

## Internal Revenue Service

## Department of the Treasury

Number: **200404010**  
Release Date: 1/23/2004  
Index Number: 721.00-00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B03 - PLR-168272-02

Date:

October 20, 2003

P =

X =

LP1 =

LP2 =

LP3 =

LP4 =

LP5 =

LP6 =

LP7 =

PLR-168272-02

LP8 =LP9 =LP10 =LP11 =S12 =S13 =S14 =S15 =LP16 =LP17 =

PLR-168272-02

LP18 =

LP19 =

LP20 =

LP21 =

LP22 =

LP23 =

LP24 =

LP25 =

LP26 =

LP27 =

LP28 =

PLR-168272-02

LP29 =

LP30 =

LP31 =

LP32 =

LP33 =

LP34 =

LP35 =

LP36 =

LP37 =

LP38 =

PLR-168272-02

S39 =

LP40 =

LP41 =

Fund 1 =

Fund 2 =

Fund 3 =

Fund 4 =

Fund 5 =

Fund 6 =

Fund 7 =

Account 1 =

Account 2 =

Account 3 =

Account 4 =

Account 5 =

Account 6 =

State =

D1 =

PLR-168272-02

Dear \_\_\_\_\_ :

We received your letter dated December 13, 2002, and subsequent correspondence, submitted on behalf of P by P's authorized representatives, requesting certain rulings under § 721 of the Internal Revenue Code regarding the contribution of certain assets to P. This replies to your request.

### Facts

The information provided indicates P is a limited partnership, organized under State law on D1. P has one general partner, X, and 36 limited partners, LP1, LP2, LP3, LP4, LP5, LP6, LP7, LP8, LP9, LP10, LP11, LP16, LP17, LP18, LP19, LP20, LP21, LP22, LP23, LP24, LP25, LP26, LP27, LP28, LP29, LP30, LP31, LP32, LP33, LP34, LP35, LP36, LP37, LP38, LP40, and LP41.

X will contribute cash equaling less than one percent of the total value of the assets contributed by the limited partners to P. Each limited partner will contribute varying interests in seven hedge funds, Fund 1, Fund 2, Fund 3, Fund 4, Fund 5, Fund 6, and Fund 7 (Funds), all of which are partnerships, and six limited partners will contribute 100 percent of six accounts, Account 1, Account 2, Account 3, Account 4, Account 5, and Account 6 (Accounts), of investment portfolios in exchange for a partnership interest. No one limited partner has an interest in all seven of the Funds. All limited partners are trust funds except for one which is a corporation, LP6. LP6's shareholders include S12, S13, S14, S15, and S39. S12, S13, S14, S15, and S39 will not make a direct contribution to P and accordingly this ruling will not apply to them.

### Representations

P represents as follows with respect to each of the Funds and the Accounts to be contributed to P:

1. Fifty percent or more of the value of the each of the Funds are stock and securities and 80 percent or more of the value of the total assets of each of the Funds are held for investment. For purposes of this representation, the term "securities" has the meaning set forth in § 368(a)(2)(F)(vii).

2. The assets of each of the Funds and each of the Accounts constitute a diversified portfolio of stock and securities. For purposes of this representation, a portfolio of assets is diversified if it satisfies § 368(a)(2)(F)(ii), applying the relevant provisions of § 368(a)(2)(F), except that, in applying § 368(a)(2)(F)(iv), government securities are included in determining total assets, unless the government securities are acquired to meet § 368(a)(2)(F).

### Law

PLR-168272-02

Section 721(a) provides that no gain or loss shall be recognized to a partnership or to any of its partners when property is contributed to the partnership in exchange for an interest in the partnership.

Section 721(b) provides that § 721(a) shall not apply to gain realized on a transfer of property to a partnership that would be treated as an investment company (within the meaning of § 351) if the partnership were incorporated.

Under § 351(a) no gain or loss is recognized if one or more persons transfer property to a corporation solely in exchange for stock in the corporation and immediately after the exchange the transferors control the transferee corporation. Section 351(e) provides that § 351(a) shall not apply to a transfer of property to an investment company.

Section 1.351-1(c)(1) provides that a transfer to an investment company will occur when (i) the transfer results in diversification of the transferor's interest, and (ii) the transferee is a regulated investment company (RIC), a real estate investment trust (REIT), or a corporation more than 80 percent of the value of whose assets (excluding cash and nonconvertible debt obligations) are held for investment and are readily marketable stocks or securities or interests in RICs or REITs.

Section 1.351-1(c)(5) provides that a transfer ordinarily results in diversification if two or more persons transfer nonidentical assets to a corporation in the exchange. If any transaction involves one or more transfers of nonidentical assets which, taken in the aggregate, constitute an insignificant portion of the total value of the assets transferred, such transfer shall be disregarded in determining whether diversification has occurred.

Section 1.351-1(c)(6)(i) provides that a transfer of stocks and securities will not be treated as resulting in diversification if each transferor transfers a diversified portfolio of stocks and securities. A portfolio of stocks and securities is diversified if it satisfies the 25 percent and 50 percent tests of § 368(a)(2)(F)(ii), applying the relevant provisions of § 368(a)(2)(F). For this purpose, government securities are included in determining total assets, unless the government securities are acquired to meet § 368(a)(2)(F)(ii).

Under § 368(a)(2)(F)(ii) a transaction between two investment companies otherwise qualifying as a reorganization will not qualify as such for any corporation in the transaction that is not a RIC, REIT, or corporation with at least 50 percent of its assets comprised of stock or securities and 80 percent of its assets held for investment. A corporation satisfies the 25 percent and 50 percent tests of § 368(a)(2)(F)(ii) if not more than 25 percent of the value of its "total assets" is invested in the stock and securities of one issuer and not more than 50 percent of the value of its "total assets" is invested in the stock and securities of five or fewer issuers. For purposes of this clause, all members of a controlled group of corporations (within the meaning of §

PLR-168272-02

1563(a)) are treated as one issuer. Also, a person holding stock in an investment company (as defined by § 368(a)(2)(F)(iii)) is treated as holding its proportionate share of the assets held by the investment company. Under § 368(a)(2)(F)(iv) when determining “total assets” certain assets are excluded, including cash and cash items (including receivables) and government securities. Section 368(a)(2)(F)(vii) defines “securities” for purposes of § 368(a)(2)(F)(ii) and (iii).

### Rulings

Based on the information and representations submitted by P, we rule as follows:

1. The transfer of cash by X to P does not result in diversification. Consequently, the transfer of cash will not be considered a transfer to an investment company. Therefore, no gain or loss will be recognized by X under § 721(a).
2. The transfer of partnership interests in the Funds and assets from the Accounts by the limited partners does not result in a diversification of the portfolios transferred. Consequently, the transfer of the Funds and the Accounts will not be considered a transfer to an investment company. Therefore, no gain or loss will be recognized by P or the limited partners under § 721(a).

Except as specifically ruled upon above, we express or imply no opinion on the federal tax consequences of the transactions described above under any other provisions of the Code.

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

Pursuant to the power of attorney on file with this office, a copy of this letter is being sent to P.

Sincerely yours,

/s/

CHRISTINE ELLISON  
Chief, Branch 3  
Office of the Associate  
Chief Counsel  
(Passthroughs and Special  
Industries)

Enclosures: 2  
Copy of this letter



PLR-168272-02

Copy for section 6110 purposes

cc: