

**INTERNAL REVENUE SERVICE**

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Index Nos.: 851.00-00, 562.03-00

CC:FIP:B01 - PLR-115573-00  
December 13, 2000

**Legend:**

Trust A =  
Fund A =  
Fund B =  
Fund C =  
Trust B =  
Fund D =  
Fund E =  
Fund F =  
Fund G =  
Trust C =  
Fund H =  
Trust D =  
Fund I =  
Fund J =  
Fund K =  
Fund L =  
Fund M =  
Fund N =  
Trust E =  
Fund O =  
Fund P =  
Fund Q =  
Fund R =  
Trust F =  
Fund S =  
Fund T =  
Trust G =  
Fund U =  
Fund V =  
Fund W =  
Fund X =  
Trust H =  
Fund Y =  
Fund Z =  
Trust I =  
Fund AA =  
Trust J =  
Fund BB =  
Fund CC =  
Fund DD =  
Fund EE =  
Fund FF =  
Trust K =  
Fund GG =  
Fund HH =

Adviser =  
State A =  
Distributor =

Dear:

This is in reply to a letter dated July 27, 2000, and subsequent correspondence, requesting a ruling on behalf of Trusts A-K (Trusts) and Funds A-GG (Funds). You request a ruling that certain payments made by a Lower Tier Fund (as described below) or the Adviser under certain expense arrangements will not result in the payment of preferential dividends within the meaning of § 562(c) of the Internal Revenue Code that may cause the Lower Tier Fund to fail to qualify as a regulated investment company (RIC) under subchapter M of Chapter 1 of the Code.

**Facts:**

The Trusts are State A business trusts that are open-end investment companies registered under the Investment Company Act of 1940, 15 U.S.C. 80a-1 et seq., as amended (1940 Act). The Trusts are also series companies under Rule 18f-2 of the 1940 Act. The Trusts were created by the Adviser and each Trust includes one or more of a separate series of beneficial interests, the Funds. The Adviser is the investment adviser of each of the Funds. The Distributor has been retained to act as the underwriter of the shares of each Fund.

Each Fund will be a separate fund under § 851(g) and intends to qualify as a RIC. All of the Funds offer more than one group of shares. Funds L, M, and T (the Upper Tier Funds) may each invest as much as 100 percent of their assets in shares of one or more of the remaining Funds (Lower Tier Funds) and various securities and other financial instruments, including but not limited to government securities and short-term paper. The mix of investments for each Upper Tier Fund will be established by the Adviser, subject to the oversight of the Board of Trustees of the Upper Tier Fund.

Each Upper Tier Fund will pay investment advisory fees to the Adviser, and each Lower Tier Fund will pay investment advisory fees to the Adviser or another investment adviser. The services provided by the Adviser to the Upper Tier Funds will be in addition to and not duplicative of the investment advisory services provided by the advisers to the Lower Tier Funds.

Each Upper Tier Fund and Lower Tier Fund also will pay fees to their various service providers for all other services relating to its operations, such as transfer agency, shareholder servicing, custody, legal and accounting. Those fees may be reduced or eliminated, or the effect of those fees on the Funds, stated as percentages of the Fund's net assets, may fall because of an investment by an Upper Tier Fund in shares of a Lower Tier

Fund. The Upper Tier Funds are expected to generate efficiency and cost savings to investors and the Lower Tier Funds. By eliminating numerous separate shareholder accounts, the Upper Tier Funds will reduce the shareholder servicing costs to the Lower Tier Funds. Additionally, to the extent that the Upper Tier Funds attract assets to the Lower Tier Funds that would not otherwise have been attracted, expense ratios of the Lower Tier Funds are expected to decrease as the Lower Tier Funds' assets increase. The Upper Tier Fund will also benefit because the cost of investment in a Lower Tier Fund generally is less than the cost of selecting and maintaining a portfolio of the same securities in the same proportionate amounts as the Lower Tier Fund.

