

## § 1.851-1

Sections 1.897-5T, 1.897-6T and 1.897-7T also issued under 26 U.S.C. 897 (d), (e), (g) and (j) and 26 U.S.C. 367(e)(2).

Sections 1.902-1 and 902-2 also issued under 26 U.S.C. 902(c)(7).

Section 1.904-4 also issued under 26 U.S.C. 904(d)(6).

Section 1.904-5 also issued under 26 U.S.C. 904(d)(6).

Section 1.904-6 also issued under 26 U.S.C. 904(d)(6).

Section 1.904-7 also issued under 26 U.S.C. 904(d)(6).

Section 1.904(b)-1 also issued under 26 U.S.C. 1(h)(11)(C)(iv) and 904(b)(2)(C).

Section 1.904(b)-2 also issued under 26 U.S.C. 1(h)(11)(C)(iv) and 904(b)(2)(C).

Section 1.904(f)-(2) also issued under 26 U.S.C. 904 (f)(3)(b).

Section 1.904(i)-1 also issued under 26 U.S.C. 904(i).

Sections 1.905-3T and 1.905-4T also issued under 26 U.S.C. 989(c)(4).

Section 1.907(b)-1 is also issued under 26 U.S.C. 907(b).

Section 1.907(b)-1T also issued under 26 U.S.C. 907(b).

SOURCE: T.D. 6500, 25 FR 11910, Nov. 26, 1960; 25 FR 14021, Dec. 31, 1960, unless otherwise noted.

### REGULATED INVESTMENT COMPANIES AND REAL ESTATE INVESTMENT TRUSTS

#### § 1.851-1 Definition of regulated investment company.

(a) *In general.* The term “regulated investment company” is defined to mean any domestic corporation (other than a personal holding company as defined in section 542) which meets (1) the requirements of section 851(a) and paragraph (b) of this section, and (2) the limitations of section 851(b) and § 1.851-2. As to the definition of the term “corporation”, see section 7701(a)(3).

(b) *Requirement.* To qualify as a regulated investment company, a corporation must be:

(1) Registered at all times during the taxable year, under the Investment Company Act of 1940, as amended (15 U.S.C. 80a-1 to 80b-2), either as a management company or a unit investment trust, or

(2) A common trust fund or similar fund excluded by section 3(c)(3) of the Investment Company Act of 1940 (15 U.S.C. 80a-3(c)) from the definition of “investment company” and not in-

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cluded in the definition of “common trust fund” by section 584(a).

#### § 1.851-2 Limitations.

(a) *Election to be a regulated investment company.* Under the provisions of section 851(b)(1), a corporation, even though it satisfies the other requirements of part I, subchapter M, chapter 1 of the Code, for the taxable year, will not be considered a regulated investment company for such year, within the meaning of such part I, unless it elects to be a regulated investment company for such taxable year, or has made such an election for a previous taxable year which began after December 31, 1941. The election shall be made by the taxpayer by computing taxable income as a regulated investment company in its return for the first taxable year for which the election is applicable. No other method of making such election is permitted. An election once made is irrevocable for such taxable year and all succeeding taxable years.

(b) *Gross income requirement—(1) General rule.* Section 851(b) (2) and (3) provides that (i) at least 90 percent of the corporation’s gross income for the taxable year must be derived from dividends, interest, and gains from the sale or other disposition of stocks or securities, and (ii) less than 30 percent of its gross income must have been derived from the sale or other disposition of stock or securities held for less than three months. In determining the gross income requirements under section 851(b) (2) and (3), a loss from the sale or other disposition of stock or securities does not enter into the computation. A determination of the period for which stock or securities have been held shall be governed by the provisions of section 1223 insofar as applicable.

(2) *Special rules.* (i) For purposes of section 851(b)(2), there shall be treated as dividends amounts which are included in gross income for the taxable year under section 951(a)(1)(A)(i) to the extent that (a) a distribution out of a foreign corporation’s earnings and profits of the taxable year is not included in gross income by reason of section 959 (a)(1), and (b) the earnings and profits are attributable to the amounts which were so included in gross income under section

951(a)(1)(A)(i). For allocation of distributions to earnings and profits of foreign corporations, see §1.959-3. The provisions of this subparagraph shall apply with respect to taxable years of controlled foreign corporations beginning after December 31, 1975, and to taxable years of United States shareholders (within the meaning of section 951(b) within which or with which such taxable years of such controlled foreign corporations end.

(ii) For purposes of subdivision (i) of this subparagraph, if by reason of section 959(a)(1) a distribution of a foreign corporation's earnings and profits for a taxable year described in section 959(c)(2) is not included in a shareholder's gross income, then such distribution shall be allocated proportionately between amounts attributable to amounts included under each clause of section 951(a)(1)(A). Thus, for example, M is a United States shareholder in X Corporation, a controlled foreign corporation. M and X each use the calendar year as the taxable year. For 1977, M is required by section 951(a)(1)(a) to include \$3,000 in its gross income, \$1,000 of which is included under clause (i) thereof. In 1977, M received a distribution described in section 959(c)(2) of \$2,700 out of X's earnings and profits for 1977, which is, by reason of section 959(a)(1), excluded from M's gross income. The amount of the distribution attributable to the amount included under section 951(a)(1)(A)(i) is \$900, i.e., \$2,700 multiplied by (\$1,000/\$3,000).

(c) *Diversification of investments.* (1) Subparagraph (A) of section 851(b)(4) requires that at the close of each quarter of the taxable year at least 50 percent of the value of the total assets of the taxpayer corporation be represented by one or more of the following:

- (i) Cash and cash items, including receivables;
- (ii) Government securities;
- (iii) Securities of other regulated investment companies; or
- (iv) Securities (other than those described in subdivisions (ii) and (iii) of this subparagraph) of any one or more issuers which meet the following limitations: (a) The entire amount of the securities of the issuer owned by the

taxpayer corporation is not greater in value than 5 percent of the value of the total assets of the taxpayer corporation, and (b) the entire amount of the securities of such issuer owned by the taxpayer corporation does not represent more than 10 percent of the outstanding voting securities of such issuer. For the modification of the percentage limitations applicable in the case of certain venture capital investment companies, see section 851(e) and §1.851-6.

Assuming that at least 50 percent of the value of the total assets of the corporation satisfies the requirements specified in this subparagraph, and that the limiting provisions of subparagraph (B) of section 851(b)(4) and subparagraph (2) of this paragraph are not violated, the corporation will satisfy the requirements of section 851(b)(4), notwithstanding that the remaining assets do not satisfy the diversification requirements of subparagraph (A) of section 851(b)(4). For example, a corporation may own all the stock of another corporation, provided it otherwise meets the requirements of subparagraphs (A) and (B) of section 851(b)(4).

(2) Subparagraph (B) of section 851(b)(4) prohibits the investment at the close of each quarter of the taxable year of more than 25 percent of the value of the total assets of the corporation (including the 50 percent or more mentioned in subparagraph (A) of section 851(b)(4)) in the securities (other than Government securities or the securities of other regulated investment companies) of any one issuer, or of two or more issuers which the taxpayer company controls and which are engaged in the same or similar trades or businesses or related trades or businesses, including such issuers as are merely a part of a unit contributing to the completion and sale of a product or the rendering of a particular service. Two or more issuers are not considered as being in the same or similar trades or businesses merely because they are engaged in the broad field of manufacturing or of any other general classification of industry, but issuers shall be construed to be engaged in the same or similar trades or businesses if they are engaged in a distinct branch of

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business, trade, or manufacture in which they render the same kind of service or produce or deal in the same kind of product, and such service or products fulfill the same economic need. If two or more issuers produce more than one product or render more than one type of service, then the chief product or service of each shall be the basis for determining whether they are in the same trade or business.

[T.D. 6500, 25 FR 11910, Nov. 26, 1960, as amended by T.D. 6598, 27 FR 4090, Apr. 28, 1962; T.D. 7555, 43 FR 32753, July 28, 1978]

**§ 1.851-3 Rules applicable to section 851(b)(4).**

In determining the value of the taxpayer's investment in the securities of any one issuer, for the purposes of subparagraph (B) of section 851(b)(4), there shall be included its proper proportion of the investment of any other corporation, a member of a controlled group, in the securities of such issuer. See example 4 in § 1.851-5. For purposes of §§ 1.851-2, 1.851-4, 1.851-5, and 1.851-6, the terms "controls", "controlled group", and "value" have the meaning assigned to them by section 851(c). All other terms used in such sections have the same meaning as when used in the Investment Company Act of 1940 (15 U.S.C., chapter 2D) or that act as amended.

**§ 1.851-4 Determination of status.**

With respect to the effect which certain discrepancies between the value of its various investments and the requirements of section 851(b)(4) and paragraph (c) of § 1.851-2, or the effect that the elimination of such discrepancies will have on the status of a company as a regulated investment company for purposes of part I, subchapter M, chapter 1 of the Code, see section 851(d). A company claiming to be a regulated investment company shall keep sufficient records as to investments so as to be able to show that it has complied with the provisions of section 851 during the taxable year. Such records shall be kept at all times available for inspection by any internal revenue officer or employee and shall be retained so long as the contents thereof may be-

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come material in the administration of any internal revenue law.

[T.D. 6598, 27 FR 4090, Apr. 28, 1962]

**§ 1.851-5 Examples.**

The provisions of section 851 may be illustrated by the following examples:

*Example 1.* Investment Company W at the close of its first quarter of the taxable year has its assets invested as follows:

	Percent
Cash .....	5
Government securities .....	10
Securities of regulated investment companies .....	20
Securities of Corporation A .....	10
Securities of Corporation B .....	15
Securities of Corporation C .....	20
Securities of various corporations (not exceeding 5 percent of its assets in any one company) .....	20
<b>Total .....</b>	<b>100</b>

Investment Company W owns all of the voting stock of Corporations A and B, 15 percent of the voting stock of Corporation C, and less than 10 percent of the voting stock of the other corporations. None of the corporations is a member of a controlled group. Investment Company W meets the requirements under section 851(b)(4) at the end of its first quarter. It complies with subparagraph (A) of section 851(b)(4) since it has 55 percent of its assets invested as provided in such subparagraph. It complies with subparagraph (B) of section 851(b)(4) since it does not have more than 25 percent of its assets invested in the securities of any one issuer, or of two or more issuers which it controls.

*Example 2.* Investment Company V at the close of a particular quarter of the taxable year has its assets invested as follows:

	Percent
Cash .....	10
Government securities .....	35
Securities of Corporation A .....	7
Securities of Corporation B .....	12
Securities of Corporation C .....	15
Securities of Corporation D .....	21
<b>Total .....</b>	<b>100</b>

Investment Company V fails to meet the requirements of subparagraph (A) of section 851(b)(4) since its assets invested in Corporations A, B, C, and D exceed in each case 5 percent of the value of the total assets of the company at the close of the particular quarter.

*Example 3.* Investment Company X at the close of the particular quarter of the taxable year has its assets invested as follows:

	Percent
Cash and Government securities .....	20