1990

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

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is:

Recordkeeping	52 hrs., 22 min.
Learning about the law or the form	15 hrs., 17 min.
Preparing the form	29 hrs. 51 min.
Copying, assembling, and sending the form to IRS	3 hrs., 45 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form more simple, we would be happy to hear from you. You can write to both the **Internal Revenue Service,** Washington, DC 20224, Attention: IRS Reports Clearance Officer, T:FP; and the **Office of Management and Budget,** Paperwork Reduction Project (1545-1010), Washington, DC 20503. **DO NOT** send the tax form to either of these offices. Instead, see the instructions for information on where to file on page 2.

Important Change

New **Form 8826,** Disabled Access Credit, has been developed as a result of the addition of section 44 by the Revenue Reconciliation Act of 1990. This allows eligible small businesses to claim a new nonrefundable income tax credit equal to 50% of expenses that are over $250 and not more than $10,250. These expenses must be paid or incurred after November 5, 1990, to enable a small business to comply with the requirements of the Americans With Disabilities Act of 1990. An eligible small business is one with gross receipts of $1 million or less in the previous year or one that had not more than 30 full-time employees in the previous year Examples of expenses eligible for the credit include amounts paid or incurred: **(1)** to remove barriers that prevent a business from being accessible to, or usable by, individuals with disabilities; **(2)** to provide qualified interpreters or other methods of making audio materials available to hearing-impaired individuals; **(3)** to provide qualified readers, taped texts, and other methods of making visual materials available to individuals with visual impairments; or **(4)** to acquire or modify equipment or devices for individuals with disabilities.

General Instructions

Note: *In addition to those publications listed throughout these instructions, taxpayers may wish to get:* **Pub. 534,** *Depreciation;* **Pub. 535,** *Business Expenses; and* **Pub. 542,** *Tax Information on Corporations.*

A. Purpose of Form

Form 1120-RIC, U.S. Income Tax Return for Regulated Investment Companies, is used to report the income, gains, losses, deductions, credits, and to figure the income tax liability 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 (RIC) 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 RIC on Form 1120-RIC.

An electing RIC must be a domestic corporation—

(a) that is: **(1)** registered with the Securities and Exchange Commission throughout the tax year as a management company or unit investment trust under the Investment Company Act of 1940, or has in effect an election under such Act to be treated as a business development company, 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 **(Note:** *Income from a partnership qualifies under the 90% test to the extent the company's distributive share of partnership income is attributable to items described above as realized by the partnership.);*

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

(1) stock or securities (as defined in section 2(a)(36) of the Investment Company Act of 1940);

(2) options, futures, or forward contracts (other than options, futures, or forward contracts on foreign currencies); and

(3) foreign currencies (or options, futures, or forward contracts on foreign currencies) but only if such currencies (or options, futures, or forward contracts) are not directly related to the company's principal business of investing in stock or securities (or options and futures on stocks or securities);

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

(e) that was treated as a RIC 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 RIC 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).

However, any fund will not be disqualified for failure to meet the requirement of paragraph (c) above for any tax year by reason of sales resulting from abnormal redemptions on any day and occurring before the close of the 5th business day after such day if: **(1)** the sum of abnormal redemptions on that day and on prior days during the tax year exceeds 30% of net asset value, and **(2)** all funds in the series to which the fund belongs would meet the requirement if treated as a single RIC.

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 RIC 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 1990 return for calendar year 1990 and fiscal years that begin in 1990 and end in 1991. For a fiscal year, fill in the tax year space at the top of the form.

Note: *The 1990 Form 1120-RIC may also be used if:* **(1)** the fund has a tax year of less than 12 months that begins and ends in 1991, and **(2)** the 1991 Form 1120-RIC is not available by the time the fund is required to file its return. However, the fund must show its 1991 tax year on the 1990 Form 1120-RIC and incorporate any tax law changes that are effective for tax years beginning after December 31, 1990.

4. Where To File

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, New Hampshire, Rhode Island, Vermont	Andover, MA 05501
Florida, Georgia, South Carolina	Atlanta, GA 39901
Indiana, Kentucky, Michigan, Ohio, West Virginia	Cincinnati, OH 45999
Kansas, 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, 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, Minnesota, Missouri, Wisconsin	Kansas City, MO 64999
Alabama, Arkansas, Louisiana, Mississippi, North Carolina, Tennessee	Memphis, TN 37501
Delaware, District of Columbia, Maryland, Pennsylvania, Virginia	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 authorized to sign for the RIC in which the fund is a series.*

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. should not 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 fund in addition to the copy filed with IRS.

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(c).

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 **Pub. 538,** Accounting Periods and Methods.

Change in accounting period.—Generally, before changing an accounting period, the Commissioner's approval must be obtained by filing **Form 1128,** Application to Adopt, Change or Retain a Tax Year (See Regulations section 1.442-1 and Pub. 538.)

2. Rounding Off to Whole-Dollar Amounts

Money items may be shown 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. Depositary Method of Tax Payment

The fund must pay the tax due in full when the return is filed but no later than the 15th day of the 3rd month 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 depositary 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.

To help ensure proper crediting to the fund's account, write its employer identification number (EIN), "Form 1120-RIC," and the tax period to which the deposit applies on the fund's check or money order.

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

A penalty may be imposed for failure to deposit the required amount of tax. See section 6656.

For more information concerning deposits, see **Pub. 583,** Taxpayers Starting a Business.

4. Backup Withholding

If the fund has had income tax withheld from any payments it received because, for example, it failed to give the payer its correct EIN, it may claim a credit on Form 1120-RIC for the total amount withheld. This type of withholding is called "backup withholding." Show the amount withheld in the blank space in the right-hand column between lines 27 and 28h, page 1, and label the amount as "backup withholding." Also include the amount in the total for line 28h.

5. Estimated Tax

Generally, a fund must make estimated tax payments if it can expect its estimated tax to be $500 or more. For estimated tax purposes, the estimated tax of the fund is defined as its alternative minimum tax less the credit for Federal tax on fuels. Use the deposit 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 the expected income tax liability, and **(2)** at least $500. To apply, file Form 4466 after the end of the tax year, but before the 16th day of the 3rd month thereafter and before the fund files its tax return.

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 and 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

A RIC may be subject to interest and penalty charges if the RIC files a late return or fails to pay tax when due unless it can show that the failure to file or pay was due to reasonable cause and not willful neglect.

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, negligence, fraud, 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% of the unpaid tax for each month or part of a month the return is late, up to a maximum of 25% of the unpaid tax. The minimum penalty for a return that is more than 60 days late is the smaller of the tax due or $100.

3. Late Payment of Tax.—The penalty for late payment of taxes is usually ½ of 1% of the unpaid tax for each month or part of a month the tax is unpaid. The penalty cannot exceed 25% of the amount due. This penalty may also apply to any additional tax not paid within 10 days of the date of the notice and demand for payment.

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. In general, to avoid the estimated tax penalty, the fund must make estimated tax payments of at least the smaller of: 90% of its alternative minimum tax minus the credit for Federal tax on fuels as shown on the return; or 100% of its prior year's tax (computed in the same manner). See section 6655 for details and exceptions.

Form 2220, Underpayment of Estimated Tax by Corporations, is used to see if the fund owes a penalty and to figure the amount of the penalty. Generally, the fund does not have to file this form because IRS can figure the amount of any penalty and bill the fund for it. However the fund must complete and attach Form 2220 even if the fund does not owe the penalty if: **(a)** the annualized income or adjusted seasonal installment method is used, or **(b)** the fund is a "large corporation" computing its first required installment based on the prior year's tax. If Form 2220 is attached, be sure to check the box on line 29, page 1, Form 1120-RIC, and enter the amount of any penalty on this line.

5. Other Penalties.—There are also penalties that can be imposed for negligence, substantial understatement of tax, and fraud. See sections 6662 and 6663.

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 **Pub. 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, R, and **S.** Information returns for reporting abandonments, acquisitions through foreclosure, proceeds from broker and barter exchange transactions, certain dividends and distributions, interest payments, medical and dental health care payments, miscellaneous income payments, nonemployee compensation, original issue discount, patronage dividends, total distributions from profit-sharing plans, retirement plans, individual retirement arrangements, insurance contracts, etc., and proceeds from real estate transactions. Also use these returns to report amounts that were received as a nominee on behalf of another person. For more information, see the instructions for Form 1099.

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) totaling $600 or more to any one person during the calendar year.*

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

Form 2439, Notice to Shareholder of Undistributed Long-Term Capital Gains. If the fund filed Form 2438, it must complete Form 2439 for each shareholder for whom it 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 the fund's tax year.

