

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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Date:  
July 10, 2007

**Legend:**

Trust =  
Fund A =  
Fund B =  
State A =  
State B =  
Country =  
Dear :

This responds to your request dated March 8, 2007, and supplemental correspondence dated March 20, 2007, submitted by your authorized representative on behalf of Fund A and Fund B (each a “Fund,” and collectively, the “Funds”). Funds request that the Internal Revenue Service rule that income arising from investments in its wholly-owned subsidiaries constitutes qualifying income for purposes of section 851(b)(2) of the Internal Revenue Code of 1986, as amended (the “Code”).

**FACTS**

Fund A is organized as a series of Trust, a business trust organized under the laws of State A. Fund B is a statutory trust organized under the laws of State B. Each

Fund is registered as an open-end management investment company (or series thereof) under the Investment Company Act of 1940, 15 U.S.C. 80a-1 et seq., as amended (the 1940 Act). Each Fund qualifies as a regulated investment company (RIC) under section 851 of the Code.

Each Fund has an investment objective of total return and pursues its investment objective by investing in commodity-linked derivative instruments backed by a portfolio of fixed-income securities.

Each Fund intends to form a wholly-owned subsidiary (each a “Subsidiary,” and collectively the “Subsidiaries”) that will be a foreign corporation. Each Subsidiary will be incorporated as an exempted limited company under the laws of Country. Under the laws of Country, an exempted limited company provides for 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. Each Subsidiary will file an election on Form 8832, Entity Classification Election, to be taxed as a corporation pursuant to section 301.7701-3 of the Procedure and Administration Regulations.

Funds represent that, although the Subsidiaries will not be registered as investment companies under the 1940 Act, each 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 transactions in commodity index swap agreements and other transaction in derivatives.

Each of the Funds will invest a portion of its assets in its wholly-owned Subsidiary, subject to the limitations set forth in section 851(b)(3). Each Subsidiary is expected to invest in commodity futures and notional principal contracts but may also invest in other securities, debt or cash. It is expected that all of the Subsidiaries’ income will be subpart F income. Each Fund, however, may also receive income from its Subsidiary that is not properly characterized as subpart F income.

## **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 851(b) of the Code further provides that, for purposes of section 851(b)(2), there shall be treated as dividends amounts included in gross income under section 951(a)(1)(A)(i) or section 1293(a) for the taxable year to the extent that, under section 959(a)(1) or section 1293(c) (as the case may be), there is a distribution out of the earnings and profits of the taxable year that 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 section 951(b) as a United States person who owns 10 percent or more of the total voting power of a foreign corporation. Each Fund will own 100 percent of the voting power of its Subsidiary. Each Fund is a United States person. Each Subsidiary therefore will qualify as a CFC under these provisions.

Section 951(a)(1) 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 section 954. Under section 954(a)(1), foreign base company income includes foreign personal holding company income determined under section 954(c). Section 954(c) defines foreign personal holding company income to include dividends, interest, royalties, rents, and annuities.

Subsidiaries' investments in commodity futures, notional principal contracts, debt, cash, and other securities will produce income that may generate foreign personal holding company income under section 954(c) of the Code, which is subpart F income. Each Fund would therefore include in income the sum of its respective pro rata shares of its Subsidiary's subpart F income for the taxable year in accordance with section 951.

Section 851(b) of the Code includes a specific rule providing dividend treatment for certain subpart F inclusions (those attributable to distributions out of earnings and profits). Subpart F inclusions also constitute RIC qualifying income under section 851(b)(2)(A), which states that qualifying income includes "other income ... derived with respect to [the RIC's] business of investing in ... stock, securities, or currencies" (the "other income rule").

The investment by each Fund in its Subsidiary, which is a corporation for federal income tax purposes, will be an investment in stock. Each Fund's income from its Subsidiary will be derived from its stock ownership and thus will be "income derived with respect to its business of investing in such stock" under the other income rule of section 851(b)(2)(A) of the Code.

### **CONCLUSION**

We rule that income derived by each Fund from its investments in its wholly-owned Subsidiary is qualifying income to each Fund under section 851(b)(2) of the Code without regard to whether the income is subpart F income or is from another source and without regard to whether the income has been distributed.

No opinion is expressed as to whether each Fund qualifies as a RIC that is taxable under subchapter M, part I of the Code.

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

Sincerely,

Susan Thompson Baker  
Susan Thompson Baker  
Assistant to the Branch Chief, Branch 2  
Office of the Associate Chief Counsel  
(Financial Institutions & Products)