

# A Primer on Tax Treatment for Floating NAV Money Market Funds

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- + IRS REGULATIONS PROVIDE FOR A SIMPLIFIED METHOD OF ACCOUNTING FOR FLOATING NAV MONEY MARKET FUNDS.
- + THIS TAX TREATMENT APPLIES TO INSTITUTIONAL MONEY MARKET FUNDS, BOTH PRIME AND TAX-EXEMPT.
- + AN OVERVIEW OF THE IRS REGULATIONS IS BELOW.

As of October 2016, institutional prime and tax-exempt funds began transacting at a floating net asset value (NAV) rather than at a constant \$1.00 NAV. As a result of this U.S. Securities and Exchange Commission (SEC) rule, each shareholder redemption in a floating NAV money market fund may incur a gain or loss. Because shareholders tend to make a large volume of purchases and redemptions into and out of these funds to meet their liquidity needs, transactions could be onerous to track. And though price changes likely would be small, absent any regulatory relief, they would require detailed cost accounting.

To reduce the burden of tax compliance, the U.S. Treasury and the IRS issued final regulations that provide a simplified method of tax accounting for floating NAV money market funds. These regulations apply to institutional

money market funds, both prime and tax-exempt. Government and retail money market funds are not affected because they continue to transact at a constant \$1.00 NAV.

An overview of the IRS regulations is provided below. This overview is for informational purposes only and should not be construed as tax advice; shareholders should consult their tax advisor about their specific situation.

## Simplified method of accounting for floating NAV money market fund shares (NAV method)

Under the IRS regulations, simplified accounting, known as the NAV method, allows shareholders in floating NAV money market funds to measure net gains and losses rather than calculate transaction-by-transaction gains and losses.



## The NAV method works as follows:

- 01 A shareholder chooses a computational period—such as annually, quarterly, or monthly—and aggregates the net gains and losses over this period.
- 02 The calculation for the net gain or loss generally equals the value of an investor's shares in the floating NAV money market fund at the end of the computational period, minus the value of the shares in the money market fund at the end of the prior period, minus the net investment in the fund during the period.
- 03 The NAV method does not change the tax treatment of, or broker reporting requirements for, dividends paid by floating NAV money market funds.
- 04 The gain or loss is treated as a short-term gain or loss.
- 05 The NAV method is considered an accounting method by the IRS. Consult your tax advisor regarding different accounting methods for different accounts and requirements for changing accounting methods.

## Result

Shareholders in a floating NAV money market fund are not required to track gains and losses on individual transactions.

## Wash-sale rules

Because gains and losses are aggregated over a computational period, floating NAV money market funds are exempt from the

wash-sale rule stating that a taxpayer may not recognize the loss on the sale of a security if he/she acquires a substantially identical security within 30 days before or after the sale.

## Result

A shareholder in a floating NAV money market fund is not affected by wash-sale rules.

## Information reporting for floating NAV money market fund shares

Floating NAV money market funds are allowed the same waivers of gross-proceeds reporting, basis reporting, and holding-period reporting rules that apply to constant-value NAV money market funds. Information that would otherwise be included on Form 1099-B: Proceeds from Broker and Barter Exchange Transactions is not required.

## Result

Shareholders do not receive tax Form 1099-B.

## Retain classification as cash equivalents

The SEC has stated that the adoption of a floating NAV for money market funds does not, under normal circumstances, preclude shareholders from classifying their investment in money market funds as cash equivalents for purposes of U.S. generally accepted accounting principles.



## A comparison of tax and accounting treatments across investment types

	BANK DEPOSITS	CONSTANT-VALUE MONEY MARKET FUND (GOVERNMENT, TREASURY, AND RETAIL)	FLOATING NAV MONEY MARKET FUNDS (INSTITUTIONAL PRIME AND TAX-EXEMPT)	MUTUAL FUNDS	SEPARATELY MANAGED ACCOUNTS
<b>Reporting gains and losses</b>	Does not apply	Does not apply under normal circumstance due to constant \$1.00 NAV	May aggregate gains and losses over a computational period	Must calculate gains and losses for each transaction	Must calculate gains and losses for each transaction
<b>Wash-sale rule</b>	Does not apply	Does not apply under normal circumstance due to constant \$1.00 NAV	Exempt from wash-sale rule	Wash-sale rule applies; a loss must be deferred if the same share is acquired 30 days before or after the sale	Wash-sale rule applies; a loss must be deferred if the same share is acquired 30 days before or after the sale
<b>Information reporting from sale of shares</b>	Exempt from Form 1099-B	Exempt from Form 1099-B	Exempt from Form 1099-B	Form 1099-B required	Form 1099-B required
<b>Cash equivalent</b>	Yes	Yes	Yes	No	No



## Appendix—overview of floating NAV accounting method

Below is an example from the IRS of a permissible method of accounting for a gain or loss on shares in a floating NAV money market fund, shown in a hypothetical year-end statement that contains information such as beginning adjusted basis, purchases, redemptions, dividends received, and ending value.

Although the format may vary, year-end client-statement summaries that contain this information will help clients and their accountants access data that is necessary for tax reporting.

### Year-End Account Summary

January 1 through December 31

#### CHANGES IN ACCOUNT VALUE

<b>Beginning balance January 1</b>	\$5,000,000	01
Deposits	1,221,098	
Withdrawals	-1,124,591	02
Total income	32,158	03
Change in value	1,085	
<b>Ending balance December 31</b>	<b>\$5,129,750</b>	<b>04</b>

#### INCOME SUMMARY

	Year-to-date	
<b>Dividends</b>		
Taxable	\$32,158	05
Tax-exempt/deferred	0	
<b>Capital gains (paid by holdings)</b>		
Short-term	0	
Long-term	0	
<b>Total income</b>	<b>\$32,158</b>	

Source: FR 2016-16149

- 01 On January 1, the shareholder owns \$5,000,000 worth of shares in the fund in a single account as the starting basis.
- 02 During the year, the shareholder receives \$32,158 in taxable dividends from the fund and makes 120 purchases of additional shares in the fund (including purchases through the reinvestment of those dividends) totaling \$1,253,256 and 28 redemptions totaling \$1,124,591.
- 03 The shareholder adopts the NAV method with its taxable year as the computation period. The shareholder's net investment in the fund for the year equals \$128,665 (the \$1,253,256 in purchases minus the \$1,124,591 in redemptions). The shareholder's gain therefore is \$1,085, which is the ending value of the shareholder's shares (\$5,129,750), minus the starting value of the shareholder's shares (\$5,000,000), minus the shareholder's net investment in the fund for the taxable year (\$128,665). The gain of \$1,085 is treated as a short-term capital gain. The shareholder's starting basis for the next year is \$5,129,750.
- 04 The fair market value of the shareholder's shares in the fund at the end of the year is \$5,129,750. All of the shareholder's shares in fund are held as capital assets. There is no adjustment to the basis in the shareholder's shares in the fund under any provision of internal revenue law during the year.
- 05 The shareholder must also include the \$32,158 in dividends as income for the year in the same manner as if the shareholder did not use the NAV method.



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## To learn more

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## For more information, please contact:

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### Floating NAV

*For floating NAV money market funds: You could lose money by investing in the fund. Because the share price of the fund will fluctuate, when you sell your shares they may be worth more or less than what you originally paid for them. The fund may impose a fee upon sale of your shares or may temporarily suspend your ability to sell shares if the fund's liquidity falls below required minimums because of market conditions or other factors. An investment in the fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The fund's sponsor has no legal obligation to provide financial support to the fund, and you should not expect that the sponsor will provide financial support to the fund at any time.*

### Retail

*For retail money market funds: You could lose money by investing in the fund. Although the fund seeks to preserve the value of your investment at \$1.00 per share, it cannot guarantee it will do so. The fund may impose a fee upon sale of your shares or may temporarily suspend your ability to sell shares if the fund's liquidity falls below required minimums because of market conditions or other factors. An investment in the fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The fund's sponsor has no legal obligation to provide financial support to the fund, and you should not expect that the sponsor will provide financial support to the fund at any time.*

### Government

*For government money market funds: You could lose money by investing in the fund. Although the fund seeks to preserve the value of your investment at \$1.00 per share, it cannot guarantee it will do so. An investment in the fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The fund's sponsor has no legal obligation to provide financial support to the fund, and you should not expect that the sponsor will provide financial support to the fund at any time.*

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