MEMO# 2361

December 4, 1990

TAXABLE-EQUIVALENT YIELDS FOR TAX-EXEMPT FUNDS

December 4, 1990 TO: TAX COMMITTEE NO. 30-90 SUBCOMMITTEE ON ADVERTISING RE: TAXABLE-EQUIVALENT YIELDS FOR TAX-EXEMPT FUNDS ____ As you may know, the Omnibus Budget Reconciliation Act of 1990 ("OBRA 90") modified the individual income tax rate structure in several respects. Specifically, Congress eliminated the 33 percent marginal income tax rate (the so-called "bubble") and provided: 1) a new maximum marginal income tax rate of 31 percent; 2) a new phase-out of personal exemptions for taxpayers with adjusted gross income exceeding certain amounts; and 3) an overall limitation on itemized deductions for taxpayers with adjusted gross income exceeding $100,000. One effect of these changes has been to create different effective marginal federal income tax rates for different investors based upon their particular circumstances, i.e., their income levels, the amount of their itemized deductions and the number of dependents they have. Since OBRA 90 was enacted, the Institute has received calls from several members regarding the appropriate marginal federal income tax rate to be used in calculating the taxable-equivalent yield for advertisements of tax-exempt funds. The two rates that have been suggested as possibilities are 31 percent, the new highest marginal rate, and 31.9 percent, the 31 percent rate plus the increment attributable to the overall limitation on itemized deductions. In response to these inquiries, the Institute conducted an informal survey of members to determine which marginal tax rate they believed should be used in tax-exempt fund advertisements. Most members contacted stated that the appropriate marginal federal income tax rate for determining taxable-equivalent yields is 31 percent. These members stated that since all investors in tax-exempt funds might not be subject to the overall limitation on itemized deductions, and since there are some limits on the overall limitation, a 31 percent rate would be more appropriate (although it will produce slightly lower yields than a 31.9 percent rate). A few members expressed a preference for use of a 31.9 percent rate. However, these members expressed a willing- ness to use a 31 percent rate, in order to avoid shareholder confusion, if other funds did so. We will keep you informed of developments. Craig S. Tyle Associate General Counsel Keith D. Lawson Associate General Counsel