

consider the adequacy of its unrealized depreciation before making a distribution.

vii. Capitalization of Retained Earnings Available for Distribution. Ordinarily, contributed capital and earned capital are maintained and reported separately. In the SBIC program, however, a Licensee which has attained positive Retained Earnings Available for Distribution has the option of "capitalizing" such earnings by permanently reclassifying them as contributed capital. As a result of the reclassification, Undistributed Net Realized Earnings are reduced, while paid-in capital is increased; the net effect is the same as if the Licensee had made a distribution to its owners, who then reinvested the same amount in the Licensee. From a regulatory perspective, this action results in an increase in the Licensee's Leverageable Capital, thus increasing its eligibility for SBA leverage. Capitalization of Retained Earnings Available for Distribution reflects the intent of a Licensee to pursue long-term growth by reinvesting its earnings in small businesses.

viii. 1940 Act Companies. A Licensee which has registered under the Investment Company Act of 1940 may elect to be taxed as a regulated investment company under the Internal Revenue Code (§§ 851 through 855). In general, such a company can avoid taxation at the corporate level if it distributes at least 90 percent of its investment company taxable income for a given year.

ix. Licensees which are (or contemplate becoming) 1940 Act companies should be aware that the distribution requirements imposed on such companies by the Internal Revenue Code may, under certain circumstances, conflict with SBA regulations concerning distributions to shareholders. SBA regulations allow profit distributions to be made only from Retained Earnings Available for Distribution. Any distribution which would exceed Retained Earnings

Available for Distribution requires the prior written approval of SBA.

Z. Partnership Capital Accounts

i. To provide the information necessary to determine compliance with various SBA regulations, Licensees which organize as limited partnerships must divide partners' capital into specified categories. The categories are (1) Partners' Contributed Capital, (2) Unrealized Gain (Loss) on Securities Held, (3) Non-Cash Gains/Income, and (4) Undistributed Net Realized Earnings (Partners' Earned Capital). The sum of these four accounts is the equivalent of the total partners' capital of a non-SBIC partnership. The Licensee must also record the general and limited partners' shares of each capital account, which results in eight separate control accounts for partners' capital.

ii. *Partners' Permanent Capital Contribution.* This balance represents proceeds from the sale of partnership units and any other partners' contributions of cash or other consideration to the partnership, less any returns of capital or other deductions.

iii. *Undistributed Net Realized Earnings and Non-Cash Gains/Income.* The sum of these two accounts represents the total undistributed earned capital of the Licensee. Separate totals must be maintained because SBA rules and regulations do not permit Non-cash Gains/Income to be distributed until they have been converted to cash. Both of these terms are explained in detail in paragraph X of this section V.

iv. *Unrealized Gain (Loss) on Securities Held.* This component of partnership capital results from the valuation of Loans and Investments by the Board of Directors or General Partner(s). Unrealized appreciation is recognized for valuations above cost and unrealized depreciation is recognized for valuations below cost. Unrealized gain or loss is the sum of the unrealized appreciation or depreciation of all Loans and Investments.

Estimated future tax effects associated with unrealized appreciation or depreciation are not taken into account because partnerships are not taxed at the entity level. For further information, see paragraph W of this section V.

VI. Availability of Publications and Forms

i. This section contains information about where to obtain various publications and forms cited in this appendix I.

ii. The following forms may be obtained from the Investment Division of SBA, 409 Third Street, SW., suite 6300, Washington, DC 20416: Form 468 (Annual Financial Report), Form 1031 (Portfolio Financing Report), and CO Form 112 (IPA Certification). Forms 468 and 1031 are provided to all Licensees in the form of electronic reporting software. SBA Policy and Procedural Releases #2001 through 2021 may also be obtained from the Investment Division.

iii. Pronouncements of the Financial Accounting Standards Board (FASB) and its predecessor, the Accounting Principles Board (APB) may be purchased from the Order Department, FASB, 401 Merritt 7, P.O. Box 5116, Norwalk, CT 06856-5116.

iv. Publications of the American Institute of Certified Public Accountants (AICPA) may be purchased from the Order Department, AICPA, Harborside Financial Center, 201 Plaza III, Jersey City, NJ 07311-3881.

3. Appendix II, Chart of accounts for SBICs, is removed and Appendix III, Valuation Guidelines for SBICs, is redesignated as Appendix II.

Dated: December 7, 1994.

Philip Lader,

Administrator.

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