

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **201206015**
Release Date: 2/10/2012

Third Party Communication: None
Date of Communication
Person To Contact:

Index Number: 851.02-00

, ID No.

Telephone Number:

Refer Reply To:
CC:FIP:B02
PLR-124501-06
Date:
June 13, 2006

Legend:

Fund =

Portfolio =

State A =

State B =

Country =

Dear :

This responds to your request received April 6, 2006, and supplemental correspondence dated April 11, 2006, submitted by your authorized representative, that the Internal Revenue Service rule that income earned from the ownership of a wholly-owned subsidiary that is a controlled foreign corporation constitutes qualifying income to Fund and Portfolio for purposes of section 851(b)(2) of the Internal Revenue Code of 1986, as amended (the Code).

FACTS

Fund is organized as a series of a business trust under the laws of State A. The business trust is registered as an open-end investment company under the Investment

Company Act of 1940, 15 U.S.C. 80a-1 et seq., as amended (the 1940 Act). Fund has elected to be taxed as a regulated investment company (RIC) under section 851 of the Code.

Portfolio is a series of a business trust under the laws of State B. The business trust is registered as an open-end investment company under the 1940 Act. Portfolio has elected to be taxed as a RIC under section 851 of the Code. Portfolio is available only through the purchase of a variable life insurance or variable annuity contract.

Fund and Portfolio invest in commodity-linked derivative instruments, including swap agreements, commodity options, futures, options on futures and commodity-linked structured notes. Fund and Portfolio also invest in inflation-indexed securities and fixed income securities.

Fund and Portfolio each intend to form a wholly-owned subsidiary that will be a foreign corporation (“each a “Subsidiary” and, collectively, “Subsidiaries”). 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 to be taxed as a corporation pursuant to §301.7701-3 of the Procedure and Administration regulations.

Fund and Portfolio represent that, although the Subsidiaries will not be registered as investment companies under the 1940 Act, the Subsidiaries will comply with the requirements of section 18(f) of the 1940 Act, Investment Company Act Release No. 1066, and related SEC and staff guidance pertaining to asset coverage with respect to transactions in commodity index swap agreements and other transactions in derivatives.

Fund and Portfolio each will invest a portion of its assets in its Subsidiary, subject to the limitations set forth in section 851(b)(3) of the Code. Each Subsidiary will invest primarily in commodity index swap agreements and fixed income securities, and may also invest in other commodity-linked instruments, including swap agreements on commodities, options, futures contracts, options on futures, and commodity-linked notes.

LAW AND ANALYSIS

Section 851(b)(2) provides that a corporation shall not be considered a RIC for any taxable year unless it derives at least 90 percent of its gross income from certain enumerated sources (qualifying income). 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) further provides that, for purposes of section 851(b)(2) of the Code, there shall be treated as dividends amounts included in gross income under section 951(a)(1)(A)(i) or 1293(a) for the taxable year to the extent that, under section 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 section 951(b) as a United States person who owns 10 percent or more of the total voting power of a foreign corporation. Fund and Portfolio will own 100 percent of the voting power and value described in (1) and (2), above. Both Fund and Portfolio are United States persons. Each Subsidiary therefore will qualify as a CFC under these provisions of the Code.

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 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; gains in excess of losses from transactions (including futures, forward, and similar transactions) in any commodities; and net income from notional principal contracts not entered into for purposes of hedging any other described income item.

Subsidiaries' investments in commodity index swap agreements, fixed income securities, and other commodity-linked instruments, including swap agreements on commodities, options, futures contracts, options on futures, and

commodity-linked notes may generate foreign personal holding company income under section 954(c), which is subpart F income. Fund and Portfolio would therefore include in income the sum of their respective pro rata shares of the Subsidiaries' subpart F income for the taxable year in accordance with section 951 of the Code.

Fund and Portfolio may also receive income from the Subsidiaries that is not properly characterized as subpart F income.

We rule that income derived by Fund and Portfolio from their investments in Subsidiaries, whether or not attributable to subpart F income, is income derived with respect to Fund's and Portfolio's business of investing in the stock of Subsidiaries and thus constitutes qualifying income to Fund and Portfolio under section 851(b)(2) of the Code.

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

Sincerely,

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