

MEMO# 10436

October 30, 1998

OMNIBUS APPROPRIATIONS BILL RESOLVES CAPITAL GAINS TECHNICAL CORRECTION AND IMPOSES INTERNET TAX MORATORIUM

1 See Memorandum to Board of Governors No. 46-98, Federal Legislation Members No. 16-98, Primary Contacts-Member Complex No. 64-98 and Public Information Committee No. 29-98, dated July 17, 1998. [10436] October 30, 1998 TO: BOARD OF GOVERNORS No. 74-98 FEDERAL LEGISLATION MEMBERS No. 29-98 PRIMARY CONTACTS - MEMBER COMPLEX No. 104-98 PUBLIC INFORMATION COMMITTEE No. 51-98 RE: OMNIBUS APPROPRIATIONS BILL RESOLVES CAPITAL GAINS TECHNICAL CORRECTION AND IMPOSES INTERNET TAX MORATORIUM

On October 21, President Clinton signed into law the Omnibus Consolidated and Emergency Supplemental Appropriations Act (the "Omnibus Act"). Although the new law primarily provides the operating budgets for dozens of federal agencies, it also contains several provisions that will simplify operations for mutual fund companies and their shareholders. Chief among these is a technical correction that resolves the capital gains problem for mutual fund shareholders that was unintentionally created in the IRS restructuring bill approved this summer.¹ The Omnibus Act also imposes a short-term moratorium on certain state and local taxes levied on Internet activities, authorizes Fiscal Year 1999 funding for the Securities and Exchange Commission (allowing the mandated reduction in 6(b) registration fees) and requires the federal government to accept official forms using electronic signatures. Capital Gains Technical Correction The Internal Revenue Service Restructuring and Reform Act, which was enacted this summer, lowered the capital gains rate by reducing from 18 months to 12 months the holding period for 20 percent rate long-term capital gains treatment. This change, which effectively reduced the top rate on most long-term capital gains from 28 to 20 percent, was effective for assets disposed of after December 31, 1997. In the case of mutual fund assets, the effective date related only to assets disposed of by any mutual fund after December 31, 1997. Thus, as originally written into law, some of the gains realized by a mutual fund in the last few months of 1997, but distributed to shareholders in 1998, would have been taxed at a 28 percent rate. Congress did not intend this result and consequently included a technical correction in the Omnibus Act to correct this matter so that long-term capital gains received by mutual fund shareholders in 1998 would not be taxed at a 28 percent rate. Instead, essentially all capital gain dividends paid in 1998 to shareholders in regulated investment companies will be taxed at a 2 See Memorandum to Board of Governors No. 51-98, Federal Legislation Members No. 20-98, Primary Contacts-Members Complex No. 70-98 and Public Information Committee No. 36-98, dated August 13, 1998. maximum rate of 20 percent (for taxpayers

in the 15 percent rate bracket, the capital gains rate drops to 10 percent). Internet Tax Moratorium To address concerns that taxes imposed by state and local governments could threaten the continued growth of the Internet and electronic commerce, the Omnibus Act places a moratorium on certain state and local taxes relating to Internet activities.² It establishes a three-year moratorium on state and local Internet access taxes and "multiple" and "discriminatory" taxes on electronic commerce. Certain existing taxes will be grandfathered and exceptions will be made for some situations involving materials that are harmful to minors. The moratorium is effective from October 1, 1998, through October 21, 2001. The new law establishes an Advisory Commission on Electronic Commerce to study federal, state and local, and international taxation and tariff treatment of Internet transactions and access, as well as comparable intrastate, interstate or international sales activities. The Commission must report to Congress within 18 months. Finally, the new law also states that it is the sense of Congress that no new federal Internet-related taxes should be enacted during the moratorium, and that the President should seek agreements through various international organizations to remove barriers to global electronic commerce.

SEC FY 1999 Funding The Omnibus Act includes SEC funding for Fiscal Year 1999 at a level of \$324 million, slightly below the Administration's request. As a result of this regular appropriation, the scheduled reduction in fees as provided under the National Securities Markets Improvement Act is triggered. Consequently, the SEC's filing fee rate dropped to approximately 1/36 of one percent (.000278). This became effective on October 22.

Electronic Signatures The Omnibus Act also includes a title that requires the federal government to accept all official forms electronically, guaranteed with an electronic signature. While this does not apply directly to the business of registered investment companies, it is an important policy development that indicates legislators may be prepared to address commercial use of electronic authentication technologies when the 106th Congress convenes in January.

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