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April 22, 2009

Hon. Douglas Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Request for Guidance on the Treatment of Interests in Money Market Mutual Funds under
Section 856(c)(4)(A)

Dear Commissioner Shulman:

Enclosed are comments concerning the treatment of interests in money market mutual funds as "cash items" within the meaning of section 856(c)(4)(A). These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association, and should not be construed as representing the policy of the American Bar Association.

Sincerely,

Stuart M. Lewis
Chair- Elect, Section of Taxation

Enclosure

cc: Clarissa C. Potter, Acting Chief Counsel, Internal Revenue Service
Eric San Juan, Acting Tax Legislative Counsel, Department of the Treasury

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**AMERICAN BAR ASSOCIATION
SECTION OF TAXATION
REQUEST FOR GUIDANCE ON THE TREATMENT OF INVESTMENTS IN
MONEY MARKET MUTUAL FUNDS AS “CASH ITEMS” FOR PURPOSES OF
SECTION 856(c)(4)(A)**

The following comments (“Comments”) are submitted on behalf of the American Bar Association Section of Taxation (“Section”) and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Thayne Needles and James Sowell of the Section’s Real Estate Committee (the “Committee”). Substantive contributions were provided by David Miller, Peter Genz, and Morris Kramer of the Committee, and Deanna Flores, Chair of the Section’s Investment Management Committee. These Comments were reviewed by Kevin Thomason, Chair of the Committee, Jerald August of the Section's Committee on Government Submissions and William Caudill, the Section’s Council Director for the Committee.

Although the members of the Section who participated in preparing these Comments have clients who might be affected by the federal tax principles addressed by these Comments or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

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Date: April 22, 2009

EXECUTIVE SUMMARY

Money market mutual funds (“money market funds”) play a pivotal role in the day-to-day operations of many companies, including real estate investment trusts (“REITs”), when cash must be readily available to meet the needs of their business. Money market funds are an attractive alternative to interest-bearing checking accounts due to the convenience they provide, their competitive returns, and their regulatory safeguards that are intended to provide liquidity and minimal risk to principal. In light of these features common to money market funds, industry practice for financial personnel and the accounting rules such personnel rely upon generally treat money market funds as “cash items.”

REITs must satisfy numerous requirements in order to maintain qualification as a REIT, including the requirement set forth in section 856(c)(4)(A)¹ that at least 75 percent of the value of the total assets of a REIT at the close of each quarter of the REIT’s taxable year must consist of “real estate assets, cash and cash items (including receivables) and Government securities.” These Comments address the need for guidance concerning whether the term “cash items” properly includes investments in money market funds for purposes of section 856(c)(4)(A).

Neither the regulations nor the legislative history under section 856 define the term “cash items” and the Treasury Department (“Treasury”) and the Internal Revenue Service (the “Service”) have not issued any other guidance regarding the meaning of this term as it applies to money market funds. The Office of Chief Counsel of the Division of Investment Management of the U.S. Securities and Exchange Commission (the “SEC Office of Chief Counsel”), however, has issued two No-Action Letters concluding that money market funds are “cash items” for certain purposes of the Investment Company Act of 1940, as amended (the “1940 Act”). Such determinations are relevant because section 856 provides that terms not otherwise defined in section 856 are to be given the meanings ascribed to them under the 1940 Act.

We believe that the analysis of the SEC Office of Chief Counsel set forth in the No-Action Letters, when considered with the attributes of money market funds generally, justify the conclusion that such funds are “cash items” for purposes of the REIT rules. Accordingly, we respectfully request that Treasury and the Service promptly issue guidance clarifying that a REIT’s investment in the shares of a money market fund constitutes an investment in a “cash item” for purposes of section 856(c)(4)(A).

¹ References to a “section” herein are to sections of the Internal Revenue Code of 1986, as amended (the “Code”), unless otherwise indicated.

DISCUSSION

I. Description of a Money Market Fund

A money market fund is a regulated investment company (“RIC”) that is regulated by the Securities and Exchange Commission (the “SEC”) and that invests in short-term debt instruments. Rule 2a-7 of the 1940 Act restricts the investments that a money market fund may make by quality, maturity and diversity. In that regard, a money market fund must maintain a portfolio of debt instruments with a weighted average maturity of 90 days or less and may not invest more than 5 percent of its assets in any one issuer, with an exception for government securities and repurchase agreements.

As noted above, many companies, including REITs, invest cash in money market funds where such funds must be readily available to meet the needs of their businesses. The convenience and generally higher rates of return provided by money market funds and the regulatory safeguards intended to provide liquidity and minimal risk to principal make such funds an attractive choice for these purposes. For these reasons, many view money market funds as the functional equivalent of an interest-bearing checking account.

In that regard, Rule 2a-7 subjects a RIC holding itself out as a money market fund to strict risk-limiting conditions relating to portfolio maturity, quality and diversification. Money market funds that satisfy those conditions, and that seek to maintain a stable net asset value of \$1.00 per share, are designed to preserve the principal of their assets. In addition, section 22(e) of the 1940 Act helps to ensure the liquidity of money market fund shares by generally requiring a money market fund to pay redemption proceeds to a redeeming shareholder within seven days.² In practice, money market funds historically have provided immediate liquidity for their investors.³

II. The REIT Rules and Section 856(c)(4)

Section 856(c)(4) provides, in part, that a corporation will qualify to be taxed as a REIT only if:

at the close of each quarter of the taxable year-

² The SEC Office of Chief Counsel observed that this requirement in section 22(e) of the 1940 Act also has served as the basis for the SEC’s standard for determining liquidity. In that regard, the SEC considers a security to be illiquid if it cannot be disposed of within seven days in the ordinary course of business at approximately the price at which the fund has valued it. *See, e.g.*, Investment Company Institute (pub. avail. May 26, 1995).

³ We recognize that, as a result of circumstances surrounding recent economic problems, a small number of money market funds have experienced problems which have caused delays in returning funds to their investors. *Cf.* Rev. Proc. 2009-10, 2009-2 I.R.B. 1 (providing safe harbor treatment of certain payments made by sponsors to support the value of the Money Market Funds that they administer). In addition, the SEC recently adopted a temporary rule for money market funds participating in the Treasury Department’s temporary guarantee program whereby a money market fund that experiences a “guarantee event” (*i.e.* the first date that the Market-Based NAV of the fund is less than \$0.995) would be entitled to suspend redemptions beyond the seven-day period in order to accomplish an orderly liquidation of the fund. 17 CFR Part 270, § 270.22e-3T.

- (A) at least 75 percent of the value of its total assets are represented by real estate assets, cash and cash items (including receivables), and Government securities; and
- (B) (i) not more than 25 percent of the value of its total assets is represented by securities (other than those includible under subparagraph (A)), . . . and
 - (iii) except with respect to a taxable REIT subsidiary and securities includible under subparagraph (A)-
 - (I) not more than 5 percent of the value of its total assets is represented by securities of any one issuer,
 - (II) the trust does not hold securities possessing more than 10 percent of the total voting power of the outstanding securities of any one issuer, and
 - (III) the trust does not hold securities having a value of more than 10 percent of the total value of the outstanding securities of any one issuer.

Accordingly, at the close of any quarter of a REIT's taxable year, if shares of a money market fund are not considered a "cash item," such securities, together with any other non-mortgage securities held by the REIT, may not represent more than 25 percent of the value of the REIT's total assets (the "25% Asset Value Test"); the securities of any single money market fund issuer may not represent more than 5 percent of the total assets of the REIT (the "5% Asset Value Test"); and the REIT may not own more than 10 percent, by value, of the outstanding securities of any single money market fund issuer (the "10% Asset Value Test" and, collectively with the 25% and 5% Asset Value Tests, the "REIT Asset Value Tests".)

As a result of the foregoing, a REIT's ability to invest in money market funds would be subject to material limitations if the shares of such funds are not treated as "cash items." In such a case, for example, an investment in a single money market fund "issuer" would not be allowed if such investment would constitute more than 5 percent of the REIT's total assets. This could easily occur in connection with cash temporarily held in a money market fund as a result of the disposition of real property assets or in anticipation of other transactions. Further, a REIT with a significant "taxable REIT subsidiary"⁴ or other non-qualifying assets could fail to satisfy the 25% Asset Value Test in part due to its investment of operating cash in money market funds, even if its investment in any single money market fund did not represent more than 5 percent of total assets of the REIT.

III. Meaning of the Term "Cash Item" under the REIT Rules

A. Historical Development of the Service's Interpretation

⁴ As a result of legislative changes made in connection with the Emergency Economic Stabilization Act of 2008, stock of "taxable REIT subsidiaries" (as defined in section 856(l)) now may comprise up to 25% of a REIT's assets without disqualifying an entity's qualification as a REIT. Such stock still is treated as a non-qualifying asset for purposes of the 25% Asset Value Test.

The term “cash item” is not defined in either section 856 or in the Regulations thereunder. It appears that the Service first considered the meaning of this term in PLR 7104280610A.⁵ In that ruling, the Service analyzed specifically whether a banker’s acceptance or certificate of deposit should be considered a “cash item” for purposes of section 856(c). The ruling explains that a banker’s acceptance is a credit instrument that is principally used in foreign trade. Under the terms of such an instrument, a bank substitutes its credit for that of a buyer. Banker’s acceptances are generally short-term instruments and trade as bearer instruments that are considered to be of high credit because they constitute a primary obligation of the accepting bank. The Service noted that, prior to the maturity date, a banker’s acceptance may be sold for cash in the market or to the accepting bank. Noting that neither the Code, nor the Regulations, nor the 1940 Act provided a definition of “cash or cash items,” the Service observed that former Regulation section 301.7701-13(d)(2) [currently Regulation section 301.7701-13A(e)(1)] defined the term “cash,” for purposes of an asset test applicable to Domestic Building and Loan Associations, as “cash on hand, and time or demand deposits with, or withdrawable accounts in, other financial institutions.” The Service also noted that, because section 856(c) used the phrase “cash or cash items (including receivables)” and not the word “cash” standing alone, the term “cash items” must include, within its confines, items that would not meet the strict definition of “cash.” Nevertheless, the Service stated that a banker’s acceptance could not be considered as “cash” under the definition contained in former Regulation section 301.7701-13 or under general accounting principles. Based on those determinations, the Service concluded that banker’s acceptances did not constitute “cash or cash items” for purposes of section 856(c).⁶

The Service subsequently revisited the treatment of banker’s acceptances in Rev. Rul. 72-171.⁷ Consistent with its conclusion in the PLR 7104280610A, the Service focused its analysis on the definition of the term “cash” under what was then Temporary Regulation section 402.1-2(e)(1) (again relating to the asset test applicable to Domestic Building and Loan Associations) and stated that a banker’s acceptance was not cash as that term was defined in those temporary regulations. Accordingly, the Service ruled that banker’s acceptances did not constitute “cash items” for purposes of the REIT Asset Value Tests.

The Service next analyzed the term “cash items” in Rev. Rul. 77-59,⁸ where it considered the status of certain repurchase agreements. At issue was a REIT’s purchase of Treasury obligations or other negotiable obligations from a bank with an agreement by the REIT to resell or redeliver the securities to the bank on a fixed date for a specified amount and return thereon. The Service concluded that, for tax purposes, the repurchase agreements at issue were loans by the REIT to the bank secured by the underlying obligations. Citing

⁵ (Apr. 28, 1971).

⁶ Interestingly, while acknowledging that the term “cash items” suggested a meaning broader than the word “cash,” the Service appeared to base its conclusion on that narrower definition.

⁷ 1972-1 C.B. 208.

⁸ 1977-1 C.B. 196.

Rev. Rul. 72-171, the Service determined in conclusory fashion that the repurchase agreements did not constitute “cash or cash items” within the meaning of section 856(c).⁹

Later the same year, in Rev. Rul. 77-199¹⁰ the Service considered whether certificates of deposit held by a RIC or a REIT were properly treated as “cash items” for purposes of sections 851 and 856.¹¹ In this ruling, the Service did not make reference to its previous reliance on the definition of the word “cash” under former Regulation section 301.7701-13 or Temporary Regulation section 402.1-2(e)(1). Instead, the Service relied upon *Securities and Exchange Commission v. Fifth Avenue Coach Lines, Inc.*¹², a U.S. District Court case involving the determination of status as an investment company under the 1940 Act of a busing company that had invested condemnation proceeds in securities, and noted that, in the absence of a definition of the term “cash items” under the 1940 Act, the court in that case had relied on section 210.6-03 (1) of Regulation S-X¹³ to conclude that certificates of deposit were “cash items” for purposes of the test used in determining whether an issuer would be considered an investment company under the 1940 Act. The term “cash items” is defined in former section 210.6-03 of Regulation S-X, which prescribes accounting rules for the financial statements of investment companies, as follows:

Cash and cash items - State separately (a) cash on hand, demand deposits, and time deposits; (b) call loans; and (c) funds subject to withdrawal restrictions. Funds subject to withdrawal restrictions and deposits in closed banks shall not be included under this caption unless they will become available within one year.

