

**CSRS PRESENT VALUE FACTORS APPLICABLE TO ANNUITY PAYABLE FOLLOWING AN ELECTION UNDER SECTION 8339(J) OR (K) OR SECTION 8343A OF TITLE 5, UNITED STATES CODE, OR UNDER SECTION 1043 OF PUBLIC LAW 104-106 OR FOLLOWING A REDEPOSIT UNDER SECTION 8334(D)(2) OF TITLE 5, UNITED STATES CODE—Continued**

Age	Present value factor
70	160.0
71	153.4
72	146.7
73	140.1
74	133.5
75	127.0
76	120.7
77	114.4
78	108.3
79	102.3
80	96.5
81	90.9
82	85.4
83	80.2
84	75.2
85	70.3
86	65.7
87	61.2
88	56.9
89	52.9
90	49.2
91	45.7
92	42.4
93	39.5
94	36.8
95	34.4
96	32.3
97	30.3
98	28.6
99	26.9
100	25.4
101	24.1
102	22.8
103	21.6
104	20.8
105	20.2
106	19.3
107	17.7
108	14.8
109	9.5

**CSRS PRESENT VALUE FACTORS APPLICABLE TO ANNUITY PAYABLE FOLLOWING AN ELECTION UNDER SECTION 1043 OF PUBLIC LAW 104-106**  
[For ages at calculation below 40]

Age at calculation	Present value of a monthly annuity
17	393.7
18	391.3
19	388.8
20	386.3
21	383.8
22	381.2
23	378.5

**CSRS PRESENT VALUE FACTORS APPLICABLE TO ANNUITY PAYABLE FOLLOWING AN ELECTION UNDER SECTION 1043 OF PUBLIC LAW 104-106—Continued**

[For ages at calculation below 40]

Age at calculation	Present value of a monthly annuity
24	375.8
25	373.0
26	370.2
27	367.3
28	364.4
29	361.4
30	358.4
31	355.3
32	352.1
33	348.9
34	345.6
35	342.2
36	338.7
37	335.2
38	331.6
39	328.0

U.S. Office of Personnel Management.

**Katherine Archuleta,**  
*Director.*

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**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-72173; File No. 811-02815]

**Copley Fund, Inc.; Notice of Application**

May 15, 2014.

**AGENCY:** Securities and Exchange Commission (“Commission”).

**ACTION:** Notice of an application for exemptive relief.

**SUMMARY OF APPLICATION:** Applicant requests an order exempting it from rule 22c-1 under the Investment Company Act of 1940 (“Company Act”) and rule 4-01(a)(1) of Regulation S-X.

**APPLICANT:** Copley Fund, Inc. (“Copley” or “Fund”).

**FILING DATE:** The application (together with the exhibits, the “Application”) was filed on September 4, 2013.

**HEARING OR NOTIFICATION OF HEARING:** Interested persons may request a hearing by writing to the Commission’s Secretary and serving applicant with a copy of the request, personally or by mail. Hearing requests should be received by the Commission by 5:30 p.m. on June 9, 2014, and should be accompanied by proof of service on the applicant, in the form of an affidavit or,

for lawyers, a certificate of service. Hearing requests should state the nature of the writer’s interest, the reason for the request, and the issues contested. Persons who wish to be notified of a hearing may request notification by writing to the Commission’s Secretary. Absent a request for a hearing that is granted by the Commission, the Commission intends to issue an order under the Company Act denying the Application.

**ADDRESSES:** Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-1090; Applicant, 5348 Vegas Drive, Suite 391, Las Vegas, Nevada 89108.

**FOR FURTHER INFORMATION CONTACT:** David Joire, Senior Counsel, or Nadya Roytblat, Assistant Chief Counsel, at (202) 551-6825, Division of Investment Management, Chief Counsel’s Office.

**SUPPLEMENTARY INFORMATION:** The following is a summary of the application. The complete application may be obtained via the Commission’s Web site at <http://www.sec.gov/rules/other.shtml> or by calling (202) 551-8090.

**I. Background**

*A. The Applicant*

1. Copley is a Nevada corporation registered under the Company Act as an open-end management investment company (“open-end fund”) that issues redeemable securities.<sup>1</sup> Copley has been operating since 1978 and invests primarily in U.S. equity securities. The Application states that Copley’s “stated investment objective is the generation and accumulation of dividend income” and “[i]ts secondary objective is ‘long-term capital appreciation.’” The Application also states that “[k]ey to the Fund’s investment objective is its strategy, contrary to most other [open-end] funds, of not distributing dividends and capital gains to shareholders but rather accumulating them within the Fund.”

<sup>1</sup> Section 4(3) of the Company Act defines a “management company” as any investment company other than a face-amount certificate company or a unit investment trust. Section 5(a)(1) of the Company Act defines an “open-end company” as a management company which is offering for sale or has outstanding any redeemable security of which it is the issuer. Section 2(a)(32) of the Company Act defines “redeemable security” to mean any security, other than short term paper, under the terms of which the holder, upon presentation to the issuer or to a person designated by the issuer, is entitled (whether absolutely or only out of surplus) to receive approximately his proportionate share of the issuer’s current net assets, or the cash equivalent thereof.

### *B. Copley's Status Under the Internal Revenue Code ("Code")*

2. Virtually all open-end funds take advantage of special provisions in the Code, known as Subchapter M, that enable them to avoid a layer of tax at the corporate, *i.e.*, fund, level.<sup>2</sup> Under Subchapter M, an open-end fund that elects status as a "regulated investment company" ("RIC") and meets certain requirements, one of which is to distribute at least 90% of investment company taxable income, in any taxable year, does not pay federal taxes at the fund level.<sup>3</sup>

3. Copley has never availed itself of RIC status under the Code, so that, according to the Application, its shareholders "are able to defer dividend and capital gains taxes [at the shareholder level] until redemption." Copley instead has elected to be treated as a "C Corporation" under the Code and thus is subject to federal taxation at the fund level.<sup>4</sup> A shareholder of Copley, therefore, is subject to two layers of tax—once (indirectly) at the fund level and again (directly) at the shareholder level.<sup>5</sup> Copley has significant unrealized gains in its portfolio and a federal income tax liability ("federal income tax liability") would arise if those gains were realized by the Fund (*i.e.*, if Copley were to sell any of its portfolio securities that had appreciated in value since the Fund acquired them).

## II. The Application

4. The Application concerns the provision that Copley should make for its federal income tax liability for purposes of (i) calculating the current net asset value on which the price of Copley's redeemable securities must be based under rule 22c-1 under the Company Act, and (ii) preparing Copley's financial statements filed with the Commission as required by the Company Act. Copley currently makes a provision for federal income taxes for both purposes in the full amount of federal income tax that would be due if the full amount of Copley's existing unrealized gains were realized. Copley's current provision for federal income taxes is consistent with generally

accepted accounting principles ("GAAP").<sup>6</sup>

5. The Application requests an exemption from rule 22c-1 under the Company Act and rule 4-01(a)(1) of Regulation S-X so that Copley could estimate a provision for federal income tax liability for both purposes using one of two formulas developed by Copley and described in the Application (together, the "Proposed Method").<sup>7</sup> The Proposed Method would result in a provision for Copley's federal income tax liability that is less than the full amount of federal income tax that would be due if the full amount of Copley's existing unrealized gains were realized,<sup>8</sup> and thus is inconsistent with

<sup>6</sup> Specifically, Financial Accounting Standards Board ("FASB") Accounting Standards Codification Topic 740, *Income Taxes* ("ASC 740") indicates that financial statements should reflect deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns. FASB ASC 740-10-1(b). ASC 740 incorporates an assumption that the assets and liabilities of an entity will be recovered and settled at their carrying amounts for financial statement reporting purposes, which may be different from their carrying amounts for income tax purposes. Differences between book and tax carrying amounts that are caused by differences in the timing of recognition of transactions or events for financial reporting versus income tax purposes are referred to as temporary differences. See FASB ASC 740-10-25-20. ASC 740 provides examples of such differences. Revenues or gains that are taxable after they are recognized as income for financial reporting purposes are included as an example of a temporary difference. See FASB ASC 740-10-25-20(a). Unrealized gains on investments, which are taxable after they are recognized in the financial statements (*i.e.*, they are generally taxable only when the investments are sold), represent a temporary difference on which a deferred tax liability must be recognized; the recognized deferred tax liability is calculated by multiplying the temporary difference (*i.e.*, the unrealized gains) by the expected tax rate at the expected time of reversal. See generally FASB ASC 740-10-10-3 (indicating that the objective is to measure a deferred tax liability using the enacted tax rate expected to apply to taxable income in the periods in which the deferred tax liability is expected to be settled).

<sup>7</sup> One of the formulas would be based on a quarterly calculation of Copley's historical portfolio turnover rate over the past five or ten years. The alternative formula would be based on the highest daily redemptions of Fund shares during the previous five years.

<sup>8</sup> The Application includes an extensive discussion of Copley's use, for a period of time prior to 2007, of a methodology similar to the Proposed Method, as well as Copley's subsequent discussions with the staff of the Commission's Division of Enforcement, resulting in Copley changing its methodology to make a provision for federal income tax liability in the full amount of federal income tax that would be due if the full amount of Copley's existing unrealized gains were realized. The Application also discusses a letter from the staff of the Commission's Division of Investment Management to Copley's counsel, dated April 5, 2013, available at <http://www.sec.gov/divisions/investment/noaction/2013/copley-fund-040513-22c1.pdf>, in which the staff rejected Copley's request for assurance that it would not recommend enforcement action to the Commission if Copley were to make a provision for federal

GAAP. In support of its request for exemptions, the Application argues that "the entire [federal income tax liability] would be due only in the unlikely event the entire portfolio were liquidated." The Application further argues that the "use of the full liquidation value method has produced a skewed and unreasonable result—Copley's per share [net asset value] does not reflect the realistic value of the Fund," and that using the Proposed Method would "fairly and accurately [reflect] a realistic tax liability."

## III. Legal Analysis

### *A. Rules 22c-1 and 2a-4 Under the Company Act*

6. As an open-end fund, Copley issues redeemable securities under the terms of which all of the holders, upon presentation to Copley or to a person designated by Copley, are entitled to receive approximately their proportionate share of Copley's current net assets or the cash equivalent thereof.<sup>9</sup> Rule 22c-1 under the Company Act states, in relevant part, that no registered investment company issuing any redeemable security shall sell, redeem, or repurchase any such security except at a price based on the "current net asset value" of such security which is next computed after receipt of a tender of such security for redemption or of an order to purchase or sell such security. Rule 2a-4 under the Company Act defines the term "current net asset value" for use in computing periodically the price of a fund's shares to mean one determined substantially in accordance with the provisions of the rule. Rule 2a-4(a)(4) provides, in relevant part, that in determining the current net asset value, "[a]ppropriate provision shall be made for Federal income taxes if required [by the open-end fund]." An open-end fund that has elected RIC status under the Code generally would not need to make a "provision . . . for Federal income taxes" under rule 2a-4(a)(4), because it would not be subject to federal taxation at the fund level.<sup>10</sup> In contrast, Copley, which has chosen to be a C Corporation and thus is subject to federal taxation at the fund level, must make an "appropriate provision . . . for Federal

income tax liability according to the Proposed Method.

<sup>9</sup> See *supra* note 1 (definition of "redeemable security").

<sup>10</sup> An open-end fund that has elected RIC status under the Code may be subject to a 4% excise tax on undistributed income to the extent that the open-end fund does not satisfy certain distribution requirements for a calendar year. See Code Section 4982 "Excise Tax on Undistributed Income of Regulated Investment Companies."

<sup>2</sup> See sections 851-855 and 860 of the Code.

<sup>3</sup> *Id.*

<sup>4</sup> See section 11 of the Code.

<sup>5</sup> A shareholder of a RIC and a shareholder of an open-end fund that is a C Corporation pay taxes at the shareholder level on any distributions from the fund and on any capital gains on the fund shares that they redeem. The Application states that Copley does not make any distributions to its shareholders.

income taxes” in computing its current net asset value under rule 2a-4 for purposes of complying with rule 22c-1 under the Company Act. The Commission is aware of several other existing open-end funds that have chosen to be C Corporations and to which this provision of rule 2a-4(a)(4) is relevant; none of these funds has requested an exemption relating to this provision.

7. Under rule 22c-1, an open-end fund may sell and redeem its redeemable securities only at a price based on its current net asset value, which equals the value of the fund’s total assets minus the amount of the fund’s total liabilities. Under rule 2a-4, an open-end fund generally must value its assets at their market value, in the case of securities for which market quotations are readily available, or at fair value, as determined in good faith by the fund’s board of directors, in the case of other securities and assets.<sup>11</sup> When calculating its current net asset value for purposes of rule 22c-1, an open-end fund: (i) adds up the current values of all of its assets (using their market values or fair values, as appropriate), which reflect any unrealized gains; and (ii) subtracts all of its liabilities, which include an appropriate provision for federal income taxes on any unrealized gains. If the open-end fund understates a liability, among other consequences, the calculated current net asset value will be overstated, as will the price at which the fund’s redeemable securities are sold and redeemed. As a result, investors purchasing the fund’s shares will pay too much for them, redeeming shareholders will receive too much for their shares, and the net asset value of shares held by the remaining shareholders may be reduced correspondingly when the full amount of the liability must be paid. This outcome would be counter to one of the primary principles underlying the Company Act, which is that sales and redemptions of redeemable securities should be effected at prices that are fair, and which do not result in dilution of shareholder interests or other harm to shareholders.<sup>12</sup>

<sup>11</sup> See also section 2(a)(41) of the Company Act defining the term “value.”

<sup>12</sup> See *Investment Trusts and Investment Companies: Hearings on S.3580 Before a Subcommittee of the Senate Committee on Banking and Currency*, 76th Cong., 3d Sess. 136-38 (1940) (hearings that preceded the enactment of the Company Act). In addition, all funds must accurately calculate their net asset values to ensure the accuracy of their payment of asset-based fees, such as investment advisory fees, as well as the accuracy of their reported performance. Statement

#### *B. Rule 4-01(a)(1) of Regulation S-X*

8. Under the Company Act, Copley is required to file with the Commission a registration statement and annual reports, which must contain Copley’s financial statements.<sup>13</sup> The form and content of and requirements for the financial statements filed pursuant to the Company Act are set forth in Regulation S-X. Rule 4-01(a)(1) of Regulation S-X states, in relevant part, that “[f]inancial statements filed with the Commission which are not prepared in accordance with [GAAP] will be presumed to be misleading or inaccurate, despite footnote or other disclosures, unless the Commission has otherwise provided.”<sup>14</sup>

#### *C. Section 6(c) of the Company Act*

9. Although the Application requests an exemption from rule 22c-1 under the Company Act and rule 4-01(a)(1) of Regulation S-X pursuant to section 36(a) of the Exchange Act, the Commission is considering the requested exemptions under section 6(c) of the Company Act because the provisions of rule 22c-1 under the Company Act and rule 4-01(a)(1) of Regulation S-X are made applicable to Copley by the requirements of the Company Act and the rules thereunder. Section 6(c) of the Company Act provides, in relevant part, that the “Commission, . . . by order upon application, may conditionally or unconditionally exempt any person . . . from any provision or provisions of [the Company Act] . . . or of any rule or regulation thereunder, if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of [the Company Act].”

#### **IV. The Commission’s Preliminary Views**

##### *A. Rule 22c-1 Under the Company Act*

10. Rule 22c-1 under the Company Act, as described above, prohibits Copley from selling or redeeming its redeemable securities at a price other than one based on the “current net asset value,” as defined in rule 2a-4 under the Company Act. Copley seeks to sell and redeem its redeemable securities at

Regarding “Restricted Securities,” Investment Company Act Release No. 5847 (Oct. 21, 1969).

<sup>13</sup> Sections 8(b) and 30 of the Company Act require the filing of registration statements and annual reports, respectively.

