Dear Acting Assistant Secretary Mundaca and Acting Chief Counsel Potter:

The Investment Company Institute (“ICI”) is pleased to recommend the following issues affecting regulated investment companies (“RICs”) and their shareholders for inclusion on the 2009-2010 Guidance Priority List. The attached memorandum describes these recommendations in greater detail.

I. 2008-2009 Guidance Priority List Items

The ICI requests that the Internal Revenue Service (“IRS”) and Treasury Department issue guidance as promptly as possible on several items currently on the 2008-2009 Guidance Priority List that relate to or affect RICs. Specifically, these guidance projects would:

- address the accrual of interest on distressed debt (an issue that has been exacerbated by recent market events);\(^3\)
- permit minor errors made by RICs and real estate investment companies (“REITs”) to be corrected;\(^4\)

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\(^1\) 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 $9.71 trillion and serve over 93 million shareholders.

\(^2\) A separate ICI submission describes our Guidance Priority List recommendations for retirement security issues.

\(^3\) See, e.g., ICI letter to Eric Solomon and Donald Korb, dated July 28, 2008.
• clarify the application of section 1(h) to RIC capital gain dividends and address similar bifurcation-related issues arising under section 871(k)(2);5

• clarify the tax treatment of notional principal contracts;6 and

• clarify the tax treatment of prepaid forward contracts.7

II. Making Permanent/Extending Recent Temporary Guidance

We urge the IRS and Treasury to make permanent or extend certain recently-issued guidance with temporary effect. Specifically, we urge that the government:

• make permanent the guidance set forth in Revenue Procedure 2009-10, which provides safe harbor treatment for certain payments received by a money market fund; and

• extend for another year the effective date for Revenue Procedure 2009-15, which permits RICs and REITs to make elective stock dividends.8

III. Guidance Priority List Item Arising From Enacted Legislation

We encourage the IRS and Treasury to release proposed guidance, as soon as tentative conclusions on issues are reached, to implement the mandatory cost basis reporting requirements enacted in 2008.9 Given the significant number of issues that must be addressed, and the time necessary to implement the new rules, the IRS and Treasury should not wait and release the entire guidance project at once.

IV. Other Issues Directly Affecting RICs and Their Shareholders

The ICI also requests that the IRS and Treasury include on the 2009-2010 Guidance Priority List projects involving: (1) the application of general corporate tax rules to RICs; (2) tiered RIC structures; (3) RIC portfolio investments; and (4) information reporting. Specific guidance projects within each of these categories are described below.

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4 See ICI letter to Eric Solomon and Donald L. Korb, dated September 12, 2008.

5 See ICI letter to Alice Bennett, dated May 24, 2006.


7 See ICI letter to Eric Solomon and Donald L. Korb, dated May 13, 2008.

8 See ICI letter to Eric Solomon and Donald L. Korb, dated December 10, 2008.

9 See ICI letter to Clarissa C. Potter, dated April 9, 2009.
A. The Application of General Corporate Tax Rules to RICs

Guidance involving the application of general corporate tax rules to RICs is requested to:

- clarify the application of the “business continuity” requirement to RICs under section 368 and Treas. Reg. § 1.368-1(d)(2);10
- clarify that a redemption of shares by an investor in an open-end investment company (e.g., a mutual fund) is not essentially equivalent to a dividend; and
- permit a RIC to look through participant-directed retirement accounts and variable insurance product account owners, for purposes of sections 382 and 383, 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.

B. Tiered RIC Structures

We request guidance regarding “tiered-RIC structures,” in which one RIC (“RIC 1”) invests in another RIC (“RIC 2”) that either distributes exempt-interest dividends or flows through foreign tax credits.

C. RIC Portfolio Investments

We request guidance on issues involving RIC portfolio investments that would:

- provide additional guidance regarding passive foreign investment companies (“PFICs”);11
- permit a RIC, that invests in a partnership with a tax year different from the RIC’s, to take partnership items into income at the end of each month, rather than at year-end; and
- 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.12

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12 See ICI letters to Eric Solomon and Donald L. Korb, dated May 12, 2006, and to Lon B. Smith, dated December 29, 2006.
D. Information Reporting

We request guidance on information reporting issues that would:

• provide Form 1120-RIC filers with an automatic extension to file these returns without having to file a request for such an extension by the return’s original due date;\(^{13}\)

• clarify that “identifying logos” are not advertising or promotional material for purposes of statement mailing requirements, and that payors may continue to use such identifying logos on substitute and composite Forms 1099;\(^{14}\) and

• permit payors to “mask” social security numbers on Forms 1099 and 5498 mailed to investors.\(^{15}\)

V. Education Savings Issues

We urge Treasury and the IRS to propose regulations described in a 2008 Advance Notice of Proposed Rulemaking that reflects comments submitted jointly by the ICI and Securities Industry and Financial Markets Association ("SIFMA")\(^{16}\) as well as additional comments submitted by the ICI.\(^{17}\)

VI. Foreign Bank and Financial Account Reporting

Finally, we request guidance clarifying that persons who are employees of firms that provide services to RICs, and who have signature authority over a RIC’s foreign accounts, may utilize the employee exception to the filing requirement for the Report of Financial Bank and Financial Accounts (the “FBAR”) – TD F 90-22.1.\(^{18}\)

\* \* \* \* \* 

\(^{13}\) See ICI letter to Lon B. Smith and Stuart A. Mann, dated March 2, 2007.

\(^{14}\) See ICI and SIFMA letter to Douglas Shulman, dated March 5, 2009.

\(^{15}\) See ICI letter to Douglas H. Shulman, Donald L. Korb and Eric Solomon, dated September 18, 2008.

\(^{16}\) See ICI and SIFMA letter to Michael Desmond, dated June 12, 2007.

\(^{17}\) See ICI letter to Richard Hurst, Mary Berman and Monice Rosenbaum, dated May 12, 2008.

If we can provide you with any additional information regarding these issues, please do not hesitate to contact Keith Lawson at (202)326-5832 or Karen Gibian at (202)371-5432.

Sincerely,

/s/ Keith Lawson           /s/ Karen L. Gibian
Keith Lawson               Karen Lau Gibian
Senior Counsel             Associate Counsel

cc: CC:PA:LPD:PR (Notice 2009-43)
    Eric A. San Juan
    John Harrington
    Jeffrey Van Hove
    David H. Shapiro
    John J. Cross III
    Michael S. Novey
    Catherine V. Hughes
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    William D. Alexander
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    Steven A. Musher
    Curtis G. Wilson
    Phoebe Mix
    Alice M. Bennett
    Rebecca Harrigal
    Susan T. Baker
    Walter Harris
    Richard LaFalce
    Stephen J. Schaeffer
    Roger E. Wade
Investment Company Institute Suggestions for 2009-2010 Guidance Priority List

I. 2008-2009 Guidance Priority List Items

The ICI requests that the following items currently on the 2008-2009 Guidance Priority List be issued as promptly as possible.

A. Distressed Debt

First, the 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. These issues have been exacerbated by recent market events.

B. Minor Errors/Preferential Dividends

Second, we request guidance addressing the correction of minor errors made by RICs and real estate investment companies ("REIT"). This project was added after the ICI requested a de minimis rule for preferential dividends paid by publicly-offered RICs. Our request followed extensive discussions between ICI, its members, their service providers and the IRS and Treasury regarding preferential dividend issues arising from mathematical, computer, and other processing errors. These errors, which often arise in RICs with multiple classes, may cause a RIC unintentionally to pay a dividend to some shareholders that is more or less than they are entitled to receive.

Specifically, consistent with this guidance plan project, the ICI requests guidance providing publicly offered RICs with a simple and administrable “self-correction” procedure to obtain automatic relief (with appropriate penalties) for inadvertent violations of the preferential dividend rule. If a RIC voluntarily complies with the requirements of the proposed self-certification procedure, then (i) inadvertent violations would not be treated as preferential dividends; and (ii) any corrective distributions made to comply with the self-certification procedure also would not be treated as preferential.

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1 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).

2 See, e.g., ICI letter to Eric Solomon and Donald Korb, dated July 28, 2008.

3 See ICI letter to Eric Solomon and Donald L. Korb, dated September 12, 2008.
C. 1(h) Guidance

Third, we request guidance clarifying the application of section 1(h) to RIC capital gain dividends\(^4\) and addressing similar bifurcation-related issues arising under section 871(k)(2), which permits flow-through of short-term capital gain dividends.

D. Notional Principal Contracts

Fourth, the ICI remains very interested in the guidance plan project on notional principal contracts. In our letter on the regulations proposed in 2004,\(^5\) we expressed reservations about the proposed regulations’ complexity and recommended significant modifications. We recommended 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 suggested that credit default swaps and certain short-term swaps should be excluded from the modified noncontingent swap method and the mark-to-market election. We requested additional guidance on determining whether a payment is “significant.” We also commented on several technical issues, most importantly on the need for RICs to treat adjustments to income attributable to a redetermination or a mark-to-market arising after October 31 of a taxable year as arising on the first day of the following taxable year. Finally, we suggested that the proposed regulations should be made entirely prospective upon promulgation of final regulations.

E. Prepaid Forward Contracts

Finally, we urge guidance on prepaid forward contracts.\(^6\) Specifically, the ICI strongly supports prompt and comprehensive guidance regarding the tax treatment of exchange-traded notes (“ETNs”). In the absence of legislation, regulations should be issued under Treasury’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.

II. Making Permanent/Extending Recent Temporary Guidance

The ICI also asks the IRS and Treasury to make permanent or extend certain recently issued guidance that is set to expire this year.

\(^4\) See ICI letter to Alice Bennett, dated May 24, 2006.


A. Money Market Fund Safe Harbor

We request that the IRS and Treasury make permanent the guidance set forth in Revenue Procedure 2009-10, which provides safe harbor treatment for certain payments received by a money market fund regulated under Rule 2a-7 of the Investment Company Act of 1940. The proper tax treatment of such payments has been an issue for several years, and the guidance provided by the revenue procedure provides much needed certainty in this area.

B. Elective Stock Dividends

In addition, we request that the IRS and Treasury extend the effective date for Revenue Procedure 2009-15, which permits RICs and REITs to make elective stock dividends. The revenue procedure applies to distributions declared on or after January 1, 2008, with respect to a taxable year ending on or before December 31, 2009. Given the current state of the markets, some business development corporations and closed-end funds may need to make elective stock dividends with respect to taxable years ending after December 31, 2009. Therefore, it would be helpful if this guidance were extended for another year.

III. Guidance Priority List Item Arising From Enacted Legislation

The ICI urges the IRS and Treasury to issue, as soon as practicable, guidance implementing the new mandatory cost basis reporting requirements that were enacted by the Economic Stabilization Act of 2008. Prompt guidance is needed so that firms can effectively implement the new requirements before the applicable effective date. As discussed in our comment letter,\(^7\) effective implementation of this legislation will require tremendous effort by the financial services industry within a very short time period. Given the significant number of issues that must be addressed, we encourage the IRS and Treasury to issue guidance regarding the most critical issues first, rather than attempting to release the entire guidance project at once. Providing guidance incrementally would permit the industry to begin the necessary programming and systems changes as soon as possible. Again, as mentioned in our comment letter and in our recent meeting with the IRS and Treasury, we gladly will meet with you as often as necessary to discuss cost basis reporting as this project progresses.

IV. Other Issues Directly Affecting RICs and Their Shareholders

A. The Application of General Corporate Tax Rules to RICs

The ICI requests that the IRS and Treasury address several 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.

\(^7\) See ICI letter to Clarissa C. Potter, dated April 9, 2009, in response to Notice 2009-17.
1. Business Continuity Requirement for Tax-Free Mergers

First, the ICI requests guidance clarifying the application of the “business continuity” requirement to RICs under code section 368 and Treas. Reg. § 1.368-1(d)(2). 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 that (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. This issue has become increasingly important given recent financial conditions, under which more and more RICs are being merged. The ICI most recently requested guidance on this issue in 2004; at that time, the IRS informed us that they wished to gather more information on RIC mergers through the private letter ruling process. The ICI hopes that the IRS and Treasury now have sufficient information to open a project on this issue and requests that they do so.

2. Redemption of Mutual Fund Shares Not Essentially Equivalent to a Dividend

Second, we request guidance clarifying that a redemption of shares by an investor in a RIC that issues shares redeemable upon shareholder demand (i.e., an “open-end investment company” or “mutual fund”) is not essentially equivalent to a dividend under section 302 even if the redemption does not reduce the investor’s proportionate ownership of the RIC. Application of section 302 to routine redemptions of RIC shares creates substantial uncertainty and unnecessary administrative burdens. Certain types of RICs, such as variable insurance funds that have only one legal owner (the insurance company) and RICs in fund-of-funds structures, are particularly vulnerable to difficulties arising from uncertainty in this area.

Literal application of section 302 could require testing every partial shareholder redemption, of which there may be hundreds or thousands a day, to determine if the redemption should be treated as a section 302 exchange or as a section 301 distribution. This testing would impose significant burdens, but no benefits. Redemption decisions made independently by the RIC’s shareholders exercising their daily redemption right are not a devise to divert section 301 distributions to select shareholders. RICs are required to distribute all of their income and seek to treat all shareholders equally; shareholders would not be treated equally if redeeming shareholders received most or all of the fund’s taxable income and remaining shareholders had little or no taxable income.

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9 See Treas. Reg. § 1.368-1(d)(3).
3. **Ownership Tracking Requirements**

Finally, the 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 and to variable insurance products. Specifically, the regulations should permit a RIC to look through participant-directed retirement accounts and variable insurance product account owners 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 against which sections 382 and 383 are directed are not implicated when a RIC’s new shareholders are retirement accounts or variable insurance product 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 what 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. Likewise, absent this change, an ownership change could occur if another company buys the insurance company holding the variable insurance product shares.

B. **Tiered Structures**

The ICI also requests guidance regarding “tiered-RIC structures,” in which one RIC (“RIC 1”) invests in another RIC (“RIC 2”) that either distributes exempt-interest dividends or flows through foreign tax credits. Specifically, we ask that RIC 1 be permitted to look through to the underlying assets of RIC 2 to determine whether RIC 1 has met its statutory requirement to invest at least 50 percent of the value of its total assets in bonds exempt under section 103 (for exempt-interest dividend purposes) or in stock or securities in foreign corporations (for foreign tax credit purposes).

C. **RIC Portfolio Investments**

The ICI requests guidance on several issues arising from RICs’ portfolio investments.

1. **PFICs**

First, we ask the IRS and Treasury to issue additional guidance regarding passive foreign investment companies (“PFICs”). The preamble to the final PFIC mark-to-market regulations (TD

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10 Pursuant to section 852(b)(5), when at least 50 percent of the value of the total assets of a RIC consists of tax-exempt obligations, a RIC may designate its distributions attributable to interest earned on bonds exempt from tax under section 103 as exempt-interest dividends.

11 Pursuant to section 853, where more than 50 percent of the value of the total assets of a RIC consist of foreign stock or securities, a RIC may elect to treat its shareholders as having paid directly any foreign taxes paid on the foreign-source income (by grossing up the dividend for the amount of such taxes and flowing through the foreign tax credit).
9123) published on April 29, 2004, 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. We request that a regulations project be opened to address these and other PFIC-related issues faced by the industry.

Specifically, the 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) rules resolving “post-October” PFIC loss issues that are modeled after the rules governing a RIC’s “post-October” foreign currency losses under Treas. Reg. § 1.852-11(d); (iv) 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; (v) 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 (vi) that RICs may determine qualified electing fund (“QEF”) inclusions using audited financial statements that were prepared using U.S. Generally Accepted Accounting Principles or International Financial 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.

2. 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 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. 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.

3. Taxable Mortgage Pools

Third, we request 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. While Notice 2006-97 addressed a few issues, and responded to some of the ICI’s concerns with the lack of guidance in this area,14 many critically-important issues remain unresolved. At a minimum, and as requested by the 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.15

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14 See ICI letter to Eric Solomon and Donald L. Korb, dated May 12, 2006.

15 See ICI letter to Lon B. Smith, dated December 29, 2006.
D. Information Reporting

The ICI also asks the IRS and Treasury to issue guidance on several important reporting issues affecting RICs and their shareholders.

1. Automatic Extensions to File IRS Form 1120-RIC

The ICI requests guidance providing Form 1120-RIC filers with an automatic extension to file these returns without having to file a request for such an extension by the return’s original due date. The requested guidance would reduce administrative burdens and costs on both fund shareholders and the IRS. Fund shareholders would benefit from the assurance that fund-level taxes would not be incurred because of inadvertent errors in requesting extensions to file Forms 1120-RIC. The IRS would benefit because resources no longer would be needed to consider requests for relief when funds inadvertently fail to request filing extensions.

2. Identifying Logos on Substitute and Composite Forms 1099

We also request guidance clarifying that “identifying logos” are not advertising or promotional material for purposes of statement mailing requirements, and that payors may continue to use such identifying logos on substitute and composite Forms 1099. Pursuant to guidance issued in 1996, RICs and brokers have placed identifying logos on substitute and composite forms for many years. To our knowledge, the use of such logos has not resulted in shareholder confusion. To the contrary, we believe that our shareholders use these logos to identify the various tax forms received and to reconcile such forms with their quarterly account statements and trade confirms. Eliminating these logos likely would create, rather than reduce, shareholder confusion.

3. TIN Masking

Finally, the ICI requests guidance permitting payors to “mask” (or obscure) the full Social Security number on Forms 1099 and 5498 mailed to investors. Masking or obscuring the full taxpayer identification number is the most effective way to combat identity theft, and many RICs already do so on non-tax documents sent to shareholders.

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16 See ICI letter to Lon B. Smith and Stuart A. Mann, dated March 2, 2007.

17 See ICI and SIFMA letter to Douglas Shulman, dated March 5, 2009.


V. Education Savings Issues

The 2009-2010 Guidance Priority List included a guidance project regarding section 529 qualified tuition programs (“section 529 Plans”), and in 2008, the IRS released an Advance Notice of Proposed Rulemaking (“Advance Notice”) regarding 529 Plans. We are pleased that the Advance Notice reflects several comments previously submitted jointly by the ICI and the Securities Industry and Financial Markets Association (“SIFMA”). It remains important, for those saving for education through section 529 plans, that the tax treatment of investments in such plans be clear. We urge the IRS to continue its work on this guidance project to address outstanding issues.

VI. Foreign Bank and Financial Account Reporting

Finally, we request guidance clarifying that persons who are employees of firms that provide services to RICs, and who have signature authority over a RIC’s foreign accounts, may utilize the employee exception to the filing requirement for the Report of Financial Bank and Financial Accounts (the “FBAR”) – TD F 90-22.1. This guidance is necessary because of confusion within the industry regarding how the FBAR employee exception applies in the context of a fund that does not have employees of its own. The requested guidance would prevent Treasury from being inundated with unnecessary and duplicate submissions.

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21 See ICI letter to Richard Hurst, Mary Berman and Monice Rosenbaum, dated May 12, 2008, for comments regarding the Advance Notice.