Based on that definition, the Service concluded that a certificate of deposit represented a form of time deposit and therefore should be considered a “cash item” for purposes of sections 851 and 856.¹⁴

B. SEC Treatment of Money Market Funds as “Cash Items”

Section 856(c)(5)(F) provides that all terms not defined in section 856(c)(5) “shall have the same meaning as when used in the 1940 Act.” While the 1940 Act does not define the term “cash items,” the SEC Office of Chief Counsel has issued two No-Action Letters interpreting that term for purposes of the 1940 Act. As discussed below, each of these

⁹ In GCM 35876 (Jun. 27, 1974), the Service analyzed whether repurchase agreements should be treated as “cash or cash items” by reference to the definition of “cash” under Temp. Reg. § 402.1-2(e)(1). *See also* PLR 7507249710A (Jul. 24, 1975) (considering the treatment of repurchase agreements).

¹⁰ 1977-1 C.B. 195.

¹¹ *See also* GCM 36782 (Jul. 6, 1976) and PLR 7104280610A (Apr. 28, 1971); *compare* GCM 39531 (Jul. 16, 1986), where the Service determined that “overnight loans” were not “cash items” within the meaning of section 851(b)(4).

¹² *Securities and Exchange Commission v. Fifth Avenue Coach Lines, Inc.*, 289 F. Supp. 3 (S.D.N.Y. 1968), *aff’d on other grounds*, 435 F.2d 510 (2d Cir. 1970).

¹³ 17 CFR Part 210.

¹⁴ *See* GCM 36782 as well as PLRs 8217092 (Jan. 28, 1982); 8230112 (Apr. 29, 1982); 8336027 (June 6, 1983); and 8514029 (Jan. 7, 1985) as other authorities addressing a certificate of deposit and other time deposits as cash items under section 851 or 856.

No-Action Letters concluded that a money market fund should be considered a “cash item” for purposes of particular provisions of the 1940 Act.

1. The 2000 No-Action Letter

Section 3(a)(1)(C) of the 1940 Act,¹⁵ in part, defines the term “investment company” to mean any issuer which proposes to engage primarily in the business of investing, reinvesting, or trading in securities and owns or proposes to acquire “investment securities” having a value exceeding 40 percent of the value of such issuer’s total assets (exclusive of Government securities and *cash items*)¹⁶ on an unconsolidated basis (the “Investment Company 40% Test”).

As described above, the Investment Company 40% Test is a fraction the numerator of which is the investment securities held by the issuer and the denominator of which is the issuer’s total assets. If the issuer’s investment securities exceed 40 percent of total assets, the issuer would meet the definition of an investment company. As used in section 3(a)(1)(C) of the 1940 Act, the term “investment securities” includes all securities except Government securities, securities issued by employees’ securities companies, and securities issued by majority-owned subsidiaries of the owner which (i) are not investment companies and (ii) are not relying on the exception from the definition of investment company in sections 3(c)(1) or 3(c)(7) of the 1940 Act. While government securities are specifically excluded from both the numerator and denominator, “cash items” are specifically excluded only from the denominator of the fraction, leaving their inclusion as investment securities in the numerator uncertain.

In 1981, the SEC adopted Rule 3a-1 to exclude certain issuers from regulation under the 1940 Act.¹⁷ The rule generally provides that, notwithstanding the Investment Company 40% Test, an issuer will not be considered an investment company if: (i) no more than 45 percent of the value of the issuer’s total assets (exclusive of government securities and *cash items*)¹⁸ consists of certain securities (“adjusted investment securities”) (the “Rule 3a-1 Asset Test”) and (ii) no more than 45 percent of the issuer’s net income after taxes is derived from those adjusted investment securities (the “Rule 3a-1 Income Test”). The Rule 3a-1 Asset Test and Rule 3a-1 Income Test (collectively the “Rule 3a-1 Tests”) specifically excluded “cash items” from their denominator (total assets or total income). The Rule 3a-1 Tests, however, did not specifically address whether “cash items” would be excluded from the definition of adjusted investment securities and thereby excluded from the numerator of these tests.

In a No-Action Letter issued in October 2000 (the “2000 No-Action Letter”),¹⁹ the SEC Office of Chief Counsel was asked to concur that an issuer may treat money market fund

¹⁵ 15 U.S.C.S. 80-3.

¹⁶ Emphasis added.

¹⁷ 64 FR 70844, 70917 (Dec. 22, 1998).

¹⁸ Emphasis added.

¹⁹ SEC No-Action Letter, Willkie, Farr & Gallagher, [2000-2001 Transfer Binder] Fed. Sec. L. Rep. (CCH) P. 78,011, at 77,270 (Oct. 23, 2000).

shares as “cash items” and not as “investment securities” for purposes of the Investment Company 40% Test and the Rule 3a-1 Tests.

In support of its request, the issuer seeking the 2000 No-Action Letter explained the importance of the request based on common business practices. In that regard, the request noted that operating companies in capital intensive businesses were required to maintain substantial cash holdings and generally invested their cash holdings in short-term instruments. According to the request, many companies elect to invest in money market funds as an alternative to bank checking accounts and other forms of short-term liquid investments because of the liquidity, relatively minimal risk to principal, competitive returns and convenience afforded by such funds.

The issuer further stated that the financial community generally views money market funds as the functional equivalent of the interest-bearing checking accounts offered by banks. In that respect, the issuer noted that money market funds generally are open-end management investment companies registered under the 1940 Act that have as their investment objective generation of income, preservation of capital and maintenance of liquidity through investment in short-term, high quality securities.

Finally, the issuer emphasized its duty to its shareholders to earn the highest possible investment return on cash holdings consistent with the preservation of principal, pending the use of those cash holdings in the company’s operations. The ability to invest cash holdings in money market funds was deemed important to fulfilling this duty.

In responding, the SEC Office of Chief Counsel acknowledged that issuers would be penalized if “cash items” were to be considered investment securities or adjusted investment securities for purposes of the Investment Company 40% Test or the Rule 3a-1 Tests, respectively, because such assets would be included in the numerator of the fraction computed under these tests while at the same time specifically being excluded from the denominator by the applicable statute or rule.²⁰

Having concluded that “cash items” should be excluded from the definition of investment securities and adjusted investment securities for purposes of the Investment Company 40% Test and the Rule 3a-1 Tests, respectively (resulting in the exclusion of “cash items” from both the numerator and denominator of these tests), the SEC Office of Chief Counsel then considered the issuer’s specific inquiry of whether a money market fund should be treated as a “cash item” under these tests. The 2000 No-Action Letter notes that money market funds did not exist when Congress drafted the Investment Company 40% Test, nor did they exist in their current form when the SEC adopted Rule 3a-1 in

²⁰ The SEC Office of Chief Counsel observed that, although the term “cash items” is not defined in the text of the 1940 Act or in the text of Rule 3a-1, the wording of section 3(a)(1)(C) of the 1940 Act and Rule 3a-1 provided evidence of the meaning of that term. It reasoned that the failure of these authorities to specifically exclude “cash items” from the definition of the term investment securities, while “cash items” are expressly excluded from the calculation of an issuer’s total assets, was an indication that Congress did not contemplate “cash items” as securities. Accordingly, an explicit exclusion for “cash items” from the definition of investment securities was unnecessary.

1981. The SEC Office of Chief Counsel concluded, however, that, had money market funds existed at such times in their current form, Congress and the SEC would have determined that an issuer's holdings of money market fund shares – even though they are securities – usually are not determinative of an investment company business, because money market fund shares generally are equivalent to “cash items.” As support for that position, the SEC Office of Chief Counsel noted that, in proposing Rule 3a-1, the SEC set forth the following list of what would be considered to be cash items for purposes of the rule: cash, coins, paper currency, demand deposits with banks, timely checks of others, cashier checks, certified checks, bank drafts, money orders, travelers checks, and letters of credit.²¹ The SEC Office of Chief Counsel concluded that this list illustrated the essential qualities of a “cash item” for purposes of these investment company tests – a high degree of liquidity and relative safety of principal.

