

Internal Revenue Service

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PLR-129897-05

Date:

September 30, 2005

Legend:

Fund =

State =

Date A =

Date B =

Date C =

Date D =

Date E =

Year A =

Y Rate =

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Dear _____ :

This responds to your request submitted June 1, 2005, and subsequent correspondence submitted September 15, 2005, by your authorized representative on behalf of Fund, that the Internal Revenue Service (the Service) rule that (i) the designation of dividend income eligible for the dividends received deduction (DRD-eligible income) to the Remarketed Preferred Stock (RPS) complies with the "grandfather clause" of Rev. Rul. 89-81, 1989-1 C.B. 226; (ii) the designation of DRD-eligible income (both qualified dividend income (QDI DRD-eligible income) and non-qualified dividend income (Non-QDI DRD-eligible income)), to the extent any remains after designations are made to the RPS, qualified dividend income (QDI) not eligible for the dividends received deduction, net capital gain (NCG), and any other specially designated income type among the Common Shares and the Auction Preferred Stock (APS) (and the RPS to the extent the Fund's DRD-eligible income is less than the distribution to the RPS) in the manner described in this ruling request complies with Rev. Rul. 89-81; and (iii) the payment of dividends by Fund on the RPS, the Common Shares, and the APS will not be considered preferential under section 562(c) of the Internal Revenue Code of 1986 (Code) by virtue of the designation of dividends as proposed. Fund further requests that the Service rule that the issuance of the APS will not affect the Service's conclusions in PLR 200332005 and the earlier private letter rulings regarding the disproportionate designations with respect to the RPS.

FACTS

Fund is a closed-end diversified management investment company registered under the Investment Company Act of 1940, 15 U.S.C. 80a-1 et seq., as amended (the 1940 Act). Fund is organized as a corporation under the laws of State. Fund has qualified and elected to be treated since its inception as a regulated investment company (RIC) under subchapter M, part I, of the Code.

Fund currently has two classes of stock, common and preferred. The shares of common stock are listed for trading on the New York Stock Exchange.

Fund's preferred shares are issued pursuant to authority granted to the board of directors under Fund's charter to issue one or more series of preferred stock and to fix the preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends, qualifications, and terms and conditions of redemptions, of each series. On Date A, a date prior to June 13, 1989, the board exercised this authority by filing Articles Supplementary to Fund's charter (the RPS Articles) that designated a certain number of the authorized shares of preferred stock as shares of five series of RPS. Each series carries a mandatory redemption date. Registration statements for each series of RPS were filed with the Securities and Exchange Commission (SEC) on dates prior to June 13, 1989.

Pursuant to the RPS Articles, Fund designates dividends paid on the RPS as DRD-eligible income to the extent the dividends do not exceed the Fund's income qualifying for the corporate dividends received deduction (qualifying income). Distributions on the common shares are designated as DRD-eligible income only to the extent that any qualifying income remains after distributions are made on the RPS.

On Date B, a date prior to June 13, 1989, and also prior to Date A, Fund was issued a private letter ruling (PLR 8842048) holding that Fund was entitled to designate dividends on the RPS as consisting of DRD-eligible income each year. On Date C, a date prior to June 13, 1989, and also prior to Date A, the Internal Revenue Service withdrew this ruling (PLR 8845037, withdrawing PLR 8842048) because it was reconsidering its positions in two published rulings on which Fund had relied in seeking its private letter ruling. The Fund thereafter sought relief under section 7805(b) of the Code and was granted this relief on Date D, a date prior to June 13, 1989, and also prior to Date A, in the form of a private letter ruling (PLR 8850018).

On June 26, 1989, the Service issued Rev. Rul. 89-81, which held that if a RIC that has two or more classes of stock 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 designations are not effective for federal tax purposes to the extent that they exceed the class' proportionate share of that type of income. The ruling contains, however, a statement of prospective application (a "grandfather clause"), described more fully below in the LAW AND ANALYSIS section of this letter.

Fund was granted another private letter ruling with respect to this designation on Date E (PLR 200332005). In Year A, then-prevailing market conditions threatened to impede the remarketing agent's ability to set the dividend rate payable on the RPS at a level that would enable all tendering holders to sell their RPS at a price equal to their liquidation value because of the operation of the maximum dividend rate provision applicable to the remarketing of the RPS. The maximum dividend rate is set by reference to a specified percentage (the "applicable percentage") of the y Rate, a published variable rate, in effect on the day the dividend is set.

In order to restore the ability of the remarketing agent to set the dividend rate payable on the RPS at a level that would enable all tendering holders to sell their RPS at a price equal to their liquidation value, Fund amended its charter to increase the applicable percentage specified in the maximum dividend rate provisions governing the remarketing of the RPS.

PLR 200332005 concluded that since the amendment to the charter required neither the filing of a new registration statement with the SEC nor any amendment to the original registration statement filed with respect to the RPS, the designations made on the RPS pursuant to the provisions of the amended charter will be made by Fund pursuant to a rule described in a registration statement that was filed with the SEC before June 13, 1989, and thus satisfies the "grandfather clause" of Rev. Rul. 89-81.

Recently, on Date F, the Fund's board of directors authorized the issuance and sale of additional shares of preferred stock in one or more series. Pursuant to this board authorization, the Fund intends to offer y shares of APS at a price of \$z per share. A new registration statement for the APS on Form N-2 will be filed with the SEC and Articles Supplementary to Fund's charter will be filed designating the series of APS.

Pursuant to the RPS Articles, the Fund designates dividends paid on the RPS as DRD-eligible to the extent such dividends do not exceed the Fund's aggregate DRD-eligible income. Currently, distributions on the Common Shares are designated as DRD-eligible only to the extent that any DRD-eligible Income remains after designations are made on the RPS. After the APS have been issued, distributions on the Common Shares and the APS will be designated as DRD-eligible on a pro rata basis between the Common Shares and the APS, to the extent any DRD-eligible Income remains after designations are made on the RPS.

Under section 1(h)(11), certain dividends may be taxed as net capital gain provided the income is qualified dividend income under section 1(h)(11)(B). DRD-eligible income may be either income that is also qualified dividend income, or non-qualified dividend income. There was no qualified dividend income concept under the federal income tax law when the RPS registration statements were filed or when Rev. Rul. 89-81 was issued. Qualified dividend income constitutes a particular type of income for purposes of Rev. Rul. 89-81.

Thus, in a distribution of 1) Non-QDI DRD-eligible income, 2) QDI DRD-eligible income, 3) QDI Non-DRD-eligible income, and 4) NCG, the distribution will be made as follows. Firstly, all DRD-eligible income (categories (1) and (2)) will be designated to the RPS pro rata between the Non-QDI DRD-eligible income and the QDI DRD-eligible income. To the extent any DRD-eligible Income remains after designations are made on the RPS, distributions on the Common Shares and the APS will be designated as DRD-eligible (pro rata between the Non-QDI DRD-eligible income and the QDI DRD-eligible income) on a pro rata basis between these classes. QDI Non-DRD-eligible income and NCG (Categories (3) and (4)) will be designated to the Common Shares and the APS (and to the RPS to the extent the Fund's DRD-eligible income is less than the distribution to the RPS) on a pro rata basis among these classes.

The following example assumes that Fund has \$30 of Non-QDI DRD-eligible income, \$120 of QDI DRD-eligible income, \$100 of QDI, and \$50 of NCG. It is further assumed that, based on the dividend rates set at the relevant remarketings of the RPS and auctions of the APS, the RPS, APS, and Common Shares each are entitled to receive \$100 of Fund's distributable income. Fund's designations will be as follows: The RPS will receive 100 of DRD-eligible income (2/3 of total DRD-eligible income [150]) consisting of 20 Non-QDI DRD-eligible income (2/3 of total Non-QDI DRD-eligible income [30]) and 80 QDI DRD-eligible income (2/3 of total QDI DRD-eligible income [120]). The Common Shares and the APS will each receive 5 Non-QDI DRD-eligible

income (1/2 of Non-QDI DRD-eligible income remaining after designation to RPS [10]), 20 QDI DRD-eligible income (1/2 of QDI DRD-eligible income remaining after designation to RPS [40]), 50 QDI (1/2 of total QDI [100]), and 25 NCG (1/2 of total NCG [50]).

LAW AND ANALYSIS

Section 562(c) of the Code provides that the amount of any distribution shall not be considered as 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.

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, Rev. Rul. 89-81 holds that these designations are not effective for federal tax purposes to the extent that they exceed the class' proportionate share of that type of income. Rev. Rul. 89-81 further provides, however, under the authority contained in section 7805(b) of the Code, that it will not be applied to render ineffective for federal income tax purposes a non-proportionate designation made by a RIC pursuant to a rule described in a registration statement that was filed with the SEC before June 13, 1989 (the "grandfather clause").

Fund has represented that the proposed amendment of its charter will require neither the filing of a new registration statement with the SEC nor any amendment to the original registration statements filed with respect to the RPS. Accordingly, designations made on the RPS will be made by Fund pursuant to a rule described in a registration statement that was filed with the SEC before June 13, 1989.

We rule, therefore, that (i) the "grandfather clause" of Rev. Rul. 89-81 will apply to designations made on the RPS; (ii) the designations of DRD-eligible income/QDI, Non-QDI DRD-eligible income, QDI, NCG, and any other specially designated income type among the RPS, Common Shares, and the APS in the manner described above complies with Rev. Rul. 89-81; and (iii) the payment of dividends by Fund on the RPS, the Common Shares, and the APS will not be considered preferential under section 562(c) of the Code by virtue of the designation of dividends as proposed. Further, the issuance of the APS will not affect the Service's conclusions in PLR 200332005 and the earlier private letter rulings regarding the disproportionate designations with respect to the RPS.

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.

A copy of this letter should be attached to the federal income tax return of Fund for each taxable year in which it makes a designation of dividend income as qualifying for the dividends received deduction pursuant to the provisions of the amended charter as described in this letter.

Sincerely,

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