

MEMO# 1695

February 1, 1990

REGULATIONS UNDER SECTION 852(B)(3)(C) ON POST-OCTOBER 31 LOSSES

- 1 - February 1, 1990 TO: TAX MEMBERS NO. 7-90 CLOSED-END FUND MEMBERS NO. 7-90
ACCOUNTING/TREASURERS MEMBERS NO. 6-90 RE: REGULATIONS UNDER SECTION
852(b)(3)(C) ON POST-OCTOBER 31 LOSSES

Code sections 852(b)(3)(C) and 852(b)(8) provide regulatory authority for the IRS to treat net capital losses, net long-term capital losses (in the absence of a net capital loss) and net foreign currency losses arising after October 31 of a regulated investment company's (RIC's) taxable year (post-October losses) as arising on the first day of the RIC's next taxable year for purposes of computing the RIC's taxable income. Post-October 31 capital losses are already treated by section 852(b)(3)(C) as arising on the first day of the RIC's next taxable year for capital gain designation purposes. Regulations under sections 852(b)(3)(C) and 852(b)(8) are needed, and were requested by the Institute, to permit the proper interaction between the distribution requirements of the section 4982 excise tax and Subchapter M. (See Institute Memorandum to Tax Committee No. 16-89, Closed-End Fund Committee No. 43-89, and Accounting/Treasurers Committee No. 42-89, dated October 6, 1989). Attached are temporary and proposed regulations which provide rules relating to the effect of a post-October capital loss and a post-October currency loss on a RIC's taxable income, its earnings and profits, and the amount that it may designate as a capital gain dividend for the taxable year in which the loss is incurred and the succeeding taxable year. These regulations apply to taxable years ending after October 31, 1987. The election prescribed by these regulations for deferring post-October capital or currency losses to the next taxable year may be made by the RIC with respect to part or all of such losses. Any post-October loss deferred pursuant to the election is treated as arising on the first day of the RIC's next taxable year for purposes of computing the RIC's taxable income. This - 2 - election has no effect, however, on the amount of the RIC's income for purposes of the RIC qualification tests under sections 851(b)(2) and 851(b)(3). Special rules are provided depending upon whether the entire amount or only part of any such loss is deferred until the next taxable year. The regulations also provide rules for determining earnings and profits. Under the general rule, a RIC's current earnings and profits for a taxable year are determined without regard to any post-October loss for that year, but a post-October loss is generally taken into account in determining the RIC's accumulated earnings and profits. If a RIC elects to defer part or all of a post-October loss in computing its taxable income, however, the amount of loss deferred is taken into account in determining the RIC's current earnings and profits and accumulated earnings and profits as if the part of the loss so

deferred had arisen on the first day of the succeeding taxable year. The election to defer post-October losses shall be made by completing the income tax return in accordance with the applicable instructions. Until the instructions are available, however, the RIC may make the election by entering the appropriate amounts on its tax return and attaching an explanatory written statement. A special transition rule is provided for any taxable year ending before March 2, 1990 in which a RIC incurred a post- October loss. Under this rule, the RIC may use any reasonable method that is consistently applied to determine the amounts of income and loss taken into account in that taxable year and the succeeding year. A retroactive election may also be made for a taxable year with respect to which a RIC filed its income tax return on or before May 1, 1990. To make this retroactive election, the RIC must file an amended tax return for the taxable year (and for any succeeding year for which a return has already been filed) reflecting the appropriate amounts and by attaching an explanatory written statement to the return. The deadline for making a retroactive election is December 31, 1990. A retroactive dividend may be paid by any RIC making a retroactive election. A RIC shall include the amount of any retroactive dividend paid in computing its deduction for dividends paid for the year to which the retroactive dividend relates. A retroactive dividend must be declared with respect to a taxable year on or before the date a retroactive election is made for that year and must be paid (or treated as paid) on or before December 31, 1990. The regulations provide certain limitations on the amount of retroactive dividends. - 3 - The comment period for these regulations expires on April 2, 1990. Please contact the undersigned at (202) 955-3585 by March 16, 1990 if you would like the Institute to file comments on these regulations. We will keep you informed of developments. Keith D. Lawson Assistant General Counsel Attachment KDL:bmb

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