



Mutual Fund Directors Forum

Regulated Investment Company Tax
Reporting - Year End Considerations

September 7, 2023



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Today's presenters



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Today's agenda



1. Current tax developments
2. Quick refresher: regulated investment company (RIC) tax qualification requirements
3. Year-end RIC tax matters
 - Shareholder distributions
 - Shareholder tax reporting
4. Alternative funds in an investment company Act of 1940 (1940 Act) wrapper: tax considerations
5. Other hot topics



Current tax developments for registered funds

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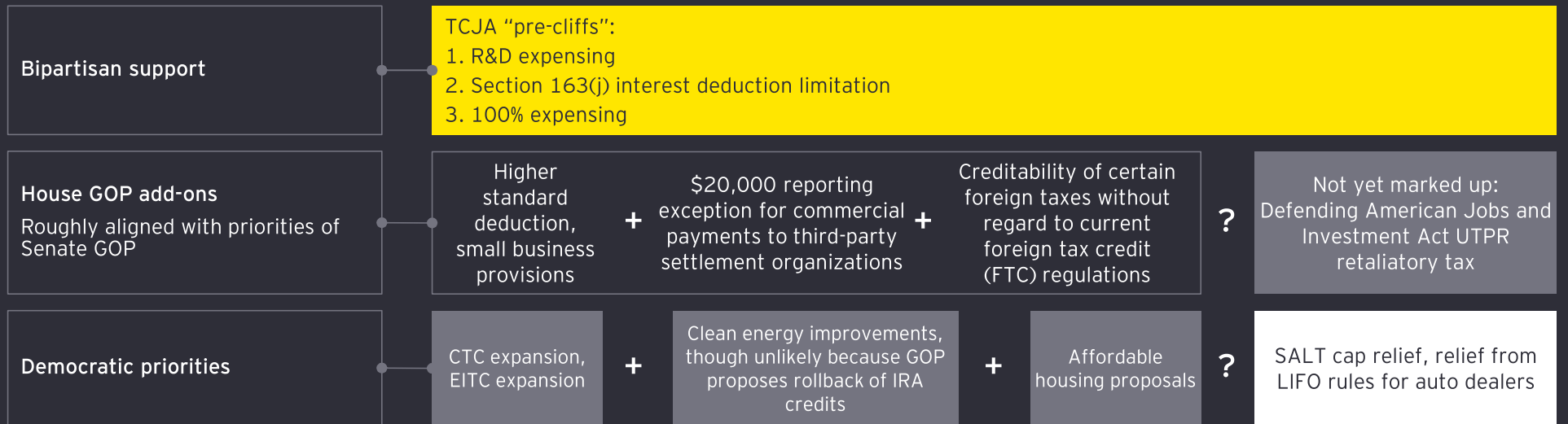
Upcoming congressional business (September 30 deadlines)

- ▶ Government funding expires September 30
 - ▶ Continuing resolution or agreement on next year's budget needed before deadline to avoid avoid government shutdown
- ▶ Congress needs to address the farm bill before September 30 expiration, which includes divisive topics like nutrition assistance.
 - ▶ Some senators expect a short-term extension of the 2018 farm bill.
- ▶ Excise taxes funding the Airport and Airway Trust Fund are due to expire on September 30.
 - ▶ Trust fund pays for the majority of the Federal Aviation Administration's programs and activities.
 - ▶ House bill (H.R. 3796) would provide for an extension of these taxes through September 30, 2028 .
- ▶ Both chambers may consider the National Defense Authorization Act (NDAA).

Mapping out a potential 2023 tax bill

Ways & Means bills could be GOP blueprint for tax extenders package should the opportunity arise and a government spending or other must-pass vehicle for the package emerge.

- 1 Ways & Means bills won't likely be brought to the floor anytime soon, given concerns of Freedom Caucus about spending post-debt limit deal. They do represent potential GOP tax writers' negotiating position.
- 2 The bills won't be enacted as-is. The TCJA "pre-cliffs" relating to expensing of R&D costs, interest deduction limitations under Section 163(j) and 100% expensing remain mired in a partisan standoff over a child tax credit (CTC) expansion sought by Democrats, who are also opposed to rolling back clean energy provisions from the IRA that Republicans want to use as revenue offsets.




Pillar Two of BEPs 2.0 initiative of the Organisation for Economic Co-operation and Development (OECD): understanding scope

- ▶ Global Anti-Base Erosion (GloBE) rules under Pillar Two
 - ▶ GloBE rules are main component of Pillar Two and aim to ensure large multinational enterprise (MNE) groups pay a minimum effective tax rate of at least 15% on their profits in every jurisdiction in which they operate
 - ▶ Generally, apply to MNE groups with consolidated revenues of at least €750m per annum
- ▶ Many countries have implemented or will soon implement GloBE rules
 - ▶ Expected January 1, 2024, effective date for some countries
 - ▶ Implementation of Pillar Two currently stalled in the US
- ▶ Potential impacts for MNE groups
 - ▶ Annual filings: even if no tax is due, annual filings required
 - ▶ Pay a “top-up tax” in a jurisdiction where applicable entity’s effective tax rate in that jurisdiction is below 15%
 - ▶ Financial statements impact: potential tax liability would need to be assessed as part of 2024 financial statements
- ▶ How do these rules impact US-registered funds?
 - ▶ US-registered funds are generally exempt from these rules
 - ▶ See Article 1.5 of [OECD GloBE Model Rules](#) (generally excluding investment funds and asset holding companies)
 - ▶ Funds’ investment advisers, however, are potentially in scope, assuming part of an MNE group and meet the €750m threshold

Other current developments

- ▶ U.S. Treasury and Internal Revenue Service (IRS) updates
 - ▶ New Foreign Tax Credit (FTC) regulations on hold
 - ▶ In July, U.S. Treasury issued Notice 2023-55, providing welcome temporary relief from controversial, new FTC regulations in Sections 1.901-2 and 1.903-1, which were originally effective for taxable years beginning on or after 12/28/21
 - ▶ For tax years ending on or before 12/31/23, notice generally allows taxpayers to, among other things, apply the former FTC regulations' more permissive standards for determining whether a foreign tax was creditable under Section 901
 - ▶ Funds can choose revert to those former FTC regulations in determining what foreign taxes to pass through to shareholders under Section 853
 - ▶ Biggest (positive) impact for funds: capital gains taxes paid on sale of foreign securities in various foreign countries (e.g., India, Indonesia and Thailand)
 - ▶ IRS provides transitional guidance with respect to stock repurchase excise tax
 - ▶ In June, the IRS issued Announcement 2023-18 with respect to the new excise tax in IRS Section 4501 for repurchases of corporate stock by covered corporations (which includes certain exchange-traded registered, closed-end funds and ETFs that are taxable C corporations and not RICs for tax purposes)
 - ▶ Excise tax applies to repurchases made after 12/31/22
 - ▶ Announcement provides that no taxpayer is required to report the new excise tax during a covered corporation's taxable year on any tax returns filed with IRS, or to make any payments of such tax, before the time specified in forthcoming regulations addressing the application of the excise tax
- ▶ Russian investments
 - ▶ Some funds electing to defer dividend and interest income under IRS Rulings 74-351 and 81-290 (Blocked Income Rulings)



Quick refresher: regulated investment company (RIC) tax qualification requirements

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Quick refresher: RIC tax qualification requirements

- ▶ 1940 Act-registered investment companies typically elect to be RICs for tax purposes
- ▶ RICs are corporations for tax purposes, but RICs and their shareholders receive special (favorable) tax treatment, provided they meet certain ongoing qualification requirements
- ▶ Each of the following requirements must be met annually to qualify as a RIC:
 - ▶ **Asset diversification tests** (each fiscal-quarter end)
 - ▶ 50% test and 25% test
 - ▶ **90% qualifying income test** (each fiscal-year end)
 - ▶ **90% distribution requirement** (each fiscal-year end)
- ▶ Failure to qualify results in taxation of the RIC (and its shareholders) as a regular corporation (and its shareholders), including
 - ▶ Corporate-level income tax at fund level (21% rate)
 - ▶ Inability to pass through tax character of distributions (e.g., long-term capital gain, exempt-interest dividends)



