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Date:
September 30, 2013

Legend:

Fund 1 =

Fund 2 =

Fund 3 =

Fund 4 =

Fund 5 =

Fund 6 =

Fund 7 =

Fund 8 =

Fund 9 =

Fund 10 =

Fund 11 =

Fund 12 =

Fund 13 =

Fund 14 =

Manager =

Index A =

Index B =

Time Period =

a =

b =

c =

Dear :

This responds to your request for a ruling dated July 19, 2012, and subsequent correspondence, submitted on behalf of Funds 1 through 14 (each a "Fund," collectively, the "Funds"). Funds request a ruling that income from certain derivative contracts will constitute other income derived with respect to the Funds' business of investing in stock, securities, or currencies, and therefore will constitute qualifying income under section 851(b)(2) of the Internal Revenue Code of 1986, as amended (the "Code").

Facts:

Each Fund is a series of an entity registered as an open-end management investment company under the Investment Company Act of 1940, 15 U.S.C. 80a-1 et seq., as amended (the "1940 Act"). Each Fund is treated as a separate corporation under section 851(g). The Funds are managed by Manager and seek to qualify annually as regulated investment companies (RICs) under subchapter M of the Code.

Fund 1 is authorized to hold investment assets, such as debt obligations and equities, directly, but currently principally invests in other RICs and exchange-traded funds. Funds 2 through 14 generally invest in debt obligations with Funds 2 through 6 also investing in equities.

CPI Swaps

In order to protect against the risk of future inflation eroding the value of a Fund's debt instruments or group of debt instruments in a Fund's portfolio, Funds intend to invest in swaps on certain Consumer Price Indices ("CPIs"). U.S. inflation equates to a diminished value of the U.S. dollar. Fund represents that the debt instruments are "securities" under section 2(a)(36) of the 1940 Act. Because the interest and principal of Funds' debt instruments are repaid in U.S. dollars, inflation causes a decrease in the value of Funds' debt obligations.

Funds may seek to reduce the effects of inflation on some or all of their debt obligations by entering into swap contracts based on the Consumer Price Index Urban Non-Seasonally Adjusted ("CPI-U NSA") or the Chained Consumer Price Index for All Urban Consumers ("C-CPI-U") (together, the "CPI Swaps"). Both indices are published by the U.S. Bureau of Labor Statistics and are regarded as measures of inflation. The CPI-U NSA is a non-seasonally adjusted measure for estimating inflation by referencing changes in the price levels for urban consumers of a standard basket of goods and services. The C-CPI-U is similar to the CPI-U NSA except that the C-CPI-U reflects changes in the types of items that consumers might purchase as prices change. The CPI Swaps are fixed maturity derivatives in which the counterparty receives the "realized" rate of inflation as measured by the applicable CPI over the life of the swap. Some of the CPI Swaps could involve two or more payments over the term of the swap, whereas other CPI Swaps will have a "bullet" structure, where all cash flows are exchanged at maturity.

Funds represent that each Fund enters into the CPI Swaps primarily to manage or reduce the effects of inflation on some or all of the debt obligations it owns. The inflation indexed payments that Funds receive under the CPI Swaps offset in whole or in part the effect of inflation on their debt obligations. Each Fund is an actively managed RIC, and, as such, the CPI Swaps are entered into, maintained, and exited based upon on-going portfolio management decisions. However, Funds have represented that the notional amount of the CPI Swaps generally will not exceed an amount reasonably calculated to reduce each Fund's level of risk with respect to its investment in debt obligations. This representation will be satisfied if the total notional amount of each Fund's CPI Swaps generally will not exceed an amount equal to the total fair market value of its debt obligations.

Index A Contracts

In order to protect against the risks of market volatility on its equity securities, Fund 1 intends to invest in futures contracts and options contracts on Index A. Index A captures implied volatility, or a measure of the expected volatility of Index B that is reflected in the value of Index A. Exposure to Index A can be used to reduce the risk of loss of the value of investments in securities because volatility, as reflected in Index A, has historically tended to correlate negatively to the performance of the U.S. equity markets.

Index A is a benchmark index designed to measure the implied market price volatility in large capitalization U.S. stocks over a thirty-day period. Index A is calculated by averaging the weighted prices of certain put and call options on Index B.

Index A historically has had a significant negative correlation to broad based market indices including Index B. The negative correlation indicates that the value of Index A moves in the opposite direction from the value of the broad based market indices, like Index B. Since 2005, the first calendar year of trading in futures contracts on Index A, the correlation of Index A to other broad based indices has been between negative a% and negative b%.

Fund 1 intends to invest in futures contracts and options contracts on Index A ("Index A Contracts") in order to protect Fund 1's value during times of actual or anticipated heightened investment market volatility. Fund 1 will seek exposure to Index A if its investment advisor determines that actual or projected equity market volatility poses a risk to the value of all or a portion of Fund 1's equity portfolio and that risk justifies incurring the cost to enter into and maintain Index A exposure. Fund 1 is "actively managed," meaning that the positions in Fund 1's portfolio (including Index A Contracts) are entered into, maintained, and exited based on ongoing portfolio management decisions (the "Program"). As a result, determinations to enter into or to terminate Index A Contracts constitute "judgment calls" and there is no guarantee that the Program will achieve its intended or any beneficial effect.

Under the Program, the percentage correlation between the value of Fund 1's equity investments and Index A will be reasonably calculated for each Time Period ("Investment Time Period"). Under the Program, the determination of that correlation with respect to an Investment Time Period will be based on that correlation for the c-month or other statistically significant period (comprised of Time Periods), as determined by Fund 1's investment manager, ending immediately before the Time Period that precedes the Investment Time Period ("Testing Period"). If the correlation is negative for a Testing Period, it will be deemed to be negative for the Investment Time Period linked to that Testing Period. If the correlation is positive for a Testing Period, Fund 1 will terminate its positions in Index A Contracts before or promptly after the beginning of the Investment Time Period with respect to which the correlation is deemed positive and will enter into new Index A Contracts only during a subsequent Investment Time Period with respect to which the correlation is negative.

Fund represents that the notional amount of its investments in Index A Contracts generally will not exceed an amount reasonably calculated to reduce Fund 1's level of volatility risk with respect to its equity investments. This amount may be quantified as follows: the notional amount of Fund 1's investments in Index A Contracts generally will not exceed the product of (a) the reciprocal of the absolute value of the percentage correlation of Index A and Fund 1's equity investments as determined under the Program for the Investment Time Period (assuming such percentage correlation is negative), and (b) the sum of the current values of Fund 1's equity investments (such product hereinafter the "Quantity Limitation").

Under the Program, the values of Fund 1's investments in equities taken into account will be the same as those taken into account for purposes of determining Fund 1's net asset value. Since Fund 1's net asset value is generally determined once each business day, at the close of business, the Quantity Limitation for a given business day normally will be based on closing net asset value as of the prior business day. If, under the Program, on a business day in an Investment Time Period, the Quantity Limitation is exceeded, Fund 1 will reduce its exposure to Index A promptly to bring that exposure within the Quantity Limitation.

Law:

Section 851(a) of the Code defines a RIC, in part, as a domestic corporation registered under the 1940 Act as a management company.

Section 851(b) of the Code limits the definition of a RIC to a corporation meeting certain election, gross income, and diversification requirements.

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 (such income is referred to as "qualifying income").

Prior to the enactment of the Tax Reform Act of 1986 (the "1986 Act"), section 851(b)(2) of the Code identified qualifying income 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 stocks or securities." Section 851 did not contain its own definition of the term "securities," but section 851(c)(5) provided that, for the purpose of section 851(b)(3) (the "asset diversification test"), "[a]ll other terms shall have the same meaning as when used" in the 1940 Act.[1]

The 1986 Act expanded the meaning of qualifying income under section 851(b)(2) in a number of ways: (1) by adding an explicit cross-reference to the definition of "securities" in the 1940 Act; (2) by adding gains from the sale or other disposition of foreign currencies; and (3) by adding an "other income' provision. As so amended, qualifying income under section 851(b)(2) includes, in relevant part, –

> . . . 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 Investment Company Act of 1940) or foreign currencies, or other income (including but not limited to gains from options, futures or forward contracts) derived with respect to its business of investing in such stock, securities, or currencies. . . .

Section 2(a)(36) of the 1940 Act defined the term "security" as –

[1] Section 851(c)(5) of the Code was redesignated as section 851(c)(6) by the American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 331(c) (10-22-2004).

> . . . 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.

Analysis:

In analyzing whether a derivative financial instrument generates qualifying income under the "other income" clause of section 851(b)(2), we examine the relationship between the income or loss generated by the derivative and the RIC's business of investing in stock, securities, or currencies. In conducting this analysis, we must also consider the legislative history accompanying the 1986 enactment of the other income provision to determine Congressional intent.

<u>Relationship of Income from the CPI Swaps and Index A Contracts to the RIC's Business of Investing in Stock, Securities, or Currencies</u>

CPI Swaps

Income and gain from the CPI Swaps may be other income that is qualifying income to the Funds, if the income and gain is derived with respect to each Fund's business of investing in stocks, securities, or currencies. As noted above, the Funds represent that the debt obligations they hold are "securities" under the 1940 Act.

Each Fund represents that its purpose in investing in CPI Swaps is to protect against losses in the value of its debt obligations due to inflation, and further that its position in the CPI Swaps is reasonably calculated to reduce the Fund's inflation risk with respect to its investment in debt obligations. The inflation indexed payments each Fund receives under the CPI Swaps are intended to reduce the effects of inflation on its debt obligations. The payments that the Funds expect to receive from the CPI Swaps and corresponding decrease in the inflation-adjusted value of each Fund's debt obligations demonstrate the requisite relationship between the income generated by each Fund's positions in CPI Swaps and its business of investing in debt obligations.

Funds have represented that the notional amount of the CPI Swaps generally will not exceed an amount reasonably calculated to reduce each Fund's level of risk with respect to its investment in debt obligations. This representation will be satisfied if the total notional amount of each Fund's CPI Swaps generally will not exceed an amount equal to the total fair market value of its debt obligations.

Index A Contracts

Income and gain from futures and options contracts on Index A may be other income that is qualifying income to Fund 1 if the income and gain is derived with respect to Fund 1's business of investing in stocks, securities, or currencies. Fund 1 has represented that the notional amount of its investments in Index A Contracts generally will not exceed an amount reasonably calculated to reduce Fund 1's level of volatility risk with respect to its equity investments. Fund 1 represents that its equity investments with respect to which it may enter into Index A Contracts are 1940 Act securities.

Fund 1 invests in Index A Contracts in order to reduce volatility risks with respect to its equity investments, consistent with an investment objective of positive total returns. According to the facts and representations submitted by Fund 1, Index A has historically displayed a significant negative correlation to the value of broad-based indices. In this context, a negative correlation indicates that the trends of Index A and other broad-based equity indices move in opposite directions.

Fund 1 further represents that the notional amount of its investments in Index A Contracts generally will not exceed an amount reasonably calculated to reduce its level of volatility risk with respect to its equity investments. This amount may be quantified by the Quantity Limitation. Fund 1 thus has demonstrated a strong relationship between the income generated by its investments in Index A Contracts and its business of investing in securities.

Controlling Statutory Language

In amending section 851(b)(2) in 1986, Congress inserted parenthetical language that specifically enumerated gains from futures contracts (as well as gains from options and forward contracts) as a type of income that may constitute other income derived with respect to a RIC's business of investing in stock, securities, or currencies. Congress specifically noted that the Service had previously ruled favorably under section 851(b)(2) on income from futures contracts (131 Cong. Rec. 24570-71 (1985)), creating a strong inference that the statutory language should be interpreted in a manner consistent with those prior rulings.

The pricing and economics of the CPI Swaps at issue are similar to those of the futures contracts enumerated in section 851(b)(2) and discussed in the legislative history to that provision. In addition, futures and options contracts on Index A are exchange-traded futures and options contracts based on Index B, an index that is based on the common stock prices of a collection of certain stocks. Therefore, income from the CPI Swaps and Index A Contracts falls within a category of income which Congress intended to include as qualifying income under the other income provision if derived with respect to the RIC's business of investing in stock, securities, or currencies.

Passive Nature of Income

The types of investments expressly permitted under the Code for RICs are passive in nature. Congress has explained that the favorable RIC tax provisions are intended for passive investment entities that do not engage in active business and that a RIC's investments should be limited to income from stocks and securities, as opposed to other property. STAFF OF THE JOIN COMMITTEE ON TAXATION, GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1986 (1987), at 377. A letter by J. Roger Mentz, Acting Assistant Secretary of the Treasury (Tax Policy) ("the Mentz letter"), explained the fundamental policy served by the qualifying income requirement:

> . . . First, income qualifying under section 851(b)(2) should be limited to income from property held for investment, as opposed to property held for sale to customers in the ordinary course of business. Second, income qualifying under section 851(b)(2) should be limited to income from stocks and securities, as opposed to other property. . . For example, under the second limit, we would generally not treat as qualifying income gains from trading in commodities, even if the purpose of that trading is to hedge a related stock investment.

132 Cong. Rec. 4048 (1986) (remarks from Senator Armstrong, inserting letter of J. Roger Mentz, Acting Assistant Secretary of the Treasury (Tax Policy), dated February 5, 1986, to Rep. Flippo).

The trading of securities held by a RIC for investment is treated as passive in nature. Id. Here, the income and gain generated by the Funds from investments in the CPI Swaps and by Fund 1 from its investments in Index A Contracts are also passive in nature, similar to those generated by investments in stock and securities within the meaning of section 851(b)(2).

Policy Limitation on Investment in Commodities

As noted above, Congress has explained that a RIC's investments should be limited to income from stocks and securities. With respect to commodities, the Mentz letter states that ". . . we would generally not treat as qualifying income gains from trading in commodities, even if the purpose of that trading is to hedge a related sock investment." Id.

CPI Swaps

Although the CPI-U NSA and the C-CPI-U, the underlying referents for the CPI swaps, include the value of certain baskets of commodities in measuring the average change in prices over time of goods and services of urban consumers, the annual percentage change of the CPI-U NSA and the C-CPI-U is predominantly used as a measure of inflation. Thus, a position in a derivative referencing the CPI-U NSA or the C-CPI-U is not predominantly an indirect investment in commodities.

Underlying Referent

Index A Contracts

Index A Contracts are derivative instruments whose value is derived from the performance of Index A. The value of Index A, in turn, reflects changes in the prices of certain options on Index B. Therefore, the price of an Index A Contract is tied to the values of the underlying stocks of issuers contained in Index B. Thus, the underlying referents of the Index A Contracts are options on stocks. Because stocks and options on stocks are specifically enumerated securities within the 1940 Act definition of the term security, the underlying referents of the Index A Contracts are securities.

Conclusion:

CPI Swaps

We rule that the income and gain derived from the CPI Swaps constitute other income derived with respect to each Fund's business of investing in securities within the meaning of section 851(b)(2) of the Code, provided that the notional amount of the CPI Swaps generally will not exceed an amount reasonably calculated to reduce each Fund's level of risk with respect to its investment in its debt obligations and that each Fund's debt obligations are "securities" under section 851(b)(2). This will be satisfied if the total notional amount of each Fund's CPI Swaps generally will not exceed an amount equal to the total fair market value of that Fund's debt obligations.

Index A Contracts

We rule that income and gain derived from Fund 1's Index A Contracts constitute other income derived with respect to Fund 1's business of investing in securities within the meaning of section 851(b)(2) of the Code, provided that:

1. the notional amount of Fund 1's investment in Index A Contracts generally will not exceed an amount reasonably calculated to reduce Fund 1's level of volatility risk with respect to its equity investments;
2. the percentage correlation with respect to the value of Fund 1's equity investments and Index A (determined in accordance with the Program) is negative; and
3. the notional amount of Fund 1's investments in Index A Contracts generally will not exceed the product of (a) the reciprocal of the absolute value of the percentage correlation of Index A and Fund 1's equity investments (determined under the Program), and (b) the sum of the current values of Fund 1's equity investments.

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 whether Funds otherwise qualify as RICs under part I subchapter M of Chapter 1 of the Code, whether Funds debt obligations and Fund 1's equities constitute securities under section 851(b)(2), or whether gains generated by Funds' CPI Swaps and Fund 1's Index A Contracts may also constitute qualifying income under section 851(b)(2) as gains from the sale or other disposition of stock or securities (as defined in section 2(a)(36) of the 1940 Act).

This ruling is directed only to the taxpayers 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,

Andrea M. Hoffenson
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Assistant to the Branch Chief, Branch 1
Office of Associate Chief Counsel
(Financial Institutions & Products)