INVESTMENT COMPANY INSTITUTE

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Money Market Fund Reform - Tax Implications: ICI Discussion Paper

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TO: ICI Members
Investment Company Directors
ICI Global Members
Broker/Dealer Advisory Committee
Money Market Funds Advisory Committee
Operations Committee
Tax Committee SUBJECTS: Money Market Funds
Operations
Tax
Transfer Agency RE: Money Market Fund Reform - Tax Implications: ICI Discussion Paper

The ICI submitted the attached analysis of tax implications resulting from recent SEC money market fund reforms to the U.S. Treasury and requested a meeting to discuss these tax issues. The ICI discussion paper addresses the potential tax implications to both money market funds, and their shareholders, resulting from the liquidity fee rule and the reverse distribution mechanism (RDM) rule. The analysis addresses the following tax issues:

- Liquidity fees
    - Liquidity fees retained by money market funds:
        - are likely not taxable income to the fund, and
        - are likely to be either included in the fund's earnings and profits or deemed to be included.
    - Liquidity fees withheld from redemptions:
        - are treated as reductions to the shareholder's gross proceeds from those redemptions, increasing loss or reducing gain recognized on that redemption, and
        - shareholders incurring liquidity fees can account for losses or gains attributable to liquidity fees either:
            - transaction-by-transaction (a realization method of accounting), or
            - under the net asset value (NAV) method of accounting. Shareholders using the NAV method of accounting would likely need assistance from fund intermediaries to provide the shareholder with information

        required to calculate gain or loss under the NAV method of accounting.
    - The IRS does not intend to apply the wash sale rules to losses incurred on money market fund share redemptions.
  - If a fund distributes amounts attributable to liquidity fees, shareholders would treat such distributions as dividends, if included (or deemed to be included) in the fund's earnings and profits and reported as dividends on Form 1099-DIV.
  - Shareholders incurring liquidity fees would not receive forms 1099-B because money market fund shares are exempt from 1099-B reporting.
- Tax implications of reverse distributions
  - The RDM share cancellation transaction is a nontaxable event, for both the fund and its shareholders.
  - The shareholder's cost basis in the cancelled shares is reallocated to their remaining shares.
  - The shareholder's loss from the RDM share cancellation would be recognized under their method of accounting for those shares, either:
    - a realization method (when redeemed), or
    - the NAV method (at least annually).
  - The NAV method of accounting is generally simpler, and would also allow for recognition of losses resulting from money market funds applying RMD, liquidity fees, or both. Funds and their intermediates could provide shareholders with information required to comply with the NAV method of accounting.
  - No 1099-B reporting is required for share cancellation transactions, or for redemptions of shares.

While the ICI's analysis finds that existing tax rules provide sufficient guidance on these tax issues, we welcome feedback and input from U.S. Treasury, and an opportunity to discuss the tax issues addressed. Please contact Mike Horn at michael.horn@ici.org, or Katie Sunderland at katie.sunderland@ici.org, if you have any questions or comments on these tax issues.

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