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Date:
March 17, 2000

Legend

Portfolio =

Trust =

Fund 1 =

Fund 2 =

Fund 3 =

Fund 4 =

Co-administrator =

Advisor =

State =

Declaration =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

$a =

This letter responds to your submission of September 15, 1999, together with subsequent correspondence, in which you requested certain rulings under §§ 704, 721, 851, and 7704 of the Internal Revenue Code.

Facts

Portfolio is a series of Trust, which was organized as a business trust under the laws of State pursuant to the Declaration of Trust. The Trust is registered as an open-end, management investment company under the Investment Company Act of 1940 (1940 Act).

Portfolio is a separate business trust under the laws of State, which recognize that separate trusts established under a single instrument with common trustees are independent legal entities. Portfolio is registered as a series fund, an open-end management investment company under the 1940 Act. Portfolio is classified as a partnership under § 301.7701-3(b)(1)(i) of the Procedure and Administration Regulations. Co-administrator is a co-administrator of Portfolio.

Portfolio serves as an investment vehicle for Fund 1, Fund 2, Fund 3, and Fund 4 (the Funds). Each Fund is a series in a business trust or business corporation that is an open-end, management investment company under the 1940 Act. Each Fund invests substantially all of its assets available for investment in Portfolio, and has the same investment objective as Portfolio. Each Fund is treated as a corporation for federal income tax purposes, and has elected (or will elect) to be taxed as a regulated investment company (RIC) under part I of subchapter M of chapter 1 of subtitle A of the Code. Each Fund intends to be operated in a manner which would permit it to continue to qualify as a RIC.

On Date 1, Co-administrator became a partner in Portfolio in exchange for cash, and Fund 1 became a partner in Portfolio in exchange for securities and other assets with a fair market value of $a. On Date 2, Fund 2 became a partner in Portfolio in exchange for cash. On Date 3, Fund 3 became a partner in Portfolio in exchange for cash. On Date 4, Fund 4 became a partner in Portfolio in exchange for cash.

Beneficial interests in Portfolio are issued solely in private placement transactions that do not involve any “public offering” within the meaning of section 4(2) of the Securities Act of 1933, as amended (1933 Act). Portfolio will not register its shares under the 1933 Act, because shares in Portfolio may be issued solely in private placement transactions that do not involve any “public offering” within the meaning of section 4(2) of the 1933 Act. Investments in Portfolio only may be made by investment companies or certain other entities that are “accredited investors” within the meaning of Regulation D under the 1933 Act. The interest of each partner in Portfolio is limited to the net assets of Portfolio and does not extend to the assets of any other investment vehicles of Trust. Portfolio has not invested in any of Trust's other investment vehicles, nor are any of Trust's other investment vehicles invested in Portfolio.

Except as required by § 704(c) and §1.704-1(b)(4), each partner will be allocated a pro rata share of partnership income, gain, loss, deduction and credit in accordance with the regulations under § 704(b). Each partner's initial capital account balance will be the amount of money and the fair market value of the property contributed to Portfolio by the partner. Under § 1.704-1(b)(2)(iv)(f), Portfolio will revalue its investment portfolio to fair market value as of the close of each day. Portfolio will adjust each partner's capital account to reflect the partner's share of the net change in the value of its portfolio of securities from the close of the prior day to the close of the current day. Portfolio intends to qualify as a securities partnership under §1.704-3(e)(3)(iii).

The number of partners in Portfolio will be limited to 100 or fewer calculated pursuant to §1.7704-1(h).

Portfolio has made the following additional representations:

(1) Each of the Funds has contributed, or will contribute, either solely cash and/or a portfolio of stocks and securities that meets the diversification requirements of § 368(a)(2)(F)(ii) and § 1.351-1(c)(6). For purposes of this test, Government securities are not included within the meaning of "securities" under § 368(a)(2)(F)(ii), but are included within the meaning of total "assets" in § 368(a)(2)(F)(iv).

(2) Cash contributed by Co-Administrator and each Fund has been and will be used only to carry on the normal operating and investment activities of Portfolio. Normal operating activities would include payment of partnership level expenses and periodic withdrawals of partnership capital. Normal investment activities would consist only of investments that are consistent with the Portfolio holding itself out to investors as a money market fund, which is a type of investment fund that seeks to provide investors with a high level of income, while preserving capital and liquidity, by investing in high quality, short-term investments.

(3) For purposes of determining the required distribution under § 4982(a)(1), each Fund will account for its share of partnership items of income, gain, loss, and deduction as they are taken into account by Portfolio as required by Rev. Rul. 94-40.

(4) The organization of Portfolio was done in a manner to enable it to be classified as a partnership and was not done to enable a partner that is a RIC to make distributions that would be prohibited under Rev. Rul. 89-81 had the RIC invested directly in the assets of Portfolio.

(5) Portfolio intends to invest its assets in a manner that will allow each Fund that invests in Portfolio to meet the requirements specified for RICs in § 851(b).

Law and Analysis

Ruling # 1

Portfolio and Funds have requested a ruling that Portfolio will not be a "publicly traded partnership" within the meaning of § 7704(b).

Section 7704(a) provides that a publicly traded partnership is treated as a corporation. Section 7704(b) and § 1.7704-1(a) provide that, for purposes of § 7704, the term "publicly traded partnership" means any partnership if interests in the partnership are (1) traded on an established securities market, or (2) readily tradable on a secondary market or the substantial equivalent thereof.

Section 1.7704-1(c)(1) provides that interests in a partnership are readily tradable on a secondary market or the substantial equivalent thereof if, taking into account all of the facts and circumstances, the partners are readily able to buy, sell, or exchange their partnership interests in a manner that is comparable economically to trading on an established securities market.

Section 1.7704-1(h)(1) provides that interests in a partnership are not readily tradable on a secondary market or the substantial equivalent thereof for purposes of § 7704(b) if: (i) all interests in the partnership were issued in a transaction (or transactions) that was not required to be registered under the 1933 Act; and (ii) the partnership does not have more than 100 partners at any time during the taxable year.

Section 1.7704-1(h)(3) provides that, for purposes of § 1.7704-1(h)(1), a person owning an interest in a partnership, grantor trust, or S corporation (flow-through entity) that owns, directly or through other flow-through entities, an interest in the partnership, is treated as a partner in the partnership only if: (i) substantially all of the value of the beneficial owner's interest in the flow-through entity is attributable to the flow-through entity's interest (direct or indirect) in the partnership and (ii) a principal purpose of the use of the tiered arrangement is to permit the partnership to satisfy the 100-partner limitation of § 1.7704-1(h)(1)(ii).

Portfolio has represented that the number of partners in Portfolio will be limited to 100 or fewer calculated pursuant to §1.7704-1(h). No interest in Portfolio has been or will be issued in a transaction (or transactions) required to be registered under the 1933 Act. Accordingly, Portfolio will not be a "publicly traded partnership" within the meaning of § 7704(b).

Ruling # 2

Portfolio and Funds have requested rulings that the transfers of property to Portfolio by the Funds would not be transfers to an investment company within the meaning of § 351 and § 1.351-1(c) if Portfolio were incorporated.

Section 721 (a) provides that neither a partner nor a partnership will recognize gain or loss on a contribution of assets to a partnership in exchange for a partnership interest. Section 721(b) provides that subsection (a) shall not apply to gain realized on a transfer of property to a partnership which would be treated as an investment company (within the meaning of § 351) if the partnership were incorporated.

Section 351 (a) provides that no gain or loss will be recognized if one or more persons transfers property to a corporation solely in exchange for stock or securities in the corporation and immediately after the exchange the transferors control the transferee corporation. Section 351(e)(1) provides that § 351(a) will 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, directly or indirectly, in diversification of the transferors' interests and (ii) the transferee is a regulated investment company (RIC), real estate investment trust (REIT), or a corporation more than 80 percent of the value of whose assets (excluding cash and non-convertible debt obligations from consideration) are held for investment and are readily marketable stocks or securities, or interests in RICs or REITs.

Section 1002 of the Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 788 (1997) (the Act), amends § 351(e) for transfers after June 8, 1997, in taxable years ending after such date, subject to certain transitional relief provisions. Section 1002 of the Act is intended to expand the types of assets considered in determining whether a transfer is to a transferee described in § 1.351-1(c)(1)(ii)(c) to include certain assets in addition to "readily marketable stocks or securities" and interests in RICs or REITs. However, the Act is not in intended to alter the requirement of § 1.351-1(c)(1)(i) that a transfer of property will be considered to be a transfer to an investment company under § 351(e) only if the transfer results, directly or indirectly, in diversification of the transferors' interests. See S. Rep. No. 105- 33, 105th Cong., 1st Sess. 131 (1997); H.R. Rep. No. 105-148, 105th Cong., 1st Sess., 447 (1997); H.R. Rep. No. 105-220, 105th Cong., 1st Sess. 516-17 (1997).

Section 1.351-1(c)(5) provides that a transfer ordinarily results in diversification of the transferors' interests if two or more persons transfer nonidentical assets to a corporation in the exchange. It further provides that, if a transfer is part of a plan to achieve diversification without recognition of gain, such as a plan which contemplates a subsequent transfer, however delayed, of the corporate assets (or of the stock or securities received in the earlier exchange) to an investment company in a transaction purporting to qualify for nonrecognition treatment, the original transfer will be treated as resulting in diversification. Rev. Rul. 87-9, 1987-1 C.B. 133, provides that a transfer to a corporation of shares of corporation Y stock by one transferor, and a transfer of cash by another transferor will be treated as a transfer of nonidentical assets under § 1.351-1(c).

Section 1.351-1(c)(6)(i) provides that (1) a transfer of stocks and securities will not be treated as resulting in a diversification of the transferors' interests if each transferor transfers a diversified portfolio of stocks and securities and (2) a portfolio of stocks and securities is considered to be diversified if it satisfies the 25- and 50-percent tests of § 368(a)(2)(F)(ii), applying the relevant provisions of § 368(a)(2)(F), except that government securities are included in total assets for purposes of the denominator of the 25- and 50-percent tests (unless acquired to meet the 25- and 50-percent tests), but are not treated as securities of an issuer for purpose of the numerator of the 25- and 50-percent tests.

An investment company is diversified within the meaning of § 368(a)(2)(F)(ii) if not more than 25 percent of the value of its assets is invested in the stock and securities of any 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.

After applying the law to the facts submitted and representations made, we conclude that the transfers of property to Portfolio by the Funds would not be transfers to an investment company within the meaning of § 351 and § 1.351-1(c) if Portfolio were incorporated, provided that these are the only transfers to Portfolio (except for transfers solely of cash and/or a diversified portfolio of stocks and securities). However, we express no opinion about whether subsequent transfers of stock and securities to Portfolio by any transferor will affect the tax consequences of the original transfers.

Ruling # 3

Portfolio and Funds have requested a ruling that a Fund holding a beneficial interest in Portfolio is deemed to own a proportionate share of each of the assets and earn a proportionate share of partnership income in Portfolio attributable to that share for purposes of determining whether the Fund satisfies the requirements of §§ 851(b)(2) and 851(b)(3) of the Code.

Section 851(a) defines a RIC, in part, as a domestic corporation registered under the 1940 Act as a management company.

Section 851(b) limits the definition of a RIC to a corporation meeting certain election, gross income, and diversification requirements.

Section 851(b)(2) of the Code provides that, to qualify as a RIC, 90 percent of a corporation's gross income must be derived from dividends, interest, payments with respect to securities loans (as defined in § 512(a)(5)), gains from the sale or other disposition of stocks, securities, foreign currencies, or other income derived with respect to the business of investing in such stocks, securities, or currencies.

Section 851(b)(3)(A) of the Code requires that, to qualify as a RIC, at the close of each quarter of the taxable year, at least 50 percent of the value of a corporation's total assets must be represented by cash and cash items (including receivables), Government securities, securities of other RICs, and other securities generally limited in respect of one issuer to an amount not greater in value than 5 percent of the value of the total assets of the corporation and to not more than 10 percent of the outstanding voting securities of such issuer.

Section 851(b)(3)(B) of the Code provides that, to qualify as a RIC, not more than 25 percent of the corporation's total assets may be invested in the securities (other than Government securities and securities of other RICs) of any one issuer, or two or more issuers that the corporation controls and which are determined, under regulations, to be engaged in the same or similar trades or businesses or related trades or businesses.

Section 702(b) of the Code provides that the character of items stated in § 702(a) that are included in a partner's distributive share shall be determined as if such items were realized directly from the source from which realized by the partnership, or incurred in the same manner as incurred by the partnership. Section 702(c) provides that where it is necessary to determine the amount or character of the gross income of a partner, such amount shall include his distributive share of the gross income of the partnership.

Section 1006(n)(1) of the Technical and Miscellaneous Revenue Act of 1988 added a sentence to the flush language of § 851(b) of the Code that states that income derived from a partnership or trust shall be treated as satisfying the 90 percent test of § 851(b)(2) only to the extent that such income is attributable to items of income of the partnership or trust which would be described in § 851(b)(2) if earned directly by the RIC. The legislative history of that sentence indicates that it was intended to clarify the general rule used to characterize items of income, gain, loss, deduction, or credit includible in a partner's distributive share, as applied to RICs that are partners. It therefore explains the relationship of § 702 to the 90 percent test under § 851(b)(2). See S. Rep. No. 445, 100th Cong., 2d Sess. 78 (1988).

Under subchapter K of the Code, a partnership is considered to be either an aggregate of its members or a separate entity. Under the aggregate approach, each partner is treated as an owner of an undivided interest in partnership assets and operations. The entity theory provides that the partnership is a separate entity in which partners have no direct interest in partnership assets and operations. See S. Rep. No. 1622, 83d Cong., 2d Sess. 89 (1954) and H.R. Rep. No. 2543, 83d Cong., 2d Sess. 59 (1954).

In order for the Funds to qualify as RICs under the diversification tests of § 851 of the Code, the aggregate approach will have to be applied to each Fund's partnership interest in Portfolio. As an aggregate, each Fund will be able to take into account its share of the individual items of income and assets of Portfolio.

Rev. Rul. 75-62, 1975-1 C.B. 188, concerns a life insurance company that contributed cash to a partnership in exchange for a 50 percent interest in the partnership. The partnership held real estate as its principal asset. For the taxable year in question, § 805(b) of the Code required life insurance companies to value their assets each taxable year. For this purpose, § 805(b)(4) required that shares of stock and real estate be valued at their fair market values, and that other assets be valued at their adjusted basis. The issue presented in the ruling is whether, for purposes of § 805(b)(4), the life insurance company's interest in the partnership is considered to be an investment in the real estate held by the partnership (an aggregate approach), or an investment in other property (an entity approach).

Rev. Rul. 75-62, holds that the partnership interest held by the life insurance company must be accounted for as other property for purposes of § 805(b)(4). The ruling cites §§ 705 and 741 of the Code, both of which generally treat an interest in a partnership as an interest in an entity, as evidence of an intent in subchapter K to take the entity approach in questions concerning the nature of an interest in a partnership. The ruling states that the legislative history of § 805(b)(4) does not indicate that application of the entity approach to the facts of the ruling is inappropriate and that there is no compelling reason to take the aggregate approach.

The flush language of § 851(b) and its legislative history indicate that here, unlike the situation described in Rev. Rul. 75-62, Congress intended that an aggregate approach be taken in determining the nature of the partnership interests held by the Funds. The flush language of § 851(b) mandates an aggregate approach in applying the 90 percent gross income test of § 851(b)(2) to RICs that hold partnership interests. It would be anomalous to suggest that Congress intended that a RIC's interest in a partnership be viewed as a direct investment in the partnership's assets for purposes of the § 851(b)(2) test but not be viewed as a direct investment in those assets for purposes of the tests set out in, inter alia, § 851(b)(3).

The tax treatment accorded real estate investment trusts (REITs) lends further support to applying the aggregate approach to the present case. REITs were created to provide an investment vehicle similar to the RIC for small investors to invest in real estate and real estate mortgages. See H.R. Rep. No. 2020, 86th Cong., 2d Sess. 3-4, (1960). Like RICs, REITs are subject to restrictions on the type of assets they can hold if they want to retain the benefits accorded them under subchapter M. For example, under § 856(c)(3) of the Code, at least 75 percent of the gross income of a REIT must be derived from any or all of nine sources, including rents from real property, interest on obligations secured by mortgages, gain from the sale or disposition of real property, and income and gain derived from foreclosure property. REITs and RICs also have similar distribution and holding period requirements.

Section 1.856-3(g) of the Income Tax Regulations provides that:

> In the case of a real estate investment trust which is a partner in a partnership, as defined in section 7701(a)(2) and the regulations thereunder, the trust will be deemed to own its proportionate share of each of the assets of the partnership and will be deemed to be entitled to the income of the partnership attributable to such share. For purposes of section 856, the interest of a partner in a partnership's assets shall be determined in accordance with his capital interest in the partnership. The character of the various assets in the hands of the partnership and items of gross income of the partnership shall retain the same character in the hands of the partners for all purposes of section 856. Thus, for example, if the trust owns a 30-percent capital interest in a partnership which owns a piece of rental property the trust will be treated as owning 30 percent of such property and as being entitled to 30 percent of the rent derived from the property by the partnership. Similarly, if the partnership holds any property primarily for sale to customers in the ordinary course of its trade or business, the trust will be treated as holding its proportionate share of such property primarily for such purpose. Also, for example, where a partnership sells real property or a trust sells its interest in a partnership which owns real property, any gross income realized from such sale, to the extent that it is attributable to the real property, shall be deemed gross income from the sale or disposition of real property held for either the period that the partnership has held the real property or the period that the trust was a member of the partnership, whichever is shorter.

Thus, the regulations adopt the language of the aggregate "look-through" approach in determining how a REIT should account for its partnership interests for purposes of all of the income and asset qualification tests under § 856 of the Code.

The legislative purpose underlying the creation of both RICs and REITs was to provide small investors a means of pooling their resources to invest in a particular type of assets without the imposition of the corporate income tax. The qualification tests are similar for each. Therefore, although the RIC regulations do not specifically address the issue herein, it is appropriate to adopt an approach for RICs that parallels that set forth for REITs.

Each of the Funds, as a partner in Portfolio, will be deemed to own a proportionate share of the assets of Portfolio and will be deemed to be entitled to the income of Portfolio attributable to such share for purposes of determining whether the Fund satisfies the requirements of §§ 851(b)(2) and 851(b)(3). For purposes of these sections, the interest of a Fund in Portfolio shall be determined in accordance with the Fund's capital interest in Portfolio.

Ruling # 4

Portfolio and Funds have requested a ruling that Portfolio's method of aggregating gains and losses from qualified financial assets for the purpose of making reverse § 704(c) allocations is reasonable within the meaning of § 1.704-3(e)(3).

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 the contribution. This allocation must be made using a 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 under § 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 purposes of § 704(c). 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 (except for reasonable special allocations to a partner that provides management services or investment advisory services to the partnership). 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 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; evidences 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.

Section 1.704-3(e)(3)(iv) and (e)(3)(v) describe two approaches to making aggregate reverse § 704(c) allocations that are generally reasonable -- the partial netting approach and the full netting approach. However, § 1.704-3(e)(3)(i) provides that other approaches may be reasonable in appropriate circumstances.

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 consequence of built-in gain or loss among the partners in a manner that substantially reduces the present value of the partners' aggregate tax liability.

Furthermore, § 1.704-3(e)(3)(vi) provides that the character and other tax attributes of gain or loss allocated to the partners under an aggregate approach must: (A) preserve the tax attributes of each item of gain or loss realized by the partnership; (B) be determined under an approach that is consistently applied; and (C) not be determined with a view to reducing substantially the present value of the partners' aggregate tax liability. Portfolio has represented that its allocations have complied and will comply with § 1.704-3(e)(3)(vi).

