26 CFR 601.201: Rulings and determination letters. (Also Part I, §§ 851(b)(3), 852(b)(5), 853(a); 1.851–2, 1.853–1)

Rev. Proc. 2001–57

SECTION 1. PURPOSE

This revenue procedure sets forth conditions under which a regulated investment company (RIC) that holds a partnership interest is treated for certain purposes as if it directly invested in the assets held by the partnership. This revenue procedure applies to an affected taxpayer for purposes of qualifying as a RIC under section 851(b)(3), for purposes of the payment of exempt-interest dividends under section 852(b)(5), and for purposes of the passthrough of the foreign tax credit under section 853.

SECTION 2. BACKGROUND

.01 The Internal Revenue Service responds to a large number of letter ruling requests from RICs that hold partnership interests in master-feeder structures. In order to save these taxpayers the time and expense involved in obtaining a ruling, the Service is issuing this revenue procedure.

.02 In a typical master-feeder structure, a domestic corporation (Feeder Fund) invests substantially all its assets in an investment partnership (Master Partnership). Some Feeder Funds may invest in more than one Master Partnership. A Feeder Fund is registered as an open-end management investment company under the Investment Company Act of 1940 (the

1940 Act), 15 U.S.C. 80a–1 *et seq.*, and elects to be treated as a RIC under subchapter M, part I, of the Code. A Master Partnership is registered as a management company under the 1940 Act.

.03. For purposes of determining its required distribution under § 4982(a) of the Code, a Feeder Fund accounts for its share of items of income, gain, loss, and deduction of the Master Partnership as they are taken into account by the Master Partnership. *See* Rev. Rul. 94–40 (1994–1 C.B. 274) modified by Rev. Rul. 94–40A (1994–1 C.B. 276) (requiring a RIC to include its share of partnership income on a current basis in calculating the required distribution to avoid excise tax liability under § 4982(a)(1) of the Code). *See also* Rev. Proc. 94–71 (1994–2 C.B. 810) (defining circumstances in which a RIC may apply the income inclusion timing rule of § 706 rather than the current inclusion rule of Rev. Rul. 94–40).

.04 A Feeder Fund commonly requests that the Internal Revenue Service rule that it will be deemed to own a proportionate share of each asset of the Master Partnership for purposes of determining whether it satisfies the requirements of §§ 851(b)(3), 852(b)(5), and 853 of the Code.

.05 Section 851(b) provides that certain requirements must be satisfied in order for a domestic corporation to be taxed as a RIC under subchapter M, part I, of the Code.

.06 Section 851(b)(2) provides that, in order to qualify as a RIC, at least 90 percent of a corporation's gross income must be derived from dividends, interest, payments with respect to securities loans (as defined in § 512(a)(5)), gains from the sale or other disposition of stocks, securities, foreign currencies, or other income derived with respect to its business of investing in such stocks, securities, or currencies.

.07 Section 851(b)(3)(A) requires that, in order for a corporation to qualify as a RIC, at the close of each quarter of the taxable year, at least 50 percent of the value of the corporation's total assets must be represented by cash and cash items (including receivables), Government securities, securities of other RICs, and other securities generally limited in respect of any one issuer to an amount not greater in value than 5 percent of the value of the total assets of the corporation and to not more than 10 percent of the outstanding voting securities of such issuer.

.08 Section 851(b)(3)(B) provides that, in order for a corporation to qualify as a RIC, not more than 25 percent of the corporation's total assets may be invested in the securities (other than Government securities and the securities of other RICs) of any one issuer, or of two or more issuers that the corporation controls and which are determined, under regulations, to be engaged in the same or similar trades or businesses or related trades or businesses.

.09 Section 852(b)(5) provides that, if at least 50 percent of the value (as defined in § 851(c)(4)) of a RIC's total assets at the close of each calendar quarter consists of obligations described in § 103(a), the RIC is eligible to pay exempt-interest dividends, which are treated by the RIC's shareholders as interest excludable from gross income pursuant to § 103(a).

.10 Section 853(a) provides that, if more than 50 percent of the value (as defined in § 851(c)(4)) of a RIC's total assets at the close of the taxable year consists of stock or securities in foreign corporations and if the RIC meets the requirements of § 852(a) for the taxable year, then, for purposes of determining a shareholder's foreign tax credit under § 901, the RIC may elect to treat its shareholders as if they had paid certain foreign taxes paid by the RIC.

.11 A RIC's allocable share of items of income, gain, loss, deduction, and credit of a partnership in which it holds an interest is determined under subchapter K of the Code. Section 702(a) provides that a partner, in determining his income tax, shall take into account separately his distributive share of such items as are set forth in that section. Section 702(b) provides that the character of items stated in § 702(a) that are included in a partner's distributive share shall be determined as if such items were realized directly from the source from which they were realized by the partnership, or incurred in the same manner as incurred by the partnership. Section 702(c) provides that, where it is necessary to determine the gross income of a partner, such amount shall include that partner's distributive share of the gross income of the partnership. A partner's distributive share of income, gain, loss, deduction, or credit is determined in accordance with the rules set forth in section 704.

.12 The flush language of § 851(b) states that income derived from a partnership or trust shall be treated as satisfying the 90 percent requirement of § 851(b)(2) only to the extent that such income is attributable to items of income of the partnership or trust which would be described in § 851(b)(2) if earned directly by the RIC. The legislative history of that sentence indicates that it was intended to clarify the general rule used to characterize items of income, gain, loss, deduction, or credit includable in a partner's distributive share, as applied to RICs that are partners. It therefore explains the relationship of § 702 to the 90 percent test under § 851(b)(2). *See* S. Rep. No. 445, 100th Cong., 2d Sess. 93 (1988).

SECTION 3. SCOPE

This revenue procedure applies to a domestic corporation that meets the following requirements:

.01 It is registered as an open-end management investment company under the 1940 Act and elects to be treated as a RIC under subchapter M, part I, of the Code.

.02 It is a publicly offered RIC as defined in § 67(c)(2)(B) of the Code and § 1.67–2T(g)(3)(iii) of the regulations.

.03 It invests substantially all its assets in one or more Master Partnerships that are registered as management companies under the 1940 Act.

.04 Except as required by § 1.704–3 of the regulations, its allocable share of each item of the Master Partnership's income, gain, loss, deduction, and credit is proportionate to its percentage of ownership of the capital interests in the Master Partnership.

SECTION 4. PROCEDURE

For purposes of qualifying as a RIC under section 851(b)(3), for purposes of the payment of exempt-interest dividends under section 852(b)(5), and for purposes of the passthrough of the foreign tax credit under section 853, a domestic corporation meeting the requirements of Section 3 of this procedure is treated as if it directly invested in the assets held by the Master Partnership in which it invests. For these purposes, its interest in Master Partnership assets is determined in accordance with its percentage of ownership of the capital interests in the Master Partnership.

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective for asset determinations that are made as of dates after December 10, 2001.

DRAFTING INFORMATION

The principal author of this revenue procedure is Susan Thompson Baker of the Office of the Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue procedure, contact her at (202) 622–3940 (not a toll-free call).