

rulemaking (REG-142299-01 and REG-209135-88) cross-referencing the temporary regulations was published in the **Federal Register** for the same day (67 FR 48).

The regulations under § 1.337(d)-6T provide that, if property of a C corporation that is not a RIC or REIT becomes the property of a RIC or REIT in a conversion transaction, then the C corporation is subject to deemed sale treatment, unless the RIC or REIT elects to be subject to section 1374 treatment. Thus, the C corporation generally recognizes gain and loss as if it sold the property converted to RIC or REIT property or transferred to the RIC or REIT (the converted property) to an unrelated party at fair market value immediately before the conversion transaction. If the C corporation recognizes net gain on the deemed sale, then the basis of the converted property in the hands of the RIC or REIT is adjusted to its fair market value immediately before the conversion transaction. The regulations under § 1.337(d)-6T do not permit a C corporation to recognize a net loss on the deemed sale. Where there is a net loss, the C corporation recognizes no gain or loss on the deemed sale, and the C corporation's basis in the converted property carries over to the RIC or REIT.

The regulations under § 1.337(d)-7T provide that, if property of a C corporation that is not a RIC or REIT becomes the property of a RIC or REIT in a conversion transaction, then the RIC or REIT will be subject to tax on the net built-in gain in the converted property under the rules of section 1374 and the regulations thereunder, unless the C corporation that qualifies as a RIC or REIT or transfers property to a RIC or REIT elects deemed sale treatment. In most other respects, the regulations under § 1.337(d)-7T follow the regulations under § 1.337(d)-6T.

No public hearing was requested or held on the 2002 temporary regulations. Written or electronic comments responding to the notice of proposed rulemaking were received. After consideration of all the comments, the proposed regulations are adopted as amended (the final regulations) by this Treasury decision, and the corresponding temporary regulations are removed. The revisions are discussed below.

Explanation and Summary of Comments

This preamble first discusses a change in the time for making the section 1374 election under § 1.337(d)-6. This preamble then discusses the clarification of the rules concerning the

use of loss carryforwards, credits and credit carryforwards found in the regulations under both § 1.337(d)-6 and § 1.337(d)-7. Finally, this preamble discusses the clarification of certain issues related to the special rule for partnerships found in § 1.337(d)-7.

Time for Making Section 1374 Election Under § 1.337(d)-6

As explained above, the regulations under § 1.337(d)-6T provide that, if property of a C corporation that is not a RIC or REIT becomes the property of a RIC or REIT in a conversion transaction, then the C corporation is subject to deemed sale treatment, unless the RIC or REIT elects to be subject to section 1374 treatment. Under § 1.337(d)-6T(c)(4)(ii), the section 1374 election may be filed by the RIC or REIT with any Federal income tax return filed by the RIC or REIT on or before March 15, 2003, provided that the RIC or REIT has reported consistently with such election for all periods. Commentators expressed concern that, in the case of a conversion transaction occurring on January 1, 2002 (the last date of applicability of § 1.337(d)-6T), the time limit for making a section 1374 election could preclude a RIC or REIT from extending the due date of its Federal income tax return beyond March 15, 2003. In response to this comment, the final regulations under § 1.337(d)-6 extend the time for making the section 1374 election to September 15, 2003.

Use of Loss Carryforwards, Credits and Credit Carryforwards

Under the 2002 temporary regulations, recognized built-in gains and recognized built-in losses that have been taxed in accordance with these regulations are treated like other gains and losses of RICs and REITs that are not subject to tax under these regulations. Thus, they are included in computing investment company taxable income for purposes of section 852(b)(2), real estate investment trust taxable income for purposes of section 857(b)(2), net capital gain for purposes of sections 852(b)(3) and 857(b)(3), gross income derived from sources within any foreign country or possession of the United States for purposes of section 853, and the dividends paid deduction for purposes of sections 852(b)(2)(D), 852(b)(3)(A), 857(b)(2)(B), and 857(b)(3)(A).

In addition, consistent with section 1374, the 2002 temporary regulations generally allow RICs and REITs to use loss carryforwards and credits and credit carryforwards arising in taxable years for which the corporation that generated the attribute was a C

corporation (and not a RIC or REIT) to reduce net recognized built-in gain and the tax thereon, subject to the limitations imposed by sections 1374(b)(2) and (b)(3) and §§ 1.1374-5 and 1.1374-6. The 2002 temporary regulations also provide an ordering rule for applying loss carryforwards, credits, and credit carryforwards to reduce net recognized built-in gain (and the tax thereon) and RIC or REIT taxable income (and the tax thereon). Under this ordering rule, loss carryforwards of a RIC or REIT must be used to reduce net recognized built-in gain for a taxable year to the greatest extent possible before such losses can be used to reduce investment company taxable income for purposes of section 852(b) or real estate investment trust taxable income for purposes of section 857(b). A similar rule applies to the use of credits and credit carryforwards.

A commentator asked whether the use of loss carryforwards, credits and credit carryforwards for purposes of section 1374 affected the use of loss carryforwards, credits and credit carryforwards for purposes of subchapter M. In response to this comment, the final regulations under §§ 1.337(d)-6 and 1.337(d)-7 clarify that the use of loss carryforwards, credits and credit carryforwards for purposes of the section 1374 tax does not change the extent to which such loss carryforwards, credits and credit carryforwards can be used for purposes of subchapter M.

Special Rule for Partnerships Under § 1.337(d)-7

Section § 1.337(d)-7T applies to property transferred by a partnership to a RIC or REIT to the extent of any C corporation partner's proportionate share of the transferred property (the partnership rule). The regulations state that, if the partnership elects deemed sale treatment with respect to such transfer, then any gain recognized by the partnership on the deemed sale must be specially allocated to the C corporation partner.

In response to comments, the regulations have been revised to clarify that the principles of section 704(b) and (c) apply in determining the C corporation partner's share of the transferred property. As revised, the regulations provide that the principles of these regulations apply to property transferred by a partnership to a RIC or REIT to the extent of any C corporation partner's distributive share of the gain or loss in the transferred property. The following sections highlight other specific comments received with respect to this rule.