



## IRS expands guidance on wash sale relief for redemptions of shares in money market funds

### Tax Alert

### Overview

On September 29, 2023, the Treasury Department and the Internal Revenue Service (IRS) released new guidance, [Rev. Proc. 2023-35](#), which provides that the IRS will not treat a redemption of shares in a money market fund (MMF) as part of a wash sale for purposes of [section 1091\(a\)](#).

Specifically, Rev. Proc. 2023-35 extends wash sale relief to redemptions of shares in MMFs that maintain fixed share prices but impose liquidity fees on shareholder redemptions. The new guidance amplifies and supersedes [Rev. Proc. 2014-45](#), which exempted losses on floating-net asset value (NAV) MMF shares from the wash sale rule. The IRS issued Rev. Proc. 2023-35 in response to final rules adopted by the Securities and Exchange Commission (the “SEC”) on July 12, 2023, which amended Rule 2a-7 under the Investment Company Act of 1940 (the “1940 Act”) to expand the circumstances in which an MMF may (or may be required to) impose a liquidity fee on redeeming shareholders.

The new guidance is effective for redemptions of shares in MMFs after October 2, 2023.

### Background

#### MMFs and Rule 2a-7

An investment company registered under the 1940 Act that meets the requirements of Rule 2a-7 may hold itself out as an MMF. Historically, MMFs have sought to keep stable the prices (typically at \$1.00) at which their shares are distributed, redeemed, and repurchased.

Prior to amendments in 2014, Rule 2a-7 generally permitted an MMF to compute its price per share by using either or both of (a) the amortized cost method of valuation, and (b) the penny-rounding method of pricing. These methods were intended to enable MMFs to maintain stable share prices under most circumstances.

## 2014 Amendments to Rule 2a-7

In 2014, the SEC amended (“2014 Amendments”) Rule 2a-7 to bar many MMFs from the use of the amortized cost method of valuation and the penny-rounding method of pricing.

Under the 2014 Amendments, an MMF that is neither a government MMF nor a retail MMF must value its portfolio securities using market-based factors and use basis point rounding (*i.e.*, rounding the fund’s NAV to a minimum of the fourth decimal place) to price its shares. An MMF that uses market factors and basis point rounding has a share price that is expected to change regularly, or float, and, thus, is known as a floating-NAV MMF. On the other hand, a government MMF or retail MMF that continues to use the amortized cost method and penny rounding (stable-NAV MMF) can maintain a constant share price under most market conditions.

The 2014 Amendments also permitted an MMF to institute a liquidity fee if certain liquid assets of the MMF fall below a specified percentage of the MMF’s total assets. If those liquid assets fall below another (lower) specified percentage, the 2014 Amendments generally required the MMF (other than a government MMF) to institute a liquidity fee unless the MMF’s board of directors determines that imposing such a fee is not in the best interests of the MMF. When an MMF has a liquidity fee in effect, the fee reduces the proceeds received by all redeeming shareholders.

## 2023 Amendments to Rule 2a-7

On July 12, 2023, the SEC amended (“2023 Amendments”) Rule 2a-7 to eliminate any link between an MMF’s liquid assets and its ability (or obligation) to institute liquidity fees. Under Rule 2a-7(c)(2)(i), as amended, any MMF other than a government MMF must institute a liquidity fee if the MMF’s board of directors determines that a liquidity fee is in the best interests of the MMF. A government MMF is permitted to impose liquidity fees on the same terms.

The amendments regarding liquidity fees are effective October 2, 2023, so any MMF may impose a liquidity fee after that date based solely on a determination of its board of directors.

## Wash sale rule of section 1091(a)

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

If a taxpayer acquired property consisting of stock or securities the acquisition of which (or the contract or option to acquire which) resulted in the disallowance of a loss under section 1091(a), then under [section 1091\(d\)](#), the taxpayer's basis in the property so acquired equals the basis of the stock or securities disposed of at a loss, increased or decreased to take into account any difference between the price at which the replacement property was acquired and the price at which the original stock or securities were disposed of.

## Earlier guidance

Shareholders typically will realize gain or loss on redemptions of floating-NAV MMF shares. Similarly, for a redeeming shareholder of a stable-NAV MMF that has adopted a liquidity fee, the liquidity fee typically will result in a realized loss on the redemption. Because many MMF shareholders engage in frequent

redemptions and purchases of MMF shares, a realized loss could be subject to the wash sale rule under section 1091(a). In response to the 2014 Amendments, the IRS released two guidance items to mitigate the administrative burdens associated with gains and losses on MMF shares, including those associated with the wash sale rule, as follows:

1. [Treas. Reg. § 1.446-7](#) provides a simplified method of accounting for gain or loss on MMF shares (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 and on the net amount of purchases and redemptions during the computation period. Because no gain or loss is determined for particular redemptions under the NAV method, no redemption implicates the wash sale rule. A taxpayer may apply the NAV method to floating-NAV MMFs and stable-NAV MMFs. See [Treas. Reg. § 1.446-7\(a\)](#).
2. Rev. Proc. 2014-45 provided that the IRS will not treat a redemption of a floating-NAV MMF share as a part of a wash sale. Thus, Rev. Proc. 2014-45 provided relief from the wash sale rule for shareholders in floating-NAV MMFs not using the NAV method, but it did not extend the relief to stable-NAV MMFs.

## Rev. Proc. 2023-35

Similar to the earlier guidance, the new guidance is intended to mitigate undue tax compliance burdens, which may otherwise result if the section 1091(a) wash sale rule applies to realized losses attributable to liquidity fees imposed by MMFs on redeeming shareholders under the 2023 Amendments. Because of the constant value of shares in stable-NAV MMFs, the frequency with which many taxpayers continuously acquire and redeem shares in these MMFs, and the administrative and compliance burdens that would flow from applying section 1091(a) to these transactions, the IRS believes that it is in the interest of sound tax administration to extend to all MMF shares the relief that Rev. Proc. 2014-45 already provides to shares in floating-NAV MMFs.

### Scope and application

The IRS will not treat as part of a wash sale a redemption of a share in **any** MMF that results in a loss. Section 1091(a) will not disallow the deduction for the resulting loss in the year realized and section 1091(d) will not cause the basis of any property to be determined by reference to the basis of the redeemed shares.

### Effective date

Rev. Proc. 2023-35 is effective for redemptions of shares in MMFs after October 2, 2023.



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