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Washington, DC 20224

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CC:PSI:B01
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Date:
March 23, 2007

Legend:

X =

Y =

Z =

a =

b =

State =

Country =

Dear :

This responds to your letter dated September 19, 2006, and subsequent correspondence, submitted on behalf of X, requesting rulings under §§ 851(b)(2) and 7704(c) of the Internal Revenue Code.

FACTS

The information submitted states that X is a State limited liability company. For federal tax purposes, X intends to be classified and will file returns as a partnership. X intends to structure its investments and rely on the exception in § 7704(c) so that X will be taxed as a partnership and will not be classified either as an association taxable as a

corporation or as a publicly traded partnership (“PTP”) treated as a corporation for federal tax purposes.

X is a holding company formed to invest in fixed income assets consisting primarily of commercial mortgage-backed securities, residential mortgage-backed securities, corporate securities, consumer and commercial asset-backed securities, loans and trust preferred securities held by certain structured finance entities (“Subsidiaries” collectively and “Subsidiary” individually), which are commonly known as collateralized debt obligation (“CDO”) issuers. X will own all or a majority of the equity interest in the CDO issuers and may also own subordinated debt securities issued by the CDO issuers. X may hold its equity and debt interests directly in the CDO issuers which are usually classified as corporations for United States federal income tax purposes. X may also hold equity and debt interests in the CDO issuers through one or more foreign holding companies which are classified as corporations.

X and Subsidiaries will be externally managed by Y, a State limited liability company, which is a disregarded entity for federal income tax purposes owned by X. X is expected to utilize a portion of its capital to purchase Z, a wholly-owned subsidiary, which is a Country limited company treated as a corporation for United States federal income tax purposes.

Each Subsidiary that satisfies the requirements of §§ 957(a) or 1297(a) will be classified for United States federal income tax purposes as a controlled foreign corporation (“CFC”) or a passive foreign investment company (“PFIC”), respectively. With respect to any Subsidiary characterized as a PFIC, X may elect to treat the Subsidiary as a qualified electing fund (“QEF”) within the meaning of § 1295.

X will acquire all or a majority of the equity of a CDO issuers that are structured and managed by Y and will acquire b additional CDO issuers that are structured by third parties. Each CDO issuer is structured either as an asset-backed CDO or as a synthetic asset-backed CDO which enters into both total return and credit default swaps to achieve collateral exposure.

The CDO issuers typically invest all or substantially all of their capital in fixed income assets. Accordingly, the income they generate consists mostly of interest income (i.e., income that constitutes foreign personal holding company income and is subpart F income under § 954(c)(1)(A)).

X will receive cash flow primarily through distributions it receives as an equity holder from Subsidiaries. Subsidiaries will be subject to a series of financial covenants under their governing agreements that may require that excess cash flow from their portfolios be applied to repay their debt, rather than make distributions to X. Consequently, the CFC provisions or the QEF provisions of the Code may cause X to

have taxable income with respect to a Subsidiary for a given year in excess of the amount backed by cash distributions.

X represents that it would not be described in § 851(a) if it were a domestic corporation. Specifically, X represents that X (1) is not registered, or required to register, under the Investment Company Act of 1940 (the 1940 Act) as a management company or unit investment trust, (2) does not have in effect (and is not required to have in effect) an election under the 1940 Act to be treated as a business development company, and (3) is not a common trust fund or similar fund excluded by section 3(c)(3) of the 1940 Act from the definition of “investment company.” This is a material representation upon which this ruling is based.

LAW AND ANALYSIS

Section 7704(a) provides that, except as provided in § 7704(c), a PTP will be treated as a corporation. Section 7704(b) defines a PTP as a partnership if (1) interests in the partnership are traded on an established securities market; or (2) interests in the partnership are readily tradable on a secondary market (or the substantial equivalent thereof).

Under section 7704(c), if 90 percent or more of the gross income of a PTP for a taxable year consists of “qualifying income,” § 7704(a) does not apply to the PTP for the taxable year. Section 7704(d)(4) provides that qualifying income includes any income that would qualify under § 851(b)(2)(A) or § 856(c)(2).

Section 7704(c)(3) provides that § 7704(c) does not apply to any partnership that would be described in § 851(a) if such partnership were a domestic corporation.

Section 851(b)(2)(A) defines qualifying income for a regulated investment company (“RIC”), in relevant part, as

dividends, interest, payments with respect to securities loans (as defined in § 512(a)(5)), and gains from the sale or other disposition of stock or securities (as defined in § 2(a)(36) of the Investment Company Act of 1940, as amended) 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 § 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 is a distribution out of the earnings and profits of the taxable year that are attributable to the amounts so included.

Section 952 defines subpart F income to include foreign base company income determined under § 954. Under § 954(a)(1), foreign base company income includes foreign personal holding company income determined under § 954(c). Section 954(c)(1)(A) defines foreign personal holding company income to include dividends, interest, royalties, rents, and annuities.

Subsidiaries' investments in fixed income assets, including debt securities, will produce interest income that may generate foreign personal holding company income under § 954(c)(1)(A), which is subpart F income. X would therefore include in income the sum of its respective pro rata share of each Subsidiary's subpart F income (if the Subsidiary is a CFC with respect to X) for the taxable year in accordance with § 951(a)(1)(A)(i). Section 951(a)(1) income inclusions are often termed "subpart F inclusions."

In addition, X will include in income, for each Subsidiary that is a PFIC with respect to X, its pro rata share of the Subsidiary's ordinary earnings and net capital gains (or "QEF inclusions") for the taxable year in accordance with § 1293(a).

Section 851(b) includes a specific rule providing dividend treatment for certain subpart F inclusions and QEF inclusions. However, subpart F and QEF inclusions will also constitute RIC qualifying income under § 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 X in Subsidiaries that are corporations will be an investment in stock. All of X's income from Subsidiaries will be derived as a result of its stock ownership and will be "income derived with respect to its business of investing in such stock" under the other income rule of § 851(b)(2)(A).

CONCLUSION

Based solely on the information submitted, we conclude that X's income from Subsidiaries that are corporations for federal income tax purposes will be qualifying income under §§ 851(b)(2)(A) and 7704(d)(4) without regard to whether the income has been distributed and without regard to whether the income results from a subpart F or QEF inclusion, or is income in excess of cash distributions.

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. Furthermore, this letter ruling is dependent on the taxpayer's representation that it would not be described in § 851(a) if it were a domestic corporation.

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.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Audrey W. Ellis
Senior Counsel, Branch 1
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2):
Copy of this letter,
Copy for § 6110 purposes

cc: