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By Electronic Delivery

October 23, 2014

Hon. Mark Mazur
Assistant Secretary (Tax Policy)
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Hon. William Wilkins
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

RE: Proposed Regulations and Revenue Procedure on Floating NAV Money Market Funds

Dear Mr. Mazur and Mr. Wilkins:

The Investment Company Institute[1] commends the Treasury Department and the Internal Revenue Service ("IRS") for releasing tax guidance in connection with the Securities and Exchange Commission's ("SEC's") adoption of its money market fund rule (the "SEC Rule"). The proposed regulations and Revenue Procedure 2014-45 largely address the many tax burdens raised by the new floating net asset value ("NAV") requirement. Although we have a few recommendations, we generally believe that this guidance provides a workable tax accounting method for shareholders in floating NAV money market funds. We especially appreciate the Treasury Department and IRS's commitment to providing guidance on these issues in a timely fashion.

The Institute recommends three changes to the "NAV method" in the proposed regulations. First, shareholders should be permitted to use the NAV method on an account-by-account basis. Second, the NAV method should be available for shareholders in stable NAV money market funds that charge a liquidity fee. Third, the IRS and the Treasury Department should confirm that a regulated investment company (a "RIC") is permitted to use the one-year period from November 1 to October 31 as its "computation period" for purposes of the excise tax.

The Institute also asks the IRS to extend the wash sale exemption in Rev. Proc. 2014-45 to stable NAV funds that impose a liquidity fee.

[1] The Investment Company Institute (ICI) is the world's leading association of regulated funds, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors and advisers. ICI's U.S. fund members manage total assets of $17.2 trillion and serve more than 90 million U.S. shareholders.

In addition to the guidance already released, the Institute asks the IRS and Treasury Department to provide guidance regarding the tax implications to funds and shareholders if a stable NAV fund imposes a liquidity fee. First, the government should clarify that a money market fund may treat the liquidity fee as "paid-in capital," resulting in no gain or income, and that shareholders should treat the liquidity fee as a reduction in gross proceeds. We also ask the government to provide that a stable NAV RIC that pays out liquidity fees will be deemed to have sufficient earnings and profits to make the distribution a dividend under section 301, to the extent the distribution otherwise would be a return of capital.

Finally, the Institute asks the Treasury Department and the IRS to provide guidance permitting a money market fund that separates existing institutional and retail classes into standalone funds, in order to comply with the SEC Rule, to treat such transaction as a tax-free reorganization under section 368.

In addition to these written comments, the Institute wishes to speak at the public hearing on the proposed regulations scheduled for November 19, 2014. An outline of the topics to be discussed at the hearing is attached.

NAV Method Proposed Regulations

The proposed regulations set forth a new, simplified method of tax accounting for shareholders in floating NAV money market funds. Pursuant to this NAV method, shareholders in a floating NAV money market fund may report their gain or loss from the fund based on the change in the aggregate value of the shares in the fund during a specified computation period.

Permissible on Account-by-Account Basis

The proposed regulations provide that a taxpayer who uses the NAV method must use that method for all of the taxpayer's floating NAV money market fund accounts, although the method applies separately to each account. The Institute asks the Treasury Department and the IRS to provide in the final regulations that shareholders may apply the NAV method on an account-by-account basis. Thus, a taxpayer would be permitted to use the NAV method for some of its floating NAV money market funds while using standard tax accounting in other floating NAV money market fund accounts. This would eliminate operational issues for taxpayers, which is important because many shareholders in floating NAV money market funds will be large institutional investors that own such funds across multiple business units. Permitting taxpayers to apply the NAV method on an account-by-account basis would prevent inadvertent failures to apply the NAV method across all accounts. It also would be consistent with the calculation of cost basis of securities under current law.[2] Fund shareholders may apply different basis methods to different accounts, even if those different accounts include shares in

[2] *See* section 1012(c)(1).

the same mutual funds. Mutual funds, intermediaries, and fund shareholders have become familiar with this account-by-account method since its implementation in 2012.

The proposed regulations clarify that the current exemption from information reporting under sections 6045, 6045A and 6045B applies to all money market funds that qualify under SEC rule 2a-7, even if the money market fund is required to maintain a floating NAV. The Institute and its members believe this is the proper approach, particularly as most shareholders in the floating NAV money market funds will be "exempt recipients" for whom information reporting generally is not required. We understand, however, that some floating NAV money market funds may choose to provide gross proceeds and basis information to their shareholders, on a voluntary basis, as a customer service; these funds may choose to do so using any permissible basis method.

If a floating NAV money market fund chooses to provide such information to its shareholders, those shareholders should be permitted to use the information provided. If a shareholder has investments in other floating NAV money market funds, however, that investor may have applied the NAV method with respect to the other funds. Under the proposed regulations, the investor would be required to use the NAV method for all of its money market funds, even if another fund provided the information necessary to calculate gains and losses under standard tax accounting. The Institute believes that shareholders should have the ability to use any information provided by the funds and should not be restricted in that ability by a method applied to another fund. Thus, we ask the Treasury Department and the IRS to provide that shareholders may use the NAV method on an account-by-account basis.

Application to Stable NAV Funds

The Institute also asks the Treasury Department and IRS to provide in final regulations that the NAV method is available to shareholders in stable NAV funds that charge a liquidity fee. The preamble to the proposed regulations specifically requests comments on this issue. We agree with the Treasury Department and the IRS that shareholders in stable NAV funds likely will lack the systems necessary to record losses and to track the cost basis of shares that vary from $1.00. This is particularly true given that many of these shareholders may be retail shareholders (*i.e.*, natural persons) who likely rely upon the cost basis reporting provided by funds and/or brokers (voluntarily or under section 6045) for their other mutual funds.

The preamble notes that the imposition of a liquidity fee in a stable NAV fund typically will result in an increased basis if the acquisition of additional shares causes the loss arising from the liquidity fee to be disallowed under the wash sale rule. As discussed below, we believe that stable NAV funds that impose a liquidity fee should be exempt from the wash sale rule, as are floating NAV money market funds in Rev. Proc. 2014-45. This would ensure that the imposition of a liquidity fee would result in an immediate recognized loss to applicable shareholders and could not cause a shareholder to have a basis equal to more than $1.00.

Additionally, shareholders in a stable NAV money market fund could have a basis equal to less than $1.00 if the fund distributes all or some of the liquidity fees it receives, and if such distributions are treated as a return of capital to current shareholders. As discussed below, we believe that in this circumstance the fund should be deemed to have sufficient earnings and profits to support the distribution, resulting in an ordinary dividend and leaving the shareholder with a cost basis equal to $1.00.

If, however, the Treasury Department and IRS do not provide both the wash sale exemption and the deemed earnings and profits approach, shareholders who pay a liquidity fee will need the NAV method to account for future losses and/or gains in their stable NAV fund. Even if the Treasury Department and the IRS do provide both the wash sale exemption and the deemed earnings and profits approach, the Institute believes that the NAV method still should be available to shareholders of stable NAV funds so that shareholders who own both floating NAV funds and stable NAV funds[3] can report all of their gains and losses from redemptions of money market fund shares on a consistent basis if they wish to do so. In other words, such shareholders should be permitted to report based on the aggregate gain/loss impact of all transactions and value changes in each money market fund during the applicable period, rather than reporting the individual redemption transactions in the stable NAV funds.

Application to RICs for Excise Tax Purposes

Finally, the Institute asks the Treasury Department and the IRS to clarify that a RIC that uses the NAV method is permitted to use the one-year period from November 1 to October 31 as its "computation period" for excise tax purposes. The proposed regulations provide that a taxpayer may choose any computation period for applying the NAV method, so long as (i) the computation periods are of approximately equal duration; (ii) every day during the taxable year falls within only one computation period; and (iii) each computation period contains days from only one taxable year.

RICs are subject to an excise tax regime under section 4982. To avoid the excise tax, RICs must distribute each year 98 percent of the RIC's ordinary income for the calendar year, plus 98.2 percent of the RIC's capital gain net income for the one-year period ending on October 31 of such calendar year.[4] A RIC must include its gain or loss from investments in floating NAV money market funds in the excise tax calculation. Because such gains or losses would be capital, a RIC should be permitted to use the year ending on October 31 as its computation period for excise tax purposes.

Most RICs, however, have a fiscal year that ends in a month other than October 31 and do not or cannot use that fiscal year as its measurement period for capital gain net income for excise tax purposes. Thus, the computation period for excise tax purposes would contain days from more than

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[3] For example, an institutional investor could own both a floating NAV fund and a stable NAV government fund.

[4] If a RIC has a taxable year ending November 30 or December 31, the RIC is permitted to elect to measure capital gain net income for excise tax purposes based on its taxable year rather than the one-year period ending October 31. A RIC that makes such an election thus would use its taxable year as its computation period for both income tax and excise tax purposes.

one of the RIC's taxable years. Further, the proposed regulations do not specifically address the application of the NAV method to RICs for excise tax purposes. Accordingly, to prevent any confusion, we ask the Treasury Department and the IRS to specify that this is an appropriate approach.

Wash Sale Exemption

The Institute and its members greatly appreciate the guidance in Rev. Proc. 2014-45, which provides an exception to the wash sale rule for shareholders in floating NAV money market funds that choose not to use the NAV method. As discussed in our earlier comment letters, we believe that the burdens on funds and shareholders of applying the wash sale rule in this context would have greatly outweighed any benefit to the government. This is especially true given that we expect very slight fluctuations in the NAVs of floating NAV money market funds. Further, these funds should not give rise to the types of abuse that the wash sale rule is intended to prevent.

The Institute recommends that the wash sale exemption in Rev. Proc. 2014-45, which is limited to floating NAV money market funds, also apply to shareholders in stable NAV money market funds that impose a liquidity fee. Under current law, a shareholder in a stable NAV money market fund who is charged a liquidity fee could be subject to the wash sale rule if the redemption that triggered the liquidity fee takes place within 30 days before or 30 days after a purchase in the same fund. This purchase typically would occur when a shareholder automatically reinvests dividends or uses the fund as a cash management account and makes routine cash deposits. A shareholder who is charged the liquidity fee would recognize a loss on the redeemed shares; if the wash sale rule were applied, the disallowed loss would be added to the basis of the purchased replacement shares.

Although the shareholder would acquire the replacement shares at $1.00 per share (or other stable NAV), the basis of those shares would now equal an amount greater than $1.00. The shareholder thus would have to track the cost basis of those replacement shares to ensure that the loss is recognized when the shareholder later sells those replacement shares. As discussed above, permitting shareholders in stable NAV funds that impose a liquidity fee to use the NAV method would ease this burden. Exempting stable NAV funds from the wash sale rule entirely, however, is preferable because it does not require any additional accounting by the fund shareholders. This is particularly true as many of these shareholders will be retail investors who may not invest in floating NAV funds and therefore will not be familiar with the NAV method.

The rationale for exempting floating NAV money market funds from the wash sale rule applies equally to a stable NAV fund that imposes a liquidity fee. We believe it is unlikely that money market fund shareholders will incur a liquidity fee in a stable NAV fund, because we believe the imposition of such fees will be a rare event; nevertheless, the wash sale rule should not apply if this rare event occurs. Therefore, we ask that the IRS extend the guidance in Rev. Proc. 2014-45 to cover shareholders in stable NAV funds that impose a liquidity fee.

Liquidity Fees

The Treasury Department's and IRS's recent guidance does not address money market funds' treatment of liquidity fees. We met with representatives from the Treasury Department last year to discuss our concerns, and we followed that meeting with a letter describing the issues and our proposed solutions.[5] We still believe that such guidance is needed, and we ask the government to provide such guidance as quickly as possible.

First, we ask the Treasury Department and the IRS to issue formal guidance setting forth the proper treatment of liquidity fees when received by a fund. As discussed in the SEC Rule, the industry generally believes that a fund's receipt of such fees does not result in income or gains.[6] No formal guidance exists, however. We thus ask the government to provide such guidance to eliminate any confusion.

For shareholders who must pay the liquidity fee, we believe the fee reduces the shareholders' amount realized, thereby creating a capital loss on the transaction.[7] The preamble to the proposed regulations indicates that the Treasury Department and the IRS agree with this treatment.[8] In the absence of further guidance from the government, we believe that funds and shareholders will treat liquidity fees in this manner, but we welcome more formal confirmation that this is correct.

Second, we ask the Treasury Department and the IRS to issue guidance providing that, if a fund receives liquidity fees and subsequently chooses to distribute those liquidity fees to shareholders, the fund will be deemed to have sufficient earnings and profits to support the distribution. This would allow the funds to treat the distributions as ordinary dividends to their shareholders, rather than returns of capital that would cause the shareholders' bases in their fund shares to be less than $1.00 per share. A fund may need to distribute excess liquidity fees to ensure that the receipt of such fees does not cause the fund's NAV to exceed $1.0050. We believe, as the SEC notes in the SEC Rule, that the likelihood of this scenario is remote. It is not impossible, however, and funds must know how to treat such distributions should they arise.

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[5] *See* Institute Letter to Lisa Zarlenga and Michael Novey regarding SEC Proposals for Money Market Reform – Liquidity Fee Tax Issues, dated September 12, 2013 (attached).

[6] *See* Private Letter Rulings 8849026 and 9710019.

[7] Redemptions from stable NAV money market funds do not normally result in any gain or loss, as all redemptions and purchases are transacted at $1.00 per share. If the liquidity fee reduces the gross proceeds received by the shareholder, it will result in a loss, because the gross proceeds will be some amount less than the shareholder's basis of $1.00 per share.

[8] The preamble states: "When a liquidity fee is in place, the proceeds received by any shareholder that redeems shares are reduced by the liquidity fee even though the redeemed shares may be in [a money market fund] that uses penny-rounding to price its shares (a stable-value [money market fund]). Because the cost of each stable-value [money market fund] share redeemed (generally $1.00) will exceed the net amount of proceeds received for that share ($1.00, minus the liquidity fee), these redemptions would produce recognized losses under standard tax accounting." Federal Register, Vol. 79, No. 144, p. 43696.

If a distribution of excess liquidity fees is treated as a return of capital, current shareholders would reduce the basis of their shares, resulting in an unrealized gain in those shares. Shareholders thus would have to track the cost basis of those shares until they are redeemed. Again, as discussed above, many of these shareholders may be retail investors, who will not have the systems or expertise to do so. Permitting shareholders to use the NAV method in these situations would ease the reporting burdens but would not eliminate them. Therefore, our preferred solution is the deemed earnings and profits approach.

Tax-Free Split-Offs

The SEC Rule requires institutional prime money market funds to use a floating NAV, while permitting retail and government money market funds to continue using a stable NAV. Many fund complexes have existing non-government money market funds with both retail and institutional shareholders. To achieve the separate fund structure encouraged by the SEC Rule, those fund complexes may need to divide the existing fund into a stable NAV retail fund and a floating NAV institutional fund. The Institute asks the Treasury Department and the IRS to provide guidance permitting funds to reorganize existing funds tax-free under section 368.

To accomplish this reorganization, the existing money market fund could create a new wholly-owned subsidiary and transfer the assets associated with the interests of either the retail shareholders or the institutional shareholders to the subsidiary in exchange for all of the stock of the subsidiary. The existing money market fund then would distribute the shares of the subsidiary to the retail or institutional shareholders (as applicable) in exchange for their fund shares. Following these steps, the fund complex would have the two desired money market funds: A stable NAV retail-only fund and a floating NAV institutional fund. Other transaction structures may be possible.

In connection with the new money market fund rules, the SEC has exercised its authority to permit funds to reorganize into separate money market funds for retail and institutional investors without seeking exemptive relief from sections 17(a), 18, and 22(e) of the Investment Company Act of 1940.[9] A fund may do so provided that the fund's board of directors, including a majority of the independent directors, determines that the reorganization results in a "fair and approximately pro rata allocation of the fund's assets between the class being reorganized and the class remaining in the fund."[10] Pursuant to this relief, a fund also may involuntarily redeem investors that will no longer meet the eligibility requirements of the newly established or existing money market fund, provided that the fund provides written notice to such investors at least 60 days before the redemption occurs. The SEC thus has made it easier for existing money market funds to reorganize in order to comply with the SEC Rule.

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[9] *See* Money Market Fund Reform: Form PF, Investment Company Release No. 31, 166 (July 23, 2014) at 228-232.

[10] *Id.*, p. 230.

The Institute asks the Treasury Department and the IRS similarly to provide guidance making it easier for money market funds to separate existing classes into separate retail and institutional funds. Specifically, we ask the government to provide that this type of "split-off" transaction will be treated as a tax-free reorganization under section 368(a)(1)(D). Absent this type of guidance, a fund complex that wishes to maintain a stable NAV fund for retail shareholders of an existing fund may have to engage in one or more transactions that triggers gain/loss recognition, as well as restarted holding periods. Given that the sole reason for splitting up the existing fund into two separate funds is to adjust the fund's shareholder base so that retail and institutional investors are treated as intended by the SEC Rule, we do not believe it would be appropriate for a transaction in these circumstances to trigger tax consequences to the fund or the shareholders. This could harm investors unduly.

We thus ask that funds be given some latitude under the tax rules to restructure in light of the changing money market fund environment. Neither the retail shareholders nor the institutional shareholders would be materially advantaged or disadvantaged by the allocation of the underlying assets in the split-off transaction, as the fund would have to divide the underlying assets in compliance with its fiduciary duties to shareholders and the requirements under the SEC rule. Thus, a fund generally would be required to allocate either a pro rata portion of each of the underlying assets to the subsidiary or otherwise make the allocation in such a way as to ensure that neither class of shareholders is materially advantaged or disadvantaged by receiving a disproportionate share of the unrealized gains/losses embedded in the assets at the time of the transaction.[11] Although any gains or losses that would be recognized if the split-off transaction were treated as taxable likely would be small, the associated administrative burdens of determining and reporting the gains/losses and restarting holding periods could be significant. Taxable treatment also could jeopardize the fund's ability to get the approval of its board and/or its shareholders to engage in the split-off transaction.

Members of the industry previously have sought broader relief from the IRS and the Treasury Department permitting RICs to engage in tax-free reorganizations. Our understanding is that the IRS has been reluctant to rule that RICs can satisfy the "active conduct of a trade or business" requirement for tax-free reorganization treatment under section 355. Although we continue to believe that RICs can satisfy that requirement and that tax-free split-offs by RICs should be more broadly permitted, the government could limit this relief to money market funds reorganizing in response to the SEC Rule. Further, the guidance could limit its applicability to permit only those tax-free split-offs effected prior to (or around the time of) the compliance date of the floating NAV provisions of the SEC Rule.

Existing money market funds with both retail and institutional investors must decide quickly whether and how to separate those classes into individual funds. Permitting RICs to do so in a tax-free reorganization would simplify this process and eliminate any potential tax consequences to investors

[11] The Treasury Department and IRS could make this a condition of the relief if it is a significant concern.

and the funds themselves. We thus ask the Treasury Department and the IRS to provide that such split-off transactions will qualify as tax-free reorganizations.[12]

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The Institute appreciates your consideration of these comments. Please do not hesitate to contact me, at (202) 371-5432 or kgibian@ici.org, if you would like to discuss them further.

Sincerely,

/s/ Karen L. Gibian

Karen Lau Gibian
Senior Associate Counsel – Tax Law

Attachments

cc: Lisa Zarlenga
Michael Novey
Krishna Vallabhaneni
Bill Alexander
Helen Hubbard

[12] If the Treasury Department and the IRS cannot get comfortable providing this guidance, however, we hope that they will consider other possible approaches that might avoid taxation at both the shareholder and fund level.

Hearing on REG 107102-14:
Method of Accounting for Gains and Losses in Certain Money Market Funds;
Broker Returns with Respect to Sales of Shares in Money Market Funds

November 19, 2014

Comments of the Investment Company Institute

I. Introduction [1 min.]

II. NAV Method [4 min.]

A. The NAV Method should be permitted on an account-by-account basis.

B. The NAV Method should be available for stable NAV funds that charge a liquidity fee.

C. The IRS should confirm that RICs may use as their computation period for excise tax purposes the one-year period ending on October 31.

III. Additional Guidance Needed [5 min.]

A. The IRS should issue formal guidance regarding the treatment of liquidity fees to funds and shareholders.

B. The IRS should provide that funds that distribute liquidity fees will be deemed to have sufficient earnings and profits to support the distribution.

C. The IRS should permit a tax-free "split-off" of institutional and retail classes in existing funds.

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By Electronic Delivery

September 12, 2013

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Washington, DC 20220

Michael Novey
Associate Tax Legislative Counsel
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
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RE: SEC Proposals for Money Market Fund Reform – Liquidity Fee Tax Issues

Dear Ms. Zarlenga and Mr. Novey:

The Investment Company Institute[1] thanks you for taking the time to meet with us recently to discuss the tax issues arising from the Securities and Exchange Commission ("SEC") proposal to reform money market funds (the "SEC Release").[2] Specifically, we recommended a solution for resolving the possibility of returns of capital if a fund must distribute excess liquidity fees to avoid breaking a $1.00 net asset value ("NAV").[3] Under our proposal, the Treasury Department and the Internal Revenue Service ("IRS") would deem the fund to have sufficient earnings and profits to distribute any excess liquidity fees, thereby creating an ordinary distribution and avoiding a return of capital.[4] We ask the

[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 $15.4 trillion and serve more than 90 million shareholders.

[2] *See Money Market Fund Reform; Amendments to Form PF,* SEC Release No. IC-30551 (June 5, 2013).

[3] We also discussed IRS Notice 2013-48, which proposes a *de minimis* exception to the wash sale rule for shares in money market funds with a floating net asset value. We will provide comments on the Notice in a separate letter.

[4] We also discussed a second alternative, in which the fees would be treated as capital gains to the fund when received, under the theory that the fees are being used to offset capital losses incurred by the fund on its portfolio in order to pay the redeeming shareholders. *See Arrowsmith et al v. Commissioner of Internal Revenue*, 344 U.S. 6 (1952); *see also* Revenue Procedure 2009-10, 2009-1 C.B. 267. If the fees have to be distributed to avoid breaking the $1.00 NAV, the distributions would be capital gain distributions, rather than returns of capital. The primary concern with this approach is that a fund would be required to distribute the liquidity fees as gains, regardless of their effect on the NAV, unless it has offsetting capital losses. Although a fund likely would have current or prior year losses that it could utilize, in other situations losses might have to be generated to offset the gains. This loss management effort could result in unnecessary transaction costs. Therefore, the deemed earnings and profits approach is the industry's preferred solution.

Treasury Department and the IRS to provide guidance permitting this solution, should the SEC Release be implemented.

SEC Proposal: Liquidity Fees

The SEC Release proposes two options for reforming money market funds, which could be implemented separately or together. One of these proposals would permit all money market funds to transact at a stable value, but it would require funds in certain circumstances to institute a liquidity fee and would permit them to impose redemption gates in times of stress. The liquidity fee would be imposed if the money market fund's level of weekly liquid assets fell below a certain percentage. The liquidity fee would apply to any redemptions and would equal 2 percent of the gross proceeds, although the fund's board would have discretion to reduce the amount of the fee or to waive the fee altogether.

Current Treatment of Early Redemption Fees

As the SEC Release briefly mentions, the treatment of liquidity fees to funds and shareholders should be the same as the current treatment of early redemption fees pursuant to SEC Rule 22c-2 under the Investment Company Act of 1940. The tax treatment of early redemption fees is well settled. Specifically, receipt of early redemption fees results in no income or gain to the fund under section 311(a)(2). For book purposes, the fee is treated as "paid-in capital." For shareholders who are assessed an early redemption fee, the amount of the fee reduces their amount realized, thereby decreasing any capital gain or increasing any capital loss. The liquidity fee proposed by the SEC is similar in purpose and operation to an early redemption fee; therefore, the same tax analysis should apply.

Potential Returns of Capital

The SEC Release raises one issue that may arise if liquidity fees are imposed. A money market fund could collect enough liquidity fees to push the fund's NAV close to $1.0050. In such a case, the fund would need to make a distribution to its shareholders to avoid "breaking the buck" on the upside. The distribution would be treated as an ordinary distribution to the shareholders, subject to ordinary income tax rates, if the fund has sufficient earnings and profits to support the distribution. It is more likely, however, that in this scenario the fund would not have sufficient earnings and profits, in which case some or all of the distribution would be a return of capital to the existing shareholders. Shareholders would reduce the basis in their existing shares (*e.g.*, $1.00 per share in a stable NAV fund) by the amount of the return of capital. Because their basis would now equal something less than $1.00, those shareholders would have unrealized gains in their money market fund shares. In other words, although the fund's NAV would never vary from a stable $1.00, the return of capital distribution would cause all existing shareholders in the stable NAV fund to "break the buck" on the upside when they

redeem shares, which is the very position the fund was trying to avoid by making the distribution in the first place.[5]

We believe the likelihood of this scenario is remote; however, it is possible. Thus, funds must be prepared to deal with the situation if it should arise. The Institute believes the best solution for resolving the return of capital issue is to deem the fund to have sufficient earnings and profits to make any distribution resulting from excess liquidity fees. Under this alternative, any distribution would be treated as an ordinary dividend distribution and would not affect the shareholders' basis. During our recent meeting, you asked whether there should be some limit or ceiling on the amount of deemed earnings and profits a fund may have. We believe that money market funds' boards should have discretion to determine how much of the excess liquidity fees they need to distribute. Some funds may decide that they only want to distribute enough to bring the NAV to just under $1.005; others may decide to distribute enough to bring the NAV closer to $1.000. Of course, funds should not be deemed to have more earnings and profits than the total amount of liquidity fees collected. We thus suggest that funds be deemed to have earnings and profits equal to the lesser of (i) the total amount of fees collected, or (ii) the total amount of distributions that would reduce the fund's NAV back to $1.000.

When determining the total amount of fees collected, the amount should be cumulative and not limited to fees collected in a particular time period. These fees are permanent items that will increase the NAV. If a fund must make a distribution to avoid exceeding a NAV of $1.005, it likely will be due to liquidity fees collected in another year. The cumulative amount of fees received thus should be taken into consideration when determining how much earnings and profits a fund should be deemed to have.

We also ask the government to issue formal guidance setting forth the proper treatment of liquidity fees, clarifying that the liquidity fees are not income or gains to the fund when received. The industry generally believes that this is the correct answer. Given that the government has not provided formal guidance on the treatment of Rule 22c-2 fees, however, some uncertainty remains. Clarification by the Treasury Department and the IRS would provide assurance to the industry that they are accounting correctly for these fees if the SEC moves forward with this proposal.

Tax and Information Reporting

Money market funds that maintain a stable NAV under SEC Rule 2a-7 currently are exempt from information reporting under section 6045.[6] One question is whether payment of the fee, which effectively is a capital loss to the redeeming shareholder, creates an obligation by the fund to report the

[5] If the liquidity fees are imposed in conjunction with the floating NAV proposal, the return of capital issue is not a concern with respect to those funds required to have a floating NAV. The shareholders' basis in floating NAV money market funds already might be something other than $1.00, so a return of capital distribution in and of itself would not necessarily create unrealized gains.

[6] Treas. Reg. § 1.6045-1(c)(3)(vi).

redemption on IRS Form 1099-B. The same question arises if a money market fund must make a return of capital distribution, which reduces a shareholder's basis below $1.00. Because the money market fund in these situations still is maintaining a stable NAV under SEC Rule 2a-7, we do not believe any information reporting is required under section 6045 in either scenario. Funds will have other means of communicating this information to their shareholders, either through trade confirmations, quarterly statements, or other shareholder communications. We thus ask the Treasury Department and the IRS to confirm that no information reporting under section 6045 is required in these circumstances.

If the liquidity fees and redemption gates are proposed in conjunction with a floating NAV, and if a Form 1099-B otherwise is required on a floating NAV money market fund, then we ask the Treasury Department and the IRS to clarify that liquidity fees paid by a shareholder must be reflected on the Form 1099-B as a reduction in the amount of gross proceeds.[7] This would provide consistency across funds and brokers and would assist shareholders in filing their tax returns.

* * *

We appreciate your attention to these issues. As you know, timely resolution of the tax issues raised by the SEC's proposals is essential if the reforms are adopted. If you have any further questions or concerns, please contact me at 202-371-5432 or kgibian@ici.org.

Sincerely,

/s/ Karen L. Gibian

Karen L. Gibian
Associate Counsel – Tax Law

cc: Norm Champ
Director, Division of Investment Management
Securities and Exchange Commission

Mark Mazur
Assistant Secretary, Tax Policy
U.S. Department of the Treasury

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[7] Many investors in floating NAV money market funds will be "exempt recipients" under Treas. Reg § 1.6045-1(c)(3)(i), for which no information reporting is required. Funds and intermediaries should not be required to provide a Form 1099-B to those shareholders simply because a liquidity fee is imposed. The liquidity fee will be disclosed to those shareholders on their transaction confirmations and through other disclosures.

Emily McMahon
Deputy Assistant Secretary, Tax Policy
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