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By Electronic Delivery

March 19, 2013

Steven T. Miller
Acting Commissioner
Internal Revenue Service
1111 Constitution Avenue NW
Washington, DC 20224

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

RE: Use of Form 8949 by 1940-Act Registered Funds

Dear Mr. Miller and Mr. Wilkins:

The Investment Company Institute¹ respectfully asks the Internal Revenue Service (“IRS”) to reconsider its recent decision to extend beyond individuals the requirement to attach Form 8949, “Sales and Other Dispositions of Capital Assets,” to a federal income tax return. Specifically, we urge that funds registered under the Investment Company Act of 1940 (“the 1940 Act”) not be required to file Form 8949. These funds typically will be taxed as regulated investment companies (“RICs”), but alternatively, could be taxed as partnerships. This requirement, as discussed below, is overly burdensome for funds and will result in little benefit to the IRS.

Background

Form 8949 was developed in 2011 as an attachment to the Schedule D, “Capital Gains and Losses,” for the individual tax return Form 1040. This new form was necessary to reflect the different categories of capital gains and losses that must now be reported as a result of mandatory cost basis reporting. Instead of simply two categories (long-term and short-term), taxpayers now may have up to six different categories of capital transactions that must be reported on their tax returns: long-term gains for covered shares;² short-term gains for covered shares; long-term gains for noncovered shares; short-term gains for noncovered shares; long-term gains for shares not reported to the taxpayer on a Form 1099-B; and short-term gains for shares not reported to the taxpayer on a Form 1099-B.

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 \$14.6 trillion and serve over 90 million shareholders.

² “Covered” securities are those securities acquired after the effective date for mandatory cost basis reporting; “noncovered” securities generally are those acquired before the effective date for mandatory cost basis reporting, or other securities for which the broker does not have cost basis information.

For each category of capital transactions, the taxpayer must include separately for each disposition (a) a description of the property; (b) the date acquired; (c) the date sold or disposed; (d) the proceeds from the sale; (e) the cost or other basis; (f) any adjustments to the gain or loss (*e.g.*, wash sales); and (g) the amount of gain or loss. The proceeds, basis, amount of basis adjustments, and gain or loss for each category must then be totaled and transferred to the Schedule D.

When the Form 8949 was released in draft form, there was no indication that it would be used by any taxpayers other than individuals. The fund industry thus reviewed the draft form in their roles as payors. Our primary concern was ensuring that the Form 8949 was easily understandable and useable by our shareholders, and that it conformed to the Form 1099-B and substitute form requirements. We were not aware that the IRS was considering requiring *all* taxpayers to use this form.

When the 2012 Form 1120-RIC was released in late 2012, several of our members noticed that the Schedule D included a new statement, instructing RICs to “[c]omplete Form 8949 before completing” certain lines on the Schedule D. At the time, it was unclear whether RICs were required to include a completed Form 8949 with their tax return. The 2012 instructions for the Form 8949 were released several weeks later. Those instructions clearly state that the Form 8949 must be filed with the Schedule D for a variety of tax returns, including the Forms 1120-RIC and 1065. Although the instructions permit taxpayers to report the required information on an attached statement, rather than the Form 8949 itself, the statement must include all of the required information in a similar format. Further, the instructions explicitly state that a taxpayer may not enter “available upon request” and summary totals in lieu of reporting the details of each transaction.

Application to RICs and Other 1940 Act-Registered Funds

Given the tremendous number of capital transactions incurred by RICs and other 1940 Act-registered funds on a daily basis, requiring them to report all such transactions on their tax returns will be both burdensome to the industry and of little, if any, benefit to the IRS. Funds are investment vehicles with substantial capital transactions in a given year. Even if they could easily report all of this information to the IRS, it would increase the size of the tax return (which is not filed electronically) exponentially. Further, it is not clear that the IRS has the capability, the manpower, or the need to examine all of this information.

The mutual fund industry currently manages over \$14.6 trillion in assets in over 8749 open-end funds.³ The median assets under management for a fund are \$305.6 million. These portfolios are not static; rather, they are changing constantly. As such, a fund could have anywhere from 5,000 sales transactions (for a smaller fund) to over 30,000 sales transactions (for a large fund) *per year*, depending on the size and investment strategy of the fund. Requiring funds to list all of these transactions on the Form 8949 or a similar statement could add thousands of pages to their tax returns. Because funds may

³ This information was calculated as of January 31, 2013.

not file their returns electronically, this means boxes of additional paper that must be delivered to the IRS as part of the RIC or partnership tax return.⁴

A fund could compile a list of all of its sales transactions, which still would require an incredible amount of paper, if it only had to record the basic information (acquisition and sale dates, purchase and sale prices, and resulting gain or loss) for the transactions. Funds do not currently have the systems in place, however, to report these transactions with related basis adjustments. Share lot information currently is maintained in an accounting system that makes daily adjustments for book purposes. Tax adjustments are made offline after year-end and do not currently update the gain or loss for each security. Funds could report the tax adjustments, but they would have to be listed in a separate section. If the IRS required them to be reported in the format required on the Form 8949, it would have to be done manually. This would be a herculean task, given the sheer volume of transactions in a given year for a particular fund, not to mention a fund complex.

