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By Electronic Delivery

June 2, 2022

Lily Batchelder
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US Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

William M. Paul
Principal Deputy Chief Counsel
Deputy Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
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RE: Guidance Priority List Recommendations

Dear Ms. Batchelder and Mr. Paul:

The Investment Company Institute[1] recommends the following issues affecting regulated investment companies (RICs) and their shareholders for inclusion on the 2022-2023 Guidance Priority List.[2]

As requested in Notice 2022-21, these recommendations have been listed in order of priority. Those issues that ICI believes require prompt guidance are listed immediately below. ICI notes, however, that there are many outstanding issues that are important to the industry; additional items that have been included in prior requests for guidance from the Department of the Treasury (Treasury Department) and Internal Revenue Service (IRS) are included below as Enclosure A.

I. Excess Foreign Tax Recoveries from European Union Member States under *Santander*

ICI urges the Treasury Department and the IRS to issue guidance, expanding upon Notice 2016-10, that provides an administrable solution for the US fund industry's receipt of withholding tax refunds

[1]The Investment Company Institute (ICI) is the leading association representing regulated investment funds. ICI's mission is to strengthen the foundation of the asset management industry for the ultimate benefit of the long-term individual investor. Its members include mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and UCITS and similar funds offered to investors in Europe, Asia and other jurisdictions. Its members manage total assets of $29.7 trillion in the United States, serving more than 100 million investors, and an additional $9.3 trillion in assets outside the United States. ICI has offices in Washington, DC, Brussels, London, and Hong Kong and carries out its international work through ICI Global.

[2] A separate submission describes our Guidance Priority List recommendations for retirement security issues.

following the European Court of Justice (ECJ) decisions in *Santander*[3] and *DFA Emerging Markets.*[4] Specifically, we reiterate our proposals in previous letters[5] that the Treasury Department and the IRS permit RICs to carry forward to future years any excess tax recoveries that cannot be fully netted under the Notice against foreign tax credits in the year the payment is received. Importantly, permitting carryforward would reduce substantially the administrative burdens to the IRS and the financial costs to funds and their shareholders.

II. Electronic Filing of Form 8802, Application for US Residency Certification and Processing of Form 6166, Certification of US Tax Residency

ICI recommends changes to improve Form 8802 and the process for issuing Form 6166, Certification of US Tax Residency (CoRs).[6] Currently, the IRS does not accept Forms 8802 that are postmarked earlier than December 1 of the prior year. The typical processing time ranges from 8-12 weeks, and even then, erroneous rejections are frequent and many CoRs are issued with errors or omissions. This results in a permanent loss of treaty benefits for income received prior to the date on which the CoR can be furnished to a withholding agent and for which retroactive relief through tax reclaims is not permitted. The US Treasury ultimately bears the cost for foreign taxes that cannot be recovered to the extent that US investors claim foreign tax credits.

The pandemic working environment has dramatically increased these problems for taxpayers and the IRS. For example, IRS agents must confirm that a Form 8802 applicant timely filed the previous year's tax return—typically by checking the IRS internal system. Because a Form 1120-RIC, however, can be filed only on paper the IRS takes a very long time to process these returns, resulting in cascading delays for issuing CoRs to RICs. There are also delays when an agent requests additional information by mail, but the taxpayer does not actually receive the request for many weeks, either because of postal delays or internal delays due to the pandemic remote working environment. We understand a delayed response from the taxpayer may result in an application's open status being "closed," requiring the taxpayer to resubmit a new application. This practice distorts the IRS's true processing rates of Forms 8802s as many open applications are deemed complete if taxpayers are not able to timely respond.

The recommendations below would allow the IRS to more quickly reduce the backlog of Forms 8802 and CoRs. Specifically, the ICI recommends the following:

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[3] The *Santander* decision involves joined cases C-338/11 to C-347/11. The decision was rendered in French and translated into the other languages of the European Union ("EU"). The decision can be found online in English and in French.

[4] The DFA Emerging Markets decision is cited in full as C-190/12 *Emerging Markets Series of DFA Investment Trust Company* (10 April 2014).

[5] *See* Institute letters to Robert Stack, Marjorie Rollinson, and Helen Hubbard, dated April 1, 2016, to Marjorie Rollinson and Helen Hubbard, dated July 18, 2017, and to Mark Mazur and William M. Paul, dated March 12, 2021.

