

Internal Revenue Service

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:2 – PLR-130400-03

Date:

November 26, 2003

Legend

Partnership:

Operating Partnership:

W:

X:

Y:

Z:

State:

Country:

Date:

a:

b:

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Dear _____ :

This responds to your letter dated May 8, 2003, and subsequent correspondence submitted on behalf of Partnership, requesting a ruling that interest income Operating Partnership derives from the debt obligations of Operating Partnership's directly and indirectly owned companies, X, Y, and Z, is "qualifying income" within the meaning of § 7704(d)(1)(A) of the Internal Revenue Code.

The information submitted states that Partnership is a limited partnership organized on Date under the laws of State that is classified as a partnership for federal tax purposes. Partnership is a publicly traded partnership within the meaning of § 7704(b). Partnership intends that 90 percent or more of its gross income be qualifying income within the meaning of § 7704(d), thus causing Partnership to meet the gross income requirements of § 7704(c). Partnership's sole asset is a limited partnership interest in Operating Partnership, a limited partnership that is also organized in State and classified as a partnership for federal tax purposes. Operating Partnership has interests in several corporations, limited liability companies, and a partnership. Operating Partnership's ownership interests in other companies include the ownership of W and X, corporations organized under the laws of State that are classified as corporations for federal tax purposes. W owns Z a corporation organized under the laws of State that is classified as a corporation for federal tax purposes. Operating Partnership also owns Y, a foreign corporation organized under the laws of Country. Operating Partnership derives interest income from debt obligations made to X, Y, and Z. The interest income derived from these debt obligations are the subject of this ruling request. These debt obligations are equal to a percent of the principal balance of the outstanding combined debt of the Partnership, Operating Partnership and the companies the Operating Partnership owns.

Partnership represents that Operating Partnership makes no loans to unaffiliated third parties and that the interest income is not derived in the conduct of a financial business as an integral part of the active conduct of Operating Partnership's business. Partnership also represents that the interest income derived from the debt obligations is at a fixed rate of interest and is not contingent on profits. All of the interest realized by the Operating Partnership from the debt obligations is treated as interest income for federal income tax purposes. Furthermore, the interest income derived from the debt obligations represents only b percent of the Operating Partnership's gross income. A majority of Operating Partnership's income comes from its ownership interests in several corporations, limited liability companies, and a partnership.

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Section 7704(a) provides that except as provided in § 7704(c), a publicly traded partnership shall be treated as a corporation.

Section 7704(c)(1) provides that § 7704(a) shall not apply to any publicly traded partnership for any taxable year if such partnership met the gross income requirements of § 7704(c)(2) for such taxable year and each preceding taxable year beginning after December 31, 1987, during which the partnership (or any predecessor) was in existence. For purposes of the preceding sentence, a partnership shall not be treated as being in existence during any period before the first taxable year in which such partnership (or a predecessor) was a publicly traded partnership.

Section 7704(c)(2) provides that a partnership meets the gross income requirements of § 7704(c)(2) for any taxable year if 90 percent or more of the gross income of such partnership for such taxable year consists of qualifying income.

Section 7704(d)(1)(A) provides that except as otherwise provided in § 7704(d), the term "qualifying income" includes interest.

Section 7704(d)(2) provides that certain interest shall not be treated as qualifying income if—(A) such interest is derived in the conduct of a financial or insurance business, or (B) such interest would be excluded from the term "interest" under § 856(f).

The legislative history to § 7704 states that "Under the provision, publicly traded partnerships are treated as corporations for Federal income tax purposes. An exception is provided for certain partnerships, 90 percent or more of whose gross income is passive-type income." H.R. Rep. No. 391 (Part 2), 100th Cong., 1st Sess. 1067. The legislative history also states that "the definition of passive-type income for purposes of this provision is not coextensive with existing statutory categories of passive income (e.g., the passive loss rule or the S corporation rules), but rather, is specific to the purposes of this provision." *Id.* at 1068.

The legislative history explains that the purpose of the qualifying income exception is "to distinguish those partnerships that are engaged in activities commonly considered as essentially no more than investments, and those activities more typically conducted in corporate form that are in the nature of active business activities." *Id.* at 1068.

The legislative history further states,

In determining whether income is treated as passive-type income under the provision, in the case of interest and real property rents, it is not intended that amounts contingent on profits be treated as interest or rent. . . Interest or rent (or other amounts) contingent on profits involves a

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greater degree of risk, and also a greater potential for economic gain, than fixed (or even market-indexed) rate of interest or rent, and thus is more properly regarded as from an underlying active business activity. . . . Similarly, interest is not treated as passive-type income if it is derived in the conduct of a financial or insurance business. . . . Thus, for example, interest income from the conduct of a banking business is not treated as passive-type income, as deriving interest is an integral part of the active conduct of the business. *Id.* at 1068.

Based solely on the representations made and the information submitted, we conclude that, solely for purposes of § 7704(d)(1)(A), the interest income is passive-type income because the interest income from the debt obligations is not contingent on profits, is at a fixed rate of interest, and Operating Partnership is not conducting a banking business nor is it engaged in the conduct of a financial business for purposes of § 7704(d)(2). Accordingly, interest income that Operating Partnership derives from the debt obligations of Operating Partnership's directly and indirectly owned companies, X, Y, and Z, will be considered "qualifying income" within the meaning of § 7704(d)(1)(A).

Except as specifically ruled above, we express no opinion concerning the Federal tax consequences of the interest income derived from the debt obligations described above under any other provision of the Code. No ruling is expressed or implied as to whether at least 90 percent of Partnership's gross income is qualifying income under section 7704(d).

This ruling 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.

Pursuant to the power of attorney on file with this office, a copy of this letter is being sent to X and X's other authorized representative.

Sincerely,

J. Thomas Hines
Chief, Branch 2
Associate Chief Counsel
(Passthroughs and Special Industries)

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

Cc: