

## Internal Revenue Service

## Department of the Treasury

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Person to Contact:

Telephone Number:

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Date:

August 28, 2001

### Legend:

Fund =  
State =  
Country =  
Stock exchange of Country =

Dear

This responds to your request for a ruling dated March 2, 2001, submitted by your authorized representative on behalf of Fund. Fund requests a ruling that it will not recognize gain or loss under section 852(b)(6) of the Internal Revenue Code of 1986 upon the distribution of stock and securities in redemption of shares of Fund upon the request of a shareholder.

### FACTS

Fund is a closed-end management investment company, registered under the Investment Company Act of 1940, 15 U.S.C. 80a-1 et seq., as amended (the 1940 Act). Its shares are registered under the Securities Act of 1933 and the Securities Exchange Act of 1934, and are listed and traded on the New York Stock Exchange. Fund is organized as a corporation under the laws of State. Fund has qualified and elected to be treated since its inception as a regulated investment company (RIC) under subchapter M, part I, of the Code.

Fund invests exclusively in the securities market of Country. Its investments consist primarily of equity securities listed on the stock exchange of Country, and also include debt securities and bank time deposits. Fund holds an aggregate number of shares in Country corporations that is several times greater in number than the daily trading volume of the stock exchange of Country.

Compared to major world markets, the stock exchange of Country is relatively small and illiquid. It has suffered in recent years from a contraction of trading activity and decreased market capitalization. Accordingly, Fund's holdings tend to be relatively illiquid, and Fund's shares have historically traded at a substantial discount to the net asset value of Fund's portfolio.

In order to combat the substantial market discount at which Fund's shares trade, its Board of Directors has applied for exemptive relief from the Securities and Exchange

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Commission (SEC) to allow it to redeem its shares on a periodic basis. Because periodic cash redemptions would require Fund to sell assets which are illiquid and therefore likely to yield depressed sales prices, Fund proposes to redeem shares by distributing securities in kind.

Pursuant to its proposal, Fund would offer to repurchase a limited amount of its shares at specified intervals. A shareholder seeking to redeem shares would receive a pro rata distribution of portfolio securities equal to no less than a specified percentage of the aggregate net asset value of the shareholder's shares. Fund may pay cash for fractional shares and/or odd lots of securities and/or amounts attributable to any cash position (including short-term non-equity securities). It may alternatively round off to eliminate fractional shares and odd lots of securities.

Fund represents that it will distribute to a shareholder exercising a redemption right a pro rata share of each of the securities held by Fund, except for (a) securities that are subject to restrictions on resale or transfer, such as private placement securities, (b) rounding off to eliminate fractional shares and odd lots of securities, and (c) cash distributions as described in the preceding paragraph. Fund further represents that its tax basis in its assets distributed in redemption, as a percentage of its tax basis in all its assets prior to the redemption, will be no more than 1% less than its aggregate tax basis in all its assets prior to the redemption. For example, if a total of 10% of Fund securities are distributed in redemption, the Fund's aggregate tax basis in all assets distributed in redemption will equal not less than 9% of the Fund's aggregate tax basis in all its assets prior to the redemption.

## LAW AND ANALYSIS

Section 311(b) of the Code provides, in general, that if a corporation distributes appreciated property to a shareholder, it recognizes gain as if the property were sold to the distributee at its fair market value. Section 852(b)(6) provides, however, that section 311(b) shall not apply to any distribution by a RIC to which subchapter M, part I applies, if the distribution is in redemption of its stock upon the demand of its shareholder.

Section 317(b) defines a redemption as the acquisition of a corporation's stock, by the corporation, from a shareholder in exchange for property. Section 317(a) defines property as money, securities and any other property, except stock in the corporation making the distribution (or rights to acquire such stock).

Section 852(b)(6) does not define the term "redemption upon demand" of a shareholder. Elsewhere in the tax law, the term has been read to apply to redemptions of stock in an open-end regulated investment company. Cf. Section 162(k)(2)(B); H.R. Conf. Rep. No. 99-841, 99<sup>th</sup> Cong., 2d Sess., at 168.

Under applicable securities law, an open-end management company is a management company which is offering for sale or has outstanding any redeemable security of which it is the issuer. 15 U.S.C. § 80a-5(a)(1). A redeemable security is

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defined as any security, other than short-term paper, under the terms of which the holder, upon its presentation to the issuer or to a person designated by the issuer, is entitled (whether absolutely or only out of surplus) to receive approximately his proportionate share of the issuer's current net assets, or the cash equivalent thereof. 15 U.S.C. § 80a-2(32).

Fund is not an open-end fund and does not issue redeemable securities within the meaning of the 1940 Act. Upon the grant of the requested exemptive relief from the securities laws, however, Fund will be authorized to redeem a limited amount of its shares at specified intervals. Were it required to sell assets to meet such redemption requests, Fund, like a similarly situated open-end fund, would be exposed to the market risk of disadvantageous sale prices and to the risk of potential depletion of its holdings. The policy concerns underlying section 852(b)(6) that are applicable to an open-end fund are therefore also applicable to Fund.

Fund has represented that it will distribute a pro rata share of each of its securities to a redeeming shareholder (subject to exceptions described above) and that its tax basis in its assets distributed in redemption, as a percentage of its tax basis in all its assets prior to the redemption, will be no more than 1% less than its aggregate tax basis in all its assets prior to the redemption. The transaction, therefore, will neither defer the recognition of gain to Fund's nonredeeming shareholders nor permit the disproportionate elimination of tax at Fund's level.

Accordingly, we rule that Fund will recognize neither gain nor loss under section 852(b)(6) of the Code upon the distribution of stock or other securities in redemption of its shares upon the request of a shareholder.

No opinion is expressed or implied concerning the federal income tax consequences of the transaction described in this letter, except as expressly provided.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter should be attached to the federal income tax return of Fund for each taxable year in which it distributes stock or other securities in redemption of its shares upon the request of a shareholder as described in this letter.

Sincerely yours,  
William E. Coppersmith, Chief, Branch 2  
Office of Associate Chief Counsel  
(Financial Institutions & Products)

Enclosure: 6110 copy