

*By Facsimile*

June 26, 2012

Cynthia Morton  
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Internal Revenue Service  
1111 Constitution Avenue, NW  
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*Re: Follow-Up to ICI Submission on RIC  
Deemed Check-The-Box Election*

Dear Ms. Morton:

Thank you for your recent call regarding the ICI's<sup>1</sup> August 17, 2011 submission (enclosed) that requested a deemed check-the-box ("CTB") election for regulated investment companies ("RICs"). Specifically, we requested that Treas. Reg. § 301.7701-3 be amended to provide that an eligible entity that elects to be a RIC will be deemed to have made a CTB election to be taxed as a corporation. This election would be made, as a procedural matter, by the RIC filing its first IRS Form 1120-RIC.

Coordinating the election to be a RIC with the election to be taxed as a corporation, as discussed in the ICI's prior submission and below, would reduce administrative burdens on RICs and the Service and would provide certainty regarding an entity's tax status. The regulations already permit such a tax-return-filing election for real estate investment trusts ("REITs").<sup>2</sup>

The requested guidance is necessary, as we discussed, to ameliorate an existing ambiguity regarding section 851(g)'s application to a RIC organized as a series trust. This ambiguity exists because of uncertainty regarding how the CTB rules, which were adopted after section 851(g) was enacted, apply for section 851(g) purposes.

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<sup>1</sup> 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 \$13.4 trillion and serve over 90 million shareholders.

<sup>2</sup> Treas. Reg. § 301.7701-3(c)(1)(v)(B).

Some practitioners apply section 851(g) by viewing a trust with multiple series as a hybrid; the trust is treated under this view as a single entity (by looking at the “overall trust”) for section 851(a)<sup>3</sup> purposes and as multiple entities for all other purposes. This first interpretation of section 851(g) – which evaluates the overall trust as a single entity to determine whether it is a domestic corporation for purposes of section 851(a) – was followed by the industry when section 851(g) was enacted in 1986.

Entity classification determinations were made prior to the 1986 Act under the so-called “Kintner regulations.” Under those regulations, an entity was a corporation if had at least three of four attributes: continuity of life, centralization of management, limited liability, and free transferability of interest. Applying this test at the overall trust level for section 851(a) purposes resulted in RICs organized as trusts generally being treated as corporations. As a result, every new series of the trust was a separate corporation pursuant to section 851(g). As Rev. Rul. 88-14 makes clear, section 851(g) applies to both incorporated and unincorporated entities.

If the CTB rules are applied using this hybrid entity approach, practitioners must evaluate whether the overall trust, including its series, is an eligible entity or a *per se* corporation. The answer appears clear if any series of the trust is a publicly offered RIC. In this first scenario, it appears that the trust is a *per se* corporation under the publicly traded partnership (“PTP”) rules because interests in the trust (*i.e.*, interests in the publicly offered series) are publicly traded. The answer is not clear, however, if none of the series are publicly traded. In this second scenario, it is unclear how to analyze whether the trust as a whole (including its series that have filed Forms 1120-RIC) is an eligible entity or a *per se* corporation.

Other practitioners apply section 851(g) by viewing the CTB regulations as having affirmatively changed the series fund analysis. Under the CTB regulations, it is unclear whether a state law trust itself is an entity for tax purposes if it has no assets and engages in no activities except through its separate series. The preamble to the proposed regulations on series entities asks for comments on whether the state law entity (referred to as the “series organization”) should be an entity for tax purposes in these situations. Practitioners who take the view that the trust is not itself an entity for tax purposes believe that the trust is not described in section 851(a) and, therefore, that section 851(g) does not apply. Under this view, each series is a separate eligible entity that will default to partnership status (unless interests in the series are publicly traded). Thus, a new series created by the trust that is intended to be a RIC would need to elect corporate status (unless its interests are publicly traded) under the CTB rules.

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<sup>3</sup> Section 851(a) defines a RIC as a domestic corporation registered with the Securities and Exchange Commission (“SEC”) under the Investment Company Act of 1940.

This interpretive issue, as we discussed, is limited to those RICs that are not publicly offered. While many RICs are publicly offered, and hence are corporations under the PTP rules, there are many RICs that are not publicly offered.

