

§ 1.851-3

Assuming that at least 50 percent of the value of the total assets of the corporation satisfies the requirements specified in this subparagraph, and that the limiting provisions of subparagraph (B) of section 851(b)(4) and subparagraph (2) of this paragraph are not violated, the corporation will satisfy the requirements of section 851(b)(4), notwithstanding that the remaining assets do not satisfy the diversification requirements of subparagraph (A) of section 851(b)(4). For example, a corporation may own all the stock of another corporation, provided it otherwise meets the requirements of subparagraphs (A) and (B) of section 851(b)(4).

(2) Subparagraph (B) of section 851(b)(4) prohibits the investment at the close of each quarter of the taxable year of more than 25 percent of the value of the total assets of the corporation (including the 50 percent or more mentioned in subparagraph (A) of section 851(b)(4)) in the securities (other than Government securities or the securities of other regulated investment companies) of any one issuer, or of two or more issuers which the taxpayer company controls and which are engaged in the same or similar trades or businesses or related trades or businesses, including such issuers as are merely a part of a unit contributing to the completion and sale of a product or the rendering of a particular service. Two or more issuers are not considered as being in the same or similar trades or businesses merely because they are engaged in the broad field of manufacturing or of any other general classification of industry, but issuers shall be construed to be engaged in the same or similar trades or businesses if they are engaged in a distinct branch of business, trade, or manufacture in which they render the same kind of service or produce or deal in the same kind of product, and such service or products fulfill the same economic need. If two or more issuers produce more than one product or render more than one type of service, then the chief product or service of each shall be the

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basis for determining whether they are in the same trade or business.

[T.D. 6500, 25 FR 11910, Nov. 26, 1960, as amended by T.D. 6598, 27 FR 4090, Apr. 28, 1962; T.D. 7555, 43 FR 32753, July 28, 1978]

§ 1.851-3 Rules applicable to section 851(b)(4).

In determining the value of the taxpayer's investment in the securities of any one issuer, for the purposes of subparagraph (B) of section 851(b)(4), there shall be included its proper proportion of the investment of any other corporation, a member of a controlled group, in the securities of such issuer. See example 4 in § 1.851-5. For purposes of §§ 1.851-2, 1.851-4, 1.851-5, and 1.851-6, the terms "controls", "controlled group", and "value" have the meaning assigned to them by section 851(c). All other terms used in such sections have the same meaning as when used in the Investment Company Act of 1940 (15 U.S.C., chapter 2D) or that act as amended.

§ 1.851-4 Determination of status.

With respect to the effect which certain discrepancies between the value of its various investments and the requirements of section 851(b)(4) and paragraph (c) of § 1.851-2, or the effect that the elimination of such discrepancies will have on the status of a company as a regulated investment company for purposes of part I, subchapter M, chapter 1 of the Code, see section 851(d). A company claiming to be a regulated investment company shall keep sufficient records as to investments so as to be able to show that it has complied with the provisions of section 851 during the taxable year. Such records shall be kept at all times available for inspection by any internal revenue officer or employee and shall be retained so long as the contents thereof may become material in the administration of any internal revenue law.

[T.D. 6598, 27 FR 4090, Apr. 28, 1962]

§ 1.851-5 Examples.

The provisions of section 851 may be illustrated by the following examples:

Example 1. Investment Company W at the close of its first quarter of the taxable year has its assets invested as follows:

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	Percent
Cash	5
Government securities	10
Securities of regulated investment companies	20
Securities of Corporation A	10
Securities of Corporation B	15
Securities of Corporation C	20
Securities of various corporations (not exceeding 5 percent of its assets in any one company)	20
Total	100

Investment Company W owns all of the voting stock of Corporations A and B, 15 percent of the voting stock of Corporation C, and less than 10 percent of the voting stock of the other corporations. None of the corporations is a member of a controlled group. Investment Company W meets the requirements under section 851(b)(4) at the end of its first quarter. It complies with subparagraph (A) of section 851(b)(4) since it has 55 percent of its assets invested as provided in such subparagraph. It complies with subparagraph (B) of section 851(b)(4) since it does not have more than 25 percent of its assets invested in the securities of any one issuer, or of two or more issuers which it controls.

Example 2. Investment Company V at the close of a particular quarter of the taxable year has its assets invested as follows:

	Percent
Cash	10
Government securities	35
Securities of Corporation A	7
Securities of Corporation B	12
Securities of Corporation C	15
Securities of Corporation D	21
Total	100

Investment Company V fails to meet the requirements of subparagraph (A) of section 851(b)(4) since its assets invested in Corporations A, B, C, and D exceed in each case 5 percent of the value of the total assets of the company at the close of the particular quarter.

Example 3. Investment Company X at the close of the particular quarter of the taxable year has its assets invested as follows:

	Percent
Cash and Government securities	20
Securities of Corporation A	5
Securities of Corporation B	10
Securities of Corporation C	25
Securities of various corporations (not exceeding 5 percent of its assets in any one company)	40
Total	100

Investment Company X owns more than 20 percent of the voting power of Corporations B and C and less than 10 percent of the voting power of all of the other corporations. Corporation B manufactures radios and Corporation C acts as its distributor and also

distributes radios for other companies. Investment Company X fails to meet the requirements of subparagraph (B) of section 851(b)(4) since it has 35 percent of its assets invested in the securities of two issuers which it controls and which are engaged in related trades or businesses.

Example 4. Investment Company Y at the close of a particular quarter of the taxable year has its assets invested as follows:

	Percent
Cash and Government securities	15
Securities of Corporation K (a regulated investment company)	30
Securities of Corporation A	10
Securities of Corporation B	20
Securities of various corporations (not exceeding 5 percent of its assets in any one company)	25
Total	100

Corporation K has 20 percent of its assets invested in Corporation L and Corporation L has 40 percent of its assets invested in Corporation B. Corporation A also has 30 percent of its assets invested in Corporation B, and owns more than 20 percent of the voting power in Corporation B. Investment Company Y owns more than 20 percent of the voting power of Corporations A and K. Corporation K owns more than 20 percent of the voting power of Corporation L, and Corporation L owns more than 20 percent of the voting power of Corporation B. Investment Company Y is disqualified under subparagraph (B) of section 851(b)(4) since more than 25 percent of its assets are considered invested in Corporation B as shown by the following calculation:

	Percent
Percentage of assets invested directly in Corporation B	20.0
Percentage invested through the controlled group, Y-K-L-B (40 percent of 20 percent of 30 percent)	2.4
Percentage invested in the controlled group, Y-A-B (30 percent of 10 percent)	3.0
Total percentage of assets of investment Company Y invested in Corporation B	25.4

Example 5. Investment Company Z, which keeps its books and makes its returns on the basis of the calendar year, at the close of the first quarter of 1955 meets the requirements of section 851(b)(4) and has 20 percent of its assets invested in Corporation A. Later during the taxable year it makes distributions to its shareholders and because of such distributions it finds at the close of the taxable year that it has more than 25 percent of its remaining assets invested in Corporation A. Investment Company Z does not lose its status as a regulated investment company for the taxable year 1955 because of such distributions, nor will it lose its status as a regulated investment company for 1956 or any

subsequent year solely as a result of such distributions.

Example 6. Investment Company Q, which keeps its books and makes its returns on the basis of a calendar year, at the close of the first quarter of 1955, meets the requirements of section 851(b)(4) and has 20 percent of its assets invested in Corporation P. At the close of the taxable year 1955, it finds that it has more than 25 percent of its assets invested in Corporation P. This situation results entirely from fluctuations in the market values of the securities in Investment Company Q's portfolio and is not due in whole or in part to the acquisition of any security or other property. Corporation Q does not lose its status as a regulated investment company for the taxable year 1955 because of such fluctuations in the market values of the securities in its portfolio, nor will it lose its status as a regulated investment company for 1956 or any subsequent year solely as a result of such market value fluctuations.

§ 1.851-6 Investment companies furnishing capital to development corporations.

(a) *Qualifying requirements.* (1) In the case of a regulated investment company which furnishes capital to development corporations, section 851 (e) provides an exception to the rule relating to the diversification of investments, made applicable to regulated investment companies by section 851(b)(4)(A). This exception (as provided in paragraph (b) of this section) is available only to registered management investment companies which the Securities and Exchange Commission determines, in accordance with regulations issued by it, and certifies to the Secretary or his delegate, not earlier than 60 days before the close of the taxable year of such investment company, to be principally engaged in the furnishing of capital to other corporations which are principally engaged in the development or exploitation of inventions, technological improvements, new processes, or products not previously generally available.

(2) For the purpose of the aforementioned determination and certification, unless the Securities and Exchange Commission determines otherwise, a corporation shall be considered to be principally engaged in the development or exploitation of inventions, technological improvements, new processes, or products not previously generally available, for at least 10 years after the

date of the first acquisition of any security in such corporation or any predecessor thereof by such investment company if at the date of such acquisition the corporation or its predecessor was principally so engaged, and an investment company shall be considered at any date to be furnishing capital to any company whose securities it holds if within 10 years before such date it had acquired any of such securities, or any securities surrendered in exchange therefor, from such other company or its predecessor.

(b) *Exception to general rule.* (1) The registered management investment company, which for the taxable year meets the requirements of paragraph (a) of this section, may (subject to the limitations of section 851(e)(2) and paragraph (c) of this section) in the computation of 50 percent of the value of its assets under section 851(b)(4)(A) and paragraph (c)(1) of § 1.851-2 for any quarter of such taxable year, include the value of any securities of an issuer (whether or not the investment company owns more than 10 percent of the outstanding voting securities of such issuer) if at the time of the latest acquisition of any securities of such issuer the basis of all such securities in the hands of the investment company does not exceed 5 percent of the value of the total assets of the investment company at that time. The exception provided by section 851(e)(1) and this subparagraph is not applicable to the securities of an issuer if the investment company has continuously held any security of such issuer or of any predecessor company (as defined in paragraph (d) of this section) for 10 or more years preceding such quarter of the taxable year. The rule of section 851(e)(1) with respect to the relationship of the basis of the securities of an issuer to the value of the total assets of the investment company is, in substance, a qualification of the 5-percent limitation in section 851(b)(4)(A)(ii) and paragraph (c)(1)(iv) of § 1.851-2. All other provisions and requirements of section 851 and §§ 1.851-1 through 1.851-6 are applicable in determining whether such registered management investment company qualifies as a regulated investment company.