

Part III

Administrative, Procedural, and Miscellaneous

26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.

(Also Part I, Sections 851; 1.851–3, 1.851–5.)

Rev. Proc. 2015-45

SECTION 1. PURPOSE

This revenue procedure describes conditions under which the Internal Revenue Service will treat a regulated investment company (RIC) that invests in one or more other RICs as satisfying the asset diversification requirements of section 851(b)(3)(B) (the 25 percent tests) of the Internal Revenue Code.

SECTION 2. BACKGROUND

.01 The 25 percent tests impose asset diversification requirements applied at the close of each quarter of a RIC's taxable year. These tests permit no more than 25 percent of the value of a RIC's total assets to be invested in (i) the securities (other than Government securities or the securities of other RICs) of any one issuer; (ii) the securities (other than the securities of other RICs) of two or more issuers that the RIC

controls and that are determined, under regulations prescribed by the Secretary, to be engaged in the same or similar trades or business or related trades or businesses; or (iii) the securities of one or more qualified publicly traded partnerships (as defined in section 851(h)) (QPTPs).

.02 Section 851(c) contains special rules applicable to the 25 percent tests. Under these rules, in ascertaining the value of a RIC's investment in the securities of an issuer for purposes of the 25 percent tests, the RIC must include its proper proportion (as determined under regulations prescribed by the Secretary) of the investment in securities of that issuer that are held by any other corporation that is a member of the RIC's controlled group. Section 851(c)(3) defines a controlled group as one or more chains of corporations connected through stock ownership with the RIC if 20 percent or more of the total combined voting power of all classes of stock entitled to vote of each of the corporations (except the RIC) is owned directly by one or more of the other corporations, and the RIC owns directly 20 percent or more of the total combined voting power of all classes of stock entitled to vote of at least one of the other corporations. The Treasury Department and the Internal Revenue Service have issued final regulations designated as §§ 1.851-3 and 1.851-5 of the Income Tax Regulations to clarify the application of the controlled group rules of section 851(c). See TD 9737, published in the Federal Register on September 15, 2015.

.03 A Fund of Funds is a structure composed of a RIC (Upper RIC) that invests in stock (and possibly other securities) of one or more other RICs (Lower RICs). The Upper RIC and Lower RICs generally are members of the same fund family. A Fund of Funds structure may be used by an Upper RIC to allocate its investment exposure

among the investment exposures of one or more Lower RICs in which it invests. For example, an Upper RIC that is a target-date retirement fund may invest in equity and bond funds based on the investment timeline of the Upper RIC's investors, gradually moving a greater percentage of the Upper RIC's assets out of equity funds and into bond funds as the target retirement date of the Upper RIC's investors approaches.

.04 If an Upper RIC holds 20 percent or more of the total combined voting power of all classes of stock entitled to vote of a Lower RIC or RICs within the meaning of section 851(c)(3), the Upper RIC and Lower RIC or RICs constitute a chain of corporations connected through stock ownership and are members of a controlled group. Section 851(c)(1) and § 1.851-3 therefore require the Upper RIC to include its proportionate share of the assets of the Lower RIC or RICs in determining whether the Upper RIC satisfies the 25 percent tests at the end of each of its quarters.

.05 Section 851(d)(1) contains two remedial provisions, referred to as the "market value exception" and the "30-day cure provision," which assist a RIC in avoiding loss of RIC status due to a failure to satisfy the asset diversification rules of section 851(b)(3) and (c) as of the end of a quarter.

.06 The market value exception under section 851(d)(1) provides that a corporation that meets the requirements of section 851(b)(3) and (c) at the close of any quarter shall not lose its status as a RIC because of a discrepancy during a subsequent quarter between the value of its various investments and such requirements unless such discrepancy exists immediately after the acquisition of any security or other property and is wholly or partly the result of such acquisition. This provision ensures that fluctuations in market values of securities alone will not cause a RIC to fail its asset

diversification requirements and that a RIC may dispose of its assets under certain circumstances without endangering the RIC's satisfaction of these requirements. See § 1.851-5, Example 5.

.07 The 30-day cure provision under section 851(d)(1) provides that, if a RIC does not meet the requirements of section 851(b)(3) and (c) at the close of any quarter by reason of a discrepancy that exists immediately after the acquisition of any security or other property and that is wholly or partly the result of such acquisition during such quarter, the RIC shall not lose its status for such quarter if such discrepancy is eliminated within 30 days after the close of such quarter, and, in such cases, the RIC shall be considered to have met such requirements at the close of such quarter. See also Rev. Rul. 69-134, 1969-1 C.B. 187 (stating that, for purposes of applying the 30-day cure provision to eliminate a discrepancy, the value of the securities disposed of shall be the value on the last business day of the quarter).

.08 An Upper RIC may have a quarter-end date (quarterly testing date) that differs from that of one or more of the Lower RICs in its controlled group. On the Upper RIC's quarterly testing date, such a Lower RIC may hold assets that, if the Upper RIC included its proportionate share of the Lower RIC's assets on the Upper RIC's quarterly testing date, that inclusion might appear to cause the Upper RIC to fail one or more of the 25 percent tests on that date. The terms of the 30-day cure provision and of the market value exception are both expressed with respect to a RIC's quarterly testing date. As a result, inflexibly including an Upper RIC's share of a Lower RIC's assets on a date that differs from the Lower RIC's testing date might in some circumstances undermine the protection conferred by these relief provisions.

SECTION 3. SCOPE

.01 This revenue procedure applies to an Upper RIC that directly holds 20 percent or more of the total combined voting power of all classes of stock entitled to vote of one or more Lower RICs.

.02 This revenue procedure does not apply to any Upper RIC if a purpose of the Fund of Funds structure is to enable the Upper RIC to invest (directly or indirectly through one or more members of the Upper RIC's controlled group) in securities of an issuer or category of issuers at levels that would not be permissible if the 25 percent tests were applied without regard to this revenue procedure. Thus, for example, this revenue procedure would not apply if direct or indirect transfers of assets are made among controlled group members (whether through contributions, distributions, or otherwise), or controlled group members otherwise acquire or transfer assets, as part of a plan to enable each RIC to satisfy the 25 percent tests on its respective quarter-end date and to maintain an aggregate level of investment in an issuer or a category of issuers in excess of that which would be permissible if the 25 percent tests were applied without regard to this revenue procedure.

SECTION 4. APPLICATION

.01 An Upper RIC will be treated as satisfying the 25 percent tests for a quarter provided that—

(1) The Upper RIC invests solely in cash, cash items, Government securities, and securities of one or more Lower RICs, and each Lower RIC that is a member of the Upper RIC's controlled group, taking into account the market value exception and 30-

day cure provision of section 851(d)(1), is treated as satisfying the 25 percent tests for each quarter that ends during or concurrently with the quarter of the Upper RIC; or

(2) The Upper RIC invests in cash, cash items, Government securities, and securities of one or more Lower RICs, and other stocks and securities, and—

(a) Each Lower RIC that is a member of the Upper RIC's controlled group, taking into account the market value exception and 30-day cure provision of section 851(d)(1), satisfies the 25 percent tests for each quarter that ends during or concurrently with the quarter of the Upper RIC; and

(b) Disregarding the Upper RIC's investments in the securities in each Lower RIC that is a member of the Upper RIC's controlled group and the Upper RIC's proportionate share of any securities held by those Lower RICs, the Upper RIC satisfies the 25 percent tests with respect to the remainder of its assets.

.02 In determining whether a RIC within a chain of corporations satisfies the requirements of section 4.01 of this revenue procedure, the 25 percent tests (taking into account the market value exception and 30-day cure provision of section 851(d)(1)), are applied—

(1) First, to a Lower RIC that is not also an Upper RIC in the chain; and

(2) Next, successively up the chain to each other Lower RIC in the chain; and

(3) Last, to the Upper RIC that is not also a Lower RIC.

