

1987



Department of the Treasury
Internal Revenue Service

Instructions for Form 1120-RIC

U.S. Income Tax Return for Regulated Investment Companies

(Section references are to the Internal Revenue Code unless otherwise noted.)

Paperwork Reduction Act Notice

We ask for this information to carry out the Internal Revenue laws of the United States. We need it to ensure that taxpayers are complying with these laws and to allow us to figure and collect the right amount of tax. You are required to give us this information.

Pending Legislation May Affect Form 1120-RIC

At the time Form 1120-RIC and these instructions were printed, Congress was considering a tax bill to make technical corrections to the Tax Reform Act of 1986 and for other purposes. Among the proposed changes that may affect Form 1120-RIC are: a provision requiring regulated investment companies to include dividends in income on the ex-dividend date (rather than on the date received), changes in the types of income that are included for purposes of the 90% and 30% of gross income tests; a provision allowing a corporation electing to be treated as a business development company under the Investment Company Act of 1940 to be eligible to elect regulated investment company status; and, exclusion of regulated investment companies from the imposition of the environmental tax.

General Instructions

Note: In addition to those publications listed throughout these instructions, taxpayers may wish to get: **Publication 534, Depreciation**; **Publication 535, Business Expenses**; **Publication 542, Tax Information on Corporations**; and **Publication 921, Explanation of the Tax Reform Act of 1986 for Business**.

A. Purpose of Form

Form 1120-RIC is used to report the income, gains, losses, deductions, and credits of regulated investment companies as defined in section 851.

B. Filing Form 1120-RIC

1. Who Must File

A domestic corporation that elects to be treated as a regulated investment company for the tax year (or has made such election for a prior tax year) and that meets the requirements listed below must file Form 1120-RIC. The election is made by computing taxable income as a regulated investment company on Form 1120-RIC.

An electing regulated investment company must be a domestic corporation—

(a) that is: (1) registered with the Securities and Exchange Commission throughout the tax year as a management company, business development company,

or unit investment trust under the Investment Company Act of 1940, or (2) a common trust fund or similar fund excluded by section 3(c)(3) of such Act from the definition of "investment company" and is not included in the definition of "common trust fund" under section 584(a);

(b) that derives at least 90% of its gross income (including tax-exempt interest income) from dividends, interest, payments with respect to securities loans (as defined in section 512(a)(5)), and gains from the sale or other disposition of stock or securities (as defined in section 2(a)(36) of the Investment Company Act of 1940) or foreign currencies, or other income (including gains from options, futures, or forward contracts) derived with respect to its business of investing in such stock, securities, or currencies;

(c) that derives less than 30% of its gross income (including tax-exempt interest income) from the sale or other disposition of stock or securities held for less than 3 months;

(d) that meets the diversification of investment requirements of sections 851(b)(4) and (c);

(e) that was treated as a regulated investment company for all tax years ending after November 7, 1983, or as of the end of the tax year, the corporation had no accumulated earnings and profits from any non-RIC year; and

(f) for which the deduction for dividends paid (excluding capital gain dividends) equals or exceeds the sum of:

(1) 90% of its investment company taxable income (determined without regard to the deduction for dividends paid); and

(2) 90% of its net income from tax-exempt obligations.

See sections 851 and 852 for details and exceptions.

If a regulated investment company has more than one fund (as defined below), each fund is treated as a separate corporation for purposes of the Internal Revenue Code (except with respect to the definitional requirement of paragraph (a) above). For tax years beginning before October 23, 1986, this statutory provision was not in effect. A regulated investment company with more than one fund that had previously been treated as a single corporation must allocate the tax attributes of the company among its funds. No gain or loss is recognized by the company, its funds, or shareholders as a result of this rule.

2. Definition of Fund

A fund is a separate portfolio of assets, the beneficial interests in which are owned by

the holders of a class or series of stock that is preferred over all other classes or series with respect to that portfolio of assets.

Note: As used in these instructions and Form 1120-RIC, the term "fund" refers to the above definition and to any regulated investment company that does not have more than one such portfolio of assets.

3. When To File

Generally, the fund must file its income tax return by the 15th day of the 3rd month after the end of the tax year. A new fund filing a short-period return must generally file by the 15th day of the 3rd month after the short period ends. A fund that has dissolved must generally file by the 15th day of the 3rd month after the date it dissolved.

Extension.—File **Form 7004**, Application for Automatic Extension of Time To File Corporation Income Tax Return, to request an automatic 6-month extension of time to file.

Period covered.—File the 1987 return for calendar year 1987 and fiscal years that begin in 1987 and end in 1988. For a fiscal year, fill in the tax year space at the top of the form.

Final return.—If the fund ceases to exist, check the box for Final Return in item E at the top of the form.

4. Where To File

Use the preaddressed envelope. If you do not use the envelope, file your return at the applicable IRS address listed below.

If the fund's principal business, office, or agency is located in	Use the following Internal Revenue Service Center address
New Jersey, New York (New York City and counties of Nassau, Rockland, Suffolk, and Westchester)	Holtsville, NY 00501
New York (all other counties), Connecticut, Maine, Massachusetts, Minnesota, New Hampshire, Rhode Island, Vermont	Andover, MA 05501
Alabama, Florida, Georgia, Mississippi, South Carolina	Atlanta, GA 39901
Kentucky, Michigan, Ohio, West Virginia	Cincinnati, OH 45999
Kansas, Louisiana, New Mexico, Oklahoma, Texas	Austin, TX 73301
Alaska, Arizona, California (counties of Alpine, Amador, Butte, Calaveras, Colusa, Contra Costa, Del Norte, El Dorado, Glenn, Humboldt, Lake, Lassen, Marin, Mendocino, Modoc, Napa, Nevada, Placer, Plumas,	Ogden, UT 84201

Sacramento, San Joaquin, Shasta, Sierra, Siskiyou, Solano, Sonoma, Sutter, Tehama, Trinity, Yolo, and Yuba), Colorado, Idaho, Montana, Nebraska, Nevada, North Dakota, Oregon, South Dakota, Utah, Washington, Wyoming	Ogden, UT 84201
California (all other counties), Hawaii	Fresno, CA 93888
Illinois, Iowa, Missouri, Wisconsin	Kansas City, MO 64999
Arkansas, Indiana, North Carolina, Tennessee, Virginia	Memphis, TN 37501
Delaware, District of Columbia, Maryland, Pennsylvania	Philadelphia, PA 19255

5. Signature

The return must be signed and dated by the president, vice president, treasurer, assistant treasurer, chief accounting officer, or any other officer (such as tax officer) authorized to sign. A receiver, trustee, or assignee must sign and date any return required to be filed on behalf of the fund.

Note: *If this return is being filed for a series fund (as defined in section 851(h)(2)), the return may be signed by any officer of the registered investment company (within which the fund is a series) authorized to sign.*

If a corporate officer filled in the fund's tax return, the Paid Preparer's space under "Signature of officer" should remain blank. If someone prepares the tax return and does not charge the fund, that person should not sign the return. Certain others who prepare the tax return should not sign. For example, a regular, full-time employee of the fund, such as a clerk, secretary, etc., does not have to sign.

Generally, anyone who is paid to prepare the tax return must sign it and fill in the blanks in the Paid Preparer's Use Only area of the return.

The preparer required to sign the return MUST complete the required preparer information and:

- Sign it, by hand, in the space provided for the preparer's signature. (Signature stamps or labels are not acceptable.)
- Give a copy of the tax return to the taxpayer in addition to the copy filed with IRS.

Tax return preparers should be familiar with their responsibilities. See **Publication 1045**, Information for Tax Practitioners, for more details.

C. Figuring and Paying the Tax

1. Accounting

Accounting methods.—Taxable income must be computed using the method of accounting regularly used in keeping the fund's books and records. In all cases, the method adopted must clearly reflect taxable income. See section 446.

Generally, funds with average annual gross receipts of more than \$5,000,000 must use the accrual method of accounting. See section 448 for definitions and exceptions.

Unless the law specifically permits otherwise, the fund may change the method of accounting used to report taxable income in earlier years (for income as a

whole or for any material item) only by first getting consent on **Form 3115**, Application for Change in Accounting Method. Also see **Publication 538**, Accounting Periods and Methods.

Change in accounting period.—Generally, before changing its accounting period, the fund must obtain the Commissioner's approval by filing **Form 1128**, Application for Change in Accounting Period. (See Regulations section 1.442-1 and Publication 538.)

2. Rounding Off to Whole-Dollar Amounts

The fund may show money items on the return and accompanying schedules as whole-dollar amounts. To do so, drop any amount less than 50 cents and increase any amount from 50 cents through 99 cents to the next higher dollar.

3. Depository Method of Tax Payment

The fund must pay the tax due in full when the return is filed but no later than 2½ months after the end of the tax year.

Deposit fund income tax payments (and estimated tax payments) with **Form 8109**, Federal Tax Deposit Coupon. Be sure to darken the "1120" box on the coupon. Make these deposits with either a financial institution qualified as a depository for Federal taxes or the Federal Reserve Bank or Branch servicing the geographic area where the fund is located. Do not submit deposits directly to an IRS office; otherwise, the fund may be subject to a failure to deposit penalty. Records of deposits will be sent to IRS for crediting to the fund's account. See the instructions contained in the coupon book (Form 8109) for more information.

In order for us to better process your deposits, please write on your check your employer identification number, type of tax paid, and the tax period to which the deposit applies.

To get more deposit coupons, use the reorder form (Form 8109A) provided in the coupon book.

For more information concerning deposits, see **Publication 583**, Information for Business Taxpayers.

4. Backup Withholding

If a person receives certain payments and does not give the payer the correct employer identification number, the payer will withhold taxes from those payments. This type of withholding is called "backup withholding." If the fund has had any backup withholding withheld from payments, it should show this amount in the blank space in the right-hand column between lines 27 and 28, page 1, Form 1120-RIC, and label the amount as backup withholding. The fund should then include the amount in the total for line 28.

5. Estimated Tax

The fund must make estimated tax payments if it can expect its estimated tax to be \$40 or more. For estimated tax purposes, the estimated tax of the fund is defined as the sum of its **alternative minimum tax and environmental tax** (minus the credits for Federal tax on gasoline and special fuels and overpaid windfall profit tax). Use the Payment Coupons (Forms 8109) in making deposits of estimated tax.

If the fund overpaid estimated tax, it may be able to get a "quick refund" by filing **Form 4466**, Corporation Application for Quick Refund of Overpayment of Estimated Tax. The overpayment must be both: (1) at least 10% of expected income tax liability, and (2) at least \$500. To apply, file Form 4466 within 2½ months after the end of the tax year and before the fund files its tax return.

Caution: *Pending legislation would exempt regulated investment companies from the imposition of the environmental tax. If this provision becomes law, the requirement to make payments of estimated tax will no longer apply to regulated investment companies.*

6. Timing Change in Deducting Accrued Expenses

Generally, an accrual basis taxpayer can deduct accrued expenses in the tax year that all events have occurred that determine the liability, and the amount of the liability can be figured with reasonable accuracy. However, all the events that establish liability for the amount generally are treated as occurring only when economic performance takes place. There are exceptions for recurring items. See section 461(h).

7. Rule of 78's Not an Acceptable Method of Figuring Interest

Taxpayers are reminded that, generally, the Rule of 78's is not an acceptable method for computing interest income or expense. Anyone using the Rule of 78's should see Revenue Procedures 84-27, 84-28, 84-29, and 84-30 (which are in Cumulative Bulletin 1984-1) to change their method.

D. Interest and Penalties

1. Interest.—Interest is charged on taxes not paid by the due date, even if an extension of time to file is granted. Interest is also charged on penalties imposed for failure to file, gross valuation overstatements, and substantial understatements of tax from the due date (including extensions) to the date of payment. The interest charge is figured at a rate determined under section 6621.

2. Late Filing of Return.—A fund that fails to file its return when due (including extensions of time for filing) may be subject to a penalty of 5% a month or fraction of a month, up to a maximum of 25%, for each month the return is not filed. The penalty is imposed on the net amount due. The minimum penalty for failure to file a tax return within 60 days of the due date for filing (including extensions) is the lesser of the underpayment of tax or \$100.

3. Late Payment of Tax.—Generally, the penalty for not paying tax when due is ½% of the unpaid amount, up to a maximum of 25%, for each month or fraction of a month the tax remains unpaid. The penalty is imposed on the net amount due.

4. Underpayment of Estimated Tax.—A fund that fails to pay estimated tax payments when due may be subject to an underpayment penalty for the period of underpayment. To avoid the estimated tax penalty, the fund must make estimated tax payments of at least 90% of the sum of its alternative minimum tax and environmental tax (minus the credits for Federal tax on

gasoline and special fuels and overpaid windfall profit tax) as shown on the return. See sections 6655(b)(1) and (d)(3).

If the fund underpaid estimated tax, attach **Form 2220**, Underpayment of Estimated Tax by Corporations, to show either how the penalty was figured or the exceptions which apply. Also be sure to check the box on line 29, Form 1120-RIC. If the fund owes a penalty, enter the amount of the penalty on this line.

5. Overstated Tax Deposits.—If deposits are overstated, the fund may be subject to a penalty of 25% of the overstated deposit claim. See section 6656(b).

6. Other Penalties.—There are also penalties that can be imposed for negligence, substantial understatement of tax, and fraud. See sections 6653 and 6661.

E. Other Forms, Returns, Schedules, and Statements That May Be Required

1. Forms

The fund may have to file any of the following:

Forms W-2 and W-3. Wage and Tax Statement; and Transmittal of Income and Tax Statements.

Form W-2P. Statement for Recipients of Annuities, Pensions, Retired Pay, or IRA Payments.

Form 966. Corporate Dissolution or Liquidation.

Forms 1042 and 1042S. Annual Withholding Tax Return for U.S. Source Income of Foreign Persons; and Foreign Person's U.S. Source Income Subject to Withholding. Use these forms to report and transmit withheld tax on payments or distributions made to nonresident alien individuals, foreign partnerships, or foreign corporations to the extent such payments or distributions constitute gross income from sources within the U.S. (see sections 861 through 865). For more information, see sections 1441 and 1442, and **Publication 515**, Withholding of Tax on Nonresident Aliens and Foreign Corporations.

Form 1096. Annual Summary and Transmittal of U.S. Information Returns.

Form 1098. Mortgage Interest Statement. This form is used to report the receipt from any individual of \$600 or more of mortgage interest in the course of the recipient's trade or business for any calendar year.

Forms 1099-A, B, DIV, INT, MISC, OID, PATR, and R. Information returns for reporting abandonments, acquisitions through foreclosure, proceeds from brokers and barter exchange transactions, real estate transactions, certain dividends and distributions, interest payments, medical and dental health care payments, miscellaneous income payments, nonemployee compensation, original issue discount, patronage dividends, and total distributions from profit-sharing plans, retirement plans, and individual retirement arrangements. Also use these returns to report amounts that were received as a nominee on behalf of another person.

For more information, see **Publication 916**, Information Returns.

Note: Every fund must file information returns if, in the course of its trade or business, it makes payments of rents, commissions, or other fixed or determinable income (see section 6041) totalling \$600 or more to any one person during the calendar year.

Form 2438. Regulated Investment Company Undistributed Capital Gains Tax Return. If you designate undistributed capital gains under section 852(b)(3)(D), you must file this return and pay tax on the gains so designated within 30 days after the end of your tax year. In addition, a copy of Form 2438 (with Copy A of all Forms 2439) must be attached to the Form 1120-RIC you file.

Form 2439. Notice to Shareholder of Undistributed Long-Term Capital Gains. If you file Form 2438, you must complete this form for each shareholder for whom you paid tax on undistributed capital gains designated under section 852(b)(3)(D) and furnish a copy to each such shareholder within 60 days after the end of your tax year.

Form 5452. Corporate Report of Nontaxable Dividends.

Form 5498. Individual Retirement Arrangement Information. Use this form to report contributions (including rollover contributions) to an individual retirement arrangement (IRA) and the value of an IRA or simplified employee pension account.

