MEMO# 14475

February 22, 2002

IRS GUIDANCE PERMITTING MONTHLY INCLUSION OF TAX-EXEMPT PARTNERSHIP INCOME BY MONEY MARKET FUND PARTNERS

[14475] February 22, 2002 TO: TAX COMMITTEE No. 6-02 RE: IRS GUIDANCE PERMITTING MONTHLY INCLUSION OF TAX-EXEMPT PARTNERSHIP INCOME BY MONEY MARKET FUND PARTNERS The attached Internal Revenue Service ("IRS") Revenue Procedure (Rev. Proc. 2002-16)1 provides guidance pursuant to which a tax-exempt money market fund organized as a regulated investment company ("RIC") may take into account each month its allocable share of tax-exempt income from certain "eligible partnerships." Absent the revenue procedure, a tax- exempt money market fund partner with a taxable year end that differs from the partnership's taxable year end could encounter a mismatch between its monthly distributions of income and its distributive share of tax-exempt partnership income.2 In order for a partnership to be eligible to make the election, inter alia, at least 95 percent of the partnership's income must be tax-exempt under Internal Revenue Code ("IRC") section 103. An eligible partnership may make the election by filing a "Monthly Closing Election" statement with the IRS. A partner is eligible if it is a RIC that is a money market fund.3 Such partner may consent to monthly inclusion by providing a "Monthly Closing Consent" statement 1 The revenue procedure may also be downloaded from the IRS at http://ftp.fedworld.gov/pub/irs- drop/rp-02-16.pdf 2 The revenue procedure provides the following example: assume that on January 2, 2002, a money market fund with a taxable year ending June 30 acquires a preferred interest in a tax-exempt bond partnership with a taxable year ending of December 31. Under 706(a), the money market fund's distributive share of the tax-exempt bond partnership's income for the money market fund's taxable year ending June 30, 2002, is zero. If the money market fund's daily dividends do not reflect its portion of the interest that the partnership earns between January 2 and June 30, the fund will be unable to maintain a constant net asset value for each share of its stock. (Whether or not the tax- exempt bond partnership distributes the exempt interest to the money market fund as that interest is earned, the per share net asset value of the fund will rise if the fund does not make continual distributions to its shareholders to reflect those partnership earnings.) On the other hand, if the money market fund's daily dividends are based in part on the income earned by the partnership between January 2, 2002, and June 30, 2002, the distributions made by the money market fund during its taxable year ending June 30, 2002, will exceed the includible tax-exempt income for the year, causing all or a portion of those distributions to be characterized as a return of capital. 3 The partner must be entitled to hold itself out as a money market fund, or the equivalent of a money market fund, in accordance with the provisions of Rule 2a-7(b). 2 to

the partnership.4 A partner's Monthly Closing Consent is ineffective on any day when the partner is not "eligible" to consent but is effective on any day that the partner is "eligible" to consent. Accordingly, after an eligible partner has completed a Monthly Closing Consent, no additional consent must be filed if the partner sells one interest in an electing partnership and acquires another interest in the same partnership provided that the partnership continues to have a Monthly Closing Election in effect. The election generally is effective for the calendar month in which the election is filed. Consenting partners must include in income their shares of partnership items described in IRC section 702(a) and any guaranteed payments under IRC section 707(c) for the period from the last closing of the books through the first month that the election is effective. Thereafter, there will be a closing of the books for consenting partners at the end of each month. Partnerships must provide monthly statements to the consenting partners. Although the partnership and the consenting partners must maintain the monthly statements, they should not be filed with the IRS. At the end of its taxable year, the partnership must provide a single Schedule K-1 (Form 1065) to each of its partners that, in the case of consenting partners, includes all amounts shown on the monthly statements. The revenue procedure is effective on January 1, 2002. The IRS has requested comments on the Revenue Procedure. Comments are requested on such things as ways to enhance the quality, utility, and clarity of the information to be collected and ways to minimize the burden of the collection of information on respondents, including through the use of automated collection techniques or other forms of information technology. Comments on the Revenue Procedure are due to the IRS on April 22, 2002. Please contact the undersigned (cbarre@ici.org or 202/326/5821) by March 22, 2002, if you have any comments regarding the Revenue Procedure. Catherine Barre Assistant Counsel Attachment (in .pdf format) 4 A copy of the statement of consent should also be attached to the partner's Form 1120 RIC, U.S. Income Tax Return for Regulated Investment Companies, for the first taxable year in which the consent is effective.
