

MEMO# 12409

September 14, 2000

IRS ISSUES GUIDANCE ON CAPITALIZATION OF 12B-1 FEES

[12409] September 14, 2000 TO: BOARD OF GOVERNORS No. 53-00 RE: IRS ISSUES GUIDANCE ON CAPITALIZATION OF 12B-1 FEES I am pleased to inform you that the Internal Revenue Service has issued Revenue Procedure 2000-38, which provides electing mutual fund distributors with certainty that the IRS will not challenge the deductibility of commissions paid on the sale of B shares through December 31, 2000 and will not impose any adjustment for prior years. The guidance does not affect the deductibility of commissions paid on C shares. Commissions incurred by electing distributors on sales after December 31, 2000 will be capitalized and amortized using one of three methods. Elections into the Revenue Procedure must be made on or before April 2, 2001. Distributors that do not elect to be subject to the Revenue Procedure will remain subject to audits and adjustments, both retroactively and prospectively. In its guidance, the IRS provides that fund distributors may elect, on a fund-by-fund basis, to capitalize B share commissions based either on the average "useful life" of a fund's B share or on one of two safe harbor methods. Under all three methods, accelerated deductions will be permitted for securitizations. Distributors electing to follow a "useful life" method do not need pre-approval for their method for determining the useful life of B shares or the rate of recovery. Under the guidance, however, the IRS reserves the right to audit a distributor's useful life calculation. The "fixed method" safe harbor permits fund distributors to capitalize B share commissions pro rata over a five-year period. The "tracking method" safe harbor permits fund distributors to capitalize commissions pro rata over the period that a distributor is to receive a distribution fee from the fund, with accelerated deductions permitted for contingent deferred sales commissions actually received. I would like to thank the many Institute members who helped to achieve this result. Matthew P. Fink President Attachment 2Attachment (in .pdf format)