

COMMENT LETTER

June 26, 2012

Follow-Up Letter to IRS on Request for Check-The-Box Guidance (pdf)

By Facsimile June 26, 2012 Cynthia Morton Attorney, Branch 2, Passthroughs & Special Industries Internal Revenue Service 1111 Constitution Avenue, NW Washington, DC 20224

Re: Follow-Up to ICI Submission on RIC Deemed Check-The-Box Election Dear Ms. Morton: Thank you for your recent call regarding the ICI's¹ August 17, 2011 submission (enclosed) that requested a deemed check-the-box ("CTB") election for regulated investment companies ("RICs"). Specifically, we requested that Treas. Reg. § 301.7701-3 be amended to provide that an eligible entity that elects to be a RIC will be deemed to have made a CTB election to be taxed as a corporation. This election would be made, as a procedural matter, by the RIC filing its first IRS Form 1120-RIC. Coordinating the election to be a RIC with the election to be taxed as a corporation, as discussed in the ICI's prior submission and below, would reduce administrative burdens on RICs and the Service and would provide certainty regarding an entity's tax status. The regulations already permit such a tax-return-filing election for real estate investment trusts ("REITs").² The requested guidance is necessary, as we discussed, to ameliorate an existing ambiguity regarding section 851(g)'s application to a RIC organized as a series trust. This ambiguity exists because of uncertainty regarding how the CTB rules, which were adopted after section 851(g) was enacted, apply for section 851(g) purposes.

¹ The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$13.4 trillion and serve over 90 million shareholders.

² Treas. Reg. § 301.7701-3(c)(1)(v)(B). ICI Letter Following Up on RIC Deemed Check-The-Box Election Submission June 26, 2012 Page 2 of 3

Some practitioners apply section 851(g) by viewing a trust with multiple series as a hybrid; the trust is treated under this view as a single entity (by looking at the "overall trust") for section 851(a)³ purposes and as multiple entities for all other purposes. This first interpretation of section 851(g) – which evaluates the overall trust as a single entity to determine whether it is a domestic corporation for purposes of section 851(a) – was followed by the industry when section 851(g) was enacted in 1986. Entity classification determinations were made prior to the 1986 Act under the so-called "Kintner regulations." Under those regulations, an entity was a corporation if had at least three of four attributes: continuity of life, centralization of management, limited liability, and free transferability of interest. Applying this test at the overall trust level for section 851(a) purposes resulted in RICs organized as trusts generally being treated as corporations. As a result, every new series of the trust was a separate corporation pursuant to section 851(g). As Rev. Rul. 88-14 makes clear, section 851(g) applies to both incorporated and unincorporated entities.

If the CTB rules are applied using this hybrid entity approach, practitioners must evaluate whether the overall trust, including its series, is an eligible entity or a per se corporation. The answer appears clear if any series of the trust is a publicly offered RIC. In this first scenario, it appears that the trust is a per se corporation under the publicly traded partnership ("PTP") rules because interests in the trust (i.e., interests in the publicly offered series) are publicly traded. The answer is not clear, however, if none of the series are publicly traded. In this second scenario, it is unclear how to analyze whether the trust as a whole (including its series that have filed Forms 1120-RIC) is an eligible entity or a per se corporation. Other practitioners apply section 851(g) by viewing the CTB regulations as having affirmatively changed the series fund analysis. Under the CTB regulations, it is unclear whether a state law trust itself is an entity for tax purposes if it has no assets and engages in no activities except through its separate series. The preamble to the proposed regulations on series entities asks for comments on whether the state law entity (referred to as the "series organization") should be an entity for tax purposes in these situations. Practitioners who take the view that the trust is not itself an entity for tax purposes believe that the trust is not described in section 851(a) and, therefore, that section 851(g) does not apply. Under this view, each series is a separate eligible entity that will default to partnership status (unless interests in the series are publicly traded). Thus, a new series created by the trust that is intended to be a RIC would need to elect corporate status (unless its interests are publicly traded) under the CTB rules.

3 Section 851(a) defines a RIC as a domestic corporation registered with the Securities and Exchange Commission ("SEC") under the Investment Company Act of 1940. ICI Letter Following Up on RIC Deemed Check-The-Box Election Submission June 26, 2012 Page 3 of 3 This interpretive issue, as we discussed, is limited to those RICs that are not publicly offered. While many RICs are publicly offered, and hence are corporations under the PTP rules, there are many RICs that are not publicly offered. The most significant example of non-publicly offered RICs is in the insurance area. Insurance companies that offer variable annuities and variable life insurance typically allow the holder of the annuity or insurance contract to select among multiple investment alternatives, such as a bond fund, a growth fund, an international equity fund, etc. These funds are typically organized as RICs but their interests are not publicly traded; the only way to invest in these RICs (known as "variable insurance product" or "VIP" RICs) is through the insurance company. Variable insurance product RICs represent a substantial portion of the mutual fund industry. Assets in these RICs totaled \$1.36 trillion in February 2012. Approximately 75 percent of these RICs are trusts or series of trusts. This ratio is comparable to the overall mutual fund industry ratio of funds organized as trusts to funds organized as corporations; specifically, 74 percent of all RICs are organized as either Massachusetts business trusts or Delaware statutory trusts.⁴ The guidance we request will not provide funds, as a practical matter, with any additional time beyond that provided by the existing CTB rules to decide whether to elect corporate tax treatment. Federal securities laws require funds to issue prospectuses for the sale of their shares. These prospectuses, which are prepared before a fund offers its shares for sale, state whether the fund intends to qualify as a RIC. Thus, even though the election to be a RIC is made on the tax return for the RIC's first taxable year, the entity's intent to qualify as a RIC - and therefore to be treated as a corporation - is announced before the fund is open to investors. Thank you again for your attention to this issue. Please feel free to call me (at 326-5832) if I can provide you with any additional information. Sincerely, /s/ Keith Lawson Keith Lawson Senior Counsel - Tax Law Enclosure 4 http://www.ici.org/pdf/2012_factbook.pdf (page 199 of the Fact Book; page 215 of the 262 page file).

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