs result in the acquisition of an asset and provide significant long-term benefits. The

Service rejected the taxpayer's argument that the relevant costs constituted "selling expenses." In addition, relying on *PNC Bancorp v. Commissioner*, 110 T.C. 349 (1998), and citing FMR for additional support, the Service rejected the taxpayer's argument that the recurring nature of the expenses justified section 162 deductibility. Naomi Gendler Camper Assistant Counsel Attachments Note: Not all recipients receive the attachments. To obtain a copy of the attachment referred to in this Memo, please call the ICI Library at (202) 326-8304, and ask for attachment number 11608. ICI Members may retrieve this Memo and its attachment from ICINet (<http://members.ici.org>).

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