

# Investment Management Tax

Stradley Ronon's national tax practice group provides advice on a range of corporate and business law issues, with a special focus on the federal and state tax issues relating to domestic and investment companies and other commingled investment vehicles. We offer guidance on the taxation and operation of regulated investment companies (RICs) and their foreign wholly owned derivatives-trading subsidiaries (controlled foreign corporations or CFCs). The tax group also advises on exchange-traded funds (ETFs), private investment funds, real estate investment trusts (REITs), real estate mortgage investment conduits (REMICs), fixed investment trusts, collective trust funds, Section 529 plans and various charitable collective funds, among other pooled vehicles.

We assist in the formation of funds, issue tax opinions in connection with fund mergers and reorganizations, and advise on the taxation of financial instruments and derivatives held by such entities.

Collaborating with our nationally recognized investment company practice, the tax group regularly advises on both basic and complex issues.

## BASIC INVESTMENT COMPANY TAX ADVICE

Among the many issues we advise on are:

- The "90 percent good income" and "RIC diversification" tests, their application to commodities and related derivatives, and the related use of CFCs, including:
  - issuance of a tax opinion documenting that investments in senior loans give rise to qualifying income; issuance of a tax opinion that foreign currency gains realized by a currency fund are qualifying income;
  - obtaining a private letter ruling that investments in consumer price index (CPI) swaps give rise to qualifying income in a master-feeder arrangement;
- issuance of a tax opinion documenting use of various derivatives for other than hedging purposes gives rise to qualifying income;
- issuance of a tax opinion that income from a Cayman Islands offshore CFC formed to invest in commodity-linked derivatives gives rise to qualifying income (including review and comment on the various Cayman fund documents and structure); and
- preparation of a comprehensive analysis of a variety of derivative financial instruments identifying the issuer and valuation of such instruments for asset diversification purposes).

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- Section 19(a) and Section 19(b) of the 1940 Act issues (e.g., seeking relief for a special capital gains dividend; review and comment on draft Section 19(a) notices and corrections of notices).
- Commodity and other tax risk disclosure in registration statements; drafting of tax sections in summary prospectuses, statutory prospectuses and statements of additional information (SAI).
- Issues affecting holdings in passive foreign investment companies (PFICs) (e.g., the tax effects of distributing PFIC stock in a redemption in kind; obtaining private letter rulings for late Section 1296 mark-to-market

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- elections; and identifying whether certain securities qualify as PFICs).
- Reviewing and editing the annual tax booklet and FAQs posted to a sponsor's website.
- Dividend policies, including standing dividend resolutions, excise tax rules, tax equalization and preferential dividends.
- Posting Forms 8937 on sponsor websites regarding organizational action that affects the basis of fund shares.
- Mutual fund structures such as fund-of-funds, partnership and RIC master-feeders and wrap products; unwind of structures (including to minimize foreign tax and custody charges).
- Tax withholding and certification issues for U.S. and non-U.S. investors.
- Tax accounting rules such as market-to-market, wash sales, straddles and foreign currency gains and losses .
- The Foreign Account Tax Compliance Act (FATCA), including, for example, drafting FATCA disclosure provisions in various agreements relating to FATCA, and advising on the application of FATCA to CFCs organized in the Cayman Islands and to U.S. disregarded entities organized under the laws of Mauritius.
- Drafting of payee representations in International Security Dealers Association (ISDA) agreements and cleared derivative documentation; reviewing documentation for payees; advising on including a stated maturity date in repurchase agreements to qualify as a short-term obligation under Section 871(g).
- State tax issues.
- Processing closing agreements with the Internal Revenue Service relating to over-stated qualified dividend income, distribution failures and qualification failures.
- Issuing tax opinions in connection with various type C, D and F reorganizations, including drafting the tax sections in the N-14 and the Plan of Reorganization; performing a COBE analysis; and structuring transactions involving more than one mutual fund.
- Conversions of private funds to RICs, including drafting transfer agreements and structuring such transactions to be tax free for federal income tax purposes.

## REGISTERED FUND PRODUCT DEVELOPMENT

Among our more specialized tax services is our work with investment management clients in new product development to identify and solve tax constraints and promote tax efficiency.

For registered funds, we have:

- Restructured an institutional fund group in order to externalize fees.
- Structured a real estate fund that invests, in part, in real estate through a captive REIT.
- Structured a fund that obtains exposure to various markets through derivatives for other than hedging purposes and, when it's necessary, to hold derivatives through a Cayman Islands offshore CFC.
- Structured an MLP fund as a C corporation to avoid unrelated business taxable income for tax-exempt investors, effectively connected income for foreign investors and enabled the fund to issue Forms 1099 in lieu of Schedule K-1s; tax risk disclosure regarding incurrence of federal income tax and deferred tax assets/liabilities; tax issues arising on lending of MLP securities.

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- Issued a tax opinion that a distribution of securities in-kind by an index ETF in a redemption transaction in connection with the rebalancing of the ETF's portfolio results in no gain under IRC Section 852(b).
- Analyzed Wisconsin and Illinois income and franchise taxes in connection with organization of new closed-end funds.
- Analyzed and advised on restructuring a retail commodity fund (RIC) with a Cayman CFC into a master-feeder structure to accommodate foreign feeders.

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