

and prudence. For example, if in determining its taxable income under section 1247(a) the company relied in good faith upon estimates and opinions of independent certified public accountants or other experts which are also used for purposes of its financial statements filed with the Securities and Exchange Commission under the Investment Company Act of 1940, such reliance would constitute reasonable cause for purposes of this paragraph. In such a case, the company's election under section 1247(a) for the taxable year would not be terminated nor would the company be required to make an additional distribution for such taxable year in order to comply with the provisions of section 1247(a)(1)(A).

[T.D. 6798, 30 FR 1174, Feb. 4, 1965]

§ 1.1247-2 Computation and distribution of taxable income.

(a) *In general.* Taxable income of a foreign investment company means taxable income as defined in section 63(a), computed without regard to subchapter N, chapter 1 of the Code, and in accordance with the following rules:

(1) There shall be excluded the excess, if any, of the company's net long-term capital gain over the net short-term capital loss. See § 1.1247-3 for the manner of computing such excess.

(2) The deduction provided in section 172 (relating to net operating losses) shall not be allowed.

(3) Except for the deduction provided in section 248 (relating to organizational expenditures), the special deductions provided for corporations in part VIII (sections 241 and following), subchapter B, chapter 1 of the Code shall not be allowed.

(4) In computing the amount of the deduction allowed under section 164 there shall be included taxes paid or accrued during the taxable year which are imposed by the United States or by the country under the laws of which the company is created or organized. See, however, § 1.1247-4.

(b) *Election to distribute taxable income after close of taxable year.* A company may elect under section 1247(a)(2)(B), in respect of taxable income for a taxable year, to treat a distribution made not later than 2 months and 15 days after the close of such taxable year as

a distribution made during such taxable year of such taxable income. The company shall make the election by attaching to the information return required by paragraph (c)(1) of § 1.1247-5 for such taxable year a statement setting forth the amount of each distribution (or portion thereof) to which the election applies and the date of each such distribution. The election shall be irrevocable after the expiration of the time for filing such information return. The distribution (or portion thereof) to which the election applies shall be considered as paid out of the earnings and profits of the taxable year for which such election is made, and not out of the earnings and profits of the taxable year in which the distribution is actually made. A distribution to which this paragraph applies shall be includable in the gross income of a shareholder of the foreign investment company for his taxable year in which received or accrued.

[T.D. 6798, 30 FR 1175, Feb. 4, 1965]

§ 1.1247-3 Treatment of capital gains.

(a) *Treatment by the company—(1) In general.* If an election to distribute income currently pursuant to section 1247(a) is in effect for a taxable year of a foreign investment company, the company shall designate (in the manner described in subparagraph (3) of this paragraph) to each shareholder his pro rata amount of the excess of the net long-term capital gain over the net short-term capital loss for the company's taxable year, and the portion thereof which is being distributed to each such shareholder. See section 1247(a)(1)(B). Except as provided in subparagraph (2) of this paragraph, the company shall compute such excess (hereinafter referred to as *excess capital gains*) as if such company were a domestic corporation, but without regard to subchapter N, chapter 1 of the Code. See paragraph (d) of § 1.1247-1 for rules relating to termination of election under section 1247(a) for failure to properly compute or to properly designate excess capital gains. A company may make an irrevocable election (by notifying its shareholders as provided in subparagraph (3) of this paragraph) to distribute, on or before the 45th day following the close of its taxable year,

all or a portion of the excess capital gains and have any such distribution treated as if made during such taxable year.

(2) *Rules for computing capital gains and losses.* Generally, the adjusted basis of property held by a foreign investment company shall be its cost adjusted in accordance with the applicable provisions of the Code. However, in respect of property held by a foreign investment company on the first day of the first taxable year for which the election under section 1247(a) applies, the amounts shown on such day in the permanent books of account, records, and other documents of the company shall, at the option of the company, be accepted as the adjusted basis of such property, if on such day such books, records, and other documents were being maintained in the manner prescribed by regulations under section 30 of the Investment Company Act of 1940 (15 U.S.C. 80a-30). In computing capital gains and losses of a foreign investment company under section 1247, the provisions of section 1212 (relating to allowance of capital loss carryover) shall not apply to any capital loss incurred in or with respect to taxable years before the first taxable year for which the election under section 1247(a) applies. See section 1247(a)(2)(C).

(3) *Notice to shareholders.* The company shall designate by written notice, mailed on or before the 45th day following the close of its taxable year:

(i) To each person who is a shareholder at the close of such taxable year, his pro rata amount of the portion of the excess capital gains for such year which was not distributed, and

(ii) To each person who received a distribution of excess capital gains with respect to such taxable year, the amount and the date of each such distribution.

Each notice shall show the name and address of the foreign investment company and the taxable year of the company for which the designation is made.

(b) *Treatment of capital gains by qualified shareholder*—(1) *Definition of qualified shareholder.* (i) The term *qualified shareholder* means any shareholder of a registered foreign investment company who is a United States person (as de-

defined in section 7701(a)(30)), other than a shareholder described in subdivision (ii) of this subparagraph.

(ii) A United States person shall not be treated as a qualified shareholder for a taxable year if in his return for such taxable year (or for any prior taxable year) he did not include, in computing his long-term capital gains, his pro rata amount of the undistributed portion of the excess capital gains which the company designated for its taxable year ending within or with such taxable year of the shareholder. Thus, for example, if a shareholder fails to include as long-term capital gain in his return for his taxable year ending December 31, 1966, the amount designated by the company as his pro rata amount of undistributed excess capital gains for the company's taxable year ending June 30, 1966, he would not be a qualified shareholder for his taxable year ending December 31, 1966, or for any subsequent taxable year. However, if the shareholder can show that his failure to include his pro rata amount of the undistributed portion of the excess capital gains in his return was due to reasonable cause and not due to willful neglect, he will continue to be a qualified shareholder. Such shareholder shall, for the year with respect to which such failure occurred, include in his taxable income his previously omitted pro rata amount of the undistributed portion of excess capital gains.

(2) *Treatment of excess capital gains.* A qualified shareholder of a foreign investment company, for any taxable year of the company for which the election under section 1247(a) is in effect, shall include in his return in computing his long-term capital gains:

(i) For his taxable year in which received, his pro rata amount of the distributed portion of the excess capital gains for such taxable year of the company, and

(ii) For his taxable year in which or with which the taxable year of the company ends, his pro rata amount of the undistributed portion of the excess capital gains for such taxable year of the company.

(3) *Sales at end of company's taxable year.* For purposes of determining whether the purchaser or seller of a

share of foreign investment company stock is the shareholder at the close of such company's taxable year who is required to include an amount of undistributed excess capital gains in gross income, the amount of the undistributed excess capital gains shall be treated in the same manner as a cash dividend payable to shareholders of record at the close of the company's taxable year. Thus, if a cash dividend paid to shareholders of record as of the close of the foreign investment company's taxable year would be considered income to the purchaser, then the purchaser is also considered to be the shareholder of such company at the close of its taxable year for purposes of including an amount of undistributed excess capital gains in gross income. For rules for determining whether a dividend is income to the purchaser or seller of a share of stock, see paragraph (c) of § 1.61-9.

(4) *Partners and partnerships.* If the shareholder required to include an amount of undistributed excess capital gains in gross income under section 1247(d)(2) and subparagraph (2)(ii) of this paragraph is a partnership, such amount shall be taken into account by the partnership for the taxable year of the partnership in which occurs the last day of the taxable year of the foreign investment company in respect of which the undistributed portion of the excess capital gains were designated. The amount so includible by the partnership shall be taken into account by the partners as distributive shares of the partnership gains and losses from sales or exchanges 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) pursuant to section 702(a)(2) and paragraph (a)(2) of § 1.702-1. The partners shall increase the basis of their partnership interests under section 705(a)(1) by their distributive shares of such gains.

(5) *Effect on earnings and profits of corporate shareholder.* If a shareholder required to include an amount of undistributed excess capital gains in gross income under section 1247(d)(2) and subparagraph (2)(ii) of this paragraph is a corporation, such corporation, in computing its earnings and profits for

the taxable year for which such amount is so includible, shall treat such amount as if it had actually been received in that year.

(6) *Example.* The application of this paragraph may be illustrated by the following example:

Example: Smith owns one share of stock in a foreign investment company which he purchased in 1964. In respect of the company's taxable year ending June 30, 1966, during which the election under section 1247(a) was in effect, Smith receives from the company on July 15, 1966, a distribution in the amount of \$8. He also receives a notice stating that for such taxable year \$9 was being designated as his pro rata amount of the excess capital gains, \$8 of which was distributed on July 15, 1966, and \$1 of which was being designated as the undistributed portion. In order for Smith to be a qualified shareholder for his taxable year ending December 31, 1966, he must include in computing his long-term capital gains in his return for 1966, his pro rata amount of the undistributed portion of the excess capital gains, that is, \$1. Smith must also include in such return his pro rata amount of the distributed portion of excess capital gains, that is, \$8. If, however, Smith does not include in income his pro rata amount of the undistributed portion of excess capital gains, he is not a qualified shareholder for 1966 (or for any subsequent year). In such a case, the \$8 is not treated under the provisions of section 1247(d)(1) as a distribution of long-term capital gains for such year but as a corporate distribution taxable as ordinary income to the extent provided in subchapter C, chapter 1 of the Code.

(c) *Adjustments relating to undistributed capital gains—(1) Adjustments in earnings and profits of the company.* If a foreign investment company, to which the election under section 1247(a) applies, designates an amount as the undistributed portion of excess capital gains for its taxable year, the earnings and profits of the company (within the meaning of subchapter C, chapter 1 of the Code) shall be reduced, and its capital account shall be increased, by such amount.

(2) *Increase in basis of qualified shareholder's stock.* A qualified shareholder, who computes his long-term capital gains for a taxable year by including (in respect of each share of stock which he owns in a foreign investment company) the pro rata amount of the undistributed portion of the excess capital gains which was designated by the company for its taxable year ending

with or within such taxable year of the shareholder, shall, as of the day following the close of such taxable year of the company, increase the adjusted basis of each share by such pro rata amount.

(d) *Loss on sale or exchange of certain stock held 1 year or less—(1) In general.* If:

(i) A qualified shareholder of a foreign investment company to which the election under section 1247(a) applies treats any amount designated under section 1247(a)(1)(B) with respect to a share of stock as long-term capital gain, and

(ii) Such share is held by the taxpayer for 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977) or less,

Then any loss on the sale or exchange of such share shall, to the extent of the amount described in subdivision (i) of this subparagraph, be treated under section 1247(i) as loss from the sale or exchange of a capital asset held for more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977).

(2) *Example.* The application of this paragraph may be illustrated by the following example:

Example: On October 1, 1966, B, a calendar year taxpayer, purchases for \$100 a share of stock in a foreign investment company to which the election under section 1247(a) applies. On January 20, 1967, the company, in a notice to B, designates for its taxable year ending December 31, 1966, \$8 per share as excess capital gains of which \$6 was distributed on December 1, 1966, and \$2 was designated as undistributed. B includes the \$8 in computing his long-term capital gains in his return for 1966 and, under paragraph (c)(2) of this section, B's basis for the share is increased to \$102 as of January 1, 1967. On February 1, 1967, B sells the share for \$93, incurring a \$9 loss of which \$8 is treated as a long-term capital loss under section 1247(i) and \$1 is treated as a short-term capital loss.

[T.D. 6798, 30 FR 1175, Feb. 4, 1965, as amended by T.D. 7728, 45 FR 72650, Nov. 3, 1980]

§ 1.1247-4 Election by foreign investment company with respect to foreign tax credit.

(a) *In general—(1) Election.* If an election to distribute income currently pursuant to section 1247(a) is in effect

for a taxable year of a foreign investment company, and if at the close of such taxable year more than 50 percent of the value of the total assets of the company consists of stock or securities in foreign corporations, then the company may elect for such taxable year, in the manner provided in paragraph (d) of this section, the application of section 1247(f) in respect of foreign taxes referred to in subparagraph (2) of this paragraph which are paid during such taxable year. For purposes of this section, the term *value* shall have the same meaning as assigned to such term in section 851(c)(4) (relating to definition of regulated investment company). For definition of foreign corporation, see section 7701(a).

(2) *Taxes affected.* The election under section 1247(f) for a taxable year applies with respect to income, war profits, and excess profits taxes described in section 901(b)(1) which are paid by the company to foreign countries and possessions of the United States. A tax paid by a foreign investment company does not include a tax which is paid by the shareholders of the company. Whether a tax is paid by the company, and whether a tax is an income, war profits, or excess profits tax described in section 901(b)(1), shall be determined under the principles of chapter 1 of the Code without regard to the law of any foreign country and without regard to any income tax convention, including any income tax convention to which the United States is a party. Section 1247(f) does not apply with respect to foreign taxes which would be deemed to have been paid by the company under section 902 if the company were a domestic corporation. For purposes of this paragraph, taxes paid to the United States are not considered foreign taxes.

(b) *Effect of election—(1) Effect on company.* If a valid election under section 1247(f) is made for a taxable year of a foreign investment company, then, for purposes of determining under section 1247(a)(1)(A) whether the company has distributed to its shareholders with respect to such taxable year 90 percent or more of what the company's taxable income would be for such year if the company were a domestic corporation, the following rules shall apply: