

MEMO# 20728

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SEC Clarifies and Delays Implementation of Accounting Pronouncement Regarding Uncertain Tax Positions

©2006 Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice. [20728] December 26, 2006 TO: BOARD OF GOVERNORS No. 35-06 INVESTMENT COMPANY DIRECTORS No. 32-06 PRIMARY CONTACTS - MEMBER COMPLEX No. 24-06 ACCOUNTING/TREASURERS MEMBERS No. 32-06 TAX MEMBERS No. 50-06 SEC RULES MEMBERS No. 113-06 RE: SEC CLARIFIES AND DELAYS IMPLEMENTATION OF ACCOUNTING PRONOUNCEMENT REGARDING UNCERTAIN TAX POSITIONS We are pleased to inform you that the Securities and Exchange Commission ("SEC") has issued staff guidance ("the SEC letter")¹ responding favorably to Institute President Paul Stevens' letter regarding an accounting pronouncement governing uncertain tax positions.² The SEC letter delays implementation of this accounting pronouncement - the Financial Accounting Standards Board's ("FASB's") Interpretation No. 48, Accounting for Uncertainty in Income Taxes ("FIN 48")³ - and clarifies its application. 1 http://www.sec.gov/divisions/investment/letter_mutual_fund_fin_48.htm. 2 See Institute Memorandum (20680) to Board of Governors No. 30-06, Investment Company Directors No. 29-06, Primary Contacts - Member Complex No. 21-06, Accounting/Treasurers Members No. 27-06, Tax Members No. 45-06, and SEC Rules Committee No. 53-06, dated December 13, 2006. This letter follows up on earlier Institute submissions on FIN 48. See, e.g., Institute Memorandum (20061) to Accounting/Treasurers Members No. 11-06 and Tax Members No. 17-06, dated May 23, 2006. 3 FIN 48 mandates a two-part test for recognition of a tax benefit in the financial statement of any company (such as an investment company) that follows generally accepted accounting principles. Under the first (recognition) part of the test, the company must determine that it has a greater than 50 percent likelihood of sustaining its position upon examination based upon the "technical merits" of the position. Under the second (measurement) part of the test, the company must determine the amount of benefit that may be recognized by considering all of the potential outcomes and measuring the probability that each will occur. As originally issued, FIN 48 would have applied to investment companies beginning as early as January 2, 2007. See, e.g., Institute Memorandum (20183) to Accounting/Treasurers Members No. 14-06, Tax Members No. 24-06, and Advisor Distributor Tax Issues Task Force No. 8-06, dated July 14, 2006. 2 FIN 48 Clarifications The SEC letter first clarifies the types of guidance upon which investment companies can rely in assessing the technical merits of a tax position. Importantly, the SEC letter states that the staff believes that FIN 48 "permit[s], and indeed necessitate[s]" the consideration of informal IRS guidance that often is relied upon by investment companies in assessing the technical merits of their tax positions. According to the SEC staff, "we do not

believe that [FIN 48] places any limits on the type of guidance that an enterprise can look to in making [this] determination.” The SEC letter then clarifies the types of IRS administrative practices and precedents that should be considered. Specifically, the SEC letter responds to the Institute’s assertion, as described by the SEC staff, that “in the event the IRS objects to a tax position taken by a fund, the IRS at times grants prospective transition to cure the underlying deficiency such that no additional taxes are due for prior periods.” The SEC letter then provides that, “[i]f this is in fact the case, we believe that funds can, and should, consider the taxing authority’s practices of addressing fund industry issues on a prospective basis as part of the administrative practices and precedents of the taxing authority.” FIN 48 Implementation Delay Acknowledging the unique issues that FIN 48 presents for investment companies that calculate net asset values (“NAVs”), the SEC letter also permits investment companies to delay FIN 48’s implementation. Specifically, the SEC letter provides that the staff would not recommend enforcement action “if a fund implements [FIN 48] in its NAV calculation as late as its last NAV calculation in the first required financial statement reporting period for its fiscal year beginning after December 15, 2006.” Thus, • A calendar-year open-end or closed-end fund would implement FIN 48 no later than its June 29, 2007⁴ NAV; the effects of FIN 48 would be reflected in the fund’s semi-annual financial statements contained in its Form N-CSR filing. • Similarly, a fund with a February year-end would implement FIN 48 no later than its August 31, 2007 financial statements and NAV calculation. • A calendar-year business development company would implement FIN 48 as of the last day of the period for filing Form 10-Q, which would be March 31, 2007. • A unit investment trust would implement FIN 48 no later than December 31, 2007, which is the date of the information contained in its next Form N-SAR for fiscal years beginning after December 15, 2006. Elizabeth Krentzman General Counsel 4 June 29, 2007 is the last business day of the semi-annual reporting period.