SECTION 5. EXAMPLES

.01 Example 1. RIC A has a quarterly testing date of March 31. RIC A invests solely in cash, cash items, Government securities, and shares of RIC B, RIC C, RIC D, and RIC E. RIC B and RIC E are members of RIC A's controlled group. RIC A's Fund

of Funds structure does not have a purpose of enabling RIC A to invest (directly or indirectly through one or more members of RIC A's controlled group) in securities of an issuer or category of issuers at levels that would not be permissible if the 25 percent tests were applied without regard to this revenue procedure. RIC A is an Upper RIC that is described in section 3 of this revenue procedure. The quarterly testing date for RIC B and RIC E is February 28. On February 28, RIC B satisfies the 25 percent tests. RIC E, however, fails to satisfy one of the 25 percent tests on February 28 due to its acquisition during the quarter of some holdings in Corporation F. On March 15, which is within 30 days after the close of the quarter ending February 28, RIC E sells shares of Corporation F so that the discrepancy between the value of its investments and the requirements of section 851(b)(3)(B) is eliminated. RIC E is therefore considered to have met the 25 percent tests at the close of the quarter ending February 28. Under section 4.01(1) of this revenue procedure, RIC A is treated as satisfying the 25 percent tests for its quarter ending March 31. This is because each Lower RIC that is a member of RIC A's controlled group, taking into account the market value exception and 30-day cure provision of section 851(d)(1), satisfies the 25 percent tests for each quarter that ends during or concurrently with the quarter of RIC A.

.02 Example 2. RIC S has a quarterly testing date of June 30. RIC S invests 30 percent of its assets in shares of RIC T, a member of its controlled group, and the remaining 70 percent of its assets in other stocks and securities. RIC S's Fund of Funds structure does not have a purpose of enabling RIC S to invest (directly or indirectly through one or more members of RIC S's controlled group) in securities of an issuer or category of issuers at levels that would not be permissible if the 25 percent

tests were applied without regard to this revenue procedure. RIC S is an Upper RIC described in section 3 of this revenue procedure. The quarterly testing date for RIC T is May 31. On May 31, RIC T fails to satisfy one of the 25 percent tests due to its acquisition during the quarter of some holdings in Corporation U. On June 15, which is within 30 days after the close of the quarter ending May 31, RIC T sells shares of Corporation U so that the discrepancy between the value of its investments and the requirements of section 851(b)(3)(B) is eliminated. RIC T is therefore considered to have met the 25 percent tests at the close of its quarter ending May 31. On June 30, disregarding RIC S's investments in the stock and securities of RIC T, RIC S satisfies the 25 percent tests with respect to the remainder of its assets. Under section 4.01(2) of this revenue procedure, RIC S is treated as satisfying the 25 percent tests for its quarter ending June 30. This is because RIC T, taking into account the market value exception and the 30-day cure provision of section 851(d)(1), satisfies the 25 percent tests for its quarter that ends during or concurrently with the quarter of RIC S, and, disregarding RIC S's investments in the stock and securities of RIC T, RIC S satisfies the 25 percent tests with respect to the remainder of its assets.

.03 Example 3. RIC V has a quarterly testing date of June 30. RIC V invests in shares of RIC W. RIC W is a member of RIC V's controlled group and has a quarterly testing date of May 31. RIC V's Fund of Funds structure does not have a purpose of enabling RIC V to invest (directly or indirectly through one or more members of RIC V's controlled group) in securities of an issuer or category of issuers at levels that would not be permissible if the 25 percent tests were applied without regard to this revenue procedure. RIC V is an Upper RIC described in section 3 of this revenue procedure.

RIC W's investment in securities of one or more QPTPs increases in value during the quarter ending May 31, with the result that more than 25 percent of RIC W's assets is invested in securities of one or more QPTPs on May 31. Taking into account the market value exception of section 851(d)(1), RIC W satisfies the 25 percent tests for the quarter ending on May 31. During June, RIC V acquires interests in one or more QPTPs. On June 30, disregarding its investment in the securities of RIC W, RIC V satisfies the 25 percent tests with respect to the remainder of its assets, including its interests in one or more QPTPs. Under section 4.01(2) of this revenue procedure, RIC V is treated as satisfying the 25 percent tests for its quarter ending June 30. This is because RIC W, taking into account the market value exception of section 851(d)(1), satisfies the 25 percent tests for its quarter that ends during or concurrently with the quarter of RIC V, and disregarding RIC V's investments in the stock and securities of RIC W, RIC V satisfies the 25 percent tests with respect to the remainder of its assets.

SECTION 6. EFFECTIVE DATE

This revenue procedure is effective for quarters ending after September 14, 2015.

SECTION 7. DRAFTING INFORMATION

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