banking laws of the State in which it is incorporated.

(ii) A detailed schedule showing the computation of the average amount of tax-exempt obligations, the average amount of total assets of such institutions, and the total amount of interest paid or accrued on face-amount certificates and on amounts received for the purchase of such certificates for the taxable year.

[T.D. 6927, 32 FR 13221, Sept. 19, 1967]

§ 1.265–3 Nondeductibility of interest relating to exempt-interest dividends.

(a) *In general.* No deduction is allowed to a shareholder of a regulated investment company for interest on indebtedness that relates to exempt-interest dividends distributed by the company to the shareholder during the shareholder's taxable year.

(b) *Interest relating to exempt-interest dividends.* (1) All or a portion of the interest on an indebtedness relates to exempt-interest dividends if the indebtedness is either incurred or continued to purchase or carry shares of stock of a regulated investment company that distributes exempt-interest dividends (as defined in section 852(b)(5) of the Code) to the holder of the shares during the shareholder's taxable year.

(2) To determine the amount of interest that relates to the exempt-interest dividends the total amount of interest paid or accrued on the indebtedness is multiplied by a fraction. The numerator of the fraction is the amount of exempt-interest dividends received by the shareholder. The denominator of the fraction is the sum of the exempt-interest dividends and taxable dividends received by the shareholder (excluding capital gain dividends received by the shareholder and capital gains required to be included in the shareholder's computation of long-term capital gains under section 852(b)(3)(D)).

[T.D. 7601, 44 FR 16013, Mar. 16, 1979]

§ 1.266–1 Taxes and carrying charges chargeable to capital account and treated as capital items.

(a)(1) *In general.* In accordance with section 266, items enumerated in paragraph (b)(1) of this section may be capitalized at the election of the taxpayer.

Thus, taxes and carrying charges with respect to property of the type described in this section are chargeable to capital account at the election of the taxpayer, notwithstanding that they are otherwise expressly deductible under provisions of Subtitle A of the Code. No deduction is allowable for any items so treated.

(2) See §§ 1.263A–8 through 1.263A–15 for rules regarding the requirement to capitalize interest, that apply prior to the application of this section. After applying §§ 1.263A–8 through 1.263A–15, a taxpayer may elect to capitalize interest under section 266 with respect to designated property within the meaning of § 1.263A–8(b), provided a computation under any provision of the Internal Revenue Code is not thereby materially distorted, including computations relating to the source of deductions.

(b) *Taxes and carrying charges.* (1) The taxpayer may elect, as provided in paragraph (c) of this section, to treat the items enumerated in this subparagraph which are otherwise expressly deductible under the provisions of Subtitle A of the Code as chargeable to capital account either as a component of original cost or other basis, for the purposes of section 1012, or as an adjustment to basis, for the purposes of section 1016(a)(1). The items thus chargeable to capital account are:

(i) In the case of unimproved and unproductive real property: Annual taxes, interest on a mortgage, and other carrying charges.

(ii) In the case of real property, whether improved or unimproved and whether productive or unproductive:

(*a*) Interest on a loan (but not theoretical interest of a taxpayer using his own funds),

(*b*) Taxes of the owner of such real property measured by compensation paid to his employees,

(*c*) Taxes of such owner imposed on the purchase of materials, or on the storage, use, or other consumption of materials, and

(*d*) Other necessary expenditures, paid or incurred for the development of the real property or for the construction of an improvement or additional improvement to such real property, up