

for the shareholder's taxable year in which or with which the taxable year of the corporation ends, except that, in the case of the death of a shareholder during any taxable year of the corporation (during which the corporation is an electing small business corporation), the items of tax preference of the corporation for such taxable year are taken into account for the final taxable year of the shareholder.

(c) *Capital gains.* (1) Capital gains of an electing small business corporation, other than those capital gains subject to tax under section 1378, do not result in an item of tax preference at the corporate level since, in applying the formula specified in sections 57(a)(9)(B) and § 1.57-1(i)(2), the rate of tax on capital gains (and the resulting tax) at the corporate level is zero. Under section 1375 (a) shareholders of an electing small business corporation take into account the capital gains of the corporation (including capital gains subject to tax under section 1378). Therefore, the computation of the capital gains item of tax preference at the shareholder level, with respect to such capital gains, is taken into account automatically by operation of section 57(a)(9) and § 1.57-1(i). To avoid double inclusion of the capital gains item of tax preference by a shareholder with respect to capital gains subject to tax under section 1378, the capital gains item of tax preference which results at the corporate level by reason of section 58 (d)(2) is not treated under section 58 (d)(1) as an item of tax preference of the shareholders of the corporation.

(2) The capital gains item of tax preference of an electing small business corporation subject to the tax imposed by section 1378 is the excess of the amount of tax computed under section 1378(b)(2) over the sum of—

(i) The amount of tax that would be computed under section 1378(b)(2) if the following amount were excluded:

(a) That portion of the net section 1201 gain of the corporation described in section 1378(b)(1), or

(b) If section 1378(c)(3) applies, that portion of the net section 1201 gain attributable to the property described in section 1378(c)(3), and

(ii) The amount of tax imposed under section 1378 divided by the sum of the

normal tax rate and the surtax rate under section 11 for the taxable year.

(3) The principles of this paragraph may be illustrated by the following example.

Example. Corporation X is a calendar year taxpayer and an electing small business corporation. For its taxable year 1971 the corporation has net section 1201 gain of \$650,000 and taxable income of \$800,000 (including the net section 1201 gain). Although X's election under section 1372(a) has been in effect for its three immediately preceding taxable years, X is subject to the tax imposed by section 1378 for 1971 since it has net section 1201 gain (in the amount of \$200,000) attributable to property with a substituted basis. The tax computed under section 1378(b)(1) is \$187,500 (30 percent of (\$650,000 minus \$25,000)) and under section 1378(b)(2) is \$377,500 (22 percent of \$800,000 plus 26 percent of \$775,000). By reason of the limitation imposed by section 1378(c) the tax actually imposed by section 1378 is \$60,000 (30 percent of \$200,000, the net section 1201 gain). The tax computed under section 1378(b)(2) with the modification required under subparagraph (2)(i) of this paragraph is \$281,500 (22 percent of \$600,000 plus 26 percent of \$575,000). Thus, the 1971 capital gains item of tax preference X is \$75,000 computed as follows:

1. Tax computed under 1378(b) (2)	\$377,500
2. Tax computed under 1378(b) (2) with modification	281,500
3. Excess	96,000
4. Tax actually imposed under 1378	60,000
5. Difference	36,000
6. Normal tax rate plus surtax rate48
7. Tax preference (line 5 divided by line 6)	\$75,000

In addition each shareholder of X will take into account his distributive share of the \$650,000 of net section 1201 gain of X less the taxes paid by X under sections 56 and 1378 on the gain

[T.D. 7564, 43 FR 40483, Sept. 12, 1978]

§ 1.58-5 Common trust funds.

Section 58(e) provides that each participant in a common trust fund (as defined in section 584 and the regulations thereunder) is to treat as items of tax preference his proportionate share of the items of tax preference of the fund computed as if the fund were an individual subject to the minimum tax. The participant's proportionate share of the items of tax preference of the fund is determined as if the participant had realized, or incurred, his pro rata share of items of income, gain, loss, or

deduction of the fund directly from the source from which realized or incurred by the fund. The participant's pro rata share of such items is determined in a manner consistent with section 1.584-2(c). Items of tax preference apportioned to a participant pursuant to this paragraph are taken into account by the participant for the participant's taxable year in which or with which the taxable year of the trust ends.

[T.D. 7564, 43 FR 40484, Sept. 12, 1978]

§ 1.58-6 Regulated investment companies; real estate investment trusts.

(a) *In general.* Section 58(f) provides rules with respect to the determination of the items of tax preference of regulated investment companies (as defined in section 851) and their shareholders and real estate investment trusts (as defined in section 856) and their shareholders, or holders of beneficial interest. In general, the items of tax preference of such companies and such trusts are determined at the company or trust level and the items of tax preference so determined (other than the capital gains item of tax preference (sections 57(a)(9) and § 1.57-1(i)) and, in the case of a real estate investment trust, accelerated depreciation on section 1250 property (sections 57(a)(2) and § 1.57-1(b)) are treated as items of tax preference of the shareholders, or holders of beneficial interest, in the same proportion that the dividends (other than capital gains dividends) paid to each such shareholder, or holder of beneficial interest, bear to the taxable income of such company or such trust determined without regard to the deduction for dividends paid. In no case, however, is such proportion to be considered in excess of 100 percent. For example, if a regulated investment company has items of tax preference of \$500,000 for the taxable year, none of which resulted from capital gains, and distributes dividends in an amount equal to 90 percent of its taxable income, each shareholder treats his share of 90 percent of the company's items of tax preference, or (a proportionate share of) \$450,000, as items of tax preference of the shareholder. The remaining \$50,000 constitutes items of tax preference of the company. Amounts treated under this paragraph as items

of tax preference of the shareholders, or holders of beneficial interest, are deemed to be derived proportionately from each item of tax preference of the company or trust, other than the capital gains item of tax preference and, in the case of a real estate investment trust, accelerated depreciation on section 1250 property. Such amounts are taken into account by the shareholders, or holders of beneficial interest, in the same taxable year in which the dividends on which the apportionment is based are includible in income. The minimum tax exemption of the trust or company shall not be reduced because a portion of the trust's or company's items of tax preference are allocated to the shareholders or holders of beneficial interests.

(b) *Capital gains.* Section 58(g)(1) provides that a regulated investment company or real estate investment trust does not treat as an item of tax preference the capital gains item of tax preference under section 57(a)(9) (and § 1.57-1(i)) to the extent that such item is attributable to amounts taken into income by the shareholders of such company under section 852(b)(3) or by the shareholders or holders of beneficial interest of such trust under section 857(b)(3). Thus, such a company or trust computes its capital gains item of tax preference on the basis of its net section 1201 gain less the sum of (1) the capital gains dividend (as defined in section 852(b)(3)(C) or 857(b)(3)(C)) for the taxable year of the company or trust plus (2), in the case of a regulated investment company, that portion of the undistributed capital gains designated, pursuant to section 852(b)(3)(D) and the regulations thereunder, by the company to be includible in the shareholder's return as long-term capital gains for the shareholder's taxable year in which the last day of the company's taxable years falls. Amounts treated under section 852(b)(3) or 857(b)(3) as long-term capital gains of shareholders, or holders of beneficial interest, are automatically included, pursuant to sections 57(a)(9) and 1.57-1(i), in the computation of the capital gains item of tax preference of the shareholders, or holders of beneficial interest.