Application of Wash Sale Rules to Money Market Fund Shares

Notice 2013-48

PURPOSE

This notice proposes a revenue procedure describing circumstances in which the Internal Revenue Service (IRS) will not treat a redemption of shares in a money market fund as part of a wash sale under § 1091 of the Internal Revenue Code. The proposed revenue procedure provides that if a taxpayer realizes a loss upon a redemption of certain money market fund shares and the amount of the loss is not more than a specified percentage of the taxpayer's basis in such shares, the IRS will treat such loss as not realized in a wash sale.

This proposed guidance is intended to mitigate tax compliance burdens that may result from proposed changes in the rules that govern the prices at which certain money market fund shares are issued and redeemed. The Securities and Exchange Commission (SEC) has issued proposed regulations to effect these changes. *See* Money Market Fund Reform, Securities Act Release No. 9408, Investment Advisors Act Release No. 3616, Investment Company Act Release No. 30,551, 78 Fed. Reg. 36834 (proposed June 5, 2013). The proposed revenue procedure is drafted as if the SEC had already adopted final rules addressing floating net asset value in substantially the same form as the proposed rules. If those rules are not adopted in substantially the same form as they have been proposed, the revenue procedure proposed by this notice may not be adopted or may be adopted in materially modified form.

REQUEST FOR COMMENTS

The Treasury Department and the IRS request comments on all aspects of the proposed revenue procedure. Consideration will be given to any written public comments that are submitted on or before October 28, 2013. A signed original and eight (8) copies of public comments should be sent by mail to Internal Revenue Service, CC:PA:LPD:PR (IRS Notice 2013-48), Room 5203, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Public comments also may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to the Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC 20224, Attn: CC:PA:LPD:PR (IRS Notice 2013-48). Comments also may be transmitted electronically to the following e-mail address: Notice.Comments@irscounsel.treas.gov. Please include "Notice 2013-48" in both the subject line of the e-mail and the body of the comment. All comments will be available for public inspection and copying.

DRAFTING INFORMATION

The principal author of this notice is Steven Harrison of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this notice, contact Mr. Harrison at (202) 622-3930 (not a toll-free call).

PROPOSED REVENUE PROCEDURE

SECTION 1. PURPOSE

This revenue procedure describes circumstances in which the Internal Revenue Service (IRS) will not treat a redemption of shares in a money market fund (MMF) as part of a wash sale for purposes of § 1091 of the Internal Revenue Code.

SECTION 2. BACKGROUND

.01 Money Market Funds

(1) An MMF is a type of investment company registered under the Investment Company Act of 1940 (1940 Act) and regulated as a money market fund under Rule 2a-7 under the 1940 Act (17 C.F.R. § 270.2a-7). Unlike other types of mutual funds, MMFs have historically sought to keep stable (typically at $1.00) the prices at which their shares are issued and redeemed. The types of securities that MMFs are permitted to hold and the share-pricing and valuation methods specific to MMFs have made stable prices possible.

(2) To be treated as an MMF, an investment company must meet the requirements specified in Rule 2a-7, which, among other things, establishes limitations as to the maturity, quality, diversification, and liquidity of an MMF's investments. Generally, an MMF must hold a diversified portfolio of short-term, low-risk securities. The securities that an MMF holds generally result in no more than minimal fluctuations in the MMF's net asset value.

(3) Previously, an MMF meeting the requirements of Rule 2a-7(c) was permitted by that provision to compute its price per share for purposes of issuance and redemption

by using either or both of (a) the amortized cost method of valuation and (b) the penny-rounding method of pricing. Under the amortized cost method, an MMF's net asset value is determined by treating the fund's portfolio securities as having a value equal not to their then-current fair market value but rather to their acquisition cost, adjusted for amortization of premium or accretion of discount. Under the penny-rounding method, an MMF's net asset value per share is rounded to the nearest one percent. These methods generally enabled MMFs to maintain constant share prices except in situations in which the amortized cost method or penny-rounding method resulted in a variation in share price that exceeded one-half of one percent (commonly called "breaking the buck").

(4) The perceived safety and simplicity of MMFs have led to their widespread use as cash management vehicles. It is therefore common for investors to purchase and redeem MMF shares frequently. An MMF is often used as a sweep account into which cash is automatically deposited on a daily basis. MMFs generally declare dividends daily and distribute them monthly. MMF shareholders typically reinvest these distributions automatically in the MMF.