[6] *See* Institute letter to Charles Rettig and Michael J. Desmond, *Taxpayer First Act: Form 8802, Application for United States Tax Residency Certification*, dated February 26, 2020.

1. Accelerate the availability of Forms 6166.
2. Permit electronic filing of Forms 8802.
3. Improve communications between filers and the IRS regarding processing delays and rejections.
4. Permit filers to pay for multiple taxpayers (such as RICs) with a single electronic payment.

III. Electronic Filing and Permanent Digital Signature Relief

ICI recommends that the IRS expand and make permanent the ability of RICs and their officers to sign and file electronically Form 1120-RIC, US Income Tax Return for RICs and Form 8613 Return of Excise Tax on Undistributed Income of RICs.[7] The requirement that these returns, which can be hundreds of pages long, be physically signed and filed on paper is particularly problematic in the COVID-19 environment.[8] We also recommend eliminating the requirement that RICs file Form 8621, Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund, for each foreign investment and clarifying that RICs do not need to file Form 8990, Limitation on Business Interest Expense under section 163(j).

Specifically, we suggest that the Modernized e-File (MeF) system be updated to process these forms. In the interim, until the MeF system can process 1120-RICs, we recommend that RICs be permitted to submit PDF copies of the returns to a secure IRS email address. Additionally, we are greatly appreciative of the IRS extending temporary relief for digital signatures and request that the guidance be made permanent so that RIC officers may utilize the same signing options –rubber stamp, mechanical device, or a computer software program – that are available to a paid preparer. Electronic filing reduces tax compliance burdens on taxpayers, especially with respect to bulky corporate returns such as the Form 1120-RIC.

IV. IRS Form SS-4 Daily Application Limit

ICI recommends improvements to Form SS-4, Application for Employer Identification Number (EIN). Specifically, we recommend that the IRS increase the current limitation of issuing only one EIN per responsible party per day to 10 EINs per responsible party per day. The current limitation is causing significant delays for large taxpayers that must obtain multiple EINs per day for business purposes or on behalf of their clients. We believe increasing the number of EINs issued per responsible party per day will allow taxpayers to obtain EINs more efficiently so that IRS can better serve all taxpayers applying for EINs.

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[7] See Institute letter to Charles Rettig and Michael Desmond, *Changes to IRS Forms 1120-RIC*, dated November 20, 2019,

[8] *See* Institute letter to Charles Rettig and David Kautter, *COVID-19: IRS Guidance Urgently Needed for RICS*, dated March 23, 2020.

V. Active Trade or Business Requirement under Section 355

ICI requests guidance clarifying that RICs can satisfy the "active trade or business requirement" under section 355(b)(1) with respect to their business of investing in securities.[9] The inability of RICs to use tax-free split-offs negatively impacts RIC shareholders by limiting an asset manager's capability to optimize the investment management services provided by the fund. While RICs may wish to use section 355 for legitimate non-tax business purposes intended to benefit these shareholders, they ultimately will avoid a division that results in additional taxable income to the investors.
RICs are engaged in the business of investing on behalf of their shareholders, as noted in section 852(b)(2). RICs also perform other active and substantial management and operational functions through their boards and provide many ancillary services to investors through their advisers and other third parties.

The primary purpose of the active trade or business requirement is to serve as an objective means of testing whether a transaction is being used principally as a device to use a section 355 distribution to convert what otherwise would be dividends taxable as ordinary income into capital gain. The bail-out of corporate earnings generally is not a concern when a RIC pursues a split-off to establish a new fund. Another purpose of section 355 is to prevent circumvention of the repeal of General Utilities. This rationale likewise is not applicable to RICs, as section 852(b)(6) permits RICs to distribute stock or securities in-kind upon the demand of shareholders without incurring fund-level tax.

Given that RICs should be viewed as engaged in an active trade or business and the lack of potential for tax avoidance or abuse, we thus ask the Treasury Department and the IRS to clarify that RICs can satisfy the active trade or business requirement in section 355.

VI. Qualified Interest Income

ICI appreciates that the Treasury Department and IRS have issued guidance over the past few years to address SEC money market rules and prevent tax considerations from undermining a RIC's ability to meet them. One last issue arising from the resulting increased demand for government securities, however, must be addressed for these RICs to remain attractive for foreign investors.

Specifically, RICs are being forced by the increased demand for government securities to gain this exposure through repurchase agreements (repos) on government securities. Disparities in banking regulations, however, are causing banks to conduct their repo business through foreign branches that, as a general matter, result in "foreign source" income.

For government money market funds to make distributions that are fully exempt from US withholding tax as qualified interest income (QII) when paid to foreign investors, the income must have a US

[9] *See* ICI Letter to Krishna Vallabhaneni and Robert Wellen, dated May 11, 2022.

source. US tax is problematic for foreign investors using money market funds for cash management purposes, particularly when non-US alternatives are available.

The Institute therefore requests guidance that amounts received on repos, that are collateralized solely by US government securities (as that term is applied under Subchapter M), will be treated as US source income in determining QII under Code section 871(k)(1)(E).[10]

* * *

If we can provide you with any additional information regarding these issues, please contact Keith Lawson (202-326-5832 or lawson@ici.org), Karen Gibian (202-371-5431 or kgibian@ici.org) or me (202-326-5826 or katie.sunderland@ici.org).

Sincerely,

Katie Sunderland

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Assistant General Counsel – Tax Law

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[10] *See* Institute letters to Helen Hubbard, dated July 31, 2017, and January 16, 2018.

Enclosure A: Additional Recommendations for the 2022-2023 Guidance Priority List

I. Issues on the 2021-2022 Guidance Priority List

ICI requests that the Treasury Department and IRS issue guidance on the following items currently on the 2021-2022 Guidance Priority List.

A. FATCA

ICI strongly supports FATCA's tax compliance objectives and welcomed the recent proposed regulations to eliminate withholding on gross proceeds, defer withholding on foreign passthru payments, and clarify the definition of investment entity. We urge the Treasury Department and IRS to finalize the proposed regulations.

ICI encourages the continued refinement of administrable rules that implement, consistent with Congressional intent, the Chapter 4 reporting and withholding regime. Consistent with prior submissions, ICI recommends that the IRS and Treasury Department (1) clarify the Form 1042-S coding for long-term capital gain dividends, (2) improve the interaction of Forms 1042-S and W-8, and (3) smooth the transition to the new W-8 series forms.[11] As FATCA's phased implementation is well underway, ICI recommends giving FATCA issues continued high priority.

B. PFICs

We ask the Treasury Department and IRS to issue additional guidance regarding passive foreign investment companies (PFICs). The preamble to the final PFIC mark-to-market regulations[12] notes in three places that comments received relating to the impact of the PFIC rules on RICs were beyond the scope of that regulations project.[13] We request that a regulations project be opened to address these and other PFIC-related issues faced by the industry.

Specifically, ICI requests guidance providing (i) that gains from dispositions of former PFIC stock are capital while losses are ordinary to the extent of prior unreversed inclusions; (ii) RICs with automatic consent to terminate a section 1296 election during a non-PFIC year; (iii) that RICs may recognize any change in PFIC status of a foreign corporation for the RIC's taxable year within which the taxable year of the foreign corporation ends; (iv) that the consequences to RICs of applying former Prop. Treas. Reg. § 1.1291-8 will be respected, where relevant, for purposes of section 1296; and (v) that RICs may determine qualified electing fund (QEF) inclusions using audited financial statements that were prepared using US Generally Accepted Accounting Principles (GAAP) or International Financial

[11] *See* Institute's Submission for July 27, 2016, IRS FATCA Roundtable, dated July 13, 2016.

[12] T.D. 9123, published on April 29, 2004.

[13] *See* Institute letter, dated November 22, 2002, and Institute letter to Dale Collinson, dated April 24, 2003.

Reporting standards, and that all QEF inclusions subject to this election will be treated as ordinary, but retain the capital character of disposition gains and losses.

C. Guidance on Income and Asset Diversification

ICI recommends that the Treasury Department and IRS provide guidance regarding the application of the "cure" provisions in Code sections 851(d)(2) and (i), added by the Regulated Investment Company Modernization Act,[14] including the schedules referred to in sections 851(d)(2)(A)(i) and (i)(1)(A) and the meaning of "due to reasonable cause and not due to willful neglect" in sections 851(d)(2)(A)(ii) and (i)(1)(B). Specifically, ICI requests that the IRS provide guidance allowing RICs to rely on the REIT regulations[15] for purposes of the RIC income test. ICI also requests that the IRS provide guidance regarding the asset diversification cure provisions for RICs.

D. Check-the-Box Election

ICI urges the Treasury Department and IRS to issue guidance to coordinate the entity classification election under the check-the-box regulations[16] with the RIC election under section 851(b)(1). Specifically, we request that an eligible entity electing to be treated as a RIC will be deemed to have elected to be classified as an association taxable as a corporation, effective as of the first day the entity is treated as a RIC.[17] The regulations already provide such a deemed check-the-box election for entities that elect to be treated as REITs, for certain entities claiming tax-exempt status, and for entities electing to be taxable as S corporations. Amending the regulations to similarly coordinate the RIC election with the check-the-box rules will reduce administrative burdens for affected entities and the IRS and provide certainty as to an entity's status.

E. Section 529 Qualified Tuition Programs

ICI commends the Treasury Department and IRS for releasing Notice 2018-58 announcing its intention to issue regulations clarifying matters relating to the administration of amounts recontributed to section 529 plans.[18] Specifically, the Notice provides that the entire recontributed amount will be treated as principal, rather than requiring a portion to be treated as earnings, based on the amount that represented earnings when distributed. The Notice explains that it is implementing this rule of administrative convenience to eliminate the burdens associated with determining the earnings portion. It also confirms that the recontributed amount will not count against the contribution limit applicable to the beneficiary, because the amount will already have been taken into

[14] Pub. L. No. 111-325, 124 Stat. 3537. The Institute previously has asked for additional guidance implementing the RIC Modernization Act.

[15] Specifically, Treas. Reg. § 1.856-7, which provides guidance regarding a REIT's failure to meet its gross income requirements.

[16] Treas. Regs. § 301.7701-3.

[17] *See* Institute letter to Emily McMahon and William Wilkins, dated June 1, 2011.

[18] *See* Institute letter to Victoria Judson and Janine Cook, dated January 24, 2017.

account when it was originally contributed to the 529 plan. We urge the Treasury Department and IRS to issue such regulations.

In addition, a project to address section 529 plan issues, which was included on prior Guidance Priority Lists, was deleted from the 2009-2010 list without guidance being issued. Guidance regarding section 529 plans remains necessary to implement fully the Advance Notice of Proposed Rulemaking ("Advance Notice") regarding section 529 plans that the IRS released in 2008. We are pleased that the Advance Notice reflects several comments previously submitted jointly by ICI and the Securities Industry and Financial Markets Association ("SIFMA").[19] It remains important, for those saving for education through section 529 plans, that the tax treatment of investments in such plans is clear. We urge the IRS to continue its work on this guidance project to address outstanding issues.[20]

II. Outstanding Issues on Previous Years' Requests for Guidance

ICI requests that the Treasury Department and IRS issue guidance on the following items which have been included in ICI's previous requests for guidance.

A. Fund Liquidations

ICI asks the IRS and Treasury Department to clarify issues arising from the liquidation of RICs.[21] The current rules under Subchapter C and Subchapter M do not adequately address fact patterns that are unique to RIC liquidations, resulting in substantial uncertainty and administrative burden. Unfortunately, the incidence of fund liquidations may increase, given market conditions and further consolidation in the industry.

Specifically, ICI requests that the IRS and the Treasury Department provide that a RIC that is not a personal holding company (PHC) will not be treated as a PHC once the RIC has adopted a plan of liquidation, so long as the RIC liquidates within 90 days of the adoption of such plan. Second, we ask that the IRS treat a RIC as satisfying the asset diversification test in section 851(b)(3), the requirements for the tax-exempt interest pass-through in section 852(b)(5), and the requirements for the foreign tax credit pass-through in section 853(a)(1), so long as the RIC satisfies such requirements on the date the RIC adopts a plan of liquidation (and has otherwise satisfied the requirements for prior quarters in the taxable year, as applicable), and so long as the RIC liquidates within 90 days of the adoption of such plan.

Finally, we request that the IRS simplify the tax reporting of liquidating distributions from a RIC. As previously explained, the industry needs clarification on whether liquidating distributions from a RIC should be reported on IRS Form 1099-DIV or 1099-B.[22] We also ask the IRS and Treasury

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[19] *See* Institute and SIFMA letter to Michael Desmond, dated June 12, 2007.

[20] *See* Institute letter to Richard Hurst, Mary Berman and Monice Rosenbaum, dated May 12, 2008, for comments regarding the Advance Notice.

[21] ICI will submit a letter describing these issues and recommendations in more detail.

[22] *See* Institute Letter to Emily S. McMahon and William J. Wilkins, dated July 28, 2011; *see also* Enclosure A, Section II.D.

Department to confirm that RICs may satisfy the requirement to report the character of certain dividends to shareholders in a "written statement" by posting the information on their public websites.[23] This is particularly important for liquidating funds because they do not file financial statements in which such character normally would be reported. Clarification on both reporting issues would reduce significant confusion and administrative burdens.

B. Items Related to RIC Modernization Act of 2010

ICI continues to seek regulatory guidance necessary to properly implement the provisions of the RIC Modernization Act of 2010 (the RIC Modernization Act).[24]

Specifically, we request guidance allowing a RIC to meet the RIC Modernization Act's requirement to provide its shareholders with a "written statement" regarding the character of its distributions by posting the information on its website and advising its shareholders, in writing, to consult the website for this information.[25] This guidance is of particular importance given the recent implementation of SEC Rule 30e-3, which permits RICs to deliver shareholder reports by making them publicly accessible on a website, free of charge, and sending investors a paper notice of each report's availability by mail.[26] RICs typically include the character of distributions in the annual reports sent to shareholders. As many funds take advantage of the new SEC rule, RICs should be permitted to report distributions in publicly posted materials. Absent such guidance, RICs might be required to send a separate statement to shareholders for tax purposes. Such a requirement would be unnecessarily costly and burdensome.

C. Foreign Bank and Financial Account Reporting

ICI urges that the proposed revisions[27] to the Report of Foreign Bank and Financial Accounts (FBAR)[28] filing requirements be modified to resolve difficulties for the fund industry. In light of the many issues raised with respect to FBAR, we encourage the government to conduct a comprehensive review of the FBAR reporting requirements to eliminate unnecessary filings that do not have the "high degree of usefulness in criminal, tax, regulatory, and counterterrorism matters" required by the Bank Secrecy Act.[29]

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[23] *See* ICI Letter to Emily S. McMahon and William J. Wilkins, dated June 30, 2011; *see also* Enclosure A, Section II.A.

[24] *See* Institute letter to Emily McMahon and William Wilkins, dated June 30, 2011.

[25] Section 301 of the Act.

[26] *Final Rule: Optional Internet Availability of Investment Company Shareholder Reports*, SEC Rel. Nos. 33-10506, 34-83380, IC-33115 (June 5, 2018), *available at* https://www.sec.gov/rules/final/2018/33-10506.pdf. Investors who prefer to receive the full reports in paper may, at any time, choose that option free of charge. RICs may apply the new "notice and access" method beginning no earlier than January 1, 2021.

[27] 81 Fed. Reg. 12614 (March 10, 2016).

[28] FinCEN Report 114.

[29] 31 U.S.C. 5311.

The concerns expressed in ICI's letter[30] relate to the likelihood that FinCEN will be overwhelmed by essentially worthless FBAR filings unless three different areas are addressed. Specifically, amendments are needed to prevent counterproductive FBAR filings by (1) persons employed by fund managers, (2) individuals with signature authority over 25 or more foreign accounts, and (3) both a fund and its US global custodian with respect to the same account. We also recommend a permanent waiver of the filing obligations of individual employees with signature authority over foreign accounts whose requirement to file continues to be extended. While the fund industry appreciates and relies on the filing extensions, employers must still maintain filing records for these individuals even though many years have passed and may no longer be employed. Our requested guidance is consistent with FBAR's purposes of thwarting abusive tax schemes and combatting terrorism; adopting our suggestions will lead to improved compliance.

