Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

Refer Reply To:
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Date:
September 02, 2005

In Re:

Corp =

Partnership =

Taxpayer =

LLC 1 =

Trust =

Trustee =

LLC 2 =

Advisor =

Country A =

Area A =

Area B =

Currency A =

Dear and :

This is in response to your letter dated April 22, 2005, in which you request a ruling under Treas. Reg. § 1.985-1(b)(1)(iii) that Taxpayer, LLC 1, Trust, Trustee, and LLC2 may use a currency other than the U.S. dollar as their functional currency. Specifically, you request a ruling that permits each entity to determine its functional currency by applying the principles used to determine the functional currency of a qualified business unit that is not required to use the dollar as set forth in Treas. Reg. § 1.985-1(c).

The ruling contained in this letter is predicated upon facts and representations submitted by the Taxpayer and accompanied by a penalties of perjury statement executed by the appropriate party. This office has not verified any of the material submitted in support of the request for a ruling. Verification of factual information, representations and other data may be required as part of the audit process. Taxpayer has represented the facts described below.

FACTS:

Corp is a U.S. corporation that has elected to be taxed as a real estate investment trust ("REIT") under subchapter M of the Internal Revenue Code. Corp owns general and limited partnership interests in Partnership, a U.S. limited partnership. Partnership owns 100% of the membership interests in Taxpayer.

Taxpayer is a U.S. limited liability company that intends to elect to be taxed as a REIT under subchapter M of the Internal Revenue Code. Taxpayer owns LLC 1, a U.S. limited liability company.

LLC 1 owns a 50% beneficial interest in Trust, a property unit trust formed under the laws of Area B which is treated as a partnership for U.S. tax purposes. The trustee of LLC 1 is Trustee, an Area B entity treated as a partnership for U.S. income tax purposes. Taxpayer owns 50% of Trustee. Taxpayer also owns 100% of the membership interests in LLC2, a U.S. limited liability company, and 100% of Advisor. Taxpayer represents that Advisor will provide property management services to Trust.

Taxpayer's assets include its interests in LLC1, Trustee, LLC2, and Advisor and loans to Trustee on behalf of Trust. LLC1's only significant asset will be its beneficial interest in Trust. LLC2's only significant asset will be property it is contemplating developing in Country A. Trustee will not have any significant assets. Taxpayer may acquire additional projects in Area A.

Taxpayer represents that the majority of the transactions of Taxpayer, LLC 1, Trust, Trustee, and LLC2 will be conducted in Currency A. Specifically, Taxpayer represents that the following will be conducted in Currency A: paying invoices, borrowing funds, and entering into leases. Additionally, Taxpayer represents that all significant revenues

and expenses will be incurred in Currency A. Taxpayer anticipates that a small amount of administrative expenses may be satisfied in the U.S. dollar.

Taxpayer represents that the activities of Taxpayer, LLC1, and LLC2 will be limited to receiving capital contributions and loan proceeds, making capital contributions and loans, receiving distributions, and performing administrative acts. With the exception of certain administrative expenses, these transactions will be conducted in Currency A.

Taxpayer, LLC1, LLC2, and Trustee will not have any employees. Trust will only have Area A-based employees. Taxpayer, LLC1, LLC2, Trust, and Trustee will not conduct a trade or business in the United States. These entities will maintain separate books and records in Currency A.

LAW:

In general, section 985 provides that all determinations for Federal income tax purposes shall be made in the taxpayer's functional currency. Section 985(a). Treas. Reg. § 1.985-1(b)(1)(iii) provides that except as otherwise provided by ruling or administrative pronouncement, the U.S. dollar shall be the functional currency of a QBU that has the United States as its residence as defined in section 988(a)(3)(B). Treas. Reg. § 1.989(a)-1(b)(2)(i) provides that a corporation is a QBU, a partnership is a QBU of a partner, and a trust is a QBU of a beneficiary.

An eligible entity that files an election under section 856(c)(1) to be treated as a real estate investment trust is treated as having made an election to be classified as an association as of the first day the entity is treated as a real estate investment trust. Treas. Reg. §301.7701-3(c)(1)(v)(B). An association as determined under Treas. Reg. §301.7701-3 is a corporation. Treas. Reg. §301.7701-2(b)(2).

