

§ 1.852-3

the corporation but deemed paid by the shareholder.

[T.D. 6500, 25 FR 11910, Nov. 26, 1960, as amended by T.D. 6598, 27 FR 4091, Apr. 28, 1962; T.D. 6921, 32 FR 8754, June 20, 1967; T.D. 7337, 39 FR 44972, Dec. 30, 1974]

§ 1.852-3 Investment company taxable income.

Section 852(b)(2) requires certain adjustments to be made to convert taxable income of the investment company to investment company taxable income, as follows:

(a) The excess, if any, of the net long-term capital gain over the net short-term capital loss shall be excluded;

(b) The net operating loss deduction provided in section 172 shall not be allowed;

(c) The special deductions provided in part VIII (section 241 and following, except section 248), subchapter B, chapter 1 of the Code, shall not be allowed. Those not allowed are the deduction for partially tax-exempt interest provided by section 242, the deductions for dividends received provided by sections 243, 244, and 245, and the deduction for certain dividends paid provided by section 247. However, the deduction provided by section 248 (relating to organizational expenditures), otherwise allowable in computing taxable income, shall likewise be allowed in computing the investment company taxable income. See section 852(b)(1) and paragraph (a) of § 1.852-2 for treatment of the deduction for partially tax-exempt interest (provided by section 242) for purposes of computing the normal tax under section 11;

(d) The deduction for dividends paid (as defined in section 561) shall be allowed, but shall be computed without regard to capital gains dividends (as defined in section 852(b)(3)(C) and paragraph (c) of § 1.852-4); and

(e) The taxable income shall be computed without regard to section 443(b). Thus, the taxable income for a period of less than 12 months shall not be placed on an annual basis even though such short taxable year results from a change of accounting period.

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§ 1.852-4 Method of taxation of shareholders of regulated investment companies.

(a) *Ordinary income.* (1) Except as otherwise provided in paragraph (b) of this section (relating to capital gains), a shareholder receiving dividends from a regulated investment company shall include such dividends in gross income for the taxable year in which they are received.

(2) See section 853 (b)(2) and (c) and paragraph (b) of § 1.853-2 and § 1.853-3 for the treatment by shareholders of dividends received from a regulated investment company which has made an election under section 853(a) with respect to the foreign tax credit. See section 854 and §§ 1.854-1 through 1.854-3 for limitations applicable to dividends received from regulated investment companies for the purpose of the credit under section 34 (for dividends received on or before December 31, 1964), the exclusion from gross income under section 116, and the deduction under section 243. See section 855 (b) and (d) and paragraphs (c) and (f) of § 1.855-1 for treatment by shareholders of dividends paid by a regulated investment company after the close of the taxable year in the case of an election under section 855(a).

(b) *Capital gains*—(1) *In general.* Under section 852(b)(3)(B), shareholders of a regulated investment company who receive capital gain dividends (as defined in paragraph (c) of this section), in respect of the capital gains of an investment company for a taxable year for which it is taxable under part I, subchapter M, chapter 1 of the Code, as a regulated investment company, shall treat such capital gain dividends as gains from the sale or exchange of capital assets held for more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977) and realized in the taxable year of the shareholder in which the dividend was received. In the case of dividends with respect to any taxable year of a regulated investment company ending after December 31, 1969, and beginning before January 1, 1975, the portion of a shareholder's capital gain dividend to which section 1201(d) (1) or (2) applies is the portion

so designated by the regulated investment company pursuant to paragraph (c)(2) of this section.

(2) *Undistributed capital gains.* (i) A person who is a shareholder of a regulated investment company at the close of a taxable year of such company for which it is taxable under part I of subchapter M shall include in his gross income as a gain from the sale or exchange of a capital asset held for more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977) any amount of undistributed capital gains. The term "undistributed capital gains" means the amount designated as undistributed capital gains in accordance with paragraph (a) of §1.852-9, but the amount so designated shall not exceed the shareholder's proportionate part of the amount subject to tax under section 852(b)(3)(A). Such amount shall be included in gross income for the taxable year of the shareholder in which falls the last day of the taxable year of the regulated investment company in respect of which the undistributed capital gains were designated. The amount of such gains designated under paragraph (a) of §1.852-9 as gain described in section 1201(d) (1) or (2) shall be included in the shareholder's gross income as gain described in section 1201(d) (1) or (2). For certain administrative provisions relating to undistributed capital gains, see §1.852-9.

(ii) Any shareholder required to include an amount of undistributed capital gains in gross income under section 852(b)(3)(D)(i) and subdivision (i) of this subparagraph shall be deemed to have paid for his taxable year for which such amount is so includible—

(a) In the case of an amount designated with respect to a taxable year of the company ending before January 1, 1970, a tax equal to 25 percent of such amount.

(b) In the case of a taxable year of the company ending after December 31, 1969, and beginning before January 1, 1975, a tax equal to the tax designated under paragraph (a)(1) of §1.852-9 by the regulated investment company as his proportionate share of the capital gains tax paid with respect to such amount, or

(c) In the case of an amount designated with respect to a taxable year of the company beginning after December 31, 1974, a tax equal to 30 percent of such amount.

Such shareholder is entitled to a credit or refund of the tax so deemed paid in accordance with the rules provided in paragraph (c)(2) of §1.852-9.

(iii) Any shareholder required to include an amount of undistributed capital gains in gross income under section 852(b)(3)(D)(i) and subdivision (i) of this subparagraph shall increase the adjusted basis of the shares of stock with respect to which such amount is so includible—

(a) In the case of an amount designated with respect to a taxable year of the company ending before January 1, 1970, by 75 percent of such amount.

(b) In the case of an amount designated with respect to a taxable year of the company ending after December 31, 1969, and beginning before January 1, 1975, by the amount designated under paragraph (a)(1)(iv) of §1.852-9 by the regulated investment company, or

(c) In the case of an amount designated with respect to a taxable year of the company beginning after December 31, 1974, by 70 percent of such amount.

(iv) For purposes of determining whether the purchaser or seller of a share or regulated investment company stock is the shareholder at the close of such company's taxable year who is required to include an amount of undistributed capital gains in gross income, the amount of the undistributed capital gains shall be treated in the same manner as a cash dividend payable to shareholders of record at the close of the company's taxable year. Thus, if a cash dividend paid to shareholders of record as of the close of the regulated investment company's taxable year would be considered income to the purchaser, then the purchaser is also considered to be the shareholder of such company at the close of its taxable year for purposes of including an amount of undistributed capital gains in gross income. If, in such a case, notice on Form 2439 is, pursuant to paragraph (a)(1) of §1.852-9, mailed by the regulated investment company to the seller, then the seller

shall be considered the nominee of the purchaser and, as such, shall be subject to the provisions in paragraph (b) of § 1.852-9. For rules for determining whether a dividend is income to the purchaser or seller of a share of stock, see paragraph (c) of § 1.61-9.

(3) *Partners and partnerships.* If the shareholder required to include an amount of undistributed capital gains in gross income under section 852(b)(3)(D) and subparagraph (2) of this paragraph is a partnership, such amount shall be included in the gross income of the partnership for the taxable year of the partnership in which falls the last day of the taxable year of the regulated investment company in respect of which the undistributed capital gains were designated. The amount so includible by the partnership shall be taken into account by the partners as distributive shares of the partnership gains and losses from sales or exchanges of capital assets held for more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977) pursuant to section 702(a)(2) and paragraph (a)(2) of § 1.702-1. The tax with respect to the undistributed capital gains is deemed paid by the partnership (under section 852(b)(3)(D)(ii) and subparagraph (2)(ii) of this paragraph), and the credit or refund of such tax shall be taken into account by the partners in accordance with section 702(a)(8) and paragraph (a)(8)(ii) of § 1.702-1 and paragraph (c)(2) of § 1.852-9. In accordance with section 705(a), the partners shall increase the basis of their partnership interests under section 705(a)(1) by the distributive shares of such gains, and shall decrease the basis of their partnership interests by the distributive shares of the amount of the tax under section 705(a)(2)(B) (relating to certain non-deductible expenditures) and paragraph (a)(3) of § 1.705-1.

(4) *Nonresident alien individuals.* If the shareholder required to include an amount of undistributed capital gains in gross income under section 852(b)(3)(D) and subparagraph (2) of this paragraph is a nonresident alien individual, such shareholder shall be treated, for purposes of section 871 and the regulations thereunder, as having realized a long-term capital gain in such

amount on the last day of the taxable year of the regulated investment company in respect of which the undistributed capital gains were designated.

(5) *Effect on earnings and profits of corporate shareholders of a regulated investment company.* If a shareholder required to include an amount of undistributed capital gains in gross income under section 852(b)(3)(D) and subparagraph (2) of this paragraph is a corporation, such corporation, in computing its earnings and profits for the taxable year for which such amount is so includible, shall treat such amount as if it had actually been received and the taxes paid shall include any amount of tax liability satisfied by a credit under section 852(b)(3)(D) and subparagraph (2) of this paragraph.

(c) *Definition of capital gain dividend—*

(1) *General rule.* A capital gain dividend, as defined in section 852(b)(3)(C), is any dividend or part thereof which is designated by a regulated investment company as a capital gain dividend in a written notice mailed to its shareholders within the period specified in paragraph (c)(4) of this section. If the aggregate amount so designated with respect to the taxable year (including capital gain dividends paid after the close of the taxable year pursuant to an election under section 855) is greater than the excess of the net long-term capital gain over the net short-term capital loss of the taxable year, the portion of each distribution which shall be a capital gain dividend shall be only that proportion of the amount so designated which such excess of the net long-term capital gain over the net short-term capital loss bears to the aggregate amount so designated. For example, a regulated investment company making its return on the calendar year basis advised its shareholders by written notice mailed December 30, 1955, that of a distribution of \$500,000 made December 15, 1955, \$200,000 constituted a capital gain dividend, amounting to \$2 per share. It was later discovered that an error had been made in determining the excess of the net long-term capital gain over the net short-term capital loss of the taxable year, and that such excess was \$100,000 instead of \$200,000. In such case each

shareholder would have received a capital gain dividend of \$1 per share instead of \$2 per share.

(2) *Shareholder of record custodian of certain unit investment trusts.* In any case where a notice is mailed pursuant to subparagraph (1) of this paragraph by a regulated investment company with respect to a taxable year of the regulated investment company ending after December 8, 1970, to a shareholder of record who is a nominee acting as a custodian of a unit investment trust described in section 851(f)(1) and paragraph (d) of § 1.851-7, the nominee shall furnish each holder of an interest in such trust with a written notice mailed on or before the 55th day following the close of the regulated investment company's taxable year. The notice shall designate the holder's proportionate share of the capital gain dividend shown on the notice received by the nominee pursuant to subparagraph (1) of this paragraph. The notice shall include the name and address of the nominee identified as such. This subparagraph shall not apply if the regulated investment company agrees with the nominee to satisfy the notice requirements of subparagraph (1) of this paragraph with respect to each holder of an interest in the unit investment trust whose shares are being held by the nominee as custodian and, not later than 45 days following the close of the company's taxable year, files with the Internal Revenue Service office where the company's income tax return is to be filed for the taxable year, a statement that the holders of the unit investment trust with whom the agreement was made have been directly notified by the regulated investment company. Such statement shall include the name, sponsor, and custodian of each unit investment trust whose holders have been directly notified. The nominee's requirements under this paragraph shall be deemed met if the regulated investment company transmits a copy of such statement to the nominee within such 45-day period; provided however, if the regulated investment company fails or is unable to satisfy the requirements of this subparagraph with respect to the holders of interest in the unit investment trust, it shall so notify the Internal

Revenue Service within 45 days following the close of its taxable year. The custodian shall, upon notice by the Internal Revenue Service that the regulated investment company has failed to comply with the agreement, satisfy the requirements of this subparagraph within 30 days of such notice. If a notice under paragraph (c)(1) of this section is mailed within the 120-day period following the date of a determination pursuant to paragraph (c)(4)(ii) of this section, the 120-day period and the 130-day period following the date of the determination shall be substituted for the 45-day period and the 55-day period following the close of the regulated investment company's taxable year prescribed by this subparagraph (2).

