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Department of the Treasury

Washington, D.C. 20224

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LEGEND:

Company A =
Company B =
Company C =

Limited Partnership A =
Limited Partnership B =

State X =
State Y =
State Z =

a =

Dear:

This is in response to a letter dated August 14, 2000, and subsequent correspondence submitted on behalf of the Master Trusts (each a "Master Trust" and collectively "the Master Trusts") and the Company A Feeder Funds and the Company B Feeder Funds (each a "Feeder Fund" and collectively "the Feeder Funds") as described in sections A, B, and C respectively, of the Appendix to this ruling. The eight rulings requested in the letter are as follows:

Ruling 1: Whether each of the Feeder Funds will be deemed to own a proportionate share of each of the assets of its corresponding Master Trust and will be deemed to be entitled to the income of the Master Trust attributable to such share for purposes of determining whether the Feeder Fund satisfies the requirements of §§ 851(b)(2), 851(b)(3), 852(b)(5), 853(a), and 854 of the Internal Revenue Code.

Ruling 2: Whether the Master Trusts will be publicly traded partnerships, taxed as corporations, under § 7704 of the Code.

Ruling 3: Whether each Feeder Fund’s basis in the shares of beneficial interest received in its corresponding Master Trust will equal the basis of the assets transferred in exchange therefor, reduced by the sum of such Feeder Fund’s liabilities assumed by the Master Trust or liabilities to which the assets transferred were subject.

Ruling 4: Whether each Feeder Fund’s holding period in shares of beneficial interest received in its corresponding Master Trust will include the period during which the property exchanged was held by the Feeder Fund, provided that such property constitutes a capital asset as defined in § 1221 or property described in § 1231 on the date of the exchange.

Ruling 5: Whether each Master Trust’s basis in the assets received from a Feeder Fund will equal the bases of such assets in the hands of the Feeder Fund before the exchange.

Ruling 6: Whether each Master Trust’s holding periods in the assets received from a Feeder Fund will include the periods during which the Feeder Fund held such assets.

Ruling 7: Whether the method employed by each Master Trust for making forward and reverse § 704(c) allocations among its partners, including aggregating qualified financial assets, is a reasonable method within the meaning of §§ 1.704-3(a)(1) and 1.704-3(e)(3) of the Income Tax Regulations, and is permitted under § 1.704-3(e)(4)(iii).

Ruling 8: Whether under § 721, no gain or loss will be recognized by Master Trust or the Feeder Funds upon a contribution of property to a Master Trust by a Feeder Fund in exchange for shares of beneficial interest in the Master Trust.

FACTS

Company A and Company C are limited partners in Limited Partnership A and Limited Partnership B. Limited Partnership A and Limited Partnership B provide investment management and related services and are registered investment advisors (the "Investment Advisors"). Limited Partnership A and Limited Partnership B have organized a number of feeder funds (each a Company A Feeder Fund). Limited Partnership A and Limited Partnership B will organize a number of feeder funds (each a Company B Feeder Fund).

Feeder Funds are or will be organized as either State X corporations or State Z business trusts. The Company A Feeder Funds have elected, and the Company B Feeder Funds will elect, to be treated as regulated investment companies (RICs) under § 851 of the Code. Thereafter, each Feeder Fund intends to operate in a manner that continues to qualify it as a RIC.

Limited Partnership A and Limited Partnership B will organize a Master Trust for each of their Feeder Funds. The Master Trusts will be organized as State Y business trusts under the State Y Business Trust Act. The Master Trusts will be registered as open-end management companies under the Investment Company Act of 1940 (the "1940 Act"). Each Master Trust will serve as an investment vehicle for two corresponding Feeder Funds, one of which will be a Company A Feeder Fund, and the other of which will be a Company B Feeder Fund. The exact corresponding relationship among the Master Trusts, the Company A Feeder Funds, and the Company B Feeder Funds is described in the Appendix to this ruling. Each Master Trust's investment objective will be identical to that of its two corresponding Feeder Funds.

Each Company A Feeder Fund will contribute a diversified portfolio of securities to its corresponding Master Trust in exchange for its beneficial interest in that Master Trust. Each Company B Feeder Fund will contribute $ <u>a</u> in cash to its corresponding Master Trust in exchange for its beneficial interest in that Master Trust. Each Feeder Fund will hold an interest in its corresponding Master Trust after the contribution. A Master Trust may also receive cash and/or assets from an affiliate of the applicable Investment Advisor and/or from an institutional investor in exchange for an interest in the Master Trust.

Although Master Trusts will be investment trusts, the declarations of trust for each Master Trust will provide a power to vary the investment of the holders, which will classify Master Trusts as business entities under § 301.7701-4(c) of the Procedure and Administration Regulations. It is represented that each Master Trust will be classified as a partnership for federal tax purposes under § 301.7701-3(b)(1)(i).

REPRESENTATIONS

The following representations are made on the behalf of the Master Trusts and the Feeder Funds:

<u>Ruling 1</u>:

For purposes of determining the required distribution under § 4982(a)(1) of the Code, the Feeder Funds will each account for its share of partnership items of income, gain, loss, and deduction as they are taken into account by its corresponding Master Trust.

Except as required by § 704(c) of the Code and § 1.704-1(b)(4) of the regulations, each Feeder Fund's allocable share of its corresponding Master Trust's income, gain, loss, deduction, and credit will be comprised of a proportionate share of each item of income includible in the corresponding Master Trust's gross income.

The organization of the Master Trusts was done in a manner to enable them to be classified as partnerships and was not done to enable a partner that is a RIC to make distributions that would be prohibited under Rev. Rul. 89-81, 1989 C.B. 226, had the RIC invested directly in the Master Trust's assets.

Rulings 2,3,4,5,6,7:

Each Feeder Fund will contribute solely cash and/or a diversified portfolio of stock and securities to its corresponding Master Trust. Beneficial interests in Master Trusts will be issued solely in private placement transactions that do not involve any "public offering" within the meaning of § 4(2) of the Securities Act of 1933, as amended (1933 Act). Master Trusts will not register their shares under the 1933 Act, because shares in Master Trusts may be issued solely in private placement transactions that do not involve any "public offering" within the meaning of § 4(2) of the 1933 Act.

Except as required by § 704(c) of the Code and § 1.704-1(b)(4) of the regulations, 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 the Master Trust by the partner. Under § 1.704-1(b)(2)(iv)(f), Master Trusts will revalue their investment portfolios to fair market value daily. Each Master Trust will adjust the capital account of each partner to reflect the partner's share of the net change in the value of its assets from the close of the prior day to the close of the current day. Each Master Trust will qualify as a securities partnership under § 1.704-3(e)(3)(iii). Finally, contributions, revaluations, and the corresponding allocations of tax items will not be made with a view to shifting the tax consequences of built-in gain or loss among its partners in a manner that substantially reduces the present value of the partners' aggregate tax liability.

No Master Trust will have a holder that is a flow-through entity with a principal purpose of permitting the Master Trust to satisfy the 100-partner limitation under § 7704 of the Code.

The number of holders owning interests in Master Trust will be less than 100 and none of the holders will be a partnership, grantor trust, or an S corporation that is beneficially owned by more than one individual.

Ruling 8:

Each Feeder Fund will contribute a portfolio of assets that meets the diversification requirements of § 368(a)(2)(F)(ii).

There is no plan or intention for any Feeder Fund to transfer assets other than cash and/or a diversified portfolio of stock and securities to a Master Trust.

Any other transferor who has contributed or will contribute assets to a Master Trust has contributed or will contribute solely cash and/or a diversified portfolio of stocks and securities.

