

**MEMO# 34136**

May 11, 2022

# **ICI Requests Clarification of Section 355 Active Trade or Business Requirement for RICs**

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TO: ICI Members

Investment Company Directors

Tax Advisory Committee

Tax Committee SUBJECTS: Tax RE: ICI Requests Clarification of Section 355 Active Trade or Business Requirement for RICs

ICI has submitted the attached letter to the Treasury Department and the Internal Revenue Service (IRS) requesting clarification that regulated investment companies (RICs) can satisfy the "active trade or business requirement" under section 355(b)(1) with respect to their business of investing in securities. The inability of RICs to use tax-free split-offs negatively impacts RIC shareholders by limiting an asset manager's capability to optimize the investment management services provided by the fund. While RICs may wish to use section 355 for legitimate non-tax business purposes intended to benefit these shareholders, they ultimately will avoid a division that results in additional taxable income to the investors.

ICI argues that RICs are engaged in the business of investing on behalf of their shareholders, as specifically noted in section 852(b)(2). RICs also perform other active and substantial management and operational functions through their boards and provide many ancillary services to investors through their advisers and other third parties.

The primary purpose of the active trade or business requirement is to serve as an objective means of testing whether a transaction is being used principally as a device to use a section 355 distribution to convert what otherwise would be dividends taxable as ordinary income into capital gain. The bail-out of corporate earnings generally is not a concern when a RIC pursues a split-off to establish a new fund. Another purpose of section 355 is to prevent circumvention of the repeal of the General Utilities doctrine.[\[1\]](#) This rationale likewise is not applicable to RICs, as section 852(b)(6) permits RICs to distribute stock or securities in-kind upon the demand of shareholders without incurring fund-level tax.

Given that RICs should be viewed as engaged in an active trade or business and the lack of

potential for tax avoidance or abuse, ICI asks the Treasury Department and the IRS to clarify that RICs can satisfy the active trade or business requirement in section 355.

Karen Lau Gibian  
Associate General Counsel

**endnotes**

[\[1\]](#) The General Utilities doctrine held that corporations do not recognize gain or loss upon distributing appreciated or depreciated asset to its shareholders. This rule was repealed by the Tax Reform Act of 1986.

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