MEMO# 9378

October 28, 1997

IRS CAPITAL GAINS GUIDANCE

1 See Institute Memorandum to Tax Members No. 27-97, Accounting/Treasurers Members No. 31-97, Operations Members No. 13-97, International Members No. 12-97, Closed-End Investment Company Members No. 23-97, Unit Investment Trust Members No. 28-97 and Transfer Agent Advisory Committee No. 36-97, dated August 1, 1997. 2 See Institute Memorandum to Tax Members No. 37-97, Accounting/Treasurers Members No. 40-97, Operations Members No. 22-97, Closed-End Investment Company Members No. 29-97, Unit Investment Trust Members No. 40-97 and Transfer Agent Advisory Committee No. 56-97, dated October 10, 1997. [9378] October 28, 1997 TO: TAX MEMBERS No. 41-97 ACCOUNTING/TREASURERS MEMBERS No. 44-97 OPERATIONS MEMBERS No. 25-97 CLOSED-END INVESTMENT COMPANY MEMBERS No. 33-97 UNIT INVESTMENT TRUST MEMBERS No. 46-97 TRANSFER AGENT ADVISORY COMMITTEE No. 61-97 BROKER/DEALER ADVISORY COMMITTEE No. 17-97 RE: IRS CAPITAL GAINS GUIDANCE ____ The Internal Revenue Service ("IRS") has released the attached Announcement and Notice regarding implementation of the capital gains rules enacted on August 5, 1997 as part of the Taxpayer Relief Act of 1997 ("the 1997 Act"). 1 The Announcement clarifies the reporting by regulated investment companies ("RICs") and brokers of RIC capital gain dividends. The Notice explains that IRS will administer the capital gains rules for 1997 by taking into account pending technical corrections legislation that will apply, once enacted, retroactively to original enactment of the 1997 Act.2 Capital Gains Reporting Guidance for 1997 As you may know, the Institute has been seeking guidance from the IRS since August regarding information reporting uncertainties created by the 1997 Act. In addition to seeking clarification regarding the categories of gain that RICs and brokers must report to RIC shareholders for 1997 (e.g., total long-term capital gain and one or more subcategories of that gain, such as the portion taxed at a maximum rate of 28%), the Institute has sought clear 3 The Announcement also indicates that further guidance will be issued "shortly" regarding the computation of capital gain distributions by RICs and real estate investment trusts ("REITs"). 4 28% rate gain, as defined by the technical corrections bill approved recently by the House Ways and Means Committee, includes all gains taxed at a maximum rate of 28%. 5 Unrecaptured section 1250 gain includes certain gain on depreciable real property that is taxed at a maximum rate of 25%. 6 See Institute Memorandum to Tax Members No. 38-97, Accounting/Treasurers Members No. 42-97, Broker/Dealer Advisory Committee No. 16-97, Closed-End Investment Company Members No. 30-97, Operations Members No. 23-97, Transfer Agent Advisory Committee No 57-97 and Unit Investment Trust Members No. 42-97, dated October 17, 1997. - 2 - authority permitting RICs (and brokers) to provide information regarding one or more subcategories of gain either as a dollar amount or as a percentage of total gain. We are pleased to report that the attached IRS Announcement (Number 97-109) provides the information reporting guidance sought by the Institute.3 Specifically, as discussed below, RICs and brokers must provide a recipient

with the total amount of long-term gain and information sufficient to determine the amount of 28% rate gain4 and unrecaptured section 1250 gain,5 rather than with "the amount" of these types of gain, which is the standard imposed by the Announcement on certain other payers. This language makes clear that RIC 28% rate gain information may be presented for 1997 either as a percentage of total long-term gain or as a dollar amount. The Announcement emphasizes that these modified information reporting requirements apply only for certain forms filed for certain years, including (1) the 1997 Form 1099-DIV (Dividends and Distributions) for dividends paid or deemed paid during 1997 and (2) the 1996 Form 2439 (Notice to Shareholder of Undistributed Long-Term Capital Gains) for 1996-1997 fiscal years ending after May 6, 1997. For subsequent years, according to the IRS Announcement, the reporting requirements will be included on the forms and/or stated in the instructions. The Form 1099-DIV reporting requirements applicable to RICs and brokers for 1997 are as follows. As in prior years, payers must report each recipient’s total capital gain distribution in Box 1c of Form 1099-DIV. Because the instructions previously released by IRS for the 1997 Form 1099-DIV do not reflect the recent legislative changes, the Announcement provides that payers should advise recipients that the total capital gain distribution amount must be reported on line 13, column (f) of Schedule D (Capital Gains and Losses).6 The Announcement also provides that "payers must provide to recipients information sufficient to determine . . . [t]he amount of 28% rate gain . . . [and] [t]he amount of unrecaptured section 1250 gain." Payers are given the choice of providing this additional information to recipients on a substitute Form 1099-DIV or on a separate statement. Payers are not required to report this additional information to the IRS. 7 See Institute Memorandum to Tax Committee No. 33-97 and Accounting/Treasurers Committee No. 37-97, dated October 6, 1997. 8 The Notice does not address the capital loss carryover rules for corporations, such as RICs, which were not amended by the 1997 Act and still provide that a capital loss carryforward is treated by the RIC as a short-term loss. - 3 - The Form 2439 reporting requirements for a RIC with a 1996-1997 fiscal year ending after May 6, 1997 are as follows. As in prior years, payers must report each recipient’s total undistributed long-term capital gain on line 1 of Form 2439. The announcement provides that payers should advise individual shareholders that the undistributed long-term capital gain amount must be reported on line 11, column (f) of Schedule D. As in the case of Form 1099-DIV reporting, the Announcement provides that payers "must provide to recipients information sufficient to determine" the amount of 28% rate gain and unrecaptured section 1250 gain. Payers also should advise recipients that the amount of undistributed 28% rate gain is reported on line 11, column (g) of Schedule D and the amount of unrecaptured section 1250 gain that was not distributed is reported on line 25 of Schedule D. Payers are given the choice of providing this additional information to recipients on a substitute Form 2439 or on a separate statement. Payers are not required to report this additional information to the IRS. IRS Notice on Administering Capital Gains Rules for 1997 Based Upon Pending Legislation In Notice 97-59, the IRS summarizes the new capital gains rules as they will be amended by the recently-introduced technical corrections legislation. IRS plans to administer the Internal Revenue Code for 1997 by taking into account the recently-introduced technical corrections legislation because the Treasury Department has been advised, in a letter from the chairmen and ranking members of the House Ways and Means and Senate Finance Committees,7 that Congress intends to enact this legislation with application retroactive to the effective date of the 1997 Act (in general, transactions occurring after May 6, 1997). The Notice’s "background" summary of the capital gains rules characterizes an individual’s long-term capital gains and losses as being separated into three "tax groups": (1) the "28-percent group," (2) the "25-percent group" and (3) the "20-percent group." Reflecting technical corrections, the 28-percent group includes (1) gains and losses properly taken into account before May 7, 1997, from assets held for more than one year; (2) gains and losses properly taken into account after July 28, 1997, from assets held for more than one year but not more than 18 months; (3) gains and losses from collectibles held for more than one year; and (4) the individual's long-term capital loss carryover, if any.8 The Notice also discusses the netting rules for capital gains and losses in different "baskets." As under prior law, short-term losses first offset short-term gains. A net short-term loss offsets long-term gains by being applied first against 28-percent group gain, then against 25-percent group gain and finally against 20-percent group gain. A net loss from the 28-percent group is applied first against 25-percent group gain, then against 20-percent group gain and - 4 - finally against short-term gain. A net loss from the 20-percent group is applied first against 28- percent group gain, then against 25-percent group gain and finally against short-term gain. Among the other changes that will be made by technical corrections, and are addressed in the Notice, are the treatment of section 1256 contracts, the long-term portion of any gain or loss on which are to be treated as 20-percent group gain or loss, and the short sale holding period rules of section 1233, which will be modified to cover situations in which assets are held for more than one year but not more than 18 months. Keith D. Lawson Associate Counsel - Tax Attachment (in .pdf format) Note: Not all recipients of this memo will receive an attachment. If you wish to obtain a copy of the attachment referred to in this memo, please call the Institute's Library Services Division at (202)326-8304, and ask for this memo's attachment number: 9378.
