INVESTMENT COMPANY INSTITUTE

MEMO# 2321

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YEAR-END TAX INFORMATION REPORTING FOR 1990 RETURNS

1 */ The BDAC members of the liaison group also served as representatives of the Technical Tax Committee of the Securities Industry Association (SIA). - 1 - November 26, 1990 TO: OPERATIONS MEMBERS NO. 33-90 ACCOUNTING/TREASURERS MEMBERS NO. 24-90 TAX MEMBERS NO. 50-90 SEC RULES MEMBERS NO. 80-90 CLOSED-END FUND MEMBERS NO. 47-90 TRANSFER AGENT ADVISORY COMMITTEE NO. 47-90 BROKER/DEALER ADVISORY COMMITTEE NO. 43-90 RE: YEAR-END TAX INFORMATION REPORTING FOR 1990 RETURNS ____ As you may know, in 1989 the Institute formed a liaison group consisting of members of the Institute's Accounting/ Treasurers Committee (ATC) and its Broker/Dealer Advisory Committee (BDAC) to coordinate the date by which broker-sold funds registered in street name should provide year-end tax information to broker/dealers and the manner in which that information is provided. The discussions and any agreements of this group are intended to apply to both open-end and closed-end funds. On October 26, 1990, the liaison group met to discuss reporting of 1990 tax information in January 1991. Participating for the fund industry were: Joe Connoly Dreyfus Sue Cote Prudential Mutual Funds John Gargana Lord, Abbett Murray Goldsmith Prudential Mutual Funds Richard Rose The Boston Company Rich Silver Colonial Participating for the broker/dealers*/1 were: John Cirrito Prudential-Bache Emil Polito PaineWebber Al Rubin Shearson Lehman Bros. John Scrobola Merrill Lynch - 2 - Dan Spadaccini Shearson Lehman Bros. Darryl Vines PaineWebber Robin Wallick Piper Jaffray ICI Staff: Don Boteler Keith Lawson In addition, Sandy Manata of the National Securities Clearing Corporation (NSCC) provided a brief description of an automated reporting facility developed by NSCC that is expected to be made available beginning in December 1990 for funds to report year-end tax information to broker/dealers in a centralized standardized environment. 1989 Information Returns Experience During 1989, the liaison group agreed that funds would endeavor to report the final year-end tax information (including any post year-end dividend reclassifications) for 1989 no later than Monday, January 15, 1990. The Institute then urged all of its fund members to adopt the agreement as an industry standard. (See Memorandum to Operations Members No. 29-89, SEC Rules Members No. 54-89, Tax Members No. 33-89, Broker/Dealer Advisory Committee No. 44-89 and Accounting/Treasurers Members No. 5-89, dated October 4, 1989.) Two problems developed with the 1989 agreement. First, many fund groups were contacted by broker/dealers requesting the information earlier than January 15, 1990, and in several instances prior to the end of December, 1989. Second, broker/dealers experienced some difficulty getting information from certain fund groups by January 15, 1990. October 26, 1990 Meeting At the request of the BDAC members of the liaison group, on behalf of the SIA's Technical Tax Committee, the October 26 meeting of the liaison group was arranged

