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Person to Contact:

Telephone Number:

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Legend

Portfolio	=
State	=
Fund 1	=
Fund 2	=
Fund 3	=
Fund 4	=
Fund 5	=
X	=
Target	=
D1	=
D2	=
N1	=
N2	=
N3	=

This responds to the April 25, 2000 letter, and subsequent correspondence, submitted on behalf of Portfolio, requesting a ruling under § 704(c) of the Internal Revenue Code. Specifically, a ruling has been requested that Portfolio may aggregate built-in gains and losses from qualified financial assets contributed to Portfolio with built-in gains and losses from revaluations of qualified financial assets held by Portfolio, for purposes of making § 704(c)(1)(A) and reverse § 704(c) allocations.

FACTS

Portfolio was organized as an unincorporated trust under the laws of State pursuant to a Declaration of Trust, under which the Board of Trustees are authorized to issue shares of beneficial interest in Portfolio. Portfolio is registered as an open-end management investment company under the Investment Company Act of 1940 (1940 Act), and is classified as a partnership for federal tax purposes.

Portfolio serves as an investment vehicle for Fund 1, Fund 2, Fund 3, Fund 4, and Fund 5 (the Funds). The Funds, along with X, are the current partners in Portfolio.

In the future, Portfolio may have additional contributing partners.

Each Fund is a series in a business trust or is a business corporation that is registered as an open-end management investment company under the 1940 Act. Each Fund has elected to be taxed as a regulated investment company (RIC) under § 851 of the Code, and intends to operate in a manner that continues to qualify it as a RIC.

In general, each Fund contributes cash to Portfolio in exchange for an interest in Portfolio. The Funds invest substantially all of their assets available for investment in Portfolio. The Funds that are open-end funds issue additional shares from time to time and invest all or a portion of the cash in Portfolio. Investors in such open-end Funds are able to have their interests in the related Fund redeemed. The additional investments and redemptions may occur on a daily basis. For purposes of making reverse § 704(c) allocations occasioned by such additional investments and redemptions, Portfolio applies § 1.704-3(e)(3) of the Income Tax Regulations and aggregates gains and losses from qualified financial assets. In particular, Portfolio aggregates reverse § 704(c) allocations pursuant to § 1.704-3(e)(3)(v).

Except as required by §§ 704(c) and 1.704-3, each partner is allocated a pro rata share Portfolio's income, gain, loss, deduction and credit in accordance with the regulations under § 704(b). Portfolio maintains a single capital account for each of its partners. Capital account balances are stated in standard units that represent the partner's shares in Portfolio. Increases and decreases in the size of a partner's investment in Portfolio are accomplished by adjustments to that partner's capital account that may occur on a daily basis.

On or about D1, Fund 1 intends to acquire substantially all of Target's assets in exchange for voting common stock of Fund 1 in a transaction that qualifies as a reorganization under § 368(a)(1)(C). Target is an open-end management investment fund that is registered under the 1940 Act and qualifies as a RIC. Fund 1 will contribute the assets of Target to Portfolio in exchange for additional shares in Portfolio. The contributed assets will be a diversified portfolio of stocks of the S&P 500 Companies and will have built-in gains and losses to which § 704(c) will apply. As of D2, the fair market value of such assets was N1. It is expected that the contributed assets will include stocks of N2 of the S&P 500 Companies. The individual stock holdings will consist of N3 separate tax lots acquired at various prices on different dates.

Portfolio represents the following:

(1) Portfolio's burden of making § 704(c) allocations separate from reverse § 704(c) allocations is substantial, and that without permission to aggregate § 704(c) gains and losses with reverse § 704(c) gains and losses, Portfolio will have to track pre-contribution unrealized gains and losses on a property-by-property basis (stock by stock

and lot by lot), largely nullifying the benefits of the aggregate approach for making reverse § 704(c) allocations;

(2) Portfolio invests in qualified financial assets within the meaning of § 1.704-3(e)(3)(iii); and

(3) Portfolio's revaluations and the corresponding allocations of tax items are not made with a view toward 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.

LAW AND ANALYSIS

Section 704(c) provides that a partnership must allocate income, gain, loss, and deduction 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. The purpose of § 704(c) is to prevent the shifting of tax consequences among partners with respect to pre-contribution gain or loss. Section 1.704-3(a)(1).

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 under § 1.704-1(b)(2)(iv)(f) (reverse § 704(c) allocations).

Section 704(c) allocations and reverse § 704(c) allocations must be made using a reasonable method that is consistent with the purpose of § 704(c). Sections 1.704-3(a)(1) and 1.704-3(a)(6).

Section 1.704-3(a)(2) indicates that § 704(c) generally applies on a property-by-property basis. Therefore, in determining whether a disparity exists 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 Portfolio will use for aggregating reverse § 704(c) gains 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. Under § 1.704-3(e)(3)(iii)(B)(1), a partnership is a management company if it is registered as a management company under the 1940 Act.

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). For a management company, qualified financial assets also include the following, even if not actively traded: shares of stock in a corporation; notes, bonds, debentures, or other evidences of indebtedness; interest rate, currency, or equity notional principal contracts; evidence of an interest in , or derivative financial instruments in, any security, currency, or commodity, including any option, forward or futures contract, or short position, or any similar financial instrument.

The aggregation rules of § 1.704-3(e)(3) generally apply only to reverse § 704(c) allocations. Therefore, 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 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).

CONCLUSIONS

Based solely upon the information submitted and the representations made, we conclude that Portfolio may aggregate built-in gains and losses from the qualified financial assets acquired by Fund 1 from Target, and contributed to Portfolio by Fund 1, with built-in gains and losses from revaluations of qualified financial assets held by Portfolio for purposes of making § 704(c)(1)(A) and reverse § 704(c) allocations.

We further conclude that Portfolio may aggregate built-in gains and losses from qualified financial assets contributed by partners with built-in gains and losses from revaluations of qualified financial assets for purposes of making § 704(c)(1)(A) and reverse § 704(c) allocations to the extent that the partners are qualified contributors. A qualified contributor is partner which satisfies the following conditions: (1) the partner is

registered under the 1940 Act and would be considered a "publically offered regulated investment company" as defined in §§ 67(c)(2)(B) and 1.67-2T(g)(3)(ii); (2) the contribution is made and accepted for valid business purposes (and not made primarily for tax motivated reasons (other than the fact that the contribution to Portfolio is tax-free)); and (3) to the extent Portfolio relies on this ruling for the contribution, Portfolio will document any such contribution on its tax return filed subsequent to the contribution.

This ruling is limited to allocations of gain or loss from the sale or other disposition of qualified financial assets made under §§ 704(b), 704(c)(1)(A), and 1.704-3(a)(6).

Except as specifically ruled upon above, we express no opinion on the federal tax consequences of the transactions described above under any other provisions of the Code and regulations, or about the tax treatment of any conditions existing at the time of, or effects resulting from, any transaction(s) that are not specifically covered by this ruling. Specifically, we express no opinion concerning: (1) whether any Fund qualifies as a RIC under § 851; (2) the aggregation of built-in gains and losses from qualified financial assets contributed to Portfolio other than the contribution by Fund 1 of Target's assets and any contributions by partners that qualify as Qualified Contributors; and (3) the tax consequences of Fund 1's contribution of assets to Portfolio, including whether the transfer of assets is taxable under § 721(b). In addition, Portfolio must maintain sufficient records to enable it and its partners to comply with §§ 704(c)(1)(b) and 737.

This ruling is directed only to the taxpayer 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 ruling is being sent to your authorized representative.

Sincerely,
/s/ David R. Haglund
Senior Technician Reviewer, Branch 1
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes