



1401 H Street, NW, Washington, DC 20005-2148, USA
202/326-5800 www.ici.org

May 10, 2007

Senator Stephen D. Alves
Chairperson
Senate Finance Committee
317 State House
Providence, RI 02903

Re: S. 0974 Harms Mutual Fund Investors By Increasing Taxes on Savings

Dear Chairperson Alves:

The Investment Company Institute¹ strongly opposes the application to regulated investment companies (“RICs”) of the introduced version of S. 0974. This legislation appears intended to address potential issues regarding so-called “captive RICs” that engage in abusive behavior. The current version of the bill seems to apply to all RICs.

RICs, commonly called “mutual funds” if open-ended (i.e., always ready to redeem shares upon shareholder request), are investment vehicles that provide an economical way for investors to pool their resources to invest in a large number of securities, obtain professional advice and diversify their investments. Investors use mutual funds to save for retirement, education, emergency reserves or other goals. Mutual fund shareholders are entitled to all of the fund's income and gain from fund investments, net of fees and other operating expenses. To protect investors, RICs and/or their advisers are vigorously regulated under several statutes, including the Investment Company Act of 1940, the Securities Act of 1933, the Securities Exchange Act of 1934 and the Investment Advisers Act of 1940. In addition, the Internal Revenue Code of 1986 grants pass-through tax treatment to mutual funds, but only if they follow certain operational requirements.

RICs are designed to give their investors tax treatment comparable to that provided to direct investors in securities. Federal law provides RICs with a dividends paid deduction (“DPD”), which eliminates what would otherwise be an additional layer of tax to the extent that a RIC distributes substantially all of its income to its shareholders. Mutual fund shareholders report on their tax returns

¹ ICI members include 8,826 open-end investment companies (mutual funds), 666 closed-end investment companies, 398 exchange-traded funds, and 4 sponsors of unit investment trusts. Mutual fund members of the ICI have total assets of approximately \$10.634 trillion (representing 98 percent of all assets of US mutual funds); these funds serve approximately 93.9 million shareholders in more than 53.8 million households.

the dividends received from the fund. Every state conforms to federal law and provides a DPD to RICs, except for a few states that may limit the DPD to curb abusive captive RIC structures.

S. 0974 should be revised to target expressly your concerns. We understand that certain arrangements involving a corporation that holds substantially all of a RIC's shares allow the corporation to take a dividends received deduction in addition to the RIC's DPD, which eliminates the tax that would otherwise be imposed on a RIC shareholder. Other states have addressed these arrangements with targeted statutes that eliminate the corporate shareholder's dividends received deduction. These measures typically include exceptions for closely-held RICs in non-abusive arrangements, such as start-up mutual funds. We urge you to take a similar approach; eliminate the corporate shareholder's dividends received deduction and tailor S. 0974 to curb abusive captive RICS structures without harming mutual fund shareholders. We look forward to working with you to achieve this result.

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The Investment Company Institute is committed to encouraging savings and compliance with federal and state tax laws. I would like the opportunity to speak with you or someone on your staff about S. 0974. If you have any questions, you may contact me at 202-326-5835.

Sincerely,

/s/Lisa Robinson

Lisa Robinson
Associate Tax Counsel