If funds reported all of their capital transactions, with or without the tax adjustments as required by the Form 8949, it is unclear what purpose this would serve. The significant amount of data that would be provided by the industry likely would be unused; it is inconceivable that the IRS has the time or resources to sort through that much paper documentation, much less the storage space. Also, all funds registered under the 1940 Act are “exempt recipients” under Treas. Reg. § 1.6045-1(c)(3)(i)(B)(9) and therefore do not receive Forms 1099-Bs from other brokers, so there would be no information returns to match (if that were even possible).⁵ Requiring funds to report all of their capital transactions thus would entail an unnecessary expenditure of resources with little perceivable benefit to the IRS.⁶

Although the funds that fund complexes offer to customers/investors are typically structured as RICs, for portfolio management reasons the complexes sometimes use 1940Act-registered partnerships to make the underlying securities investments. In the so-called “master-feeder structure,” for example, the complex will create a “master fund” (typically organized as a partnership) that holds the portfolio

⁴ The treatment of capital loss carryforwards adds to the problem. Under section 1212(a)(3)(A) of the Internal Revenue Code, RICs treat capital loss carryforwards as arising on the first day of the next taxable year. It is unclear whether RICs thus are required to list on the Form 8949 all of the transactions giving rise to that capital loss carryforward in the year to which it is carried. Because these carryforwards never expire, a RIC could be required to continue listing these transactions for each taxable year to which the losses are carried forward.

⁵ The instructions for the 2012 Form 8949 state that the purpose of the form is to allow the taxpayer and the IRS to reconcile amounts that were reported to the taxpayer and the IRS on Form 1099-B or a substitute statement. Because 1940-Act registered funds are exempt recipients who do not receive Forms 1099-B or substitute statements, requiring these funds to complete and attach Form 8949 does not advance that purpose.

⁶ RICs must comply with a set of stringent tax rules to maintain their tax qualification under Subchapter M of the Internal Revenue Code and strive to distribute all of their income to avoid tax at the fund level. Given the ramifications of a failure to satisfy these requirements, the mutual fund industry as a whole has a very strong compliance record. The additional data the IRS would obtain from Form 8949 is not necessary to ensure tax compliance by RICs. Therefore, the burden imposed by the Form 8949 will yield very little benefit to the IRS in its tax administration and in increasing tax compliance.

securities; its only investors will be the “feeder funds”⁷ (organized as RICs), the shares of which are offered to the public. In the so-called “fund of funds” structure, publicly-offered “upper-tier” funds (organized as RICs) will invest in “lower-tier” funds (that may be organized as RICs or partnerships); each “lower-tier” fund will have a distinct investment objective (such as investing in a particular sector, like the energy sector). By varying the upper-tier fund’s allocation among the lower-tier funds, different investment exposure can be provided to investors. These structures offer the potential for better performance and broader diversification (*e.g.*, due to economies of scale and, in the case of the fund of funds structure, specialized sub-portfolio management).

Any 1940 Act-registered partnership will file Form 1065, instead of Form 1120-RIC. They often have just as many portfolio transactions in a given year, however, as a RIC. Therefore, requiring such partnerships to complete and file Form 8949 similarly creates unnecessary burdens with little discernable benefit.

Requested Relief

Given the extraordinary number of capital transactions effected by RICs and 1940 Act-registered partnerships on an annual basis, and the lack of any significant tax compliance benefit from reporting these transactions on Form 8949, we respectfully request that funds that are registered under the 1940 Act not be required to file the Form 8949 (or a similar statement) with their tax returns.⁸ Alternatively, the instructions should permit RICs and these 1940 Act-registered partnerships to state on the Form 8949 that the information is available upon request.

It is imperative that the IRS grant this relief as soon as possible, as some RIC tax returns for 2012 may be filed in the coming months. The 2012 Form 1120-RIC is filed for RICs with fiscal years that begin in 2012. The return is due on the 15th day of the third month after the RIC’s fiscal year end, though funds can request an automatic extension of six months. Thus, the first funds that would have to file the Form 8949 for a normal fiscal year-end would be funds with a December 31 year-end; those returns would be due by September 15, 2013 (with extensions). If, however, a fund has a short year that began and ended in 2012, the Form 1120-RIC could be due much sooner.⁹ For example, a fund with a March 31 year-end that liquidated in July of 2012 would have to file a tax return for that short year by April 15, 2013. Therefore, it is critical that this issue be resolved before more RICs begin to file their 2012 tax returns.

⁷ The investment management company or sponsor sometimes holds a small interest in the master fund.

⁸ RICs and 1940 Act-registered partnerships still would file the Schedule D. As has always been the case, documentation to support the amounts reported on the Schedule D would be available to the IRS if requested.

⁹ We know of at least five funds for which this is true; there likely are many others.

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We appreciate your immediate attention to this issue. If you have any questions or would like to discuss this issue further, please contact me at (202) 371-5432 or kgibian@ici.org.

Sincerely,

/s/ Karen L. Gibian

Karen Lau Gibian
Associate Counsel – Tax Law

cc: Erik Corwin
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