

MEMO# 15392

December 9, 2002

DRAFT COMMENT LETTER ON TEMPORARY AND PROPOSED REGULATIONS ADDRESSING ABUSIVE TAX AVOIDANCE TRANSACTIONS

[15392] December 9, 2002 TO: ACCOUNTING/TREASURERS COMMITTEE No. 54-02 ADVISER DISTRIBUTOR TAX ISSUES TASK FORCE No. 3-02 TAX COMMITTEE No. 38-02 UNIT INVESTMENT TRUST COMMITTEE No. 30-02 RE: DRAFT COMMENT LETTER ON TEMPORARY AND PROPOSED REGULATIONS ADDRESSING ABUSIVE TAX AVOIDANCE TRANSACTIONS The Treasury Department ("Treasury") and the Internal Revenue Service ("IRS"), pursuant to an announcement earlier this year of an initiative to combat abusive tax shelter transactions, released amended temporary and proposed regulations under sections 6011 and 6112 of the Internal Revenue Code (the "Code"). As discussed in a prior memorandum, the amended regulations provide certain exceptions for regulated investment companies ("RICs") that were suggested by the Institute.¹ Notwithstanding the fact that RICs are specifically exempted from certain reporting obligations under the proposed regulations, the Institute expressed concern that the regulations are so broadly drafted that they may still require RICs to disclose reportable transactions and maintain records with respect to such transactions in situations where the actual risk that the RIC has engaged in an abusive tax avoidance transaction are minimal. The attached draft comment letter to the IRS requests that a number of revisions be made to the proposed regulations. Specifically, the letter requests that certain entities be exempt from loss transactions and significant book-tax difference transactions in the same manner that RICs are excluded from these disclosure requirements, including (i) partnerships held exclusively by RIC partners; (ii) investment vehicles that invest exclusively in RICs, such as variable insurance product separate accounts and 529 plans; and (iii) certain unit investment trusts registered under the Investment Company Act of 1940. The letter requests that the regulations define what it means to participate in a reportable transaction and limit participation to situations where (1) the taxpayer knows or should know that the transaction is a reportable transaction and (2) the taxpayer's tax liability is significantly affected by the transaction. The letter also reiterates the Institute's previous request that RICs be exempt from the disclosure requirements with respect to transactions involving brief asset holding periods. The letter requests that the regulations clarify that contractual protection transactions do not include (a) a bondholder's right to an

increased yield on a purported tax-exempt bond if the bond is determined to be taxable or (b) the put feature in a synthetic municipal instrument (of the type described in Revenue Procedure 2002-68) where the put right is intended largely to ensure that the instrument may be held by a tax-exempt money market fund. These two features are intended merely to ensure that an obligation intended to be appropriate for a particular tax-exempt bond fund is appropriate, and should therefore not be subject to the disclosure rules. With respect to the list maintenance requirements, we request that an investment adviser to RICs and other 1940 Act-registered investment vehicles not be treated as a material advisor with respect to investment advice provided to such vehicles in the ordinary course of business so long as the amount of compensation received does not vary based upon the extent of tax advice and is not dependent on the investment producing any specific tax results. In addition, we recommend that an investment adviser to RICs and other 1940-Act registered investment vehicles, which nevertheless is treated as a material advisor, be required to include an investor on a reportable transaction list only if the material adviser knows or has reason to know that the investor is required to disclose that transaction. Finally, the letter requests that Treasury consider these comments on an expedited basis. In addition, we request that Treasury provide sufficient time for RICs and similar entities to comply with the regulations. Your input is requested regarding whether additional issues relating to RICs or related investment vehicles should be addressed in the letter. Please provide any comments that you have to the attached draft comment letter to me no later than December 16, 2002 by phone (202-326-5835), fax (202-326-5841), or e-mail (lrobinson@ici.org). Lisa Robinson Assistant Counsel Attachment (in .pdf format)