Section 988(a)(3)(B)(i)(II) provides that the United States shall be the residence of a corporation, partnership or trust which is a United States person. Section 988(a)(3)(B)(i)(III) states that generally the residence of a corporation or partnership which is not a United States person shall be a country other than the United States. Section 988(a)(3)(B)(ii) states an exception to the above rule, that in the case of a QBU of any taxpayer, the residence of such unit shall be the country in which the principal place of business of the QBU is located.

Section 7701(a)(30) provides, in part, that the term "United States person" means a domestic corporation. Section 7701(a)(4) provides that the term "domestic," as applied to a corporation, means created or organized in the United States or under the law of the United States or any State. See also Treas. Reg. § 1.988-4(d)(1)(ii).

Treas. Reg. § 1.985-1(c)(1) provides that if a QBU is not required to use the dollar as its functional currency, then its functional currency shall be the currency of the economic environment in which a significant part of the QBU's activities are conducted, if the QBU

keeps, or is presumed to keep, its books and records in such currency. Treas. Reg. § 1.985-1(c)(2) provides that the economic environment in which a significant part of the QBU's activities are conducted shall be determined by taking into account all the facts and circumstances. Treas. Reg. § 1.985-1(c)(2)(i) sets forth a non-inclusive list of facts and circumstances which are considered when determining the economic environment in which a significant part of the QBU's activities are conducted.

The General Explanation of the Tax Reform Act of 1986 states that "[i]n appropriate circumstances, a domestic QBU (such as a regulated investment company organized to invest in securities denominated in a specific currency) may have a foreign currency as the functional currency." Staff of the Joint Committee on Taxation, 100th Cong., 1st Sess., General Explanation of the Tax Reform Act of 1986, at 1093-94 (Comm. Print 1987).

ANALYSIS:

If Taxpayer is required to use the U.S. dollar as its functional currency pursuant to Treas. Reg. § 1.985-1(b)(1)(iii), it would recognize foreign currency gain or loss on every section 988 transaction because such transactions would be denominated in Currency A, which would be a non-functional currency to it. See section 988 and Treas. Reg. § 1.988-1(a). Moreover, any QBU of Taxpayer with a currency other than the dollar as its functional currency would generally be subject to section 987. Since foreign currency gain or loss is not expressly listed as qualifying income in sections 856(c)(2) or 856(c)(3), and since currency fluctuations could affect the valuation of assets under section 856(c)(4), Taxpayer risks losing its REIT status if it is not permitted to adopt Currency A as its functional currency.

If the ruling requested herein is issued, the functional currency of Taxpayer, LLC 1, Trust, Trustee, and LLC2 would be determined by applying the principles of Treas. Reg. § 1.985-1(c). Under these principles, Taxpayer, LLC 1, Trust, Trustee, and LLC2 would each be eligible to adopt Currency A as their functional currency. This conclusion is consistent with the language contained in the General Explanation of the Tax Reform Act of 1986 as set forth above.

Based solely on the facts and representations submitted, Taxpayer may apply the principles of Treas. Reg. § 1.985-1(c)(2) to determine its functional currency. LLC1, LLC2, Trust, and Trustee may also apply the principles of Treas. Reg. § 1.985-1(c)(2) to determine their functional currency. Should each of the above entities properly adopt Currency A as its functional currency, it will compute its taxable income or loss in that currency and translate its taxable income into dollars using the average exchange rate for the taxable year.

No opinion is expressed regarding the proper functional currency of Taxpayer, LLC1, Trust, Trustee, or LLC2 under the principles of Treas. Reg. § 1.985-1(c).

No opinion is expressed whether Taxpayer or any entity referred to herein qualifies as a real estate investment trust under section 856.

No opinion is expressed regarding the character of dividends or other income distributed by Taxpayer to U.S. investors, or the character of income or loss realized on the sale by investors of their ownership interest in Taxpayer.

No opinion is expressed regarding the treatment of foreign currency received as dividends in the hands of the shareholders of Taxpayer.

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

It is important that a copy of this letter be attached to the Federal income tax return of the taxpayers involved for the taxable year in which the determination covered by this letter is made.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the Taxpayer.

Sincerely,

_____
Theodore Setzer
Senior Counsel, Branch 5 International

cc: