

RIC Tax Measures Enacted

By: Stephen D.D. Hamilton, Glenn E. Ferencz and Leila E. Fusfeld

Two significant tax acts affecting the federal tax treatment of regulated investment companies (RICs) have been signed into law in the past week.

First, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, signed into law on December 17, 2010, to extend the “Bush tax cuts” for two years, contained three extender provisions that relate specifically to foreign investors in RICs. These consist of two-year extensions of the withholding tax exemptions for RIC dividends attributable to portfolio interest income from U.S. sources and for RIC dividends attributable to short-term capital gains, which will now apply for RIC taxable years beginning before January 1, 2012, and a two-year extension of the look-through rule that provides generally that RIC shares will be included in the gross taxable estate of a foreign decedent only to the extent of the RIC’s investment in U.S. assets, which will now apply for individuals who die before January 1, 2012.

Second, the Regulated Investment Company Modernization Act of 2010 (RIC Modernization Act), which President Obama signed yesterday, contains a number of RIC tax-related provisions. Those provisions were discussed in our October 13, 2010, alert on the initial House version of the legislation.

The RIC Modernization Act as enacted is very similar to the House bill, but differs in one main respect as a result of a Senate amendment. Although the House version of the bill expanded the definition of “qualifying income” to include income from trading in commodities, the enacted version does not contain that provision.

The RIC Modernization Act contains all the other changes detailed in our earlier alert:

- > The rules that effectively prohibit the payment of “preferential dividends” by RICs, by denying the dividends-paid deduction for such dividends, have been repealed. So, from a tax perspective, there will no longer be a tax concern regarding differential investment advisory fees for different classes of shareholders or other unequal treatment – although compliance with applicable Securities and Exchange Commission requirements under the Investment Company Act of 1940 will still be required.
- > Certain inadvertent failures to meet RIC income or asset diversification tests will no longer result in loss of RIC status.
- > RICs that invest in other RICs will have a greater ability to pass through to shareholders the benefits of foreign tax credits and tax-exempt interest dividends from those other RICs.

- > A RIC will be permitted to carry forward its capital loss carryovers indefinitely, and they will retain their character as short-term or long-term.
- > A RIC will be permitted to make capital gain and other special dividend designations on Forms 1099-RIC without also having to provide separate written notices to shareholders of those designations within 60 days of the end of the RIC's taxable year.
- > Non-calendar-year RICs will be able to carry over certain excess distributions from one calendar year to the next, so as to reduce the potential need for amended Forms 1099-RIC and amended returns by shareholders.
- > The period during which a RIC may make a "spillover" dividend so as to generate deductions in its prior taxable year will be slightly extended.

The new provisions will generally be effective for RIC taxable years beginning after 2010 or, in the case of inadvertent failures to meet the RIC asset or income test, for taxable years for which the RIC's return is due after 2010.

Disclaimer Required by IRS Rules of Practice

The discussion of tax matters contained herein is not intended or written to be used, and cannot be used, for the purpose of avoiding any penalties that may be imposed under Federal tax laws.

Investment Management Group

For more information about the matters discussed in this Alert, please contact your regular Drinker Biddle lawyer, one of the authors of the Alert, or any other member of our Investment Management Group.

Partners and Counsel

Gary D. Ammon
(215) 988-2981
Gary.Ammon@dbr.com

Jeffrey Blumberg
(312) 569-1106
Jeff.Blumberg@dbr.com

Stephen T. Burdumy
(215) 988-2880
Stephen.Burdumy@dbr.com

Mark F. Costley
(202) 230-5108
Mark.Costley@dbr.com

Joshua B. Deringer
(215) 988-2959
Joshua.Deringer@dbr.com

Glenn E. Ferencz
(312) 569-1246
Glenn.Ferencz@dbr.com

Stephen D.D. Hamilton
(215) 988-1990
Stephen.Hamilton@dbr.com

Veena K. Jain
(312) 569-1167
Veena.Jain@dbr.com

Michelle M. Lombardo
(215) 988-2867
Michelle.Lombardo@dbr.com

Michael P. Malloy
(215) 988-2978
Michael.Malloy@dbr.com

David M. Matteson
(312) 569-1145
David.Matteson@dbr.com

Diana E. McCarthy
(215) 988-1146
Diana.McCarthy@dbr.com

Nancy P. O'Hara
(215) 988-2699
Nancy.OHara@dbr.com

Mary Jo Reilly
(215) 988-1137
MaryJo.Reilly@dbr.com

Audrey C. Talley
(215) 988-2719
Audrey.Talley@dbr.com

Other Publications



www.drinkerbiddle.com/publications

Sign Up



www.drinkerbiddle.com/publications/signup