Form 5452, Corporate Report of Nondividend Distributions.

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 the fund is liable for the 4% excise tax on undistributed income imposed under section 4982 or wishes to make an election under section 4982(e)(4), it must file this return for the calendar year.

Form 8621, Return by a Shareholder of a Passive Foreign Investment Company or

Qualified Electing Fund. A fund that was a shareholder in a passive foreign investment company (as defined in section 1296) at any time during the tax year must complete and attach this form to its return.

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 of U.S. Persons With Respect to Certain Foreign Corporations.

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

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

Election under Temporary Regulations section 1.67-2T(j)(2).—Generally, shareholders in a nonpublicly offered fund that are individuals or pass-through entities are treated as having received a dividend in an amount equal to the shareholder's allocable share of affected RIC expenses for the calendar year and as having paid or incurred an expense described in section 212 (and subject to the 2% limitation on miscellaneous itemized deductions) in the same amount for the calendar year. A nonpublicly offered fund may elect to treat its affected RIC expenses for a calendar year as equal to 40% of the amount determined under Temporary Regulations section 1.67-2T(j)(1)(i) for that calendar year. To make this election, attach to Form 1120-RIC for the tax year that includes the last day of the calendar year for which the fund makes the election, a statement that it is making an election under paragraph (j)(2) of Temporary Regulations section 1.67-2T. Once made, the election remains in effect for all subsequent calendar years and may not be revoked without IRS consent. See Temporary Regulations section 1.67-2T for definitions and other details.

3. Attachments

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

Please complete every applicable entry space on Form 1120-RIC. 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. **Be sure to show totals 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 EIN on each sheet.

F. Additional Information

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

1. Question G(2)(c)

Foreign person.—The term "Foreign person" means:

1. A foreign citizen or nonresident alien;
2. A foreign partnership;
3. A foreign corporation;
4. Any 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 I

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, 1991, 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

Address.—Include the suite, room, or other unit number after the street address. If the Post Office does not deliver mail to the street address and the RIC has a P.O. box, show the P.O. box number instead of the street address.

Item B. Date 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 RIC was incorporated or organized.

Item C. Employer identification number.—Enter the EIN of the fund. 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 Pub. 583.

Item D. 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.

Item E.—Indicate a final return, change in address, or amended return by checking the appropriate box.

Form 8822, Change of Address, can be filed to notify IRS of a change of address that occurs after the return is filed.

Part I

Income

Line 1. Dividends.—A fund that is the holder of record of any share of stock on the record date for a dividend payable on that stock must include the dividend in gross income by the later of: **(1)** the date the share became ex-dividend, or **(2)** the date the company acquired the share.

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,** Sales of Business Property, 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 any adjustment under section 481(a) required to be included in income during the current tax year due to a change in method of accounting; gross rents; recoveries of fees or expenses in settlement or litigation; the amount of credit for alcohol used as fuel (determined 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.

7. *Passive activity limitations.* Limitations on passive activity losses and credits under section 469 apply to funds that are closely held (as defined in section 469(j)(1)). Funds subject to the passive activity limitations must complete **Form 8810,** Corporate Passive Activity Loss and Credit Limitations, to compute their allowable passive activity loss and credit.

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 $500,000 or more. Do not include compensation deductible elsewhere on the return, such as elective contributions to a section 401(k) cash or deferred arrangement or amounts contributed under a salary reduction SEP agreement.

1.163-8T for the interest allocation rules. 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 1990 prepaid interest allocable to any period after 1990 can deduct only the amount allocable to 1990. See **Pub. 545,** Interest Expense.

Generally, the interest and carrying charges on straddles must be capitalized. See section 263(g).

See section 163(e)(5) which provides special rules for the disqualified portion of original issue discount on a high yield discount obligation.

Certain interest paid or accrued by the fund (directly or indirectly) to a related person may be limited if no tax is imposed on such interest. See section 163(j) for more information.

Line 14. Depreciation.—Besides depreciation, include on line 14 the part of the cost (up to $10,000) that the fund

Generally, a deduction may not be taken for the amount of any item or part thereof allocable to a class of exempt income. See Section 265(b) for exceptions.

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 an employee of the fund must be present at the meal. See section 274(k)(2) for exceptions. 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 **Pub. 463,** Travel, Entertainment, and Gift Expenses, for 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.—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. But the at-risk rules do not apply to: **(1)** holding real property placed in service by the taxpayer before 1987; **(2)** equipment leasing under sections 465(c)(4), (5), and (6); and **(3)** any qualifying business of a qualified corporation under section 465(c)(7). However, the at-risk rules do apply to the holding of mineral property. For more information, see section 465 and **Form 6198,** At-Risk Limitations.

Part II

Line 1. Net capital gain.—Enter on this line 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.

Tax on Certain Built-In Gains

IRS intends to issue regulations under section 337(d) that will impose a tax on the net built-in gain of C corporation assets in connection with: **(1)** the qualification of a corporation to be taxed as a RIC, or **(2)** the transfer of such assets to a RIC in a carryover basis transaction.

Generally, the net built-in gain equals the excess of aggregate gains over aggregate losses that would have been realized if the corporation had sold all of its assets at their respective fair market values on the relevant date described below and immediately liquidated. Unless the corporation makes the election described below, the gain must be recognized by the corporation as of: **(a)** the last day of the tax year immediately preceding the year in which it qualified as a RIC, in the case of (1) above; or **(b)** the day before the date of the transfer of assets, in the case of (2) above.

Election.—The regulations will allow the RIC to elect to pay the tax on any built-in gains recognized within a 10-year period on the assets held by the corporation before it was taxed as a RIC or before it transferred the assets in a carryover basis transaction to the RIC. The built-in gains of an electing RIC and the tax imposed on such gains will be subject to rules similar to the rules relating to net income from foreclosure property of real estate investment trusts under section 857

In the case of a corporation qualifying to be taxed as a RIC, the regulations generally will apply to tax years beginning after June 9, 1987 However, the regulations will not apply to any corporation that was taxed as a RIC for its tax year that included June 9, 1987 In addition, a previously qualifying RIC that fails to meet the qualifications to be taxed as a RIC for a single tax year generally will not be required to recognize net built-in gain under the regulations upon requalification as a RIC. For carryover basis transactions, the regulations will generally apply to transactions occurring after June 9, 1987

For more information, see Notice 88-19, 1988-1 C.B. 486, and Notice 88-96, 1988-2 C.B. 420.

Note: *Details on how to compute and report this tax on Form 1120-RIC (if the fund makes the election described above) were not available at the time these instructions were printed but will be announced by IRS after publication of the regulations under section 337(d). If the fund is required to file Form 1120-RIC before these details are announced, the fund should not include the built-in gains tax on Form 1120-RIC at the time of original filing. Rather, the tax should be shown on an amended Form 1120-RIC filed after the announcement is issued by IRS.*

Schedule A

Deductions 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)).

Line 3.—Dividends declared in October November, or December and payable to shareholders of record on a specified date in such a month are treated as having been paid by the fund and received by each shareholder on December 31 of such year provided the dividends are actually paid in January of the following year Enter on line 3 all such dividends that are not already included on line 1 or 2.

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 it 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, are entitled to one $50,000 and one $25,000 taxable income bracket amount (in that order) on line 2a.

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.

Equal apportionment plan. If no apportionment plan is adopted, the members of the controlled group must divide the amount in each taxable income bracket equally among themselves. For example, controlled group AB consists of corporation A and corporation B. They do not elect an apportionment plan. Therefore, both corporation A and corporation B are entitled to $25,000 (one-half of $50,000) in the $50,000 taxable income bracket on line 2a(i) and to $12,500 (one-half of $25,000) in the $25,000 taxable income bracket on line 2a(ii).

Unequal apportionment plan. Members of a controlled group may elect an unequal apportionment plan and divide the taxable income brackets as they wish. There is no need for consistency between

taxable income brackets. Any member of the controlled group may be entitled to all, some, or none of the taxable income brackets. (But the total amount for all members of the controlled group cannot be more than the total amount in each taxable income bracket.)

Each member of a controlled group must compute the tax on its investment company taxable income as follows (except funds that are personal holding companies or that are not in compliance with Regulations section 1.852-6):

1. Enter investment company taxable income (line 26, page 1, Form 1120-RIC) _____
2. Enter line 1 or the fund's share of the $50,000 taxable income bracket, whichever is less _____
3. Subtract line 2 from line 1 _____
4. Enter line 3 or the fund's share of the $25,000 taxable income bracket, whichever is less _____
5. Subtract line 4 from line 3 _____
6. Enter 15% of line 2 _____
7. Enter 25% of line 4 _____
8. Enter 34% of line 5 _____
9. If the taxable income of the controlled group exceeds $100,000, enter this member's share of the lesser of: **(a)** 5% of the excess over $100,000, or **(b)** $11,750. (See instructions for additional 5% tax, below.) _____
10. Total of lines 6 through 9. Enter this amount on line 3a, Schedule J, Form 1120-RIC. _____

Additional 5% tax. Members of a controlled group are treated as one corporation for purposes of figuring the applicability of the additional 5% tax that must be paid by corporations with taxable income in excess of $100,000. If the additional tax applies, each member of the controlled group will pay that tax based on the part of the amount that is used in each taxable income bracket to reduce that member's tax. (See section 1561(a).) Each member of the group must enter its share of the additional 5% tax on line 2b and attach to its tax return a schedule that shows the taxable income of the entire group as well as how its share of the additional tax was figured.

Line 3a.—The fund must compute its tax on its investment company taxable income as follows:

(1) Funds that are not personal holding companies and are in compliance with Regulations section 1.852-6 regarding disclosure of the fund's actual stock ownership (Members of a controlled group should see the instructions above for lines 1 and 2):

If its investment company taxable income (line 26, Form 1120-RIC) on page 1 is: Over—	But not over—	Its tax is:	Of the amount over—
0	$50,000	15%	0
$50,000	75,000	$7,500 + 25%	$50,000
75,000	100,000	13,750 + 34%	75,000
100,000	335,000	22,250 + 39%	100,000
335,000	----	34%	0

(2) Funds that are personal holding companies or are not in compliance with Regulations section 1.852-6:

A fund that is a personal holding company or is not in compliance with Regulations section 1.852-6 is taxed at a flat rate of 34% on its investment company taxable income.

Line 3c. Deferred tax amount under section 1291.—If the fund was a shareholder in a passive foreign investment company (PFIC) that received an excess distribution or disposed of its investment in the PFIC during the year it must include the aggregate increases in taxes due under section 1291(c)(2) in the amount to be entered on line 3c, Schedule J. Write on the dotted line to the left of line 3c, Schedule J, "Sec. 1291—$(amount). Do not include on line 3c the interest charge due under section 1291(c)(3). Instead, write "Sec. 1291 interest" and the amount owed in the bottom margin of page 1, Form 1120-RIC. See Form 8621 for details.

Line 4a. Foreign tax credit.—See **Form 1118,** Computation of Foreign Tax Credit— Corporations, for an explanation of when the fund can take credit for payment of income tax to a foreign country or U.S. possession. The fund may not claim this credit if an election under section 853 was made for the tax year

Line 4b. General business credit.—This credit is made up of the sum of the following credits:

Investment credit. The investment credit was generally repealed for property placed in service after 1985. See **Form 3468,** Investment Credit, for exceptions.

Jobs credit. The jobs credit, if elected, is allowed for hiring members of targeted groups during the tax year See **Form 5884,** Jobs Credit, for definitions, special rules, and limitations.

Do not take an expense deduction for the part of the wages or salaries paid or incurred which is equal to the amount of the jobs credit (determined without regard to the limitation based on the tax (section 38(c))).

Alcohol fuel credit. The fund may be able to take a credit for alcohol used as fuel. Use **Form 6478,** Credit for Alcohol Used as Fuel, to figure the credit.

Credit for increasing research activities. See **Form 6765,** Credit for Increasing Research Activities, and section 41.

Low-income housing credit. See **Form 8586,** Low-Income Housing Credit, and section 42.

Disabled access credit. A corporation may be able to take a credit for certain expenditures paid or incurred to assist individuals with disabilities. See "Important Change" on page 1 for more information on this credit.

Form 3800, *General Business Credit.* Complete Form 3800 if the fund has: **(1)** more than one of the above credits; **OR (2)** a credit carryforward or carryback (including one from an ESOP credit); **OR (3)** a passive activity credit. Enter the amount of the general business credit on the appropriate line and check the Form 3800 box on that line.

Form 3800 is not required if the fund has only one of the general business credits (and items (2) and (3) do not apply). Instead, attach the applicable credit form to the return and check the appropriate box for that form.

If the corporation's only general business credit is the disabled access credit, attach Form 8826 to the return and write "From Form 8826" in the space to the left of line 4b.

Line 4c. Credit for prior year minimum tax.—Use **Form 8801,** Credit for Prior Year Minimum Tax, to figure the minimum tax credit and any carryforward of that credit.

Line 4d. Credit for fuel produced from a nonconventional source.—A credit is allowed for the sale of qualified fuels produced from a nonconventional source. Section 29 contains a definition of qualified fuels, provisions for figuring the credit, and other special rules. Attach a separate schedule to the return showing the computation of the credit. Include the amount of the credit in the total for line 4d, Schedule J. Write next to the entry for line 4d the amount of the credit and identify it as "section 29 credit."

Also see Form 8801 if any of the credit is disallowed solely because of the tentative minimum tax limitation. Also see section 53(d).

Line 6. Personal holding company tax.—The fund is taxed as a personal holding company under section 542 if:

- At least 60% of its adjusted ordinary gross income for the tax year is personal holding company income, and
- At any time during the last half of the tax year more than 50% in value of its outstanding stock is owned, directly or indirectly, by not more than 5 individuals.

See section 543(a) for the definition of personal holding company income and section 543(b)(2) for the definition of adjusted ordinary gross income.

Use **Schedule PH (Form 1120),** U.S. Personal Holding Company Tax, to figure this tax.

Line 7 Recapture taxes.—*Recapture of investment credit.* If property is disposed of or ceases to be qualified property before the end of the life-years used in computing the regular or energy investment credit, there may be a recapture of the credit. See **Form 4255,** Recapture of Investment Credit.

Recapture of low-income housing credit. If the fund must recapture part of the low-income housing credit because there has been a decrease in the qualified basis of a building from the prior year or if it disposed of the building or an ownership interest in it, see **Form 8611,** Recapture of Low-Income Housing Credit, and section 42(j).

Line 8. Alternative minimum tax.—File Form 4626 if the total of investment company taxable income or (loss) and retained capital gains not designated under section 852(b)(3)(D) plus adjustments and tax preference items of the fund exceeds the lesser of **(a)** $40,000, or **(b)** the fund's allowable exemption amount. See Form 4626 for details. Reduce alternative minimum tax

by any credit allowed under section 38(c)(2) on line 19 of Schedule A, Form 3800. Write on the dotted line to the left of line 8, "Sec. 38(c)(2)—$(amount)."

Line 9. Deferred tax and interest on undistributed earnings of a qualified electing fund under section 1294.—Follow the instructions for Form 8621 to determine the amount of tax owed or deferred to include in or subtract from the total tax on line 9, Schedule J. Write on the dotted line to the left of line 9, Schedule J, "Sec. 1294" and the amount of tax to be added to or subtracted from the total for line 9. (Show an amount to be subtracted in brackets.) Do not include on line 9 the interest charge due on the deferred tax. Instead, write "Sec. 1294 interest" and the amount owed in the bottom margin of page 1, Form 1120-RIC.

Interest on tax deferred under the installment method for certain non-dealer installment obligations.—If an obligation arising from the disposition of property to which section 453A applies is outstanding at the close of the year, the fund must include the interest due under section 453A(c) in the amount to be entered on line 9, Schedule J. Write on the dotted line to the left of line 9, Schedule J, "Sec. 453A(c) interest—$(amount)." Attach a schedule showing the computation.

Schedule L

Balance Sheets

Line 4. Tax-exempt securities.—Include on this line:

(1) State and local government obligations, the interest on which is excludible from gross income under section 103(a), and

(2) Stock in another mutual fund or other RIC that distributed exempt-interest dividends during the tax year of the fund.

Schedule M-1

Reconciliation of Income per Books With Income per Return

Line 5d. Travel and entertainment.—Include on this line: 20% of meals and entertainment not allowed under section 274(n); expenses for the use of an entertainment facility; the part of business gifts in excess of $25; expenses of an individual allocable to conventions on cruise ships in excess of $2,000; employee achievement awards in excess of $400; the cost of entertainment tickets in excess of face value (also subject to 20% disallowance); the cost of skyboxes in excess of the face value of non-luxury box seat tickets; the part of the cost of luxury water travel not allowed under section 274(m); expenses for travel as a form of education; and other travel and entertainment expenses not allowed as a deduction.

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