

INTERNAL REVENUE SERVICE  
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The Honorable Ellen O. Tauscher  
U.S. House of Representatives  
Attention: Emily Zielske  
1801 North California Boulevard  
Suite 103  
Walnut Creek, CA 94596

April 4, 2000

Dear Ms. Tauscher:

This letter responds to your inquiry to Mr. Floyd Williams dated February 20, 2000, on behalf of your constituent, [REDACTED] [REDACTED] asks whether he should treat his short-term capital gains from mutual funds as dividends or as short-term capital gains.

A distribution received from a mutual fund may be an ordinary dividend, a capital gain dividend, an exempt-interest dividend, or a return of capital. A mutual fund is required to send its shareholder a Form 1099-DIV or similar statement to tell its shareholder the kind of distribution he or she receives.

Form 1099-DIV displays in Box 1 the total ordinary dividends received from a mutual fund. The related "Instructions for Recipient" accompanying Form 1099-DIV explains that the amount shown in Box 1, Ordinary dividends, includes any net short-term capital gains from the mutual fund. The total amount shown in Box 1 is fully taxable as ordinary income. Accordingly, your constituent, [REDACTED], should report this amount on the "Ordinary dividends" line of Form 1040 or 1040A. He should also report it on Schedule B (Form 1040) or Schedule 1 (Form 1040A), if required. Enclosed for your convenience is a copy of a Form 1099-DIV and accompanying instructions.

The following general information on capital gains dividends may also be useful to your constituent.

- Section 852(b)(3) of the Internal Revenue Code limits the amount of a mutual fund's capital gain dividend to the mutual fund's net capital gain.
- Section 1222(11) defines the term "net capital gain" as the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for that year.
- Section 1222(7) defines the term "net long-term capital gain" as the excess of long-term capital gains for the taxable year over the long-term capital losses for that year.

- Section 1222(6) defines the term “net short-term capital loss” as the excess of short-term capital losses over the short-term capital gains for that year.

If the mutual fund’s short-term capital gains exceed the short-term capital losses, this excess does not fall within the definition of net capital gain, and cannot therefore be designated by the mutual fund as a capital gain dividend. Dividends not designated by the mutual fund as capital gain dividends (or as exempt-interest dividends) are ordinary dividends includable in income of the recipient as described in the preceding paragraph.

We hope this information will be helpful in responding to your constituent. If we can be of any further assistance, please call Susan Baker at (202) 622-3940.

Sincerely yours,  
Assistant Chief Counsel  
(Financial Institutions & Products)

By: \_\_\_\_\_  
William E. Coppersmith  
Chief, Branch 2

Enclosure: Form 1099-DIV and instructions