

Excise Tax in a Modernized RIC World

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Circular 230

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RIC Modernization Act Overview

- Key areas of the law:
 - Capital Loss Carryovers
 - RIC Qualification Test Remedies
 - RIC Excise Tax
 - Distributions/1099 Reporting

Changes to Funds Subject to Section 4982

4982(f) Exception for Certain Regulated Investment Companies.—This section shall not apply to any regulated investment company for any calendar year if at all times during such calendar year each shareholder in such company was—

4982(f)(1) a trust described in section 401(a) and exempt from tax under section 501(a),

4982(f)(2) a segregated asset account of a life insurance company held in connection with variable contracts (as defined in section 817(d))[,]

4982(f)(3) any other tax-exempt entity whose ownership of beneficial interests in the company would not preclude the application of section 817(h)(4), or

Changes to Funds Subject to Section 4982

4982(f)(4) another regulated investment company described in this subsection.

For purposes of the preceding sentence, any shares attributable to an investment in the regulated investment company (not exceeding \$250,000) made in connection with the organization of such company shall not be taken into account.

*****ADDS QUALIFIED ANNUITY PLANS, IRAs, PENSION PLANS AND GOVERNMENT RETIREMENT PLANS *****

Distribution Requirement for Capital Gains

- Increased from 98% to 98.2%
- Turned bill from revenue loser to small revenue raiser

Capital Loss Carryovers

PROVISION	OLD RULE	NEW RULE **
Term of Carryover	8 years	Unlimited
Character of Carryover	Short-term	Maintain character

Capital loss carryovers generated after enactment must be fully utilized before pre-enactment capital loss carryovers

*** Effective for tax years beginning after December 22, 2010*

Excise Tax Capital Loss Carryforwards

- When to apply new rules? No specific guidance given.
 - As of 11/1/2010. Includes the complete excise year as “new” CLCF. Would mean the law was applied retroactively
 - As of 11/1/2011. Represents the 1st excise tax year after enactment. All current excise computed CLs are subject to old CLCF rules
 - Bifurcate excise tax year

Excise CLCFs – Bifurcated Approach

- Old CLCF rules apply from 11/1/2010 through end of fiscal year.
- New CLCF rules apply from 1st day of fiscal year after enactment.
- Allows for implementation date for fiscal and excise to be the same.

Excise CLCF Bifurcated Example

Example:

- 6/30 year-end. Fund has capital gains through 10/31/210.
- 11/1/2010-6/30/2011 STCG/(STCL) \$ (40,000)
- 11/1/2010-6/30/2011 LTCG/(LTCL) \$ (50,000)
- 7/1/2011-10/31/2011 STCG/(STCL) \$ 80,000
- 7/1/2011-10/31/2011 LTCG/(LTCL) \$(150,000)

Result:

- “Old” CLCF subject to 8 year expiration \$ (90,000)
- “New” CLCF – CF as LTCL \$ (70,000)
- Compare to using 11/1/2011 enactment –
“Old” CLCF of \$160,000

Specified Gains and Losses - Section 4982(e)(5)

- Ordinary income items measured at 10/31 for excise
 - Foreign Currency Section 988 gains and losses
 - PFICs
 - Market discount
 - Section 751 gains on partnerships
 - CPDI
 - Paydown gains?
 - Gain on sale of CFC shares?
 - Swaps treated as NPCs?

IRC Section 4982(e)(7) Elective Deferral of Certain Ordinary Losses

4982(e)(7)(A) such company (NON CALENDAR YEAR RIC) may elect to determine its ordinary income for the calendar year without regard to any net ordinary loss (determined without regard to specified gains and losses taken into account under paragraph (5)) which is attributable to the portion of such calendar year which is after the beginning of the taxable year which begins in such calendar year, and

4982(e)(7)(B) any amount of net ordinary loss not taken into account for a calendar year by reason of subparagraph (A) shall be treated as arising on the 1st day of the following calendar year.

Specified gains and losses are excluded due to Late Year Loss deferral (PELs)

Can a fund defer some but not all? Not answered.

IRC Section 4982(e)(7) - cont.

- To defer or not to defer adjusts the over/under distribution for future periods
- When to make deferral election:
 - When the fund would otherwise lose NIL (aka, would not be able to be offset against a STCG)
 - If 855 dividend > excise requirement, and fund does not want to make multiple distributions or defer payment of 855 dividend
- When to NOT make deferral election
 - If excise requirement > 855 dividend as deferral would increase excise requirement
 - If 855 dividend > excise requirement, and fund would like to defer payment of spillback until next calendar year

IRC Section 4982(e)(7) Example 1

- Assume 6/30 fiscal year-end with no capital gains or losses. Fund starts on 7/1/2011

NII/(NIL) from 7/1/2011-12/31/2011	(100,000)
NII/(NIL) from 1/1/2012-6/30/2012	150,000
NII/(NIL) from 7/1/2012-12/31/2012	NONE
Excise 2011 requirement	NONE
Fiscal Y/E 6/30/2012 Section 855	50,000
Excise 2012 requirement w/o e7 deferral in 2011	150,000
Excise 2012 requirement w e7 deferral in 2011	50,000
Future E&P issues if the fund does not elect e7 loss deferral	

IRC Section 4982(e)(7) Example 2

6/30 year-end. Fund begins operations on 1/1/2011

NII/(NIL) - 1/1/2011-6/30/2011	90,000
NII/(NIL) - 7/1/2011-12/31/2011	(20,000)

	<u>w/e7 deferral</u>	<u>w/o e7</u>
FYE 6/30/2011 855 Div	90,000	90,000
2011 Excise Requirement	90,000	70,000
Additional 2012 Div paid (PY 855)	0	20,000

IRC Section 4982(e)(7) Example 3

Assume:

6/30 year-end.

NII/(NIL)-7/1/2011-12/31/2011 (40,000)

Calculated Excise Requirement Before Loss Deferral 50,000

6/30/2011 Section 855 Dividend 45,000

	<u>w/e7 deferral</u>	<u>w/o e7</u>
FYE 6/30/2011 855 Div	45,000	45,000
2011 Excise Requirement	90,000	50,000

RIC ROC Rules for Non-calendar Year-ends

- Old Rule – E&P is allocated ratably to all distributions
- New Rule –
 - Excess distributions first allocated to post-December distributions (next calendar year) to extent they do not exceed distributions made in calendar year two.
 - Fiscal reminder – new CLCFs reduce current E&P in the year utilized.

RIC ROC Rules - cont.

Example –

- 9/30 year-end
- Income for FYE 9/30/2012 is \$500,000
- Distributions made –
 - December 2011 \$300,000
 - June 2012 \$300,000
- Return of Capital of \$100,000 is applied to the June 2012 distribution
- No need to amend 2011 - 1099s as December 2011 distribution is ordinary

Other Specially Designated Dividends

- Similar rules to ROC rules apply to non-calendar year-end funds for LTCG dividends, exempt-interest dividends, interest-related dividends, and STCG dividends.
- Allocate any excess first to distributions made in 2nd calendar year of any fiscal year. If excess, pro rata allocation rules apply.

4982(c)(4) – Estimated Tax Payments

4982(c)(4) Special rule for estimated tax payments.—

4982(c)(4)(A) In general.—In the case of a regulated investment company which elects the application of this paragraph for any calendar year—

4982(c)(4)(A)(i) the distributed amount with respect to such company for such calendar year shall be increased by the amount on which qualified estimated tax payments are made by such company during such calendar year, and

4982(c)(4)(A)(ii) the distributed amount with respect to such company for the following calendar year shall be reduced by the amount of such increase.

4982(c)(4)(B) Qualified estimated tax payments.—For purposes of this paragraph, the term "qualified estimated tax payments" means, with respect to any calendar year, payments of estimated tax of a tax described in paragraph (1)(B) for any taxable year which begins (but does not end) in such calendar year.

Fund of Fund Flow Through

852(g) Special Rules for Fund of Funds.—

852(g)(1) In general.—In the case of a qualified fund of funds—

852(g)(1)(A) such fund shall be qualified to pay exempt-interest dividends to its shareholders without regard to whether such fund satisfies the requirements of the first sentence of subsection (b)(5), and

852(g)(1)(B) such fund may elect the application of section 853 (relating to foreign tax credit allowed to shareholders) without regard to the requirement of subsection (a)(1) thereof.

Fund of Fund Flow Through - cont.

852(g)(2) Qualified fund of funds.—For purposes of this subsection, the term ‘qualified fund of funds’ means a regulated investment company if (at the close of each quarter of the taxable year) at least 50 percent of the value of its total assets is represented by interests in other regulated investment companies.

CFC Rules and Excise (not RIC Modernization)

- CFC distributions are treated as dividends to the extent of current income inclusion
- Subpart F inclusion is limited to E&P – all treated as ordinary. Capital losses can offset ordinary income.
- Section 898 – generally same tax year as RIC, can elect one month earlier
- 12/31 RICs can use 11/30 for CFC. Need to close books of CFC as of 11/30. Uncertainty for year-ends other than 12/31 for RICs.

Questions

If you have any general or fund-specific questions, please contact Rob Velotta or another member of your Cohen Fund Audit Services team.

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