Industry Trends – August 2018

Industry Statistics – Mutual Funds

Fund Category	Net Assets (in billions)		Percentage Change in Net Assets	Dollar Change in Net Assets (in billions)		
					Change Due to	
	June-18	March-17		Total Change	Net Cash Flows	Market
Stock	$10,456.3	$10,280.0	1.7%	$176.3	($38.7)	$215.0
Hybrid	$1,495.8	$1,497.9	(0.1%)	($2.1)	($15.9)	$13.8
Taxable Bond	$3,435.2	$3,424.2	0.3%	$11.0	$23.8	($12.8)
Municipal Bond	$676.6	$670.7	0.9%	$5.9	$0.2	$5.7
Money Market	$2,820.9	$2,793.0	1.0%	$27.9	$21.8	$6.1
Total	$18,884.8	$18,665.8	1.2%	$219.0	($8.8)	$227.8

- Stock funds assets had an increase during the quarter of $176.3 billion. For the quarter ended June 30, 2018, market appreciation was $215.0 billion compared to a depreciation of $10.4 billion for the quarter ending March 31, 2018. The net assets for stock funds increased from $10,280.0 billion as of March 31, 2018 to $10,456.3 billion at the end of June, 2018.

- Hybrid fund assets decreased from $1,497.9 billion as of March 31, 2018 to $1,495.8 billion as of June 30, 2018. This compares to a decrease of $27.9 billion in the first quarter of 2018. The increase was the result of market appreciation of $13.8 billion and net outflows of $15.9 billion.

- Bond funds had net inflows of $24.0 billion for the quarter ended June 30, 2018, compared to the previous quarter inflows of $58.8 billion. Assets for all bond funds increased $16.9 billion for the quarter ended June 30, 2018 which included, market depreciation of $7.1 billion.

- Money market funds had net inflows of $21.8 billion for the three months ended June 30, 2018, compared to the previous quarter outflows of $61.2 billion. Money market fund net assets, over the three month period, increased from $2,793.0 billion as of March 31, 2018 to $2,820.9 billion as of June 30, 2018.

Source: Investment Company Institute website

Regulatory Update

SEC Approves New ETF Rule Proposal

On Thursday, June 28, 2018, the SEC unanimously approved proposed Rule 6c-11 that would allow exchange-traded funds ("ETFs") that meet certain conditions to operate without first seeking exemptive relief. Proposed Rule 6c-11 would provide exemptions for both index-based and actively managed ETFs.

Proposed Rule 6c-11 would be subject to certain conditions, including the following:

1. **Transparency.** Under proposed Rule 6c-11, an ETF would be required to provide daily portfolio transparency on its website. However, unlike under prior ETF exemptive orders, dissemination of an intraday indicative value every 15 seconds would not be required under the proposed rule.
2. **Custom basket policies and procedures.** An ETF relying on proposed Rule 6c-11 would be permitted to use baskets that do not reflect a pro rata representation of the fund's portfolio or that differ from other baskets used in transactions on the same business day ("custom baskets") if the ETF adopts written policies and procedures setting forth detailed parameters for the construction and acceptance of custom baskets that are in the best interests of the ETF and its shareholders.
3. **Posting of a Published Basket.** The proposal would require an ETF, at the beginning of each business day, to post on its website information regarding a published basket. This may come as a surprise to some ETF providers, as not all ETF providers currently show this information on their websites. In addition, ETFs would also be required to maintain records detailing the composition of baskets, which would allow the SEC staff to review an ETF's baskets as part of an examination.
4. **Website disclosure.** The proposed rule would require ETFs to disclose certain information on their websites, including (i) the ETF's NAV per share, market price, and premium or discount, each as of the end of the prior business day; (ii) bid-ask spreads; and (iii) historical information regarding premiums and discounts. These disclosures are intended to inform investors about the efficiency of an ETF's arbitrage process.
5. **Recordkeeping.** ETF providers would be required to preserve and maintain copies of all agreements with authorized participants.

To help create a consistent ETF regulatory framework, the proposal recommends rescinding exemptive relief previously granted to ETFs that would be able to rely on the proposed rule. Lastly, the Commission is proposing several amendments to Form N-1A to provide more

useful, ETF-specific information to investors who purchase ETF shares on an exchange. The Commission is also proposing that ETFs organized as unit investment trusts ("UITs") provide the same information to investors on Form N-8B-2.

Comments on the proposal will be due 60 days after publication in the Federal Register.

Dodd-Frank Relief Bill Enacted into Law

On May 24, 2018, the Economic Growth, Regulatory Relief, and Consumer Protection Act (the "Relief Bill") was passed, which modifies the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") by amending certain requirements of federal securities laws. Title V of the Relief Bill, among other things, amends the following:

- Expansion of exemption from certain state securities laws relating to state registration/qualification laws;
- Expansion of Regulation A+ offerings to reporting companies;
- Increase in the amount of securities that may be sold under Rule 701 in a 12-month period without having to provide additional disclosure;
- Investment Company Act of 1940 (the "Investment Company Act") registration exemption for qualifying venture capital funds;
- Elimination of Investment Company Act exemption for U.S. possessions, such as Puerto Rico and the Virgin Islands; and
- Parity for closed-end companies regarding offering and proxy rules.

The Relief Bill is also intended to ease restrictions of certain federal banking laws and is the first significant legislative modification to the Dodd-Frank Act since its adoption.

Private Fund Advisors Charged with Filing Failures

In early June, the SEC announced that it had entered into settlements with 13 advisers that failed on a repeated basis to file Form PF. Form PF provides information to the SEC about the private funds advised by advisers with $150 million or more in assets. The SEC uses information from Form PF to monitor industry trends, inform rulemaking, identify compliance risks and target examinations and enforcement investigations. The SEC's orders find that the advisers violated the reporting requirements of the Investment Advisors Act of 1940, as amended, and the advisers agreed to be censured, to cease and desist and to each pay a $75,000 penalty.

SEC Adopts Optional E-Delivery Rule for Shareholder Reports

On June 4, 2018, the SEC adopted Rule 30e-3 under the Investment Company Act (the "Rule") to provide certain registered investment companies ("Funds") with a new option for an internet-based "notice and access" method for delivering annual and semi-annual reports to shareholders. Under the Rule, beginning on January 1, 2021, Funds may meet their shareholder report delivery requirements by making their reports and other related materials publicly available, free of charge, on a website, and sending fund shareholders a paper notice of the availability of such reports. Funds may choose to rely on the Rule, or continue meet their shareholder delivery requirements under the current delivery methods of either mailing paper reports or delivering electronic reports to shareholders who have elected to receive reports electronically.

For Funds that rely on the Rule, electronic delivery will replace paper delivery as the default delivery method. The SEC's objectives in adopting the rule are to modernize the way that shareholder reports are delivered, improve the investors' experience and reduce expenses associated with printing and mailing reports.

Requirements for Funds seeking to rely on the Rule include:

- **Website Availability of Reports and Other Information:** shareholder reports and other required materials must be made publicly available and free of charge at a website address specified in a notice to investors. In addition to a Fund's most recent annual and semi-annual reports, portfolio holdings for its first and third fiscal quarters must be made available at the website address.
- **Election to Receive Reports in Paper:** shareholders may elect to continue to receive reports in paper. Such requests apply to all Funds held in the same account with the Fund Company. Upon request, Funds must also provide free paper copies of the reports and other materials contained on the website within three business days
- **Notice Requirements:** a written notice of availability of shareholder reports must be mailed each time a new report is available online. The notice must conform to the following disclosure requirements:
    - Written in plain English;
    - Contain a prominent legend in bold-face type stating that an important report is available online or in print by request;
    - State that the report contains important information about the Fund, including its portfolio holdings and financial statements;

- State that the report is available at the specified website address or, upon request, by mail, and encourage the shareholder to access and review the report.
- Include a website address where the report and other specified materials are available.
- Provide a toll-free telephone number to contact the Fund or the shareholder's financial intermediary, and include (i) instructions on how a shareholder may request a free paper or e-mail copy of the report, (ii) an explanation that the shareholder may elect to receive print reports and instructions on how to make such an election, and (iii) instructions on how the shareholder may elect to receive reports via electronic delivery.

The SEC has implemented an extended transition period with staged effective dates for reliance on the Rule. The earliest date that notices may be used in lieu of paper reports is January 1, 2021. Existing Funds seeking to rely on the Rule as of that date must notify shareholders of the planned change in delivery method for a two-year period beginning at the start of 2019. Prominent notice of the change must be provided in the Fund's prospectus, summary prospectus, and annual/semi-annual reports to shareholders. The two-year notice requirement ends on January 1, 2022. The SEC also amended Rule 498 under the Securities act and Fund-related registration forms (e.g., Form N-1A, Form N-2) in connection with the notices required during the transition period.

In related releases, the SEC issued two requests for public comment. First, the SEC seeks comment on additional ways to improve fund information disclosures, such as modernizing the design, delivery and content of fund information. Next, the SEC seeks comment on the framework for certain processing fees that broker-dealers and other intermediaries charge for delivering shareholder reports and other materials to investors.

Safe Harbor Proposal for Brokers' Fund Research

Broker dealers often compose research on mutual funds, stocks and corporate debt, among other securities, with an ultimate desire to publish the research to larger audiences. Current laws classify brokers' research on mutual funds as an offer for sale of the funds which can greatly restrict a brokers' use of research. In contrast, brokers' research on stocks and corporate debt enjoys "safe harbor" protections from the offer for sale rules. A new proposal from the SEC would extend these "safe harbor" protections to brokers' research on mutual funds as well as reduce the filing requirements for brokers' fund research. The SEC staff has indicated that the proposed change is driven by a desire to provide investors with greater access to research to allow them to make more informed investment decisions. The SEC's public comment period

for the proposal closed in late June 2018, so the industry can likely expect an update on the proposal in the coming months.

SEC Proposes Amendments to Auditor Independence Rule

On May 2, The SEC proposed amendments to its auditor independence rule to address loans and debtor-creditor relationships. Generally, the Loan Provision provides that an audit firm will not be considered independent from an audit clients, if the audit firm, or certain people of the audit firm, has a lending relationship with a person who owns more than 10% of the equity securities of the audit client. If adopted, the proposed amendments would look at whether the auditor's objectivity and impartiality were impaired despite a failure to comply with the existing rule. The proposal would focus the analysis on the relationship by eliminating violations solely due to record ownership, replace existing bright-line 10% test with the concept of significant influence and adding a "known through reasonable inquiry" standard.

Comments are due within 60 days.

SEC Issues Proposed Rules for Standards of Conduct for Broker-dealers and Investment Advisers

The SEC recently proposed rules designed to create a regulatory framework to provide clarity for retail customers of broker-dealers and investment advisers. These proposed rules are comprised of three main components: (i) the creation of a "best interest" standard for broker-dealers; (ii) a proposed interpretation to reaffirm, and clarify in some areas, the SEC's views regarding the fiduciary duty owed by investment advisers to their clients and (iii) the creation and use of a required client/customer relationship disclosure form for both broker-dealers and investment advisers (Form CRS).

The proposed best interest obligation under the Securities Exchange Act of 1934, as amended, would require broker-dealers (as well as any persons associated with the broker-dealer) recommending a securities transaction to a retail client to act in the best interest of the customer at the time the recommendation is made without placing the financial or other interest of the broker-dealer ahead of the client's interests. This obligation is satisfied if all three of the disclosure obligation, care obligation and conflict of interest obligation are met. The disclosure obligation would require the broker-dealer prior to or, at the time of the recommendation, to reasonably disclose in writing material facts related to the scope and terms of the business relationship with the retail customer and all material conflicts associated with the recommendation. The care obligation requires the broker-dealer to exercise reasonable diligence, care, skill and prudence to: (i) understand the potential risks and rewards associated with the recommendation and have a reasonable basis to believe the recommendation is in the

best interest of at least some retail customers; (ii) have a reasonable basis to believe that the recommendation is in the best interests of the particular customer based on the customer's investment profile and; (iii) have a reasonable basis to believe that a series of recommendations, even if in the customer's best interest when viewed in isolation, is not excessive and is in the customer's best interest when taken together in light of the customer's investment profile. The conflict of interest obligation requires a broker-dealer to identify, and at a minimum disclose, or eliminate all material conflicts of interest associated with a securities transaction recommendation. The conflict of interest obligation also requires the broker-dealer to identify, disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives associated with securities transaction recommendations. In the proposal the SEC has provided multiple examples of methods to satisfy these obligations.

With respect to the fiduciary duty owed by investment advisers to their clients, the SEC states that the Investment Advisers Act of 1940, as amended (the "Advisers Act"), has created a "federal fiduciary standard" for investment advisers based on common law provisions and which is enforceable by way of the anti-fraud provisions of the Advisers Act. The proposal then elaborates on the duty or care and duty of loyalty which comprise this fiduciary duty and factors that the adviser should consider in meeting these standards. The SEC then requested comments regarding three potential enhancements to the existing fiduciary obligations: (i) licensing and continuing education requirements for investment adviser personnel; (ii) delivery of account statements to clients with advisory accounts; and (iii) financial responsibility requirements, including fidelity bonds, for federally registered investment advisers.

Proposed Form CRS would require investment advisers and broker-dealers to provide retail investors with a standardized, short-form customer relationship summary. It is intended to highlight differences in services provided, applicable legal standards to such services, fees a customer may pay and conflicts of interest that may exist. The form also would contain a list of questions that a retail customer may want to ask the adviser or broker-dealer.

The SEC's proposals are considered less restrictive than the Department of Labor's vacated fiduciary rule but more expansive, covering all investment recommendations to retail customers rather than just investment recommendations for retirement accounts.

SEC Releases Proposal for a Pilot Program to Temporarily Limit Stock Exchange Transaction Fees

The SEC recently announced that it unanimously approved a proposal to create a transaction fee pilot program for exchange-listed stocks. The program would create temporary limits on transaction fees imposed by national securities exchanges while also requiring the exchanges to compile and share data gathered during the pilot program. Currently, national securities

exchanges use a variety of fee models, including the fee-and-rebate pricing model and "maker-taker" pricing model. These models can reward, and in turn take fees from, the opposing broker dealers in a transaction that provide or reduce liquidity. In proposing the pilot program, the SEC noted that these types of fee models could create a conflict of interest between achieving best execution for their clients and receiving economic incentives. The goal of the pilot program is to provide the SEC with appropriate data to determine whether, and how, to amend Regulation NMS to prevent these potential conflicts of interest.

SEC Issues No-Action Letter Relating to Section 22(e) of the Investment Company Act of 1940

On June 1, 2018, the SEC's Division of Investment Management issued a no-action relief letter (the "Letter") relating to Section 22(e) of the Investment Company Act of 1940 in response to the Investment Company Institute's (the "ICI's") request. The Letter states that the Division of Investment Management would not recommend enforcement action against a mutual fund or its SEC-registered transfer agent under Section 22(e) if they temporarily delay disbursement of redemption proceeds for more than seven (7) days, based on a reasonable belief that financial exploitation has occurred, is occurring, has been attempted, or will be attempted. In their request, the ICI cited FINRA Rule 2165, which allows a FINRA member to place a temporary hold on the disbursement of funds or securities if they have a reasonable belief that financial exploitation has occurred, is occurring, has been attempted, or will be attempted. The ICI also noted that in certain situations, based their relationship with direct-at-fund shareholders, the transfer agent may be best positioned to detect financial exploitation of certain shareholders.

The Letter is based on the facts and representations of the ICI's request. Alternative facts or representations may warrant a different conclusion.

Mutual Fund Fees and Active Share

The Investor Protection Bureau of the Office of the New York Attorney General ("NYOAG") recently concluded an investigation into mutual fund fees and disclosures. NYOAG looked to understand if a fund's fees reflect its opportunity to outperform its benchmark index, measured by the amount of overlap between the holdings in the fund and the holdings in the fund's benchmark index. Among the key findings of the NYOAG:

- Actively managed funds can be up to 4.5 times more expensive than index funds.
- A higher management fee does not equate to a higher level of active management.
- Most retail investors do not have access to a metric known as "Active Share."

Active Share measures the degree of difference between a mutual fund's holdings and the holdings of the fund's benchmark index. The higher the Active Share, the more divergent the

fund's holdings are from its benchmark. A mutual fund with no holdings that are held by its benchmark would have an Active Share of 100%. NYOAG deems Active Share to be a key piece of information for retail investors, yet it is typically only provided to institutional investors. Accordingly, NYOAG calls upon mutual fund companies to make Active Share available to retail investors.

Advisory Fee and Expense Compliance Issues Identified

The Office of Compliance Inspections and Examinations ("OCIE") published a risk alert including a list of compliance issues most frequently included in deficiency letters sent to advisers relating to fees and expenses charged by SEC-registered investment advisers. Clients' advisory fees and expenses are generally detailed in an investment advisory agreement and further described in an adviser's Form ADV. An adviser may be deemed to have violated the Advisers Act of 1940, as amended ("Advisers Act") if it does not follow the terms of the advisory agreement and other disclosures or engages in inappropriate fee billing and expense practices.

The most frequent deficiencies that the OCIE staff identified regarding advisory fees and expenses include the following:

- Fee billing based on incorrect account valuations;
- Billing fees in advance or with improper frequency;
- Applying incorrect fee rate;
- Omitting rebates and applying discounts incorrectly; and
- Disclosure issues involving advisory fees.

The objective of publishing the risk alert is to encourage advisers to assess their advisory fees and expense practices and related disclosures to ensure that they are in compliance with the Advisers Act and their fiduciary duty to their clients.

Legislation Passed which would Provide Efficiencies to Closed-end and Registered Interval Funds

In May, President Trump signed into law the "Economic Growth, Regulatory Relief and Consumer Protection Act" (the "Act"). In addition to addressing other subjects, the Act directs the SEC to finalize rules by May 24, 2020 to implement the following provisions regarding share offerings and proxy solicitations. If the SEC does not meet the May 24, 2020 deadline, eligible closed-end funds will be deemed "eligible issuers" meaning that they would be able to make use of the SEC's existing securities offering and proxy rules without additional SEC action.

The additional rules should reduce the amount of time spent to update closed-end fund registration statements and printing costs. Among other things the rules would provide that:

- An eligible closed-end fund that is a "well-known seasoned issuer" as defined in Rule 405 of the Securities Act of 1933, as amended, would be permitted to use a shelf registration statement which becomes effective immediately upon filing and without SEC staff review.
- Eligible closed-end funds that qualify as a "seasoned issuer" would be able to forward incorporate certain information, such as financial statements, into their registration statements. Registration statements would not need to be amended to include each new set of financial statements.
- Eligible closed-end funds would be permitted to deliver written notices, instead of final prospectuses to purchasers during an offering of shares (with the commitment to provide a final prospectus upon request).

Pursuant to the Act, the SEC has been directed to propose such rules by May 24, 2019.

FinCEN Issues FAQs Regarding Customer Due Diligence Rules and Virtual Currency

In May 2016 the Financial Crimes Enforcement Network ("FinCEN") issued its customer due diligence requirements for financial institutions, including mutual funds. These rules require financial institutions to identify the beneficial owners of legal entity customers. The rules also state the obligations of the financial institutions to (a) understand the nature and purpose of customer relationships and (b) conduct ongoing monitoring and update customer information.

Recently FinCEN issued a series of FAQs related to these customer due diligence rules and also the application of various anti-money laundering rules to virtual currency transactions. With respect to the customer due diligence rules, FinCEN has provided additional guidance regarding beneficial ownership thresholds, identification and verification of beneficial owners, collection and updating of beneficial ownership information, exclusions from the "legal entity customer" definition and exemptions from the requirement to identify and verify beneficial owners.

With respect to virtual currency, FinCEN confirmed that a person's OFAC obligations are the same regarding less of whether a transaction is denominated in digital currency or flat currency. FinCEN also noted that OFAC may include identifiers on its Specially Designated Person ("SDN") List of specific digital currency addresses associated with blocked person and explains how parties should respond if they identify digital currency identifiers that they believe are owned by or otherwise associated with an SDN.

ACCOUNTING UPDATE

AICPA Releases Draft of Accounting and Valuation Guide

In May, the AICPA released for comment a guide titled "Valuation of Portfolio Company Investments of Venture Capital and Private Equity Funds and other Investment Companies." The Guide is intended to provide guidance to investment companies regarding their valuation and accounting for investments in equity and debt of privately-held entities, including an overview of the valuation process and the roles of the parties to the process and best practice recommendations for complying with FASB 946 and FASB 820.

The Guide has chapters summarizing fair value concepts, calibration, back-testing and factors to consider. The Guide also addresses frequently asked questions and includes documentation, consideration, and case studies.

The Guide is non-authoritative. It is designed to help interpret and apply existing fair value requirements. Comments are due by August 15, 2018 and a final version of the Guide is expected to be released next year.

TAX UPDATE

Regulatory

AICPA Recommends IRS FAQs on Virtual Currency Taxation

The American Institute of Certified Public Accountants ("AICPA") submitted a letter, dated May 30, 2018, to the IRS providing updated recommendations on IRS Notice 2014-21, IRS Virtual Currency Guidance. The recommendations were developed by the AICPA Virtual Currency Task Force and approved by the AICPA Tax Executive Committee.

The AICPA recommend the IRS release immediate guidance regarding the tax treatment of virtual currency transactions, similar to that of Notice 2014-21 so that authoritative guidance exists. Specifically, the AICPA requests additional guidance that will address items from the original Notice 2014-21, and new issues that are relevant to the 2017 tax year, such as chain splits, that have arisen subsequent to the release of the original notice.

The AICPA request suggested FAQs to address the following areas:

- Expenses of obtaining virtual currency
- Acceptable valuation and documentation
- Computation of gains and losses
- Need for de minimis election
- Valuation for charitable contribution purposes
- Virtual currency events
- Virtual currency held and used by a dealer
- Traders and dealers of virtual currency
- Treatment under Section 1031 - exchange of real property held for productive use or investment
- Treatment under Section 453 - installment method
- Holding virtual currency in a retirement account
- Foreign reporting requirements for virtual currency

The AICPA indicates that virtual currency transactions, in which taxpayers increasingly engage, add a new layer of complexity to the analysis of a client's reporting requirements. The issuance of clear guidance in this area will provide confidence and clarity to preparers and taxpayers on application of the tax law to virtual currency transactions.

IRS Submits Recommendations for IRS 2018-2019 Priority Guidance List

The Investment Company Institute ("ICI") submitted a letter, dated June 14, 2018, to the U.S. Department of the Treasury ("Treasury") and IRS in response to IRS Notice 2018-43, inviting public comment on recommendations for items that should be included on the 2018-2019 Priority Guidance Plan. The Treasury's Office of Tax Policy and the IRS use the Priority Guidance Plan each year to identify and prioritize the tax issues that should be addressed through regulations, revenue rulings, revenue procedures, notices and other published administrative guidance. The 2018-2019 Priority Guidance Plan will identify guidance projects that the Treasury Department and the Service intend to work on as priorities during the period from July 1, 2018, through June 30, 2019.

On December 22, 2017, the commonly referred to Tax Cuts and Jobs Act ("the Act") was enacted. Since that time the Treasury and IRS have focused their efforts on guidance projects necessary to implement the Act. The Treasury and IRS expect to continue to concentrate on guidance implementing the Act for the balance of the current plan year and during the 2018-2019 plan year. As a result, the Treasury and IRS do not expect to be able to complete a number of the guidance projects on the 2017-2018 Priority Guidance Plan and currently expect that many of these projects will be carried over to the 2018-2019 Priority Guidance Plan.

The ICI recommendations and requests for guidance to implement 2017 tax law changes include guidance regarding pass-through of section 199A deduction to RIC shareholders, amended section 451(b), section 965 transition tax on deferred foreign income and section 163(j) interest expense limitation. Additional recommendations and requests include guidance regarding section 851 investments in controlled foreign corporations ("CFC"s) and passive foreign investment companies ("PFIC"s), qualified interest income, foreign tax recoveries from European Union member states under Santander, items related to RIC Modernization Act of 2010, deemed distributions under section 305(c), cost basis reporting and foreign bank and financial account reporting, ownership tracking requirements, electronic filing of Form 1120-RIC, money market fund reform and foreign account tax compliance act ("FATCA").

ICI Letter to Treasury and IRS on Amendments to Section 451(b)

The Investment Company Institute ("ICI") submitted a letter, dated May 4, 2018, to the U.S. Department of the Treasury ("Treasury") and IRS, urging the Treasury and IRS to clarify the application of the amendments to internal revenue code ("IRC") section 451(b) that were enacted as part of the 2017 Tax Cuts and Jobs Act (the Act). Specifically, the ICI asks the government to issue guidance confirming that the amended section 451(b) does not apply to market discount and applies to OID only with respect to items, such as certain fees, that are

treated as something other than discount under the Generally Accepted Accounting Principles ("GAAP').

The ICI indicates in the letter that the new section 451(b)(1) states in general terms that the "all events test" is met with respect to an item of gross income for an accrual method taxpayer no later than when the taxpayer takes such item into account as revenue for financial accounting purposes on an "applicable financial statement." New section 451(b)(2) then states that the general rule in (b)(1) does not apply to the extent the Internal Revenue Code specifies a special rule of accounting, other than a rule in Part V of Subchapter P (sections 1271 to 1288). These changes were intended to overturn case law and IRS guidance that permits taxpayers to treat credit card and other fees as original issue discount ("OID") for tax purposes, even though such items are treated as fees for book purposes.

It is unclear, however, to what extent section 451(b) applies to items beyond these types of credit card and other fees. The ICI and its members are concerned that section 451(b) could be interpreted to apply to market discount and the rat of accrual of OID on debt.

The ICI indicates in the letter that it believes that section 451(b) does not override the statutory market discount rules. The ICI also believes that Congress did not intend for the provisions to cover items that are treat as discount for both book and tax purposes. The ICI asks Treasury and the IRS to confirm that the amendments to section 451(b) do not apply to market discount and with respect to OID, are limited to credit card fees and other items that are treated as something other than discount for book purposes.

Legislative / Judicial

Supreme Court of the United States Ruling on South Dakota v. Wayfair

The Supreme Court of the United States on June 21, 2018, issued a decision in South Dakota v. Wayfair, overturning the physical presence standard in Quill v. North Dakota and National Bellas Hess v. Department of Revenue of Ill. The decision overturned a rule that an out-of-state seller must have physical presence in a State before the State can require the seller to collect sales and use taxes. The Court concluded that the physical presence sales and use tax nexus rule was an "unsound and incorrect" interpretation of the Commerce Clause. In overturning prior cases, the Court determined that physical presence is not required to meet the "substantial nexus" requirement. The Court held that the respondents had established substantial nexus in this case through extensive virtual presence.

International

Swiss Government Response to ICI Global Submission Proposing Procedures by Which US Funds Establish Treaty Eligibility

The Swiss Federal Tax Administration ("FTA") has responded to the Investment Company Institute ("ICI") Global proposal for additional methods by which US funds tax as regulated investment companies ("RIC"s) can establish that they are owned by US persons. RICs under the US-Swiss tax treaty are receiving a reduced Swiss withholding tax (from 35 percent to 15 percent) on dividends paid by Swiss companies only to the extent that the RICs establish to the FTA's satisfaction that their shares are owned by US residents.

The Swiss FTA stated in their response that with regard to the ICI Global's model letter, they have included their need of information for each proposed disclosure solution and some general views and thoughts, which are in accordance to the current state of the art of the Swiss FTA for the processes and procedures of claims for refund ("CIV"s). The Swiss FTA provided mostly technical feedback to the proposed model letter.

While reviewing all documents, the Swiss FTA noted the following main topics:

- Fund-units information sources (directly-, indirectly-, indirectly held fund-units and sales restrictions)
- Calculation methodology (extrapolation or sum of different sources)
- Beneficial owner information (substantial presence + US residence address + Form 1099 or TIN-No.)

With regard to the aforementioned three topics, the Swiss FTA noted that different sources of information and calculation methodologies may be used for the quote of US residents. The initiated process of beneficial ownership disclosure is in general similar to potential solutions the Swiss FTA are in negotiation with other CIV associations / representatives. The Swiss FTA presented their views and thoughts about the received proposed model letter explaining basis for treaty relief under 2018 procedure.

State

California Legislative Proposal to Tax Investment Management Services Interest

The Investment Company Institute ("ICI") submitted a letter, dated April 20, 2018, to California Assembly member Mike A. Gipson, in opposition to Assembly Bill 2731, Income taxes:

investment management services interest: education funding. Assembly Bill 2731, introduced by Assemblymember Gipson, would impose a tax of 17% on that portion of an individual's taxable income derived from an investment management services interest, as defined in the bill.

Investment management services interest is defined in the bill as "any interest in a business which is held by any individual if that individual provides, directly or indirectly, in the active conduct or a trade or business, a substantial quantity of any of the following services to the business: (a) advising the business, including a partnership, "S" corporation, or any other business entity, as to the advisability of investing in, purchasing or selling any specified asset, (b) managing, acquiring, or disposing of any specified asset, (c) arranging financing with respect to acquiring specified assets, (d) any activity in support of any service described in (a) to (c)."

Carried interest is a term used to describe the compensation paid to the manager or general partner of an investment partnership (such as a private equity or a hedge fund) through a share of the investment partnership's profits. There are other states that have considered carried interest tax proposals.

The ICI is concerned that this bill defines the investment management services interest subject to the additional 17% tax much too broadly. The definition could apply to an individual employee who plays a role in providing the business with investment, acquisition, and financing advice and include-and impose an additional 17% tax on-the investment return on personal assets of any individual employed by an asset manager irrespective of whether the individual receives carried interest.

The ICI strongly recommends that the mutual fund industry be exempted from the surtax because fund managers are not compensated for their portfolio management services by receiving carried interest. In addition, the ICI recommends express exemption from the surtax for employees who receive company stock as part of their compensation and for income from capital provided by owners.

ICI Opposition Letter - NY Stock Transfer Tax Proposal

The Investment Company Institute (“ICI”) submitted a letter, dated May 16, 2018, to the New York Assemblymember Phil Steck, in opposition to Assembly Bill A9666, a reduction of the rebate of stock transfer sales tax from 100 percent to 60 percent.

The ICI indicates that the proposed reduced rebate would significantly increase the cost of transactions that funds conduct in their portfolios. Because fund investors are the sole owners of a fund, the investors' return is reduced by the costs incurred by the fund.

The ICI strongly recommends that any reduction of the rebate on stock transfer tax paid not be extended to 1940 Act-registered funds. Any such reduction on the rebate to funds would be borne by their investors-average Americans saving for their long-term needs. The unintended (and most unfortunate) consequence of the bill would be to harm those Americans to whom the bill's sponsor is trying to help.

Pension/Retirement

IRS Guidance on Reporting and Withholding for Payments from IRAs to State Unclaimed Property Funds

The IRS issued Revenue Ruling 2018-17, which provides guidance on withholding and reporting with respect to payments from individual retirement accounts ("IRA"s) to State unclaimed property funds. In Revenue Ruling 2018-17, the IRS clarifies that federal income tax withholding and Form 1099-R reporting generally apply for the year a payment is made from an IRA to a State unclaimed property fund. The revenue ruling concludes that federal income tax withholding applies for a trustee's payment of an individual's interest in an IRA to a State unclaimed property fund and that the payment is subject to reporting requirements.