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Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
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Date:
November 17, 1998

Legend

Partnership =

GP =

Parent =

Sub =

LP =

D1 =

Dear

This responds to your representative’s letter of November 12, 1998, and prior correspondence, requesting rulings under §§ 752 and 465 of the Internal Revenue Code regarding Partnership's proposal to issue a single loan and use the proceeds to pay some of Partnership's outstanding debt obligations.

Facts

GP is a wholly owned subsidiary of Parent. On D1, GP and LP formed Partnership. Partnership, GP, LP, and Parent intend to undertake a series of transactions that will result in the conversion of Parent into a Real Estate Investment

Trust (REIT) taxable under §§ 856-860, the contribution by Parent to Partnership of all of its hotel related assets, and the acquisition by Partnership of partnership interests in a number of partnerships owned by outside parties ("the Consolidation"). As part of the Consolidation, Partnership will acquire, in exchange for Partnership units, interests in partnerships (the "Property Partnerships") that own full service hotels located throughout the United States and Canada. Partnership will become the owner of substantially all of the interests in the Property Partnerships, but the Property Partnerships will be structured so that they remain partnerships for federal tax purposes by having a limited liability company owned by Partnership and Parent as the other partner. Parent, and some of its subsidiaries, will also contribute approximately full service hotels owned entirely by Parent (and its subsidiaries) to Partnership in exchange for Partnership units. Finally, Partnership will acquire, in exchange for Partnership units, partial interests in a number of other partnerships that own full service hotels throughout the United States ("Partial Interest Partnerships").

After the Consolidation, the Partnership, the Property Partnerships, and the Partial Interest Partnerships will lease the hotels to indirectly controlled subsidiaries of Sub. Sub is currently a wholly-owned subsidiary of Parent, but will become a separate company as part of the REIT conversion. Sub will operate the hotels under the existing management agreements and pay rent to Partnership, certain Property Partnerships, and certain Partial Interest Partnerships. Partnership will be engaged in the acquisition and development of full service hotels.

Partnership has elected to use the traditional allocation method (with curative allocations only upon sale of property) under § 704(c) and § 1.704-3(d) of the Income Tax Regulations to account for the variation between the basis of each property contributed to Partnership and the fair market value of the property at the time of contribution.

Partnership intends to issue unsecured debt ("Unsecured Debt") that will be a general obligation of Partnership but will not be recourse to any of Partnership's partners, any partner of any of the Partial Interest Partnerships, any assets of any partner, any related person (as defined in § 1.752-4(b)), or any assets of any related person. An exception to the nonrecourse nature of the Unsecured Debt is that it will become recourse to Parent if Parent, without the lenders' approvals, acquires more than an insignificant amount of assets other than its interest in Partnership. In addition, Partnership and some of its subsidiaries will pledge their membership interests in entities disregarded for federal tax purposes as security for the Unsecured Debt. Partnership anticipates that it will use the Unsecured Debt proceeds (1) to repay a portion of the outstanding debt obligations that it will assume on the Consolidation, and (2) to fund the acquisition and development of real estate.

The aggregate gross fair market value of the property that will be owned by Partnership that is neither real property nor property incidental to the activity of holding real property will be less than 10 percent of the aggregate gross fair market value of the Partnership property that is deemed to secure the Unsecured Debt.

The Unsecured Debt originally will be issued to nationally recognized underwriters and/or major money center banks. In some cases, however, the underwriters may immediately attempt to sell the Unsecured Debt, but only to "qualified persons" as defined in § 49(a)(1)(D)(iv) who are also either (i) "qualified institutional buyers" as defined in Rule 144A under the Securities Act of 1933, or (ii) "institutional accredited investors" as defined in Rule 501(a)(1), (2), (3), or (7) of the Securities Act of 1933 (the "Initial Purchasers"). Each Initial Purchaser will acknowledge and represent that it:

1. Is purchasing an interest in the Unsecured Debt for its own account or an account over which it exercises sole investment discretion and that it and any such account is a "qualified person" as defined in § 49(a)(1)(D)(iv) and is either a "qualified institutional buyer" or an "institutional accredited investor,"

2. Acknowledges that the Unsecured Debt has not been registered under the Securities Act of 1933 and may not be offered or sold within the U.S. or to U.S. persons (except as provided below),

3. Agrees that if it resells or transfers the Unsecured Debt before the second anniversary of its issuance by Partnership, it will resell or transfer the Unsecured Debt only to (i) Partnership, (ii) a "qualified institutional buyer" or an "institutional accredited investor," (iii) under an exemption from registration under the Securities Act of 1933 (if available) if the purchaser represents that it is a "qualified person" under § 49(a)(1)(D)(iv), or (iv) under a registration statement filed with the Securities and Exchange Commission, and

4. Agrees that it will give each subsequent purchaser notice of any restrictions on the transfer of the Unsecured Debt.

Partnership anticipates that it will enter into a registration rights agreement with the Initial Purchasers. The registration rights agreement will require Partnership to use its reasonable best efforts to file a registration statement for the Unsecured Debt with the Securities and Exchange Commission within 60 days of its issuance and to cause the registration statement to be declared effective under the Securities Act of 1933 within 135 days of the debt's issuance. When the registration statement becomes effective, the resale restrictions described above will terminate.

Partnership represents that (1) the allocation of the Unsecured Debt among its multiple properties established at the time of the borrowing will be used throughout the time the Unsecured Debt is outstanding, (2) to the best of its knowledge, the Initial Purchasers will be qualified persons as defined in § 49(a)(1)(D)(iv) until the earlier of (i) two years, or (ii) a registration statement for the Unsecured Debt is declared effective under the Securities Act of 1933 and that, during that time period, substantially all of the benefits and burdens of ownership of the Unsecured Debt will inure to those purchasers, and (3) the Unsecured Debt will not be convertible into an equity interest in Partnership.

Rulings Requested

1. Partnership may allocate its nonrecourse debt, including the Unsecured Debt, among its multiple properties serving as security for the debt in any amounts determined by it. Partnership will be limited in the amount of debt it may allocate to any one property by the lesser of (1) the fair market value of the property or (2) the amount of debt (previously allocated to the property) repaid with the proceeds of the newly issued Unsecured Debt.

2. The Unsecured Debt is treated as a nonrecourse liability secured by Partnership's assets (including the assets of the Property Partnerships and the Partial Interest Partnerships guaranteeing repayment of the Unsecured Debt) for purposes of § 1.752-3(a)(2) to the extent that a creditor has a claim against the assets under state law in the event of Partnership's default.

3. For purposes of § 752, reductions occurring during the taxable year to the amount of the Unsecured Debt outstanding resulting from principal repayments may be allocated by Partnership among its multiple properties in the same manner and same proportion as the Unsecured Debt is initially allocated pursuant to Ruling Request #1.

4. The Unsecured Debt is treated as qualified nonrecourse financing secured by Partnership's real estate assets and as to which no person has personal liability for purposes of § 465(b)(6)(A). Also, that the Unsecured Debt will be treated as qualified nonrecourse financing to the extent that a creditor has a claim against Partnership's properties under state law if Partnership defaults on the Unsecured Debt.

Law and Rulings

Section 752 Issues and Rulings

1. Allocation of the Unsecured Debt among Partnership's properties under § 752

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

Section 1.704-3(a)(2) provides that except as otherwise provided in the regulations, § 704(c) 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 losses on items of contributed property cannot be aggregated.

Section 752(a) provides that any increase in a partner's share of the liabilities of a partnership, or any increase in a partner's individual liabilities by reason of the assumption by such partner of partnership liabilities, will be considered as a contribution of money by such partner to the partnership.

Section 752(b) provides that any decrease in a partner's share of the liabilities of a partnership, or any decrease in a partner's individual liabilities by reason of the assumption by the partnership of such individual liabilities, will be considered as a distribution of money to the partner by the partnership.

Section 752(c) provides that, for § 752, a liability to which property is subject will, to the extent of the fair market value of such property, be considered as a liability of the owner of the property.

Section 1.752-3(a) provides that a partner's share of the nonrecourse liabilities of a partnership equals the sum of the amounts specified in § 1.752-3(a)(1)-(3).

Section 1.752-3(a)(2) provides that the partner's share of the nonrecourse liabilities of the partnership includes the amount of any taxable gain that would be allocated to the partner under § 704(c) (or in the same manner as § 704(c) in connection with a revaluation of partnership property) if the partnership disposed of (in a taxable transaction) all partnership property subject to one or more nonrecourse liabilities of the partnership in full satisfaction of the liabilities and for no other consideration. The gain a partner would be allocated under the hypothetical sale in § 1.752-3(a)(2) is referred to as § 704(c) minimum gain.

Section 704(c) minimum gain is the amount of gain that a partner would receive under § 704(c) from a hypothetical sale solely in satisfaction of the nonrecourse liabilities encumbering partnership property. With limited exceptions (see § 1.704-3(e)(2)), § 704(c) gain is calculated on a property-by-property basis. If more than one item of partnership property is subject to a single nonrecourse liability, the partnership must allocate the nonrecourse liability among the individual items of partnership property before the partnership can calculate each partner's share of § 704(c) minimum gain. The portion of the nonrecourse liability allocated to each item of partnership property is then treated as a separate loan under § 1.752-3(a)(2).

In this case, more than one item of partnership property is subject to the Unsecured Debt. We conclude, based solely on the facts submitted and the representations made, that, when determining the § 704(c) minimum gain under § 1.752-3(a)(2), Partnership may allocate the Unsecured Debt among its properties that are subject to the Unsecured Debt in any amount that does not exceed the lesser of (i) the fair market value of the property or (ii) the amount of debt previously allocated to the property and repaid with proceeds of the Unsecured Debt.

2. Nonrecourse liability

Section 1.752-1(a)(2) provides that a partnership liability is a nonrecourse liability under § 752 to the extent that no partner or related person bears the economic risk of loss under § 1.752-2. The Unsecured Debt will be a general obligation of Partnership. The creditors, however, will have no claim against the partners in Partnership or any related person (as defined in § 1.752-4(b)) or any such persons' assets if Partnership defaults on the Unsecured Debt. Thus, no partner or related person bears the economic risk of loss under § 1.752-2. Therefore, the Unsecured Debt is a nonrecourse liability under § 752.

No individual item of Partnership's property will secure the Unsecured Debt, but the creditors will have a claim against all of Partnership's properties if Partnership defaults on the debt. Additionally, the creditors have an interest in Partnership’s interests in entities disregarded for federal tax purposes. We conclude, based solely on the facts submitted and the representations made, that Partnership's properties are subject to the Unsecured Debt under § 1.752-3(a)(2) to the extent a creditor on the Unsecured Debt has a claim against such properties under state law if Partnership defaults on the Unsecured Debt.

3. Allocation of debt reductions

For purposes of § 752, reductions occurring during the taxable year of the amount of Unsecured Debt outstanding resulting from principal payments must be allocated by Partnership among its multiple properties in the same manner and same proportion as the Unsecured Debt is initially allocated by Partnership to the properties.

Section 465 Issue and Ruling

4. Qualified nonrecourse financing

For an individual or a C corporation that satisfies the stock ownership requirement of § 542(a)(2), § 465(a) limits the deductions for losses for any taxable year for an activity to the extent of the total amount for which the taxpayer is at risk for the activity at the close of the taxable year. For partnerships, the § 465 at-risk limitation applies at the partner level.

Under § 465(c)(3), the activity of holding real property is subject to the at-risk limitation of § 465.

Section 465(b)(2)(A) provides that a taxpayer's at-risk amount includes amounts borrowed for use in an activity to the extent that the taxpayer is personally liable for the repayment of the borrowed amounts. Section 465(b)(6), however, allows a taxpayer to treat qualified nonrecourse financing as an amount at risk even though the taxpayer is not personally liable for the repayment of the financing. Section 465(b)(6)(A) provides that notwithstanding any other provision of § 465(b), for an activity of holding real property, a taxpayer is considered at risk for the taxpayer's share of any "qualified nonrecourse financing" that is secured by real property used in the activity of holding real property.

Section 465(b)(6)(B) defines qualified nonrecourse financing to mean any financing (i) that is borrowed by the taxpayer for the activity of holding real property, (ii) that is borrowed by the taxpayer from a qualified person or represents a loan from any federal, state, or local government or instrumentality thereof, or is guaranteed by any federal, state, or local government, (iii) except to the extent provided in regulations, for which no person is personally liable for repayment, and (iv) that is not convertible debt.

Section 1.465-27(b)(4) states that the personal liability of any partnership for repayment of a financing is disregarded and the financing is treated as qualified nonrecourse financing secured by real property if (i) the only persons personally liable to repay the financing are partnerships; (ii) each partnership with personal liability holds only property described in § 1.465-27(b)(2)(i); and (iii) in exercising its remedies to collect on the financing in a default or default-like situation, the lender may proceed only against property that is described in § 1.465-27(b)(2)(i) and that is held by the partnership or partnerships. Section 1.465-27(b)(5) states that principles similar to those found in § 1.465-27(b)(4) apply in determining whether a financing of an entity disregarded for federal tax purposes is treated as qualified nonrecourse financing secured by real property.

We conclude, based solely on the facts submitted and representations made, that the Unsecured Debt is qualified nonrecourse financing under § 465(b)(6). Therefore, the partners of Partnership will be considered at risk for their share of the

Unsecured Debt to the extent a creditor on the Unsecured Debt has a claim against Partnership’s properties under state law if Partnership defaults on the Unsecured Debt.

This ruling is directed only to the taxpayer who requested it. Under § 6110(k)(3), this ruling may not be used or cited as precedent.

Pursuant to a Power of Attorney on file with this office, we are sending copies of this letter to Partnership's authorized representatives.

Sincerely yours,

Signed/Daniel J. Coburn

DANIEL J. COBURN
Assistant to the Branch Chief, Branch 1
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)

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