

MSCAP FEDERAL TAX COMMITTEE  
TAX FORUMS SUBCOMMITTEE  
CURRENT DEVELOPMENTS – TAX ACCOUNTING

Outline

1. Transfer of Restricted Property – Stock Options
2. Taxation of Loan from Foreign Sub
3. Tax Treatment of Cell Phones Provided to Employees
4. Capitalization/Expense of Electrical Transmission and Distribution Property
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The following information was taken from RIA Checkpoint from the period of January 1, 2011 through September 15, 2011.

**Income Tax – Transfer of Restricted Property:** Taxpayer was the President and COO for a technology company during the late 90s/early '00s. During this time, she exercised various stock option grants per her employment agreement. The taxpayer was trying to defer her capital gains (to a tax period where the price had fallen significantly) stating that her rights were subject to “restrictions on transfer to comply with the pooling of interests accounting rules” 26 C.F.R. § 1.83-3(k) due to several subsequent mergers. In general, the pooling of interests rules restrict officers from trading in shares during the merger process, thus making it restricted property. Since the exercise dates were spread out over a significant portion of time and the factual lack of shared risks during the merger for acquiring the company, the court found that the pooling of interest accounting rules did not apply.

STROM v. U.S., Cite as 107 AFTR 2d 2011-1704 (641 F. 3d 1051) , 04/06/2011 , Code Sec(s) 83

**Income Tax – Income Deferral – Foreign Sub Loan – Substance vs. Form:** District court properly denied pharmaceutical conglomerate/U.S. parent's refund complaint that lump sum income from purported swap/notional principal contract sales transactions should be taxed ratably over life of swap under **Notice 89-21, 1989-1 CB 651** rather than all at once under Subpart F as loan from foreign sub./as investment of repatriated earnings in U.S. property: taxpayer's sales argument notwithstanding, transaction's objective economic attributes as well as taxpayer's and other transaction parties' belief about what they were creating showed that transaction was in substance loan. Notably, and looking at parties' intent at time of transaction, it was clear that even if not explicit, transaction carried effectively unconditional repayment obligation/hallmark loan attribute. Also, just because 3d-party bank was interposed didn't mean transaction couldn't have been loan between taxpayer and sub.; in fact, evidence indicated no real independent purpose for bank's participation other than to serve as conduit and mask transaction's true nature.

MERCK & CO., INC. v. U.S., Cite as 107 AFTR 2d 2011-2596 (2011-1 USTC P 50461), 06/20/2011 , Code Sec(s) 956; 952; 988; 451; 461; 446

**Income Tax – Cell Phones Provided to Employees:** Many employers provide their employees with cell phones primarily for non-compensatory business reasons. The value of the business use of an employer-provided cell phone is excludable from an employee's income as a working condition fringe to the extent that, if the employee paid for the use of the cell phone themselves, such payment would be allowable as a deduction under section 162 for the employee. An employer will be considered to have provided an employee with a cell phone primarily for non-compensatory business purposes if there are substantial reasons relating to the employer's business, other than providing compensation to the employee, for providing the employee with a cell phone. For example, the employer's need to contact the employee at all times for work-related emergencies, the employer's requirement that the employee be available to speak with clients at times when the employee is away from the office, and the employee's need to speak with clients located in other time zones at times outside of the employee's normal work day are possible substantial non-compensatory business reasons. A cell phone provided to promote the morale or good will of an employee, to attract a prospective employee or as a means of furnishing additional compensation to an employee is not provided primarily for non-compensatory business purposes.

This notice provides that, when an employer provides an employee with a cell phone primarily for non-compensatory business reasons, the IRS will treat the employee's use of the cell phone for reasons related to the employer's trade or business as a working condition fringe benefit, the value of which is excludable from the employee's income and, solely for purposes of determining whether the working condition fringe benefit provision in section 132(d) applies, the substantiation requirements that the employee would have to meet in order for a deduction under § 162 to be allowable are deemed to be satisfied. In addition, the IRS will treat the value of any personal use of a cell phone provided by the employer primarily for non-compensatory business purposes as excludable from the employee's income as a de minimis fringe benefit. The rules of this notice apply to any use of an employer-provided cell phone occurring after December 31, 2009. The application of the working condition and de minimis fringe benefit exclusions under this notice apply solely to employer-provided cell phones and should not be interpreted as applying to other fringe benefits.

Notice 2011-72, 2011-38 IRB, 09/14/2011, IRC Sec(s).

## **Income Tax – Capitalization/Expense of Electrical Transmission and Distribution**

**Property:** Due to difficulty inherent in determination whether expenses to maintain, replace, or improve electrical transmission and distribution property must be capitalized under **Code Sec. 263(a)**; , IRS has established safe harbor accounting method that classifies property as either linear or non-linear and defines “units” of both types. Several specified expenditures must be capitalized per se. **Rev. Proc. 2011-14, 2011-4 IRB 330, Sec. 3** is modified to include this change in accounting method. The following examples illustrate the application of this revenue procedure. In each example, it is assumed that X, the taxpayer, files its federal income tax return on a calendar year basis and uses the transmission and distribution property safe harbor method of accounting provided by this revenue procedure.

A taxpayer using the transmission and distribution property safe harbor method provided by this revenue procedure must determine its units of transmission and distribution property as provided in section 5.02 of this revenue procedure. For each replacement of a portion of a unit of linear property, the taxpayer must determine whether more than 10 percent of the unit of linear property is replaced. If more than 10 percent of the unit of linear property is replaced, the cost of the replacement must be capitalized. If 10 percent or less of the unit of property is replaced, the cost of the replacement is not required to be capitalized under § 263(a). In general, individual replacements within a circuit are not aggregated in determining the percentage of a unit of linear property replaced. But see section 5.04 of this revenue procedure for situations where aggregation is required. The safe harbor method described in this section 5 provides the exclusive means for taxpayers using the transmission and distribution property safe harbor method to determine whether an expenditure for linear property is deductible or must be capitalized.

**Example 1.** On July 20 of Year 1, X received authorization from its regulatory commission to replace a number of defective poles in Circuit A, which consists of 2,000 poles in total. On July 21 of Year 1, X approves the replacement of and replaces three of the defective poles. On July 22 of Year 1, X approves the replacement of and replaces two additional defective poles. Although final approval of the July 21 and July 22 replacements occurred on different days, the replacements are aggregated because the replacement of all five poles was required by a single event, the July 20 authorization. X's cost of replacing the five poles is currently deductible

because the replacement of five poles represents 0.25 percent of the poles in Circuit A, which is 10 percent or less of the poles in the circuit.

Example 2. In addition to the facts provided in Example 1, in response to a regulatory commission decision rendered in a prior year to replace utility poles with fungus damage, between November 1 of Year 1 and January 21 of Year 2, X replaces 500 poles in Circuit A. X authorized the replacement of the 500 poles through the issuance of two work orders: one that authorized the replacements made in Year 1 and another that authorized the replacements made in Year 2. The replacements are aggregated, however, because the replacement of all 500 poles was required by the regulatory commission decision. X's costs of replacing the 500 poles are capital expenditures because the replacement of 500 poles represents 25 percent of the poles in Circuit A, which is more than 10 percent of the poles in the circuit.

Rev. Proc. 2011-43, 2011-37 IRB 326, 08/19/2011, IRC Sec(s). 446

**Income Tax - Capitalization of Success-Based Fee:** This revenue procedure provides a safe harbor election for allocating success-based fees paid in business acquisitions or reorganizations described in § 1.263(a)-5(e)(3) of the Income Tax Regulations. In lieu of maintaining the documentation required by § 1.263(a)-5(f), this safe harbor permits electing taxpayers to treat 70 percent of the success-based fee as an amount that does not facilitate the transaction. The remaining portion of the fee must be capitalized as an amount that facilitates the transaction.

The Service will not challenge a taxpayer's allocation of a success-based fee between activities that facilitate a transaction described in § 1.263(a)-5(e)(3) and activities that do not facilitate the transaction if the taxpayer—

- (1) treats 70 percent of the amount of the success-based fee as an amount that does not facilitate the transaction;
- (2) capitalizes the remaining 30 percent as an amount that does facilitate the transaction; and
- (3) attaches a statement to its original federal income tax return for the taxable year the success-based fee is paid or incurred, stating that the taxpayer is electing the safe harbor, identifying the transaction, and stating the success-based fee amounts that are deducted and capitalized.

An election under this revenue procedure applies only to the transaction for which the election is made and, once made, is irrevocable. The election applies with respect to all success-based fees paid or incurred by the taxpayer in the transaction for which the election is made.

An election under this revenue procedure for any transaction does not constitute a change in method of accounting for success-based fees generally. Accordingly, a § 481(a) adjustment is neither permitted nor required.

Rev. Proc. 2011-29, 2011-18 IRB 746, 04/08/2011, IRC Sec(s). 263

**Income Tax – Capitalization/Expense of Wireless Network:** IRS provided two alternative safe harbor approaches taxpayers may use to determine whether expenditures to maintain or upgrade wireless network assets must be capitalized under **Code Sec. 263(a)**; or are deductible as repairs under **Code Sec. 162**; . Taxpayers may obtain IRS's automatic consent to change method of accounting for either safe harbor. **Rev. Proc. 2011-14,2011-4 IRB 330, Sec. 3** is modified.

This revenue procedure provides two alternative safe harbor approaches that taxpayers may use to determine whether expenditures to maintain, replace, or improve wireless network assets must be capitalized under § 263(a) of the Internal Revenue Code: a network asset maintenance allowance method or a units of property method. This revenue procedure also provides procedures for obtaining automatic consent to change to either safe harbor method of accounting permitted by this revenue procedure.

This revenue procedure applies to a taxpayer that has a depreciable interest in wireless network assets (as described in section 4 of this revenue procedure) used primarily to provide wireless telecommunication or broadband services by mobile phones (for example, cell phones or smartphones). This revenue procedure does not apply to a taxpayer that is primarily a cable operator. The determination of whether a taxpayer is within the scope of this revenue procedure is made by each member of a consolidated group, by a partnership, or by an S corporation. The wireless network asset capital expenditures for § 263(a) for the taxable year under the network asset maintenance allowance method are determined as follows:

(1) Start with the adjusted basis for 5-year, 7-year, and 15-year property and nonresidential real property determined in section 5.02(4) above.

(2) For each class of property, multiply the adjusted basis attributable to the class of property by 95%. The result is each class of property's basis amount after taking into account the network asset maintenance allowance.

(3) For each class of property, allocate that class of property's basis amount determined in 5.03(2) among the class of property's wireless network assets (excluding wireless network assets acquired in an applicable asset acquisition as defined in § 1060 or in a transaction to which § 338(h)(10) applies) according to the basis of each wireless network asset determined before application of the network asset maintenance allowance.

(4) The amount determined in (3) for each network asset (excluding wireless network assets acquired in an applicable asset acquisition as defined in § 1060 or in a transaction to which § 338(h)(10) applies) is the basis of such asset to be used to determine the deductions allowable or income tax credits available that require tax basis to be reduced before any depreciation is computed (for example, § 179, § 179D, or similar provisions; § 44 and § 46; and section 1603 payments). The net amount for each network asset after the reduction in basis for such deductions, credits, and section 1603 payments is that property's § 1.168(b)-1(a)(3) unadjusted depreciable basis.

(5) In addition, expenditures for wireless network assets acquired in an applicable asset acquisition as defined in § 1060 or in a transaction to which § 338(h)(10) applies are capital expenditures under § 263(a) to which the ordinarily applicable basis and holding period rules and regulations apply.

A taxpayer utilizing the network asset maintenance allowance method must attach a schedule to its federal income tax return for the taxable year identifying the amounts for each step of the network asset maintenance allowance method computation provided in sections 5.02(1)-(5) above.

**Income Tax – Capital Gains/Losses – Trader vs. Investor:** Pro se manufacturing S corp. sole shareholder/securities day trader was restricted by **Code Sec. 1211(b)** 's capital loss limitations to \$3,000 per year deduction of his trading losses: although taxpayer made timely mark-to-market election pursuant to **Code Sec. 475(f)** , losses were clearly capital and not ordinary since taxpayer was merely investor whose trading activity was insubstantial and who didn't seek to profit from short-term stock market swings. Although taxpayer managed large amounts of money, his trading activity was infrequent and he derived most of his income from corp.; and he rarely purchased and sold same stock on same day. Also, taxpayer was denied NOL carryover from prior year into years at issue arising from similar trading activity.