(5) The Securities and Exchange Commission (SEC) has limited the situations in which an MMF is permitted to use the amortized cost method to those in which other mutual funds are permitted to use this method. [Cite final SEC rules.] In addition, the SEC has restricted the use of the penny-rounding method to government MMFs and

retail MMFs.[1] In the case of an MMF that is neither a government MMF nor a retail MMF, Rule 2a-7 now requires the MMF to value its portfolio securities using market-based factors and to issue and redeem shares at a price that is rounded to the nearest basis point, or one one-hundredth of one percent (basis point rounding).[2]

(6) An MMF that uses market factors to value its securities and uses basis point rounding to price its shares for issuance and redemption will have a share price that changes frequently, or "floats" (a floating-NAV MMF). A floating-NAV MMF will therefore resemble other mutual funds that are not MMFs, except for the restrictions on the assets that an MMF is permitted to hold and the unique role that MMFs have historically occupied.

(7) Constant share prices have simplified the taxation of MMF share transactions because a shareholder does not realize gain or loss when a share is redeemed for an amount equal to its basis. Shareholders will typically realize gain or loss, however, on redemptions of floating-NAV MMF shares. In certain circumstances, a loss realized on the redemption of an MMF share may implicate the wash sale rules of § 1091, as discussed in section 2.02 of this revenue procedure.

(8) Sections 6045, 6045A, and 6045B establish certain reporting requirements relating to securities. Each of those sections has an exception for an MMF that stabilizes its share price at a constant amount that approximates its issue price or the

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[1] A government MMF is an MMF that maintains at least 80 percent of its assets in cash and certain government securities and repurchase agreements. A retail MMF is an MMF that limits each shareholder's redemptions to $1 million per business day.

[2] The SEC has also amended Rule 2a-7 to require every MMF to disclose daily the fund's current net asset value (NAV) per share rounded to the nearest basis point, but government and retail MMFs are not required to use basis point rounding to issue and redeem shares.

price at which it was originally sold to the public. *See* §§ 1.6045-1(c)(3)(vi), 1.6045A-1(a)(1)(v), and 1.6045B-1(a)(5) of the Income Tax Regulations. A floating-NAV MMF that does not stabilize its share price at a constant amount is not eligible for those exceptions. Sections 6045, 6045A, and 6045B, however, also contain exceptions for certain transactions involving exempt recipients, which include subchapter C corporations and certain other entities. *See* §§ 1.6045-1(c)(3)(i), 1.6045A-1(a)(1)(iii), and 1.6045B-1(a)(4). Most shareholders of floating-NAV MMFs are expected to be exempt recipients, which will reduce reporting obligations for transactions in floating-NAV MMF shares.

.02 Wash Sale Rules

(1) Section 1091(a) disallows a loss realized by a taxpayer on a sale or other disposition of shares of stock or securities if, within a period beginning 30 days before and ending 30 days after the date of such sale or disposition, the taxpayer acquires (by purchase or by an exchange on which the entire amount of gain or loss is recognized by law), or enters into a contract or option to so acquire, substantially identical stock or securities (unless the taxpayer is a dealer in stock or securities and the loss is sustained in a transaction made in the ordinary course of such business).

(2) Under § 1091(d), a taxpayer's basis in the property the acquisition of which resulted in the nondeductibility of a loss under § 1091(a) equals the basis of the stock or securities disposed of, increased or decreased to take into account any difference between the price at which the replacement property was acquired and the price at which the original stock or securities were disposed of.

(3) A shareholder that redeems shares in a floating-NAV MMF may realize a loss on the redemption. Moreover, because many MMF shareholders engage in frequent purchases of MMF shares (including purchases made as a result of sweep arrangements and reinvestments of distributions), a shareholder that realizes a loss on a redemption of MMF shares will often acquire shares in that MMF within 30 days before or after the redemption.

(4) Redemptions of shares of MMFs, which have relatively stable values even when share prices float, do not give rise to the concern that § 1091 is meant to address. Moreover, given the expected volume of transactions in MMF shares, tracking wash sales of MMF shares will present shareholders of floating-NAV MMFs with significant practical challenges. Therefore, it is in the interest of sound tax administration to prescribe circumstances in which the IRS will not treat a redemption of these MMF shares as part of a wash sale under § 1091. Those circumstances are set forth in sections 3 and 4 of this revenue procedure.

SECTION 3. SCOPE

This revenue procedure applies to a redemption of one or more shares in an investment company registered under the 1940 Act if—

.01 The investment company is regulated as an MMF under Rule 2a-7 and holds itself out to the public as an MMF; and

.02 At the time of the redemption, the investment company is a floating-NAV MMF.

SECTION 4. APPLICATION

.01 If a redemption is within the scope of section 3 of this revenue procedure and results in a *de minimis* loss, the IRS will not treat such redemption as part of a wash sale. Therefore, § 1091(a) will not disallow the deduction for the resulting *de minimis* loss in the year realized and § 1091(d) will not cause the basis of any property to be determined by reference to the basis of the redeemed shares.

