

MEMO# 4416

January 13, 1993

CHAIRMAN ROSTENKOWSKI INTRODUCES TAX BILLS

11/ See Institute Memorandum to Tax Members No. 65-92, Accounting/Treasurers Members No. 37-92, Closed-End Fund Members No. 37-92, Operations Members No. 37-92, Unit Investment Trust Members No. 50-92, International Members No. 22-92 and Transfer Agent Advisory Committee No. 58-92, dated October 8, 1992; and to Board of Governors No. 19-92, Tax Members No. 15-92, Closed-End Fund Members No. 13-92, Unit Investment Trust Members No. 20-92, Accounting/Treasurers Members No. 12-92, Operations Members No. 11-92, International Committee No. 7-92, Institutional Funds Committee No. 3-92 and Transfer Agent Advisory Committee No. 14-92, dated March 23, 1992. 22/ A separate memorandum to Pension Members describes various pension simplification provisions. January 13, 1993 TO: TAX MEMBERS NO. 5-93 ACCOUNTING/TREASURERS MEMBERS NO. 3-93 CLOSED-END FUND MEMBERS NO. 4-93 OPERATIONS MEMBERS NO. 4-93 UNIT INVESTMENT TRUST MEMBERS NO. 4-93 INTERNATIONAL MEMBERS NO. 4-93 TRANSFER AGENT ADVISORY COMMITTEE NO. 3-93 RE: CHAIRMAN ROSTENKOWSKI INTRODUCES TAX BILLS _____ House Ways and Means Committee Chairman Rostenkowski recently introduced H.R. 13, the Tax Simplification Act of 1993, and H.R. 17, the Technical Corrections Act of 1993. Many of the provisions contained in H.R. 13 are similar to provisions contained in the two tax bills vetoed last year by President Bush. 1/1 This memorandum describes several non-pension-related provisions in the bills that would affect regulated investment companies ("RICs") and their shareholders. 2/2 Attached are copies of statutory bill language and the Joint Committee on Taxation's Technical Explanation for several of the provisions. Anyone interested in obtaining copies of materials for other provisions may do so by calling the undersigned at (202) 955-3585. - 1 - I. Mutual Fund Tax Simplification H.R. 13 would repeal the 30 percent test of Internal Revenue Code section 851(b)(3) for taxable years ending after the date of enactment. (See Attachment A.) H.R. 13 also would require funds and brokers to provide shareholders and the Internal Revenue Service with average cost basis information for shares redeemed. (See Attachment B.) As under previous bills, the reporting would be done on an account- by-account basis and the taxpayer could elect whether or not to use the information for each account. The provision would apply to accounts opened on or after January 1, 1995, but would not apply to accounts in which shares were acquired other than through purchase. Two significant changes are made by H.R. 13 to earlier basis reporting proposals. First, the wash sale rule of Code section 1091 would be amended to disregard any shares purchased, pursuant to a dividend reinvestment plan, after January 15 of the year following the year of redemption, so long as (1) the shareholder entered into the dividend reinvestment plan when the account was opened or, if later, at least 6 months before the date of redemption and (2) the redemption is from a "covered account" on which basis reporting is required. Second, the sales load basis deferral rule of Code section 852(f)

would be amended to provide that if (1) Load Fund A shares are purchased and redeemed within 90 days and (2) Load Fund B shares are purchased after January 15 of the year following the year of the redemption, and the load on the Fund B shares is reduced or waived because of a "reinvestment right", the amount of the load paid on the Fund A shares would (1) not be subtracted from the basis of the previously-sold Fund A shares, (2) be included in the shareholder's gross income as short-term capital gain in the year the reinvestment right is exercised and (3) be included in the basis of the Fund B shares. In addition, H.R. 13 would permit the tax-free conversion of bank common trust funds into RICs. (See Attachment C.) Unlike the bill vetoed by President Bush last November, H.R. 13 would not permit RICs to convert tax free to bank common trust funds.

II. Foreign Investment Provisions H.R. 13 would allow individuals with no more than \$200 of creditable foreign taxes (\$400 in the case of a joint return) and no other foreign source income to elect a simplified method for claiming the foreign tax credit. The provision would apply to taxable years beginning after December 31, 1992. In addition, H.R. 13 would modify the passive foreign investment company ("PFIC") rules. Under the bill, all shares of - 2 - passive foreign corporations ("PFCs") held by RICs would be - 3 - marked to market each year at October 31 for excise tax purposes and at the RIC's fiscal year-end for income tax purposes, unless a "qualified electing fund" election had been made by the RIC to currently include in its income the PFC's income. Under a transition rule, a RIC would be required to (1) mark to market all PFC stock in its portfolio on the first day of the RIC's first taxable year beginning after December 31, 1993, (2) pay a nondeductible interest charge on the tax that would have been collected had the PFC shares been marked to market in the prior years and (3) distribute the mark-to-market gains to its shareholders.

III. Amortization of Intangibles H.R. 13 would require that the purchase price of certain acquired intangible assets be amortized over a uniform 14-year period. Among the intangible assets covered by the bill are goodwill, going concern value and various customer-based intangibles, such as investment advisory contracts. The provision would be generally effective for property acquired after the date of enactment, although a taxpayer could elect to have the bill apply to all property acquired after July 25, 1991.

IV. RIC - NonRIC Mergers The Technical Corrections bill (H.R. 17) would amend Code section 852(a) to provide that a RIC will not qualify for tax treatment under Subchapter M of the Internal Revenue Code if a nonRIC (such as a personal holding company) merges into the RIC after January 5, 1993 and any earnings and profits accumulated by the nonRIC are not distributed prior to the end of the RIC's fiscal year. (See Attachment D.) As you may know, the IRS issued proposed regulations last month which would provide the same rule with respect to mergers occurring on or after December 22, 1992. (See Institute Memorandum to Tax Members No. 80-92 and Accounting/Treasurers Members No. 45-92, dated December 23, 1992.) The Technical Explanation to H.R. 17 provides that no inference is intended with respect to present law on whether a RIC that succeeds to earnings and profits of a nonRIC is permitted to retain those earnings and profits and continue to be taxable as a RIC. * * *

We will keep you informed of developments. Keith D. Lawson Associate Counsel - Tax