Rev. Proc. 2016-31

SECTION 1. PURPOSE

This revenue procedure provides temporary relief for certain money market funds (MMFs) that receive contributions from their advisers as the MMFs transition to comply with Securities and Exchange Commission (SEC) rules that change how certain MMF shares are priced. See Money Market Fund Reform; Amendments to Form PF (79 FR 47736) (SEC MMF Reform Rules).

SECTION 2. BACKGROUND

.01 An MMF is a type of investment company registered under the Investment Company Act of 1940 (1940 Act) and regulated as an MMF under Rule 2a–7 under the 1940 Act (17 CFR 270.2a–7) (Rule 2a–7). (The SEC MMF Reform Rules amended Rule 2a–7.) MMFs have historically sought to keep stable (typically at $1.00) the prices at which their shares are distributed, redeemed, and repurchased. The securities that Rule 2a–7 permits an MMF to hold generally result in no more than minimal fluctuations in the MMF’s net asset value per share (NAV).
.02 Before the SEC MMF Reform Rules amended Rule 2a–7, MMFs meeting the requirements of Rule 2a–7 were generally permitted to value all of their assets at acquisition cost, with certain adjustments (amortized cost valuation method), and to price their shares by rounding the resulting NAV to the nearest 1 percent (penny-rounding pricing). These methods have enabled MMFs to maintain stable share prices in almost all circumstances.

.03 The SEC MMF Reform Rules bar the use of the amortized cost valuation method and penny-rounding pricing for certain MMFs and require these MMFs to value their assets using market factors and to round their price per share to the nearest basis point, which is the fourth decimal place in the case of a fund with a $1.0000 share price. MMFs that value their assets in this way and round to this level of accuracy are called “floating-NAV MMFs.” MMFs that invest 99.5 percent or more of their assets in government securities or repurchase agreements collateralized fully with government securities or cash items (government MMFs) or limit all of their beneficial owners to natural persons (retail MMFs) may continue to use the amortized cost valuation method and penny-rounding pricing (stable-NAV MMFs). An MMF that is not a government MMF or a retail MMF must convert to a floating-NAV MMF no later than October 14, 2016. An MMF converting to a floating NAV may receive (from, for example, the MMF’s adviser) a contribution so that when the MMF transitions to a floating NAV all shareholders receive the same value per share at the time of the transition (a top up contribution).

.04 The Treasury Department and the Internal Revenue Service (the “Service”) issued proposed regulations under sections 446 and 6045 of the Internal Revenue
Code (Code) in 2014 (79 FR 43694) (the 2014 proposed regulations) providing a permissible, simplified method of accounting for gains and losses on shares in MMFs and clarifying reporting requirements for shares in MMFs. The Service received written comments responding to the 2014 proposed regulations. One commenter stated that it believes that sponsors of an MMF that will become a floating-NAV MMF may wish to make contributions to the MMF to raise the MMF’s NAV to $1.0000 before the MMF’s NAV begins to float. The commenter added that contributions may be made in other transitional contexts, such as the merger, conversion, or other reorganization of one or more MMFs, to facilitate compliance with the SEC MMF Reform Rules.

.05 In the preamble to the SEC MMF Reform Rules, the SEC provided exemptive relief for certain reorganizations and involuntary redemptions undertaken in connection with beginning to comply with the amendments to Rule 2a–7. Provided certain conditions are met, MMFs may therefore carry out these reorganizations and redemptions without seeking the separate exemptive relief from the SEC that would ordinarily be required. See 79 FR at 47798–99.

.06 Under the SEC MMF Reform Rules, an MMF must disclose the occurrence of certain events, including the provision to the fund by the fund’s sponsor (or certain other persons) of “any form of financial support to the fund (including any (i) capital contribution, …).” 17 CFR 274.222. Specifically, if an MMF receives financial support from its sponsor, it must timely report this support on Form N-CR, “Current Report: Money Market Fund Material Events,” and must disclose the support prominently on its website. See 17 CFR 270.30b1–8; 17 CFR 270.2a–7(h)(10)(v).
.07 The staff of the SEC Division of Investment Management has stated that it will not object if certain transactions that provide financial support are not reported on Form N-CR. In particular, if a top up contribution occurs as part of a transition for money market funds to implement the floating NAV reform before the October 14, 2016, compliance deadline, the staff has stated that it would not object if the transaction is not reported on Form N-CR, because such transactions are primarily intended to bring a fund into compliance with revised money market fund regulations in a way that avoids unfair results or dilution.¹

.08 An MMF must meet distribution requirements to be taxed as a regulated investment company (RIC) under part 1 of subchapter M and to avoid the imposition of an excise tax under section 4982 of the Code. Section 852(b)(1) imposes a tax, computed under section 11, on a RIC’s investment company taxable income (ICTI). Section 852(b)(2) defines ICTI as taxable income with several adjustments, including the exclusion of net capital gain and the allowance of a deduction for dividends paid. For an MMF to be taxed as a RIC, section 852(a)(1) requires the MMF’s deduction for dividends paid (determined without regard to capital gain dividends) to equal or exceed the sum of 90 percent of the RIC’s ICTI for the taxable year (determined without regard to the deduction for dividends paid) and 90 percent of the excess of the RIC’s interest income excludable from gross income under section 103(a) over the RIC’s deductions disallowed under sections 265 and 171(a)(2).

.09 Section 4982(a) imposes an excise tax on a RIC for each calendar year equal to 4 percent of the excess of the required distribution for the calendar year over the distributed amount for the calendar year. Under section 4982(b), a RIC’s required distribution for a calendar year generally is the sum of 98 percent of the RIC’s ordinary income for the calendar year, plus 98.2 percent of the RIC’s capital gain net income for the 1-year period ending on October 31 of the calendar year.\(^2\) Under section 4982(c), the distributed amount for a calendar year generally is the sum of the RIC’s deductions for dividends paid during the calendar year and any amount on which tax is imposed under section 852(b)(1) or (b)(3)(A) for a taxable year ending in the calendar year.\(^3\) Under section 4982(c)(4), if a RIC has an amount taxed under section 852(b)(1) or (b)(3)(A) for a taxable year and the RIC makes estimated tax payments on that amount during the calendar year in which the taxable year begins, the RIC may elect to include that amount in the RIC’s distributed amount for that calendar year (instead of the calendar year in which the taxable year ends).

.10 If the distribution requirements in sections 852 and 4982 apply to an adviser contribution, it may be impossible or impractical for the advisers of some MMFs to make contributions that raise the MMFs’ NAVs to $1.0000, so that shareholders will receive the same value per share both before and after the transition to a floating NAV. If contributions from an adviser are subject to the distribution requirements, then, to increase the value of an MMF’s portfolio by a given amount, an adviser may need to

\(^2\) Section 4982(b) also contains rules for increasing the required distribution for a calendar year that follows a calendar year in which there is a shortfall. Section 4982(e) defines the terms “ordinary income” and “capital gain net income” for purposes of section 4982 and provides additional rules.

\(^3\) Section 4982(c) also contains rules for determining the dividends paid during a calendar year and for adjusting the distributed amount for a calendar year that follows a calendar year in which there is an overdistribution.
contribute more than ten times that amount to “gross up” the contribution for both a 90-percent distribution requirement and tax on the undistributed amount. Comments submitted in response to the 2014 proposed regulations recommended guidance that would facilitate contributions to raise the MMF’s NAV to $1.0000. Specifically, a commenter recommended that if a sponsor makes contributions to an MMF before October 14, 2016, the contributions would neither result in income or gain to the MMF nor reduce the basis of the MMF’s assets.

The Treasury Department and the Service believe that it is in the interest of sound tax administration to apply section 852 in a manner that will support the efforts of the staff of the SEC Division of Investment Management to facilitate a smooth transition to compliance with SEC MMF Reform Rules. The Treasury Department and the Service believe that excluding certain adviser contributions from ICTI for purposes of the distribution requirements in section 852(a) is important to facilitate those contributions but do not believe the contributions should be excluded from the RIC’s income for other federal tax purposes.

SECTION 3. SCOPE

This revenue procedure applies to a top up contribution that is received by an MMF as part of a transition to implement the floating NAV reform before the October 14, 2016, compliance deadline, as described in Section 2.07 above.

SECTION 4. APPLICATION

If an MMF receives a contribution that is described in section 3 of this revenue procedure, the Service will not challenge the MMF’s treatment of the contribution as an amount that is included in ICTI for purposes of section 852(b)(2) but is excluded from
ICTI for purposes of section 852(a)(1). The treatment described in this section 4 applies only to contributions described in section 3 of this revenue procedure.

SECTION 5. EXAMPLE

The following example illustrates the operation of this revenue procedure.

(i) Fund is an MMF that uses a March 31 taxable year for federal income tax purposes. Fund has a stable NAV but is required under SEC MMF Reform Rules to become a floating-NAV MMF before October 14, 2016. As of April 22, 2016, Fund has 500 million outstanding shares and assets with a fair market value of $498,000,000. Fund’s published NAV on April 22, 2016, is $1.00, but Fund’s NAV determined using market factors and rounded to the nearest basis point is $0.9960. On April 25, 2016, Fund’s investment adviser makes a $3,000,000 contribution to Fund that is described in section 3 of this revenue procedure. During its taxable year ending on March 31, 2017, Fund has $2,000,000 in ordinary income from securities in its portfolio and distributes $2,000,000 in ordinary dividends to its shareholders. Fund has no capital gains or losses and pays no capital gain dividends. Fund elects the application of section 4982(c)(4) for the 2016 calendar year. Consistent with that election, Fund makes an estimated tax payment of $1,020,000 during the 2016 calendar year with respect to Fund’s taxable year ending on March 31, 2017. This amount reflects the tax under section 852(b)(1) on $3,000,000 of Fund’s ICTI for that taxable year.

(ii) For its taxable year ending on March 31, 2017, Fund has ordinary income of $5,000,000. For purposes of section 852(b)(2), Fund’s ICTI for that year is $3,000,000, because Fund has a $2,000,000 deduction for dividends paid. The tax on $3,000,000,
computed under section 11, is $1,020,000, which was timely satisfied by the estimated tax payments that Fund made during 2016.

(iii) For purposes of section 852(a)(1), Fund treated its ICTI as being $2,000,000 (excluding the adviser contribution and disregarding the deduction for dividends paid). Because Fund distributed $2,000,000 of dividends in that taxable year, it distributed over 90 percent of the amount that it is treating for purposes of section 852(a) as its ICTI. Consistent with section 4 of this revenue procedure, the Service will not assert that Fund failed to satisfy the distribution requirement in section 852(a)(1).

(iv) Under section 4982(c)(4)(A)(i), Fund’s distributed amount for 2016 is increased by the $3,000,000 with respect to which Fund made a $1,020,000 estimated tax payment. Thus, section 4982 does not impose an excise tax on Fund for 2016. Under section 4982(c)(4)(A)(ii), Fund’s distributed amount for 2017 will be decreased by $3,000,000 to avoid double-counting.

(v) After payment of $1,020,000 of income taxes, the contribution of $3,000,000 increased the value of Fund’s portfolio to $499,980,000. After this increase, Fund’s NAV, rounded to the nearest basis point, is $1.0000.

SECTION 6. EFFECTIVE DATE

This revenue procedure is effective for contributions that are described in section 3 of this revenue procedure. Section 3 of this revenue procedure does not describe any contribution made after certain MMFs are required to become floating-NAV MMFs.

SECTION 7. DRAFTING INFORMATION

The principal author of this revenue procedure is Grace Cho of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information
regarding this revenue procedure contact Ms. Cho at (202) 317-6945 (not a toll-free call).