

## Internal Revenue Service

## Department of the Treasury

Washington, DC 20224

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Person To Contact:

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Telephone Number:

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Date:

October 14, 2010

### Legend:

Fund =

Trust =

Advisor =

Subsidiary =

Type A Company =

State =

Country =

Dear :

This responds to your letter dated July 9, 2010 submitted by your authorized representative on behalf of Fund. Fund requests that the Internal Revenue Service rule that income derived from its investments in a wholly-owned subsidiary that is a controlled foreign corporation ("CFC") constitutes qualifying income under Section 851(b)(2) of the Internal Revenue Code of 1986, as amended (the "Code").

### Facts:

Fund is registered as an open-end management investment company under the Investment Company Act of 1940, 15 U.S.C. 80a-1 et seq., as amended (the “1940 Act”). Fund is a series of Trust, which is a State business trust. Fund is a calendar year, accrual method taxpayer, classified as a corporation for federal income tax purposes. Fund intends to qualify each year as a regulated investment company (“RIC”) under § 851(a) of the Code.

Fund has formed Subsidiary, a wholly-owned subsidiary incorporated as a Type A Company under the laws of Country. Under the laws of Country, a Type A Company provides limited liability for all holders of shares. A shareholder’s liability is limited to the amount, if any, unpaid with respect to the shares acquired by the shareholder. As a result, Subsidiary will be treated as a corporation for federal income tax purposes under default entity classification rules, but intends to ensure such classification by filing a protective election on Form 8832.

Fund represents that, although Subsidiary will not be registered as an investment company under the 1940 Act, Subsidiary will comply with the requirements of section 18(f) of the 1940 Act, Investment Company Act Release No. 10666, and related SEC guidance pertaining to asset coverage with respect to investments that would apply if the Subsidiary were registered under the 1940 Act.

Fund will invest a portion of its assets in Subsidiary, subject to the limitations set forth in § 851(b)(3) of the Code. It is expected that Subsidiary will invest in commodities and commodity-related investments, such as commodity futures and derivative contracts related to commodities and commodity indices. The Subsidiary will also invest in short-term, high quality securities to be used to support its commodity derivative investments.

Subsidiary will be wholly-owned by Fund, and is thus expected to be classified as a CFC, as defined in § 957. Fund will include its “subpart F income” attributable to its subsidiary under the rules applicable to CFCs under the Code.

### **Law and Analysis:**

Section 851(b)(2) of the Code provides that a corporation shall not be considered a RIC for any taxable year unless it meets an income test (the “Qualifying Income Requirement”). Under this test, at least 90 percent of its gross income must be derived from certain enumerated sources. Section 851(b)(2) defines qualifying income, in relevant part, as –

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 1940 Act) or foreign

currencies, or other income (including but not limited to gains from options, futures or forward contracts) derived with respect to [the RIC's] business of investing in such stock, securities, or currencies . . . .

Section 2(a)(36) of the 1940 Act defines the term “security” as –

any note, stock, treasury stock, security future, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security (including a certificate of deposit) or on any group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a “security”, or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

In addition, § 851(b) of the Code provides that, for purposes of § 851(b)(2), there shall be treated as dividends amounts included in gross income under §§ 951(a)(1)(A)(i) or 1293(a) for the taxable year to the extent that, under §§ 959(a)(1) or 1293(c) (as the case may be), there is a distribution out of the earnings and profits of the taxable year which are attributable to the amounts so included.

Section 957 of the Code defines a controlled foreign corporation (“CFC”) as any foreign corporation in which more than 50 percent of (1) the total combined voting power of all classes of stock entitled to vote, or (2) the total value of the stock is owned by United States shareholders on any day during the corporation’s taxable year. A United States shareholder is defined in § 951(b) as a United States person who owns 10 percent or more of the total voting power of a foreign corporation. Fund represents that it will own 100 percent of the voting power of the stock of Subsidiary. Fund is a United States person. Fund therefore represents that Subsidiary will qualify as a CFC under these provisions.

Section 951(a)(1) of the Code provides that, if a foreign corporation is a CFC for an uninterrupted period of 30 days or more during any taxable year, every person who is a United States shareholder of this corporation and who owns stock in this corporation on the last day of the taxable year in which the corporation is a CFC shall include in gross income the sum of the shareholder’s pro rata share of the CFC’s subpart F income for the taxable year.

Section 952 of the Code defines subpart F income to include foreign base company income determined under § 954. Under § 954(a)(1), foreign base company income includes foreign personal holding company income determined under § 954(c). Section 954(c)(1)(A) defines foreign personal holding company income to include dividends, interest, royalties, rents, and annuities.

Subsidiary's income from its investments in commodities, commodity-related investments and short-term, high quality securities to be used to support its commodity derivative investments may generate subpart F income. Fund therefore represents that it will include in income Subsidiary's subpart F income for the taxable year in accordance with § 951.

**Conclusion:**

Based on the facts as represented, we rule that subpart F income of the Subsidiary attributable to the Fund is income derived with respect to Fund's business of investing in the stock of Subsidiary and thus constitutes qualifying income under § 851(b)(2), without regard to whether that income is distributed by Subsidiary to the Fund.

This ruling is directed only to the taxpayer who requested it, and is limited to the facts as represented by the taxpayer. Section 6110(k)(3) provides that this letter may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Robert Martin  
Robert Martin  
Acting Senior Technical  
Reviewer, Branch 1  
Office of Associate Chief Counsel  
(Financial Institutions & Products)