Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

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Date:
February 2, 2007

Legend

Trust 1 =

Trust 2 =

Fund =

Portfolio =

State A =

State B =

v =

w =

x =

y =

z =

Index A =

Index B =

Dear :

This responds to the request dated July 26, 2006, and supplemental correspondence dated November 29, 2006 and January 17, 2007, submitted by your authorized representative on behalf of Fund and Portfolio. Fund and Portfolio request that the Internal Revenue Service rule that income earned from investments in the commodities-linked notes described in this letter will constitute qualifying income to Fund and Portfolio under section 851(b)(2) of the Internal Revenue Code of 1986, as amended (the "Code").

FACTS

Fund is organized as a series of Trust 1. Trust 1 is a business trust under the laws of State A and 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 classified as a "regulated investment company" ("RIC") under section 851 of the Code.

Portfolio is organized as a series of Trust 2. Trust 2 is a business trust under the laws of State B and is registered as an open-end investment company under the 1940 Act. Portfolio has elected to be classified as a RIC under section 851 of the Code. Portfolio is only available through the purchase of a variable life insurance or a variable annuity contract.

Fund and Portfolio seek to maximize real return by investing in commodity-linked derivative instruments, including commodity-linked notes, backed by a portfolio of inflation-indexed securities and other fixed income securities. Fund and Portfolio intend to invest in commodities-linked notes having the terms and conditions of the following two notes (collectively, the "Notes"): The first note ("Note 1") will be issued to Fund (or Portfolio) at a par value of $v. Its payout formula will be determined with reference to Index A. Its term will be fourteen months. Fund (or Portfolio), as holder of Note 1, has the right to put Note 1 to the issuer at the calculated redemption price based on the closing level of Index A as of the end of the next day after notification to the issuer. In addition, if Index A falls w%, Note 1 will "knockout" and automatically redeem based on a redemption price calculated using the Index A closing value from the next day.

The repayment obligation upon early redemption, knockout, or at maturity is calculated under a formula that provides for the repayment of the face amount of Note 1, increased or decreased by an amount equal to the face amount of Note 1 multiplied by a leverage factor of x, multiplied by the percentage of the increase or decrease of the beginning level of Index A compared to the ending level of Index A for the applicable period. To this amount is added an amount that reflects interest on Note 1 at the coupon rate of y. To this amount is subtracted an annual fee amount of z basis points of the notional value (leveraged face amount) of Note1.

The second note ("Note 2") will be issued to Fund (or Portfolio) at a par value of $v. Its payout formula will be determined with reference to Index B. Its term will be fourteen months. Fund (or Portfolio), as holder of Note 2, has the right to put Note 2 to the issuer at the calculated redemption price based on the closing level of Index B as of the end of the next day after notification to the issuer. In addition, if Index B falls w%, Note 2 will "knockout" and automatically redeem based on a redemption price calculated using the Index B closing value from the next day.

The repayment obligation upon early redemption, knockout, or at maturity is calculated under a formula that provides for the repayment of the face amount of Note 2, increased or decreased by an amount equal to the face amount of Note 2 multiplied by a leverage factor of x, multiplied by the percentage of the increase or decrease of the beginning level of Index B compared to the ending level of Index B for the applicable period. To this amount is added an amount that reflects interest on Note 2 at the Coupon Rate of y. To this amount is subtracted an annual fee amount of z basis points of the notional value (leveraged face amount) of Note 2. The redemption price formula under Note 2 also includes an adjustment for the reversal of the interest rate factor included in the computation of Index B.

Fund and Portfolio make the following representations with respect to these two Notes:

(1) The issuer of the Notes will receive payment in full of the purchase price of the Notes substantially contemporaneously with the delivery of the Notes;

(2) Fund (or Portfolio) while holding the Notes will not be required to make any payment to the issuer of the Notes in addition to the purchase price paid for the Notes, whether as margin, settlement payment, or otherwise, during the life of the Notes or at maturity;

(3) The issuer of the Notes is not subject by the terms of the instrument to mark-to-market margining requirements of the Commodities Exchange Act, 7 U.S.C. 2, as amended (CEA); and

(4) The Notes are not marketed as a contract of sale of a commodity for future delivery (or option on such a contract) subject to the CEA.

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 2(a)(36) of the 1940 Act defines the term "security" as—

> any note, stock, treasury stock, security future, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security (including a certificate of deposit) or on any group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

Section 2(f)(1) of the CEA provides that the CEA is not applicable to a hybrid instrument that is predominantly a security. Section 2(f)(2) of the CEA provides that a hybrid instrument shall be considered to be predominantly a security if—

> (A) the issuer of the hybrid instrument receives payment in full of the purchase price of the hybrid instrument, substantially contemporaneously with the delivery of the hybrid instrument;
>
> (B) the purchaser or holder of the hybrid instrument is not required to make any payment to the issuer in addition to the purchase price paid under subparagraph (A), whether as margin, settlement payment, or otherwise, during the life of the hybrid instrument or at maturity;
>
> (C) the issuer of the hybrid instrument is not subject by the terms of the instrument to mark-to-market margining requirements; and

(D) the hybrid instrument is not marketed as a contract of sale of a commodity for future delivery (or option on such a contract) subject to the CEA.

Section 2(f)(3) of the CEA provides, in part, that for purposes of section 2(f)(2)(C) of the CEA, mark-to market margining requirements do not include the obligation of an issuer of a secured debt instrument to increase the amount of collateral held in pledge for the benefit of the purchaser of the secured debt instrument to secure the repayment obligations of the issuer under the secured debt instrument.

CONCLUSION

Based on the facts as represented, we rule that income and gain arising from the Notes constitute qualifying income to Fund and Portfolio under section 851(b)(2) of the Code.

Sincerely,

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