DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1
[TD 9774]
RIN 1545–BM04
Method of Accounting for Gains and Losses on Shares in Money Market Funds; Broker Returns With Respect to Sales of Shares in Money Market Funds

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that provide a simplified method of accounting for gains and losses on shares in money market funds (MMFs). The final regulations also provide guidance regarding information reporting requirements for shares in MMFs. The final regulations respond to Securities and Exchange Commission (SEC) rules that change the amount for which certain MMF shares are distributed, redeemed, and repurchased. The final regulations affect MMFs and their shareholders.

DATES: Effective date: These regulations are effective on July 8, 2016.

Applicability dates: For the dates of applicability, see §§ 1.446–7(e) and 1.6045–1(c)(3)(vi)(B).

FOR FURTHER INFORMATION CONTACT: Grace Cho at (202) 317–6895 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background


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). MMFs have historically sought to keep stable 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). MMFs meeting the requirements of Rule 2a–7 have been permitted to value their assets based on the assets’ cost, with certain adjustments (amortized cost method), and to price their shares by rounding the resulting NAV to the nearest 1 percent (penny rounding). These methods have enabled MMFs to maintain constant share prices in almost all circumstances. Because most MMFs target a $1.00 share price, an MMF that fails to maintain a constant share price is said to “break the buck.”

The SEC MMF Reform Rules generally bar the use of the amortized cost method and penny rounding for certain MMFs (floating-NAV MMFs) and require a floating-NAV MMF to value its assets using market factors and to round its price per share to the nearest basis point (the fourth decimal place, in the case of a fund with a $1.0000 share price). Certain government-security-focused MMFs (government MMFs) and certain MMFs the beneficial owners of which are limited to natural persons (retail MMFs) may continue to use the amortized cost method and penny rounding. (A government MMF or retail MMF that continues to use the amortized cost method and penny rounding is called a stable-NAV MMF.) The SEC MMF Reform Rules also establish circumstances under which an MMF is permitted or required to impose a liquidity fee or is permitted to impose a redemption gate. When an MMF has a liquidity fee in effect, the liquidity fee reduces the proceeds received by all redeeming shareholders. A redemption gate is the temporary suspension of redemptions of shares in the MMF. Liquidity fees and redemption gates

1 Note that the term “NAV” is used throughout this document to indicate the per-share amount that may be described elsewhere as “NAV per share.”
may be imposed by both floating-NAV MMFs and stable-NAV MMFs. An MMF other than a government MMF is required to impose a liquidity fee in certain circumstances, unless the fund’s board of directors determines that such a fee is not in the best interests of the fund.

The Treasury Department and the IRS published a notice of proposed rulemaking and notice of public hearing (REG-107012-14) in the Federal Register on July 28, 2014 (79 FR 43694). The proposed regulations described a simplified method of accounting for gain or loss on shares in a floating-NAV MMF (the net asset value method, or NAV method). Under the NAV method, a taxpayer’s gain or loss on shares in an MMF is based on the change in the aggregate value of the taxpayer’s shares during a computation period selected by the taxpayer and on the net amount of the purchases and redemptions during the computation period. The proposed regulations also provided guidance regarding information reporting requirements for shares in MMFs. A request for a public hearing was received, and the hearing was held on November 19, 2014. The IRS received written comments responding to the proposed regulations regarding the method of accounting for gains and losses on shares in MMFs. The written comments are available for public inspection at http://www.regulations.gov or upon request.

After considering the comments, the Treasury Department and the IRS adopt the proposed regulations regarding the method of accounting as final regulations with the modifications described in this Treasury decision. No comments were received on the portion of the proposed regulations that would revise § 1.6045–1(c)(3)(vi) to clarify that the exceptions under sections 6045, 6045A, and 6045B continue to apply to all MMFs, including floating-NAV MMFs. The Treasury Department and the IRS adopt the proposed regulations revising § 1.6045–1(c)(3)(vi) as final regulations without substantive change.

