

For the definition of the term “undistributed capital gains” and for the treatment of such amounts by a shareholder, see paragraph (b)(2) of §1.852-4. For the rules relating to the method of making such designation, the returns to be filed, and the payment of the tax in such cases, see paragraph (a) of §1.852-9.

(ii) *Effect on earnings and profits of a regulated investment company.* If a regulated investment company designates an amount as undistributed capital gains for a taxable year, the earnings and profits of such regulated investment company for such taxable year shall be reduced by the total amount of the undistributed capital gains so designated. In such case, its capital account shall be increased—

(a) In the case of a taxable year ending before January 1, 1970, by 75 percent of the total amount designated,

(b) In the case of a taxable year ending after December 31, 1969, and beginning before January 1, 1975, by the total amount designated decreased by the amount of tax imposed by section 852(b)(3)(A) with respect to such amount, or

(c) In the case of a taxable year beginning after December 31, 1974, by 70 percent of the total amount designated. The earnings and profits of a regulated investment company shall not be reduced by the amount of tax which is imposed by section 852(b)(3)(A) on an amount designated as undistributed capital gains and which is paid by the corporation but deemed paid by the shareholder.

[T.D. 6500, 25 FR 11910, Nov. 26, 1960, as amended by T.D. 6598, 27 FR 4091, Apr. 28, 1962; T.D. 6921, 32 FR 8754, June 20, 1967; T.D. 7337, 39 FR 44972, Dec. 30, 1974]

#### § 1.852-3 Investment company taxable income.

Section 852(b)(2) requires certain adjustments to be made to convert taxable income of the investment company to investment company taxable income, as follows:

(a) The excess, if any, of the net long-term capital gain over the net short-term capital loss shall be excluded;

(b) The net operating loss deduction provided in section 172 shall not be allowed;

(c) The special deductions provided in part VIII (section 241 and following, except section 248), subchapter B, chapter 1 of the Code, shall not be allowed. Those not allowed are the deduction for partially tax-exempt interest provided by section 242, the deductions for dividends received provided by sections 243, 244, and 245, and the deduction for certain dividends paid provided by section 247. However, the deduction provided by section 248 (relating to organizational expenditures), otherwise allowable in computing taxable income, shall likewise be allowed in computing the investment company taxable income. See section 852(b)(1) and paragraph (a) of §1.852-2 for treatment of the deduction for partially tax-exempt interest (provided by section 242) for purposes of computing the normal tax under section 11;

(d) The deduction for dividends paid (as defined in section 561) shall be allowed, but shall be computed without regard to capital gains dividends (as defined in section 852(b)(3)(C) and paragraph (c) of §1.852-4); and

(e) The taxable income shall be computed without regard to section 443(b). Thus, the taxable income for a period of less than 12 months shall not be placed on an annual basis even though such short taxable year results from a change of accounting period.

#### § 1.852-4 Method of taxation of shareholders of regulated investment companies.

(a) *Ordinary income.* (1) Except as otherwise provided in paragraph (b) of this section (relating to capital gains), a shareholder receiving dividends from a regulated investment company shall include such dividends in gross income for the taxable year in which they are received.

(2) See section 853 (b)(2) and (c) and paragraph (b) of §1.853-2 and §1.853-3 for the treatment by shareholders of dividends received from a regulated investment company which has made an election under section 853(a) with respect to the foreign tax credit. See section 854 and §§1.854-1 through 1.854-3 for limitations applicable to dividends received from regulated investment companies for the purpose of the credit under section 34 (for dividends received