INVESTMENT COMPANY INSTITUTE

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BY ELECTRONIC MAIL

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US Department of the Treasury
Room 1000
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220

Re: RIC Implementation of JGTRRA
Qualified Foreign Corporation Rules

Dear Barbara:

Thank you again for meeting with the Investment Company Institute[1] last week to discuss the procedures by which regulated investment companies ("RICs") will implement the "qualified dividend income" ("QDI") rules of the Jobs and Growth Tax Relief and Reconciliation Act of 2003 ("JGTRRA"). We appreciate the thoughtful consideration that you and your colleagues have given to these issues and we support your effort to develop administrable rules that conform to the statute and Congressional intent.

As we discussed at the meeting, RICs and other portfolio investors have significant holdings in shares of foreign corporations that may be "qualified foreign corporations" ("QFCs") under either the treaty-based test, the publicly-traded test, or the US-possession test.[2] Information received this week from Institute members (while not comprehensive in scope) indicates that a substantial portion, if not a large majority, of their foreign securities[3] are issued as local shares[4] by corporations resident in treaty countries. These local shares typically are

[1] The Investment Company Institute is the national association of the American investment company industry. Its membership includes 8,678 open-end investment companies ("mutual funds"), 555 closed-end investment companies, 106 exchange-traded funds and 6 sponsors of unit investment trusts. Its mutual fund members have assets of about $6.697 trillion, accounting for approximately 95% of total industry assets, and 90.2 million individual shareholders.

[2] QFC status for corporations organized in a US possession has not generated any industry issues.

[3] The typical investment company complex will have multiple RICs holding foreign equities. These complexes often have many hundreds, sometimes thousands, of different foreign equities in their RICs' portfolios. As noted in my July 21 letter, assets of RICs with an investment objective of holding foreign equities (hereinafter foreign equity funds) totaled $365 billion at the end of 2002 ($358 billion in RICs organized as mutual funds and $7 billion in RICs organized as closed-end funds). Foreign equity mutual fund assets were over 13 percent of total assets for all equity mutual funds. *See* Mutual Fund Fact Book, 2003, pp. 68 (mutual funds) and 102 (closed-end funds) -- available at http://www.ici.org/statements/res/2003_factbook.pdf.

[4] Some portion of these shares may be of the same class as shares that back American Depository Receipts ("ADRs") that trade in the US. As we discussed at the meeting, the Institute supports regulatory clarification that all shares of

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issued by corporations that are not targeting US investors; RICs are buying these shares to gain exposure to foreign markets.

Under JGTRRA, RICs and other portfolio investors will need to determine -- for every foreign security that does not meet the publicly-traded or US-possession test -- whether the issuing corporation qualifies for tax benefits under its home country's income tax treaty with the United States. Accordingly, administrable rules under the treaty-based test are essential if RIC shareholders are to receive JGTRRA's intended benefits.

Moreover, as we stated at the meeting, any such guidance must be issued promptly if it is to have any practical application for dividends received this year. RICs are currently attempting to identify QFCs so that they can (1) appropriately reflect in their records, either manually or electronically, all dividends received since January 1, 2003 that are eligible for QDI treatment and (2) accurately report tax information to RIC shareholders. Since many RICs already have declared dividends attributable to dividend income received in 2003 (and often provide shareholders with ongoing estimates of the tax consequences of year-to-date distributions), the need for prompt guidance is particularly acute.

Corporate Certifications and Shareholder Determinations -- In General

Since meeting with you last week, we have had extensive discussions with our members regarding corporate certifications of QFC status and/or treaty-eligibility and the likelihood that a foreign corporation might certify, or otherwise notify investors regarding, its status as a QFC (or, perhaps, as eligible to claim benefits under its home country's treaty with the US). An obvious benefit of corporate certifications would be that the taxpayer's responsibility for correctly determining and reporting income is straightforward to the extent that (1) the corporation made the relevant determination, (2) the portfolio investor received that information, and (3) the portfolio investor was entitled to rely on that determination.

While the parties in the best position to answer your question regarding the likelihood that foreign corporations would make the requisite certifications are the foreign corporations themselves, we question whether a certification procedure would resolve any significant number of QFC determinations that RICs will be required to make. Thus, in what may well be the vast majority of cases, the portfolio investor[5] will remain responsible for determining whether or not to report dividend income it receives as QDI.

As we discussed last week the difficulties that a portfolio investor will face in gathering the factual information necessary to determine with complete confidence whether the corporations in which it invests are treaty-eligible, we will not repeat them here. Nevertheless,

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the same class are eligible for QDI treatment if any shares of that class back ADRs. As we also discussed, an appropriate and timely remedy is necessary, as some US investors already are selling local shares and buying ADRs to ensure that the dividends they receive qualify for QDI treatment.

[5] In the case of foreign dividend income received by a RIC and distributed, in turn, to the RIC's shareholders as a dividend, the RIC's manager will need to determine the portion of the RIC's dividend that qualifies, at the RIC level, for QDI treatment and report that amount on IRS Forms 1099-DIV.

we believe it is useful to keep in mind the differences that exist between what a corporation and its portfolio investors can easily determine with respect to a corporation's status as treaty-eligible. Our proposed treaty-based safe harbor addresses the difficulty that portfolio investors will have in making treaty-eligibility determinations with a high degree of confidence. The rationale for our proposal does not extend to the corporation itself when it is earning income that is actually subject to treaty relief.

Factual Representation to be Certified

In considering a certification-based approach, the first issue to address is the precise content of the certification. More specifically, would the foreign corporation certify that it is a QFC or only that it is eligible for treaty benefits? If the latter representation is being certified, the portfolio investor would still need to determine whether the foreign corporation is, among other things, a passive foreign investment company ("PFIC").

If the certification is of QFC status, the foreign corporation would need to certify both (1) its eligibility for treaty benefits (which is not, in many cases, a determination that can be made quickly -- particularly by a corporation with no US activities) and (2) that it is not a PFIC, a foreign investment company ("FIC"), or a foreign personal holding company ("FPHC") under US law. Our experience with PFIC identification -- where less than ten foreign corporations, to our knowledge, have identified themselves as PFICs in their offering documents -- suggests that many foreign corporations would be unwilling to address the PFIC determination issue.

If the factual representation to be certified is only that the foreign corporation is eligible for benefits under a treaty with the US, there would be some foreign corporations that already have made this determination. For example, as you noted in the meeting, some foreign corporations may have provided IRS Forms W-8BEN to a US payor so that they could claim treaty benefits and may have received an IRS Form 1042-S.[6]

In contrast, there are many foreign corporations that are potentially eligible for treaty benefits that have no US-source income or that otherwise have never determined their eligibility for treaty benefits. For these corporations to determine whether or not they are eligible for treaty benefits would likely require a significant investment of resources. We believe there is at least a substantial likelihood that such a company would be unwilling to invest the resources, and take on any associated liability, to certify that it is treaty-eligible.

Another issue would be the period covered by the certification. While the statute requires, for example, that the treaty-based test be satisfied for the year the dividend is paid, the certification could relate to either the taxable year of the foreign corporation or the calendar year. We would recommend that certifications be valid based on calendar years.[7] RICs have

[6] In these cases, the IRS would have received an IRS Form 1042 from the US payor attaching the IRS Forms 1042-S for each foreign corporate payee. We understand that taxpayer confidentiality considerations most likely would prevent the IRS from releasing a list of these foreign corporations that have certified their status as eligible for treaty benefits in the US.

[7] Certifications could be valid for more than one calendar year. Treaty-eligibility certifications made on IRS Form W-8BEN, for example, typically are valid for three years.

strong recordkeeping reasons to prefer that any certification be made or otherwise valid as early in the calendar year as possible; proper identification of dividends as QDI-eligible at the time they are received would ease administrative burden and reduce the possibility of error.

Corporate Consequences of Certification

To some extent, of course, the question of whether a foreign company would be willing to make a certification would depend on what sort of risks it was exposed to as a result of the certification, either with regard to the US government or with regard to its shareholders. For example, we would expect that Treasury would provide some sanction for an erroneous certification. At a minimum, we would expect that the certification would have to be filed under penalties of perjury.[8] Companies may view the potential risk associated with false filing (including perhaps civil fraud prosecution) as too great to justify certification. The possibility of greater government penalties would, in our view, make it less likely for companies to participate in any certification process.[9]

In the event of erroneous certification, and efforts by the IRS to collect back taxes from investors who reported dividends as QDI that were not, in fact, QDI-eligible, there could be a risk of shareholder suit in a US court if jurisdiction could be obtained and the potential recovery was sufficient to justify the effort.[10] The risk of exposure to US litigation could be a serious detriment, particularly to a foreign corporation not presently exposed to the US legal system. The foreign corporation also might have litigation risk in relation to the securities or tort laws of other countries.

It is important to recognize that all foreign companies would be forced to evaluate these risks. Thus, even those companies that had already determined they were treaty-eligible would need to decide whether the risks of certification outweighed the benefits.

Certification Dissemination

Another significant issue with the corporation-based certification model is how the information would be communicated to shareholders. One possibility is that Treasury would collect and disseminate the information. It is also possible that once a corporation decided to certify its treaty eligibility, that information would be disseminated through commercial financial information providers. However, given the number of issuers of foreign securities

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[8] If the certification were filed with the IRS, it would be subject to penalties for false filing, but would have to avoid designation as taxpayer information in order to be disclosed to shareholders by the government.

[9] Under one possible approach, a foreign corporation that provided an incorrect certification without good faith and reasonable cause for the error would be denied the ability to issue such a certification for one or more years following the year for which the incorrect certification was provided.

[10] For example, it might be possible for a class action lawsuit to be initiated against a foreign corporation for erroneous certifications. Similarly, a RIC would have a cause of action if, rather than sending amended IRS Forms 1099-DIV to its shareholders, it reached an agreement with the IRS to pay an amount equal to what the IRS would have collected in taxes and interest had the RIC shareholders received amended IRS Forms 1099-DIV and filed amended IRS Forms 1040.

world-wide, it might be impractical for any one such firm to track all securities issued by QFCs. Once multiple service providers were involved, however, there would almost surely be differences in their lists (since, at a minimum, it would be unlikely that each service provider would simultaneously update its list). Where differences arose or the information was not otherwise available, RICs might attempt to contact some or all of the many corporations in which they invest for certification information.

Shareholder Determinations

To the extent that foreign corporations certify their QFC status, we would expect portfolio investors to rely on those certifications. As noted above, however, we question whether a significant percentage of foreign corporations would make these determinations, particularly in those cases where the foreign corporation is not targeting the US market. In most cases, we believe, RICs and other portfolio investors will simply lack the leverage to force foreign corporations to master the QFC and PFIC tests of US law and make the necessary certifications.

Where a certification is not made (or cannot be located), the shareholder would need to make its own determination of the foreign corporation's QFC status (since the statute does not require certification as a condition of QFC status). The smaller the number of corporations certifying and communicating their QFC status, the larger the number of QDI-eligibility determinations being made by portfolio investors.

Consequently, we believe that an administrable and widely-available safe harbor (other than certification) is necessary, so that taxpayers with the same portfolios of foreign equities are treating their dividend distributions in the same way and receiving the intended benefits of JGTRRA. Absent such a safe harbor, shareholders will either make (1) a significant investigation of the corporation, its income, and the nature of trading in its stock or (2) their best judgments of QFC status based upon available information and their varying risk tolerances.

Proposal

We strongly support administrable guidance, consistent with the statute and Congressional intent, that will assist a portfolio investor (including a RIC) in determining the QFC status of a foreign corporation in which it invests. While a certification procedure might resolve some QDI-eligibility questions (and, for that reason, we would support certification guidance), we believe that additional guidance is essential.

Thus, we would be pleased to discuss with you further the suggestions that we made last week and/or any alternative solutions that improve on them. As you know, our suggestions are that:

1. A dividend paid by a foreign corporation should be treated as QDI if (a) the foreign corporation is resident in a treaty country, (b) shares on which the dividend is paid are publicly traded on a recognized stock exchange identified for the purposes of this provision, and (c) the shareholder does not otherwise

have actual knowledge that the corporation is not eligible for the benefits of the treaty with respect to substantially all of its income.

2. Stock should be considered readily tradable on an established securities market in the United States if stock of the same class is listed on a national securities exchange registered under the Securities Exchange Act of 1934 or is traded on the NASDAQ System.

3. If stock on which a dividend is paid is in the same class of stock as stock that is traded on an established securities market in the United States through an ADR program, dividends on any share in that class will constitute QDI irrespective of where the stock in question is acquired.

Finally, we strongly urge that any guidance in this area be issued promptly, so that it will have practical application for dividends received this year.

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After you and your colleagues have had an opportunity to review this letter, we would be pleased to meet with you again to discuss these matters further. If we can provide you with any additional information or respond in the interim to any questions, please do not hesitate to call me at (202) 326-5832.

Sincerely,

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