**Summary of Comments and Explanation of Revisions**

1. **Application of the NAV Method to Stable-NAV MMFs**

Under the proposed regulations, the NAV method would apply only to floating-NAV MMF shares. In the preamble to the proposed regulations, the Treasury Department and the IRS requested comments regarding whether the NAV method should be a permissible method of accounting for stable-NAV MMF shares. Although stable-NAV MMFs seek to maintain constant share prices, there are circumstances in which shares in a stable-NAV MMF will give rise to gain or loss. On rare occasions, shares in a stable-NAV MMF may be redeemed at a price other than the target price, such as when the MMF breaks the buck. In addition, a stable-NAV MMF may impose liquidity fees, which will generally result in the realization of a loss by a redeeming shareholder. If the acquisition of other shares causes such a redemption to be a wash sale under section 1091, section 1091(d) will generally cause the basis of the acquired shares to exceed the cost of the shares. Because the price of a stable-NAV MMF share rarely changes, any disposition of those acquired, higher-basis shares will likely result in another loss, which also may be deferred by the wash sale rules. Therefore, even if a liquidity fee is in effect for only one redemption by a shareholder and the share price of the MMF remains constant, that fee may cause a difference between the basis and value of the shareholder’s MMF shares that persists indefinitely. Determining gain or loss on the basis of the transaction in a stable-NAV MMF, taking into account the wash sale rules, would impose significant burdens on shareholders under these circumstances. To eliminate those burdens, a shareholder might need to terminate the shareholder’s entire interest in the affected MMF (and not initiate a new position until after the end of the period described in section 1091(a)). Commenters recommended that the NAV method be applicable not only to shares in floating-NAV MMFs but also to shares in stable-NAV MMFs. The commenters added that many shareholders of stable-NAV MMFs may be retail shareholders (generally, individuals) who are likely to rely upon the cost basis reporting provided by funds or brokers for their other mutual funds. Those individuals are unlikely to have the systems necessary to record gains and losses and to track wash sales and the resulting basis adjustments. The NAV method would reduce the complexity, and any tax-based motivation to terminate investments in MMFs, that would result from the imposition of a liquidity fee by a stable-NAV MMF. Under the NAV method, any loss that resulted from the imposition of a liquidity fee by an MMF would be determined for a shareholder’s entire interest in the MMF (or in an account) for the appropriate taxable year (or computation period) rather than for a single transaction. Therefore, the wash sale rules would not defer the loss. The NAV method also requires fewer and simpler computations than traditional accounting, even if there are no wash sales. For the years after an MMF breaks the buck or imposes a liquidity fee, the NAV method simplifies recordkeeping, because the gain or loss for each year is based on changes in the NAV during that year. Therefore, the final regulations permit taxpayers to apply the NAV method to shares in stable-NAV MMFs.

2. **Consistency Requirement**

The proposed regulations would provide that if a taxpayer applies the NAV method to shares in any MMF for a taxable year, the taxpayer must apply the NAV method to its shares in all MMFs for which that method is permissible.

Commenters requested that the final regulations permit taxpayers to apply different methods to shares in different MMFs or to shares in a single MMF held in different accounts. Commenters said that some taxpayers may receive sufficient information regarding their shares in certain MMFs to compute gain or loss realized on each transaction and that those taxpayers should be permitted to compute gain or loss realized on each transaction for those MMFs.

Commenters also noted that taxpayers may hold shares in a single MMF through different kinds of accounts (for example, an account with a broker and an account with the MMF itself) and may receive different information for the different accounts. The commenters recommended that, because of that possibility, taxpayers should be permitted to use different accounting methods for shares held in different accounts. Commenters also noted that many MMF shareholders will be large institutional investors, which might hold shares in the same MMF through separate accounts controlled by different divisions.

In response to these comments, the final regulations 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.

3. **Choosing NAV Method Computation Periods for RIC Excise Tax Purposes**

Under the NAV method, computation periods are the periods that a taxpayer selects for computing gain and loss for an MMF. The proposed regulations would provide 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.

Most regulated investment companies (RICs) must pay an excise tax under section 4982 if they do not make the required distribution described in section 4982(b) for a calendar year. The required distribution is generally 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 one-year period ending on October 31 of the calendar year. A commenter requested clarification that a RIC that holds MMF shares may use the NAV method for excise tax computations. That commenter also requested that the Treasury Department and the IRS confirm that a RIC that uses the NAV method is permitted to use the one-year period from November 1 to October 31 as its computation period for excise tax purposes. The commenter explained that RICs generally account for items that are marked to market using two different one-year periods for income tax and excise tax purposes. The commenter explained that, under section 4982(e)(2)(A), the term “capital gain net income” when used in section 4982 is determined by treating the one-year period ending on October 31 of any calendar year as the company’s taxable year.

The Treasury Department and the IRS agree that the NAV method should be applicable for purposes of the computations required by section 4982 and that the taxable year for purposes of those computations should be the relevant period under section 4982(e). The final regulations adopt this change.

The final regulations, however, require a RIC to be consistent in applying the NAV method to MMF shares for income tax and excise tax purposes. For each MMF in each account, the final regulations generally require a RIC to use the NAV method either for both income tax and excise tax computations or for neither computation. The final regulations also clarify how a RIC may change to or from the NAV method.

The final regulations require a RIC to use the same computation periods for purposes of both excise tax and income tax computations. Therefore, under the final regulations, a RIC using the NAV method for its shares in an MMF generally treats the one-year period for which gain or loss from the MMF would be included in the amount determined under section 4982(e)(2) or (e)(6) (the section 4982 period) like a taxable year in applying the NAV method to determine the RIC’s required distribution under section 4982(b).2 The RIC, however, may not use the section 4982 period as a computation period for excise tax purposes if the section 4982 period contains days from more than one income tax year.3 Instead, in this situation, the RIC must divide the section 4982 period into at least two computation periods so that each computation period contains days from only one income tax year. Similarly, the RIC may not use its full income tax year as a computation period for income tax purposes if the year contains days from more than one period ending on October 31 of the calendar year. These consistency requirements simplify and clarify the interaction of sections 852(b) and 4982.

The final regulations eliminate the requirement that computation periods be of approximately equal duration. The Treasury Department and the IRS do not believe that this requirement is essential to the operation of the NAV method, and eliminating the requirement will allow taxpayers more flexibility. In particular, permitting computation periods of unequal duration will reduce the burden on RICs of complying with the requirement of consistent computation periods for income and excise tax purposes. For example, a RIC that applies the NAV method to its shares in an MMF (held as a capital asset) and that has an income tax year ending on January 31 may meet the consistency requirements with two computation periods of unequal duration—one ending on January 31 and the other on October 31. The RIC also may use additional computation periods ending on other dates, such as December 31.

4. Clarification of Certain Amounts

A. Fair Market Value of MMF Shares

Under the proposed regulations, gain and loss under the NAV method would be determined by reference to the fair market value of MMF shares. Commenters requested that the Treasury Department and the IRS clarify that the fair market value of an MMF share for purposes of determining the fair market value of MMF shares surrendered or received in a redemption or exchange, the presumption generally applies to the NAV (other redemption amount) used to determine the consideration received in the transaction, or if the consideration is not based on a published NAV (other redemption amount), the first NAV (or other redemption amount) published for the MMF shares after the transaction. If no NAV (or other redemption amount) is published, or if facts and circumstances indicate that the NAV (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.

B. Aggregate Amount Received

Under the proposed regulations, 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. A commenter suggested that the final regulations clarify that the aggregate amount received is based on: (i) if cash is received, the cash proceeds, (ii) if shares in another MMF are received, the published NAV of the shares received as of the end of the day on which the redemption or exchange occurs (or the next trading day, if the day in question is not a trading day), or (iii) if other non-cash property is received, the NAV of the redeemed or exchanged shares as of the end of the day on which the redemption or exchange occurs (or the next trading day if the day in question is not a trading day or, if the fund will
not publish a NAV on or after the end of the day on which the redemption or exchange occurs, the fund’s last published NAV).

The final regulations include provisions for determining the amount received for purposes of computing a taxpayer’s net investment in an MMF for a computation period. If the consideration received in exchange for an MMF share consists only of cash, other MMF shares, or both, the amount received is the amount of any cash plus the fair market value of any MMF shares received. 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.

The same commenter recommended that a phrase in § 1.446–7(b)(5)(i)(B) of the proposed regulations, “if the transaction is one in which gain or loss would be recognized,” be clarified to indicate that it refers to recognition of gain or loss other than pursuant to the NAV method. The final regulations make this clarification.

C. Substituted Basis

Under the proposed regulations, a taxpayer’s net investment would increase if, during the computation period, the taxpayer acquired any shares in an MMF other than by purchase. In such cases, the net investment increases by the adjusted basis (for purposes of determining loss) of each such share immediately after its acquisition. The proposed regulations would also provide that if that adjusted basis would be determined by reference to the basis of one or more shares in an MMF that are being disposed of by the taxpayer in a transaction in which gain or loss is not recognized (exchanged basis), then the basis of each such disposed share is treated as being the fair market value of that share at the time of its disposition. A commenter noted that the proposed regulations do not address a situation in which the shareholder receives a transferred basis in MMF shares acquired from another person. The commenter suggested that, in that situation, if the person from whom the shareholder acquired the shares used the NAV method, then the adjusted basis of the acquired shares should be treated as the published NAV applicable to the acquisition date.

The final regulations clarify the effect on net investment of a share acquired from another person with a transferred basis. Similar to the commenter’s suggestion, the final regulations provide that, if 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, which value is presumed to be the next NAV (or other redemption amount) published by the MMF.

5. MMF Accounts With Shares of Mixed Character

The proposed regulations would provide that if a taxpayer uses the NAV method for shares in an MMF and each of those shares otherwise would give rise to capital gain or loss if sold or exchanged in a computation period, then the gain or loss from the shares in the MMF is treated as capital gain or loss under the NAV method. Likewise, if each of the shares otherwise would give rise to ordinary gain or loss if sold or exchanged in a computation period, then the gain or loss is treated as ordinary gain or loss. If, however, the sale of all the shares in the MMF would give rise to a combination of ordinary gain or loss and capital gain or loss if sold or exchanged in a computation period, then all gain or loss from the shares in the MMF is treated as capital gain or loss.

A commenter noted that the proposed regulations do not explain why all gain or loss should be treated as capital in the case of an account containing MMF shares of mixed character. The commenter recommended that the character of gain or loss with respect to a mixed character account be bifurcated based on the portion of the shares that would generate gain or loss of each character.

The Treasury Department and the IRS believe that it is rare for a shareholder to hold shares of a single MMF the disposition of which would produce a mix of ordinary income and capital gain. Under that circumstance, a taxpayer may use different accounts to preserve the character of the shares that would produce ordinary income and capital gain. The purpose of the NAV method is to provide an alternative to traditional accounting for taxpayers seeking simplicity. The rationale for offering a method solely for MMFs is that the value of MMFs fluctuates so little that simplicity is more important than tracking each individual gain or loss. A rule that bifurcates gain or loss based on the value of the shares in a single account, when those values may change during a computation period, would make the NAV method more complex. That additional complexity is not warranted in light of the rarity of the circumstance the proposed bifurcation would address and the ability of shareholders to prevent the treatment of all gain or loss as capital by using separate accounts. Therefore, the final regulations retain the simplifying rule for mixed-character accounts.

6. Other Requests and Comments

A. Wash Sale Rules Exemption for Stable-NAV MMFs

Concurrently with the release of the proposed regulations, the Treasury Department and the IRS released Rev. Proc. 2014–45 (2014–34 IRB 388), which provides that the wash sale rules in section 1091 will not be applied to redemptions of shares in floating-NAV MMFs. Commenters requested that the wash sale exemption, which is limited to floating-NAV MMFs, be extended to stable-NAV MMFs that impose liquidity fees.

The final regulations permit shareholders of stable-NAV MMFs to use the NAV method. A shareholder who uses the NAV method would not require an exemption from the wash sale rules because under the NAV method, net gain or loss is determined for each computation period, and no gain or loss is determined for any particular redemption of a taxpayer’s shares in an MMF. Without a determination of loss for a particular redemption, that redemption does not implicate the wash sale rules. Because taxpayers may use the NAV method to prevent wash sales, the Treasury Department and IRS are not extending the exemption in Rev. Proc. 2014–45 to stable-NAV MMFs.

B. Other Requests

A commenter requested that the Treasury Department and the IRS issue guidance regarding the tax treatment of an MMF’s receipt of financial support from an investment adviser to raise the NAV of the MMF (determined without the amortized cost method or penny rounding) to $1.0000. In addition, the commenter requested guidance regarding the diversification requirements of section 817(h) for a segregated asset account that qualifies as, or invests in, a government MMF. On May 5, 2016, the Treasury Department and the IRS released guidance related to both of these requests. See Rev. Proc. 2016–31 (2016–21 IRB 988); Notice 2016–32 (2016–21 IRB 878).

The commenter also requested (and later withdrew its request) that the Treasury Department and the IRS issue guidance providing tax-free treatment for certain divisions of MMFs into retail and institutional MMFs. The Treasury Department and the IRS have
determined that this guidance does not appear essential to an orderly separation of different types of shareholders into different MMFs.