The following guidelines have been taken into account in making the foregoing representations:

(1) all members of a controlled group of corporations (as defined in § 1563(a)) will be treated as one issuer;

(2) cash and cash items (including receivables) will be excluded in determining each Feeder Fund’s total assets;

(3) government securities are included in total assets for purposes of the denominator of the 25 and 50 percent tests (unless the government securities are acquired to meet the 25 and 50 percent tests) but are not treated as securities of an issuer for purposes of the numerator of the 25 and 50 percent tests;

(4) all bonds will be treated as issued by the ultimate obligor on the bonds, including any larger government agency or unit whose full faith and credit backs the bonds; and

(5) in the case of any bond for the benefit of a private user nominally issued by a governmental entity which is liable only to the extent of revenues from the bond-financed project, the bond will be treated as issued by the private user that is the ultimate obligor on the bond.

LAW AND ANALYSIS

Ruling 1:

Section 851(a) of the Code 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) 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) 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) 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 of 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 852(b)(5) provides that a RIC at least 50 percent of the value (as defined in § 851(c)(4)) of whose total assets at the close of each calendar quarter consists of obligations described in § 103(a) is eligible to pay exempt-interest dividends, which are treated by the RIC’s shareholders as interest excludable from gross income pursuant to § 103(a).

Section 853(a) provides that a RIC more than 50 percent of the value (as defined in § 851(c)(4)) of whose total assets at the close of the taxable year consists of stock or securities in foreign corporations and which meets the requirements of § 852(a) for the taxable year may elect to treat its shareholders as if they had paid certain foreign taxes incurred by the RIC for purposes of determining a shareholder’s foreign tax credit under § 901.

Section 854(b)(1)(A) provides that a dividend, other than a capital gain dividend, received from a RIC qualifies for the dividends received deduction under § 243(a) to the extent so designated by the RIC provided that the RIC meets the requirements of § 852(a) for the taxable year during which it paid the dividend.

Section 854(b)(1)(B) provides that the aggregate amount that may be designated as dividends under § 854(b)(1)(A) shall not exceed the aggregate dividends received by the RIC for the taxable year.

Section 854(b)(3)(A) provides that the term "aggregate dividends received" includes only dividends received from domestic corporations.

Section 854(b)(4) provides, in part, that for purposes of determining an amount to be treated as a dividend eligible for the dividends received deduction under § 243 of the Code a payment to a RIC shall not be treated as a dividend unless, had it not been a RIC, it would have been allowed a dividends received deduction under § 243 with respect to the payment.

Section 702(b) 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 Feeder Funds to qualify as RICs under the diversification tests of § 851, the aggregate approach will have to be applied to each Feeder Fund’s partnership interest in its corresponding Master Trust. As an aggregate, each Feeder Fund will be able to take into account its share of the individual items of income and assets of its corresponding Master Trust.

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) 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)(3) of the Code 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 Feeder 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 regulations provides that:

> In the case of a real estate investment trust which is a partner in a partnership, as defined in § 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 § 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 § 856. Thus, for example, if a 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.

Ruling 2:

Section 7704(a) of the Code provides that a publicly traded partnership is treated as a corporation. Section 7704(b) and § 1.7704-1(a) of the regulations 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: (1) all interests in the partnership were issued in a transaction (or transactions) that was not required to be registered under the 1933 Act; and (2) 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: (1) 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 (2) 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).

It is represented that the number of partners in each Master Trust will be limited to 100 or fewer calculated pursuant to § 1.7704-1(h). No interest in any of the Master Trusts will be issued in a transaction (or transactions) required to be registered under the 1933 Act. Accordingly, Master Trusts will not be "publicly traded partnerships" within the meaning of

§ 7704(b).

Ruling 3:

Section 722 provides that the basis of an interest in a partnership acquired by a contribution of property, including money, to the partnership shall be the amount of such money and the adjusted basis of such property to the contributing partner at the time of the contribution increased by the amount, if any, of gain recognized under § 721(b) to the contributing partner.

Each Feeder Fund’s basis in the shares of beneficial interest received in its corresponding Master Trust will equal the basis of the assets exchanged by the Feeder Fund for that interest, reduced by the sum of the Feeder Fund’s liabilities assumed by Master Trust to which the assets transferred were subject.

Ruling 4:

Section 1223(1) provides that where property received in an exchange acquires the same basis, in whole or in part, as the property surrendered in the exchange, the holding period of the property received includes the holding period of the property surrendered to the extent such surrendered property was a capital asset as defined in § 1221 or property described in § 1231.

Each Feeder Fund’s holding period in shares of beneficial interest received in its corresponding Master Trust will include the period during which the property exchanged was held by the Feeder Fund, provided that such property was a capital asset as defined in § 1221 or property described in § 1231 on the date of the exchange.

Ruling 5:

Section 723 provides that the basis of property contributed to a partnership by a partner shall be the adjusted basis of such property to the contributing partner at the time of contribution increased by the amount, if any, of gain recognized under § 721(b) to the contributing partner at such time.

Each of the Master Trust’s basis in the assets received from a Feeder Fund will equal the basis of such assets in the hands of the Feeder Fund before the exchange.

Ruling 6:

Section 1.723-1 of the regulations provides that because property contributed to a partnership has the same basis in the hands of the partnership as it had in the hands of the contributing partner, the holding period of such property for the partnership includes the period during which it was held by the partner. See § 1223(2) of the Code.

Each Master Trust’s holding period in assets received from a Feeder Fund will, in each instance, include the period during which the Feeder Fund held such assets.

Ruling 7:

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 who 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(e)(3)(v) (the full netting approach) provides that to use the full netting approach, the partnership must establish appropriate accounts for each partner for the purpose of taking into account each partner's share of the tax gains and losses. Under the full netting approach, on the date of each capital account restatement, the partnership: (A) nets its book gains and book losses from qualified financial assets since the last capital account restatement and allocates the net amount to its partners; (B) nets tax gains and tax losses from qualified financial assets since the last capital account restatement; and (C) allocates the net tax gain (or net tax loss) to the partners in a manner that reduces the book-tax disparities of the individual partners.

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: (1) preserve the tax attributes of each item of gain or loss realized by the partnership; (2) be determined under an approach that is consistently applied; and (3) not be determined with a view to reducing substantially the present value of the partners' aggregate tax liability. It is represented that each Master Trust’s allocations will comply with § 1.704-3(e)(3)(vi).

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, the burden to each Master Trust of making § 704(c) allocations separate from reverse § 704(c) allocations is represented to be substantial. Each Master Trust will use the full netting approach described in § 1.704-3(e)(3)(v) for making forward and reverse § 704(c) allocations. The likelihood that this type of aggregation could be abused by the Master Trusts and their partners is minimal. It is represented that each Feeder Fund will qualify as a "publicly offered regulated investment company" as defined in § 67(c)(2)(B) and § 1.67-2T(g)(3)(ii) (a "Qualified Contributor").

Ruling 8:

Section 721(a) of the Code provides that no gain or loss is recognized to a partnership or any of its partners when a partner contributes property to the partnership in exchange for an interest in the partnership. Section 721(b) provides, however, that § 721(a) does 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.

Section 1.351-1(c)(1) of the regulations states 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) a RIC, (b) a REIT, or (c) a corporation more than 80 percent of the value of whose assets (excluding cash and nonconvertible 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 that date, subject to certain transitional relief provisions. Section 1002 of the Act expands 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 and REITs. However, the Act is not 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' interest. See S. Rep. No. 105-33, at 131 (1997); H. R. Rep. No. 105-148, at 447 (1997); H.R. Rep. No. 105-220, at 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 that contemplates a later 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.

Section 1.351-1(c)(6)(i) provides that (i) 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 (ii) 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 purposes 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 total 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.

HOLDINGS

Based upon the facts presented and the representations made by the Master Trusts and the Feeder Funds, and in accordance with the relationships detailed above we rule as follows:

Ruling 1:

Each Feeder Fund, as a partner in its corresponding Master Trust, will be deemed to own a proportionate share of the assets of the corresponding Master Trust and will be deemed to be entitled to the income of the corresponding Master Trust attributable to that share for purposes of determining whether each of the Feeder Funds satisfies the requirements of §§ 851(b)(2), 851(b)(3), 852(b)(5), 853(a), and 854 of the Code. For purposes of these sections, the interest of a Feeder Fund in its corresponding Master Trust shall be determined in accordance with the Feeder Fund’s capital interest in the Master Trust

Ruling 2:

Master Trusts will not be "publicly traded partnerships" within the meaning of § 7704(b).

Ruling 3:

Each Feeder Fund’s basis in the shares of beneficial interest received in its corresponding Master Trust will equal the basis of the assets transferred in exchange therefor, reduced by the sum of such Feeder Fund’s liabilities assumed by the Master Trust or liabilities, if any, to which the assets transferred were subject.

Ruling 4:

Each Feeder Fund’s holding period in shares of beneficial interest received in its corresponding Master Trust will include the period during which the property exchanged was held by the Feeder Fund, provided that such property constitutes a capital asset as defined in § 1221 or property described in § 1231 on the date of the exchange.

Ruling 5:

Each Master Trust’s basis in the assets received from a Feeder Fund will equal the basis of such assets in the hands of the Feeder Fund before the exchange.

Ruling 6:

Each of the Master Trust’s holding period in the assets received from a Feeder Fund will include the periods during which the Feeder Fund held such assets.

Ruling 7:

Each Master Trust’s method of making § 704(c) allocations, including reverse allocations, for its partners who invest in that Master Trust will be considered 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 a contribution or revaluation of the 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 is a Qualified Contributor.

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). Specifically, no opinion is expressed concerning allocations of items other than items of gain or loss from the sale or other disposition of qualified financial assets, or the aggregation of built-in gains and losses from qualified financial assets contributed to the Master Trusts by any partner other than the Feeder Funds. Each Master Trust must maintain sufficient records to enable it and its partners to comply with §§ 704(c)(1)(b) and 737. Additionally, this ruling applies only to the contributions to Master Trusts by the Feeder Funds for which the taxpayer supplied specific information concerning the contributed assets as described above, and not to any other contributions by the Feeder Funds or any other future partner.

Ruling 8:

Provided that each Master Trust is treated as a partnership for purposes of § 721, we conclude as follows:

The transfers by each Feeder Fund to its corresponding Master Trust are not transfers of property to a partnership that would be treated as an investment company (within the meaning of § 351) if each Master Trust were incorporated, provided that these are the only transfers to each Master Trust (except for transfers solely of cash and/or a diversified portfolio of stocks and securities).

We express no opinion on the tax treatment of the transaction described above under any other provision of the Code or regulations or the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction not specifically covered by the above ruling. In particular, we express no opinion on the consequences of other transfers to a Master Trust, either as to whether such other transfers would be "transfers to an investment company" or would (except for transfers solely of cash and/or a diversified portfolio of stocks and securities), when taken together with the transfers by the Feeder Funds, cause those transfers to be considered "transfers to an investment company."

This ruling is limited to the Master Trusts and the Feeder Funds. No opinion is expressed with respect to the federal income tax consequences of this transaction other than as concluded above. Specifically, no opinion is expressed as to whether each Feeder Fund actually qualifies as a RIC that is taxable under subchapter M, part I of the Code. Moreover, we express no opinion on the propriety of any of the rulings herein with respect to the contribution and subsequent admission of additional partners in a Master Trust which are not specifically included in any representation given by the taxpayer. Additionally, we express no opinion as to whether the transaction involving the transfers from the Feeder Funds is part of a plan to achieve diversification without recognition of gain under § 1.351-1(c)(5).

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

In accordance with the provisions of a Power of Attorney currently on file, we are sending a copy of this ruling letter to your authorized representative.

A copy of this letter should be attached to the federal income tax return for each of the Feeder Funds for every taxable year in which it participates in the arrangement described in this letter.

Sincerely yours,
Acting Associate Chief Counsel
(Financial Institutions and Products)
By: Alice M. Bennett
Chief, Branch 3

Enclosures:
Copy of this letter
Copy for section 6110 purposes