for the purpose of determining a mutually agreeable tax reporting schedule for January, 1991 and to discuss NSCC's centralized reporting facility. At least three major problems exist with reporting year-end tax information to broker-sold accounts by January 31. First, the funds confront numerous complexities in properly calculating the tax information, some of which cannot be resolved by mid- January. Second, broker/dealers face time constraints in processing and reporting fund information by January 31 along with tax information for their clients' other securities positions. Third, logistical difficulties result from funds having to report tax information to numerous broker/dealers and - 3 - from broker/dealers having to collect the data from a large number of funds. - 4 - The October 26 meeting attempted to address each of these three major problems. The third problem, relating to logistical difficulties in reporting/collecting information, may have been alleviated. In addition, shareholder confusion may be alleviated somewhat by the funds' proposal, which produced a generally favorable reaction, to draft a model letter informing shareholders of amended information which the brokers would send after 1099s were issued. However, the attempt to reach a mutually-agreeable date by which fund groups must deliver tax information to broker/dealers for all funds in a complex was unsuccessful. a. Reporting Deadline The broker/dealer representatives of the group were unified in their position that funds must deliver final tax information by 5:00 p.m. on Friday, January 11, 1991, for the information to be included in the broker/dealers' normal 1099 processing. The brokers maintained that they would need three weekends in January to process 1099 and other client information. During the upcoming January, the second and third weekends (January 12-13 and 19-20) would be used to process 1099 data and the last weekend (January 26-27) would be used to process clients' monthly statements. Fund groups would thereby be left with only one weekend (January 5-6) to perform their tax calculations. The fund representatives informed the broker representatives that numerous funds would be unable to meet a January 11 deadline and described in detail several reasons why tax information compiled in early January may be subject to reclassification. Among the problems discussed were (i) capital gain reclassifications arising from foreign currency gains or losses, (ii) short-term to long-term and long-term to short-term gain reclassifications for funds with loss deferrals from straddles and mark-to-market gains and losses from section 1256 futures contracts, (iii) the application of wash sale rules, and (iv) the 1989 statutory change requiring funds to accrue dividends to be received on ex-dividend date. The fund representatives then urged that, because of the complex nature of the tax calculations they must perform, the fund industry and the broker/dealers each have two weekends to perform their respective year-end tasks. This approach of giving two weekends to each group worked in January 1990 and should work again in 1991. The brokers were insistent, however, that January 11 must be the deadline and that any dividend classifications or reclassifications received from funds thereafter would be processed and forwarded to shareholders as corrections. Although the fund representatives strongly disagreed that January 11 should be the final deadline, we indicated that funds would make every effort to provide tax information to brokers as early as possible and to meet a January 11 date if they could. The fund representatives will continue to discuss with the broker representatives the "wisdom" of the January 11 final deadline. - 5 - b. Shareholder/Client Relations Reporting to shareholders as corrections all dividend reclassifications received after 5:00 p.m. on January 11 presents potentially serious shareholder and client relations problems. For example, if a fund reclassifies its dividends for 1990 on January 14, 1991, it will be unable to have the revised information included on the shareholders' 1099 DIVs. Shareholders later receiving the corrected information after filing their tax returns can be expected to complain to their brokers, who can in turn be expected to deflect responsibility to the funds for not being "timely" in providing the information. Funds, in turn, may be expected to respond to inquiries that such information was available to brokers on a timely basis. To help reduce this confusion, some but not all of the brokers agreed that they would forward to their clients "Dear Shareholder" letters prepared by the funds to explain why the revised tax information was not included in the 1099s sent in January. The fund representatives proposed to draft a model letter, review it with the broker/dealer representatives of the liaison group and then distribute it to the ICI Committees and mailing lists of members. c. Centralized Reporting To alleviate much of the labor intensive and time consuming reporting burden for both funds and broker/dealers, the NSCC has developed an automated procedure whereby all funds can report year-end tax information once, to NSCC, and NSCC will make that information available to its broker/dealer participants. Funds that currently participate in NSCC may use the facility at no additional charge. It is expected that funds that are non-NSCC participants will also be able to participate in this centralized reporting network. This service is available to both open-end and closed-end funds. For the present, NSCC will not charge non-participating funds to use this facility. This centralized reporting system is expected to be operational by December 1, 1990. NSCC reported that information received from funds by 6:00 p.m. on any day will be available to brokers by 7:00 p.m. on that same day. One important feature of this system is the ability to indicate whether information has been revised. Thus, if a fund provides information to NSCC on January 8 and revises that information on January 10, all brokers will be on notice that the original information was revised before the January 11, 1990 deadline. The brokers are encouraging funds to provide tax information to NSCC as early as possible. NSCC is still seeking to determine how late on January 11 funds can provide tax information that can be available to broker/dealers by 5:00 p.m. on January 11. The enclosed document prepared by NSCC describes this reporting facility. Funds wishing to use this reporting facility who are not NSCC participants may call one of the NSCC contacts listed in the enclosed document for additional information. CONCLUSION It is clear that both the broker/dealer and the mutual fund industries must continue to work together to provide accurate and timely information to shareholders. A "take it or leave it" position by brokers that funds must provide all tax information by January 11, 1991 does not advance the "common cause". The position by the broker community that the last weekend in January (January 26-27, 1991) must be reserved to process their clients' ordinary monthly statements is totally unacceptable. Broker customers can be told in advance that their January statements will be slightly delayed due to the production of tax information. Everyone should understand and accept this explanation. The use of NSCC as a data source should greatly reduce the brokers' need to individually contact each fund group. However, in negotiating deadlines, the brokers should keep in mind that funds may be required to provide data to NSCC one day before the deadline to ensure that the information will be available to brokers by the deadline. Any acceleration of the deadline puts even more pressure on the funds. Finally, in a time period where great emphasis is being placed on quality service by brokers and funds, no benefits will come from reporting incorrect tax information to shareholders. It is costly and inefficient for brokers to impose such overly stringent reporting deadlines on funds that incomplete or inaccurate information is provided. When the information is corrected, shareholders may become confused or annoyed, especially if their tax returns have already been filed. If the inaccurate information is not corrected, the investors will be at risk if they are audited by IRS. * * * * We will continue to discuss year-end information reporting procedures with the brokers and keep you informed of any developments. In the meantime, fund groups are urged to make every effort to provide brokers with timely tax information; whenever possible, that information should be provided by January 11, 1991. Donald E. O'Connor Vice President - Operations Enclosure