Form 5713. International Boycott Report, for persons having operations in or related to "boycotting" countries. In addition, persons who participate in or cooperate with an international boycott may have to complete Schedule A or Schedule B and Schedule C of Form 5713 to compute their loss of the following items: the foreign tax credit, the deferral of earnings of a controlled foreign corporation, IC-DISC benefits, and FSC benefits.

Form 8281. Information Return for Publicly Offered Original Issue Discount Instruments. This form is generally required to be filed by issuers of public offerings of debt instruments within 30 days of the issuance of the debt instrument.

Form 8300. Report of Cash Payments Over \$10,000 Received in a Trade or Business. Generally, this form is used to report the receipt of more than \$10,000 in cash or foreign currency in one transaction (or a series of related transactions).

Form 8613. Return of Excise Tax on Undistributed Income of Regulated Investment Companies. If you are liable for the 4% excise tax on undistributed income imposed under section 4982, you must file this return for calendar years beginning after 1986.

2. Statements

Stock ownership in foreign corporations.—Attach the required statement to Form 1120-RIC if the fund owned 5% or more in value of the outstanding stock of a foreign personal holding company and the fund was required to include in its gross income any undistributed foreign personal holding company income. See section 551(c).

A fund that controls a foreign corporation, or that is a 10%-or-more shareholder of a controlled foreign corporation, or acquires, disposes of, or owns 5% or more of the outstanding stock of a foreign corporation may have to file **Form 5471**, Information Return with Respect to a Foreign Corporation.

A fund that is engaged in a trade or business in the United States and is controlled by a foreign person may have to file **Form 5472**, Information Return of a Foreign Owned Corporation.

Transfers to a corporation controlled by the transferor.—If a person receives stock or securities of a corporation in exchange for property, and no gain or loss is recognized under section 351, the person (transferor) and the transferee must attach to Form 1120-RIC the information required by Regulations section 1.351-3.

3. Amended Return

To correct any error in a previously filed Form 1120-RIC, file an amended Form 1120-RIC and check the box for Amended Return in item E at the top of the form.

4. Attachments

Attach **Form 4136**, Computation of Credit for Federal Tax on Gasoline and Special Fuels, after page 4, Form 1120-RIC. Attach schedules in alphabetical order and other forms in numerical order after Form 4136.

In order to process the return, we ask that you complete every applicable entry space on Form 1120-RIC. Please do not attach statements and write "See attached" in lieu of completing the entry spaces on Form 1120-RIC.

If more space is needed on the forms or schedules, attach separate sheets indicating at the top of each attachment the form number or schedule letter of the form or schedule being continued. Also, show the same information called for on the form in the same order as on the printed forms. Please use sheets that are the same size as the forms and schedules. Attach these separate sheets after all the schedules and forms. Also, put the fund's employer identification number (EIN) on each sheet.

F. Additional Information

Be sure to answer questions G through S on page 3, Form 1120-RIC. The instructions that follow are keyed to these questions.

1. Question H(2)(c)

U.S. person.—The term "U.S. person" means:

1. A citizen or resident of the United States;
2. A domestic partnership;
3. A domestic corporation;
4. Any estate or trust (other than a foreign estate or trust within the meaning of section 7701(a)(31)).

"Owner's country," for individuals, is the owner's country of residence. For all others, it is the country where incorporated, organized, created, or administered.

2. Question J

Foreign financial accounts.—Check the Yes box if either **a** or **b**, below, applies to the fund; otherwise, check the No box:

- a. At any time during the year the fund had an interest in or signature or other authority over a financial account in a

foreign country (such as a bank account, securities account, or other financial account);

AND

- The combined value of the accounts was more than \$10,000 at any time during the year; AND

- The account was NOT with a U.S. military banking facility operated by a U.S. financial institution.

b. The fund owns more than 50% of the stock in any corporation that would answer "Yes" to item a above.

Get form **TD F 90-22.1**, Report of Foreign Bank and Financial Accounts, to see if the fund is considered to have an interest in or signature or other authority over a financial account in a foreign country (such as a bank account, securities account, or other financial account).

If Yes is checked for this question, file form TD F 90-22.1 by June 30, 1988, with the Department of the Treasury at the address shown on the form. Form TD F 90-22.1 is not a tax return, so do not file it with Form 1120-RIC.

Form TD F 90-22.1 may be obtained from IRS Forms Distribution Centers.

Also, if Yes is checked for this question, write the name of the foreign country or countries. Attach a separate sheet if more space is needed.

Specific Instructions

Data fund was established.—If this return is being filed for a series fund (as defined in section 851(h)(2)), enter the date the fund was created. Otherwise, enter the date the regulated investment company was incorporated or organized.

Employer identification number.—If the employer identification number (EIN) on the label is wrong or if the fund did not receive a label, enter the correct number at the top of the return.

A fund that does not have an EIN should apply for one on **Form SS-4**, Application for Employer Identification Number. This form may be obtained from most IRS and Social Security Administration offices. Send Form SS-4 to the same Internal Revenue Service Center to which Form 1120-RIC is mailed. If the EIN has not been received by the filing time for the fund's tax return, write "Applied for" in the space for the EIN.

For more information concerning an EIN, see Publication 583.

Total assets.—Enter the total assets of the fund as of the end of the tax year. If there are no assets at the end of the tax year, enter the total assets as of the beginning of the tax year.

Part I Income

Line 1

Dividends

Enter the total amount of dividends received during the tax year.

Line 2

Interest

Enter taxable interest on U.S. obligations and on loans, notes, mortgages, bonds, bank deposits, corporate bonds, tax refunds, etc.

Do not offset interest expense against interest income.

Line 3

Net foreign currency gain (or loss) from section 988 transactions

Enter the net foreign currency gain (or loss) from section 988 transactions that is treated as ordinary income or loss under section 988(a)(1)(A). Attach a schedule detailing each separate transaction.

Line 4

Payments with respect to securities loans

Enter the amount received or accrued from a broker as compensation for securities loaned by the fund to the broker for use in completing market transactions. Such payments must meet the requirements of section 512(a)(5).

Line 5

Excess of net short-term capital gain over net long-term capital loss

Enter on this line only the gain shown on line 9, **Schedule D (Form 1120)**, Capital Gains and Losses. To report the net capital gain on line 10, Schedule D (Form 1120), see the instructions for Part II.

Note: Every sale or exchange of a capital asset must be reported in detail on Schedule D (Form 1120), even though no gain or loss is indicated.

Line 6

Net gain (or loss)

Enter the net gain (or loss) from **Form 4797**, Gains and Losses From Sales or Exchanges of Assets Used in a Trade or Business and Involuntary Conversions, Part II, line 18.

Line 7

Other income

Enter any other taxable income not listed above, except net capital gain that must be reported in Part II, and explain its nature on an attached schedule. Examples of other income are gross rents; recoveries of fees or expenses in settlement or litigation; the amount of credit for alcohol used as fuel (determined without regard to the limitation based on tax) that was entered on **Form 6478**, Credit for Alcohol Used as Fuel; and refunds of taxes deducted in prior years to the extent it reduced income subject to tax in the year deducted (see section 111). Do not offset current year's taxes with tax refunds.

If "other income" consists of only one item, explain what it is in parentheses on line 7.

Deductions

Limitations on deductions.—

1. Transactions between related taxpayers. Generally, an accrual basis taxpayer may only deduct business expenses and interest owed to a related party in the year the payment is included in the income of the related party. See section 267 for limitation on deductions for unpaid expenses and interest.

2. Direct and indirect costs (including taxes) allocable to real or tangible personal property constructed or improved by the taxpayer. Such costs must be capitalized in accordance with section 263A.

3. Golden parachute payments. A portion of the payments made by a corporation to key personnel that exceeds their usual compensation may not be deductible. This occurs when the corporation has an agreement (golden parachute) with these key employees to pay them these excessive amounts if control of the corporation changes. See section 280G.

4. Business startup expenses are required to be capitalized unless an election is made to amortize over a period of 60 months. See section 195.

5. Section 265(a)(3) limitation. If the fund paid exempt interest dividends during the tax year (including those dividends deemed paid under section 855), no deduction is allowed for that portion of otherwise deductible expenses which the amount of tax-exempt interest income bears to total gross income (including tax-exempt income but excluding capital gain net income).

6. The net operating loss deduction is not allowed.

Line 9

Compensation of officers

Besides entering the total officers' compensation on line 9, Form 1120-RIC filers must complete Schedule E on page 2 if their total receipts (line 8, Part I, plus net capital gain from line 1, Part II, and line 9a, Form 2438) are \$150,000 or more.

Complete Schedule E, columns (a) through (f), for all officers. The regulated investment company determines who is an officer under the laws of the state where it is incorporated.

Line 10

Salaries and wages

Enter on line 10a the amount of total salaries and wages paid or incurred for the tax year. Do not include salaries and wages deducted elsewhere on the return, such as contributions to a simplified employee pension plan.

Caution: If you provided taxable fringe benefits to your employees, such as personal use of a car, do not deduct as wages the amount allocated for depreciation and other expenses that you claimed on lines 14 and 22.

Enter on line 10b the amount of jobs credit from **Form 5884**, Jobs Credit.

Line 12

Taxes

Enter taxes paid or incurred during the tax year, but do not include the following:

1. Federal income taxes;
2. Foreign or U.S. possession income taxes if a tax credit is claimed or the fund made an election under section 853;
3. Taxes, including state or local sales taxes, that are paid or incurred in connection with an acquisition or disposition of property (such taxes must be treated as a part of the cost of the acquired property or, in the case of a disposition, as a reduction in the amount realized on the disposition);
4. Excise taxes imposed under section 4982 on undistributed regulated investment company income; or
5. Taxes not imposed on the fund.

See section 164(d) for apportionment of taxes on real property between seller and purchaser.

Line 13

Interest

Do not include interest on indebtedness incurred or continued to purchase or carry obligations on which the interest is wholly exempt from tax.

Generally, a cash basis taxpayer cannot deduct prepaid interest allocable to years following the current tax year. For example, a cash basis calendar year taxpayer who in 1987 prepaid interest allocable to any period after 1987 can deduct only the amount allocable to 1987. See **Publication 545**, Interest Expense.

Generally, the interest and carrying charges on straddles cannot be deducted and must be capitalized. See section 263(g).

Line 14

Depreciation

Besides depreciation, include in line 14 the part of the cost that the fund elected to expense for certain recovery property placed in service during the tax year.

The rules for depreciation for property placed in service in 1987 or later years have been changed. Effective for property placed in service after 1986, the amount the taxpayer may expense under section 179 has been raised from \$5,000 to \$10,000. See the instructions for **Form 4562**, Depreciation and Amortization, for more information.

Line 22

Other deductions

Include in this line contributions deductible under section 170; contributions to pension and profit-sharing plans, employee benefit programs, etc.; and amortization of organization expenses.

If a contribution deductible under section 170 is in property other than money and the total claimed value of all property contributed exceeds \$500, the fund (except if closely held) shall attach a schedule describing the kind of property contributed and the method used in determining its fair market value. Closely held funds must complete **Form 8283**, Noncash Charitable Contributions, and attach it to their returns.

Employers who maintain a pension, profit-sharing, or other funded deferred compensation plan, whether or not qualified under the Internal Revenue Code and whether or not a deduction is claimed for the current tax year, generally are required to file one of the forms described below. There are penalties for failure to file these forms on time and for overstating the pension plan deduction. See sections 6652(e) and 6659A.

Form 5500.—Complete this form for each plan with 100 or more participants.

Forms 5500-C or 5500-R.—Complete the applicable form for each plan with fewer than 100 participants.

Form 5500EZ.—Complete this form for a one-participant plan.

Generally, a deduction may not be taken for the amount of any item or part thereof allocable to a class of exempt income.

Generally, the fund can deduct only 80% of the amount otherwise allowable for meals and entertainment expenses. In addition, meals must not be lavish or extravagant; a bona fide business discussion must occur during, immediately before, or immediately after the meal; and your employee must be present at the meal. If the fund claims a deduction for unallowable meal expenses, it may have to pay a penalty.

Additional limitations apply to deductions for skybox rentals, luxury water travel, convention expenses, and entertainment tickets. See section 274 and **Publication 463**, Travel, Entertainment, and Gift Expenses, for more details.

