199947030

Internal Revenue Service

Department of the Treasury

Index Number: 985.01-00

Washington, DC 20224

Refer Reply To:
CC:INTL:5-PLR- 120793-98
Date:
5/28/1999

In Re:

Corporate Parent =
U.S. Sponsor =

Foreign Sponsor =
FX =
FC1 =
FC2 =
Trust =
LP =

Dear :

This is in response to your representative's letter dated November 4, 1998, requesting a ruling under section 985(b) of the Internal Revenue Code. Specifically, your representative requested a ruling that provides that the Trust may adopt a functional currency other than the dollar by applying principles used to determine the functional currency of a qualified business unit ("QBU") under § 1.985-1(c) of the Income Tax Regulations.

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

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Corporate Parent is a U.S. corporation with its principal place of business in the United States. Corporate Parent, together with its eligible subsidiaries, file consolidated federal income tax returns on a calendar year basis utilizing the accrual method of accounting.

U.S. Sponsor and Foreign Sponsor are wholly-owned subsidiaries of Corporate Parent. U.S. Sponsor is a U.S. corporation with its principal place of business in the United States. Foreign Sponsor is a FC1 company with its principal place of business in FC1. Collectively, U.S. Sponsor and Foreign Sponsor will be referred to as Sponsor.

Sponsor, either directly or through an affiliate, plans to form Trust, which will elect to be taxed as a real estate investment trust ("REIT") pursuant to section 856(c)(1). Sponsor, either directly or through an affiliate, will provide the Trust with a portion of its equity capital. The Trust will obtain the balance of its equity capital through an offering of its shares ("Common Shares") to non-FC1 investors.

The Trust will form and contribute substantially all of its capital to a wholly-owned subsidiary organized under the laws of FC2 (the "Subsidiary"). The Subsidiary, in turn, will form and contribute substantially all of its capital to a limited partnership formed under the laws of FC2 (the "Operating Partnership"). The Operating Partnership will invest substantially all of its capital in properties located throughout FC1. In addition, the Operating Partnership will make temporary financial investments of its excess funds in short-term, FX-denominated securities.[1] The Subsidiary, under § 301.7701-3(c), will elect to be disregarded as a separate entity and for the Operating Partnership to be treated as a partnership.

The Subsidiary will serve as the sole general partner of the Operating Partnership. The Operating Partnership's sole limited partner will be LP, a closed end unit trust to be formed under the rules of FC2. LP will offer its units to FC1 investors. The Trust, Subsidiary and LP will have no significant assets other than their direct or indirect interests in the Operating Partnership. The Trust's activities will be limited to paying its directors and administrative expenses, receiving capital contributions from purchasers of Common Shares, contributing capital to the Subsidiary, distributing dividends to the holders of Common Shares, preparing and distributing required financial statements and tax returns, and engaging in other administrative tasks. The Trust will have no employees and no permanent place of business in the United States. Both the Operating Partnership's and the Subsidiary's principal place of business will be outside of the United States.

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[1] All references to FX in this ruling request refer to both the FX and any successor currencies of FC1.

All transactions of the Trust, Subsidiary and the Operating Partnership will be in FX currency. The Trust, Subsidiary and the Operating Partnership will generate and receive revenues, incur and pay expenses, borrow and make financial decisions in FX. Except in extraordinary circumstances, transactions between the Trust and its shareholders or other parties will be in FX, including purchases of and dividends with respect to Common Shares.[2] The books and records of the Trust, Subsidiary and the Operating Partnership will be denominated in FX.

The Operating Partnership will make periodic distributions to its partners. The Subsidiary, in turn, will distribute to the Trust substantially all of the distributions it receives from the Operating Partnership shortly after receiving such distributions. The Trust, in turn, will distribute to its shareholders substantially all of the distributions it receives from the Subsidiary shortly after receiving such distributions. The Operating Partnership must make such distributions, among other reasons, to ensure that the Trust satisfies the REIT minimum distribution requirements discussed below. The Trust and Subsidiary will retain the distributions they receive only to the extent doing so is necessary to meet their operating expenditures and does not violate the REIT minimum distribution requirements.

Section 985(a) provides in general that all determinations for federal income tax purposes shall be made in the taxpayer's functional currency.

Section 1.985-1(b)(1)(iii) states that except as otherwise provided by ruling or administrative pronouncement, the dollar shall be the functional currency of a QBU that has the United States as its residence as defined in section 988(a)(3)(B). Section 989(a) defines QBU as any separate and clearly identified unit of a trade or business of a taxpayer which maintains separate books and records.

Section 988(a)(3)(B)(i)(II) states that the residence of a corporation or partnership which is a United States person as defined in section 7701(a)(30), i.e., generally, a corporation or partnership created or organized in the United States, or under the laws of the United States, shall be the United States. See also section

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[2] In addition to conducting transactions directly with its shareholders in FX, the Trust may conduct these transactions through unaffiliated intermediaries. When prospective shareholders wish to purchase shares with funds denominated in currencies other than FX ("non FX currencies") the prospective shareholders will deliver the funds to intermediaries, which will convert the funds to FX on the shareholders' behalf, and forward the FX funds to the Trust. In addition, when the Trust makes distributions to its shareholders, it may distribute the funds in FX to the intermediaries, who will convert the funds on the shareholders' behalf to non FX currencies.

7701(a)(4). Section 988(a)(3)(B)(i)(III) states that generally the residence of a corporation or partnership which is not a United States person shall be a country other than the United States. Section 988(a)(3)(B)(ii) states an exception to the above rule, that in the case of a QBU of any taxpayer, the residence of such unit shall be the country in which the principal place of business of the QBU is located.

Section 1.985-1(c)(1) states that if a QBU is not required to use the dollar as its functional currency, then its functional currency shall be the currency of the economic environment in which a significant part of the QBU's activities is conducted, if the QBU keeps, or is presumed to keep its books and records in such currency. Section 1.985-1(c)(2) states that the economic environment in which a significant part of the QBU's activities is conducted shall be determined by taking into account all the facts and circumstances. Section 1.985-1(c)(2)(i) lists factors to be taken into account when determining the economic environment in which a significant part of the QBU's activities is conducted.

Section 1.989(a)-1(b)(2)(i) states that a corporation is a QBU, and that a partnership is a QBU of a partner.

Section 987 generally requires that in the case of a taxpayer having one or more QBUs with a functional currency other than the dollar, taxable income of the taxpayer shall be determined by computing the taxable income of each QBU in its functional currency, and translating the income so computed at the average exchange rate for the QBU's taxable year. See also section 989(b)(4). In addition, the taxpayer must recognize foreign currency gain or loss when property or functional currency of a QBU is remitted to the home office of the taxpayer which has a different functional currency. Assuming the taxpayer's home office has a dollar functional currency, gain or loss is generally the difference between the dollar value of the functional currency adjusted basis in the property remitted, and the taxpayer's dollar basis in the QBU's earnings or capital which the property represents. See generally § 1.987-5(b).

Section 856(a)(3) and (7) state to the extent relevant, that a REIT means a corporation which but for the provisions of IRC sections 856-859 would be taxable as a domestic corporation, and which meets the following requirements, among others, pertaining to its income. At least 75% of the REIT's gross income is derived from those types of income listed in section 856(c)(3), and at least 95% of the REIT's gross income is derived from those types of income listed in section 856(c)(2). Foreign currency gains recognized under section 987 are not included in the types of income listed in section 856(c)(2) or (c)(3).

Section 857(a)(1) generally requires that in order for the REIT to enjoy the benefits of sections 856-859 the REIT must satisfy the distribution requirements of

section 857.

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

Under these facts, assuming that the Subsidiary will be disregarded pursuant to § 301.7701-3(a), the Operating Partnership is a QBU of the Trust. § 1.989(a)-1(b)(2)(i). For purposes of sections 985-989, the Operating Partnership will not be a resident of the United States. Section 988(a)(3)(B)(i)(III) and (ii). The Operating Partnership is not required to adopt the dollar as its functional currency under § 1.985-1(b)(1). Accordingly, under § 1.985-1(c)(1) the functional currency of the Operating Partnership will be determined by applying the principles of § 1.985-1(c).

Absent a ruling to the contrary, the Trust will be required to adopt the dollar as its functional currency, since under section 988(a)(3)(B)(i)(II) it is a resident of the United States. § 1.985-1(b)(1)(iii). Accordingly, the Trust will be required to recognize foreign currency gain or loss under section 987 upon its receipt of a distribution of FX from the Operating Partnership. Recognition of the section 987 gain may cause the Trust's gross income of the types enumerated in sections 856(c)(2) and 856(c)(3) respectively to fall below 95% and 75% of the Trust's gross income, potentially causing the Trust to lose its status as a REIT, or to be subject to the tax of section 857(b)(5). In this regard it should be noted that the Trust is required to make distributions to its shareholders based on its taxable income, in order that it may enjoy the benefits of sections 856-859. Since the Trust operates through the Operating Partnership, in practice the Trust will not have the funds to make the required distributions unless it receives distributions from the Operating Partnership.

If the ruling requested herein is issued, the Trust would not be required to adopt the dollar as its functional currency. The Trust's functional currency would then be determined by applying the principles of § 1.985-1(c). Under these principles, the Trust may be required to use the FX as its functional currency. Assuming the Trust's functional currency is the FX, then section 987 would not require the recognition of gain upon the Trust's receipt of distributions from the Operating Partnership, since section 987(3), by its terms, only applies when there are transfers between two QBUs of a taxpayer having different functional currencies. Thus, the Trust's ability to operate as a REIT would not be jeopardized. We believe that allowing the Trust to use a currency other than the dollar as its functional currency is consistent with language of the General Explanation of the Tax Reform Act of 1986 as set forth above.

Based solely on the facts and information submitted, the Trust may adopt a currency other than the dollar as its functional currency. Accordingly, assuming the Trust adopts a currency other than the dollar as its functional currency, the Trust will compute its taxable income or loss in its functional currency, and translate its taxable income into dollars using the average exchange rate for the taxable year.

No opinion is expressed as to what the functional currency of the Trust, the Subsidiary or the Operating Partnership will be when the principles of § 1.985-1(c) are applied.

No opinion is expressed as to whether the Trust will qualify as a REIT under section 856.

No opinion is expressed as to whether the Subsidiary will be disregarded under § 301.7701-3(c).

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

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

Sincerely,

Jeffrey L. Dorfman
Chief, Branch 5
CC:INTL:Br5

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