In general, for Federal tax purposes, a person who purchases and sells securities falls into one of three distinct categories: dealer, trader, or investor. See *King v. Commissioner*, 89 T.C. 445, 458-459 (1987). The parties have not argued that petitioner was a dealer for the years in issue. Section 475(f) provides generally that a taxpayer engaged in business as a securities trader may elect to use the mark-to-market method of accounting for securities held in a business. Under the mark-to-market method of accounting a taxpayer generally recognizes at the end of the year ordinary gain or loss on all securities held in the business as if the securities were sold at the end of the year for fair market value. Sec. 475(d)(3), (f)(1)(A)(i); [pg. 1121] *Lehrer v. Commissioner*, T.C. Memo. 2005-167 [TC Memo 2005-167], affd. 279 Fed. Appx. 549 [101 AFTR 2d 2008-2361] (9th Cir. 2008).

Ordinary losses are thereby made available to offset ordinary income and are not subject to the \$3,000 limitation, as relevant here, imposed by section 1211(b) on the deduction of capital losses in excess of capital gains. See *Vines v. Commissioner*, 126 T.C. 279, 288 (2006). Petitioner made a timely mark-to-market election pursuant to section 475(f). However, section 475(f) applies only to those engaged in a trade or business as traders in securities.

In determining whether a taxpayer is a trader, nonexclusive factors to consider are: (1) The taxpayer's intent, (2) the nature of the income to be derived from the activity, and (3) the frequency, extent, and regularity of the taxpayer's securities transactions. *Purvis v. Commissioner*, 530 F.2d 1332, 1334 [37 AFTR 2d 76-968] (9th Cir. 1976), affg. T.C. Memo.

1974-164 [¶74,164 PH Memo TC]. For a taxpayer to be a trader, the trading activity must be substantial, which means “frequent, regular, and continuous enough to constitute a trade or business”. *Ball v. Commissioner*, T.C. Memo. 2000-245 [TC Memo 2000-245] (quoting *Hart v. Commissioner*, T.C. Memo. 1997-11 [1997 RIA TC Memo ¶97,011]). A taxpayer's activities constitute a trade or business where both of the following requirements are met: (1) The taxpayer's trading is substantial, and (2) the taxpayer seeks to catch the swings in the daily market movements and to profit from these short-term changes rather than to profit from the long-term holding of investments. *King v. Commissioner*, *supra* at 458-459; *Mayer v. Commissioner*, T.C. Memo. 1994-209 [1994 RIA TC Memo ¶94,209].

The number of trades petitioner engaged in during the years 2000, 2001, and 2002 was not substantial. In 2000, 2001, and 2002, petitioner executed 313 trades, 172 trades, and 84 trades respectively. We found similar numbers of trades to be insubstantial in the cases discussed above. In 2000, however, the total amount of money involved in trading was substantial. In that year, petitioner made over \$20 million in purchases and a similar amount in sales. In 2001 and 2002, petitioner's gross purchases and gross sales, which ranged between \$1 million and \$2.5 million, were less substantial. In any case, managing a large amount of money is not conclusive as to whether petitioner's trading activity amounted to a trade or business. See *Moller v. United States*, *supra* at 814.

Petitioner's trading activity was infrequent. In the years 2000, 2001, and 2002, petitioner conducted trading activity on just 29 percent, 7 percent, and 8 percent of the possible trading days in each year, respectively. Income from Clean Wave was his primary source of income. Despite petitioner's assertion that he spent the majority of his time as a day trader, the number of days he actually made trades show otherwise.

Petitioner generally did not hold stocks for intervals that demonstrate an intention to profit from day trading. The majority of the stocks he purchased and sold in each of the years at issue were held for over 30 days. Petitioner rarely purchased and sold the same stock on the same day. Overall, petitioner has not met the requirements for his trading activity to be treated as a trade or a business. Thus he is limited to a \$3,000 deduction of losses arising from the purchase and sale of securities in 2001 and 2002 under section 1211(b) and may not carry forward the NOL generated in 2000.

Richard Kay, Jr. v. Commissioner, TC Memo 2011-159 , Code Sec(s) 1211; 475; 172; 165.

**Income Tax – Prepaid Expenses – Deduction vs. Capitalization:** IRS's didn't abuse its discretion in denying accrual method semiconductor corp.'s request to change its accounting method to deduct, rather than capitalize, 12-month prepaid contract expenses spanning 2 tax years: taxpayer was ineligible to deduct relevant expenses before **Code Sec. 263** regs became final. Taxpayer misplaced reliance on 9th Cir. case law allowing cash method taxpayers' use of 12-month rule; 7th Cir. case law allowing accrual method taxpayers' use of 12-month rule wasn't controlling; and argument that IRS imposed its interpretation of IRC to disregard developing case law was speculative. So, because taxpayer's only option to change its accounting method was to rely on final regs and their implementation pursuant to **Rev. Proc. 2004-23, 2004-1 CB 785** , and because it sought to deduct relevant expenses 1 year before regs' effective date, IRS was justified in enforcing effective date provisions implementing those regs. [pg. 696]

The taxpayer must continue computing taxable income under its old accounting method if the Commissioner denies the taxpayer's request to change its accounting method. See, e.g., *United States v. Ekberg*, [pg. 698] 291 F.2d 913, 925 [7 AFTR 2d 1678] (8th Cir. 1961); *Advertisers Exch., Inc. v. Commissioner*, 25 T.C. 1086, 1092-1093 (1956), *affd.* 240 F.2d 958 [50 AFTR 1430] (2d Cir. 1957). In addition, the Commissioner can require a taxpayer to abandon the new accounting method and to report taxable income using the old method if the taxpayer changes its accounting method without first obtaining consent. See, e.g., *Advertisers Exch., Inc. v. Commissioner*, *supra* at 1093; *Sunoco, Inc. & Subs. v. Commissioner*, T.C. Memo. 2004-29 [TC Memo 2004-29].

The Commissioner has wide discretion to grant or deny consent to a change in accounting method. See, e.g., *Capitol Fed. Sav. & Loan Ass'n & Sub. v. Commissioner*, 96 T.C. 204, 213 (1991). The Commissioner's refusal to consent to a taxpayer's requested change in accounting method is reviewed under an abuse of discretion standard. See *id.* at 213; *S. Pac. Transp. Co. v. Commissioner*, 75 T.C. 497, 681-682 (1980).

With this background, we now consider petitioner's arguments. Petitioner argues that respondent ignored developing case-law and applied an automatic rejection policy under Rev. Proc. 2004-23, *supra*. Respondent argues that petitioner was ineligible to deduct the relevant expenses before the regulations became final. We agree with respondent.

Petitioner applied to change its accounting method to deduct, rather than capitalize, the relevant expenses. Petitioner originally cited the ANPRM <sup>4</sup> and *U.S. Freightways Corp. v. Commissioner*, 270 F.3d 1137 [88 AFTR 2d 2001-6703] (7th Cir. 2001), to support its position, highlighting recent developments favoring its accounting method change request. Petitioner later relied upon a Ninth Circuit Court of Appeals case that had earlier reversed the Tax Court. *Zaninovich v. Commissioner*, supra. We disagree with petitioner that the Ninth Circuit allowed accrual basis taxpayers, such as petitioner, to use the 12-month rule.

We acknowledge that the Ninth Circuit Court of Appeals reversed our decision in *Zaninovich* and held that 12-month rental payments by a cash method taxpayer were fully deductible in the year of payment. In doing so, it specifically distinguished between an accrual basis taxpayer (such as petitioner) and a cash basis taxpayer (such as the one in *Zaninovich*). *Id.* at 431 n.5. *Zaninovich* applies only to cash basis taxpayers. *Zaninovich* did not indicate that the Ninth Circuit would follow a 12-month rule for accrual basis taxpayers.

Approximately two decades later, the Seventh Circuit Court of Appeals reversed the Tax Court in adopting the 12-month rule for accrual method taxpayers. See *U.S. Freightways Corp. v. Commissioner*, supra. This holding, however, is not binding on respondent, the Tax Court or taxpayers outside the Seventh Circuit.

Petitioner further asks us to find that *Zaninovich* and *U.S. Freightways* indicate that the Court of Appeals for the Ninth Circuit would have adopted a 12-month rule for accrual method taxpayers even without enactment of the final regulations. Petitioner also argues that respondent imposed his interpretation of the Code to disregard developing caselaw. We disagree. We decline petitioner's invitation to speculate about whether the Court of Appeals for the Ninth Circuit would have followed *U.S. Freightways* if it had petitioner's case. Indeed, *U.S. Freightways* was inconsistent with our decision and the decisions of other Courts of Appeals at the time. See *Blasius v. Commissioner*, T.C. Memo. 2005-214 [TC Memo 2005-214] (finding substantial justification for the Commissioner's attempt to capitalize professional fees, despite appellate reversal in *U.S. Freightways*). Accordingly, we find that respondent did not abuse his discretion in rejecting petitioner's accounting method change after *Zaninovich* and *U.S. Freightways*.

