Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

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Date:
January 12, 2007

Legend:

Fund =

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Dear :

This responds to the request dated April 13, 2006, submitted by your authorized representative on behalf of Fund. Fund requests that the Internal Revenue Service rule that:

(1) The distributions paid to holders of Preferred and Common Shares pursuant to the distribution policy described in this letter will not constitute preferential dividends within the meaning of section 562(c) of the Internal Revenue Code of 1986, as amended (the “Code”);

(2) The distribution and designation of the Fund’s ordinary income, net capital gain and other items of income to the holders of the Fund’s Common and Preferred Shares complies with Revenue Ruling 89-81, 1989-1 C.B. 226; and

(3) The designation of Fund’s undistributed net capital gain to holders of the Fund’s Common’s Shares complies with section 852(b)(3)D) of the Code and with the Income Tax Regulations (the “Regulations”) promulgated thereunder.

FACTS

Fund was organized on Date 1 as a business trust under the laws of State. Fund is registered as a non-diversified, closed-end management investment company under the Investment Company Act of 1940, 15 U.S.C. 80a-1 et seq., as amended. Fund has elected to be treated as a regulated investment company (“RIC”) under section 851 of the Code. Fund uses a calendar year for federal income tax purposes.

Fund currently offers two classes of shares: common shares (“Common Shares”) and preferred shares (“Preferred Shares”). Common Shares are traded on Exchange and have equal rights to the payment of dividends and the distributions of assets upon liquidation. Fund’s Board of Trustees (the “Board”) may occasionally declare and pay dividends and distributions to Common Shares as the Board deems necessary or desirable after Fund has paid any accrued dividends, made any redemption or liquidation payments to Preferred Shares, and paid any interest and required principal payments on borrowing. Upon termination of Fund, Common Shares are entitled to receive pro rata the net distributable assets of Fund, subject to the rights of Preferred Shares. Common Shares have no pre-emptive or conversion rights. As of Date 2, the Fund had V Common Shares issued and outstanding.

Fund’s Preferred Shares are taxable auction preferred shares that pay a floating rate dividend that is usually reset every seven days through an auction. Each Preferred Share has a liquidation preference of W per share, plus any accumulated, unpaid dividends. Preferred Shares are currently issued in four series. Each series has the same preference over Common Shares with respect to dividends and payments in the event of liquidation. The auctions for each series are staggered so that an auction for no more than one series is generally held on the same day. As of Date 2, there were X Preferred Shares in each series that were issued and outstanding.

Fund represents that its total distributions in each calendar year have equaled or exceeded the aggregate of Fund's investment company taxable income ("ICTI") (as determined without the deduction for dividends paid by Fund) and net capital gains ("NCG"). Any amounts distributed in excess of Fund's ICTI (determined without the deduction for dividends paid by Fund) and NCG have been designated as non-taxable distributions (returns of capital). Each year Fund designates distributions made with respect to its Common and Preferred Shares as consisting of particular types of income (e.g., ordinary income and NCG).

Fund intends to increase its base of investment capital by retaining and reinvesting its NCG rather than distributing it. Fund makes NCG distributions to its Preferred Shares retrospectively through the process of designating the character of the distributions paid over Fund's taxable year rather than prospectively through the regular auction process for establishing the dividend rate paid on Preferred Shares. As a result, Fund cannot reduce the distributions it is required to make to its Preferred Shares because it would violate the requirements and restrictions contained in Fund's Declaration of Trust and Statement Establishing and Fixing the Rights and Preferences of Taxable Auctioned Preferred Shares ("Declaration and Statement"). Consequently, under the proposed distribution policy ("Proposed Distribution Policy"), Fund will make the required distributions to the Preferred Shares and designate to such shares their allocable portion of Fund's NCG, but will retain that portion of its NCG that it otherwise would have allocated to its Common Shares.

Under the Proposed Distribution Policy, Fund will continue to pay dividends on the Preferred Shares at the rate determined by the auction process. Fund will also continue to make monthly distributions to Common Shares consistent with past practices. Fund represents that at or near the end of its taxable year, it will make a distribution to Common Shares so that Fund will have distributed at least 90% of its ICTI in accordance with section 852(a)(1)(A) of the Code. Fund will not, however, distribute all its NCG. Rather, Fund will retain all or a portion of the NCG that it would have distributed and designated as NCG distributions to Common Shares. Fund will treat any retained amount as undistributed capital gain pursuant to section 852(b)(3)(D), and designate such amount as undistributed capital gain in timely written notices mailed to holders of Common Shares. Fund will pay the federal income tax on the undistributed capital gain according to section 852(b)(3)(A). Pursuant to section 852(b)(3)(D)(iii), each holder of Common Shares will be required to report on their federal income tax return the pro rata portion of the undistributed capital gain designated to their Common Shares, and will receive a credit for the taxes paid by Fund on the undistributed capital gains.

Fund makes the following representations with respect to its Proposed Distribution Policy:

(1) Each Preferred Share within each series will receive the same dividends and distributions as every other Preferred Share within the same series; and each Common Share will receive the same dividends and distributions as every other Common Share;

(2) Fund's ICTI, NCG, and other types of income will be allocated among the different classes of Fund's Shares so that, taking into account the undistributed capital gain that will be designated on written notices sent to Fund's Common Shares, each class will receive its pro rata share of Fund's ordinary income and NCG and no class of shares will receive more than its proportionate share of such income or gain;

(3) Each Common and Preferred Share will be treated in accordance with its respective dividend distribution rights under Fund's Declaration and Statement; and

(4) Fund will send Form 2439, Notice to Shareholder of Undistributed Long-Term Capital Gains, to all holders of Common Shares as of the last day of any taxable year in which Fund has undistributed capital gains. Pursuant to section 852(b)(3)(A), Fund will pay the tax imposed on Fund's undistributed capital gains.

LAW AND ANALYSIS

<u>Ruling Request 1</u>

Section 562(c) of the Code provides that the amount of any distribution by a RIC to its shareholders shall not be considered a dividend for purposes of computing the dividends paid deduction, unless such distribution is pro rata, with no preference to any share of stock as compared with other shares of the same class, and with no preference to one class of stock as compared with another class except to the extent that the former is entitled (without reference to waivers of their rights by shareholders) to such preference.

Section 1.562-2(a) of the Regulations provides, in part, that:

> section 562(c) imposes a limitation upon the general rule that a corporation is entitled to a deduction for dividends paid with respect to all dividends which it actually pays during the taxable year. Before a corporation may be entitled to any such deduction with respect to a distribution regardless of the medium in which the distribution is made, every shareholder of the class of stock with respect to which the distribution is made must be treated the same as every other shareholder of that class, and no class of stock may be treated otherwise than in accordance with its dividend rights as a class. . . . A corporation will not be entitled to a deduction for dividends paid with respect to any distribution upon a class of stock if there is distributed to any shareholder

> of such class (in proportion to the number of shares held by him) more or less than his pro rata part of the distribution as compared with the distribution made to any other shareholder of the same class. Nor will a corporation be entitled to a deduction for dividends paid in the case of any distribution upon a class of stock if there is distributed upon such class of stock more or less than the amount to which it is entitled as compared with any other class of stock. A preference exists if any rights to preference inherent in any class of stock are violated. The disallowance, where any preference in fact exists, extends to the entire amount of the distribution and not merely to a part of such distribution.

Fund's Declaration of Trust provides that dividends and other distributions will be paid on Common Shares in the Board's discretion. Common Shares do not have a right to receive any distributions other than those declared by the Board. As a result, Fund's retention of the NCG and deemed distribution to Common Shares will not violate the Common Shares' dividend rights. Furthermore, the distributions to each series of Preferred Shares will be paid at the rates determined in accordance with Fund's Declaration and Statement. Therefore, Fund's distributions to Preferred Shares and Common Shares are in conformity with the dividend rights of each class.

Moreover, the section 562(c) requirement is satisfied; no preference exists as to one class of stock as compared with another class, except to the extent that the former is entitled to such preference. Consequently, Fund's distributions to Preferred and Common Shares will not constitute preferential dividends within the meaning of section 562(c).

<u>Ruling Request 2</u>

Rev. Rul. 89-81, 1989-1 C.B. 226, holds that if a RIC has two or more classes of stock and designates the dividends that it pays on one class as consisting of more than that class' proportionate share of a particular type of income, the designation is not effective for Federal tax purposes to the extent it exceeds the class' proportionate share of that type of income.

In this case, the issue is whether undistributed NCG and distributed NCG are separate types of income within the meaning of Rev. Rul. 89-81 and therefore whether each class of shares, Preferred and Common, must be allocated proportionate amounts of distributed NCG and undistributed NCG. Under the Proposed Distribution Policy, Fund will treat undistributed NCG and distributed NCG as a whole in allocating each class of shares its proportionate amount of NCG. Under the Proposed Distribution Policy, some or all of the NCG allocated to the Common Shares class may be retained as undistributed NCG, whereas the Preferred Shares class will receive its NCG allocation in cash and no amount of NCG allocable to the Preferred Shares class will be retained.

The Proposed Distribution Policy does not violate the proportional distribution requirement of Rev. Rul. 89-81 because the NCG not distributed in cash to Common Shares is not permanently forgone. Fund's net asset value ("NAV") increases when NCG is retained. The value of each Common Share increases in proportion to the increase in Fund's NAV. Assuming no other change in value in Fund's NAV, this increase in value will be reflected in the amount received by a holder of Common Shares who sells or redeems shares. There is no corresponding increase in the value of Preferred Shares, however, because the Preferred Shares' liquidation preference is fixed.

Fund also intends to pay the federal income tax on the undistributed capital gain pursuant to section 852(b)(3)(A) of the Code. Common Shares will be entitled to a credit for the tax paid by Fund. The basis of each Common Share will be increased with respect to the reinvested capital gains as if Common Shares had paid the tax. This allows Common Shares to avoid incurring any additional tax liability from the increase in the value of their shares when they liquidate their interest in Fund. Therefore, the economic and tax positions of Common Shares are the same whether Fund retains or makes the NCG distribution.

Fund has represented that its ICTI and other items of income will be allocated among and distributed to the classes of shares such that each class will receive its pro rata share of ICTI and other items of income. Based on the facts represented, Fund's Proposed Distribution Policy will comply with Rev. Rul. 89-81's requirement of proportionate distributions.

Ruling Request 3

Section 852(b)(3)(D) of the Code and sections 1.852-2 and 1.852-4 of the Regulations impose certain requirements as to how a RIC and its shareholders treat undistributed capital gains. Specifically, section 1.852-4(b)(2)(i) of the Regulations requires that when a RIC designates undistributed capital gains to its shareholders, "the amount so designated shall not exceed the shareholder's proportionate part of the amount subject to tax under section 852(b)(3)(A)."

As previously discussed, distributed and undistributed capital gains are not separate types of income subject to the proportionality requirement in Rev. Rul. 89-81. Therefore, to the extent Fund's designation of undistributed NCG is not in excess of the amount a shareholder would have received in an actual distribution, Fund's designation of undistributed NCG, pursuant to the terms of the Proposed Distribution Policy, complies with section 852(b)(3)(D) of the Code and section 1.852-2(b)(2)(i) of the Regulations.

CONCLUSION

Based on the facts as represented, we rule that: (1) distributions in accordance with Fund's Proposed Distribution Policy of designating the undistributed NCG to Common Shares will not constitute a preferential dividend within the meaning of section 562(c) of the Code; (2) Fund's distributions of ICTI and NCG and other items of income to its shareholders in accordance with Fund's Proposed Distribution Policy will comply with Rev. Rul. 89-81, 1989-1 C.B. 226; and (3) Fund's designation of undistributed NCG to Common Shares in accordance with Fund's Proposed Distribution Policy will comply with section 852(b)(3)(D) of the Code and section 1.852-2(b)(2)(i) of the Regulations.

No opinion is expressed concerning whether Fund otherwise qualifies as a RIC under subchapter M, part I of the Code.

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

Sincerely,

Susan Thompson Baker
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Assistant to the Branch Chief, Branch 2
Office of the Associate Chief Counsel
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