

MEMO# 3103

September 17, 1991

INSTITUTE TESTIMONY BEFORE HOUSE WAYS AND MEANS SUBCOMMITTEE ON MUTUAL FUND TAX SIMPLIFICATION BILL

REVISED September 24, 1991 TO: BOARD OF GOVERNORS NO. 71-91 TAX MEMBERS NO. 38-91 OPERATIONS MEMBERS NO. 22-91 CLOSED-END FUND MEMBERS NO. 40-91 UNIT INVESTMENT TRUST MEMBERS NO. 39-91 ACCOUNTING/TREASURERS MEMBERS NO. 26-91 TRANSFER AGENT ADVISORY COMMITTEE NO. 42-91 RE: INSTITUTE TESTIMONY BEFORE HOUSE WAYS AND MEANS COMMITTEE ON MUTUAL FUND TAX BILL

The Institute recently testified before the House Ways and Means Subcommittee on Select Revenue Measures on H.R. 2735, a bill relating to the tax treatment of mutual funds. H.R. 2735 was introduced in June by Ways and Means Committee Chairman Dan Rostenkowski (D-Illinois) and several others, including the ranking minority member on the Committee, Congressman Bill Archer (R-Texas). H.R. 2735 would: (1) repeal the 30 percent test of Internal Revenue Code section 851(b)(3); (2) require shareholder basis reporting; and (3) clarify the treatment of reimbursed expenses under Code section 851(b)(2). (See Institute Memoranda to Board of Governors No. 46-91, dated June 25, 1991 and to Tax Committee No. 20-91, Operations Committee No. 21-91, Accounting/Treasurers Committee No. 14-91 and Transfer Agent Advisory Committee No. 31-91, dated June 25, 1991.) As it did before the Senate Finance Committee earlier this month, the Institute testified in strong support of the repeal of the 30 percent test. (See Institute Memorandum to Board of Governors No. 70-91, Tax Members No. 37-91 and Accounting/ Treasurers Members No. 24-91, dated September 12, 1991.) With respect to shareholder basis reporting, the Institute testified that the approach taken by H.R. 2735 reflects three fundamental principles which the Institute views as essential to a fair and workable shareholder basis reporting requirement. First, mutual fund shareholders should have the same options for computing taxable gain or loss as other investors in securities and should not be required to use the basis information provided. Second, distinctions should not be drawn between different categories of mutual fund shareholders, such as between shareholders who hold their shares directly and those whose shares are held in nominee name. Finally, the cost basis information provided to mutual fund shareholders should be average cost basis for new accounts opened after a prospective effective date. The testimony further stated that the effective date for the shareholder basis reporting provisions should be coordinated with the issuance of final Treasury regulations. The Institute also supported a proposal made by the Securities Industry Association that would extend until February 15 the date by which payors must provide year-end tax information to payees. In addition, support was expressed for the objective of section 3 of the bill, which provides that any amount included in a fund's income by reason of any reimbursement of expenses will not be treated as gross income for

purposes of the section 851(b)(2) 90 percent test. Also testifying in favor of the repeal of the 30 percent test were Treasury Assistant Secretary for Tax Policy Kenneth W. Gideon and Securities and Exchange Commission Chairman Richard C. Breeden. The Treasury testimony supported repeal of the 30 percent test, but noted that a revenue loss would occur. In Treasury's view, repeal of the 30 percent test would significantly reduce tax compliance costs for funds without sacrificing any legitimate tax policy objective. Of concern to the Institute was Treasury's testimony on shareholder basis reporting, which suggested that the use of the average cost method for computing gain or loss on redeemed shares be mandatory for fund shareholders. In addition, Treasury asked for regulatory authority to require reporting for existing accounts, without specifying a deadline for implementation of such authority. Finally, the Treasury opposed the proposed modification to the 90 percent test (relating to qualifying income) because of concerns regarding the breadth of the proposed amendment. SEC Chairman Breeden strongly supported the repeal of the 30 percent test and stated that the federal securities laws provide investor protection against the abuses now thought to be prevented by section 851(b)(3). In the Commission's view, repeal of the test would eliminate tax-motivated investment decisions and administrative and compliance burdens, but would not compromise investor protection or encourage speculative investing. Also testifying at the hearing were representatives of the Securities Industry Association, the American Institute of Certified Public Accountants, the American Bar Association and the American Stock Exchange. Each unanimously supported the repeal of the 30 percent test, but had diverse opinions on the other provisions of the bill. We will keep you informed of developments. Keith D. Lawson Associate Counsel - Tax

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