Petitioner also asks us to find that respondent's rejection of petitioner's accounting method change request was arbitrary and capricious because respondent instituted an automatic

rejection policy. Petitioner asserts that respondent rejected all accounting method change requests aiming to benefit from the 12-month rule if such requests did not comply with the procedures under Rev. Proc. 2004-23, supra. Accordingly, petitioner argues that respondent's automatic rejection policy meant respondent failed to evaluate petitioner's accounting method change request under traditional application procedures and developing caselaw.

We need not reach this question, however, of whether respondent implemented an automatic rejection policy. We have already found that respondent acted within his discretion in rejecting petitioner's accounting method change request under then-existing caselaw as applied to petitioner's circumstances. We need not speculate as to whether the Commissioner would have reached a different conclusion if considering a similarly-situated taxpayer in a circuit where the caselaw supported a different conclusion. <sup>5</sup>

Accordingly, petitioner's only option to change its accounting method to benefit from the 12-month rule was to rely upon the final regulations and their implementation as described in Rev. Proc. 2004-23, supra. The final regulations are effective for amounts paid or incurred on or after December 31, 2003. Petitioner had sought to deduct relevant expenses for 2002, a year before the effective date of the final regulations. Respondent was justified in enforcing the effective date provisions implementing the final regulations. See sec. 7805(a).

We hold that respondent did not abuse his discretion in denying petitioner's request to change its accounting method. Respondent acted within his discretion to assert section 446(e) and require petitioner to abandon the new method and to report taxable income using the old accounting method. See, e.g., *Advertisers Exch., Inc. v. Commissioner*, 25 T.C. at 1093; *Sunoco, Inc. & Subs. v. Commissioner*, T.C. Memo. 2004-29 [TC Memo 2004-29]. Accordingly, we sustain respondent's determination to disallow the expenses.

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Lattice Semiconductor Corporation v. Commissioner, TC Memo 2011-100 , Code Sec(s) 446; 263.

**Income Tax – Regulated Investment Company – Qualifying Income:** Subpart F income of sub. attributable to funds is income derived with respect to fund's business of investing in sub.'s stock and therefore is **Code Sec. 851(b)(2)**; qualifying income.

This responds to your request dated April 13, 2011, submitted by your authorized representative on behalf of Fund. Fund requests that the Internal Revenue Service rule that income earned by Fund from its investment in its wholly-owned subsidiary, a controlled foreign corporation (“CFC”), will constitute qualifying income to Fund under section 851(b)(2) of the Code.

Fund is a series of Trust, an open-end management investment company organized under the laws of State and registered as an 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 or will elect to be taxed as a regulated investment company (“RIC”) under Subchapter M of the Code. Fund uses an accrual method of accounting and a fiscal year ending March 31.

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. Subsidiary will file an election on Form 8832, Entity Classification Election, to ensure that Subsidiary will be treated as a corporation for federal income tax purposes.

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 to which this authority would apply if 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. Subsidiary invests in commodity-related investments, which may include commodity-linked derivatives, commodity-linked debt, and trusts or other investment vehicles that invest primarily or exclusively in commodities. Subsidiary may also invest in short-term, high quality securities.

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. 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 . . . .

In addition, the flush language of § 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 are distributions 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 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 combined voting power of all classes of voting stock of a foreign corporation. Fund represents that Subsidiary will be wholly owned by Fund. 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 such corporation and who owns stock in such corporation on the last day of the taxable year in which the corporation is a CFC shall include in gross income the shareholder's pro rata share of the CFC's subpart F income for the taxable year.

Section 952(a)(2) 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). Under section 954(c)(1), foreign personal holding company income includes (among other things): dividends, interest, royalties, rents, and annuities; gains in excess of losses from transactions in commodities (including futures, forwards, and similar transactions but excluding certain hedging transactions and certain active business gains and losses); and, subject to certain exceptions, net income from notional principal contracts.

Subsidiary's investments may generate foreign personal holding company income under section 954(c), which is subpart F income. Fund therefore will include in its income the subpart F income of Subsidiary in accordance with section 951.

Based on the facts as represented, we rule that subpart F income of Subsidiary attributable to 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) of the Code.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, no opinion is expressed with regard to whether Fund qualifies as a RIC under subchapter M of the Code.

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.

Private Letter Ruling 201134014, 08/26/2011, IRC Sec(s). 851