

Part III

Administrative, Procedural, and Miscellaneous

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability. (Also Part I, §§ 704; 1.704-1, 1.704-3.)

Rev. Proc. 2001-36

SECTION 1. PURPOSE

This revenue procedure grants automatic permission for certain securities partnerships to aggregate contributed property for purposes of making § 704(c) allocations. This revenue procedure also describes the information that must be included with ruling requests for permission to aggregate contributed property for purposes of making § 704(c) allocations submitted by partnerships that do not qualify for automatic permission.

SECTION 2. BACKGROUND

.01 To prevent the shifting of tax consequences among partners with respect to precontribution gain or loss, § 704(c) requires partnerships to allocate income, gain, loss, and

deductions with respect to property contributed by a partner so as to take into account any variation between the adjusted tax basis of the property and its fair market value at the time of the contribution. These allocations must be made using a reasonable method that is consistent with the purpose of § 704(c). Similar rules apply to differences between book value and tax basis that are created by a revaluation of partnership assets pursuant to § 1.704-1(b)(2)(iv)(f)(reverse § 704(c) allocations).

.02 Section 1.704-3(a)(10) provides that an allocation method (or combination of methods) is not reasonable if the contribution of property (or event that results in reverse § 704(c) allocations) and the corresponding allocation of tax items with respect to the property are made with a view to shifting the tax consequences of built-in gain or loss among the partners in a manner that substantially reduces the present value of the partners' aggregate tax liability.

.03 Section 1.704-3(a)(2) provides that § 704(c) allocations are generally made on a property-by-property basis. Therefore, built-in gains and losses from different items of contributed or revalued property generally cannot be aggregated.

.04 Section 1.704-3(e)(3) provides a special rule that allows securities partnerships (as defined in § 1.704-3(e)(3)(iii)) to make reverse § 704(c) allocations on an aggregate basis. Specifically, § 1.704-3(e)(3)(i) provides that,

for purposes of making reverse § 704(c) allocations, a securities partnership may aggregate built-in gains and losses from qualified financial assets (as defined in § 1.704-3(e)(3)(ii)) using any reasonable approach that is consistent with the purpose of § 704(c). This rule, however, only applies to built-in gains and losses from revaluations of partnership property; aggregation of built-in gains and losses from contributed property is only permitted pursuant to published guidance or by letter ruling. Section 1.704-3(e)(4)(iii).

.05 Section 1.704-3(e)(3)(iv) and (v) describe two methods of making § 704(c) allocations on an aggregate basis that are generally reasonable, the partial netting and the full netting approaches, respectively.

.06 Since the regulations under § 704(c) were issued, the Service has received and responded to numerous ruling requests from securities partnerships organized as part of a "Master-Feeder Structure" for permission to aggregate contributed property for purposes of making § 704(c) and reverse § 704(c) allocations.

.07 In a typical Master-Feeder Structure, two or more Feeder Funds or one or more Feeder Funds and an investment advisor, principal underwriter, or manager contribute their assets, consisting primarily of cash or financial investments, to a single Master Portfolio in exchange for beneficial interests in the Master Portfolio. In these cases, each Feeder Fund and the

Master Portfolio is registered with the Securities and Exchange Commission under the Investment Company Act of 1940 (1940 Act). The shares of these Feeder Funds are typically publicly offered and widely held by individuals, corporations, and institutional investors. Generally, each Feeder Fund is an open-end mutual fund, which continuously offers to sell new shares or redeem existing shares for a price equal to the net asset value of their proportionate interest in the portfolio.

.08 The IRS and Treasury Department have determined that it is in the best interest of sound tax administration to reduce the burden on taxpayers of submitting ruling requests by granting to certain Master-Feeder Structures automatic permission to aggregate built-in gains and losses from contributed securities.

SECTION 3. SCOPE

.01 Automatic Permission. This revenue procedure provides automatic permission to Qualified Master-Feeder Structures (QMFSs), as described in section 4 of this revenue procedure, to aggregate built-in gains and losses from contributed securities for purposes of making § 704(c) and reverse § 704(c) allocations. The Service will no longer issue letter rulings to QMFSs allowing this type of aggregation. But see section 6.02 of this revenue procedure.

.02 Securities Partnerships That Do Not Qualify for Automatic Permission. The Service recognizes that there may be securities partnerships not described in section 4 of this

revenue procedure that should be allowed to aggregate built-in gains and losses from contributed property where the burden of making § 704(c) allocations is great and the likelihood of character and timing distortions is minimal. Therefore, the Service will continue to consider ruling requests from these partnerships. Section 5 of this revenue procedure describes the information to be submitted in such a ruling request.

SECTION 4. AUTOMATIC PERMISSION FOR QUALIFIED MASTER-FEEDER STRUCTURES TO AGGREGATE CONTRIBUTED PROPERTIES

.01 In general. Permission is hereby granted for any QMFS, as defined in section 4.02 of this revenue procedure, to aggregate built-in gains and losses from contributed qualified financial assets for purposes of making § 704(c) and reverse § 704(c) allocations.

.02 Qualified Master-Feeder Structure. A QMFS is created where two or more investors contribute cash or qualified financial assets to a Master Portfolio in exchange for beneficial interests in the Master Portfolio. To qualify as a QMFS, the following requirements must be met:

(1) Each partner in the Master Portfolio is a Feeder Fund, or an investment advisor, principal underwriter, or manager of the Master Portfolio;

(2) Each Feeder Fund contributes only cash and/or a portfolio of diversified stocks and securities that satisfies the

25 and 50 percent tests of § 368(a)(2)(F)(ii) in exchange for beneficial interests in the Master Portfolio;

(3) Each partner in the Master Portfolio that is an investment advisor, principal underwriter, or manager, contributes only cash and/or services in exchange for beneficial interests in the Master Portfolio;

(4) The Master Portfolio is treated as a partnership for federal tax purposes and qualifies as a securities partnership under § 1.704-3(e)(3)(iii);

(5) Each Feeder Fund is a publicly offered regulated investment company, as defined in § 67(c)(2)(B) and § 1.67-2T(g)(3)(iii);

(6) The Master Portfolio is registered as an investment company under the 1940 Act.

(7) The Master Portfolio makes § 704(c) and reverse § 704(c) allocations under the partial netting approach or the full netting approach as described in § 1.704-3(e)(3)(iv) or § 1.704-3(e)(3)(v), respectively, and;

(8) The contributions to the Master Portfolio and the corresponding allocations of tax items with respect to the property contributed to the Master Portfolio are not made with a view to shifting the tax consequences of built-in gain or loss among the partners in a manner that substantially reduces the present value of the partners' aggregate tax liability.

SECTION 5. INFORMATION REQUIRED FOR RULING REQUESTS BY SECURITIES PARTNERSHIPS THAT DO NOT QUALIFY FOR AUTOMATIC PERMISSION

.01 In general. This section describes the information and representations that a securities partnership not described in section 4 of this revenue procedure must submit when requesting a ruling permitting the aggregation of built-in gains and losses from contributed property for purposes of making § 704(c) and reverse § 704(c) allocations. Taxpayers should be aware that additional information may be required. See also section 8 of Rev. Proc. 2001-1, 2001-1 I.R.B. 1 (or its successor), which outlines the general requirements concerning the information to be submitted as part of a ruling request.

.02 Representations. The ruling request must include the following representations:

- (1) The partnership qualifies as a "securities partnership" as defined in § 1.704-3(e)(3)(iii);
- (2) The partnership will make revaluations at least annually in accordance with § 1.704-3(e)(3)(iii)(B)(2)(ii);
- (3) The burden of making § 704(c) allocations separately from reverse § 704(c) allocations is substantial; and
- (4) The partnership's contributions, revaluations, and the corresponding allocations of tax items are not made with a view to shifting the tax consequences of built-in gain or loss among the partners in a manner that would substantially reduce the present value of the partners' aggregate tax liability.

.03 Information. The following information must be submitted with the ruling request:

(1) An explanation of the business and tax reasons for the formation of the partnership;

(2) A detailed description of each partner;

(3) A detailed description of each type of property to be contributed including its fair market value and adjusted basis;

(4) The aggregate fair market value and adjusted basis of the property to be contributed;

(5) The aggregate gross built-in gains and aggregate gross built-in losses in the property to be contributed;

(6) A representation that the partner is contributing all of its assets to the partnership or an explanation as to how the assets to be contributed to the partnership were chosen;

(7) A description of the aggregation method that the partnership will use;

(8) Copies of the partnership's organizational documents, if available; and

(9) Copies of any proxy statements, information statements, marketing materials, or prospectuses filed, distributed, or prepared by the partnership or any of its partners in connection with the formation of, or contribution of property to, the partnership.

SECTION 6. EFFECTIVE DATE

.01 In general. Section 4 of this revenue procedure applies to all contributions of property as part of a QMFS on or after **[INSERT DATE THIS DOCUMENT IS PUBLISHED IN THE INTERNAL REVENUE BULLETIN]**. Section 5 of this revenue procedure applies to all ruling requests pending in the National Office on **[INSERT DATE THIS DOCUMENT IS PUBLISHED IN THE INTERNAL REVENUE BULLETIN]** and to requests received thereafter.

.02 Transition rule for pending ruling requests. If a QMFS has filed a request for a ruling allowing it to aggregate contributed securities for purposes of making § 704(c) and reverse § 704(c) allocations and that ruling request is pending in the national office on **[INSERT DATE THIS DOCUMENT IS PUBLISHED IN THE INTERNAL REVENUE BULLETIN]**, the QMFS may withdraw that ruling request and receive a refund of its user fee. However, the national office will process ruling requests pending on **[INSERT DATE THIS DOCUMENT IS PUBLISHED IN THE INTERNAL REVENUE BULLETIN]**, unless, prior to the earlier of **[INSERT DATE THAT IS 45 DAYS AFTER THE DATE THIS DOCUMENT IS PUBLISHED IN THE INTERNAL REVENUE BULLETIN]** or the issuance of the letter ruling, the QMFS notifies the national office that it will withdraw its ruling request.

DRAFTING INFORMATION

The principal author of this revenue procedure is Horace Howells of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this

revenue procedure, contact Horace Howells on (202) 622-3050 (not a toll-free call).