The commenter also requested that the Treasury Department and the IRS issue guidance setting forth the proper tax treatment by an MMF of liquidity fees that the MMF imposes. In addition, the commenter requested guidance providing that, if an MMF imposes liquidity fees and subsequently distributes to shareholders amounts that correspond to amounts that the MMF retained as liquidity fees, the MMF will be deemed to have sufficient earnings and profits to treat the distribution as a dividend. These requests do not relate directly to the NAV method or to the information reporting provision in the proposed regulations and so are not addressed in these final regulations. The Treasury Department and the IRS may consider guidance on these questions in the future.

7. Accounting Method Changes

As under the proposed regulations, a taxpayer may adopt the NAV method for shares in a floating-NAV MMF by use of the method in the Federal income tax return for the first taxable year in which both (1) the taxpayer holds shares in that MMF and (2) that MMF is a floating-NAV MMF.

The final regulations provide that a taxpayer seeking to change to or from the NAV method must secure the consent of the Commissioner in accordance with \(1.446-1(e)\). Simultaneously with the publication of these regulations, the Treasury Department and the IRS are issuing Rev. Proc. 2016–39 (2016–30 IRB), which provides the procedures by which a taxpayer may obtain automatic consent to change to or from the NAV method for shares in an MMF.

In certain circumstances, Rev. Proc. 2016–39 permits taxpayers to change to the NAV method on a federal tax return without filing a Form 3115, “Application for Change in Accounting Method.” This simplified procedure applies to a taxpayer that holds shares in a stable-NAV MMF and wants to change to the NAV method for a taxable year if (1) the taxpayer has not used the NAV method for shares in the MMF for any taxable year prior to the year of change, and (2) prior to the beginning of 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. For certain other changes, Rev. Proc. 2016–39 provides 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.

Effective/Applicability Dates

The final regulations concerning the NAV method 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, however, shareholders of MMFs may rely either on the rules concerning the NAV method in the proposed regulations or on the final regulations.

The final regulations concerning information reporting apply to sales of shares in calendar years beginning on or after July 8, 2016. Taxpayers and brokers (as defined in § 1.6045–1(a)(1)), however, may rely on the rules in the regulations concerning information reporting for sales of shares in calendar years beginning before July 8, 2016.

Statement of Availability for IRS Documents


Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply.

Pursuant to section 7805(f) of the Code, the proposed regulations preceding these final regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small businesses. No comments were received.

Drafting Information

The principal author of the final regulations is Grace Cho, IRS Office of the Associate Chief Counsel (Financial Institutions and Products). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES


Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.446–7 also issued under 26 U.S.C. 446.

Par. 2. Section 1.446–7 is added to read as follows:

§ 1.446–7 Net asset value method for certain money market fund shares.

(a) In general. This section provides a permissible method of accounting (the net asset value method, or NAV method) for gain or loss on shares in a money market fund (or MMF).

(b) Definitions. For purposes of this section—

(1) Computation period. Computation periods are the periods (of either equal or varying length) that a taxpayer selects for computing gain and loss under the NAV method for shares in an MMF. Computation periods must possess all of the following attributes:

(i) Every day during the taxable year falls within one, and only one, computation period;

(ii) Each computation period contains days from only one taxable year; and

(iii) If the taxpayer is a regulated investment company (RIC) that is not described in section 4982(f)—

(A) The same computation periods are used for purposes of both income tax accounting under chapter 1 and excise tax computations under section 4982; and

(B) The requirements in paragraphs (b)(1)(i) and (ii) of this section are also satisfied if applied by substituting the RIC’s section 4982 period for the RIC’s taxable year.

(2) Ending value. The ending value of a taxpayer’s shares in an MMF for a computation period is the aggregate fair market value of the taxpayer’s shares at the end of that computation period.

(3) Fair market value. The fair market value of a share in an MMF is determined as follows:
(i) Presumption based on applicable published redemption amount. For purposes of this section, the fair market value of a share in an MMF is presumed to be the applicable published redemption amount for the share.

(ii) Published redemption amount. The published redemption amount for a share in an MMF is the published amount for which the MMF would redeem the share (usually, the net asset value per share (NAV)), taking into account any corrections and not taking into account any liquidity fee described in Rule 2a–7(c)(2) under the Investment Company Act of 1940 (17 CFR 270.2a–7(c)(2)).