<sup>14</sup> Rule 4-01 of Regulation S-X is made applicable to investment companies registered under the Company Act by rule 6-03 of Regulation S-X.

a price that reflects Copley’s provision, in accordance with the Proposed Method, for less than its full federal income tax liability that would arise if the unrealized gains in Copley’s portfolio were realized by the Fund. If the Proposed Method results in an “appropriate provision . . . for Federal income taxes” under rule 2a-4(a)(4), then the price of Copley’s redeemable securities would be based on the “current net asset value” as defined in rule 2a-4(a)(4) and Copley would not need an exemption from rule 22c-1. On the other hand, if the Proposed Method does not make an “appropriate provision . . . for Federal income taxes” under rule 2a-4(a)(4), the price of Copley’s redeemable securities would not be based on the “current net asset value” as defined in rule 2a-4 and would cause Copley to violate rule 22c-1, unless the Commission issues an order exempting Copley from rule 22c-1. Because the Commission, for the reasons discussed below, preliminarily believes that the Proposed Method would not result in an “appropriate provision . . . for Federal income taxes” under rule 2a-4(a)(4), the Commission preliminarily believes that Copley, in order to avoid violating rule 22c-1, would need an exemption from rule 22c-1 to be able to sell and redeem its shares at a price that is not based on the “current net asset value,” as defined in rule 2a-4.

11. Copley seeks an exemption from rule 22c-1 to be able to determine the price at which its redeemable securities may be purchased or redeemed based on a net asset value that would reflect less than the full amount of the federal income tax liability that would arise if all of the Fund’s existing unrealized gains were realized, calculated based on the Proposed Method (“Proposed Method NAV”).<sup>15</sup> The Application’s justification for the use of the Proposed Method is that it would “provide its current and future investors with a more fair and accurate presentation of its [net

<sup>15</sup> The Application provides an example of the difference in the net asset value per share resulting from the use of the Proposed Method, as opposed to making a provision for the full federal income tax liability that would arise if all of the Fund’s existing unrealized gains were realized. The Application points out that, following Copley’s discussions with the staff of the Commission’s Division of Enforcement in 2007, Copley changed its methodology to provide for the full federal income tax liability in the net asset value per share of its redeemable securities. The Application states that, whereas Copley’s net asset value per share on February 28, 2007, reflecting the use of a methodology similar to the Proposed Method, was stated in its annual report as being \$54.67, “the Restated Annual Report . . . reflect[ed] a per share [net] asset value for that same date (February 28, 2007) of \$42.54.” The \$12.13 reduction in the net asset value per share was a change of 22%.

asset value]" because "the entire [federal tax liability] would be due only in the unlikely event the entire portfolio were liquidated."

12. As an open-end fund under the Company Act, Copley must stand ready to redeem its redeemable securities daily. Although Copley has been operating for several decades and the Application states that "the highest daily redemption in the history of the Fund since inception was . . . approximately 1.6% of the total outstanding shares on the date of the redemption," Copley cannot control or fully anticipate the level and amounts of shareholder redemptions and the resulting need to sell its portfolio investments to satisfy the redemption requests. However unlikely it may seem to Copley that it may need to liquidate its entire portfolio to meet redemption requests, that is a possibility that Copley may not rule out under the Company Act.<sup>16</sup> That is because all of the holders of Copley's redeemable securities are entitled, under the terms of their securities, upon presentation to Copley or to a person designated by Copley, to receive approximately their proportionate share of Copley's current net assets or the cash equivalent thereof.<sup>17</sup>

13. If Copley were to experience a high level of redemptions necessitating liquidation of a large portion of its portfolio with significant unrealized gains, Copley's pricing of its redeemable securities based on the Proposed Method NAV could result in the redeeming shareholders receiving a price for their shares that reflects more than their pro-rata share of the net asset value of the Fund, while the price of the shares held by the remaining shareholders would reflect less than their pro-rata share of the net asset value of the Fund. Copley's use of the Proposed Method could produce this disparate result because only the net asset value per share of the shares held by the remaining, non-redeeming shareholders would reflect the full actual federal income tax expense incurred as a result of the liquidation of the portfolio, even though the same amount of federal income tax liability existed, but was not provided for, when the other shareholders redeemed at a

price based on a higher net asset value per share.

14. For example, consider the following illustrative fact pattern of an open-end fund that is a C Corporation ("Fund A") that records a 2.8% federal income tax liability in accordance with Copley's Proposed Method but is required to pay federal income taxes at a rate of 35%.<sup>18</sup> As of the close of business on March 30, 2014, Fund A has total assets comprised of investments valued at \$1,400,000, which reflects \$400,000 in unrealized gains,<sup>19</sup> and total liabilities comprised of a federal income tax liability on unrealized gains of \$11,200.<sup>20</sup> Fund A has 100,000 redeemable securities outstanding. As of the close of business on March 30, 2014, Fund A's net asset value and net asset value per share (NAV/share) are \$1,388,800<sup>21</sup> and \$13.888,<sup>22</sup> respectively. On March 31, 2014, Fund A has no profit or loss for the day<sup>23</sup> and shareholders unexpectedly request redemption of 60,000 shares, which entitles these shareholders to redeem at the March 31, 2014 closing NAV/share of \$13.888.<sup>24</sup> On April 1, 2014, in order to raise cash to satisfy the March 31, 2014 shareholder redemption requests of \$833,280,<sup>25</sup> Fund A sells investments of \$834,000 with a cost basis of \$534,000, resulting in realized gains of \$300,000.<sup>26</sup> Since Fund A realized \$300,000 in gains, Fund A would have a federal income tax liability of \$105,000.<sup>27</sup> However, since Fund A's net asset value only reflected a \$11,200

<sup>18</sup> In this example, under the Proposed Method, in lieu of recording the full federal income tax liability of 35% of unrealized gains, Fund A records a federal income tax liability of 2.8% of unrealized gains (which represents 8% times 35%, where 8% is based on highest daily redemptions of Fund A's shares during the previous five years).

<sup>19</sup> Valuation of \$1,400,000 reflects \$1,000,000 cost and \$400,000 of unrealized gains.

<sup>20</sup> \$11,200 federal income tax liability on unrealized gains equals \$400,000 unrealized gains times 2.8% recorded federal income tax liability.

<sup>21</sup> \$1,388,800 net asset value equals \$1,400,000 total assets minus \$11,200 total liabilities.

<sup>22</sup> \$13.888 NAV/share equals \$1,388,800 net asset value divided by 100,000 shares outstanding.

<sup>23</sup> Generally, an open-end fund would have daily profit or loss. However, because this is a simplified example presented solely for illustrative purposes, we assume that Fund A had no profit or loss on March 31, 2014.

<sup>24</sup> Because Fund A recorded no profit or loss on March 31, 2014, the NAV/share as of the close of business on March 31, 2014 is the same as the NAV/share as of the close of business on March 30, 2014.

<sup>25</sup> \$833,280 redemption requests equal 60,000 shares redeemed times 13.888 NAV/share.

<sup>26</sup> For purposes of this simplified example, we assume that all transactions are recorded on trade date.

<sup>27</sup> \$105,000 federal income tax liability equals \$300,000 realized gains times 35% federal income tax rate.

federal income tax liability as of March 31, 2014, Fund A has to record an additional \$93,800<sup>28</sup> of a federal income tax expense and corresponding federal income tax liability on April 1, 2014. On April 1, 2014, Fund A has no other profit or loss<sup>29</sup> besides recording the federal income tax expense and corresponding current federal income tax liability of \$93,800 and an additional federal income tax expense and corresponding federal income tax liability of \$2,800.<sup>30</sup> At the close of business on April 1, 2014, Fund A has a net asset value of \$458,920<sup>31</sup> and redeemable securities outstanding of 40,000,<sup>32</sup> resulting in an NAV/share of \$11.473.<sup>33</sup> Therefore, the redeeming shareholders received an NAV/share of \$13.888 on March 31 while the NAV/share of the remaining shareholders was reduced to reflect the federal income tax accrual on gains realized by Fund A from selling portfolio securities with unrealized gains to pay the redeeming shareholders and thus their shares have an NAV/share of \$11.473 on April 1, 2014. Although the same realized gains (\$300,000) had been fully reflected in the net asset value on March 31 as unrealized gains, only 2.8% of the full 35% federal income tax liability on those unrealized gains had been reflected in the net asset value on that day, and the remaining shareholders were harmed solely as a result of Fund A's use of the Proposed Method.<sup>34</sup> If Fund A reflected the full 35% federal income tax liability in its net asset value prior to receiving the shareholder redemption requests on March 31, 2014,

<sup>28</sup> \$93,800 additional tax expense equals \$105,000 federal income tax liability minus \$11,200 federal income tax liability on unrealized gains already reflected in the net asset value.

<sup>29</sup> See generally *supra* note 23.

<sup>30</sup> Subsequent to the sale of investments to meet redemptions, Fund A has investments valued at \$566,000 (\$1,400,000 value of investments prior to sale minus \$834,000 investments sold), with a cost basis of \$466,000 (\$1,000,000 cost of investments prior to sale minus \$534,000 cost of investments sold) and unrealized gains of \$100,000 (\$566,000 value of investments minus \$466,000 cost of investments). Therefore, Fund A, in accordance with the Proposed Method, records an additional federal income tax liability of \$2,800 (2.8% times \$100,000 unrealized gains).

<sup>31</sup> \$458,920 net asset value equals \$1,388,800 net asset value prior to redemption minus \$833,280 redemptions minus \$93,800 additional current federal income tax liability recorded minus \$2,800 additional federal income tax liability recorded.

<sup>32</sup> 40,000 redeemable securities outstanding equals 100,000 redeemable securities outstanding prior to redemption minus 60,000 shares redeemed.

<sup>33</sup> \$11.473 NAV/share equals \$458,920 net asset value divided by 40,000 redeemable securities outstanding.

<sup>34</sup> If there had been any investors who purchased Fund shares on March 31 at the NAV/share of \$13.888, they also would have been harmed by Fund A's use of the Proposed Method because they would have overpaid for their shares.

<sup>16</sup> Redemptions necessitating liquidation of a substantial amount of an open-end fund portfolio, while infrequent, have in fact been experienced by several open-end funds. See, e.g., L. Jones, "From Difficult to Disaster: Redemptions' Impact on Funds," *Morningstar* (Feb. 7, 2008), available at <http://news.morningstar.com/articlenet/article.aspx?id=227989>.

<sup>17</sup> See *supra* note 1 (definition of "redeemable security").

the redeeming shareholders would have redeemed at an NAV/share of \$12.600<sup>35</sup> and the remaining shareholders would have held shares with an NAV/share of \$12.600<sup>36</sup> (which is \$1.127, or approximately 9.8%, higher than \$11.473, their resulting NAV/share when applying the Proposed Method) on April 1, 2014. This result would have been fair and equitable to *all* of Fund A's shareholders.

15. The Commission therefore preliminarily believes that the Proposed Method would not result in an "appropriate provision . . . for Federal income taxes" as required by rule 2a-4(a)(4) under the Company Act. In the Commission's preliminary view, in order to make an "appropriate provision . . . for Federal income taxes" under rule 2a-4(a)(4), Copley must make a provision for the full federal income tax liability that would arise if all of the Fund's existing unrealized gains were realized. Making such a provision would result in purchases and redemptions of Copley's redeemable securities being effected, under rule 22c-1 under the Company Act, at a price based on a net asset value that reflects a fair and equitable treatment of all of Copley's shareholders. In contrast, the exemption from rule 22c-1 requested in the application to provide for less than the full federal income tax liability, could result in, among other things, redemptions of Copley's redeemable securities at prices based on a potentially significantly higher net asset value per share for some shareholders while the net asset value of shares held by the remaining shareholders may be reduced

<sup>35</sup> \$12.600 NAV/share on March 31, 2014 equals \$1,260,000 net asset value divided by 100,000 shares outstanding, where \$1,260,000 net asset value equals \$1,400,000 value of investments (inclusive of an unrealized gain of \$400,000) minus federal income tax liability of \$140,000 (where \$140,000 equals \$400,000 unrealized gains times 35%).

<sup>36</sup> Shareholders would have redeemed 60,000 shares at the March 31, 2014 NAV/share of \$12.600 representing redemptions of \$756,000. To satisfy redemptions, assume for illustrative purposes that Fund A would have sold the same \$834,000 of investments with a cost basis of \$534,000 resulting in a realized gain of \$300,000. Fund A would owe \$105,000 of federal income taxes (\$300,000 realized gain times 35%), however, under this fact pattern, Fund A already recorded a federal income tax liability in excess of \$105,000 (*i.e.*, Fund A recorded a federal income tax liability of \$140,000), and therefore, Fund A would not need to record an additional federal income tax expense and corresponding federal income tax liability. Fund A's net asset value after sale of investments and redemption of 60,000 shares would be \$504,000 (\$1,260,000 net asset value before redemption minus \$756,000 redemption) and Fund A's resulting NAV/share would be \$12.600 (\$504,000 net asset value divided by 40,000 shares outstanding).

correspondingly when the full federal income tax liability is accrued, producing an unfair and inequitable result among Copley's shareholders.

16. The Application discusses Copley's "willingness to convert to RIC status in the event unforeseen circumstances caused [unrealized] gains to be realized that consumed the entire amount of accumulated deferred income taxes it has recognized" as a way for the Fund to avoid having to pay more in federal income taxes than the amount provided for under the Proposed Method. Copley's suggested potential conversion to RIC status, however, does not change our analysis. In order to successfully convert to a RIC at a point in time, Copley would be required to comply with the Code's RIC requirements at all times during the taxable year, which may not be possible if Copley encountered the "unforeseen circumstances" mid-year or late-year.<sup>37</sup> Moreover, despite converting to a RIC, Copley still would be subject to federal income tax on the unrealized gains on securities which existed prior to conversion to the extent the securities are sold within ten years after the conversion.<sup>38</sup> Because Copley, as an open-end fund that has issued redeemable securities, cannot fully predict whether securities may need to be sold to meet redemption requests in the ten years after conversion to a RIC, Copley's contingent intent to convert to a RIC does not eliminate Copley's potential federal income tax liability.<sup>39</sup>

17. Based on the foregoing, the Commission's preliminary view is that an exemption from rule 22c-1 under the Company Act is not necessary or appropriate in the public interest and is not consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Company Act. Accordingly, absent a request for a hearing that is granted by the Commission, the Commission intends to deny Copley's request for an

<sup>37</sup> See section 851 of the Code.

<sup>38</sup> See Treas. Reg. section 1.337(d)-7.

<sup>39</sup> The Application discusses certain real estate investment trusts ("REITs"), which under the Code also may avoid a layer of tax at the corporate level if they elect "REIT status" and meet certain requirements, as examples of public companies that have converted from C Corporations and elected REIT status and, by doing so, avoided incurring a federal income tax liability. The Application states that "[Copley is] aware of at least two entities—Weyerhaeuser and American Tower Corp.—that converted from C Corporations into [REITs] and, in doing so, have exercised discretion with respect to accounting for deferred tax liabilities." Among other differences, the REITs discussed in the Application are not open-end funds, do not issue redeemable securities and therefore do not face the associated potential need to sell portfolio assets to satisfy redemption requests.

exemption from rule 22c-1 under the Company Act.

#### B. Rule 4-01(a)(1) of Regulation S-X

18. The Commission's preliminary view that, in order to make an "appropriate provision . . . for Federal income taxes" under rule 2a-4(a)(4) under the Company Act, Copley must make a provision for the full federal income tax liability that would arise if all of the Fund's existing unrealized gains were realized, also is consistent with GAAP. The Application, however, requests an "exemption" from rule 4-01(a)(1) of Regulation S-X for Copley to use a non-GAAP methodology in recording its federal income tax liability in its financial statements.<sup>40</sup> If Copley were to use two different methodologies in calculating its net asset value—a GAAP-consistent methodology for purposes of pricing Copley's redeemable securities for purchases and redemptions under rules 2a-4 and 22c-1 under the Company Act, and a non-GAAP methodology in its financial statements—in the Commission's preliminary view, the result may be unnecessarily confusing to investors and contrary to the policy behind the Company Act's disclosure requirements. Accordingly, absent a request for a hearing that is granted by the Commission, the Commission intends to deny Copley's request for an exemption from rule 4-01(a)(1) of Regulation S-X as not necessary or appropriate in the public interest and as not consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Company Act.

By the Commission.

**Kevin M. O'Neill,**  
Deputy Secretary.

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<sup>40</sup> The Application does not state how Copley would present the amount of its federal income tax liability in its financial statements if the Commission granted the requested exemption. The Commission assumes that Copley would present the amount according to its Proposed Method in lieu of presenting the amount determined in accordance with GAAP.