D. Ownership Tracking Requirements

ICI asks that a project be opened to amend the regulations under sections 382 and 383 with respect to ownership tracking requirements that apply to participant-directed retirement accounts holding RIC shares. Specifically, the regulations should permit a RIC to look through participant-directed retirement accounts and treat each participant/investor who holds less than five percent of the RIC's shares as part of the RIC's direct public group. The concerns addressed by sections 382 and 383 are not implicated when a RIC's new shareholders are retirement accounts that cannot benefit from such tax attributes.

This change effectively would prevent a large collection of small investors making independent investment decisions from being treated as a single entity for ownership change purposes. Absent this change, a retirement plan administrator's decision as to which RICs to offer in a plan could significantly affect whether other shareholders in the RIC can benefit from the RIC's capital losses even though the retirement plan administrator is neither a beneficial owner of RIC shares nor responsible for allocating investment assets among RICs. This scenario should not raise tax policy concerns.

E. Cost Basis Reporting

ICI continues to urge the IRS and Treasury Department to issue guidance clarifying several issues with respect to cost basis reporting. Specifically, we ask the IRS and Treasury Department to adopt in final regulations the rules provided in Notice 2011-56[31] regarding changes from a broker's default method of average cost, with the few modifications detailed in our previous letter. [32]

We also urge the IRS and Treasury Department to reconsider the requirement that a shareholder who elects to use the average cost method, revokes such election, or changes from the average cost method (whether the broker default or a shareholder election) must do so in writing. Requiring such elections, revocations, and changes in writing is unnecessarily burdensome and potentially costly for

[30] *See* Institute letter to Jennifer Shasky Calvery, dated May 9, 2016.

[31] 2011-29 I.R.B. 54.

[32] *See* Institute letter to Emily McMahon and William Wilkins, dated July 28, 2011.

shareholders.[33] ICI instead proposes that the regulations permit brokers, including RICs, to provide a written confirmation to shareholders of a cost basis method election, revocation, or change, in lieu of a written notification by the shareholder.

ICI also requests that several other issues regarding cost basis reporting be clarified. First, the IRS and Treasury Department should clarify that brokers may use any basis method as their default method for mutual fund shares, including first-in, first-out (FIFO), average cost, or any other formulaic method, as clearly intended by Congress. Second, we request that gifted shares have a carryover holding period, even if the shares were gifted at a loss (*i.e.*, the cost basis of the gifted shares exceeds the fair market value on the date of gift) and the donee subsequently sells the shares at a loss. Third, we ask the IRS and Treasury Department to clarify that, for cost basis reporting purposes, shares acquired by an estate after the decedent's death have a basis equal to the fair market value on the date of acquisition, unless the broker receives other information from an estate representative. Finally, the IRS should (i) clarify whether RIC liquidating distributions are subject to cost basis reporting and; (ii) if so, amend Forms 1099-B and 1099-DIV, and the accompanying instructions, to specify that liquidating distributions by RICs should be reported on Form 1099-B, so that brokers can properly report cost basis information for such distributions.

F. UMBS TBA Contracts and Diversification under Section 817(h)

ICI requests that the Treasury Department and IRS issue further guidance regarding diversification testing of To-Be-Announced (TBA) contracts for Uniform Mortgage Backed Securities (UMBS) for purposes of section 817(h). As outlined in our letters,[34] the guidance in Rev. Proc. 2018-54 does not address the critical question of how to test TBA contracts for UMBS.

We ask that the government issue guidance permitting taxpayers to choose either to (1) apply the deemed issuance ratio to UMBS TBA contracts or (2) treat the counterparty as the issuer, solely for purposes of section 817(h). Such guidance would provide taxpayers with certainty regarding the treatment of the UMBS TBA contracts without implicating the treatment of other contracts for this and other purposes. The current lack of certainty will affect negatively our members' ability to successfully manage and advise investment funds and managed accounts. Indeed, because UMBS have begun trading in the TBA market, we understand that the lack of guidance already is having an impact.

We also recommend that the guidance be issued as a safe harbor rather than as an affirmative election. Further, we recommend that the Treasury Department and IRS similarly amend the guidance in Rev.

[33] *See* Institute letter to William Wilkins, dated February 8, 2010. This letter commented on the proposed in-writing requirement for an affirmative average cost election. The proposed regulations did not require a revocation of such an election or a change from average cost to be in writing, so the Institute's letter does not address these rules, which were added to the final regulations.