All other ordinary and necessary travel expenses paid or incurred in the trade or business of the fund are generally fully deductible. However, expenses paid or incurred for a facility (such as a yacht or hunting lodge) that is used for an activity that is usually considered entertainment, amusement, or recreation are not deductible. (**Note:** *The fund may be able to deduct the expense if the amount is treated as compensation and reported on Form W-2 for an employee or on Form 1099-MISC for an independent contractor.*)

Note: *Do not deduct penalties imposed on the fund such as those included in General Instruction D.*

Line 24

Taxable income before deduction for dividends paid

“At risk” rules.—Special “at risk” rules under section 465 generally apply to closely held funds engaged in any activity as a trade or business or for the production of income. Such taxpayers may have to adjust the amount on line 24. However, the “at risk” rules do not apply to: (1) holding real property (other than mineral property) placed in service by the taxpayer before 1987; (2) equipment leasing under section 465(c)(4), (5), and (6); and (3) any qualifying business of a qualified corporation under section 465(c)(7). For more information, see section 465 and **Form 6198**, Computation of Deductible Loss From an Activity Described in Section 465(c).

Passive activity limitations.—Section 469 generally limits the deduction of passive activity losses and passive activity credits for closely held funds. Such taxpayers may have to adjust the amount on line 24 and the credits claimed on line 4b, Schedule J. See section 469 and **Form 8582**, Passive Activity Loss Limitations, for details.

Line 25

Deduction for dividends paid

Enter the amount from line 5, Schedule A.

Line 28e

Credit for overpaid windfall profit tax

A fund that has overpaid its windfall profit tax may claim a credit on its income tax return. Use **Form 6249**, Computation of Overpaid Windfall Profit Tax, to figure the credit. Include the amount of the credit in the total for this line. Write in the margin, next to the entry on this line, the amount of the credit and identify it as “Overpaid Windfall Profit Tax.”

Part II

Line 1

Net capital gain

Enter on this line only the gain shown on line 10, Schedule D (Form 1120). To report the excess of net short-term capital gain over net long-term capital loss, see the instructions for line 5, Part I.

Line 2

Capital gain dividends

Enter the deduction for dividends paid determined with reference to capital gain dividends only, as designated by the fund in accordance with section 852(b)(3)(C), but do not include any amount reported for the tax year on Form 2438, line 9b. The rules in section 561 (taking into account sections 852(b)(7) and 855(a)) determine the amount that is deductible for the tax year. To compute the deduction for capital gain dividends, it may be useful to prepare a worksheet similar to Schedule A, page 2, Form 1120-RIC.

Schedule A

Deduction for Dividends Paid

(Lines 1 through 5)

The rules in section 561 (taking into account sections 852(b)(7) and 855(a)) determine the deduction for dividends paid. In computing the amounts to be entered on lines 1 through 4, do not take into account capital gain dividends (as defined in section 852(b)(3)(C)) or exempt-interest dividends (as defined in section 852(b)(5)).

Schedule B

Income from Tax-Exempt Obligations

If, at the close of each quarter of the tax year, at least 50% of the value of the fund's assets consisted of tax-exempt obligations under section 103(a), the fund qualifies under section 852(b)(5) to pay exempt-interest dividends for the tax year and must check the Yes box and complete lines 1 through 4 in Schedule B. See section 852(b)(5) for the definition of exempt-interest dividends and other details.

Schedule J

Tax Computation

Lines 1 and 2

Members of a controlled group, as defined in section 1563, whose tax years begin before July 1, 1987, are entitled to only one \$25,000 amount in each taxable income bracket on line 2a.

Members of a controlled group that have tax years that end after June 30, 1987, are entitled to only one \$50,000 amount and one \$25,000 amount (in that order) in each taxable income bracket on line 2b.

When a controlled group adopts or later amends an apportionment plan, each member must attach to its tax return a copy of its consent to this plan. The copy (or an attached statement) must show the part of the amount in each taxable income bracket apportioned to that member. There are other requirements as well. See Regulations section 1.1561-3(b) for the requirements and for the time and manner of making the consent.