

IRS issues final money market regulations, and associated revenue procedure

IRS issues final regulations and Revenue Procedure 2016-39 on method of accounting for gains and losses on shares in money market funds, and broker returns with respect to sales of shares in money market funds

Recently, the Internal Revenue Service (IRS) released a set of final regulations (the “Final Regs”), under Internal Revenue Code (IRC) sections 446 and 6045¹, and Revenue Procedure 2016-39² (the “Rev. Proc.”) addressing potential tax issues presented by securities law changes (“SEC MMF Reform Rules”) imposed by the Securities and Exchange Commission (SEC) that change the amount for which certain money market fund (MMF) shares are distributed, redeemed, and purchased. The Final Regs affect MMFs and their shareholders.

Background

In response to the SEC MMF Reform Rules, the United States Treasury Department and the IRS proposed regulations (“Proposed Regs”) in the Federal Register on July 28, 2014 (Refer to [Deloitte Investment Management Tax Alert dated July 31, 2014](#)). The Proposed Regs described a simplified method of accounting to compute the gain or loss on shares in a floating-NAV MMF, referred to as the net asset value method, or NAV method. The NAV method allows a taxpayer to calculate its gain or loss on the redemption of shares in an MMF using the change in the aggregate value of the taxpayer’s shares during a computation period selected by the taxpayer and the net amount of the purchases and redemptions during the computation period. The Proposed Regs also provide guidance regarding information reporting requirements for MMF shares. **The Final Regs adopt the Proposed Regs regarding the method of accounting, with certain modifications. The Final Regs revise the information reporting requirements for MMF shares by adopting the provisions of the Proposed Regs without substantive change.**³

In drafting the Final Regs, IRS and Treasury considered comments and made revisions to the Proposed Regs with respect to the following areas: (1) application of the NAV method to Stable-NAV MMFs, (2) imposition of a consistency requirement, (3) choosing NAV method computation periods for excise tax purposes, (4) clarification of certain amounts, and (5) accounting method changes.

Application of the NAV Method to Stable-NAV MMFs

Under the Proposed Regs, the NAV method would have applied only to floating-NAV MMF shares. Occasionally, a stable-NAV MMF may be redeemed at a price other than the target price, such as when a fund “breaks the buck,” or if the MMF imposes a liquidity fee, generally causing the redeeming shareholder to realize a loss. Application of the wash sale rules under Section 1091 may cause acquisition of additional MMF shares to result in a difference between shareholder basis and MMF share value that persists indefinitely, imposing significant burdens on shareholders. **Citing the fact that many shareholders of stable-NAV MMFs, generally individuals, likely lack the systems to track basis adjustments related to wash sales on MMF shares, commenters recommended that the NAV method also be applicable to stable-NAV MMF shares. Since adopting the NAV method for a stable-NAV MMF would calculate a loss resulting from a liquidity fee for a shareholder’s entire interest in the MMF (or in an account) rather than for a single transaction, the wash sale rules would not apply in such a situation. Additionally, the NAV method simplifies record keeping since it requires fewer and simpler computations**

¹ Unless otherwise specifically stated, all section references are to the Internal Revenue Code of 1986, as Amended.

² I.R.B. 2016-30.

³ See Treas. Reg. §1.6045-1(c)(3)(vi).

compared to traditional accounting. As such, the Final Regs permit taxpayers to apply the NAV method to shares in stable-NAV MMFs⁴ as well as floating-NAV MMFs.

Consistency Requirement

The Proposed Regs provided that a taxpayer who applies the NAV method to shares in any MMF for a taxable year must apply the NAV method to its shares in all MMFs for which the NAV method is permissible. **Since commentators noted that MMF shareholders may hold shares in the same MMF through multiple accounts and may receive different information for different accounts, the Final Regs permit MMF shareholders to use different methods of accounting for shares in different MMFs or for shares in a single MMF held in different accounts.**⁵

Choosing NAV Method Computation for Periods for RIC Excise Tax Purposes

Under the NAV method, a taxpayer selects a period for computing gain and loss for a MMF (“computation period”). The Proposed Regs provided that computation periods may be the taxpayer’s taxable year or a shorter period, provided that:

- (i) Computation periods are of approximately equal duration,
- (ii) Every day during the taxable year falls within one, and only one, computation period, and
- (iii) Each computation period contains days from only one taxable year.

Many MMFs are regulated investment companies (“RICs”) for tax purposes, and most RICs are required to pay an excise tax under IRC section 4982 if they do not make the required distribution described in IRC section 4982(b). This required distribution includes 98.2 percent of capital gain net income, which would include gain or loss from the sale of MMF shares, for the one-year period ended October 31. **The Final Regs allow for a RIC to utilize the NAV method for excise tax purposes.**⁶ **However, the Final Regs generally require that for each MMF in each account, a RIC must use the NAV method either for both income tax and excise tax computations or for neither computation.**⁷ **Additionally, the Final Regs require that a RIC utilizing the NAV method must use the same computation periods for both income and excise tax purposes, and that no computation period can contain days that are included in more than one income tax year or excise tax period.**⁸ **The Final Regs also eliminate the requirement that computation periods be of approximately equal duration.**⁹

To illustrate, a RIC with an income tax year ending in January 31 which applies the NAV method to its shares in an MMF (held as a capital asset) may meet the computation period requirements outlined above with two computation periods of unequal duration— one ending on January 31 and the other on October 31.

Finally, the Final Regs clarify that the NAV method is a “specified mark to market provision” under IRC section 4982(e)(6).¹⁰

Clarification of Certain Amounts

Fair Market Value

The Proposed Regs provided that gain and loss under the NAV method be determined by reference to the fair market value of MMF shares. **The Final Regs indicate that the fair market value of a share in an MMF at the time of a transaction is presumed to be the published NAV¹¹, with the following additional clarifications for purposes of determining the fair market value:**

- **Computing ending value for computation period:** the presumption applies to the last published NAV (or other redemption amount) in that computation period.¹²

⁴ Treas. Reg. § 1.446-7(a).

⁵ Treas. Reg. § 1.446-7(c)(1) and (5).

⁶ Treas. Reg. § 1.446-7(b)(1)(iii).

⁷ Treas. Reg. § 1.446-7(c)(6).

⁸ Treas. Reg. § 1.446-7(b)(1)(iii)(A).

⁹ Treas. Reg. § 1.446-7(b)(1).

¹⁰ Treas. Reg. § 1.446-7(c)(7).

¹¹ Treas. Reg. § 1.446-7(b)(3).

¹² Treas. Reg. § 1.446-7(b)(3)(iii)(A).

- **Determining fair market value of shares surrendered or received:** the presumption generally applies to the NAV (or other redemption amount) used to determine the consideration received in the transaction, or if the consideration is not based on a published NAV (or other redemption amount), the first NAV (or other redemption amount) published for the MMF shares after the transaction.¹³
- **When no NAV (or other redemption amount) is published, or if facts and circumstances indicate that the NAV (or other redemption amount) does not represent the fair market value of a share in the MMF,** the fair market value is determined on the basis of all the facts and circumstances.¹⁴

Aggregate amount received

Under the Proposed Regs, a taxpayer's net investment in an MMF for a computation period would equal the aggregate cost of shares in the MMF purchased during the computation period, minus the aggregate amount received during the computation period in redemption of shares in the MMF, subject to certain adjustments. **The Final Regs clarify that the aggregate amount received is the amount of any cash plus the fair market value of any MMF shares received.**¹⁵ **If the consideration includes any property other than cash or MMF shares, the amount received is determined by reference to the fair market value of the surrendered MMF shares.**¹⁶

Substituted basis

Under the Proposed Regs, if, during the computation period, a taxpayer acquired any shares in an MMF other than by purchase, the taxpayer's net investment would increase by the adjusted basis (for purposes of determining loss) of each such share immediately after its acquisition. **The Final Regs clarify that, to the extent a shareholder receives a transferred basis in one or more acquired MMF shares and the person from whom the shareholder acquired the shares used the NAV method, then the adjusted basis of the acquired shares will be their fair market value at the time of the acquisition. The value is presumed to be the next NAV (or other redemption amount) published by the MMF.**¹⁷

Accounting Method Changes and Rev. Proc. 2016-39

The Final Regs provide that a taxpayer seeking to change to or from the NAV method must secure the consent of the Commissioner in accordance with §1.446-1(e).¹⁸ **Simultaneous with the publication of the Final Regs, the Treasury Department and the IRS issued Rev. Proc. 2016-39 outlining the procedures by which a taxpayer may obtain automatic consent to change to or from the NAV method for shares in an MMF.**

The Rev. Proc. provides that a change to or from the NAV method is made on a cut-off basis such that an IRC section 481 adjustment is neither permitted nor required. A taxpayer would apply the new method to the computation of gain or loss on the shares beginning with the year of change. A taxpayer changing to the NAV method takes a starting basis in applicable shares in the change year equal to the aggregate adjusted basis of the shares at the end of the immediately preceding taxable year. A taxpayer changing from the NAV method to a realization method must adjust the basis in the shares beginning on the first day of change year to account for gain or loss previously recognized under the NAV method.

For certain changes, the Rev. Proc. provides for automatic consent procedures that require a short Form 3115. For example, these automatic consent procedures apply to a taxpayer that (1) has adopted a realization method for shares in a floating-NAV MMF and wants to change to the NAV method for shares in that MMF, or (2) has adopted the NAV method for shares in a floating-NAV MMF and wants to change to a permissible realization method for shares in that MMF. The short Form 3115 must include the following information:

- (i) The identification section of page 1 (above Part I);
- (ii) The signature section at the bottom of page 1;
- (iii) Part I, line 1(a);

¹³ Treas. Reg. § 1.446-7(b)(3)(iii)(B).

¹⁴ Treas. Reg. § 1.446-7(b)(3)(iv).

¹⁵ Treas. Reg. § 1.446-7(b)(5)(ii)(A).

¹⁶ Treas. Reg. § 1.446-7(b)(5)(ii)(B).

¹⁷ Treas. Reg. § 1.446-7(b)(5)(iii)(B).

¹⁸ Treas. Reg. § 1.446-7(c)(8)(i).

- (iv) A statement specifying whether the taxpayer is changing from a realization method to the NAV method, or from the NAV method to a realization method; and
- (v) A statement specifying the MMF or MMFs to which the change applies, if the change does not apply to all MMFs in which the taxpayer holds shares (and, to the extent applicable, whether the change applies only to shares of the MMF or MMFs held in a particular account).

For certain other changes, the Rev. Proc. provides that filing Form 3115 would not be required for a taxpayer changing to the NAV method in a stable-NAV MMF if the following requirements are satisfied:

- (i) the taxpayer has not used the NAV method for shares in the MMF for any taxable year prior to the year of change; and
- (ii) Prior to the year of change, either
 - (A) The taxpayer's basis in each share of the MMF has been at all times equal to the MMF's target share price, or
 - (B) The taxpayer has not realized any gain or loss with respect to shares in the MMF.

Effective Dates

The Final Regs on the NAV method under IRC section 446 apply to taxable years ending on or after July 8, 2016. For taxable years ending on or after July 28, 2014, and beginning before July 8, 2016, taxpayers may rely upon either the Proposed Regs or the Final Regs.

The Final Regs apply the information reporting rules under IRC section 6045 to sales of MMF shares for calendar years beginning on or after July 8, 2016. Taxpayers and brokers, however, may rely upon these rules for sales of MMF shares in calendar years beginning before July 8, 2016.

The Rev. Proc. is effective for taxable years ending on or after July 8, 2016.

For additional information or questions, please contact:

<p>Jeff Barth Tax Partner Deloitte Tax LLP +1 414 347 6156</p>	<p>Rachel Becker Tax Managing Director Deloitte Tax LLP +1 414 977 2567</p>	<p>Eric Byrnes National Managing Tax Director, Regulated Investment Companies Deloitte Tax LLP +1 973 602 6710</p>	<p>Casey Yantosca Tax Senior Manager, Financial Services Deloitte Tax LLP +1 203 708 4427</p>
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