Portfolio has elected to use an aggregate method for making reverse § 704(c) allocations. Under the method adopted, Portfolio has established two revaluation accounts for each partner -- an unrealized gain account ("URGA") and an unrealized loss account ("URLA"). Each time Portfolio restates its capital accounts to reflect a revaluation of its assets, Portfolio credits each partner's URGA with the partner's share of the change in unrealized gains since the last capital account restatement by the partnership. Similarly, Portfolio credits each partner's URLA with the partner's share of the change in unrealized losses since the last partnership restatement.

After Portfolio makes the book adjustments, it allocates tax gains and tax losses for securities sold since Portfolio's last capital account restatement. Tax gain is allocated among the partners in accordance with the relative balances in the partners' URGAs. Tax loss is allocated among the partners in accordance with the relative balances in the partners' URLAs. Portfolio then reduces each partner's URGA and URLA by the amount of tax gain and loss allocated to that partner.

After applying the relevant law to the information and representations submitted, we rule that Portfolio's method of making reverse § 704(c) allocations is a reasonable method within the meaning of § 1.704-3(e)(3), provided that a contribution or revaluation of property and the corresponding allocation of tax items with respect to the property are not made with a view to shifting the tax consequences of built-in gain or loss among the partnership in a manner that substantially reduces the present value of the partners' aggregate tax liability.

Ruling # 5

Portfolio and Funds also have requested permission to 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 the purpose of making § 704(c) and reverse § 704(c) allocations.

The aggregation rule of § 1.704-3(e)(3) applies 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).

In this case, Portfolio's burden of making § 704(c) allocations separate from reverse § 704(c) allocations is represented to be substantial. In addition, the likelihood that this type of aggregation could be abused by Portfolio and its partners is minimal. It is represented that Fund 1, Fund 2, and Fund 3 each is a "publicly offered regulated investment company" as defined in § 67(c)(2)(B) and § 1.67-2T(g)(3)(ii) (a "Qualified Contributor"), and upon commencement of operations Fund 4 also will be a Qualified Contributor.

After applying the relevant law to the facts presented and the representations made, we conclude that Portfolio may aggregate built-in gains and losses from qualified financial assets 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, provided that a contribution or revaluation of property and the corresponding allocation of tax items with respect to the property 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 and that each of the partners (other than Co-administrator) is a Qualified Contributor.

Ruling # 6

Portfolio and Funds also have requested permission to use Portfolio’s method for making § 704(c) allocations, including reverse allocations, for Qualified Contributors that become partners in Portfolio.

It is anticipated that Qualified Contributors may become partners in Portfolio in the future. These new partners may contribute securities with built-in gain or loss to Portfolio, but only securities consistent with Portfolio’s investment objective.

After applying the relevant law to the information and representations submitted, we rule that Portfolio’s method of making § 704(c) allocations, including reverse allocations, for new partners who invest in Portfolio is a reasonable method within the meaning of § 1.704-3(a)(1), and is permitted by the Commissioner under § 1.704-3(e)(4)(iii), provided that: (i) a contribution or revaluation of property and the corresponding allocation of tax items with respect to the property are not made with a view to shifting the tax consequences of built-in gain or loss among the partnership in a manner that substantially reduces the present value of the partners' aggregate tax liability: (ii) the partner is registered as an open-end management company under the 1940 Act and is a Qualified Contributor; and (iii) to the extent Portfolio relies on this ruling with respect to the contribution, Portfolio will document any such contribution on its tax return filed subsequent to the contribution.

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, the transaction(s) that are not specifically covered by the above rulings. Rulings four through six are 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). Specifically, no opinion is expressed concerning (i) whether any Fund qualifies as a RIC that is taxable under subchapter M, part I of the Code, (ii) allocations of items other than items of gain or loss from the sale or other disposition of qualified financial assets, or (iii) the aggregation of built-in gains and losses from qualified financial assets contributed to Portfolio by any partner other than the Funds and future new partners that qualify as Qualified Contributors. 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(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to Fund 4 and Fund 4's second authorized representative.

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

Enclosures (2)
Copy of this letter
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