MEMO# 2357

November 30, 1990

IRS ISSUES FINAL SECTION 852(B)(3)(C) POST-OCTOBER LOSS REGULATIONS

- 1 - November 30, 1990 TO: TAX MEMBERS NO. 53-90 ACCOUNTING/TREASURERS MEMBERS NO. 27-90 CLOSED-END FUND MEMBERS NO. 49-90 RE: IRS ISSUES FINAL SECTION 852(b)(3)(C) POST-OCTOBER LOSS REGULATIONS ____ We are pleased to inform you that the IRS has issued the attached final regulations under Code section 852(b)(3)(C) relating to the effect of a post-October capital loss and a post- October currency loss on a regulated investment company's ("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 year. The final regulations are essentially as described in the Institute's recent memorandum discussing the impending release of the regulations. (See Institute Memorandum to Tax Members No. 57-90, Accounting/Treasurers Members No. 25-90, and Closed-End Fund Members No. 48-90, dated November 28, 1990.) As we previously informed you, the final regulations adopt almost all of the changes to the temporary regulations that were suggested by the Institute. (See Institute Memorandum to Tax Committee No. 8-90, Closed-End Fund Committee No. 9-90 and Accounting/Treasurers Committee No. 11-90, dated April 2, 1990.) The following discussion reiterates, revises and expands upon the description of the final regulations included in the Institute's November 28, 1990 memorandum. For your information, we have also attached a copy of the temporary regulations marked to show changes made by the final regulations. 1. The final regulations treat any decline in value of either a section 1256 contract or a straddle between October 31, when the contract or position is marked to market for excise tax purposes, and the end of the RIC's fiscal year, when the contract or position is marked to market for income tax purposes, as a post-October loss. 2. A deferred post-October loss will be treated as arising on the first day of the RIC's next fiscal year for purposes of computing the capital loss carryforward period. - 2 - 3. A RIC may reduce the amount of the retroactive dividend that must be paid or treated as paid by December 31, 1990 by the amount of any overdistribution that arose, in the year following the year in which a post-October loss occurred, as a result of a retroactive election. Thus, to the extent that an election to defer post-October losses results in an underdistribution in one year and an overdistribution in the succeeding year, the amount of the retroactive dividend that must be paid or treated as paid by December 31, 1990 can be reduced by the amount of the retroactive dividend "paid" out of the overdistribution in the second year. (For a further explanation of how this "netting" rule works, see pages 7 and 8 of the preamble and page 18 of the final regulations.) However, contrary to the Institute's request, the RIC could not receive a dividends paid deduction in some other year for the amount of any remaining overdistribution. 4. A new subsection to the regulation's transition rules has been added entitled "Certain distributions may be designated retroactively as capital gain dividends."

Under this new subsection, a RIC may retroactively designate an additional amount of dividends paid for a prior taxable year as a capital gain dividend, for purposes of computing the RIC's dividends paid deduction and the RIC-level tax on retained capital gains, notwithstanding that a written notice was not mailed to the RIC's shareholders within 60 days after the close of the taxable year in which the distribution was made. 5. RICs that filed income tax returns on or before May 1, 1990 will be required to file amended tax returns for all years in which post-October losses are deferred and in all subsequent years affected by the deferral. Amended tax returns will be required even in situations where the election to defer the losses was made in the original tax returns. All such amended tax returns must be filed pursuant to the retroactive election procedure by December 31, 1990. 6. Under the final regulations, RIC shareholders should not be notified if the effect of a retroactive election is to change the character of any income that was previously distributed by the RIC to its shareholders. As the preamble states, "to the extent that a RIC's reporting position changes as a result of making a retroactive election, the Service views the adjustments made as being purely a matter of RIC accounting and having no effect on its shareholders." We will keep you informed of developments. Keith D. Lawson Associate General Counsel Attachments

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