(3) *Subsection (d) gain for certain taxable years.* In the case of capital gain dividends with respect to any taxable year of a regulated investment company ending after December 31, 1969, and beginning before January 1, 1975 (including capital gain dividends paid after the close of the taxable year pursuant to an election under section 855), the company must include in its written notice under paragraph (c)(1) of this section a statement showing the shareholder's proportionate share of the capital gain dividend which is gain described in section 1201(d)(1) and his proportionate share of such dividend which is gain described in section 1201(d)(2). In determining the portion of the capital gain dividend which, in the hands of a shareholder, is gain described in section 1201(d)(1) or (2), the regulated investment company shall consider that capital gain dividends for a taxable year are first made from its long-term capital gains for such year which are not described in section 1201(d)(1) or (2), to the extent thereof, and then from its long-term capital gains for such year which are described in section 1201(d)(1) or (2). A shareholder's proportionate share of gains which are described in section 1201(d)(1) is the amount which bears the same ratio to the amount paid to him as a capital gain dividend in respect of such year as (i) the aggregate amount of the company's gains which are described in section 1201(d)(1) and paid to all shareholders bears to (ii) the aggregate amount of the capital gain dividend

paid to all shareholders in respect of such year. A shareholder's proportionate share of gains which are described in section 1201(d)(2) shall be determined in a similar manner. Every regulated investment company shall keep a record of the proportion of each capital gain dividend (to which this paragraph applies) which is gain described in section 1201(d)(1) or (2). If, for his taxable year, a shareholder must include in his gross income a capital gain dividend to which this paragraph applies, he shall attach to his income tax return for such taxable year a statement showing, with respect to the total of such dividends for such taxable year received from each regulated investment company, the name and address of the regulated investment company from which such dividends are received, the amount of such dividends, the portion of such dividends which was designated as gain described in section 1201(d)(1), and the portion of such dividends which was designated as gain described in section 1201(d)(2).

(4) *Mailing of written notice to shareholders.* (i) Except as provided in paragraph (c)(4)(ii) of this section, the written notice designating a dividend or part thereof as a capital gain dividend must be mailed to the shareholders not later than 45 days (30 days for a taxable year ending before February 26, 1964) after the close of the taxable year of the regulated investment company.

(ii) If a determination (as defined in section 860(e)) after November 6, 1978, increases the excess for the taxable year of the net capital gain over the deduction for capital gains dividends paid, then a regulated investment company may designate all or part of any dividend as a capital gain dividend in a written notice mailed to its shareholders at any time during the 120-day period immediately following the date of the determination. The aggregate amount designated during this period may not exceed this increase. A dividend may be designated if it is actually paid during the taxable year, is one paid after the close of the taxable year to which section 855 applies, or is a deficiency dividend (as defined in section 860(f)), including a deficiency dividend paid by an acquiring corporation to which section 381(c)(25) applies. The

date of a determination is established under § 1.860-2(b)(1).

(d) *Special treatment of loss on the sale or exchange of regulated investment company stock held less than 31 days—(1) In general.* Under section 852(b)(4), if any person, with respect to a share of regulated investment company stock acquired by such person after December 31, 1957, and held for a period of less than 31 days, is required by section 852(b)(3) (B) or (D) to include in gross income as a gain from the sale or exchange of a capital asset held for more than six months—

(i) The amount of a capital gain dividend, or

(ii) An amount of undistributed capital gains,

then such person shall, to the extent of such amount, treat any loss on the sale or exchange of such share of stock as a loss from the sale or exchange of a capital asset held for more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977). Such special treatment with respect to the sale of regulated investment company stock held for a period of less than 31 days is applicable to losses for taxable years ending after December 31, 1957.

(2) *Determination of holding period.* The rules contained in section 246(c)(3) (relating to the determination of holding periods for purposes of the deduction for dividends received) shall be applied in determining whether, for purposes of section 852(b)(4) and this paragraph, a share of regulated investment company stock has been held for a period of less than 31 days. In applying those rules, however, "30 days" shall be substituted for the number of days specified in subparagraph (B) of section 246(c)(3).

(3) *Example.* The application of section 852(b)(4) and this paragraph may be illustrated by the following example:

Example. On December 15, 1958, A purchased a share of stock in the X regulated investment company for \$20. The X regulated investment company declared a capital gain dividend of \$2 per share to shareholders of record on December 31, 1958. A, therefore, received a capital gain dividend of \$2 which, pursuant to section 852(b)(3)(B), he must treat as a gain from the sale or exchange of a capital asset held for more than 6 months.

On January 5, 1959, A sold his share of stock in the X regulated investment company for \$17.50, which sale resulted in a loss of \$2.50. Under section 852(b)(4) and this paragraph, A must treat \$2 of such loss (an amount equal to the capital gain dividend received with respect to such share of stock) as a loss from the sale or exchange of a capital asset held for more than 6 months.

(Sec. 7805, 68A Stat. 917; 26 U.S.C. 7805; 860(e) (92 Stat. 2849, 26 U.S.C. 860(e)); sec. 860(g) (92 Stat. 2850, 26 U.S.C. 860(g)))

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§ 1.852-5 Earnings and profits of a regulated investment company.

(a) Any regulated investment company, whether or not such company meets the requirements of section 852(a) and paragraphs (a)(1) (i) and (ii) of § 1.852-1, shall apply paragraph (b) of this section in computing its earnings and profits for a taxable year beginning after February 28, 1958. However, for a taxable year of a regulated investment company beginning before March 1, 1958, paragraph (b) of this section shall apply only if the regulated investment company meets the requirements of section 852(a) and paragraphs (a)(1) (i) and (ii) of § 1.852-1.

(b) In the determination of the earnings and profits of a regulated investment company, section 852(c) provides that such earnings and profits for any taxable year (but not the accumulated earnings and profits) shall not be reduced by any amount which is not allowable as a deduction in computing its taxable income for the taxable year. Thus, if a corporation would have had earnings and profits of \$500,000 for the taxable year except for the fact that it had a net capital loss of \$100,000, which amount was not deductible in determining its taxable income, its earnings and profits for that year if it is a regulated investment company would be \$500,000. If the regulated investment company had no accumulated earnings and profits at the beginning of the taxable year, in determining its accumulated earnings and profits as of the beginning of the following taxable year,

the earnings and profits for the taxable year to be considered in such computation would amount to \$400,000 assuming that there had been no distribution from such earnings and profits. If distributions had been made in the taxable year in the amount of the earnings and profits then available for distribution, \$500,000, the corporation would have as of the beginning of the following taxable year neither accumulated earnings and profits nor a deficit in accumulated earnings and profits, and would begin such year with its paid-in capital reduced by \$100,000, an amount equal to the excess of the \$500,000 distributed over the \$400,000 accumulated earnings and profits which would otherwise have been carried into the following taxable year.

§ 1.852-6 Records to be kept for purpose of determining whether a corporation claiming to be a regulated investment company is a personal holding company.

(a) Every regulated investment company shall maintain in the internal revenue district in which it is required to file its income tax return permanent records showing the information relative to the actual owners of its stock contained in the written statements required by this section to be demanded from the shareholders. The actual owner of stock includes the person who is required to include in gross income in his return the dividends received on the stock. 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 become material in the administration of any internal revenue law.

(b) For the purpose of determining whether a domestic corporation claiming to be a regulated investment company is a personal holding company as defined in section 542, the permanent records of the company shall show the maximum number of shares of the corporation (including the number and face value of securities convertible into stock of the corporation) to be considered as actually or constructively owned by each of the actual owners of any of its stock at any time during the last half of the corporation's taxable year, as provided in section 544.