[34] *See* ICI-SIFMA letter to Krishna Vallabhaneni and William Paul, dated February 11, 2019 and ICI-SIFMA letter to Peter Phelan, Krishna Vallabhaneni, and Michael Desmond, dated May 30, 2019.

Proc. 2018-54 to provide for a safe harbor. Finally, we request clarification as to the identity of the "taxpayer" for purposes of this guidance.[35]

G. Money Market Fund Reform

The Treasury Department and IRS have addressed most of the issues arising from money market reform in 2016. In addition to the QII issue discussed above, we request guidance on two remaining issues.[36] First, we ask the IRS and Treasury Department to provide guidance on how funds should treat any liquidity fees received. Second, the government should clarify whether the distribution of excess liquidity fees results in a return of capital or if the fund is deemed to have sufficient earnings and profits to support such distribution.

In addition, we note that recent proposals by the SEC to amend the rules on money market funds under the Investment Company Act of 1940 raise potential tax implications for investors.[37] As discussed in the Release, the SEC recognizes that the SEC staff will need to discuss with the Treasury Department and the IRS the tax consequences of the proposed swing pricing requirement. The potential tax implications mentioned in the Release include the consequences of an investor using the NAV method of accounting for gain or loss on floating NAV money market fund shares and the exemption from the wash sale rules for redemptions from these funds. Fund investors could be burdened, the SEC acknowledges, if current tax treatment is modified by the proposed swing pricing requirement.

We agree with the SEC that close coordination with the Treasury Department and the IRS is needed to ensure that appropriate tax guidance is issued before any SEC rule on swing pricing takes effect. Potential issues, in addition to those mentioned in the Release, could include the tax consequences to the fund and ultimately fund investors of any amounts retained pursuant to the swing price mechanism.

Issues on Previous Years' Priority Guidance Lists

ICI requests that the IRS and Treasury Department issue guidance on the following items that were on previous years' Priority Guidance Lists but were not included in the 2021-2022 Priority Guidance List.

[35] The ACLI submitted a letter to the IRS and Treasury Department on July 26, 2019, suggesting an alternative "look-through" approach. The ICI believes that the ACLI's suggestion also would resolve these issues.

[36] *See* Institute letter to Michael Novey and Helen Hubbard, dated September 8, 2016.

[37] See Money Market Fund Reforms, SEC Release No. IC-34441 (December 15, 2021) (Release), available at https://www.sec.gov/rules/proposed/2021/ic-34441.pdf.

A. Prepaid Forward Contracts

We urge guidance on prepaid forward contracts.[38] Specifically, ICI strongly supports prompt and comprehensive guidance regarding the tax treatment of exchange-traded notes (ETNs). Although ETNs can provide important investment opportunities, they also take advantage of gaps in the tax law to provide investors with tax deferral (of up to 30 years) and character conversion that is inappropriate. This treatment is far more favorable than the treatment obtained by investors in comparable financial instruments and provides a tax incentive to take on issuer credit risk, rather than invest in products that do not entail this risk. In the absence of legislation, regulations should be issued under the Treasury Department's existing authority under section 1260 and should provide a mark-to-market election. If a comprehensive regulatory approach is not developed under section 1260, guidance should be issued under section 446 to address any ETNs that remain outside the scope of the section 1260 constructive ownership solution.

B. Notional Principal Contracts

ICI remains very interested in guidance providing simplicity and certainty regarding the taxation of notional principal contracts. ICI made a number of recommendations in our letters on the regulations proposed in 2004 and 2011.[39] We recommend that marks under the elective mark-to-market method, as well as value payments under the noncontingent swap method, be treated as resulting in capital gain or loss. We also suggest that credit default swaps and certain short-term swaps be excluded from the modified noncontingent swap method and the mark-to-market election. Further, we request additional guidance regarding the definition of "payment" and on several technical issues. Finally, we suggest that the guidance should be made entirely prospective upon promulgation of final regulations.

C. Distressed Debt

ICI requests guidance addressing the accrual of interest on distressed debt. Investors have long faced uncertainty regarding how the existing original issue discount and market discount rules should apply to severely distressed, and speculative, debt. In other cases, application of these rules creates what many believe to be inappropriate results.[40] These issues were exacerbated by the events of the 2008 financial crisis and, more recently, credit issues arising from the pandemic.[41]

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[38] *See* Institute letter to Eric Solomon and Donald Korb, dated May 13, 2008. *See also*, Testimony of William M. Paul on behalf of the Institute, presented on March 5, 2008, before the House of Representatives Ways and Means Subcommittee on Select Revenue Measures.

[39] *See* Institute letter to Greg Jenner and Donald Korb, dated July 21, 2004, and Institute letter to Emily McMahon and William Wilkins, dated December 15, 2011.

[40] *See*, *e.g.*, Letter of May 15, 1991, from Jere D. McGaffey to Fred T. Goldberg, Jr. (transmitting comments prepared by members of the ABA's Section of Taxation on the application of market discount rules to speculative bonds).

[41] *See, e.g.*, Institute letter to Eric Solomon and Donald Korb, dated July 28, 2008.

D. Taxable Mortgage Pools

ICI renews its request for regulatory guidance to clarify issues relating to excess inclusion income of a REIT that is a taxable mortgage pool (TMP) or that has a qualified REIT subsidiary that is a TMP.[42] We understand that in recent years some REITS have reported distributions attributable to excess inclusion income; this impacted RICs to the extent that such REITs were held in common indexes tracked by those funds. Although Notice 2006-97[43] addressed a few issues and responded to some of ICI's concerns regarding the lack of guidance in this area,[44] many critically important issues remain unresolved. At a minimum, and as requested by ICI in 2006, guidance should be issued stating that Notice 2006-97 will not be applied until some reasonable period after a practical reporting regime is implemented and the many uncertainties arising from the Notice are resolved.[45]

III. Other Issues Directly Affecting RICs and Their Shareholders

ICI requests that the IRS and Treasury Department address issues arising from the application of the general corporate tax rules to RICs. These rules can be unnecessarily difficult to apply and can result in unintended consequences.

A. Business Continuity Requirement for Tax-Free Mergers

First, ICI requests guidance clarifying the application of the "business continuity" requirement to RICs under section 368 and Treas. Reg. § 1.368-1(d)(2).[46] This clarification is necessary because it is difficult to discern the intended scope of the business continuity test as applied to RIC reorganizations. As a result, many RICs engaging in merger transactions are compelled to rely on the "asset continuity" test;[47] this test, to the detriment of the RIC's shareholders, can place artificial limits on the ability of a portfolio manager to dispose of portfolio securities acquired from a target RIC and imposes significant compliance burdens on funds. ICI requested guidance on this issue in 2004, at which point the IRS informed us that they wished to gather more information on RIC mergers through the private letter ruling process. ICI hopes that the IRS and Treasury Department now have sufficient information to open a project on this issue and requests that they do so.

B. RIC Investments in Partnerships with Different Taxable Year-Ends

Second, we request guidance regarding RIC investments in a partnership in which the RICs and the partnership have different tax years; this guidance should allow RICs to take partnership items into

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[42] *See* Institute and Nareit letter to Krishna Vallabhaneni and Michael Desmond, dated November 27, 2019.

[43] 2006-2 C.B. 904.

[44] *See* Institute letter to Eric Solomon and Donald Korb dated May 12, 2006.

[45] *See* Institute letter to Lon Smith, dated December 29, 2006.

[46] *See* Institute letter to William D. Alexander and Lon B. Smith, dated January 15, 2003. *See also* Institute letter to William D. Alexander, dated April 30, 2004.

[47] *See* Treas. Reg. § 1.368-1(d)(3).

income at the end of each month, rather than at year-end. In general, partners must take partnership items into account at the end of the partnership's tax year.[48] If a RIC invests in a partnership with a different tax year, however, this can cause mismatches between the RIC's distributions and the amount of earnings and profits associated with the partnership's income.

[48] *See* Rev. Rul. 94-40, 1994-1C.B. 274 (for purposes of the required distribution under section 4982, a RIC must take into account its share of partnership items of income, gain, loss, and deduction as they are taken into account by the partnership, regardless of the taxable years of the RIC and the partnership in which the RIC is a partner).