

CLIENT MEMORANDUM

IRS Action on Commodity Investments and Offshore Investments

October 6, 2016

AUTHOR

Joseph Riley

On September 28, 2016, the U.S. Department of the Treasury and the Internal Revenue Service issued proposed regulations that, if finalized, would limit the types of income that regulated investment companies (“RICs”) recognize from investments in foreign investment companies, including commodity-focused subsidiaries.¹ The proposed regulations focus on income inclusions from controlled foreign corporations (“CFCs”) and passive foreign investment companies for which a qualified electing fund election has been made (“QEFs”). The proposed regulations would treat a RIC’s income inclusion from a CFC or a QEF as a dividend for the RIC income test only if there is an actual distribution of the income in the same taxable year from the CFC or QEF, from such entity’s earnings. The proposed regulations indicate that CFC or QEF income inclusions, to the extent not distributed to the RIC, would not be treated as “other income” derived with respect to the RIC’s business of investing in stocks, securities and currencies and as a result would not constitute qualifying income for RIC qualification purposes.

This position is a reversal of the IRS’s historic position on this issue. The proposed regulations would override dozens of private letter rulings issued to RICs. Those private rulings specifically concluded that imputed income recognized by RICs from investments in wholly-owned CFCs constituted qualifying income without the income actually being distributed in

¹ Notice of Proposed Rulemaking, REG-123600-16: available [here](#).

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cash to the RICs. The proposed regulations, if adopted, would apply to taxable years beginning on or after 90 days after the regulations are published as final in the Federal Register.

The proposed regulations, if finalized, would also prevent CFC and QEF income inclusions, if not distributed, from constituting qualifying income for investment partnerships that rely on the qualifying income exception from the publicly-traded partnership tax rules that can cause partnerships to become taxable as corporations.

IRS Revenue Procedure 2016-50,² issued contemporaneously with the proposed regulations, and immediately effective, states that in the future the IRS will not issue rulings or determination letters on any issue relating to the treatment of a corporation as a RIC that would require a determination of whether an asset is a “security” under the 1940 Act. The preamble to the proposed regulations specifically references the private letter rulings that the IRS released in previous years that addressed income from commodity-linked structured notes as an example of the type of ruling the IRS will no longer be issuing. It is our understanding that the IRS intends to proceed immediately with issuing official revocation letters to those funds that in past years did receive commodity-linked structured note rulings.

If you have any questions regarding this memorandum, please contact Joseph Riley (212-728-8715; jriley@willkie.com) or the Willkie attorney with whom you regularly work.

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² Revenue Procedure 2016-50, available [here](#).