

## Letter Calls for Enactment of Tax "Flow-Through" Legislation, September 2007

**September 21, 2007**

The Honorable Max Baucus  
Chairman  
Finance Committee  
United States Senate  
511 Hart Senate Office Building  
Washington, DC 20510

The Honorable Charles E. Grassley  
Ranking Member  
Finance Committee  
United States Senate  
135 Hart Senate Office Building  
Washington, DC 20510

**Re: Section 871(k)'s Flow-Through Provision Should Be Made Permanent**

Dear Chairman Baucus and Ranking Member Grassley:

The Investment Company Institute,<sup>1</sup> on behalf of mutual funds and their shareholders, urges enactment this year of legislation making permanent a provision, enacted in 2004, that improves the ability of U.S. funds to attract foreign shareholders. Specifically, we urge that Code section 871(k) be made permanent; this provision promotes tax fairness by permitting certain distributions by U.S. funds to retain their character as exempt from U.S. withholding tax when paid to foreign shareholders. Absent a legislative extension, Code section 871(k) will expire after 2007.

Most types of income received by funds (e.g., dividends, interest, and short-term capital gains) historically have been treated for tax purposes as dividends upon distribution to shareholders. Dividend treatment arises because mutual funds are corporations for tax purposes, and corporate distributions of earnings are treated as dividends (absent a special rule).

The American Jobs Creation Act of 2004 ("AJCA") provided a special rule for fund distributions attributable to interest and short-term gains. Under AJCA, a fund may elect to flow through to its foreign shareholders the character of these two types of income. Flow-through treatment is beneficial because interest and short-term gains received by foreign shareholders generally are exempt from U.S. withholding tax, while dividends are taxable.

AJCA's flow-through provision should be made permanent. Short extensions of this provision, while beneficial, do not provide foreign investors with tax certainty; short extensions also do not provide certainty to those fund companies that have not yet incurred the costs required to implement this provision. Enactment during 2007 of permanence legislation will provide tax certainty, promote tax fairness for investors, and enhance the global competitiveness of U.S. funds.

Please feel free to contact me, or Dan Crowley, ICI's Chief Government Affairs Officer at 202/326-5962, if we can provide you with additional information.

With very best regards.

Sincerely,

Paul Schott Stevens

**ENDNOTES**

<sup>1</sup> ICI members include 8,803 open-end investment companies (mutual funds), 671 closed-end investment companies, 457 exchange-traded funds, and four sponsors of unit investment trusts. Mutual fund members of ICI have total assets of approximately \$11.140 trillion (representing 98 percent of all assets of U.S. mutual funds); these funds serve approximately 93.9 million shareholders in more than 53.8 million households.

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