(iii) Applicable published redemption amount. The applicable published redemption amount is—

(A) For purposes of determining the ending value of a taxpayer’s shares in an MMF for a computation period under paragraph (b)(2) of this section, the last published redemption amount on the last day of that computation period; or

(B) For purposes of determining the value of MMF shares received in a redemption or exchange described in paragraph (b)(5)(iii)(A) of this section, the published redemption amount for such MMF shares used to determine the consideration received in the redemption or exchange, or if the consideration received is not based on a published redemption amount, the first published redemption amount for such MMF shares after the redemption or exchange;

(C) For purposes of determining the amount received in a redemption or exchange described in paragraph (b)(5)(iii)(B) of this section in which the consideration received is based on a published redemption amount for the redeemed shares, that published redemption amount; and

(D) For purposes of determining the amount received in an exchange described in paragraph (b)(5)(ii)(B) of this section that is not described in paragraph (b)(3)(iii)(C) of this section, or the amount of any adjustment resulting from a disposition transaction described in paragraph (b)(5)(iii) of this section, the first published redemption amount for the exchanged or disposed of MMF shares after the exchange or other transaction.

(iv) Facts and circumstances determination. If there is no applicable published redemption amount or if circumstances indicate that the 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 of the facts and circumstances.

(4) Method of fund (or MMF). An MMF is a regulated investment company that is permitted to hold itself out to investors as a money market fund under Rule 2a–7 under the Investment Company Act of 1940 (17 CFR 270.2a–7). See paragraph (c)(5) of this section for the treatment of shares in a single MMF held in more than one account.

(5) Net investment—(i) In general. The net investment in an MMF for a computation period may be a positive amount, a negative amount, or zero. Except as provided in paragraph (b)(5)(iii) of this section, the net investment is equal to—

(A) The aggregate cost of shares in the MMF purchased during the computation period (including purchases through reinvestment of dividends); minus

(B) The aggregate amount received during the computation period in redemption of (or otherwise in exchange for) shares in the MMF in transactions in which gain or loss would be recognized if the taxpayer did not apply the NAV method to the shares.

(ii) Adjustments. For purposes of paragraph (b)(5)(i)(B) of this section, the amount received in a redemption or exchange of an MMF share is—

(A) If no property other than cash and shares in one or more other MMFs is received, the amount of any cash plus the fair market value of any MMF shares received; or

(B) If any property other than cash or shares in one or more other MMFs is received, the fair market value of the redeemed MMF share.

(iii) Adjustments—(A) Dispositions in which gain or loss is not recognized. If, during the computation period, any shares in an MMF are disposed of in transactions in which gain or loss would not be recognized if the taxpayer did not apply the NAV method to the shares, the net investment in the MMF for the computation period is decreased by the fair market value of each such share at the time of its disposition.

(B) Acquisitions other than by purchase. If, during the computation period, any shares in an MMF are acquired other than by purchase, the net investment in the MMF for the computation period is increased by the adjusted basis (for purposes of determining loss) of each such share immediately after its acquisition. If the adjusted basis of an acquired share would be determined by reference to the basis of a share or shares in an MMF that are being disposed of by the taxpayer in a transaction that is governed by paragraph (b)(5)(iii)(A) of this section, then the adjusted basis of each such disposed share is treated for purposes of this section as being the fair market value of that share at the time of its disposition. If the adjusted basis of an acquired share would be determined by reference to the basis of that share in the hands of the person from whom the share is acquired and that person was applying the NAV method to the share at the time of the transaction, then the adjusted basis of the share in the hands of the person from whom the share is acquired is treated for purposes of this section as being the fair market value of that share at the time of the transaction.

(6) Section 4982 period. If a taxpayer using the NAV method is a RIC to which section 4982 applies, the section 4982 period is the one-year period with respect to which gain or loss is determined for purposes of section 4982(e)(2) and (e)(6). The preceding sentence is applied taking into account the application of section 4982(e)(4). See paragraph (c)(8) of this section regarding the application of section 4982(e)(6).

(7) Starting basis. The starting basis of a share in an MMF for a computation period is—

(i) Except as provided in paragraph (b)(7)(ii) of this section, the ending value of the taxpayer’s shares in the MMF for the immediately preceding computation period; or

(ii) For the first computation period in a taxable year, if the taxpayer did not use the NAV method for shares in the MMF for the immediately preceding taxable year, the aggregate adjusted basis of the taxpayer’s shares in the MMF at the end of the immediately preceding taxable year.

(c) NAV method—(1) Scope. A taxpayer may use the NAV method described in this section to determine the gain or loss for a taxable year on the taxpayer’s shares in an MMF. A taxpayer may have different methods of accounting, different computation periods, and gains or losses of differing character, for its shares in different MMFs. See paragraph (c)(5) of this section for the treatment of shares in a single MMF held in more than one account. See paragraph (c)(6) of this section for rules applicable to RICs to which section 4982 applies. See paragraph (c)(8) of this section for rules applicable to accounting method changes.

(2) Net gain or loss for a taxable year—(i) Determination for each computation period. Subject to any adjustment under paragraph (c)(2)(ii) of this section, the net gain or loss for each computation period with respect to the shares in an MMF to which the NAV method applies equals the ending value, minus the starting value, of the net investment in the MMF for the
computation period. If the computation produces a result that is greater than zero, the taxpayer has a gain for the computation period with respect to the shares in the MMF; if the computation produces a result that is less than zero, the taxpayer has a loss for the computation period with respect to the shares in the MMF; and if the computation produces a result that is equal to zero, the taxpayer has no gain or loss for the computation period with respect to the shares in the MMF.

(ii) Adjustment of gain or loss to reflect any basis adjustments. If, during a computation period, there is any downward (or upward) adjustment to the taxpayer's basis in the shares in the MMF under any provision of internal revenue law, then the net gain or loss for the computation period on shares in the MMF determined under paragraph (c)(2)(i) of this section is increased (or decreased) by the amount of the adjustment.

(iii) Timing of gains and losses. Gain or loss determined under the NAV method with respect to a taxpayer's shares in an MMF during a computation period is treated as arising on the last day of the computation period.

(iv) Determination of net gain or loss for each taxable year. The taxpayer's net gain or loss for a taxable year on shares in an MMF is the sum of the net gains or losses on shares in the MMF for the computation period (or computation periods) that comprise the taxable year.

(3) Character—(i) In the case of a taxpayer that applies the NAV method to shares in an MMF, the gain or loss with respect to those shares for a computation period is treated as ordinary gain or loss from a sale or exchange of a capital asset provided the sale or exchange of one or more of those shares during the computation period would give rise to capital gain or loss if the taxpayer did not apply the NAV method to the shares.

(ii) In the case of a taxpayer that applies the NAV method to shares in an MMF, the gain or loss with respect to those shares for a computation period is treated as ordinary gain or loss from a sale or exchange of a capital asset provided the sale or exchange of one or more of those shares during the computation period would give rise to capital gain or loss if the taxpayer did not apply the NAV method to the shares.

(iii) See paragraph (c)(5) of this section for the treatment of shares in a single MMF held in more than one account.

(4) Holding period. Capital gains and losses determined under the NAV method are treated as short-term capital gains and losses.

(5) More than one account. If a taxpayer holds shares in an MMF through more than one account, the taxpayer must treat its holdings in each account as a separate MMF for purposes of this section. A taxpayer therefore may have different methods of accounting, different computation periods, and gains or losses of differing character, for its shares of a single MMF held in different accounts.

(6) Consistency requirement for MMF shareholders that are RICs. If the taxpayer is a RIC that is not described in section 4982(f) (and therefore is subject to the section 4982 excise tax), then, for each MMF, the taxpayer must use the NAV method for both income tax and excise tax computations or for neither computation. See paragraph (c)(5) of this section for the treatment of shares in a single MMF held in more than one account. See paragraph (c)(8)(ii) of this section for changes to or from the NAV method by a RIC.

(7) Treatment of ordinary gains and losses under section 4982(e)(6). Under section 4982(e)(6)(B), this section is a specified mark to market provision, and therefore any ordinary gains and losses determined under the NAV method are governed by section 4982(e)(6)(A).

(8) Accounting method changes—(i) In general. A change to or from the NAV method is a change in method of accounting to which the provisions of section 446 and the accompanying regulations apply. 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) and follow the administrative procedures issued under § 1.446–1(e)(3)(ii) for obtaining the Commissioner's consent to change the taxpayer's accounting method. Any such change will be made on a cut-off basis. Because there will be no duplication or omission of amounts as a result of such a change to or from the NAV method, no adjustment under section 481(a) will be required or permitted.

(ii) RICs—(A) In general. A RIC that is subject to the excise tax under section 4982 and that changes to or from the NAV method for its shares in an MMF for income tax purposes must apply the new method for excise tax purposes starting with the first day of the RIC's income tax year of change. If that first day is not the first day of the RIC's section 4982 period that ends in or with the RIC's income tax year, then solely for purposes of applying the NAV method to compute the RIC's required distribution for the calendar year that ends with or within the RIC's income tax year of change, the section 4982 period is bifurcated into two portions, each of which is treated as a separate taxable year. The first portion begins on the first day of the section 4982 period and ends on the last day of the RIC's income tax year that precedes the year of change. The second portion begins on the first day of the income tax year of change and ends on the last day of the section 4982 period.

(B) Example. If a RIC that holds MMF shares as capital assets changes from a realization method to the NAV method for its income tax year ending January 31, 2019, the section 4982 period is bifurcated into two portions that are treated as separate taxable years solely for purposes of applying this section. For the portion starting on November 1, 2017, and ending on January 31, 2018, the RIC applies its realization method for excise tax purposes. For the portion starting on February 1, 2018, and ending on October 31, 2018, the RIC applies the NAV method for excise tax purposes, treating February 1, 2018, as the first day of the RIC's tax year for purposes of paragraphs (b)(1) and (6) of this section. The RIC's net gain or loss for the latter portion is determined under paragraph (c)(2)(iii) of this section. This net gain or loss and any gains and losses of the earlier portion determined under the realization method are taken into account in determining the RIC's capital gain net income for the full one-year period described in section 4982(b)(1)(B).

(d) Example. The provisions of this section may be illustrated by the following example:

Example. (i) Fund is an MMF. Shareholder is a person whose taxable year is the calendar year. On January 1 of Year 1, Shareholder owns 5,000,000 shares in Fund with an adjusted basis of $5,000,000.00. The price of Fund shares has not varied from $1.00 from the date Shareholder acquired the shares through January 1 of Year 1. During that period, Shareholder has engaged in multiple purchases and redemptions of Fund shares, but Shareholder has reported no gains or losses with respect to the shares because Shareholder realized an amount in each redemption equal to Shareholder's basis in the redeemed shares. During Year 1, the price of Fund shares begins to float. During Year 1, Shareholder receives $32,158.23 in taxable dividends from Fund and makes 120 purchases of additional shares in Fund (including purchases through the reinvestment of those dividends) totaling $1,253,256.37 and 28 redemptions totaling $1,124,591.71. The fair market value of Shareholder's shares in Fund at the end of Year 1 is $5,129,750.00. All of Shareholder's shares in Fund are held in a single account and as capital assets. There is no adjustment to the basis in Shareholder's shares in Fund under any provision of internal revenue law during Year 1.

(ii) Prior to Year 1, Shareholder has had no gains or losses to report with respect to the
Fund shares under a realization method and no changes in fair market value that would have been reported under the NAV method. Therefore, Shareholder may use the NAV method for the shares in Fund for Year 1. Shareholder uses the NAV method for the shares with its taxable year as the computation period. Shareholder’s net investment in Fund for Year 1 equals $128,664.66 (the $1,253,256.37 in purchases, minus the $1,124,591.71 in redemptions). Shareholder’s Year 1 gain therefore is $1,085.34, which is the ending value of Shareholder’s shares ($5,129,750.00), minus the starting basis of Shareholder’s shares ($5,000,000.00), minus Shareholder’s net investment in the fund for the taxable year ($128,664.66). The gain of $1,085.34 is treated as short-term capital gain.

Shareholder’s starting basis for Year 2 is $5,129,750.00. Shareholder also must include the $32,158.23 in dividends in its income for Year 1 in the same manner as if Shareholder did not use the NAV method.

(iii) If Shareholder had instead adopted the calendar month as its computation period, it would have used the NAV method for every month of Year 1, even though prices of Fund shares may have been fixed for some months.

(e) Effective/applicability date. Except as provided in the following sentence, this section applies 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, shareholders of MMFs may rely either on this section or on §1.446–7 of the 2014 proposed regulations that set out the NAV method.

(ii) The NAV method for the shares in Fund for Year 1 in the same manner as if Shareholder did not use the NAV method.

3 Pursuant to 42 U.S.C. 10603(d)(1), and as used in this preamble and rule unless context indicates otherwise, “the term ‘State’ includes the District of Columbia, the Commonwealth of Puerto Rico, the United States Virgin Islands, and any other territory or possession of the United States.”