Year-end RIC tax matters

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Year-end RIC tax matters



- ▶ Year-end excise tax distributions
- ▶ Shareholder tax reporting

Shareholder distribution requirements

90% income tax – fiscal year

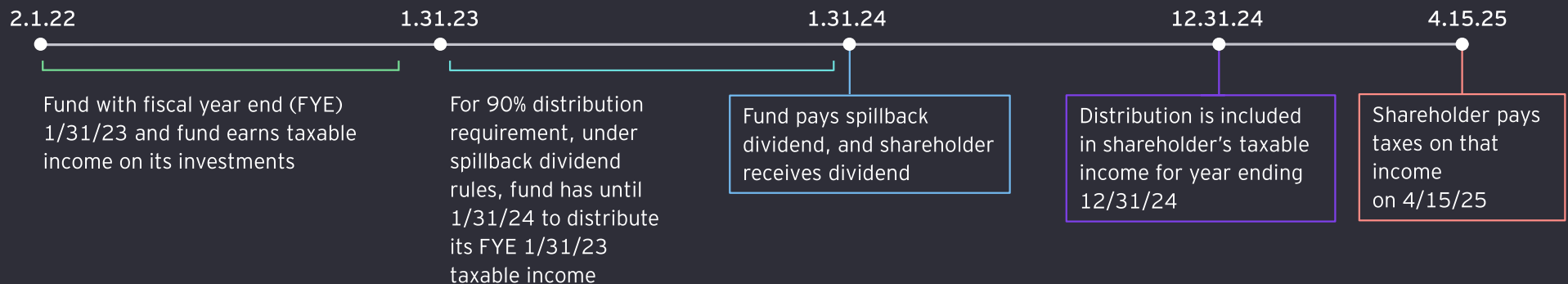
- ▶ For each fiscal year, a RIC must distribute at least 90% of:
 - ▶ Its taxable income (including net short-term capital gain)
And
 - ▶ Net tax-exempt income (if any)
- ▶ Failure to timely meet the test for a year can result in loss of RIC treatment for that year.
- ▶ Allowed to distribute some or all of these amounts after the end of its taxable year, subject to certain requirements (spillback dividends)
 - ▶ Including requirements to (i) declare the spillback dividend by the extended due date of the RIC's tax return for that year and (ii) distribute it before the end of the following fiscal (taxable) year
- ▶ RICs are not required to distribute net long-term capital gain
- ▶ Any undistributed amounts of taxable income or gain subject to fund-level corporate income tax

98%/98.2% excise tax – calendar year

- ▶ For each calendar year, a RIC must distribute by the end of the calendar year, at least:
 - ▶ 98% of its ordinary income for calendar year
 - ▶ 98.2% of its capital gain net income for 12 months ending 10/31
 - ▶ 100% of any undistributed and untaxed amounts from prior years
- ▶ Excise tax requirement is not a RIC qualification requirement; failure to meet does not impact RIC status
 - ▶ Rather, failure to meet results (*only*) in a 4% excise tax on the shortfall
- ▶ Distributions generally must be made by December 31

Shareholder distribution requirements (cont'd)

- ▶ Why do RICs have two different distribution requirements?
 - ▶ Excise tax was enacted to reduce shareholder-level tax deferral that can result from 90% income tax distribution requirements
 - ▶ Many funds adopt non-calendar year ends and rely on spillback dividend rules to reduce their taxable income to zero
- ▶ The following is an example of this deferral potential without the excise tax requirement



Year-end shareholder reporting

- ▶ Shareholder reporting done on a calendar-year basis
 - ▶ Main tax forms (US taxable shareholders)
 - ▶ Form 1099-DIV (tax character and amount of distributions)
 - ▶ Form 1099-B (gross proceeds, capital gain/loss on share redemptions)
 - ▶ Supplemental tax information provided on fund's website
 - ▶ Other reporting and withholding required for non-US shareholders
- ▶ Typically, must be complete by end of January of following year
- ▶ This is the case regardless of fiscal year end of the RIC itself
- ▶ Internal Revenue Service (IRS) penalties for inaccurate or missing Forms 1099

Year-end challenges

- ▶ Making good distribution estimates to avoid excise taxes or returns of capital (ROC) and incorrect Forms 1099-DIV
- ▶ Biggest challenges
 - ▶ Receiving timely, complete and final information on certain underlying investments, including:
 - ▶ Private equity funds
 - ▶ Hedge funds
 - ▶ Master limited partnerships (MLPs) and other publicly traded partnerships
 - ▶ Grantor trusts (commodities, digital assets, securitized loan portfolios)
 - ▶ Real estate investment trusts (REITs)
 - ▶ Collateralized loan obligations (CLOs)
 - ▶ Predicting right amounts of distributions when tax calculations are closely tied to volatile markets
 - ▶ Examples of challenging underlying investments
 - ▶ Foreign currency or foreign currency-denominated investments
 - ▶ Foreign passive investment company investments



Alternative funds in 1940 Act wrapper and other hot topics

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Alternative funds in a 1940 act wrapper: tax considerations

- ▶ Types of recent popular strategies
 - ▶ Private equity
 - ▶ Private credit
 - ▶ Real estate and infrastructure
- ▶ Different 1940 Act wrappers
 - ▶ Business development companies (BDCs)
 - ▶ Interval funds
 - ▶ Closed-end funds with periodic repurchase offers
- ▶ Special tax considerations and greater tax compliance risks
 - ▶ RIC asset diversification and qualifying income tests
 - ▶ E.g., underlying pass-through investments in funds of private equity and credit funds
 - ▶ RIC distribution requirements
 - ▶ Year-end shareholder reporting
 - ▶ Excise tax



Other hot topics

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Other hot topics

Tax technology, innovation and automation

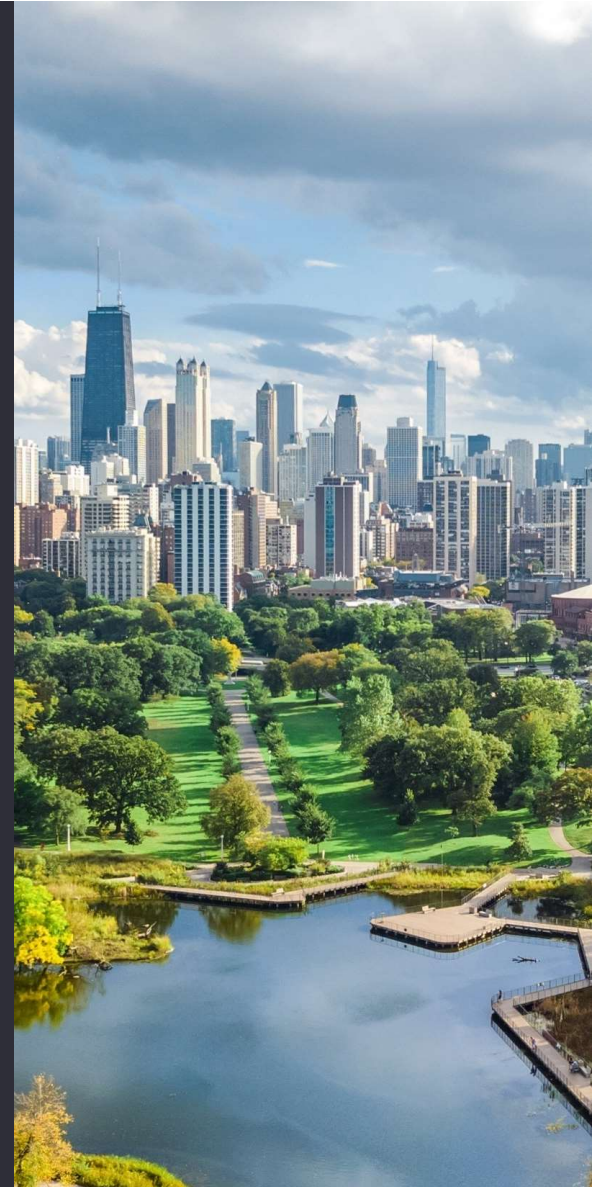
The future of fund tax

- Industry initiative to revise the tax code

- Drive toward customization

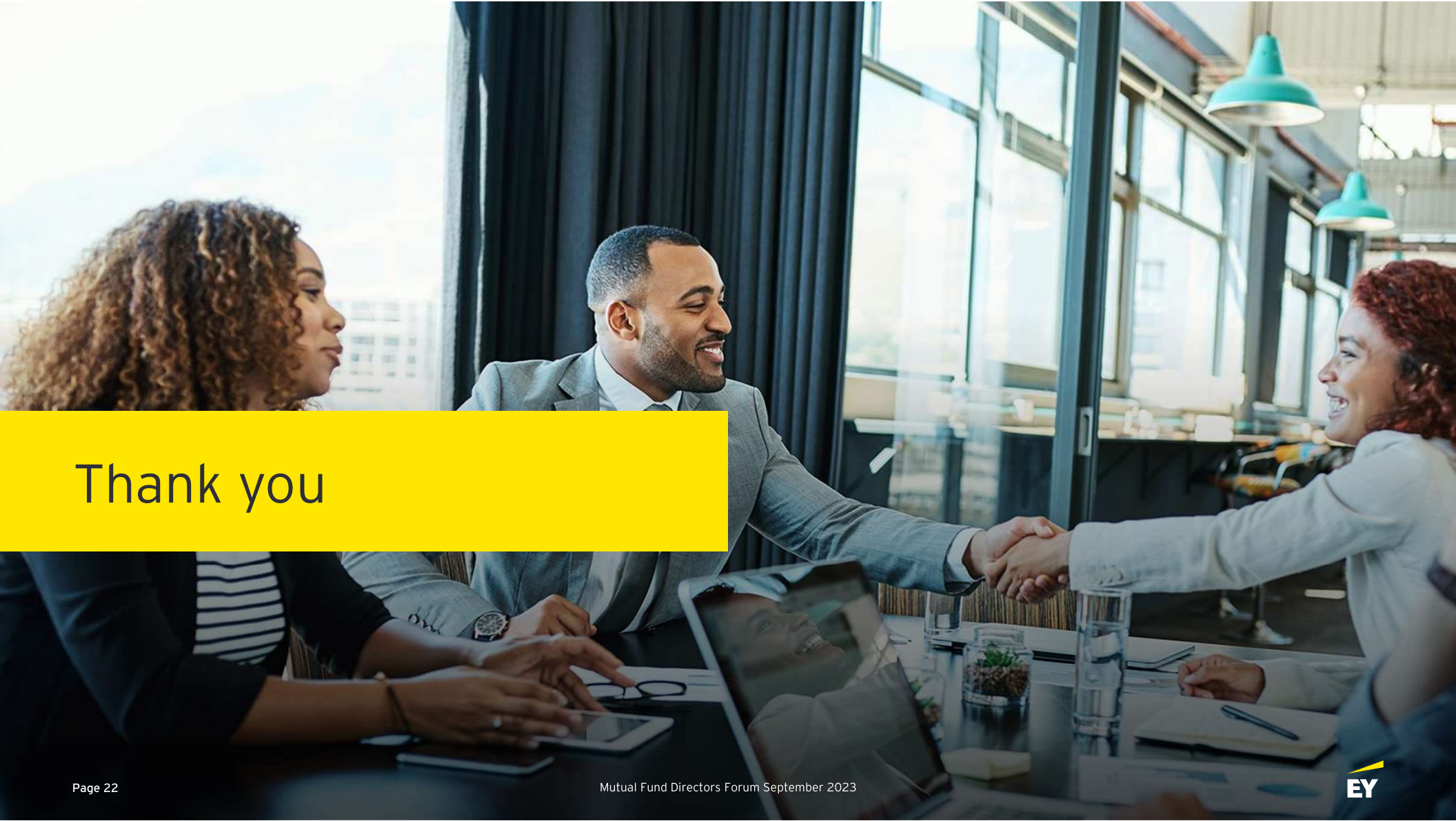
 - Direct indexing

 - Personal tax management



A man in a light blue shirt and glasses is seen from the back, addressing a large, dimly lit audience. The audience members are blurred in the background, suggesting a large-scale event or conference. A yellow rectangular box is overlaid on the left side of the image, containing the text "Questions?".

Questions?



Thank you

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