The most significant example of non-publicly offered RICs is in the insurance area. Insurance companies that offer variable annuities and variable life insurance typically allow the holder of the annuity or insurance contract to select among multiple investment alternatives, such as a bond fund, a growth fund, an international equity fund, etc. These funds are typically organized as RICs but their interests are not publicly traded; the only way to invest in these RICs (known as “variable insurance product” or “VIP” RICs) is through the insurance company.

Variable insurance product RICs represent a substantial portion of the mutual fund industry. Assets in these RICs totaled \$1.36 trillion in February 2012. Approximately 75 percent of these RICs are trusts or series of trusts. This ratio is comparable to the overall mutual fund industry ratio of funds organized as trusts to funds organized as corporations; specifically, 74 percent of all RICs are organized as either Massachusetts business trusts or Delaware statutory trusts.<sup>4</sup>

The guidance we request will not provide funds, as a practical matter, with any additional time beyond that provided by the existing CTB rules to decide whether to elect corporate tax treatment. Federal securities laws require funds to issue prospectuses for the sale of their shares. These prospectuses, which are prepared before a fund offers its shares for sale, state whether the fund intends to qualify as a RIC. Thus, even though the election to be a RIC is made on the tax return for the RIC’s first taxable year, the entity’s intent to qualify as a RIC – and therefore to be treated as a corporation – is announced before the fund is open to investors.

Thank you again for your attention to this issue. Please feel free to call me (at 326-5832) if I can provide you with any additional information.

Sincerely,

*/s/ Keith Lawson*

Keith Lawson  
Senior Counsel – Tax Law

Enclosure

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<sup>4</sup> [http://www.ici.org/pdf/2012\\_factbook.pdf](http://www.ici.org/pdf/2012_factbook.pdf) (page 199 of the Fact Book; page 215 of the 262 page file).



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***By Electronic Delivery***

August 17, 2011

Emily S. McMahon  
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William J. Wilkins  
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RE: Deemed Check-The-Box Election for  
Regulated Investment Companies

Dear Ms. McMahon and Mr. Wilkins:

The Investment Company Institute<sup>1</sup> requests that the “check-the-box” regulations, Treas. Reg. §§ 301.7701-1 through -3, be amended to provide that an eligible entity electing to be treated as a regulated investment company (“RIC”) will be deemed to have elected to be classified as an association taxable as a corporation. The regulations provide such a deemed check-the-box election for entities that elect to be treated as real estate investment trusts (“REITs”), for certain entities claiming tax-exempt status, and for entities electing to be taxable as S corporations. Just as the existing check-the-box regulations coordinate these various elections with the election to be classified as an association taxable as a corporation, amending the regulations to provide similar coordination with the RIC election will reduce administrative burdens for affected entities and the Internal Revenue Service and provide certainty as to an entity’s status.

The Check-the-Box Regulations

The check-the-box regulations permit eligible entities with more than one owner to choose between partnership and corporate status for tax purposes. An eligible entity is any business entity that is not a *per se* corporation.<sup>2</sup> Because most domestic eligible entities with more than one owner would choose partnership status, the regulations provide that such an eligible entity will be taxable as a

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<sup>2</sup> See Treas. Reg. § 301.7701-3(a).

partnership unless it affirmatively elects to be taxable as a corporation.<sup>3</sup> A domestic eligible entity wishing to be taxable as a corporation must file an election using Form 8832. Such an election cannot be effective more than 75 days before it is filed<sup>4</sup> and thus the entity must file the election (Form 8832) well before it files its tax return for the year.

The existing regulations treat certain eligible entities whose special status requires that they be corporations for tax purposes as having made an election to be taxed as a corporation. For example, the regulations provide that an eligible entity electing to be taxed as a REIT will be deemed to have elected to be taxable as a corporation under the check-the-box rules.<sup>5</sup> Thus, a state law trust that plans to qualify as a REIT can simply elect REIT status on its tax return for the year;<sup>6</sup> it need not separately file Form 8832 within 75 days of the beginning of the year to elect to be treated as a corporation. The preamble to the final regulations issued in 1996 explains that this deemed election was included in response to requests that “the classification election be coordinated with the election under section 856(c)(1) to be a real estate investment trust (REIT).” As stated in the preamble, “Because the [REIT] election is required to be made with the REIT’s first tax return, the regulations are modified to provide that an election by an eligible entity to be a REIT will be treated as a deemed election to be classified as an association [taxable as a corporation], effective for the entire period during which REIT status is claimed.”

Similarly, the regulations provide that an eligible entity that has been determined to be, or that claims to be, exempt from taxation under Code section 501(a) is deemed to have elected to be taxable as a corporation.<sup>7</sup> The election is effective as of the first day for which exemption is claimed or determined to apply, regardless of when the claim or determination is made.<sup>8</sup> The preamble to the proposed check-the-box regulations contained the following explanation for including this deemed election: “[F]or those exempt organizations that are eligible entities, the business entity classification

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<sup>3</sup> See Treas. Reg. § 301.7701-3(b). As explained in the preamble to the final check-the-box regulations issued in 1996, “In order to provide most eligible entities with the classification they would choose without requiring them to file an election, the regulations provide default classification rules that aim to match taxpayers’ expectations (and thus reduce the number of elections that will be needed.)” T.D. 8697, 61 Fed. Reg. 66584, 66585 (Dec. 18, 1996).

<sup>4</sup> Treas. Reg. § 301.7701-3(c)(1)(iii).

<sup>5</sup> See Treas. Reg. 301-7701-3(c)(1)(v)(B). In order to qualify as a REIT, an entity must be a domestic corporation for tax purposes. See Code § 856(a)(3).

<sup>6</sup> The REIT election is made on the entity’s tax return for the first tax year for which the election is to be effective. See, Treas. Reg. § 1.856-2(b). The election is made by figuring taxable income as a REIT on Form 1120-REIT. See Instructions for Form 1120-REIT, General Instructions, Who Must File.

<sup>7</sup> See Treas. Reg. § 301.7701-3(c)(1)(v)A).

<sup>8</sup> *Id.*

that is consistent with the claim of exemption is association (taxable as a corporation). Accordingly, the proposed regulations provide that a claim or determination of exempt status by an eligible entity is treated as an election to be classified as an association.”<sup>9</sup>

The regulations include a similar deemed election for S corporations.<sup>10</sup> The regulations provide that an eligible entity that makes a timely election to be an S corporation under Code section 1362(a)(1) is treated as having made an election to be taxable as a corporation (provided that the entity meets all other requirements to qualify as an S corporation). This deemed election was first added by a temporary regulation in 2004 and then adopted as an amendment to the final regulations in 2005. The preamble to the temporary regulation explained the reasons for providing this deemed check-the-box-election:

“Requiring eligible entities to file two elections in order to be classified as S corporations creates a burden on those entities and on the Internal Revenue Service (IRS). The temporary regulation simplifies these paperwork requirements by eliminating in certain cases, the requirement that the entity elect to be classified as an association. Instead, an eligible entity that makes a timely and valid election to be classified as an S corporation will be deemed to have elected to be classified as an association taxable as a corporation.”<sup>11</sup>

The inclusion of deemed check-the-box elections for REITs, tax-exempt organizations under section 501(a), and S corporations is consistent with the overall policy approach of the regulations, which is to provide entities with the classification they would choose without requiring them to file an election.<sup>12</sup>

### Regulated Investment Companies

A RIC is defined in section 851(a) as a domestic corporation that at all times during the year (i) is registered under the Investment Company Act of 1940 as a management company or unit investment trust or (ii) has in effect an election to be treated as a business development company.<sup>13</sup> In order to be taxed under the special subchapter M rules for RICs, the entity must elect to be taxed under

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<sup>9</sup> 61 Fed. Reg. 21989, 21993 (May 13, 1996).

<sup>10</sup> See Treas. Reg. § 301.7701-3(c)(v)(C).

<sup>11</sup> T.D. 9139, 69 Fed. Reg. 43317, 43318 (Jul. 20, 2004).

<sup>12</sup> See footnote 3, *supra*.

<sup>13</sup> Section 851(a) also treats certain common trust funds and similar funds that are taxable as corporations and excluded from the definition of “investment company” under Investment Company Act of 1940 as RICs; these entities, however, are very rare.

those special rules and must also satisfy certain distribution, diversification and gross income requirements.<sup>14</sup> These requirements are very similar to the requirements for REITs; in fact, the REIT provisions were modeled after the RIC provisions. Both REITs and RICs make the election to be taxed under the special subchapter M rules on their tax return for the first year to which the election is to apply (which is typically the first year of the entity's existence).<sup>15</sup>

RICs that are organized as state law corporations and therefore *per se* corporations for tax purposes do not need to file a check-the-box election to be taxable as a corporation. RICs, however, also may be organized as state law trusts (typically Massachusetts common law business trusts or Delaware statutory trusts); these RICs may be eligible entities under the check-the-box rules.<sup>16</sup> Many RICs organized as state law trusts are "series trusts," which means there is a single state law trust that forms multiple series, with each series representing a separate portfolio of assets and having separate beneficial owners.<sup>17</sup> Typically, each series is treated as a separate entity for tax purposes.<sup>18</sup>

Pursuant to Code section 851(g), if a series trust is a RIC within the meaning of Code section 851(a), which includes the requirement that the entity be a domestic corporation, then each separate series of the trust is treated as a separate corporation for tax purposes (except for purposes of section 851(a)). Section 851(g) was enacted in 1986, well before the adoption of the check-the-box regulations. While the application of section 851(g) was reasonably clear under the prior entity classification rules (the so-called Kintner regulations), there is some uncertainty as to its application in conjunction with the check-the-box rules. Some practitioners believe that subchapter M treats a series RIC as a hybrid -- it is a single entity for purposes of section 851(a) and multiple entities for all other tax purposes. Practitioners holding this view believe that when a series trust consisting of multiple series that have elected RIC status creates a new series, the new series is a *per se* corporation under section 851(g).<sup>19</sup> Others believe that under the check-the-box rules, each series stands by itself, and the series trust (apart from its individual series) is not an entity for tax purposes, including for purposes of section 851(a) and (g). Practitioners taking this view do not believe that section 851(g) determines the entity classification of a newly created series unless the series fund is organized as a state law corporation

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<sup>14</sup> See Code §§ 851(b), 852(a).

<sup>15</sup> See Treas. Reg. §§ 1.851-(b)(1) (RICs), 1.856-2(b) (REITs).

<sup>16</sup> If the trust is publicly traded under the rules of Code section 7704, it would be a *per se* corporation and not an eligible entity.

<sup>17</sup> As with other series organizations, RICs are organized as series trusts in order to achieve various efficiencies. For example, a series RIC files a single registration with the SEC and prepares a single prospectus.

<sup>18</sup> See, e.g., *National Securities Series - Industrial Stocks Series v. Comm.*, 13 T.C. 884 (1949), acq. 1950-1 C.B. 4.

<sup>19</sup> Under Treas. Reg. § 301.7701-2(b)(7), a business entity taxable as a corporation under a provision other than section 7701(a)(3) is a *per se* corporation.

(rather than a trust).<sup>20</sup> This difference of views can lead to different practices in terms of whether a Form 8832 is filed when a series trust creates a new series that intends to qualify as a RIC. In all cases, however, the taxpayer's expectation (based on the filing of a check-the-box election or on the view that section 851(g) makes the series a *per se* corporation) is that the new series electing RIC status satisfies the requirement that it be a domestic corporation.

### Proposal

We propose that Treas. Reg. § 301.7701-3 be amended by adding a section 301.7701-3(c)(1)(v)(D) providing: "Regulated investment companies.—An eligible entity that files an election under section 851(b)(1) to be treated as a regulated investment company is treated as having made an election under this section to be classified as an association. Such election will be effective as of the first day the entity is treated as a regulated investment company."

This proposal is consistent with the existing check-the-box regulations, which include a deemed election for eligible entities that elect to be taxed as REIT, for eligible entities claiming to be exempt from taxation under Code section 501(a), and for eligible entities electing to be taxed as S corporations. The policy considerations that underlie the approach reflected in these deemed elections similarly support extending the same treatment to RICs. As with the deemed elections currently provided in the regulations, adopting the deemed election approach for entities electing RIC status is consistent with the taxpayer's expectations, streamlines the administrative process by avoiding needless elections, and eliminates a trap for the unwary.

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We would be pleased to meet with your staffs to discuss this matter in greater detail at your convenience. Until then, if you have questions or concerns, please do not hesitate to contact me ([pinank.desai@ici.org](mailto:pinank.desai@ici.org) or 202/326-5876) or Keith Lawson ([lawson@ici.org](mailto:lawson@ici.org) or 202/326-5832).

Respectfully submitted,

/s/ Pinank Desai

Pinank Desai  
Assistant Counsel – Tax Law

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<sup>20</sup> A newly created series that is treated as a publicly traded partnership under Code section 7704 also will be a *per se* corporation.