

MEMO# 14401

January 25, 2002

IRS REQUESTS COMMENTS ON ADVANCE NOTICE OF GUIDANCE THAT WILL PERMIT DEDUCTIBILITY OF AMOUNTS PREVIOUSLY REQUIRED TO BE CAPITALIZED

[14401] January 25, 2002 TO: TAX COMMITTEE No. 3-02 TASK FORCE ON ADVISER/DISTRIBUTOR TAX ISSUES RE: IRS REQUESTS COMMENTS ON ADVANCE NOTICE OF GUIDANCE THAT WILL PERMIT DEDUCTIBILITY OF AMOUNTS PREVIOUSLY REQUIRED TO BE CAPITALIZED As you may know, the Internal Revenue Service ("IRS") for several years has been seeking to require capitalization of various costs that taxpayers historically have deducted. For example, IRS agents auditing mutual fund management companies have been requiring that the costs incurred by the manager in starting new funds be capitalized and amortized over 15 years.¹ In general, the costs at issue have primarily been internal costs such as employee compensation. The only time this issue was litigated, the IRS agents' position was upheld by the court.² Because of the industry's strong disagreement with the IRS position and the administrative burdens that position placed on taxpayers, the Institute repeatedly urged the IRS to reconsider its position. Among other things, we urged that guidance be issued clarifying the extent to which mutual fund start-up costs are deductible and providing a short amortization period for any costs required to be capitalized.³ Recently, we were advised by IRS that they generally would be focusing their resources on general, rather than industry-specific, capitalization guidance. Consequently, we are pleased to inform you that the Treasury Department and the IRS have issued the attached Advance Notice of Proposed Rulemaking ("ANPRM") providing guidance regarding the deductibility or capitalization of expenditures incurred in connection with intangible assets. More specifically, the ANPRM provides a framework for proposed regulations describing (1) specific categories of expenditures incurred in acquiring, creating or 1 See, e.g., Institute Memorandum to Tax Members No. 5-99 and Task Force on Adviser/Distributor Tax Issues, dated January 15, 1999. 2 See, Institute Memorandum to Accounting/Treasurers Members No. 14-98, Primary Contacts – Member Complex No. 59-98, Tax Members No. 17-98 and Adviser Distributor Task Force, dated June 25, 1998. 3 See, e.g., Institute Memorandum to Accounting/Treasurers Committee No. 45-99, Tax Committee No. 33-99 and Task Force on Adviser/Distributor Issues, dated November 24, 1999. 2 enhancing intangible assets or benefits that taxpayers are required to capitalize and (2) certain types of transaction costs otherwise capitalizable that nevertheless would be deductible.⁴ Of particular importance to the industry, the ANPRM announces that the IRS will issue regulations that generally treat internal costs, apparently including those incurred in

starting new funds, as deductible. Specifically, the ANPRM deductibility exception would apply to “employee compensation (except for bonuses and commissions that are paid with respect to the transaction), fixed overhead (e.g., rent, utilities and depreciation), or costs that do not exceed a specified dollar amount, such as \$5,000.” Comments on the ANPRM are due by March 25, 2002. With respect to the de minimis exception, as described above, the IRS and Treasury Department specifically have requested comments on (1) how expenditures should be aggregated for purposes of the applying the exception, (2) whether the exception should allow a deduction for the threshold amount where the aggregate transaction costs exceed the threshold amount and (3) whether there are certain expenditures for which the exception should not apply (e.g., commissions). In addition, comments are requested on whether “the recurring or nonrecurring nature of a transaction is an appropriate consideration in determining whether an expenditure to facilitate the transaction must be capitalized under section 263(a) and, if so, what criteria should be applied in distinguishing between recurring and non-recurring transactions.” Comments also are requested on whether a taxpayer’s treatment of transaction costs for financial or regulatory accounting purposes should be taken into account when developing simplifying assumptions. The Tax Committee will discuss the ANPRM during its next regularly scheduled meetings in Washington, DC on February 12 and 13, 2002.⁵ If you have suggestions for particular items to be discussed with respect to the ANPRM at the upcoming meetings of the Tax Committee or any other comments on the ANPRM, please contact the undersigned (lawson@ici.org or 202/326-5832) or Catherine Barré (cbarre@ici.org or 202/326-5821). Keith Lawson Senior Counsel Attachment (in .pdf format) 4 For example, the ANPRM provides a safe harbor permitting the deduction of expenditures that do not create or enhance intangible rights for the taxpayer that extend beyond the earlier of 12 months after the first date on which the taxpayer realizes the rights or benefits attributable to the expenditure or the end of the taxable year following the taxable year in which the expenditure is incurred. 5 See, Institute Memorandum to Tax Committee No. 1-02, dated January 17, 2002.