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Department of the Treasury

Washington, DC 20224

Person to Contact:

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Refer Reply To:
CC:FI&P:3/PLR-104469-00
Date:
September 12, 2000

LEGEND:

Master Trust =

Portfolio 1 =

Portfolio 2 =

Portfolio 3 =

Fund A =
Fund B =

Feeder Fund 1 =

Feeder Fund 2 =

Feeder Fund 3 =

Feeder Fund 4 =

Feeder Fund 5 =

Feeder Fund 6 =

State A =
State B =

Dear

This responds to your request for a ruling dated February 22, 2000, and subsequent correspondence, submitted by your authorized representative on behalf of the Master Trust, the Portfolios and the Feeder Funds (collectively, the "Taxpayers"). The rulings requested are as follows:

(A) As a partner investing in a Portfolio of the Master Trust, each Feeder Fund will be deemed to own a proportionate share of the assets and will be deemed to be entitled to the income of the Portfolio attributable to such share for purposes of §§ 851(b)(2), 851(b)(3), 852(b)(5), 853, and 854 of the Internal Revenue Code ("Code"). For this purpose, the interest of each Feeder Fund in its respective Portfolio will be determined in accordance with the Feeder Fund's capital interest in the Portfolio.

(B) No gain or loss will be recognized by a Portfolio or its corresponding Feeder Funds upon a contribution of property to the Portfolio by a Feeder Fund in exchange for shares of beneficial interest in the Portfolio under § 721.

(C) The method employed by each Portfolio for making forward and reverse section 704(c) allocations, including aggregating the gains and losses from the disposition of qualified financial assets contributed to the Portfolio by its Feeder Funds with built-in gains and losses arising from revaluations of qualified financial assets held by the Portfolio, is a reasonable method within the meaning of §§ 1.704-3(a)(1) and (e)(3) and is permitted by the Commissioner under § 1.704-3(e)(4)(iii).

(D) The method employed by each Portfolio for making forward and reverse section 704(c) allocations to new partners which satisfy certain criteria and invest in the 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).

FACTS

The Master Trust was organized as a business trust under the laws of State A pursuant to the terms of a Declaration of Trust (the "Declaration"). The Master Trust is registered under the Investment Company Act of 1940, 15 U.S.C. 80a-1, et seq. ("1940 Act"). The Master Trust consists of three initial series, Portfolio 1, Portfolio 2, and Portfolio 3 (individually a "Portfolio" or collectively the "Portfolios").

Each Portfolio is a separate pool of assets within the Master Trust rather than a separate legal entity under the laws of State A. Each Portfolio, however, is classified as a partnership under § 301.7701-3(b)(1)(i) of the Procedure and Administration Regulations.

Portfolio 1 serves as an investment vehicle for Feeder Fund 1 and Feeder Fund 4; Portfolio 2 serves as an investment vehicle for Feeder Fund 2 and Feeder Fund 5; and Portfolio 3 serves as an investment vehicle for Feeder Fund 3 and Feeder Fund 6 (individually a “Feeder Fund” or collectively the “Feeder Funds”). Each Feeder Fund invests substantially all of its assets available for investment in the relevant Portfolio, and has the same investment objective as the relevant Portfolio. Each Feeder Fund contributed solely cash to its respective Portfolio. Each Feeder Fund will be treated for federal tax purposes as a separate corporation under § 851(g) of the Code and will qualify for and elect status as a regulated investment company (RIC) under subchapter M, part I of the Code. Each Feeder Fund intends to operate in a manner that continues to qualify it as a RIC.

Each Feeder Fund is a series of Fund A or Fund B: Feeder Fund 1, Feeder Fund 2, and Feeder Fund 3 are series of Fund A. Feeder Fund 4, Feeder Fund 5, and Feeder Fund 6 are series of Fund B. Both Fund A and Fund B are open-end, series-type investment company under the 1940 Act whose shares were registered under the Securities Act of 1933 (1933 Act). Both Fund A and Fund B are organized as separate corporations under the laws of State B.

Cash contributed by the Feeder Funds has been and will be used only to carry on the normal operating and investment activities of each respective 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 following: Portfolio 1 holding itself out to investors as an equity securities growth fund, which is a type of investment fund that seeks to provide investors with capital appreciation, by investing in equity securities deemed to have above average prospects; Portfolio 2 holding itself out to investors as an equity securities value fund, which is a type of investment fund that seeks to provide investors with capital appreciation, by investing in equity securities deemed to be selling below normal market valuations; Portfolio 3 holding itself out to investors as an equity securities blended fund, which is a type of investment fund that seeks to provide investors with capital appreciation, by investing in securities that provide for both growth and value.

Each Portfolio is treated as a partnership for federal tax purposes and the Feeder Funds are treated as partners of each of the partnerships in which they invest. Each Feeder Fund has contributed, or will contribute, either solely cash or a portfolio of assets that meets the diversification requirements of § 368(a)(2)(F). Each Portfolio, likewise, will require that any future feeder funds which acquire a partnership interest in that Portfolio will meet 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).

The interest of each partner in each Portfolio is limited to the net assets of that Portfolio and does not extend to the assets of the other Portfolios. No Portfolio has invested in any of the Master Trust’s other Portfolios.

Each Portfolio will satisfy the terms of the private placement safe harbor from the definition of publicly traded partnership contained in § 1.7704-1(h), by reason of the fact that the interests in the Portfolios will not be registered (or required to be registered) under the 1933 Act (or any other federal or securities law regulating the offering or sale of securities) and, thus, will not be a publicly traded partnership within the meaning of § 7704.

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 its Portfolio by the partner. Under § 1.704-1(b)(2)(iv)(f), the Portfolios will revalue their investment portfolios to fair market value as of the close of each day. Each Portfolio will adjust its partners’ individual capital accounts to reflect the partner’s share of the net change in the value of its portfolio of assets from the close of the prior day to the close of the current day. Each Portfolio represents that it qualifies as a securities partnership under §1.704-3(e)(3)(iii) and that substantially all of its property will consist of readily tradeable securities.

Each Portfolio represents that none of its contributions, revaluations, and the corresponding allocations of tax items was or will 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 Portfolio will bear any investment advisory and portfolio accounting fees of any other Portfolio, nor will it bear any legal, custodial, audit or other expenses of any other Portfolio. Fund A and Fund B will bear their own distribution, shareholder servicing, management, legal, audit, and other expenses.

Taxpayers further represent as follows:

1. Each Portfolio was organized in a manner so as to enable its classification as a partnership and not to enable investors which are RICs to make distributions that would be prohibited by Rev. Rul. 89-81, 1989-1 C.B. 266, had they invested directly in the securities held by such Portfolio.

2. For purposes of determining the required distribution under § 4892(a), each Feeder Fund that is a RIC will account for its share of items of income, gain, loss, and deduction of the Portfolio which corresponds to it as they are taken into account by the Portfolio.

3. Holders of interests in any of the Portfolios will be limited to the institutional investors that are registered investment companies, insurance companies, common or commingled trust funds, group trusts, and similar entities which qualify as accredited investors within the meaning of Regulation D under the 1933 Act. No individual, S corporation, partnership, or grantor trust, a grantor of which includes an individual, S corporation or partnership, will be issued interests in any Portfolio. In addition and in all events, the number of holders of interests in each Portfolio will be limited to fewer than 100.

LAW AND ANALYSIS

Ruling 1: Proportionate ownership of Portfolio income and assets in applying the RIC qualification tests.

Section 851(b) of the Code provides that certain requirements must be satisfied in order for a domestic corporation to be taxed as a RIC and thereby to be exempt from the corporate level tax on most income.

Section 851(b)(2) of the Code provides that, to qualify as a RIC, at least 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, in order 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 any 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, in order 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 the 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) of the Code provides that a RIC at least 50% of the value (as defined in section 851(c)(4)) of whose total assets at the close of each calendar quarter consists of obligations described in section 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 section 103(a).

Section 853(a) of the Code 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 section 243(a) to the extent so designated by the RIC provided that the RIC meets the requirements of section 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 section 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 section 243, 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 section 243 with respect to the payment.

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 they were 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 that partner's 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 that 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 includable 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. 93 (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. Under the entity approach, the partnership is treated as 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); H.R. Rep. No. 2543, 83d Cong., 2d Sess. 59 (1954).

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

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 bases. 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) of the Code. The ruling cites §§ 705 and 741, 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) 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 test set out in § 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 (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 and are subject to certain gross income source tests. 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 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 the 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 the shorter.

Thus, the regulation adopts 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 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.

Based on the information and representations submitted, we rule that each Feeder Fund that qualifies as a RIC and is a partner in a Portfolio will be deemed to own a proportionate share of the assets of the Portfolio and will be deemed to be entitled to the income of the Portfolio attributable to that share for purposes of determining whether the Feeder Fund satisfies the requirements of §§ 851(b)(2), 851(b)(3), 852(b)(5), 853, and 854 of the Code. For purposes of these sections, the interests of each Feeder Fund in the Portfolio shall be determined in accordance with the Feeder Fund's capital interest in the Portfolio.

Ruling 2: No recognition of gain or loss on contributions of property in exchange for shares of beneficial interest in a Portfolio.

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 (as defined in § 368(c)). 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 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. 33, 105th Cong., 1st Sess. 131 (1997); H.R. Rep. No. 148, 105th Cong., 1st Sess., 447 (1997); H.R. Rep. No. 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.

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 Portfolios by the Feeder Funds are not transfers to a partnership that would be treated as an investment company within the meaning of § 351 and § 1.351-1(c) if the Portfolios were incorporated, provided that these are the only transfers to the Portfolios (except for transfers solely of cash and/or a diversified portfolio of stocks and securities within the meaning of § 1.351-1(c)(6)(i)). However, we express no opinion about whether subsequent transfers of stock and securities to the Portfolios by any transferor will affect the tax consequences of the original transfers.

<u>Ruling 3: Aggregate method for allocations of gains and losses on contributions of property to Portfolio is reasonable with the meaning of § 1.704-3(e)(3).</u>

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: (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. Each Portfolio has represented that its allocations have complied and will comply with § 1.704-3(e)(3)(vi).

Each Portfolio has elected to use the aggregate method for making reverse § 704(c) allocations described in § 1.704-3(e)(3)(v).

The Taxpayers also have requested permission to aggregate built-in gains and losses from qualified financial assets later contributed to a Portfolio by a partner with built-in gains and losses from revaluations of qualified financial assets held by that 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, the burden to each Portfolio 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 Portfolios and its partners is minimal. It is represented that each feeder fund, including the Feeder Funds and any future feeder funds, 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").

After applying the relevant law to the facts presented and the representations made, we conclude that each Portfolio may aggregate built-in gains and losses from qualified financial assets contributed by its partners with built-in gains and losses from revaluations of qualified financial assets held by that Portfolio for purposes of making § 704(c)(1)(A) and reverse § 704(c) allocations and that each Portfolio's method of making § 704(c)(1)(A) and reverse § 704(c) allocations is reasonable and permitted by the Commissioner under § 1.704-3(e)(4)(iii), 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 is a Qualified Contributor.

Ruling 4: Method for making § 704(c) allocations for Qualified Contributors.

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

After applying the relevant law to the information and representations submitted, we rule that each Portfolio's method of making § 704(c) allocations, including reverse allocations, for future partners who invest in that 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 a Portfolio relies on this ruling with respect to the contribution, that 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, any transaction(s) that are not specifically covered by the above rulings. Rulings two and three 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 Portfolios by any partner other than the Feeder Funds and future new partners that qualify as Qualified Contributors. In addition, each 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 Taxpayers. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. Further, except as specifically ruled upon above, no opinion is expressed or implied regarding the federal income tax consequences of the transactions described above to any other taxpayer that is now or may become a holder of an interest in any Portfolio.

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

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

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