26 CFR 601.201: Rulings and determination letters.
(Also Part I, §§ 851, 852; 1.851–2.)

Rev. Proc. 2005–20

SECTION 1. PURPOSE

This revenue procedure amplifies and supersedes Rev. Proc. 2003–32, 2003–1 C.B. 803, to take into account that Rev. Proc. 2002–68, 2002–2 C.B. 753, was modified and superseded by Rev. Proc. 2003–84, 2003–2 C.B. 1159, and describes conditions under which a regulated investment company (RIC) that holds a partnership interest is treated, for purposes of qualifying as a RIC under § 851(b)(3) of the Internal Revenue Code of 1986 and for purposes of eligibility to pay exempt-interest dividends under § 852(b)(5), as if it directly invested in the assets held by the partnership.

SECTION 2. BACKGROUND

.01 Certain RICs seek investments with a yield that is treated for federal income tax purposes as interest exempt from tax under § 103 and that reflects current short-term exempt interest rates. Partnerships described in Rev. Proc. 2003–84 offer these advantages to some of their partners. Partnerships described in its predecessor revenue procedure, Rev. Proc. 2002–68, also offered these advantages. The partnership interests are referred to as synthetic tax-exempt variable-rate bonds. Eligible partnerships described in either revenue procedure may make a monthly closing election that permits consenting partners to take into account their distributive shares of partnership income on a monthly basis.

.02 Rev. Proc. 2003–32 provides conditions under which a RIC that holds a partnership interest is treated as if it directly invested in the assets held by the partnership. It applies to consenting partners in eligible partnerships described in Rev. Proc. 2002–68. After the issuance of Rev. Proc. 2003–32, however, Rev. Proc. 2002–68 was modified and superseded by Rev. Proc. 2003–84. This revenue procedure amplifies and supersedes Rev. Proc. 2003–32 to extend this treatment to consenting partners in partnerships described in Rev. Proc. 2003–84 or in any successor published guidance that provides substantially the same treatment for consenting partners in eligible tax-exempt bond partnerships.

.03 Partners in eligible partnerships described in Rev. Proc. 2003–84 that are RICs must qualify as RICs under § 851(b)(3) and generally also seek to qualify to pay exempt-interest dividends under § 852(b)(5).

.04 Section 851(b)(3)(A) requires that, 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.

.05 Section 851(b)(3)(B) provides that, 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 that are determined, under regulations, to be engaged in the same or similar trades or businesses or related trades or businesses.

.06 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 under § 103(a).

SECTION 3. SCOPE

This revenue procedure applies to RICs that are consenting partners in eligible partnerships described in Rev. Proc. 2002–68, in Rev. Proc. 2003–84, or in any successor published guidance that provides substantially the same treatment for consenting partners in eligible tax-exempt-bond partnerships.

SECTION 4. PROCEDURE

For purposes of qualifying as a RIC under § 851(b)(3) and for purposes of eligibility to pay exempt-interest dividends under § 852(b)(5), a RIC meeting the requirements of Section 3 of this procedure is treated as if it directly invested in the assets held by the eligible partnership. For these purposes, its interest in partnership assets is determined in accordance with its capital interest in the partnership.

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective for asset determinations that are made as of dates that are on or after March 31, 2003.

SECTION 6. TRANSITION RULES

.01 The Service will not challenge a RIC partner's look-through treatment for purposes of an asset determination, provided that—

(1) The asset determination is made as of a date that is in a taxable year beginning before January 1, 2004;

(2) The partnership would be an eligible partnership as defined in Rev. Proc. 2002–68;

(3) The RIC partner's inclusion of income, gain, loss, deduction, and credits is consistent with that permitted under that revenue procedure; and

(4) The RIC partner's tax treatment is consistent with an election under § 761(a) to be excluded from the provisions of subchapter K.

.02 The Service will not challenge a consenting RIC partner's look-through treatment for purposes of an asset determination, provided that the partnership is an electing partnership under the provisions of Rev. Proc. 2002–16 or Rev. Proc. 2002–68 to which the grandfather rule in section 9.02(1) of Rev. Proc. 2003–84 applies.

.03 For purposes of this Section 6, "look-through treatment" means that a RIC makes asset determinations as if it directly invested in the assets held by a partnership in which it invests.

SECTION 7. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2003–32 is amplified and superseded.

DRAFTING INFORMATION

The principal author of this revenue procedure is Lauren J. Blecker of the Office of the Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue procedure, contact her at (202) 622–3920 (not a toll-free call).