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Legend

Investment Manager =

Date 1 =

Date 2 =

Fund 1 =

Investor Group 1 =

1A =

1B =

1C =

1D =

Fund 2 =

Investor Group 2 =

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2A =

2B =

2C =

2D =

Fund 3 =

Investor Group 3 =

3A =

3B =

3C =

3D =

Fund 4 =

Investor Group 4 =

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4A	=
4B	=
4C	=
4D	=
State	=

Dear

This letter is in response to a request submitted on Date 1, and subsequent correspondence, on behalf of Investment Manager requesting rulings with respect to the operation of Fund 1, Fund 2, Fund 3, and Fund 4 (collectively “the Funds”). Specifically, rulings were requested that (i) Investment Manager may aggregate built-in gains and losses from qualified financial assets contributed to each Fund by a member of the Fund’s respective Investor Group with built-in gains and losses from revaluations of qualified financial assets held by each Fund for the purposes of making allocations under § 704(c)(1)(A) of the Internal Revenue Code and reverse § 704(c) allocations pursuant to § 1.704-3(e)(4); and (ii) Investment Manager’s method of making § 704(c)(1)(A) allocations and reverse § 704(c) allocations is reasonable within the meaning of § 1.704-3(e)(3).

FACTS

The following facts have been represented. Investment Manager is an investment adviser registered with the Securities and Exchange Commission pursuant to Section 203 of the Investment Advisers Act of 1940. Investment Manager currently serves as adviser to mutual funds. In addition, Investment Manager also manages individual, corporate, charitable, and retirement accounts pursuant to separate agreements with each investor. Pursuant to a plan to increase investment flexibility and return while also creating economies of scale, Investment Manager has formed the Funds. Investment Manager desires to transfer the assets of particular investors (collectively, an Investor Group) currently held in investment accounts to a Fund with investment objectives that are substantially similar to those of the respective investor.

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Each Fund is organized as a securities investment trust under the laws of State and is intended to be classified as a partnership for federal tax purposes. No Fund will be a publicly traded partnership under § 7704. Substantially all of the property of each Fund will consist of readily tradeable securities, and each Fund will qualify as a “securities partnership” within the meaning of § 1.704-3(e)(3)(iii). Investment Manager will continue its management activities with respect to the operation of each Fund.

Each Fund will maintain a single capital account for each investor. In accordance with § 1.704-1(b)(2)(iv)(f), each Fund will revalue its investment portfolio to fair market value as of the close of the last business day of each calendar month and at such other dates and such other times as may be required for any purpose determined by the trustee of the fund. Each Fund will adjust each investor’s capital account to reflect the investor’s share of the net change in the value of its portfolio of securities from the close of the prior valuation date to the close of the current valuation date. Each investor’s interest in a Fund will be equal to the ratio of the investor’s book capital account balance to the total of all book capital account balances of that particular Fund. Each Fund will use the partial netting method for making aggregate reverse § 704(c) allocations. The revaluations and the corresponding allocations of tax items that will be made by each Fund will not be made with a view to shifting the tax consequences of built-in gain or loss among the transferors in a manner that substantially reduces the present value of the transferors’ aggregate tax liability.

Investment Manager will transfer the assets held by members of Investor Group 1, consisting of a total of 1A lots of securities, to Fund 1. The securities had an aggregate fair market value as of Date 2 of 1B. On Date 2, the securities had an aggregate built-in gain of 1C and an aggregate built-in loss of 1D.

Investment Manager will transfer the assets held by members of Investor Group 2, consisting of a total of 2A lots of securities, to Fund 2. The securities had an aggregate fair market value as of Date 2 of 2B. On Date 2, the securities had an aggregate built-in gain of 2C and an aggregate built-in loss of 2D.

Investment Manager will transfer the assets held by members of Investor Group 3, consisting of a total of 3A lots of securities, to Fund 3. The securities had an aggregate fair market value as of Date 2 of 3B. On Date 2, the securities had an aggregate built-in gain of 3C and an aggregate built-in loss of 3D.

Investment Manager will transfer the assets held by members of Investor Group 4, consisting of a total of 4A lots of securities, to Fund 4. The securities had an aggregate fair market value as of Date 2 of 4B. On Date 2, the securities had an aggregate built-in gain of 4C and an aggregate built-in loss of 4D.

DISCUSSION

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Section 704(c)(1)(A) provides that income, gain, loss, and deduction with respect to property contributed to the partnership by a partner is shared among the partners so as to take account of the variation between the basis of the property to the partnership and its fair market value at the time of contribution.

Section 1.704-3(a)(1) states that the purpose of § 704(c) is to prevent the shifting of tax consequences among partners with respect to precontribution gain or loss. Under § 704(c) a partnership must allocate income, gain, loss, and deductions with respect to property contributed by a partner to the partnership 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 contribution. This allocation must be made using any reasonable method that is consistent with the purpose of § 704(c).

Section 1.704-3(a)(6) provides that the principles of § 1.704-3 apply to allocations with respect to property for which differences between book value and adjusted tax basis are created when a partnership revalues partnership property pursuant to § 1.704-1(b)(2)(iv)(f) (reverse § 704(c) allocations). A partnership that makes allocations with respect to revalued property must use a reasonable method that is consistent with the purposes of § 704(b) and (c).

Section 1.704-3(a)(2) indicates that § 704(c) generally applies on a property-by-property basis. Therefore, in determining whether there is a disparity between adjusted tax basis and fair market value, the built-in gains and built-in losses on items of contributed or revalued property generally cannot be aggregated.

Section 1.704-3(e)(3) sets forth a special rule allowing certain securities partnerships 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 gains and losses from qualified financial assets using any reasonable approach that is consistent with the purpose of § 704(c). Section 1.704-3(e)(3)(i) identifies the approach that Investment Manager will use for aggregating reverse § 704(c) gains for each Fund as generally reasonable. Once a partnership adopts an aggregate approach, the partnership must apply the same aggregate approach to all of its qualified financial assets for all taxable years in which the partnership qualifies as a securities partnership.

Section 1.704-3(e)(3)(iii)(A) defines a securities partnership as a partnership that is either a management company or an investment partnership, and that makes all of its book allocations in proportion to the partners' relative book capital accounts.

Section 1.704-3(e)(3)(ii) defines qualified financial assets as any personal property (including stock) that is actively traded, as defined in § 1.1092(d)-1 (defining actively traded personal property for purposes of the straddle rules).

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The aggregate approaches described in § 1.704-3(e)(3) generally apply only to reverse § 704(c) allocations; thus, a securities partnership using an aggregate approach must generally account for any built-in gain or loss from contributed property separately. The preamble to § 1.704-3(e)(3) explains that the final regulations do not authorize aggregation of built-in gains and losses from contributed property with built-in gains and losses from revaluations because this type of aggregation can lead to substantial distortions in the character and timing of income and loss recognized by contributing partners. T.D. 8585, 1995-1 C.B. 120, 123. However, the preamble also recognizes that there may be instances in which the likelihood of character and timing distortions is minimal and the burden of making § 704(c) allocations separate from reverse § 704(c) allocations is great. Consequently, § 1.704-3(e)(4)(iii) authorizes the Commissioner to permit, by published guidance or by letter ruling, aggregation of qualified financial assets for purposes of making § 704(c) allocations in the same manner as that described in § 1.704-3(e)(3).

In this case, the burden of making § 704(c) allocations separate from reverse § 704(c) allocations is represented to be substantial. Each of the Funds will receive large contributions of securities. Unless the Commissioner permits the Funds to aggregate § 704(c) gains and losses with reverse § 704(c) gains and losses, the Funds will have to track pre-contribution unrealized gains and losses on a property-by-property basis, largely nullifying the benefits of the aggregate approach for making reverse § 704(c) allocations. Furthermore, the common investment objectives among the members of each Investment Group and the characteristics of the assets to be contributed to each Fund reduce the likelihood of abuse of an aggregate approach.

CONCLUSION

After applying the relevant law to the facts presented and the representations made, we conclude that Investment Manager, in conducting the operations of the Funds, may aggregate built-in gains and losses from qualified financial assets contributed to each Fund by members of each Fund's respective Investment Group with built-in gains and losses from revaluations of qualified financial assets held by each Fund for purposes of making § 704(c)(1)(A) and reverse § 704(c) allocations. In addition, we conclude that Investment Manager's method of making § 704(c)(1)(A) allocations and reverse § 704(c) allocations is reasonable within the meaning of § 1.704-3(e)(3).

Except as specifically ruled above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provision of the Code. Specifically, no opinion is expressed concerning the aggregation of built-in gains and losses from assets contributed to any Fund except as detailed above. In addition, no opinion is expressed on whether any transfer to a Fund is taxable under § 721(b) or on the representation that the Funds are not publicly traded partnerships.

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This letter is issued only to the person who requested it. Under § 6110(k)(3), it may not be used or cited as precedent.

Pursuant to a power of attorney on file with this office, a copy of this ruling is being sent to your authorized representative.

Sincerely yours,

Jeff Erickson
Assistant to the Branch Chief,
Branch 3
Office of the Assistant Chief
Counsel
(Passthroughs and Special
Industries)

Enclosures:
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