

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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CC:FIP:B03  
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Date:  
May 07, 2009

In Re:

LEGEND:

Taxpayer	=	
Company A	=	
Amount 1	=	
aa	=	
cc	=	
Formula	=	
Fund	=	
Country A	=	
Quotation System	=	

Dear :

This letter responds to your letter dated March 14, 2008, and subsequent correspondence, requesting a ruling that sections 871(h)(4)(A)(i) and 881(c)(4) will not prevent the interest payments described below from qualifying as portfolio interest under sections 871(h) and 881(c).

FACTS

Taxpayer, a Delaware corporation, along with the members of its consolidated group, performs a wide variety of financial services for individuals and corporations. Taxpayer is an accrual-basis taxpayer, and has a taxable year ending on December 31.

Company A, a wholly owned subsidiary of Taxpayer, is also a Delaware corporation and uses the same accounting method and taxable year as Taxpayer.

Company A issues commercial paper, medium-term notes, and structured equity-linked and credit-linked notes. All of Company A's products are guaranteed by the Taxpayer.

Company A proposes to issue Notes, which will be issued in registered form within the meaning of section 871(h)(2)(B). Taxpayer expects that most of the Note holders will be non-US persons not otherwise subject to US federal income tax on a net basis. Taxpayer represents that it will obtain a properly completed Internal Revenue Service Form W-8BEN or appropriate substitute form from the non-US Note holders prior to making any payments to such holders on the Notes.

The Notes will be issued in denominations of Amount 1, a foreign currency, and will mature aa months from their issue date. Interest will not be paid currently. Instead, at maturity, the holder of a Note is entitled to receive a) Amount 1 per Note, and b) a contingent amount determined under a formula, which is based upon the performance of the Fund during the term of the Note.

Company A expects to hedge its exposure to the contingent portion of the payment on a Note by holding shares of the Fund while a Note is outstanding. Taxpayer will guarantee all payments due on the Notes in the event that Company A's hedges do not cover the contingent amounts due on the Notes.

The Fund, formed in Country A, is registered under the European Union's Undertakings for Collective Investment in Transferable Securities regime, which Taxpayer represents is comparable to registration in the US under the Investment Company Act of 1940. For US federal income tax purposes, the Fund is treated as a corporation.

Similar to shares of US registered open-end mutual funds, transactions in shares of the Fund occur solely between the investor and the Fund; investors may not transfer Fund shares other than by redeeming the shares with the Fund, and all purchases of Fund shares occur through contribution of funds to the Fund, which then issues new shares to the investor. All sales or purchases placed before the Fund's daily cut off time will be transacted at a price equal to the Fund's net asset value at the end of that business day. The Fund's daily net asset value is available on a Quotation System.

The transfer of shares or cash will generally occur on the business day following the net asset value computation. The only exceptions to this general rule will occur if 1) an investor tenders securities, rather than cash, to the Fund to pay for Fund shares, or 2) the Fund is liquidated. Under either of these events, the Fund expects to complete the purchase or liquidation transactions within not more than five days (thirty days under certain exceptional circumstances).

The Fund has two classes of shares, one for institutional investors and legal entities, and one for individuals. The Notes' contingent payment formula would be referenced to, and Company A would invest in, the Fund's institutional investor class shares. There are no subscription or redemption fees associated with this class. While the Fund recommends that investors hold Fund shares for at least one year, there is no minimum holding period requirement.

Taxpayer believes that the Notes would satisfy market demand from investors who want to benefit from any increases in the value of the Fund shares but who also want to protect their principal from any decreases in the value of the Fund shares. Taxpayer represents that Company A's profits on the Notes would be derived from its marketing and sales activities and from efficient hedging of its risks related to the Notes.

Taxpayer represents that the shares in the Fund do not constitute United States real property interests within the meaning of sections 897(c)(1) and (g). Further, Taxpayer represents that no beneficial owner of the Notes will directly, indirectly, or through attribution, hold 10% or more of the voting stock of the Taxpayer.

#### LAW and ANALYSIS

Subject to certain exceptions, US source interest paid to a nonresident alien or foreign corporation that is not effectively connected with a US business is subject to US federal income tax at a rate of 30%. Sec. 871(a)(1) and 881(a)(1). However, interest that qualifies as "portfolio interest" is exempt from U.S. taxation. Sec. 871(h) and 881(c). Provided that the recipient is not a "10-percent shareholder" as defined under section 871(h)(3) and no other exceptions apply, interest paid on a debt instrument that would otherwise be subject to taxation under section 871(a) or 881(a) is portfolio interest if either the instrument is in registered form and the beneficial owner of the instrument provides the payor of the interest a statement meeting the requirements of the applicable regulations that the owner is not a U.S. person or in the case of an instrument not in registered form, the instrument is described in section 163(f)(2)(B). See sections 871(h) and 881(c).

Portfolio interest does not include certain contingent interest. Sec. 871(h)(4) and 881(c)(4). Taxable interest for purposes of section 871(h)(4) is defined to include, among other things, interest that is determined by reference to any change in value of any property of the debtor or a related person. Sec. 871(h)(4)(A)(i)(III) and 881(c)(4). However, this contingent interest exclusion from portfolio interest does not apply to any interest which is determined by reference to changes in the value of property, including stock, which is actively traded within the meaning of section 1092(d) (other than property described in section 897(c)(1) or (g)). Sec. 871(h)(4)(C)(v)(I).

Taxpayer has represented that the Notes will be issued in registered form, that properly completed Form W-8 BEN or substitute forms will be obtained from foreign investors,

and that no beneficial owner of the Notes would directly or indirectly hold 10% or more of the stock of Taxpayer. Therefore, provided all other applicable requirements of section 871(h), 881(c), and the underlying regulations are met, the interest paid on the Notes could potentially qualify for the portfolio interest exception to gross basis taxation under sections 871(a) or 881(a), unless the interest is excluded from the portfolio interest exception under section 871(h)(4).

The interest that Company A will pay on the Notes that it issues to foreign investors will be determined by reference to changes in the value of the Fund shares<sup>1</sup>. Company A intends to hold shares in the Fund to hedge its financial exposure to such changes in value. Therefore, the interest paid by Company A will be determined by reference to changes in the value of property held by Company A which would result in the interest being excluded from the portfolio interest exception under section 871(h)(4)(A)(i)(III). Under section 871(h)(4)(C)(v)(I), however, if the shares of Fund are “property (including stock) that is actively traded (within the meaning of section 1092(d)) other than property described in section 897(c)(1) or (g),” the interest paid by Company A could potentially qualify as portfolio interest despite the fact that it is contingent. For this purpose, the term “property” includes stock and the term “actively traded” is within the meaning given to that term under section 1092(d) of the Code.

Section 1.1092(d)-1(a) of the Income Tax Regulations provides that personal property that is “actively traded” includes property for which there is an “established financial market.” Section 1.1092(d)-1(b) provides that an established financial market includes:

- (i) A national securities exchange that is registered under section 6 of the Securities Exchange Act of 1934;
- (ii) An interdealer quotation system sponsored by a national securities association registered under section 15A of the Securities Exchange Act of 1934;
- (iii) A domestic board of trade designated as a contract market by the Commodities Futures Trading Commission;
- (iv) A foreign securities exchange or board of trade that satisfies analogous regulatory requirements under the law of the jurisdiction in which it is organized (such as the London International Financial Futures Exchange, the Marche a Terme International de France, the International Stock Exchange of the United Kingdom and the Republic of Ireland, Limited, the Frankfurt Stock Exchange, and the Tokyo Stock Exchange);
- (v) An interbank market;
- (vi) An interdealer market (as defined in paragraph (b)(2)(i) of this section); and
- (vii) Solely with respect to a debt instrument, a debt market (as defined in paragraph (b)(2)(ii) of this section).

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<sup>1</sup> The fact that the instrument is denominated in a foreign currency does not give rise to a contingency under these particular facts.

The Income Tax Regulations also provide that

[a]n interdealer market is characterized by a system of general circulation (including a computer listing disseminated to subscribing brokers, dealers, or traders) that provides a reasonable basis to determine fair market value by disseminating either recent price quotations (including rates, yields, or other pricing information) of one or more identified brokers, dealers, or traders or actual prices (including rates, yields, or other pricing information) of recent transactions. An interdealer market does not include a directory or listing of brokers, dealers, or traders for specific contracts (such as yellow sheets) that provides neither price quotations nor actual prices of recent transactions. See §1.1092(d)-1(b)(2)(i).

Taxpayer has represented that the Fund's daily net asset value is available to subscribers of Quotation System. Quotation System is a system of general circulation (including a computer listing disseminated to subscribing brokers, dealers, or traders) that provides a reasonable basis to determine fair market value by disseminating either recent price quotations (including rates, yields, or other pricing information) of one or more identified brokers, dealers, or traders or actual prices (including rates, yields, or other pricing information) of recent transactions. Therefore, Quotation System qualifies as an established financial market. Furthermore, the shares in the Fund can be purchased or redeemed on a daily basis. Therefore, shares in the Fund qualify as actively traded for purposes of section 1092(d) and §1.1092(d)-1. Because the interest on the Notes is determined by reference to changes in the value of property held by Company A which is actively traded within the meaning of section 1092(d), sections 871(h)(4)(A)(i) and 881(c)(4) will not prevent interest paid on the Notes from qualifying as portfolio interest under sections 871(h) and 881(c) provided that all applicable requirements of sections 871(h), section 881(c), and the underlying regulations are otherwise met. See Sec. 871(h)(4)(C)(v)(I).

#### HOLDINGS

Based upon the above information, we hold as follows

1. Shares in the Fund will be treated as actively traded within the meaning of section 1092(d) and §1.1092(d)-1.

2. By virtue of section 871(h)(4)(C)(v)(I), sections 871(h)(4)(A)(i) and 881(c)(4) will not prevent interest paid on the Notes from qualifying as portfolio interest under sections 871(h) and 881(c) provided that all applicable requirements of sections 871(h), section 881(c), and the underlying regulations are otherwise met.

Sincerely,

Office of Associate Chief Counsel  
(Financial Institutions and Products)

By:

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Robert B. Williams  
Senior Counsel, Branch 3

enclosures: copy of this letter  
section 6110 copy

cc: