

**MEMO# 16745**

November 6, 2003

## **ADDITIONAL IRS GUIDANCE ON SYNTHETIC TAX-EXEMPT SECURITIES**

[16745] November 6, 2003 TO: TAX MEMBERS No. 60-03 MONEY MARKET FUNDS ADVISORY COMMITTEE No. 18-03 FIXED-INCOME ADVISORY COMMITTEE No. 16-03 RE: ADDITIONAL IRS GUIDANCE ON SYNTHETIC TAX-EXEMPT SECURITIES The Internal Revenue Service (the "Service") has issued Revenue Procedure 2003-84<sup>1</sup> (the "new Revenue Procedure") that modifies and supersedes Revenue Procedure 2002-68 (the "old Revenue Procedure")<sup>2</sup> pursuant to which a regulated investment company ("RIC") may take into account each month its allocable share of tax-exempt income from certain synthetic variable rate tax-exempt securities. As you know, the Institute submitted comments to the Treasury Department ("Treasury") and the Service on the old Revenue Procedure and we are pleased to inform you that the new Revenue Procedure is responsive to the Institute's comments. 3 First, the new Revenue Procedure clarifies that gains from the sale, redemption or other disposition of certain assets are good income for purposes of the 95 percent "Income Test."<sup>4</sup> Second, the default rule with respect to partner and partnership eligibility has been revised to ensure that partnerships and partners do not inadvertently fail to be covered by the new Revenue Procedure. Under the new Revenue Procedure, partners of eligible partnerships are eligible for the monthly closing election by virtue of a binding provision in the partnership's governing documents indicating each partner's consent to the election. Finally, the tax reporting burden at the partnership level 1 Revenue Procedure 2003-84 is available at <http://www.irs.gov/pub/irs-drop/rp-03-84.pdf> and is attached to the electronic version of this memorandum. 2 See, Institute Memoranda (No. 15246) to Tax Members No. 43-02, dated October 8, 2002 and (No. 15245) to Fixed Income Advisory Committee No. 11-02, Money Market Funds Advisory Committee No. 5-02, and Tax Committee No. 30-02, dated October 9, 2002. 3 See, Institute Memoranda (No. 15444) to Tax Members No. 50-02, Fixed Income Advisory Committee No. 15-02, and Money Market Funds Advisory Committee No. 9-02, dated December 10, 2002. 4 In order for a partnership to be an "eligible partnership," inter alia, the Income Test generally requires that at least 95 percent of the partnership's income must be tax-exempt. Under the new Revenue Procedure gain from the sale of assets generating tax-exempt income is "good income" for purposes of this test. 2 is reduced through the modifications made by the new Revenue Procedure and the Treasury Regulations issued November 5, 2003, that authorize the partnership reporting exemptions.<sup>5</sup> The new Revenue Procedure contains a number of additional important changes including record keeping requirements that may apply to RIC advisors. In order for the partnership to be eligible for the reduced tax reporting requirements, certain beneficial owner information must be retained. Section 8.04 of the new Revenue Procedure provides that "[i]n the case of a group of RICs that is managed or advised by a common, or affiliated, manager or advisor (the manager), the manager may elect to be responsible for collecting, retaining, and providing the Service upon demand the

beneficial ownership information.” The new Revenue Procedure is effective November 5, 2003 but contains a grandfather provision, subject to limitations, for eligible partnerships created prior to January 1, 2004. The new Revenue Procedure also provides transition relief with respect to eligible partnerships that completed monthly closing elections in accordance with Revenue Procedures 2002-166 or 2002- 68. Catherine Barré Associate Counsel Note: Not all recipients receive the attachments. To obtain copies of the attachments, please visit our members website (<http://members.ici.org>) and search for memo 16745, or call the ICI Library at (202) 326-8304 and request the attachments for memo 16745. Attachment no. 1 (in .pdf format) 5 The new final and temporary regulations, T.D. 9094, are available at <http://www.irs.gov/pub/irs-reg/td9094.pdf> and are attached to the electronic version of this memorandum. 6 See, Institute Memorandum (No. 14476) to Tax Members No. 8-02, dated February 22, 2002.

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