

MEMO# 3962

September 30, 1992

SENATE APPROVES REVENUE ACT OF 1992

11/ See Institute Memorandum to Board of Governors No. 43-92, Tax Members No. 42-92, Accounting/Treasurers Members No. 25-92, Closed-End Fund Members No. 31-92, Operations Members No. 23-92, Unit Investment Trust Members No. 41-92 and Transfer Agent Advisory Committee No. 32-92, dated July 2, 1992. 22/ See Institute Memorandum to Board of Governors No. 19-92, Tax Members No. 15-92, Closed-End Fund Members No. 13-92, Unit Investment Trust Members No. 20-92, Accounting/Treasurers Members No. 12-92, Operations Members No. 11-92, International Committee No. 7-92, Institutional Funds Committee No. 3-92 and Transfer Agent Advisory Committee No. 14-92, dated March 23, 1992. 33/ A separate memorandum to Pension Members, Operations Members and the Transfer Agent Advisory Committee describes various pension-related provisions, including one that would permit all September 30, 1992 TO: TAX MEMBERS NO. 59-92 ACCOUNTING/TREASURERS MEMBERS NO. 35-92 CLOSED-END FUND MEMBERS NO. 36-92 OPERATIONS MEMBERS NO. 32-92 UNIT INVESTMENT TRUST MEMBERS NO. 49-92 INTERNATIONAL MEMBERS NO. 20-92 TRANSFER AGENT ADVISORY COMMITTEE NO. 52-92 RE: SENATE APPROVES REVENUE ACT OF 1992

The Senate late yesterday approved tax legislation containing several provisions relevant to the investment company industry. Many of the provisions contained in this bill are substantially identical to provisions contained in the bill passed by the House of Representatives in July 1/1 and in the earlier legislation vetoed by the President in March. 2/2 This memorandum describes the non-pension-related provisions affecting regulated investment companies ("RICs") and their shareholders.3/3 Anyone interested in obtaining copies of taxpayers to make deductible IRA contributions. 44/ See Institute Memorandum to Tax Members No. 41-91, International Members No. 5-91 and Accounting/Treasurers Members No. 27-91, dated September 25, 1991. - 1 - relevant Senate Committee Report and statutory bill language may do so by calling the undersigned at (202) 955-3585. I. Mutual Fund Tax Simplification The Senate bill includes the House bill provision that would permit the tax-free conversion of bank common trust funds into RICs. Unlike the House bill, the Senate bill also would permit RICs to convert tax-free to bank common trust funds. The provision would be effective for transfers occurring after the date of enactment. Neither of the other two mutual fund tax simplification provisions contained in the House bill (repeal of the 30 percent test and shareholder basis reporting) is included in the Senate bill. However, since these provisions are in the House bill, either or both of them could be included in any legislation resulting from a joint House-Senate conference. II. International Competitiveness Provisions The Senate bill generally would permit U.S. source interest income and short-term capital gains received by a fund to retain their character when paid to foreign shareholders. The effect of this treatment would be generally to exclude from U.S.

withholding tax that part of a fund dividend attributable to interest and short-term gains. Similar interest and short-term capital gain flow-through provisions were contained in S. 1748, the Investment Competitiveness Act of 1991, which was introduced last fall by Senator Baucus.^{4/4} This "flow-through" provision would apply to taxable years of RICs beginning after the date of enactment. In addition, the bill directs the Treasury Department to "conduct a study of tax issues relating to the maintenance and enhancement of the competitiveness of the American economy in light of changing economic policies in Europe and the increasing globalization of the world economy." The report is to be completed by January 1, 1994.

III. Foreign Investment Provisions - 2 - The Senate bill includes the House bill provision that would allow individuals with no more than \$200 of creditable foreign taxes and no other foreign source income to elect a simplified method for claiming the foreign tax credit. The provision would apply to taxable years beginning after December 31, 1991. In addition, the Senate bill includes the House bill's modifications to the passive foreign investment company ("PFIC") rules. Under the bill, all shares of passive foreign - 3 - corporations ("PFCs") held by RICs would be marked to market each year at October 31 for excise tax purposes and at the RIC's fiscal year-end for income tax purposes, unless a "qualified electing fund" election had been made by the RIC to currently include in its income the PFC's income. Under a transition rule, a RIC would be required to (1) mark to market all PFC stock in its portfolio on the first day of the RIC's first taxable year beginning after December 31, 1992, (2) pay a nondeductible interest charge on the tax that would have been collected had the PFC shares been marked to market in the prior years and (3) distribute the mark-to-market gains to its shareholders.

IV. Amortization of Intangibles The Senate bill would require that the purchase price of certain acquired intangible assets be amortized over a uniform 16-year period, rather than the 14-year period provided by the House bill. Among the intangible assets covered by the bill are goodwill, going concern value and various customer-based intangibles, such as investment advisory contracts. The provision generally would be effective for property acquired after the date of enactment, although a taxpayer could elect to have the bill apply to all property acquired after July 25, 1991. In addition, unlike the House bill, taxpayers could elect to retroactively apply the 16-year amortization period to 75 percent of the adjusted basis of the asset for any "open" tax year, with no depreciation deduction or amortization allowed for the remaining 25 percent.

V. Taxpayer Bill of Rights Amendment Like the House bill, the Senate bill would require that information statements sent to payees include the name, address and phone number of the payor's information contact. The Senate Report clarifies that the payor may provide the name and phone number of the department with the relevant information. The proposal would apply to statements required to be furnished after December 31, 1992.

VI. Private Foundation Common Investment Funds The Senate bill would provide, in new Code section 501(n), that an organization comprised solely of at least 20 tax-exempt private foundations generally would be treated as tax-exempt itself, so long as the organization is organized and operated solely to collectively invest in shares and securities on behalf of its members. The proposal would apply to taxable years ending on or after December 31, 1992.

VII. Educational Savings Bonds Provisions The Senate bill would expand eligibility for the benefits of Code section 135, which provides that interest income earned - 4 - on certain qualified U.S. Series EE savings bonds is excludable - 5 - from gross income if the proceeds of the bond upon redemption do not exceed the qualified higher education expenses paid by the taxpayer during the taxable year. Under the bill, qualified higher education expenses would include certain amounts paid by the taxpayer to an "eligible educational institution", such as a college, for the tuition and fees of any individual and not simply dependents. Second, the bill would repeal the present law provision which phases out the section 135 exclusion for married taxpayers filing joint returns with adjusted gross income between \$60,000 and \$90,000 and for single taxpayers with adjusted gross income between

\$40,000 and \$55,000. The provision would apply to U.S. Series EE savings bonds issued after December 31, 1989 and redeemed after December 31, 1992. VIII. Backup Withholding The Senate bill would increase the Code section 3406 backup withholding rate from 20 percent to 31 percent. This new rate would apply to amounts paid after December 31, 1992. * * * We will keep you informed of developments regarding this legislation. Keith D. Lawson Associate Counsel - Tax

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.