In determining that money market funds offered the essential qualities of “cash items,” the 2000 No-Action Letter focused on the specific regulatory requirements governing money market funds. In particular, Rule 2a-7 subjects a RIC holding itself out as a money market fund to strict risk-limiting conditions relating to portfolio maturity, quality and diversification. Money market funds that satisfy those conditions, and that seek to maintain a stable net asset value of \$1.00 per share, are designed to preserve the principal of their assets. In addition, section 22(e) of the 1940 Act helps to ensure the liquidity of money market fund shares by generally requiring a money market fund to pay redemption proceeds to a redeeming shareholder within seven days.²²

Because the rules governing money market funds are designed to achieve a diversified and professionally managed portfolio of securities, relative safety of principal and a high degree of liquidity, the 2000 No-Action Letter provides that the SEC would not object if an issuer were to consider money market fund shares to be “cash items” for purposes of the Investment Company 40% Test and Rule 3a-1 Tests.

2. SEC 1983 No-Action Letter

In a No-Action Letter issued May 11, 1983 (the “1983 No-Action Letter”),²³ the SEC Office of Chief Counsel again considered whether shares of a money market fund should be treated as a “cash item.” The 1983 No-Action Letter pertained to a no-load, open-end money market fund which provided checking privileges and the right to request redemption by means of a wire transfer in Federal funds. The specific issue related to whether shares of a money market fund were properly treated as a “cash item” for

²¹ See Rule 3a-1 Proposing Release. The SEC Office of Chief Counsel noted that the Commission's list consisted of “cash items” that are not securities.

²² The SEC Office of Chief Counsel observed that this requirement in section 22(e) of the 1940 Act also has served as the basis for the SEC's standard for determining liquidity. In that regard, the SEC considers a security to be illiquid if it cannot be disposed of within seven days in the ordinary course of business at approximately the price at which the fund has valued it. See, e.g., Investment Company Institute (pub. avail. May 26, 1995).

²³ SEC No-Action Letter, Crescent Management Company, Inc. [Ref. No. 82-293-CC, Crescent Management Company, Inc. File No. 132-3].

purposes of the asset test required to qualify as a “business development company” pursuant to section 55(a)(6) of the 1940 Act (the “BDC Asset Test”).

In its request, the issuer cited a number of cases²⁴ indicating that, in many contexts, the phrase “cash or cash item” has come to mean intangible instruments (but not real or personal property) that can be readily converted into money. The request went on to state that the Investment Company Act was enacted before the development of money market funds; whereas today billions of dollars are deposited in such funds by millions of customers who regard them as the functional equivalent of interest-bearing checking accounts.

In a reply, the No-Action Letter simply concluded that shares of a money market fund, where the fund seeks to maintain a constant net asset value per share, qualified as a “cash item” for purposes of the BDC Asset Test.

IV. Interplay with the RIC Rules

The definition of “cash items” also is relevant under the rules for regulated investment companies (“RICs”). Specifically, among the qualifying assets described in section 851(b)(3)(A)(i) under the 50% asset test are “cash and cash items (including receivables), Government securities and securities of other regulated investment companies.” Section 851(b)(3)(A)(ii) also includes other “securities” as qualifying assets, subject to limitations described below. As under the REIT rules, terms not otherwise defined under the RIC rules are defined by reference to the 1940 Act.²⁵

As is the case with REITs, RICs are limited as to their concentration in the securities of particular issuers by reference to the 25% asset test described in section 851(b)(3)(B). Government securities and interests in other RICs are ignored for purposes of the rule under section 851(b)(3)(B)(i) that limits the RIC’s ownership of a single issuer. Similarly, ownership interests held by a RIC in another RIC are ignored for purposes of the rule under section 851(b)(3)(B)(ii), which applies the 25% limitation to the securities of two or more issuers under the control of the subject RIC.

The RIC rules do not prohibit a RIC from owning more than 10% of the vote or value of an issuer or from owning the securities of an issuer comprising more than 5% of a RIC’s assets, as is done under the REIT rules. For purposes of applying the 50% asset test under section 851(b)(3)(A), however, qualifying securities described in section 851(b)(3)(A)(ii) exclude securities of an issuer to the extent that such securities exceed 5% of the RIC’s total assets or to the extent that the RIC owns more than 10% of the outstanding voting securities of the issuer.

V. Analysis

²⁴ *FDIC v. Continental Illinois Nat. Bank & Trust Co.*, 245 F.2d 567 (7th Cir. 1957); *In re Flynn’s Estate*, 174 A. 2d 520 (N.J. Super. 1961); *Stewart v. Selder*, 473 S.W.2d 3 (Tex. 1971).

²⁵ I.R.C. § 851(c)(6). The term “cash items” also is referenced in section 368(a)(2)(F)(iv) for purposes of defining an “investment company,” although such term is not specifically defined by reference to the 1940 Act. *Cf.* I.R.C. § 368(a)(2)(F)(vii) (defining “securities” for those purposes by reference to the 1940 Act).

A. Technical Interpretation of “Cash Items”

Section 856(c)(5) specifically directs the Service to give terms that are not defined in section 856 their meaning as used under the 1940 Act. We believe that the analysis contained in the No-Action Letters concluding that money market funds are cash items is persuasive in interpreting “cash items” for REIT purposes. Furthermore, adopting this position for purposes of the REIT rules would appear to be consistent with the position of the SEC regarding what are “cash items.”

In addition, a money market fund investment is far more liquid and secure than the banker’s acceptance described in Rev. Rul. 72-171 and the repurchase agreement described in Rev. Rul. 77-59, which were found not to be “cash items.” Indeed, a money market fund is much more analogous to the certificate of deposit that was found to be a “cash item” in Rev. Rul. 77-199. If anything, a money market fund is more like cash than a certificate of deposit, given that such a certificate often carries a substantial penalty for early withdrawal (whereas a money market fund is obligated to pay the owner in cash without penalty within seven days).²⁶ While money market fund rules obligate the fund to pay an owner within seven days, funds in practice generally return cash to investors immediately upon request.

It also seems that the language of section 856(c)(4)(A), which refers to “cash items (including receivables),” justifies a more liberal interpretation of “cash items.” The parenthetical “including receivables” indicates that the item “cash items” encompasses items that clearly go beyond cash deposit equivalents. A receivable certainly is less liquid than the shares of a money market account. In addition, the word “including” preceding “receivables” indicates that “cash items” should be interpreted to include items that are not cash equivalents and are not “receivables.” Further, the Service itself has recognized that the term “cash items” necessarily includes items which would not meet the strict definition of “cash.”²⁷

Finally, the Treasury Department’s recently established program to provide, in certain contexts, a temporary guarantee of money market funds that are regulated under Rule 2a-7 is certainly consistent with the long-established security and liquidity expectations that investors have associated with money market funds.²⁸

²⁶ Section 22(e) of the 1940 Act provides, with certain exceptions, that no registered investment company may postpone the date of payment upon redemption of a redeemable security for more than seven days after the security is tendered for redemption. The Commission has stated that all mutual funds should limit their holdings of illiquid securities to ensure that they can satisfy all redemption requests within the seven day period. The Commission considers a security to be illiquid if it cannot be disposed of within seven days in the ordinary course of business at approximately the price at which the fund has valued it. The limit on money fund holdings of illiquid securities is ten percent of fund assets. *See* Investment Company Act Release No. 14983 (Mar. 12, 1986) [51 FR 9773 (Mar. 21, 1986)] and Release No. 33-7275 (June 3, 1996) [61 FR 13956 (March 28, 1996)].

²⁷ PLR 7104280610A (April 28, 1971).

²⁸ I.R.B. 2008-41 (October 14, 2008) and Department of Treasury release dated September 21, 2008. In general the program is designed to assist money market funds in maintaining their standard \$1.00 per share net asset values and to pay their retail shareholders \$1.00 per share upon liquidation of shares, thereby

B. Securities as “Cash Items”

While the money market funds considered in the No-Action Letters were considered securities, they nevertheless were treated as “cash items” for purposes of the Investment Company 40% Test. The Service has previously considered the status of items that constitute both a security and a “cash item” in the context of certificates of deposit. In that regard, the Service concluded that, while a certificate of deposit is a “security” under the 1940 Act, it still can qualify as a “cash item” for purposes of sections 851 and 856.²⁹ Accordingly, the classification of a money market fund as a security should not preclude it from being treated as a “cash item” under section 856.

C. Requested Treatment Would Not Be Inconsistent With RIC Rules

As described above, the RIC rules also reference “cash items” in section 851(b)(3)(A)(i) as one of the types of assets qualifying under the 50% asset test. No mention is made in the RIC rules as to whether an investment in a money market fund by a RIC is a “cash item.” Such a description is unnecessary because, just as interests in other REITs are treated as qualifying assets under the REIT rules,³⁰ interests in other RICs are automatically treated as qualifying assets for a RIC.³¹ Thus, the REIT issue which is the subject of this submission is not germane to RICs, and therefore it is not surprising that there is no RIC authority interpreting “cash item” to include an interest in a money market fund. On the other hand, we do not believe that this should create any negative inference as to how the term should be interpreted in the context of the REIT rules.

assuring a full return of investors’ principal for amounts invested in participating money market funds as of the close of business on September 19, 2008. On November 24, 2008, the Treasury Department announced that the guarantee program would be extended until April 30, 2009. The primary purpose for the temporary guarantee program is not entirely clear. The Treasury Department clearly desired for investors in money market funds to have confidence in the safety of their investments. Arguably, however, the broader purpose for the program was to avoid the market implications had there been a “run” on the money market funds, forcing the administrators to liquidate large amounts of the securities held by such funds. Such a “run” almost certainly would have created significant problems for the already unstable markets. For a discussion of the guarantee program, *see* the preamble to SEC regulations relating to the temporary exemption for liquidation of certain money market funds, which were promulgated on November 26, 2008 (RIN 3235-AK24).

²⁹ GCM 36782 (Jul. 6, 1976).

³⁰ Section 856(c)(4) and (5)(B) (including shares in other REITs within the definition of “real estate assets”).

³¹ As previously described, “cash items” and interests in other RICs are among the qualifying assets under the RIC 50% asset test in section 851(b)(3)(A)(i). Therefore, interests in a money market fund would be considered a qualifying asset under this test regardless of whether the money market fund is considered a “cash item”. One might question whether Congress would have intended for interests in money market funds to be included as “cash items” under this rule if such funds were already accounted for as interests in RICs. We, however, see no compromise created with respect to the RIC rules by virtue of such an interpretation. The conclusion that money market funds are qualifying assets for two reasons under section 851(b)(3)(A)(i) makes the rule no broader or narrower than if such interests qualify for only one reason. In addition, unlike with the REIT Asset Value Tests, “cash items” are not relevant for purposes of applying the 25% asset test limiting investments in particular issuers under the RIC rules. Accordingly, interpreting “cash items” consistent with the 1940 Act definition, as interpreted by the SEC, to include money market funds would not appear to be inconsistent with the intended purposes of the RIC asset test rules.

D. Business and Accounting Practices Create a Trap for the Unwary

In most cases, balance sheets and statement of cash flows prepared in accordance with generally accepted accounting principles reflect “cash and cash equivalents.” For this purpose, cash equivalents are generally considered to include short-term, highly liquid investments that are (i) readily convertible to known amounts of cash and (ii) so near their maturity that their market value is relatively insensitive to changes in interest rates.³² Typically instruments considered to fall within this category have maturities of three months or less when purchased.³³ Historical examples of cash equivalents for this purpose have included Treasury bills, commercial paper, and money market funds.³⁴

Based upon the general accounting practice, financial officers generally consider a money market fund to be a “cash equivalent.” From the perspective of many financial officers interested in maximizing the financial performance of their companies, there is little difference between a money market fund and an interest-bearing checking or savings account other than the higher return often paid by the money market fund. Similarly, money market funds provide a logical and attractive source for investment of cash required to fund the short-term needs of a business because of the liquidity, relatively minimal risk to principal, competitive returns and convenience afforded by money market funds. As a result, treating such a fund as other than a “cash item” generally would create an unwarranted trap for the unwary.

³² Statement of Financial Accounting Standards No. 95.

³³ Id.

³⁴ Id.