requirements of section 852(a) and subparagraph (1) (i) and (ii) of this paragraph.

(b) Failure to qualify. If a regulated investment company does not meet the requirements of section 852(a) and paragraph (a)(1) (i) and (ii) of this section for the taxable year, it will, even though it may otherwise be classified as a regulated investment company, be taxed in such year as an ordinary corporation and not as a regulated investment company. In such case, none of the provisions of part I of subchapter M (other than section 852(c) in the case of taxable years beginning after February 28, 1958) will be applicable to it. For the rules relating to the applicability of section 852(c), see §1.852–3.

(T.D. 6598, 27 FR 4091, Apr. 28, 1962)

§ 1.852–2 Method of taxation of regulated investment companies.

(a) Imposition of normal tax and surtax. Section 852(b)(1) imposes a normal tax and surtax, computed at the rates and in the manner prescribed in section 11, on the investment company taxable income, as defined in section 852(b)(2) and §1.852–3, for each taxable year of a regulated investment company. The tax is imposed as if the investment company taxable income were the taxable income referred to in section 11. In computing the normal tax under section 11, the regulated investment company’s taxable income and the dividends paid deduction (computed without regard to the capital gains dividends) shall both be reduced by the deduction for partially tax-exempt interest provided by section 242.

(b) Taxation of capital gains—(1) In general. Section 852(b)(3)(A) imposes (i) in the case of a taxable year beginning before January 1, 1970, a tax of 25 percent, or (ii) in the case of a taxable year beginning after December 31, 1969, a tax determined as provided in section 1201(a) and paragraph (a)(3) of §1.1201–1, on the excess, if any, of the net long-term capital gain of a regulated investment company (subject to tax under part I, subchapter M, chapter 1 of the Code) over the sum of its net short-term capital loss and its deduction for dividends paid (as defined in section 561) determined with reference to capital gain dividends only. For the definition of capital gain dividend paid by a regulated investment company, see section 852(b)(3)(C) and paragraph (c) of §1.852–4. In the case of a taxable year ending after December 31, 1969, and beginning before January 1, 1975, such deduction for dividends paid shall first be made from the amount subject to tax in accordance with section 1201(a)(1)(B), to the extent thereof, and then from the amount subject to tax in accordance with section 1201(a)(1)(A). See §1.852–10, relating to certain distributions in redemption of interests in unit investment trusts which, for purposes of the deduction for dividends paid with reference to capital gain dividends only, are not considered preferential dividends under section 562(c). See section 855 and §1.855–1, relating to dividends paid after the close of the taxable year.

(2) Undistributed capital gains—(i) In general. A regulated investment company (subject to tax under part I of subchapter M) may, for taxable years beginning after December 31, 1956, designate under section 852(b)(3)(D) an amount of undistributed capital gains to each shareholder of the company. For the definition of the term “undistributed capital gains” and for the treatment of such amounts by a shareholder, see paragraph (b)(2) of §1.852–4. For the rules relating to the method of making such designation, the returns to be filed, and the payment of the tax in such cases, see paragraph (a) of §1.852–9.

(ii) Effect on earnings and profits of a regulated investment company. If a regulated investment company designates an amount as undistributed capital gains for a taxable year, the earnings and profits of such regulated investment company shall be reduced by the total amount of the undistributed capital gains so designated. In such case, its capital account shall be increased—

(a) In the case of a taxable year ending before January 1, 1970, by 75 percent of the total amount designated,

(b) In the case of a taxable year ending after December 31, 1969, and beginning before January 1, 1975, by the total amount designated decreased by the amount of tax imposed by section
§ 1.852–3

852(b)(3)(A) with respect to such amount, or

(c) In the case of a taxable year beginning after December 31, 1974, by 70 percent of the total amount designated. The earnings and profits of a regulated investment company shall not be reduced by the amount of tax which is imposed by section 852(b)(3)(A) on an amount designated as undistributed capital gains and which is paid by the corporation but deemed paid by the shareholder.


§ 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 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