.02 Solely for purposes of section 4.01 of this revenue procedure, the term *de minimis* loss means a loss realized upon a redemption of a share of stock of an MMF the amount of which (expressed as a positive number) is not more than one half of one percent (0.5%) of the taxpayer's basis in that share.

.03 In determining whether a loss is a *de minimis* loss within the meaning of section 4.02 of this revenue procedure, a taxpayer must use the same basis determination method and lot selection method under § 1012 and the regulations thereunder that the taxpayer uses to determine the amount of its gain or loss for purposes of calculating taxable income.

EXAMPLES

.01 Example 1. (1) Fund is an MMF that meets the requirements of Rule 2a-7 under the 1940 Act and holds itself out to the public as an MMF. Fund is a floating-NAV MMF at all times during year 1. Before September 1 of year 1, Taxpayer, a domestic corporation that is taxable under subchapter C of Chapter 1 of the Internal Revenue Code, holds no shares of Fund. On September 1 of year 1, Taxpayer invests $1,000,000.00 in Fund when Fund's price per share is $1.0000, receiving in return 1,000,000 shares of Fund. On October 1 of year 1, Taxpayer invests an additional $250,000.00 in Fund when Fund's price per share is $1.0005, receiving in return

249,875.06 shares, which Taxpayer holds in the same account. On October 15 of year 1, Taxpayer redeems $200,000.00 of Fund shares from the same account when Fund's price per share is $0.9980. Taxpayer engages in no other transactions in Fund shares or any substantially identical shares or securities during year 1. Fund is a regulated investment company within the meaning of § 1.1012-1(e)(5) and Taxpayer uses the average basis method to determine the basis of its shares.

(2) Taxpayer's average basis in each Fund share increased to $1.0001 when Taxpayer purchased 249,875.06 shares on October 1 ($1,250,000.00 total purchase price divided by 1,249,875.06 shares). Based on Fund's market NAV on October 15, Taxpayer redeemed 200,400.80 shares to receive $200,000.00 in proceeds. Taxpayer therefore realizes a loss of $420.83 on the October 15 redemption (proceeds of $200,000.00 minus basis of $200,420.83 in redeemed shares), or a loss of $.0021 per share (proceeds of $.9980 per share minus basis of $1.0001 per share). This loss is a *de minimis* loss under section 4.02 of this revenue procedure because the loss of $.0021 per share is less than $.0050 per share (.5% of $1.0001). Therefore, under section 4.01 of this revenue procedure, the IRS will not treat the loss on each Fund share as subject to current disallowance under § 1091.

.02 <u>Example 2</u>. (1) The facts are the same as in Example 1, except that Fund's price per share at the time of the October 15 redemption is $0.9940.

(2) As in Example 1, Taxpayer's average basis in each Fund share is $1.0001 after the second purchase. Based on Fund's market NAV on October 15, Taxpayer redeemed 201,207.24 shares to receive $200,000.00 in proceeds. Taxpayer therefore

realizes a loss of $1,227.36 on the October 15 redemption (proceeds of $200,000 minus basis of $201,227.36 in redeemed shares), or a loss of $.0061 per share (proceeds of $.9940 per share minus basis of $1.0001 per share). Because the loss of $.0061 per share is more than $.0050 per share (.5% of $1.0001), Taxpayer's loss is not a *de minimis* loss under section 4.02 of this revenue procedure and is subject to current disallowance under § 1091. The entire loss is disallowed under § 1091(a) because Taxpayer purchased more than 201,207.24 shares on October 1.

(3) Taxpayer's basis in its Fund shares after the application of § 1091(a) is determined as follows. First, Taxpayer's basis in 201,207.24 of the 249,875.06 shares it purchased on October 1 is increased to $202,454.71 (Taxpayer's $201,227.36 basis in the sold shares, increased by $1,227.36, which is the difference between the $201,227.36 basis in the replacement shares and the $200,000.00 received for the sold shares). Second, the average basis of all Fund shares held by Taxpayer is determined by dividing Taxpayer's total basis in its Fund shares of $1,050,000.00 (the sum of the $202,454.71 basis in the replacement shares computed above and the $847,545.29 basis in the remaining 847,460.58 shares) by Taxpayer's total remaining Fund shares of 1,048,667.82. Accordingly, Taxpayer's average basis in each Fund share on October 15, year 1 is $1.0013.

SECTION 5. EFFECTIVE DATE

[RESERVED]

SECTION 6. DRAFTING INFORMATION

The principal author of this revenue procedure is Steven Harrison of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue procedure contact Mr. Harrison at (202) 622-3930 (not a toll free call).