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Final regulations: Income test qualification for RICs

The U.S. Treasury Department and IRS today released for publication in the Federal Register final regulations (T.D. 9851) concerning the income test used to determine whether a corporation may qualify as a regulated investment company (RIC) for federal income tax purposes.

The [final regulations](#) [PDF 156 KB] provide guidance to corporations that intend to qualify as RICs, and adopt regulations proposed in 1960 as well as finalize—with certain clarifications or changes—a notice of proposed rulemaking that was proposed in 2016. The final regulations are generally effective on the date of publication in the Federal Register, scheduled for March 19, 2019.

Summary

The preamble to the final regulations explains the following clarifications or changes have been adopted.

- The final regulations adopt a clarification of the “distribution requirement”—that is, an inclusion under section 951(a)(1)(A) or 1293(a) is treated as a dividend for purposes of section 851(b)(2) only to the extent that the distribution requirement in section 851(b) is met.
- The final regulations do not include the “non-qualifying income proposal” from the proposed regulations. As proposed, dividend treatment would have been the only manner in which an inclusion under section 951(a)(1) or section 1293(a) could be qualifying income (that is, under the proposed regulations, for purposes of section 851(b)(2), neither of these inclusions would have been other income derived with respect to a RIC’s business of investing in stock, securities, or currencies—hence, the “non-qualifying income proposal”). Comments made in response to the proposed regulations recommended that this provision be excluded from the final regulations, and Treasury and the IRS concluded:

...the Non-qualifying Income Proposal creates an unintended effect on the RIC income test of section 851(b)(2). For example, certain types of income, such as interest and dividends, would be considered qualifying income if earned directly by a RIC. These types of income, however, would not be qualifying income when received by a controlled foreign corporation or PFIC and included in a RIC’s income under section 951(a)(1) or 1293(a), unless there is a corresponding distribution.

- The final regulations adopt the “qualifying income proposal” (that is, inclusions under sections 951(a)(1) and 1293(a) derived with respect to a RIC’s business of investing in stocks, securities, or currencies as other qualifying income for purposes of the RIC income test of section 851(b)(2)). Taxpayers may rely on this rule for tax years beginning after September 28, 2016.

In the 2016 notice of proposed rulemaking, the Treasury Department and IRS also requested comments as to whether Rev. Rul. 2006-1 and Rev. Rul. 2006-31 should be withdrawn. Commenters recommended that these rulings should not be withdrawn “...because RICs rely on those rulings to invest with confidence in certain derivatives on stocks and securities.” After consideration of the comments, the Treasury Department and IRS decided not to withdraw these revenue rulings “at this time.”

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