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Internal Revenue Service

Department of the Treasury

Index Number: 985.01-00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:INTL:BR5- PLR-106994-99
Date:

In Re:

DEC - 8 1999

Fund 1

Fund 2

Fund 3

The Trustee

The Company

Dear :

This is in response to your letter dated April 2, 1999, requesting a ruling under section 985(b) of the Internal Revenue Code ("the Code"). Specifically, you requested a ruling that provides that each of Fund 1, Fund 2, and Fund 3 may adopt a functional currency other than the U.S. dollar by applying the principles used to determine the functional currency of a qualified business unit under section 1.985-1(c) of the Income Tax Regulations ("the regulations").

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The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by penalties of perjury statements executed by the appropriate parties. This office has not verified any of the information submitted in support of the request for ruling. The Internal Revenue Service may require verification of the facts and representations as part of the audit process.

Each of Fund 1, Fund 2, and Fund 3 is a New Hampshire investment trust. The Trustee is the trustee of each Fund. Each Fund was formed pursuant to the New Hampshire Investment Trust Act for the purpose of providing an investment medium for cash collateral denominated in the designated currency of each Fund (the "designated currency") received in a securities lending program organized and managed by the Company, an affiliate of the Trustee. The designated currency for Fund 1 is the euro (including legacy currencies which represent subunits of the euro), the designated currency for Fund 2 is United Kingdom pounds sterling, and the designated currency for Fund 3 is Japanese yen. The participants in the securities lending program are both foreign and domestic institutions.

It is represented that each Fund will be classified as a partnership for federal income tax purposes and will not be treated as a publicly traded partnership taxable as a corporation under the rules of section 7704 of the Code. Beneficial interests in each Fund, which are represented by units, will be offered on a private placement basis, will not be registered under the Securities Act of 1933, and will not be traded on an established securities market. Each Fund is exempt from registration under the Investment Company Act of 1940 (the "1940 Act") by reason of the exceptions set forth in section 3(c)(1) or section 3(c)(7) of the 1940 Act.

Each Fund will invest all or substantially all of its assets in interest-bearing instruments denominated in its designated currency. Fund 1 and Fund 2 will seek to maintain a constant net asset value of one euro and one pound sterling per unit, respectively, and Fund 3 will seek to maintain a constant net asset value of 100 yen per unit. The Funds generally will limit their investments to short-term instruments; however, the Funds will not be strictly limited to those investments which (if denominated in U.S. dollars) would be permitted investments of a money market mutual fund registered under the 1940 Act. Units in the Funds will be offered at their current net asset value. The Trustee will restrict investors to qualified institutional investors and restrict investments as necessary in order to maintain each Fund's exemption from registration under the Securities Act and the 1940 Act and to prevent a Fund from being classified as a publicly traded partnership taxable as a corporation. Transactions between a Fund and its beneficial owners, including purchases of units of a Fund,

ordinarily will be conducted exclusively in the Fund's designated currency.[1]

Under each Fund's trust instrument, the ownership of units in the Fund will entitle the beneficial owner to an allocable share of the profits and losses generated by the Fund and a share of the assets of the Fund on liquidation. It is represented that each beneficial owner's distributive share of income from the Fund will comprise a proportionate part of each item of income includible in the Fund's gross income, except where a different allocation is made pursuant to section 704(c) of the Internal Revenue Code or sections 1.704-1(b)(2)(ii)(d) or 1.704-1(b)(4) of the regulations.

Each Fund will distribute any income allocable to the beneficial owners of units on a daily basis in a manner designed to maintain a constant net asset value per unit as measured in the Fund's designated currency. Such distributions will be only in the Fund's designated currency and will, unless otherwise directed by the beneficial owner, be reinvested automatically in additional shares of the Fund. Subject to certain limitations, each Fund will honor requests for redemption of units at their current net asset value at least as frequently as of the close of business of each business day. Redemption proceeds will be paid in the Fund's designated currency or in securities denominated in the Fund's designated currency if the Trustee believes that market conditions preclude prompt payment in the Fund's designated currency.

Section 985(a) of the Code provides that a taxpayer makes all income tax determinations in its functional currency unless otherwise provided in regulations. Section 1.985-1(b)(1)(iii) of the regulations provides that a qualified business unit ("QBU") that has the United States as its residence (as defined in section 988(a)(3)(B)) is required to use the U.S. dollar as its functional currency except as otherwise provided by ruling or administrative pronouncement. Section 1.989(a)-1(b)(2)(i) provides that a partnership is a QBU of a partner. Section 988(a)(3)(B) provides generally that the United States is the residence of any corporation or partnership that is a United States

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[1] In addition to conducting transactions directly with its beneficial owners in its designated currency, each Fund may conduct these transactions through affiliated or unaffiliated intermediaries. When prospective investors wish to purchase shares in a Fund with funds denominated in currencies other than the Fund's designated currency, the prospective investors will deliver the funds to intermediaries, which will convert the funds to the designated currency on the investors' behalf, and forward the funds denominated in the Fund's designated currency to the Fund. In addition, when the Fund redeems its beneficial owners' units, it may distribute the funds denominated in its designated currency to the intermediaries, who will convert the funds on the beneficial owners' behalf to other currencies.

person (as defined in section 7701(a)(30)). The section 7701(a)(30) definition of a U.S. person includes a domestic partnership, i.e., a partnership created or organized in the United States or under the laws of the United States or any state. Accordingly, under section 985 and the regulations thereunder, the functional currency of the Funds would be the U.S. dollar absent the considerations and conclusions set forth below.

It is claimed that the ability of the Funds to operate as currency funds in their respective designated currencies would be jeopardized unless each Fund were permitted to adopt a non-U.S. dollar functional currency, because sale of assets denominated in each Fund's designated currency will cause the Fund to recognize gain or loss on a section 988 transaction. Alternatively, if each Fund is deemed to have a QBU with its designated currency being its functional currency, remittances in connection with redemptions of units could cause the Fund to recognize currency gain or loss under section 987(3).

The General Explanation of the Tax Reform Act of 1986 recognized that a domestic QBU devoted to investments denominated in a specific currency may have a functional currency other than the U.S. dollar. The General Explanation states, "[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." General Explanation of the Tax Reform Act of 1986, Staff of Joint Committee on Taxation, H.R. 3838, 99th Cong., 2d Sess. 1093-94 (Comm. Print 1987).

If a Fund were to adopt properly a non-U.S. dollar functional currency, it would file its income tax returns in U.S. dollars with a statement of the exchange rates used. In the case of the Form 1065, the Fund would calculate each of its beneficial owners' share of allocable income and deductions under Code section 704 on a daily basis in accordance with each beneficial owner's distributive share of income and deductions for that day determined in the functional currency. Each beneficial owner's daily share of income and deductions will be converted from the functional currency into U.S. dollars at the spot exchange rate for the day. Translating the functional currency into U.S. dollars on a daily basis is in accordance with the daily distributions of income by the Fund in its functional currency.

Based solely on the facts and information submitted, including the representations that:

1. Fund 1, Fund 2, and Fund 3 each will be classified as a partnership for U.S. federal income tax purposes; and

2. Each Fund will invest all or substantially all of its assets in interest-bearing

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instruments denominated in its designated currency;

Fund 1, Fund 2, and Fund 3 may each adopt a functional currency other that the U.S. dollar by applying the principles used to determine the functional currency of a qualified business unit under section 1.985-1(c) of the regulations.

No opinion is expressed as to what the functional currency of each Fund will be when the principles of § 1.985-1(c) are applied.

No opinion is expressed regarding whether a Fund is a partnership for U.S. federal income tax purposes.

No opinion is expressed as to whether units in the Funds are section 988 transactions for the unitholders in the Funds. See section 1.988-1(a)(11) of the regulations. Accordingly, no opinion is expressed as to the character of amounts received by a U.S. partner on the redemption of the units in the Funds.

No opinion is express as to whether the Funds may continue to use the translation conventions outlined in this letter, particularly for purposes of computing the unitholder's distributive share of each Fund's income and deductions, and determining the unitholder's basis in units which are acquired with its distributive share of net income, if the Fund's income and deductions are not allocated and distributed to the unitholders daily, so as to maintain a constant net asset value per unit.

This letter is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code 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 yours,

Jeffrey Dorfman,
Chief, Branch 5,
Office of Associate Chief Counsel (International)

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