The parties may adopt one of a number of possible expense sharing arrangements that seeks to balance any savings caused by a reduction in operational expenses and fees between the Upper Tier Funds and the Lower Tier Funds. If no arrangement is adopted, the Upper Tier Funds' shareholders indirectly will pay their proportionate share of any Lower Tier Fund fee or expense.

It is anticipated that if an expense sharing arrangement is adopted, the Upper Tier Funds, the Lower Tier Funds, and the Adviser may enter into special servicing arrangements to allocate certain operational expenses of the Upper Tier Funds. Each Lower Tier Fund will agree to pay (or reimburse) a portion of the operating expenses of the Upper Tier Funds. An amount of an Upper Tier Fund's operating expenses will be allocated among the Lower Tier Funds. No Lower Tier Fund will bear operating expenses in excess of its estimated cost savings. The Lower Tier Funds will pay the Upper Tier Funds' operating expenses on a fund-wide basis rather than on a class-specific basis. The Lower Tier Funds will not pay any class-based charges of the Upper Tier Funds. Under certain circumstances, a portion of an Upper Tier Fund's allocable operating expenses in excess of the cost savings to a Lower Tier Fund may be paid, reimbursed, or waived by the Adviser.

The Upper Tier Funds will pay no front-end sales loads or contingent deferred sales charges in connection with the purchase or redemption of shares of the Lower Tier Funds whose shares are underwritten by the Distributor and do not currently intend to do so with respect to shares of the other Lower Tier Funds. The Upper Tier Funds may pay such charges in the future.

**Law:**

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

Section 851(b) limits the definition of a RIC to a

corporation meeting certain election, gross income, and diversification requirements.

Section 851(g) provides a special rule for a RIC having more than one fund. This provision treats each fund as a separate corporation for all purposes of the Code, other than the definitional requirement of § 851(a).

A corporation that is a RIC within the meaning of § 851 and that is taxable under subchapter M, part I, pays tax on its investment company taxable income under § 852(b)(2) and on the excess, if any, of its net capital gain over its deduction for dividends paid, determined with reference to capital gain dividends under § 852(b)(3).

Section 852 provides that a RIC is not taxable under subchapter M, part I, unless its deduction for dividends paid (as that term is defined in § 561(a) with certain modifications) for the tax year equals or exceeds a specified portion of its taxable income (with certain adjustments) and its net tax-exempt interest income.

Section 561(a) defines the deduction for dividends paid, for purposes of § 852, to include dividends paid during the tax year. Section 561(b) applies the rules of § 562 to determine which dividends are eligible for the deduction for dividends paid under § 561(a).

Section 561(b) applies the rules of § 562 to determine which dividends are eligible for the deduction for dividends paid under § 561(a).

Section 562(a) states that the term "dividend", except as otherwise provided, includes only dividends described in § 316 (which provides a definition of dividends for purposes of corporate distributions).

Section 316(a) defines the term "dividend" as any distribution of property made by a corporation to its shareholders (1) out of its earnings and profits (E & P) accumulated after February 28, 1913, or (2) out of its E & P of the tax year (computed as of the close of the tax year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the E & P at the time the distribution was made.

Section 562(c) provides that the amount of any distribution shall not be considered as a dividend for purposes of computing the dividends paid deduction under § 561 unless the distribution is pro rata, does not prefer any shares of stock of a class over other shares of stock of that same class, and does not prefer one class of stock over another class except to the extent that one class is entitled (without reference to waivers of their rights

by shareholders) to be preferred.

**Conclusion:**

Because of the unique nature of open-end RICs, the payments by the Lower Tier Funds of a portion of the Upper Tier Funds' operating expenses under a servicing arrangement, as described above, are not preferential dividends within the meaning of § 562(c).

Except as specifically ruled upon above, no opinion is expressed or implied regarding the federal tax consequences of this transaction. Specifically, no opinion is expressed as to whether any of the Funds or Trusts qualify as a RIC that is taxable under part I of subchapter M of Chapter 1 of the Code.

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely yours,  
Acting Associate Chief Counsel  
(Financial Institutions & Products)  
By: Alvin J. Kraft  
Chief, Branch 1

Enclosure:

Copy of this letter  
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