

Request for Comment on the Effect Under Rev. Proc. 96-47 of a Waiver or Reimbursement of an Expense of a Regulated Investment Company

Announcement 96-95

Rev. Proc. 96-47, 1996-39 I.R.B. 10, describes certain situations in which distributions made to shareholders of a regulated investment company (RIC) may vary and nevertheless be deductible as dividends under § 562 of the Internal Revenue Code. The Service understands that in some instances a person may waive or reimburse an expense of a RIC and the benefit of the waiver or reimbursement may be allocated to specific shares. In addition, various groups of shares may be allocated different investment advisory fees under a performance-based fee contract. This announcement solicits public comment on what effect, if any, these allocations should have under §§ 561 and 562.

BACKGROUND

Section 852(b)(2)(D) allows a RIC a deduction for dividends paid (as defined in § 561 with certain modifications). Section 561 defines the deduction for dividends paid and applies the rules of § 562 to determine which dividends are eligible for the deduction for dividends paid. Section 562(c) provides that the amount of any distribution is not considered a dividend for purposes of computing the dividends paid deduction under § 561 unless the distribution is pro rata, does not prefer any share of stock of a class over any other share of stock of that same class, and does not prefer one class of stock over another class except to the extent that one class is entitled (without reference to waivers of their rights by shareholders) to the preference. The legislative history to the 1986 amendment to section 562(c) explains that any difference in the investment advisory fee charged to shares of a RIC results in a preference. *See* 2 H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-246, reprinted at 1986-3 (Vol. 4) C.B. 246.

Many RICs have issued groups of shares that represent interests in the same portfolio of securities but have different arrangements for shareholder services or the distribution of shares or both (Qualified Groups). Because the fees for these arrangements and services

may vary, shareholders with equivalent investments in the same fund may receive different distributions. To permit open-end management investment companies to issue these groups of shares, the Securities and Exchange Commission has adopted Rule 18f-3, 17 C.F.R. 270.18f-3, under the Investment Company Act of 1940, 15 U.S.C. 80a-1 to -64.

Under Rev. Proc. 96-47, variations in distributions to shareholders of different Qualified Groups that exist solely as a result of the allocation of expenses in accordance with the revenue procedure do not prevent the distributions from being dividends under § 562. Occasionally, the person providing services to a RIC waives some or all of its fees for those services. In addition, occasionally a person other than the person providing particular services reimburses the RIC for some or all of the fees that the RIC incurred for those services. Rev. Proc. 96-47 is silent as to the treatment of distributions to shareholders that differ in part as a result of the allocation of the benefit of a waiver or reimbursement.

Rule 18f-3 also permits a group of shares to be allocated disproportionate advisory fees to the extent that any difference in amount allocated “is the result of the application of the same performance fee provisions in the advisory contract of the company to the different investment performance [net of other expenses]” of each group. Rev. Proc. 96-47 does not apply to variations in distributions that are due to performance-based advisory fees.

REQUEST FOR COMMENTS

Where there is an allocation of a waiver or reimbursement or of differing advisory fees under a performance-based contract, the Service requests comments on what effect, if any, the allocation should have under §§ 561 and 562. In addition to other matters that commentators are interested in addressing, comments on the following questions may be particularly helpful:

(1) What are the common situations in which expenses of a RIC are waived or reimbursed? In what situations, if any, is a waiver or reimbursement a legal necessity?

(2) What restrictions, if any, limit the ability of a person to waive or reimburse an expense of a RIC?

(3) What accounting methods are used to determine the proper allocation of a waiver or reimbursement?

(4) Should the benefit of a waiver or reimbursement of an expense be required to be allocated in a manner that does not differ from how the unwaived expense would have been allocated?

(5) Does the answer to (4) above vary depending on whether a waiver or reimbursement is made by a person unrelated to the RIC’s investment advisor, by a person related to the RIC’s investment advisor, or by the RIC’s investment advisor itself?

(6) For purposes of §§ 561 and 562, what is the appropriate treatment of variations in distributions that arise as a result of allocation of the investment advisory fee under a contract that compensates the advisor on the basis of applying the same performance-fee provisions to different groups of shares?

METHOD OF MAKING COMMENTS

Comments should be submitted in writing on or before November 22, 1996 to: CC:DOM:CORP:R (Announcement 96-95), Room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, comments may be hand delivered to CC:DOM:CORP:R (Announcement 96-95), Courier’s Desk, Internal Revenue Service, 1111 Constitution Ave., NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the IRS Internet site at http://www.irs.ustreas.gov/prod/tax_regs/comments.html. All comments will be available for public inspection and copying.

DRAFTING INFORMATION

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