than Government securities or the securities of other regulated investment companies) of issuers as to each of which such investment company (1) holds more than 10 percent of the outstanding voting securities of such issuer, and (2) has continuously held any security of such issuer (or any security of a predecessor of such issuer) for 10 or more years preceding such quarter, unless the value of its total assets so represented is reduced to 25 percent or less within 30 days after the close of such quarter.

(d) Definition of predecessor company. As used in section 851(e) and this section, the term “predecessor company” means any corporation the basis of whose securities in the hands of the investment company was, under the provisions of section 358 or corresponding provisions of prior law, the same in whole or in part as the basis of any of the securities of the issuer and any corporation with respect to whose securities any of the securities of the issuer were received directly or indirectly by the investment company in a transaction or series of transactions involving nonrecognition of gain or loss in whole or in part. The other terms used in this section have the same meaning as when used in section 851(b)(4). See paragraph (c) of §1.851–2 and §1.851–3.

§ 1.851–7 Certain unit investment trusts.

(a) In general. For purposes of the Internal Revenue Code, a unit investment trust (as defined in paragraph (d) of this section) shall not be treated as a person (as defined in section 7701(a)(1)) except for years ending before January 1, 1969. A holder of an interest in such a trust will be treated as directly owning the assets of such trust for taxable years of such holder which end with or within any year of the trust to which section 851(f) and this section apply.

(b) Treatment of unit investment trust. A unit investment trust shall not be treated as an individual, a trust estate, partnership, association, company, or corporation for purposes of the Internal Revenue Code. Accordingly, a unit investment trust is not a taxpayer subject to taxation under the Internal Revenue Code. No gain or loss will be recognized by the unit investment trust if such trust distributes a holder’s proportionate share of the trust assets in exchange for his interest in the trust. Also, no gain or loss will be recognized by the unit investment trust if such trust sells the holder’s proportionate share of the trust assets and distributes the proceeds from such share to the holder in exchange for his interest in the trust.

(c) Treatment of holder of interest in unit investment trust. (1) Each holder of an interest in a unit investment trust shall be treated (to the extent of such interest) as owning a proportionate share of the assets of the trust. Accordingly, if the trust distributes to the holder of an interest in such trust his proportionate share of the trust assets in exchange for his interest in the trust, no gain or loss shall be recognized by such holder (or by any other holder of an interest in such trust). For purposes of this paragraph, each purchase of an interest in the trust by the holder will be considered a separate interest in the trust. Items of income, gain, loss, deduction, or credit received by the trust or a custodian thereof shall be taxed to the holders of interests in the trust (and not to the trust) as though they had received their proportionate share of the items directly on the date such items were received by the trust or custodian.

(2) The basis of the assets of such trust which are treated under subparagraph (1) of this paragraph as being owned by the holder of an interest in such trust shall be the same as the basis of his interest in such trust. Accordingly, the amount of the gain or loss recognized by the holder upon the sale by the unit investment trust of the holder’s pro rata share of the trust assets shall be determined with reference the basis, of his interest in the trust. Also, the basis of the assets received by the holder, if the trust distributes a holder’s pro rata share of the trust assets in exchange for his interest in the trust, will be the same as the basis of his interest in the trust. If the unit investment trust sells less than all of the holder’s pro rata share of the trust assets and the holder retains an interest in the trust, the amount of the gain or loss recognized by the holder
§ 1.851–7

upon the sale shall be determined with reference to the basis of his interest in the assets sold by the trust, and the basis of his interest in the trust shall be reduced accordingly. If the trust distributes a portion of the holder’s proportionate share of the trust assets in exchange for a portion of his interest in the trust, the basis of the assets received by the holder shall be determined with reference to the basis of his interest in the assets distributed by the trust, and the basis of his interest in the trust shall be reduced accordingly. For purposes of this subparagraph the basis of the holder’s interest in assets sold by the trust or distributed to him shall be an amount which bears the same relationship to the basis of his total interest in the trust that the fair market value of the assets sold or distributed bears to the fair market value of such total interest in the trust, such fair market value to be determined on the date of such sale or distribution.

(3) The period for which the holder of an interest in such trust has held the assets of the trust which are treated under subparagraph (1) of this paragraph as being owned by him is the same as the period for which such holder has held his interest in such trust. Accordingly, the character of the gain, loss, deduction, or credit recognized by the holder upon the sale by the unit investment trust of the holder’s proportionate share of the trust assets shall be determined with reference to the period for which he has held his interest in the trust. Also, the holding period of the assets received by the holder if the trust distributes the holder’s proportionate share of the trust assets in exchange for his interest in the trust will include the period for which the holder has held his interest in the trust.

(4) The application of the provisions of this paragraph may be illustrated by the following example:

Example. B entered a periodic payment plan of a unit investment trust (as defined in paragraph (d) of this section) with X Bank as custodian and Z as plan sponsor. Under this plan, upon B’s demand, X must either redeem B’s interest at a price substantially equal to the fair market value of the number of shares in Y, a management company, which are credited to B’s account by X in connection with the unit investment trust, or at B’s option distribute such shares of Y to B. B’s plan provides for quarterly payments of $1,000. On October 1, 1969, B made his initial quarterly payment of $1,000 and X credited B’s account with 110 shares of Y. On December 1, 1969, Y declared and paid a dividend of 25 cents per share, 5 cents of which was designated as a capital gain dividend pursuant to section 852(b)(3) and § 1.852–4. X credited B’s account with $27.50 but did not distribute the money to B in 1969. On December 31, 1969, X charged B’s account with $1 for custodial fees for calendar year 1969. On January 1, 1970, B paid X $1,000 and X credited B’s account with 105 shares of Y. On April 1, 1970, B paid X $1,000 and X credited B’s account with 100 shares of Y. B must include in his tax return for 1969 a dividend of $22 and a long-term capital gain of $5.50. In addition, B is entitled to deduct the annual custodial fee of $1 under section 212 of the Code.

(a) On April 4, 1970, at B’s request, X sells the shares of Y credited to B’s account (315 shares) for $10 per share and distributes the proceeds ($3,150) to B together with the remaining balance of $26.50 in B’s account. The receipt of the $26.50 does not result in any tax consequences to B. B recognizes a long-term capital gain of $100 and a short-term capital gain of $50, computed as follows:

(1) B is treated as owning 110 shares of Y as of October 1, 1969. The basis of these shares is $1,000, and they were sold for $1,100 (110 shares at $10 per share). Therefore, B recognizes a gain from the sale or exchange of a capital asset held for more than 6 months in the amount of $100.

(2) B is treated as owning 105 shares of Y as of January 1, 1970, and 100 shares as of April 1, 1970. With respect to the shares acquired on January 1, 1970, there is no gain recognized as the shares were sold for $1,000, which is B’s basis of the shares. The shares acquired on January 1, 1970, were sold for $1,050 (105 shares at $10 per share), and B’s basis of these shares is $1,000. Therefore, B recognizes a gain of $50 from the sale or exchange of a capital asset held for not more than 6 months.

(b) On April 4, 1970, at B’s request, X distributes to B the shares of Y credited to his account and $26.50 in cash. The receipt of the $26.50 does not result in any tax consequences to B. B does not recognize gain or loss on the distribution of the shares of Y to him. The bases and holding periods of B’s interests in Y are as follows:

<table>
<thead>
<tr>
<th>Number of shares</th>
<th>Date acquired</th>
<th>Basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>110</td>
<td>10–1–69</td>
<td>$809</td>
</tr>
<tr>
<td>105</td>
<td>1–1–70</td>
<td>9.52</td>
</tr>
<tr>
<td>100</td>
<td>4–1–70</td>
<td>10.00</td>
</tr>
</tbody>
</table>

(d) Definition. A unit investment trust to which this section refers is a
§ 1.852–1  Taxation of regulated investment companies.

(a) Requirements applicable thereto—(1) In general. Section 852(a) denies the application of the provisions of part I, subchapter M, chapter 1 of the Code (other than section 852(c), relating to earnings and profits), to a regulated investment company for a taxable year beginning after February 28, 1958, unless—

(i) The deduction for dividends paid for such taxable year as defined in section 561 (computed without regard to capital gain dividends) is equal to at least 90 percent of its investment company taxable income for such taxable year (determined without regard to the provisions of section 852(b)(2)(D) and paragraph (d) of §1.852–3); and

(ii) The company complies for such taxable year with the provisions of §1.852–6 (relating to records required to be maintained by a regulated investment company).